# Alternative lenders sense opportunity as banks retreat

## As banks scale back lending to real estate amid concerns about borrowers' solvency, a broad pool of alternative lenders is lining up to fill the gap

BY **JANE ROBERTS**

In the midst of the Covid pandemic, well-established real estate names are launching debt funds for the first time. Tristan Capital has poached Dan Pottorff from LaSalle to head a pan-European whole loan fund, while Kennedy Wilson has also set up a lending platform.

In July, former Global Student Accommodation CEO Steve Grant teamed up with the owner and founder of GSA (and originally Unite), Nick Porter, to launch a specialist student lending business.

What is going on? Partly, it is the tactical opportunity that has opened up for alternative lenders to serve the European property industry as – once again – banks scale back their lending to the sector.

While banks are very much better capitalised than during the global financial crisis and are in no way a cause of the current crisis, they see more trouble ahead. Since the summer, the likes of JP Morgan, Wells Fargo, SocGen, Barclays and Lloyds have announced huge loan loss provisions in their half-year results, suggesting they expect significant loan impairment to come. By no means all the bad loans will be against real estate but, with the exception to a degree of the specialist German mortgage lenders, it is making banks much more cautious about the sector.

> 'During the GFC, the lending market was predominantly bank-driven. Now, you've got a much more diversified market'

Access to debt for real estate from banks is slowly drying up as their list of no-go areas grows: development; assets with transitional business plans; loan-on-loan finance; new relationships; existing relationships judged not to be profitable enough; deals that are too large to hold on balance sheet and would need to be clubbed or syndicated; even 60% leverage.

### BROADER LENDING POOL

Private equity firms and their institutional investors want to move into the gap, while existing debt funds and insurance companies want to continue to lend on good real estate. Nassar Hussain, managing partner of debt advisory business Brookland, says this broader pool of lenders is a key difference from the GFC. Then, the issue for the real estate market was 'that if you needed to refinance a property you would struggle to find anyone to refinance it, and that in itself created defaults and attendant issues. There was a real liquidity crisis'.

'Across the board, it was predominantly a bank-driven market; there was an element of CMBS and there were a few insurers. And that's certainly not the case now – you've got a much more diversified market.'

Cale Street, the private equity firm backed by the Kuwait Investment Office, made an opportunistic move when it took over the senior development financing from ICG Longbow of a 199-key hotel on Marylebone Lane in London's West End. In June, the firm provided £160 mln of senior debt alongside a €70 mln mezzanine loan from Crosstree. The borrower, Shiva Hotels, needed a speedy refinance of the luxury hotel development in which it had already invested tens of millions of pounds of equity.

Peter Robinson, a partner at Crosstree, said: 'Given the current dislocation in real estate financing markets for projects of this type, Crosstree together with Cale Street are pleased to be working with Shiva in taking forward this prime hotel development. While no doubt we are currently in a challenging period for the hospitality industry, we share a longer term vision of the resilience of London and high quality real estate and locations such as this.'

Another example is Cheyne Capital's replacement of Urban Exposure on a residential scheme on London's outskirts, in Luton. Cheyne's £75 mln loan will recapitalise the project and enable private property company Strawberry Star to build out phase one of Lu2on, comprising 401 flats which it says are 60% pre-sold.

### COSTLIER DEBT

In both instances, the debt will cost considerably more than pre-Covid bank development lending. Cale Street is known to charge margins in the higher single-digit range for senior finance. Cheyne is a high-yield lender. Whole loan pricing in the UK regions has gone up to 8%+ according to one source. Even the very best pan-European sponsors report having to pay 100-150 bps more to finance development assets.

Such debt may seem expensive but, as Hussain points out, the unique disruption caused by Covid makes it hard for lenders to assess and price risk. 'Borrowers should realise that for some asset classes, especially operating real estate, the risk position has changed significantly. At times like this, equity should be taking more risk. Equity returns are uncapped and equity investors can still do extremely well, while lenders' returns are capped but in riskier assets or markets

STRAWBERRY STAR'S LU20N RESIDENTIAL SCHEME IN LONDON

SHIVA HOTELS' MARYLEBONE LANE DEVELOPMENT IN LONDON

## As distress grows, who will be the casualties on lenders' books?

TORSTEN HOLLSTEIN, CRIM

Insolvent tenants and over-geared developers are likely to be the main causes of distress in real estate lenders' books as time goes on.

'Commercial or universal banks, those which have a view to both real estate and corporate lending, are the type of people making a few calls to us now,' says Torsten Hollstein, managing director and head of loan advisory at adviser-asset manager CR Investment Management. 'They are saying: it's not there now but we see some stress building up. We see main anchor tenants in some of our more retail-geared investments getting into trouble. This might turn into something where we would need help.'

CRIM is focused on Germany and the Netherlands where, as in the UK and the US, Covid has exacerbated problems for retailers which were already struggling. Germany's biggest department store chain, Galeria Karstadt Kaufhof, filed for creditor protection in April and is closing around a third of its 172 stores in an ongoing restructuring.

Germany's largest hairdressing chain, Klier, with brands including Essanelle, Frisör Klier, Super Cut, Styleboxx, HairExpress, Cosmo and Beautyshairshop, said it was insolvent on 8 September. It has 1,400 salons and 10,000 employees.

Chinese majority shareholder Fosun stepped in to recapitalise Tom Tailor and Bonita after the fashion chain filed for bankruptcy recently. Food & beverage is also suffering with north German-based bar and restaurant company Bolero one of the latest to launch an insolvency plan.

Hollstein expects Covid-induced distress to also emerge in some hotels, especially those which are heavily exposed to conference and fairground areas, and possibly airports too. He believes others may follow the example of the landlord of Berlin's five-star Sofitel near the Kurfürstendamm; the asset was ring-fenced and the operating company went bankrupt in Q2 when it was reportedly operating at 25% capacity.

'The problem we have is that the tenants are collapsing and lenders are no longer being paid. That also makes restructuring much more difficult because you may find you need to come up with totally different concepts to the uses of the assets before. It's competely different from the financial crisis.'

CRIM advised on real estate non-performing loans with a volume of €30 bn in the aftermath of the GFC and never disbanded its team. Hollstein says the firm has just been instructed on a mandate to advise on a large pan-German property portfolio. It is thought that the restructuring involves a syndicate from multiple jurisdictions.

The CMBS market was an early signal of distress last time. In Europe there are a number of deals issued in the last three to four years which are secured on retail, hotel and other operating assets.

'The prices of the BB tranches – not the AAA – have dropped dramatically in the US in secondary trading', says Hollstein. 'In Europe they have held up but I believe there will also be some pressure here.'



3-4
28-9-2020 12:39:46

they can still lose their capital.'

Allianz is an example of an insurer benefitting in the current climate from being able to lend at competitive pricing and take down very large ticket sizes that would now have to be clubbed or syndicated by banks. In September, Allianz Real Estate provided a £400 mln (€435 mln) facility to private property company Lazari Investments covering five prime central London office assets totalling 630,000 sq ft (58,530 m²).

Lazari has historically had a long relationship with Lloyds Bank, and the transaction is the first between the Munich-based lender and the Lazari group as well as being the largest single-loan debt transaction Allianz Real Estate has completed for its Allianz group and third-party investor debt fund Parec.

Sources say there are very large financings ongoing in other European countries where insurers are stepping up to do the whole amount, including development lending.

'Borrowers should realise that for some asset classes, notably operating real estate, the risk position has changed'

NASSAR HUSSAIN, BROOKLAND

Not all debt funds are having an easy time during the current banking disruption. In particular, lending platforms which use repo lines from banks to finance their lending – borrowing low and lending higher – have had facilities withdrawn. 'Initially many lenders dependent on loan-on-loan financing paused as the loan-on-loan lenders assessed the situation and considered margin calls. This is no longer the case but the terms have changed with lower leverage and/or more expensive terms,' Hussain says.

Well-established alternative lenders who have built up 10-year track records since the GFC are likely to be seeing their first defaults. DRC Capital, which elected not to cure the breach on a UK shopping centres loan, was one of the first but won't be the last.

For newly launching debt funds like Tristan's, Kennedy Wilson's or Kinetic Capital, having no legacy loans may now be a marketing advantage. ■

# Can alternative lenders help drive a faster recovery?

BY **CHARLES ARCHER**

Despite the lockdown of economic activity since March this year, £5.2 bn (€5.7 bn) of credit opportunities have hit our desks at Rivercrown of which £3.3 bn meet the target returns for our special situations vehicle, which we launched at the onset of the Covid-19 crisis. Anybody would agree this is an eyewatering level of potential deal volume, but where is the demand coming from?

Broadly speaking, the demand comes from two key camps; sponsors in situational distress needing short-term support during this period of crisis, and well-capitalised sponsors who continue to see attractive market opportunities, where a higher cost of capital is still accretive to their cash-on-cash economics.

The reason we are seeing this positive deal flow, is, similar to the aftermath of the 2008 financial crisis. Most major lenders have pulled back from lending into real estate amid the pandemic and are limiting their lending to existing relationships or 'no brainer' type deals. Back in 2008, this contributed to a widespread tightening of credit as there wasn't the depth in the marketplace that alternative lenders now provide. Given that many alternative lenders are now well capitalised and importantly, remain open for business, could their increased presence in the real estate finance market help drive a stronger, faster recovery this time around?

There are more flexible alternative lenders in the market than ever, and it looks like even more are gearing up to enter. According to The Economist, private equity firms have amassed $1.6 trn (€1.37 bn) in dry powder that they can deploy into new deals. They include the likes of Blackstone and Oaktree who have now become established debt funds.

We see the current crisis more as a market dislocation rather than a trigger for more radical structural change. Given the current pause by the major lenders, alternative lenders are well positioned to capitalise on the opportunity, by providing liquidity, offering certain flexibilities around leverage and structure, whilst appropriately accounting for the risk, to provide workable solutions to the sponsor.

Of course, we are not about to see a return to the pre-2007 levels of high leverage. Alternative lenders still need to take the time to appropriately assess the risk/reward and structure early warning covenants to avoid the pitfalls of the last crisis. But the significant liquidity and depth to credit markets they provide, coupled with improving market fundamentals, should help avoid a repeat of the liquidity drought seen in the aftermath of the global financial crisis. All this should aid a stronger, faster recovery this time around.

***Charles Archer is head of debt investment management at Rivercrown***