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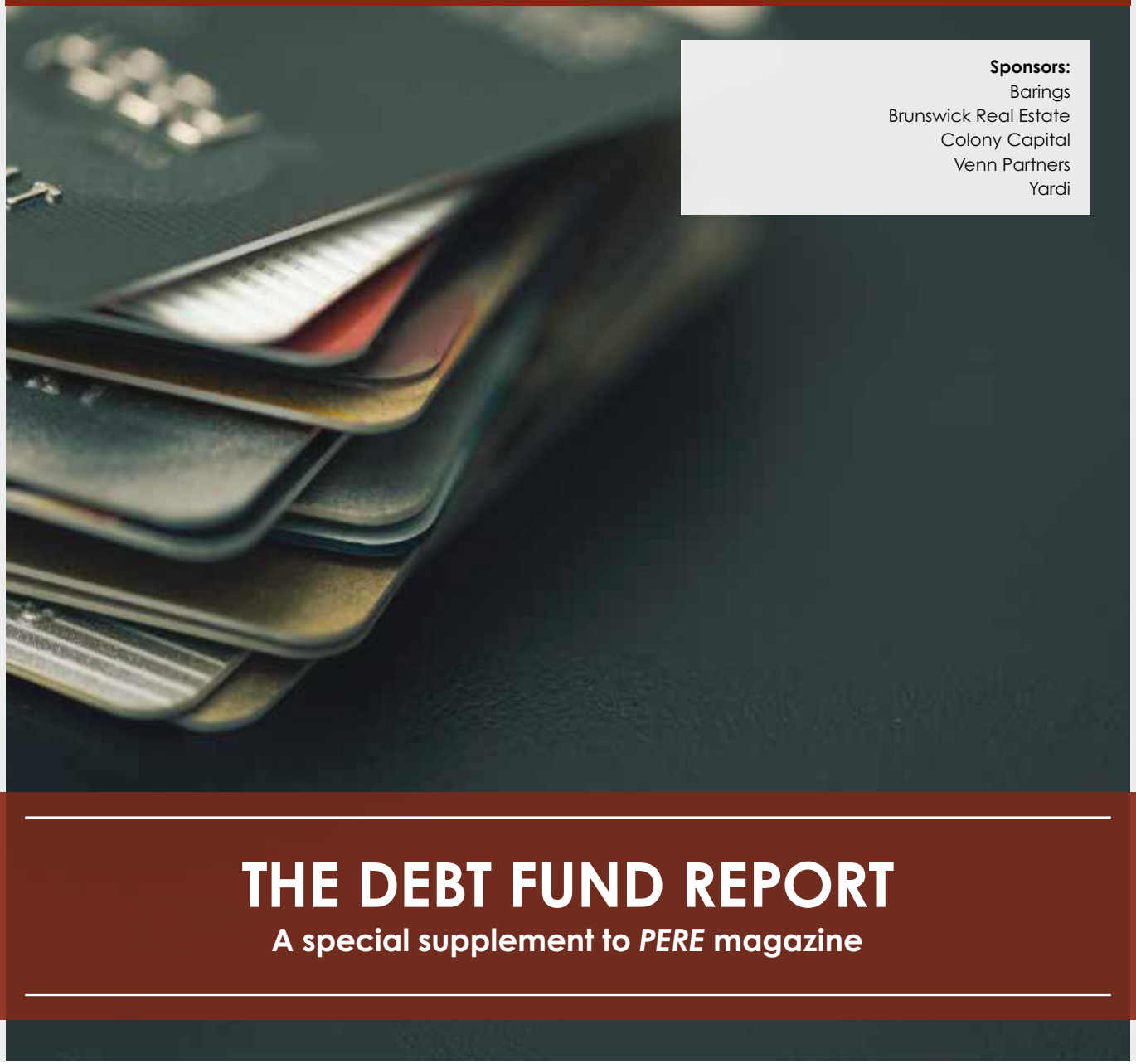

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THE DEBT FUND REPORT

A special supplement to *PERE* magazine

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A permanent fixture

A question mark hangs over debt's place in the private real estate investment world. That being whether it will remain a niche strategy, championed by the relatively small band of managers that quickly plugged the lending gap left by regulation-constrained banks post-GFC, or a strategy that more and more investors and managers will embrace going forward.

PERE data tend to support the latter trajectory. In 2010, 20 managers collectively raised $12 billion for debt-focused funds. Fast-forward to 2017 and 55 funds closed on a record-breaking capital raise of $40 billion. But there is a sting in the tail – just $20 billion was raised from 35 funds last year, after four consecutive years of increased fundraising.

So is investor appetite for property debt strategies waning? Not necessarily. The 2018 decline may indicate simply that the current crop of investors active in the space has reached portfolio allocation targets for debt and managers have switched from capital raising to capital deployment. Certainly, many commentators in this report are confident that debt is here to stay and, in the long term, will continue to grow in private real estate as a valuable diversification tool, in addition to traditional equity strategies, and as an important defensive play against future market volatility.

As this is *PERE*'s first special report on debt, it provides the perfect platform to also reveal our inaugural Top 50 ranking – the RED 50 – of global private real estate debt fund managers. Based on the capital raised for debt issuance funds between 2014 and 2018, a familiar name sits proudly atop the list – Blackstone. North American-based managers, in fact, dominate the ranking – 32 feature to Europe's 16 – perhaps a reflection of the maturity of the market stateside compared with other regions. But opinions in these pages suggest that US real estate debt has become overcrowded with attention now turning to Europe to source opportunities.

Asia-Pacific-based fund managers fare less well, occupying just two places in RED 50. But as a feature in this report suggests, this masks the potential for real estate debt to grow in the region, with China and Australia highlighted as favored markets, and a healthy level of interest from US and European institutional investors, particularly of the pensions and insurance ilk.

PERE looks forward to monitoring further how the debt story continues to unfold in 2019.

Enjoy the report,

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Debt in demand

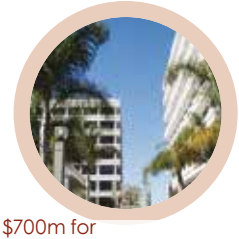
US and European managers in particular continue to attract capital for debt strategies

Oaktree surpasses $1.75bn target for second RE debt fund

The firm raised $2.18 billion for Oaktree Real Estate Debt Fund II to invest in value-added projects in North America and Europe. It will target a 30-40 percent allocation both for mezzanine loans and commercial mortgage-backed securities.

FAP Invest seeks €250m for German real estate debt

Its Luxembourg-based vehicle, FAP Balanced Real Estate Financing I, will provide mezzanine loan financing for portfolio properties, revitalization projects and project developments in Germany. It will be able to make select investments in the Netherlands and Austria and finance residential, office, retail and hotel properties. The fund has a five-year lifespan with two one-year extensions and will seek investments from €5 million and up.



PIMCO raises almost $700m for commercial real estate debt vehicle

The asset management behemoth rounded up $697 million for its PIMCO Commercial Real Estate Debt Fund. The firm also targets distressed senior real estate credit with its PIMCO DiSCO II fund, specifically residential and commercial mortgage-backed securities and restructurings of those instruments.

2018

APRIL MAY JUNE JULY

Amundi launches senior real estate debt fund

The launch marks the firm's initial foray into the property lending market. The strategy will focus on floating-rate loans provided across the Eurozone. Amundi is aiming to raise up to €500 million.

Maslow moves to fill debt gap for regional UK logistics assets

The real estate development finance specialist will expand its debt offering, lending against assets greater than 50,000 square feet, including refurbishment and multi-let schemes, with a focus on regional locations in the UK. Maslow's new division will provide loans for logistics developers with a minimum value of £5 million.

CalSTRS inks $200m RE debt JV

CalSTRS set aside $200 million for a JV with lending firm 3650 REIT, with potential for $300 million more in equity. The JV targets loan originations to well-capitalized sponsors with properties in US metropolitan markets where 3650 REIT has a presence.

Brunswick closes second Swedish senior debt fund on €640m

The Swedish asset manager closed its second property debt fund and is targeting a 2 percent net return as it provides longer-term credit across commercial real estate markets in its home market with SKr6.6 billion ($745 million; €640 million) raised.

Walton Street Capital collects $415m for latest RE debt vehicle

Six investors have so far committed to Walton Street Real Estate Debt Fund II, which targets commercial real estate with rental income potential in the US and other global markets such as Mexico.

Oaktree closes on $2.1bn for its Real Estate Debt Fund II

The fund surpassed its $1.75 billion target and brought in nearly twice as much capital as its predecessor, Oaktree Real Estate Debt Fund. Fund II, launched in 2016, is now 47 percent invested.

Laxfield raises additional £250m for UK debt fund

The UK property debt specialist upsized its real estate debt fund to £750 million ($988.1 million; €837.4 million). The firm has fully deployed the fund's original allocation in loans secured on offices, student accommodation, logistics, hotels, serviced apartments and specialist retail assets across the UK.

Amundi approaches €150m first close on its debut property debt fund

Another €100 million of investor commitments to the vehicle are under due diligence and a final close on €500 million is expected by the end of 2019. Amundi's property debt strategy is currently targeting net returns of 2 to 2.25 percent.

2019

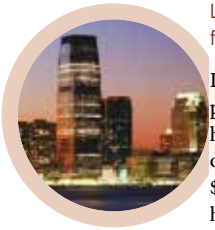
AUGUST SEPTEMBER OCTOBER JANUARY

Cheyne hits hard-cap with $800m for real estate debt

Cheyne Real Estate Credit Fund V beat its $650 million target and is 80 percent invested, with a greater focus on senior debt funds. The final close brought total assets under management at Cheyne's real estate business to £2.3 billion. The fund aims to achieve double-digit returns with a focus on capital preservation.

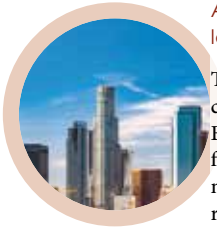
Madison Realty Capital nears $1bn close for RE debt fund

The firm raised $935.25 million in equity for Madison Realty Capital Debt Fund IV through multiple interim closes. The vehicle will target an 11-14 percent net IRR and a 1.4x-1.7x multiple on invested capital, according to documents from the Texas Municipal Retirement System, which has committed $100 million to the fund, according to *PDI* data. The fund's predecessor raised $695 million in 2016.



Locust Point raises $312m for niche debt strategy

Locust Point Private Credit Fund focuses on providing financing for senior housing and healthcare facilities. The $312 million raised over the last two years surpassed the firm's $250 million target and broke the $300 million hard-cap. The fund comprised approximately 30 percent European investors and 70 percent US-based investors.



Ares raising open-end RE debt fund, lands commitment from SIC

The New Mexico State Investment Council committed $75 million to the firm's Real Estate Enhanced Income Fund, a leveraged fund that will issue directly originated first mortgage loans to investors in stabilized real estate assets. The fund will target a net IRR of 7-8 percent and make loans with two to three-year maturities of up to 70 percent loan-to-value.

Is late-cycle debt investing a good idea?

Nuveen Real Estate's Jack Gay considers whether the time is right for real estate investors to increase commitments to debt

By many measures, the US economy remains resilient and continues to outperform as the global financial crisis gets further in the rearview mirror. In 2018, US consumer confidence reached an 18-year high while the unemployment rate reached an 18-year low, according to Bloomberg. Moreover, the US economy is expected to grow between 2 percent and 2.5 percent in 2019 – slower than what we saw in 2018, but strong enough to generate continued demand for real estate. As we enter the tenth year of economic expansion, it begs the question: how will real estate fare when the economy inevitably slows, and is now the time for investors to increase their allocation to real estate debt in their portfolios?

A resilient and stable market

Investors are understandably cautious when it comes to assessing real estate risk at this point in the economic cycle. That said, US real estate fundamentals remain in balance and, broadly speaking, we expect valuations to remain steady or rise marginally throughout the remainder of this cycle. Still, it is a prudent time to think about positioning portfolios for the next downturn, and one of the most effective ways to diversify real estate holdings and provide an element of downside protection for portfolios is through real estate debt.

Much has changed in commercial real estate lending since the financial crisis unfolded a decade ago, and these changes have made the mortgage debt markets more resilient and stable. One of the most notable changes is that stricter banking regulations after 2008 prompted many commercial banks to pull back their commercial mortgage lending activity, providing opportunities for alternative lenders to fill the void. These direct lenders, which include insurance companies, asset managers and other originators of private credit, have taken a prudent approach to lending over the past decade, giving senior mortgages originated over the past decade many of the same risk-return attributes as investment-grade corporate bonds.

For example, overall leverage levels in the CRE debt space have remained in check at 70-75 percent loan to value, providing a significant equity cushion against any downward pressure on valuations. In addition, the underlying debt instruments are less complex than those originated prior to the GFC, with fewer multi-tranche capital structures and lenders in each deal. This has led to more prudent underwriting, as risk is now concentrated with those that originated the transaction, and improves decision-making.

For these and other reasons, commercial mortgages can outperform equity and provide downside protection for real estate portfolios during an economic downturn. Unlike other fixed-income instruments, lenders have more control over the structuring of the mortgage, which helps mitigate losses down the road. And when the economic cycle does turn, the bespoke nature of each underlying mortgage investment, and the greater optionality and control over the resolution process, also means lenders are in the driver's seat when it comes to workouts.

That is not to say the markets are not likely to overshoot and repeat the same mistakes from a decade ago. And it is not to say all loans are created equally. The benefits that commercial mortgages may offer to portfolios during a downturn can be lost if the sourcing, originating and managing of the mortgages is subpar.

More investor choice

With the proliferation of real estate debt funds, investors now have a variety of ways to access commercial mortgage investments. However, superior commercial mortgage performance during a downturn will depend on a lender's ability to pick the right assets, markets and sponsors, and the lender's ability to leverage their debt and equity relationships. Scale and the ability to offer a full range of financing products, including fixed and floating rate mortgages and mezzanine, among others, will also be key to outperformance.

> "It is a prudent time to think about positioning portfolios for the next downturn, and one of the most effective ways to diversify real estate holdings and provide an element of downside protection for portfolios is through real estate debt"

If the financial crisis has taught us anything over the past decade, it is that inflection points in the markets can make or break your portfolio performance over the ensuing decade. As we look over the precipice of the current real estate cycle, it is still worth considering the shock-absorption value this asset class can provide to a well-diversified real estate portfolio. ◻

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Genesis North Tower: Barings financed the completion and lease-up of this 21-story life sciences building in the San Francisco Bay area

A time for balance

Dean Dulchinos of Barings talks to *PERE*'s Kyle Campbell about how he expects the US real estate debt market to shape up in 2019

After 10 years of steady growth, many in the private real estate industry feel a correction is imminent, even if there are as yet no clear signs of distress. Uncertainty of this kind normally drives investors toward defensive strategies, but closed-end real estate debt fundraising actually fell in 2018 for the first time in four years, according to *PERE* data. However, Dean Dulchinos, head of Barings' Real Estate Debt Portfolio Management and Capital Markets Groups, tells *PERE* that traditional methods for tracking this part of the market do not tell the whole story. The 26-year veteran has seen investors flock to real estate debt but through different vehicles and sometimes with goals that go beyond financial returns.

***PERE**: What opportunities exist today for investors in the real estate debt asset class?*

Dean Dulchinos: There are two primary opportunities that investors seem to be most focused on today. The first is the opportunity to enhance their existing exposure by adding real estate debt investments. Some may be long-time equity real estate investors looking to reduce volatility, while others may be fixed income investors looking to increase yield or reduce correlation within their portfolios by adding illiquid secured debt.

The second opportunity is more structural in nature. Many investors seeking to invest in real estate debt are focused on open-end funds, which is a shift in the marketplace. Open-end equity funds have been around for years, but the concept of an open-end debt fund is fairly new. We have seen a number of these come into the market recently. Open-end structures can offer some advantages over closed-end structures, such as investor liquidity and capital efficiency – as these structures allow investors to maintain steady capital deployment through a single investment vehicle, rather than ramping up and down as they would with multiple closed-end funds.

***PERE**: What types of investors are active in real estate debt in the US and what are the attractive characteristics of debt as opposed to equity in the current market?*

DD: We are seeing a lot of activity from pensions and insurance companies, both in the US and internationally, as well as sovereign wealth funds. It is an active, well-diversified investor market right now. We are a long way into a market recovery, and while fundamentals still look good, many investors are planning for potential volatility in the marketplace. For these investors, adding an allocation to real estate debt in their portfolio may be seen as a way to reduce volatility while maintaining exposure to real estate. Because debt is not in a first-loss position relative to the real estate asset, it can provide some protection against volatility if the value of the underlying real estate collateral fluctuates.

Another component of real estate debt that is attractive to investors is its ability to offer significant current income. For example, if you are invested in core equity real estate, you are

looking to a combination of current income and appreciation to achieve your total return, whereas the return on a debt investment can be structured as all current income. Some real estate investors see real estate debt as a complement to equity. They may have significant equity allocations in their portfolios, but their expectations for appreciation are limited. So they may view adding an allocation to real estate debt as an opportunity to de-risk while still maintaining an attractive current return.

***PERE**: Investors seem to be a little more conservative in terms of the risk-reward profile they are seeking. Is that something you are seeing at Barings too?*

DD: Yes, I think that is right. If you look at the broader investor marketplace right now, you will find that the majority of investors seeking new real estate debt investments are looking to go down the risk curve, and are willing to accept a lower return for that lower risk, and that is a valid strategy. In fact, that is a large portion of the demand in the borrowing marketplace right now. Although, at the same time, there are investors looking to provide capital where the market is less efficient, and that is a relative value play that can be really rewarding. Some examples of that might be construction lending or lending on transitional assets where there are temporarily disrupted cashflows.

The important thing is for investors to identify and understand the risk they are taking and then, if they are comfortable with that risk, to make sure they are getting appropriately paid for it. There are a lot of fund investment options in the market, each of which has a slightly different strategy for providing targeted returns. Underlying it all, there are a few basic risks that investors can take in real estate debt – for example, market risk, borrower risk, leverage risk, cashflow risk and business plan risk. The way a particular strategy accesses or avoids each of these risks is an important factor in the overall risk of the investment. Understanding how managers define 'core' or 'core-plus' strategies is a critical part of this risk management.

Dulchinos: seeing a lot of activity from foreign and domestic pensions and insurance companies

In the current market, our team at Barings is finding opportunities to take risk and get paid for it in construction lending, especially larger loans, and lending on properties that are experiencing temporary cashflow disruption. These are opportunities where we have found that some lenders may be less efficient. At the same time, you will not see us taking excessive risk on borrowers and markets, or on leverage.

***PERE**: The opportunity zones program has been a topic of conversation in the industry as of late. Although it is an equity initiative, are there opportunities for your business in and around these developments?*

DD: We have done some work around opportunity zones and understanding them as a firm, both from an equity and a debt perspective. As you said, it is really an equity play. The opportunity zone is based on a tax incentive related to capital gains. As a lender, one of the things we like about opportunity zones is the potential for the new rules to attract institutional capital to areas that need improvement and are not otherwise attracting capital efficiently. That fits well with our focus on ESG and our desire to partner with like-minded institutions to supply capital that benefits areas like this. For example, we have a robust affordable housing lending strategy.

As a result, lending into zones where more and higher quality affordable housing is needed is important to us, and the Opportunity Zone legislation is hopefully creating incentives that will bring equity capital for housing and other infrastructure into zones that need redevelopment. The rules affect all property types, but since multifamily is a particular focus for our firm, we are hopeful that the new Opportunity Zone tax incentive will provide the impetus necessary to advance the pace of development for affordable and workforce housing in underserved communities making this investment economically feasible.

***PERE**: There is the feeling that we are nearing the end of an elongated cycle. If things shift in the coming months, how do managers stay competitive and attractive to investors?*

DD: As we move through the next stage of the credit cycle, maintaining a focus on risk is paramount. Once risk in an investment is identified and mitigated through structures such as reserves and covenants, it is important for lenders to monitor ongoing risk during the life of the loan, especially where the borrower is executing a business plan at the property to increase value. Beyond that, it is important to regularly monitor assets and ensure that they are adhering to their stated guidelines. To the extent that an investment hits a speed bump, debt managers should become active participants in discussions with borrowers and be prepared to provide flexibility while maintaining credit discipline in order to get the project back on the right track.

As a lender, you also need to be ready to own real estate assets. Although the bulk of Barings' lending strategies are not focused on ownership, we will always analyze our debt investment as an investment in the real estate itself at a price equal to our loan amount, or what we call our loan basis. If we would not be comfortable owning the real estate at that price, then we won't make the loan on it. ◻

Competing for space: a greater number of US funds are chasing capital for debt strategies

US debt funds fight for territory

Private real estate debt funds need to prove their value to investors in a more crowded and competitive market. By Michelle Phillips

The real estate debt landscape in the United States has changed dramatically since the 2008 financial crisis. Whereas banks and government enterprises were the unquestioned dominant players in property lending before the Lehman Brothers' implosion, 10 years later private equity funds have emerged as a significant source of capital. The $18.9 billion raised for US private debt strategies during that time is impressive, especially considering the state of the market before the collapse.

"Real estate debt as an asset class for investors really didn't exist until after 2008," says William Lindsay, co-founding partner at real estate debt firm PCCP. The firm is one of the few that can claim to have invested in real estate debt even before the crisis hit, albeit using methods other than private funds at that time. Lindsay explains the market was largely overshadowed by the over-leveraged financial institutions, meaning his team had to find creative ways to partner with them. It was only after the crisis that a space formed for private real estate debt funds.

Since 2010, the asset class has grown in both capitalization and acceptance among the investor community. There are an increasing number of successful funds in the US market, and even more if multiregional funds run by the likes of Blackstone are included. Indeed, JLL's head of funds advisory for the Americas, Jerry Cain, says he has been surprised by the volume of capital flows into US property debt in the past 36 months.

"Post-crisis and a few years after, debt was a bad word; but as

it is still widely accepted that the banks are under restrictions and cannot do some of the traditional lending, there is more of a need for the private debt space," he says.

"From an [investor] perspective, debt is now a more widely accepted asset class in a fund structure, complementing their equity strategy."

Although global real estate debt fundraising saw a precipitous 48 percent drop worldwide in 2018 – the lowest fundraising for real estate debt globally since 2011 – the US saw only a 29.6 percent drop year-on-year, even when the large multiregional funds were excluded, such as Goldman Sachs' record-breaking $4.2 billion Broad Street Real Estate Credit Partners III. In fact, given that 2017 was the most successful fundraising year on record, with almost $9.9 billion raised, the 2018 downturn is moderate compared to the 46.5 percent drop in 2014, according to *PERE* data.

"In real estate, everyone touched the stove and got burned in 2007-08. They survived, but they still remember it." William Lindsay

Whatever the numbers may say about the past decade, the future of this young market is hardly set in stone. Investors and managers alike must consider whether private equity real estate debt fundraising is just a temporary opportunity to sustain the market while bank lending gets back on its feet, or whether the industry will evolve to remain relevant.

Crowding in

Increasing acceptance of a shiny new asset class has led to the US real estate debt space becoming crowded – not just in deals, but also in fundraising. Cain knows of other equity sponsors, such as hedge funds, trying to take on some debt origination strategies in real estate, and more managers add it to their traditional equity strategies.

"The senior loans market has really exploded," Lindsay says. "[PCCP] used to be one of just a handful of real estate debt funds out there, and today we have about 20 to 30 competitors."

What used to not even be considered its own asset class is now recognized as a strategy between fixed income and real estate, he explains. Real estate debt has become popular on every level – from mezzanine to REITs to private structured deals – and everyone seems to want a slice of the pie.

Lindsay: debt funds emerged post-crisis

One factor contributing to this crowding tendency is returns compression in more traditional real estate investments. Most opportunistic funds in the US are now offering approximately 15 percent returns, while real estate debt is not far behind with 10-11 percent on average, with some funds offering as high as 13 percent. With debt funds offering much better downside protection, it seems a logical choice.

"Many equity funds have seen a lot of pressure on returns, so on a relative value basis [real estate debt] is attractive," says Peter Weidman, global head of real estate credit at the Goldman Sachs Merchant Banking Division. "We've seen in past cycles, and we're definitely seeing it now, the compression on spreads, pressure on yields, pressure to deploy capital." He adds that this pressure is not unique to private funds.

Cain also says opportunistic deals in the US are harder to come by at this point in the cycle. In order to chase higher returns, some US investors are becoming more open to non-gateway but institutionalized markets they would not have considered 10 years ago. Third- and fourth-tier cities like Birmingham, Alabama and San Antonio, Texas are getting investor attention. However, when investors take that kind of risk, protecting their investment becomes a high priority.

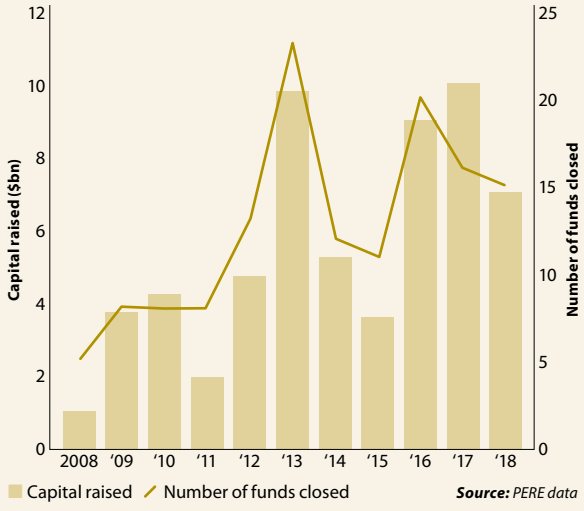
"Compared to other available real estate investments, there are a lot of defensive characteristics to our kind of investing, especially later in the investment cycle," Weidman says. "You can have a deterioration in [property] value, and still recover the full amount of your principle." In fact, some investors are so keen on this kind of real estate investment that they are beginning to make direct investments, he adds, becoming competitors to the debt funds themselves.

International investors have also made a big splash in the market, Cain says. The tens of billions of potential investor dollars pouring into the US market would be enough to make many fund managers salivate and they have not neglected to take advantage of the opportunity. PCCP had no foreign capital in its 2012 vintage fund, PCCP Credit V, but in its most recent PCCP Credit IX, it accounted for 30 percent of the fund's $1.25 billion total capital.

There is another reason international investors in the US gravitate toward debt – tax structure. According to Lindsay, the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) requires a 30 percent withholding on equity investment returns. But for debt investments, that is reduced to as low as 10 percent of the total returns, which makes returns for equity and debt investments almost neck-and-neck – maybe 10.5 percent versus 9 percent. The consequent interest of international investors combined with that of US investors has led to a market "flush with capital," Lindsay says, which might be worrying to those who remember the pre-crisis real estate market.

Soft landing

Although 2018 appears to mark the end of the second fundraising cycle, US real estate debt funds had a milder decline compared to the global market



Source: *PERE data*

Defensive posture

Generally, however, investors are not overly worried about another big crisis in real estate debt, even if they know that price corrections are on the horizon. In fact, planning for corrections in the market is what will prevent another real estate crisis in the country, some argue. Cain points out that investors in real estate debt have become savvy and are keeping an eye on policies or major trends that warrant caution. Overall, he has been impressed by their caution and rigor as they foray into this new asset class, with multilayered due diligence taking as long as six months in some cases.

"Even since we raised our first fund [in 2009], the investor base has become more educated on the strategies within debt," Weidman says. Over time, investors had to become more sophisticated on equity investments, understanding the many different strategies and risk-return profiles in the various asset classes. "And now, I think we're starting to see more of that kind of differentiation and understanding in the investor base on the debt side," he explains.

It is beyond cliché to talk about the importance of track record for fund managers, but in US real estate debt, it takes on a whole new meaning: with the disaster of 2008 fresh in most investors' memories, there is a lot to be lost. Even with the new entrants to the market, the fund sponsors need to have proved their strategies through downturns, JLL's Cain says, which means only the high-quality sponsors are being capitalized at this point in the cycle.

"There is always concern about risks, and that's why [investors] are so meticulous in their underwriting," Cain says. Cain finds that investors are looking for flexibility, quality and "one-stop shopping": a new pattern where investors want a fund manager they trust which can "take all their capital stack in one go, providing the senior and the mezzanine for real estate debt." But every investor's idea of risk is different, and they check new investments at the portfolio and fund level before committing.

"In real estate, everyone touched the stove and got burned in 2007-08," Lindsay says. "They survived, but they still remember it." He recalls investors asking detailed questions about what PCCP learned from the GFC, about their credit process, and whether the firm has "thought through everything that could possibly go wrong."

"Investors really appreciate that we find something that works and stick to it," Weidman says. He hears concerns from investors about funds taking more risk and trying different strategies to get the same or higher returns, but that is not what these investors want from their real estate debt investments – they want a consistent strategy that they can rely on for steady returns, especially because in debt investments there is no upside.

"[Investors] want to understand that there is limited downside – they already understand the limited upside," Lindsay concurs.

Looking ahead

Even if the number of managers levels out over time, fund managers and analysts alike believe real estate debt funds are here to stay. Cain sees the past two years as the second wave of real estate debt fundraising and believes 2019 will be a crucial year for determining how the US market will shape up. JLL's placement agent business is itself banking on the continued success of this market by looking for a real estate debt fund manager to partner with.

"I think we're far enough into the cycle, there are enough structural changes in the banking system, and enough investor demand for this to be a permanent shift in the landscape," Goldman Sachs' Weidman adds. The fact that funds can react to investment opportunities quickly and structure their loans creatively – in ways banks simply are not doing anymore – is a significant draw for investors, he explains. "If we were going to see that change back to the banks dominating this space, we probably would have already seen it happen."

Lindsay adds that some tactically minded investors are just in real estate debt to replace core investments temporarily as prices go up. "But my experience is once we show them what we can do in real estate debt, investors like it – and I don't think we're going to lose those investors." ◻

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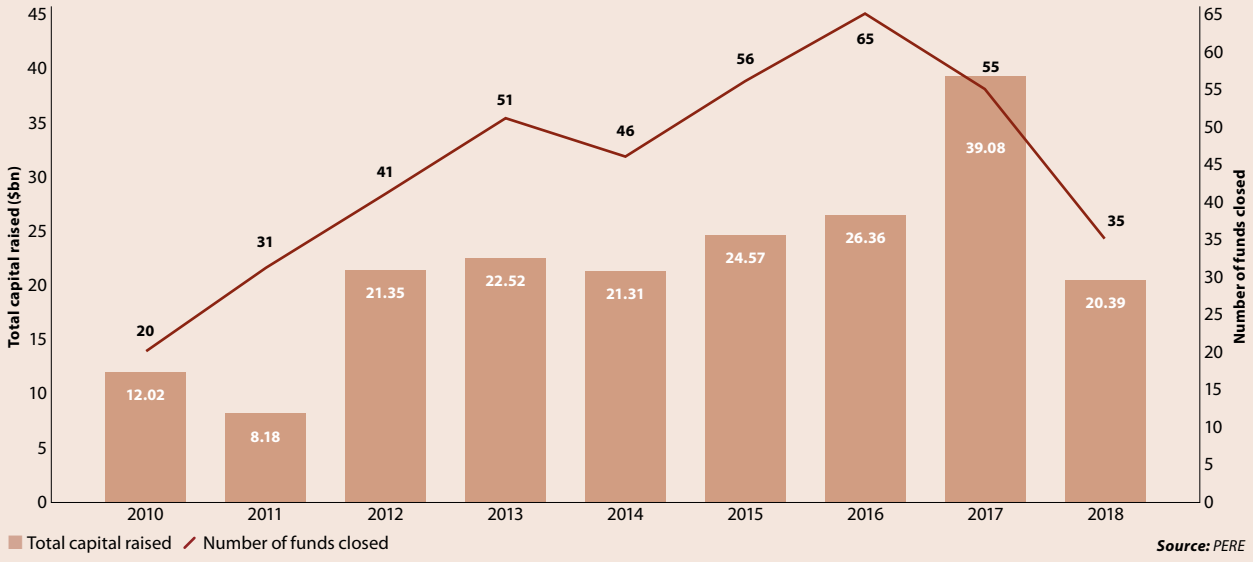
Back to normality

Debt fundraising disappointed in 2018 after the dizzy heights of a year earlier, but figures are on par with levels reached between 2012 and 2016

Steep descent

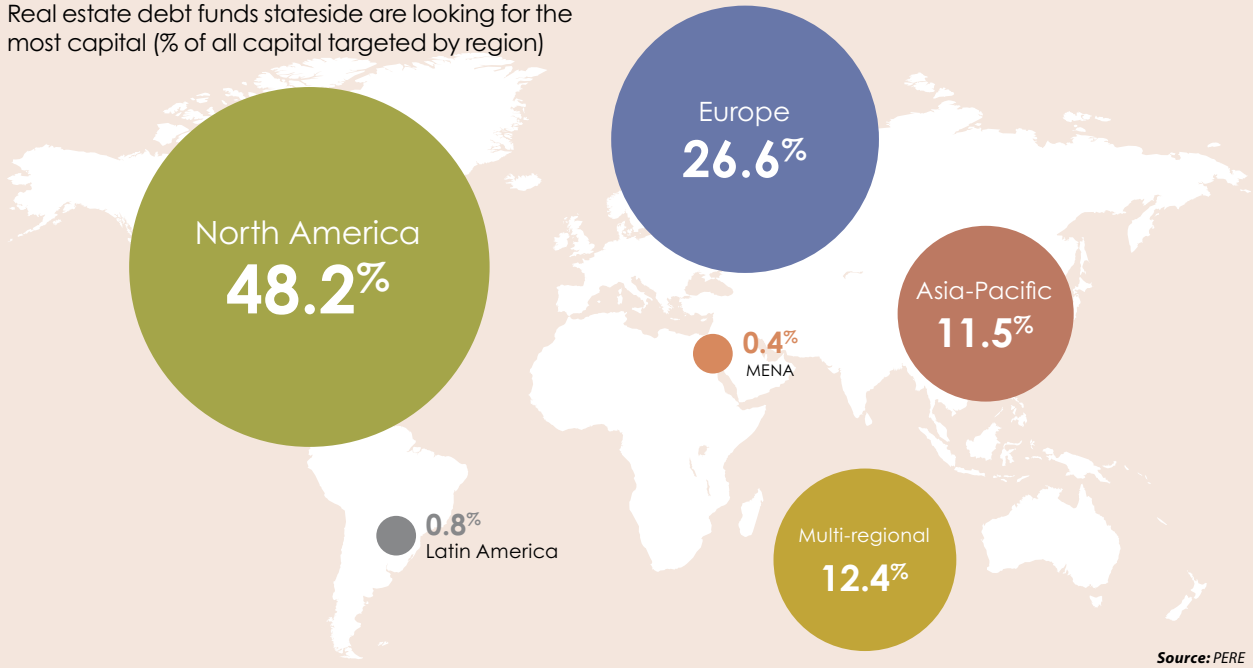
Total capital raised for debt funds fell sharply last year after a record-breaking 2017



Source: *PERE*

Target America

Real estate debt funds stateside are looking for the most capital (% of all capital targeted by region)

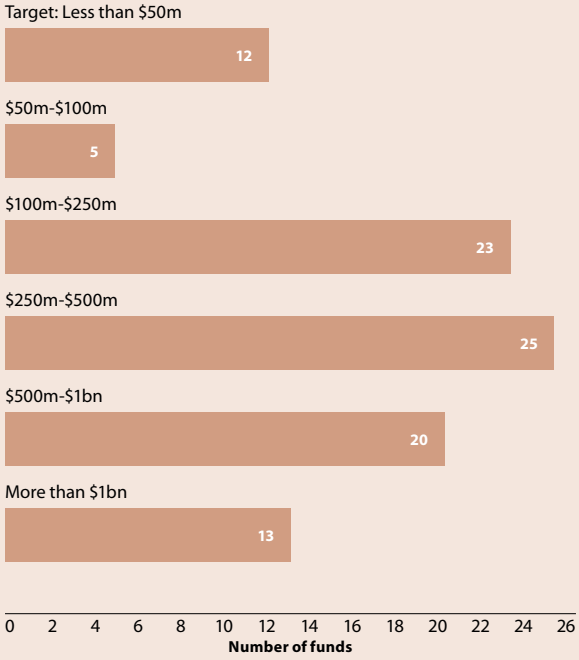


Source: *PERE*

Total capital targeted by real estate debt funds in market (as of December 31, 2018)

Midfield position

Most debt funds in market are targeting capital raises between $100m and $1bn



Source: *PERE*

Debt's A-listers

Seven of the top 10 debt funds in market have a North America or multi-regional focus

Fund name	Fund manager	Target size ($bn)	Regional focus
Related CRE Debt Fund	Related Companies	2	North America
Related HPS Joint Venture II	Related Companies	2	Multi-regional
Bridge Debt Strategies Fund III	Bridge Investment Group	1.5	North America
Fortress Real Estate Debt Fund III	Fortress Investment Group	1.5	Multi- regional
Kayne Real Estate Debt Fund III	Kayne Anderson Capital Advisors	1.5	North America
Torchlight Debt Opportunity Fund IV	Torchlight Investors	1.5	North America
ICG-Longbow UK Real Estate Debt Investments V	ICG-Longbow	1.28	Europe
Fortress Japan Opportunity IV	Fortress Investment Group	1.25	Asia-Pacific
Davidson Kempner Long-Term Distressed Opportunities Fund IV	Davidson Kempner Capital Management	1.20	Multi-regional
Bain Capital Special Situations Europe	Bain Capital	1.15	Europe

Source: *PERE*

Almere, the Netherlands: Venn is taking advantage of opportunities in the Dutch office market

Going where the banks will not venture

Traditional lenders' focus on financing core assets leaves room for alternative lenders to finance value-add properties says Venn Partners' Paul House. By Stuart Watson

Venn Partners is placing less emphasis on the UK property market these days, which has so far proved fertile ground for the credit-focused asset manager. The firm is now increasingly favoring lending against value-add real estate in continental European markets. Managing partner Paul House outlines the market dynamics driving the company's evolving strategy.

***PERE**: Why might a capital provider choose to back a debt strategy now, rather than making an equity investment?*

Paul House: Given the advanced stage in the investment cycle, it has become evident that the core market is priced on the aggressive side and asset purchases in the value-add sector are increasingly competitive, so commercial real estate debt can offer investors an interesting product that is complementary to their real estate investment allocations, and a good diversification within fixed-income investments. Lower volatility and lower deployment costs make debt a compelling case for investors. We do not fund the whole purchase price of a property, with loan proceeds of up to 75 percent loan-to-value, sometimes less, so we benefit from an insulating feature to our target return as property values can stay stagnant or even recede before impacting returns. Nothing in the current market indicates a sharp decline in the value of commercial property assets, but core is aggressively priced and we will see less growth in that space going forward. The use of debt can be viewed positively against that backdrop.

Borrowers also pay for most of the underwriting, legal and valuation work, and other consultants' reports, so debt has a very low-cost fund threshold. In the equity game, in every deal you must absorb those costs and you may not be able to acquire the asset because someone else is willing to pay more. The expense ratio is much lower in debt than in equity, so in these times of a lot of equity capital chasing deals, this feature might begin to have an impact on the comparative returns of equity and debt strategies. Importantly, the amount of capital going into debt is not massive, and competition is not massive, so we see the market conditions in our space remaining stable for the next few years.

***PERE**: Where do you see the best opportunities for investing in European real estate debt?*

PH: Attractive relative value can be made by creating a strategy where others are not focused, but where the fundamentals remain attractive. Core real estate markets in continental Europe are attractive for equity investors, and there are significant amounts of capital going into that type of real estate. Complementing this, in the occupational markets the rents and vacancy rates backing those assets are strong and it appears they will continue to be so. Supply for the most part is in control.

With this market opportunity, it is a good time to be financing value-add assets to stabilize them and then these properties feed into the much larger core markets. Banks still dominate commercial real estate lending in terms of volume because they have an extremely efficient funding model, which makes competing with them quite challenging if you target where their sweet spot is. For the most part, it is better

to choose to go where they are not, and due to regulation and their own prudence, given their own leverage model, the amount of debt they are willing to provide on assets which involve factors like leasing risk, refurbishment, development or operational risk is limited.

Therefore, backing value-add investments provides an opportunity for investors to generate higher returns because the assets themselves are higher returning, and because you can offer loans of up to 75 percent loan-to-value where a bank will typically only go up to 50 percent, then the ability to price capital efficiently is there. There are also opportunities to lend on other asset types that the banks are less comfortable with, such as real estate operating assets like hotels, student housing or care homes.

***PERE**: Which European markets currently show the most favorable fundamentals?*

PH: Our first pan-European value-add fund invested in the UK and selected European countries. We are working up to the launch of a second fund that will take the UK off the list of countries and bring in Spain. Brexit makes investing in the UK more challenging because of the uncertainty. We do not anticipate any massive decline in UK real estate and the market continues to reward private equity managers that are doing their jobs right and adding value to buildings, but nobody knows what will happen.

There are also cyclical reasons to exclude the UK and include Spain. The UK did quite well in the years immediately following the GFC, but in continental Europe the banking crisis of 2011-13 caused further economic disruption. Now, mainland Europe is doing better, including Spain, which has been through the process of recapitalizing its financial institutions and is demonstrating good prospects for GDP growth. A lot of what we do is refinancing the assets that come out of non-performing loans; as Spain is at an earlier point in the cycle, we see some potential opportunities there.

House: value-add real estate debt is not a crowded market

Amsterdam is also a very active market; we recently completed a deal just outside the city taking advantage of the spillover from an office market that has a very low vacancy rate and is cramped for space.

In France, we financed a transaction in the industrial market which is in an earlier phase of the industrial distribution evolution brought on by internet retail penetration.

***PERE**: Venn Partners was closely associated with the UK private rented residential market. Will that continue to be a focus?*

PH: In 2014, we won a competitive tender from the UK government to deploy capital into the PRS sector with a focus on stabilized income-producing properties. That business continues to provide long-term owners of institutional homes for rent with affordable debt where we raise capital with the benefit of a government guarantee and use these proceeds to cost effectively fund loans in the sector. Outside that, as part of our historical view, we also found the UK value-add residential sector interesting. We started doing residential loans back in 2013 when pricing was strong, as was the residential market overall. However, even at that time we did not like all parts of the residential sector and were shy on the high-end subsector.

"The underlying market to purchase residential is expensive everywhere and there is a need for new supply, so we like the residential sector"
Paul House

More recently, our selectivity has increased. We are doing less London-centric UK residential, but have looked to the regions where the pricing of the underlying properties are at more affordable levels. London boroughs, where supply is constrained and if properties can be acquired at a lower price, will continue to provide opportunity. Venn also has a Dutch residential mortgage business and we continue to like residential as an asset class, particularly in continental Europe. The underlying market to purchase residential is expensive everywhere and there is a need for new supply, so we like the residential sector. The more challenging sector is retail. The UK high street is struggling and conditions are not easy in continental Europe either. Online delivery is impacting retail assets everywhere, even if Europe is behind the UK and US in terms of feeling the full brunt of increased internet penetration.

***PERE**: There are more players in the debt space than before. How does a manager show their value to investors in a more competitive environment?*

PH: Investors have a good data set now for the debt funds that have been around for a number of years, so they can discern between different managers' track record on the approaches they have chosen and how they have been able to perform. That information probably did not exist when we founded our business six years ago. In the commercial real estate lending space, some loans perform better than others, so now investors can see how a manager has dealt with the problems of having potential stress on their books. One can also see how good they were at creating opportunities from the market. For example, we financed deals in the UK pubs sector in 2013, which at the time was quite an avant garde move; since then we have seen some very large and healthily priced M&A activity in that sector. ◻

Global real estate debt ranking 2019

PERE's inaugural listing of the largest real estate debt fund managers

Rank	Fund manager	Headquarters	Country	Amount raised ($m)
1	Blackstone	New York	United States	7,165.00
2	Goldman Sachs Merchant Banking Division	New York	United States	7,065.36
3	ICG-Longbow	London	United Kingdom	4,735.38
4	AllianceBernstein	New York	United States	4,655.00
5	M&G Investments	London	United Kingdom	4,607.07
6	Brookfield Asset Management	Toronto	Canada	4,324.00
7	PGIM Real Estate	Madison	United States	4,296.33
8	Pacific Coast Capital Partners	Los Angeles	United States	4,143.00
9	Oaktree Capital Management	Los Angeles	United States	3,827.00
10	LaSalle Investment Management	Chicago	United States	3,710.12
11	DRC Capital	London	United Kingdom	3,439.28
12	Prime Finance	New York	United States	3,298.38
13	Bridge Investment Group	Salt Lake City	United States	3,232.70
14	BlackRock	New York	United States	3,202.35
15	Nuveen Real Estate	London	United Kingdom	3,188.58
16	Kayne Anderson Capital Advisors	Los Angeles	United States	2,935.00
17	AgFe	London	United Kingdom	2,889.41
18	Colony Capital	Los Angeles	United States	2,755.05
19	GreenOak Real Estate	London	United Kingdom	2,684.44
20	KKR	New York	United States	2,416.00
21	Caerus Debt Investments	Düsseldorf	Germany	2,173.74
22	Cheyne Capital Management	London	United Kingdom	2,119.00
23	Torchlight Investors	New York	United States	2,018.60
24	Rialto Capital Management	Miami	United States	1,960.30
25	DWS	Frankfurt	Germany	1,650.73
26	Ares Management	Los Angeles	United States	1,592.50
27	Atalaya Capital Management	New York	United States	1,524.12
28	Tyndaris Real Estate	London	United Kingdom	1,513.63
29	Madison Realty Capital	New York	United States	1,454.99
30	Värde Partners	Minneapolis	United States	1,412.00
31	Brunswick Real Estate Capital	Stockholm	Sweden	1,334.43
32	Square Mile Capital	New York	United States	1,243.88
33	Qualitas	Melbourne	Australia	1,237.20
34	Diamond Realty Management	Tokyo	Japan	1,185.93
35	SCOR Investment Partners	Paris	France	1,071.89
36	Walton Street Capital	Chicago	United States	1,069.00
37	Laxfield Group	London	United Kingdom	1,042.89
38	Latitude Management Real Estate Investors	Beverly Hills	United States	963.00
39	Omni Partners	London	United Kingdom	946.63
40	JCR Capital	Denver	United States	941.50
41	Incus Capital	Madrid	Spain	911.30
42	Mesa West Capital	Los Angeles	United States	900.00
43	GAM Holdings	Zurich	Switzerland	805.77
44	RCG Longview	New York	United States	793.27
45	Calmwater Capital	Los Angeles	United States	740.00
46	Oz Management	New York	United States	736.23
47	Quadrant Real Estate Advisors	Alpharetta	United States	714.00
48	Pacific Investment Management Co.	Newport Beach	United States	696.60
49	AEW	Paris	France	673.75
50	KSL Capital Partners	Denver	United States	670.90

Methodology: *The PERE RED 50 ranking is based on the capital raised for the purpose of real estate debt issuance between January 1, 2014, and December 31, 2018*

1 Blackstone

$7.17 billion
New York

Part of Blackstone's Real Estate Group, Blackstone Real Estate Debt Strategies, or BREDS, launched more than a decade ago. Most recently, it closed BREDS III in summer 2016 on $4.5 billion, ahead of its $4 billion target. The fund has focused mostly on mezzanine and structured lending on well-located, institutional-quality real estate. It has returned an 18 percent net internal rate of return as of March 31, 2018, according to Pennsylvania Public School Employees' Retirement System.

The team of 114 professionals is led by Michael Nash, senior managing director and co-founder of the group and chairman; Jonathan Pollack, senior managing director and global head of the group; and Tim Johnson, senior managing editor and global head of originations for BREDS. Blackstone's real estate debt funds typically target investments with current cashflow, capital protection and high-quality borrowers. BREDS has also bought legacy commercial real estate exposure from banks. Recently, it originated a $476 million whole loan secured by The Row, a seven-building retail and office campus in Los Angeles. The unit has $17 billion in AUM as of December 31, 2018. ◻

Blackstone HQ: the New York giant takes top spot in the RED 50

2 Goldman Sachs Merchant Banking Division

$7.07 billion
New York

Focused on both Europe and North America, the real estate group of Goldman Sachs' Merchant Banking Division has raised approximately $15 billion of commitments for real estate credit since 2008.

Most recently, it held a final close for its latest real estate credit investment vehicle, Broad Street Real Estate Credit Partners III, in January 2018, raising $4.3 billion, which includes a $2.5 billion commitment from Goldman's balance sheet. Including leverage, the fund has $6.7 billion in total capital available to invest. It also recently closed on its first senior loan in Europe, a $240 million for the development of a high-end senior living facility in London.

The real estate group is headed by Alan Kava, the New York-based co-head of MBD's Real Estate Group, and Jim Garman, its London-based co-head, while Peter Weidman acts as MBD's global head of real estate credit.

Goldman Sachs focuses on direct originations of both senior and mezzanine loans secured by high-quality assets in major markets in the US and in Europe. It can provide loans of $100 million to more than $500 million. ◻

Kava: heads up Goldman's real estate group

3 ICG-Longbow

$4.74 billion
London

London-based Intermediate Capital Group's real estate investment solutions are provided and managed by its real estate division, ICG-Longbow.

ICG-Longbow's real estate team mainly invests in self-originated whole loans secured against commercial property in the UK. They also provide development funding and subordinated capital, including mezzanine debt and preferred equity. The firm also has a UK real estate senior debt program.

ICG-Longbow Senior Secured UK Property Debt Investments, a closed-end listed investment company on the London Stock Exchange, focuses on building a portfolio of UK real estate debt-related investments mainly comprising loans secured by first ranking fixed charges against commercial property investments.

As of October 2018, the portfolio had nine loan investments for an aggregate value of £105.5 million ($138.9 million; €122.6 million), mainly on properties located in London and throughout the rest of the UK. One of its most recent transactions was a £16.2 million financing secured by a multi-let office building in Bristol.

ICG-Longbow has £3.6 billion in assets under management as of September 30, 2018. □

Bristol: ICG-Longbow financed an office building in the city

4 AllianceBernstein

$4.66 billion
New York

AllianceBernstein's commercial real estate debt group, AB CRED, was formed in 2012 by its current chief investment officer Roger Cozzi to provide loans to large institutional owners and operators of commercial real estate. AB CRED focuses on first mortgage loans secured by transitional properties that demonstrate potential for value creation through lease-up, asset renovation, asset repositioning or market recovery.

AB CRED's most recent fund closed in June 2018 and totaled $3.1 billion in commitments from institutional investors worldwide, a significant increase in size compared with the two previous funds. Its first fund closed on $750 million in commitments in 2013, while the second closed in 2015 with commitments in excess of $1.5 billion. AB CRED has invested more than $5 billion since 2013 with loans ranging in size from $20 million to $250 million, encompassing all major commercial property types. All loans are held on balance sheet through maturity and the funds do not use leverage.

In January 2019, AllianceBernstein also finalized a joint venture with its real estate private equity group, now known as Prospect Ridge, led by Brahm Cramer and Jay Nydick. □

Cozzi: founded the CRED group in 2012

5 M&G Investments

$4.61 billion
London

Barakat: founded the business in 2008

M&G Investments' real estate debt finance team has invested more than £8.5 billion ($11.3 billion; €10 billion) across the UK and Europe since 2009, with a primary focus on creating value by originating whole loans secured against strong underlying properties, which it holds to maturity.

It invests across the capital structure through senior, mezzanine and whole loan strategies, and offers both commingled and separate account products. It recently provided a £125 million development financing facility to Urbanest, a developer and operator of student accommodation, for a project in the City of London.

In 2017, it launched three vehicles, M&G Real Estate Debt Finance IV, V and VI, which are being raised simultaneously to invest across the capital structure. Since these strategies launched, the team has raised over £1.5 billion for the platform. All three vehicles focus on European real estate debt, investing across the capital structure.

The real estate debt finance team, headed by John Barakat, who founded the business in 2008, counts more than 20 professionals. ◻

6 Brookfield Asset Management

$4.32 billion
Toronto

The Brookfield Real Estate Finance Investment team is led by Andrea Balkan and Chris Reilly, both managing partners based in the firm's New York office.

In late 2017, Brookfield Asset Management closed its latest fund, Brookfield Real Estate Finance Fund V, with about $3 billion. Its fifth commercial real estate finance vehicle targets mezzanine debt investments through the origination of financing for high-quality properties in major markets across the US. Brookfield committed $400 million to the fund, joining more than 60 institutional investors, including public and private pension plans, sovereign wealth funds, financial institutions, endowments, foundations and family offices. Its first vehicle closed in 2004.

Brookfield's strategy typically consists of originating whole loans, syndicating senior loans to third parties and retaining a large tranche of the mezzanine loan.

In 2017, it arranged a $375 million financing package for 70 Pine Street, an office-to-residential/hotel conversion in Manhattan's Financial District. Brookfield also manages separate accounts focused on senior mezzanine investments. ◻

The Bull, NYC: Brookfield financed the office-to-residential conversion near Wall Street

7 PGIM Real Estate

$4.30 billion
Madison, Wisconsin

Durning: leads PGIM Real Estate Finance

PGIM's real estate businesses originated a record $18.1 billion in loans in 2018 and, in the US, provided more than $500 million in financing on behalf of institutional investors, including preferred equity, core-plus and mezzanine debt. In one of its most recent transactions, it originated $88.5 million to Madison Capital and Lubert-Adler Partners to refinance 71 Fifth Avenue, an office-and-retail building in Manhattan's Flatiron District.

In Europe, the business provided more than $400 million in financing across 12 transactions on behalf of institutional investors, primarily in the UK. Transactions included whole and junior loans, and mezzanine and preferred equity positions in development and existing assets. Sectors included traditional residential, student housing, office, retail, industrial, mixed-use schemes and hotels. In Asia, the firm recently hired an executive director to lead real estate debt operations in Australia.

The real estate businesses of PGIM are led by Eric Adler, chairman of PGIM Real Estate and PGIM Real Estate Finance. The global debt real estate business is led by David Durning, president and CEO of PGIM Real Estate Finance. ◻

8 Pacific Coast Capital Partners

$4.14 billion
Los Angeles

With offices in New York, San Francisco, Los Angeles and Atlanta, Pacific Coast Capital Partners, which recently celebrated its 20th anniversary, has raised, invested and managed more than $19 billion in 850 transactions since inception. It has $9 billion in commercial real estate debt and equity assets under management.

PCCP originates senior and mezzanine loans secured by commercial real estate, often loans to lease-up and stabilize assets, loans on properties that are being repositioned, construction loans, loans on vacant buildings, and loans for discounted payoffs and discounted note acquisitions. The firm typically invests between $20 million and $300 million across properties in the US, including office, industrial, multi-family, retail, hospitality, residential and land. In December 2018, it closed a $162.5 million five-year loan on a Class A office project in Beverly Hills to Divco West.

PCCP has more than 95 employees and is led by founders Aaron Giovara, Donald Kuemmeler and Bill Lindsay. It sold a 24.9 percent stake to Sydney-based money manager AMP Capital in December 2017, while the California State Teachers Retirement System is also a major shareholder. ◻

Beverly Hills: PCCP financed a Class A office project in the LA district in December 2018

9 Oaktree Capital Management

$3.83 billion
Los Angeles

Guichard: co-portfolio manager for Oaktree's real estate debt and structured credit strategies

Although Oaktree's real estate team had actively invested in debt in its first 15 years, in 2010 the firm added real estate debt as a standalone strategy to invest capital in performing real estate debt on a global basis. Today the team focuses on a broad range of transactions in the commercial and residential sectors, investing in both private loans and traded securities.

The firm closed Oaktree Real Estate Debt Fund II, its follow-up commercial real estate debt investment fund, in 2018 on more than $2 billion. Its predecessor, Oaktree Real Estate Debt Fund, had a 14.7 percent net internal rate of return as of December, according to the firm's earnings results.

The strategy is led by John Brady, a managing director and head of the global real estate group, and Justin Guichard, a managing director and co-portfolio manager for Oaktree's real estate debt and structured credit strategies. Oaktree's real estate debt strategy has $3.2 billion in AUM as of December 31 and offices in Los Angeles, New York, London, Hong Kong, Seoul, Sydney and Tokyo. ◻

10 LaSalle Investment Management

$3.71 billion,
Chicago

LaSalle Investment Management has been investing in real estate debt and equity in the UK and Germany since 2009 through its close-end LaSalle Real Estate Debt & Special Situations Fund Series. Amy Aznar heads LaSalle's European Debt & Special Situations Group.

In late 2018, it significantly expanded its business by acquiring a $1.2 billion majority stake in the commercial real estate debt fund business of Latitude Management Real Estate Investors, broadening LaSalle's focus to the US real estate financing sector. Renamed LaSalle Mortgage Real Estate Investors, the group provides short-term, floating rate loans to mid-market commercial real estate sponsors, with a primary focus on the origination of new bridge loans for value-add and transitional properties in sustainable growth markets throughout the US.

Based in Los Angeles with an office in Denver, it is currently investing out of its most recent fund, Latitude Management Real Estate Capital IV, which has about $480 million in commitments. The team, which counts 18 employees, is headed by Glenn Sonnenberg, president and CEO. ◻

Aznar: heads LaSalle's European Debt & Special Situations Group

Lattanzio: leads DRC's 20-person team in London

DRC Capital is a value-add investment advisor focusing on the commercial real estate debt sector across the UK and Europe. Through its 20-person debt team based in London, led by managing partner Dale Lattanzio, it offers advisory and origination services to borrowers and investors. Since forming in 2008, DRC has arranged more than £2 billion ($2.7 billion; €2.4 billion) of debt investments for its client base. In 2018, it provided an €83.8 million whole loan to assist in the acquisition of a portfolio of Spanish hypermarkets. ◻

11

DRC Capital

$3.44 billion
London

Prime Finance, part of Prime Group, a real estate equity and debt investment and operating platform, directly originates mortgages, mezzanine, participation and preferred equity financing. It also acquires performing, sub-performing and distressed assets, and invests in B-Pieces of CMBS. Recent transactions include an $18 million five-year floating rate first mortgage loan for a 120-unit student housing complex in Berkeley, California, and a $27.6 million five-year floating rate first mortgage for a 70-unit historic retail and residential building in Los Angeles. ◻

San Fernando Building Lofts: Prime financed this historic building

12

Prime Finance

$3.30 billion
New York

Chung: the CIO founded the Bridge Debt Strategies team

Bridge Debt Strategies Fund Manager invests in commercial real estate-backed fixed income, focusing on underserved debt markets; more specifically Freddie Mac K-Series B-pieces and first mortgage lending on value-add opportunities in multifamily, office and senior housing assets. The team is led by James Chung, chief investment officer, who worked at Morgan Stanley before joining Bridge in 2013. Founded in 1991, Bridge Investment Group invests in multifamily, office, senior housing, medical properties, affordable housing and real estate debt strategies. The firm currently has $13.5 billion in assets under management. ◻

13

Bridge Investment Group

$3.23 billion
Salt Lake City, Utah

BlackRock invests in loans secured by commercial properties such as offices, apartments, retail centers and hotels in the US, Europe and Asia-Pacific. In March, it created a real assets debt group, combining its $10.5 billion infrastructure debt platform with its real estate debt business to create a single real assets debt platform worth more than $11 billion. Robert Karnes, who previously led the real estate debt group, leads the unit. Funds in this strategy include BlackRock US Real Estate Senior Mezzanine Debt Fund. ◻

BlackRock HQ in New York: the firm created a real assets debt group in March 2019

14

BlackRock

$3.2 billion
New York

Gay: sees real estate debt as superfood to portfolios

Nuveen's global commercial real estate debt platform invests across the capital structure, seeking income-focused, stable risk-adjusted total returns for investors. Nuveen offers open- and closed-end private funds, co-investment opportunities and separately managed accounts and finances a range of assets from industrial, office, retail and multifamily to more alternative sectors such as student housing and self-storage. The team is led by Jack Gay, managing director and head of debt, real estate, who has dubbed commercial real estate debt as "superfood" to institutional investors' portfolios by enhancing performance thanks to stable returns. ◻

15

Nuveen Real Estate

$3.19 billion
London

16

Kayne Anderson Capital Advisors

$2.94 billion
Los Angeles

Kulvin: at the helm of the LA-based firm

Kayne Anderson Real Estate Debt, or KARED, focuses on Freddie Mac B-Pieces and invests across subordinated debt. Its first debt fund, KARED I, closed in the fall of 2016 on more than $700 million in commitments, while KARED III made its first investment at the end of 2017. The debt team is headed by Karen Kulvin and Andrew Smith, co-portfolio managers and managing directors. The firm has a total $6 billion in assets under management, including $2.5 billion in real estate debt assets. ◻

17

AgFe

$2.89 billion
London

Founded in 2006 by CEO Paul Rolles, AgFe is a fully independent advisory and asset management firm specializing in complex debt-based investments. Initially specialized in providing advisory services in the private and public sectors including to central banks, regulators, commercial banks, asset managers and other companies, it branched out in 2013 when it began raising a £1 billion debut fund to lend to UK real estate. Brent Williams, a managing partner who joined in 2008, is responsible for the day-to-day management of the firm. ◻

Branched out: AgFe expanded it advisory focus to debt investing in 2013

18

Colony Capital

$2.76 billion
Los Angeles

Traenkle: Colony's CIO and head of all real estate credit strategies

Colony Capital has been investing in credit since inception in 1991. It established the CDCF Series in 2008 for credit investments and, to date, has raised approximately $5 billion of commitments through four funds. The CDCF Series focuses on the origination of high-yield debt and similar financing facilities including mezzanine debt and preferred equity, the acquisition of individual and portfolios of performing, sub-performing, and/or non-performing loans and real estate-owned assets, and investments in real estate-related, distressed or special situations. The team is led by Kevin Traenkle ◻.

19

GreenOak Real Estate

$2.68 billion
London

GreenOak's debt platform was established in 2012 by the senior management team led by Jim Blakemore. Headquartered in London, the 13-strong team has raised about $2.6 billion of capital to focus on providing senior, junior and whole loans to support sponsors to implement their business plans and create value. The firm has local presence across Europe and is an active lender in the UK and Western Europe. Currently, there are three funds under management: GreenOak UK Secured Lending Fund I; GreenOak UK Secured Lending Fund II; and GreenOak Europe Secured Lending Fund I. ◻

Blakemore: leads GreenOak's 13-strong team

20

KKR

$2.42 billion
New York

RECOP fund: raised $1bn and is now 71% invested

New York-based KKR invests in commercial real estate debt through two distinct strategies. KKR Real Estate Credit Opportunity Partners, RECOP, is a fund that invests in junior tranches of new issue commercial mortgage-backed securities. RECOP closed at the end of 2017 on $1.1 billion. As of December 31, 2018, RECOP was 71 percent invested. KKR Real Estate Finance Trust is an externally managed REIT focusing on originating senior commercial mortgage loans on transitional properties. The real estate credit team has 18 professionals, headed by Matt Salem. ◻

21

Caerus Debt Investments

$2.17 billion
Düsseldorf

Caerus Invests in German-speaking core markets and the Benelux countries with a focus on whole loans and mezzanine financing for office, hotel and residential buildings.

In 2018, the firm granted more than €370 million of real estate-secured loans. The largest transaction was a whole-loan financing of nearly €120 million secured by a diversified residential property portfolio in Germany. Michael Morgenroth, chief executive, and Patrick Züchner, chief investment officer, lead the team. ◻

22

Cheyne Capital Management

$2.12 billion
London

Cheyne invests in European real estate capital. It closed its fifth real estate credit fund, Cheyne Real Estate Credit Fund V, in July 2018 at its hard-cap of £600 million ($799 million; €704 million).

The London-based firm, led by Jonathan Lourie, co-founder, CEO and CIO, and Stuart Fiertz, co-founder, president and director of research, has been involved in direct bilateral lending, investments in securitized mortgage-backed securities and in a limited number of equity participations. ◻

23

Torchlight Investors

$2.02 billion
New York

Torchlight is pursuing investments across the spectrum of debt and other interests relating to commercial real estate, including senior and mezzanine mortgage loans, CMBS, preferred equity and equity positions.

Recent deals included $159 million of senior mortgage and mezzanine financing on two Class-A office buildings in Charlotte, North Carolina, and Sarasota, Florida.

Torchlight, led by founder Daniel Heflin, is currently raising Torchlight Debt Opportunity Fund VI. ◻

24

Rialto Capital Management

$1.96 billion
Miami

Focused on the US market, the firm has raised three flagship opportunistic funds in addition to numerous direct lending and CMBS investments funds and separate accounts. It invests in newly issued and secondary CMBS bonds and also focuses on distressed and special situations, and direct lending, including mezzanine and floating rate debt. The firm is led by CEO Jeff Krasnoff and president Jay Mantz. ◻

25

DWS

$1.65 billion
Frankfurt

Asset management firm DWS, formerly known as Deutsche Asset Management, invests in the full spectrum of debt strategies, including B-Notes, mezzanine loans and preferred equity, through DWS's direct investments team and capital markets group.

The team is led by Todd Henderson, head of real estate for the Americas, and Clemens Schaefer, head of real estate for Europe, who took up the position in the past year. ◻

26

Ares Management

$1.59 billion
Los Angeles

The Ares real estate debt platform directly originates and invests in financing opportunities for owners and operators of US commercial real estate. Ares also invests through a specialty finance company, Ares Commercial Real Estate Corporation, which is primarily focused on directly originating, managing and investing in a diversified portfolio of commercial real estate debt-related investments. Bill Benjamin and Jamie Henderson, lead the team. ◻

RED 50

Credit risks, equity returns

European real estate debt continues to present compelling opportunities for high risk-adjusted returns, argue Colony Capital's Kevin Traenkle and Nadra Moussalem. Stuart Watson reports

Fibonnaci Square, Dublin: Facebook signed a 25-year lease on a new HQ at the Colony-financed asset

While much of the interest in real estate debt investing has been generated by investors allocating capital to senior loan positions that provide stable but lower returns, Colony Capital has tended to focus on debt positions in the middle part of the capital stack. Chief investment officer and head of credit Kevin Traenkle, and Nadra Moussalem, managing director and head of Europe at the Los Angeles-headquartered real estate investor, tell *PERE* how they are seeking to achieve equity-like returns through debt-like positions.

***PERE**: How would you characterize current investor demand for the real estate debt space?*

Kevin Traenkle: We are seeing more and more investors carving out a bigger allocation specifically for real estate debt offerings. That is prudent because on a global basis the risk-adjusted rates of return that credit and debt investing provide are currently very high given where we are in the market cycle. That demand is emanating from lots of different capital sources, ranging from public entities like mortgage REITs, which tend to like strong dividend yields without a whole lot of volatility, to global institutions looking to achieve more opportunistic returns while remaining within the credit space. The latter tend to invest through private closed ended-funds, which have a higher tolerance for risk and volatility. There are a lot of opportunities coming out of Europe for more value-add and opportunistic returns and we are also seeing more investors from the European region interested in this strategy.

***PERE**: Why are higher-risk real estate debt strategies popular at this time?*

Nadra Moussalem: When many investors in Europe started to invest in credit they were trying to mirror the type of risk they were underwriting when investing in fixed-income instruments, so they began with the senior end of the debt spectrum. A couple of years ago it was still possible to find very attractive margins in Europe in financing core and stable assets because there was a massive imbalance in the demand and supply of credit. However, that situation has evolved. Core senior loan margins are much tighter again, so there has been a general view recently that this might be a good time to diversify credit portfolios by investing in other parts of the capital stack which provide more attractive risk-adjusted return profiles.

KT: Through opportunistic credit investing you can generate compelling returns that approach returns you would expect from a value-add equity fund. Given where we are in the market cycle, with more subdued inflationary pressures on real estate asset prices, being in the credit space and still getting almost equity-like returns is an attractive proposition.
NM: In 2008 in the US and in 2013 in Europe, we saw windows open to secure opportunities that had credit-like profiles in terms of risk and equity-like asset returns, so it seemed to us that a very interesting place to deploy capital is between traditional senior debt and sponsor equity.

***PERE**: Why are conditions in the European market more favorable for credit investing than they are in the US right now?*
NM: After the global financial crisis, tighter regulations were introduced in the European banking industry that had a growing impact on traditional lenders' ability to provide liquidity. In the meantime, there was also a trend toward lenders focusing on their home markets. Because Europe relied a lot on bank and balance-sheet lending, that opened up a broad gap between credit supply and demand, which was widened further because most of that liquidity was directed toward a small section of the market. If you were seeking funding for core product you would find a lot of capital. On the other hand, if you were a smaller sponsor or needed financing for a situation that was slightly more complicated, or had some value-add component, then there was much less capital available. Some mezzanine funds were created, some debt funds with senior strategies were launched, but if you aggregate all those new products and compare that to the banks' balance-sheet lending pre-global financial crisis, you find a very large chasm that does not yet seem anywhere near being bridged.

"A very interesting place to deploy capital is between traditional senior debt and sponsor equity"
Nadra Moussalem

KT: We are still active in the US, and we still see compelling opportunities there from time to time, but more often than not, the risk-adjusted returns are higher in Europe right now. There has been considerable asset appreciation in the US, and the markets are stable and mature. We also see more competition to provide financing in the US.

Traenkle: risk-adjusted returns are higher in Europe than the US

NM: There have been times when it was exactly the opposite. In 2008-12, I remember looking at the deals we were seeing on each side of the Atlantic and credit deals in the US showed better returns than the equity deals in Europe.

Moussalem: now is a good time to diversify credit portfolios

***PERE**: What situations provide the best opportunities for managers to deploy capital through opportunistic and value-add credit strategies?*
NM: Typically, opportunities arise in situations where the borrowers do not fit with the strategic objectives of the mainstream lenders. They might be smaller developers or entrepreneurs whose capital structure is in need of an injection of funding, but that want to retain control, or those seeking to transition assets from their current state to a more stabilized situation. While our capital may seem expensive at times compared to traditional lending, many sponsors are rather focused on the significant value we help them create, and that they are happy to share.

A common situation is where you have a loan that was made years ago, perhaps at the time of the financial crisis, and now represents around the fair value of the asset or slightly above it. That loan has been dragging on while lack of capital expenditure has led to a decline in the quality of the underlying asset and impaired its profitability. As a lender you can step in and recreate some equity in the capital stack by buying back the loan at a discount and providing some liquidity to the sponsor to perform capital expenditure that improves the quality and value of the real estate. After a couple of years, when that is done, you can find a more traditional source of capital willing to refinance the sponsor and make an exit. You can also acquire non-performing loan portfolios and then foreclose on assets when needed, or help more constructive borrowers refinance and retain ownership.

In Ireland, we backed the best local developers to get their projects out of foreclosure by Ireland's 'bad bank,' the National Asset Management Agency (NAMA). We would buy those assets from NAMA together with the developer and provide them with capital to begin construction or reposition the projects. Again, as those projects mature and begin to lease up, they become bankable again through more traditional sources of funding so we then start to repatriate some of our capital while sharing in the upside based on a formula set up with those sponsors. For example, last year we teamed up with developer Jonny Ronan to develop Fibonnaci Square site in Ballsbridge, Dublin, where he was in discussions with Facebook for a new headquarters building. At the time, traditional financing sources were not available, but now that a lease has been signed with Facebook the risk profile of that asset has changed dramatically. ◻

27

Atalaya Capital Management

$1.52 billion
New York

The manager invests in all major commercial and residential property types across strategies, including bridge and transitional loans, construction loans, first mortgages, mezzanine debt, and secondary performing and NPLs.

It recently provided a construction loan and preferred equity to finance the development of the new flagship Ritz-Carlton hotel in Manhattan's NoMad neighborhood. Young Kwon, managing director, leads the team. ◻

28

Tyndaris Real Estate

$1.51 billion
London

Tyndaris Real Estate focuses on mid-market commercial real estate opportunities from €15 million to €75 million in size and targets whole loans, mezzanine and subordinate loans, special situations capital and preferred equity in real estate across Europe.

The London-based firm closed its debt fund in 2015 on €350 million. The team is led by Clark Coffee, head of Tyndaris Real Estate, and also counts David White as partner. The firm has offices in London and Madrid. ◻

29

Madison Realty Capital

$1.45 billion
New York

Originates senior secured and mezzanine debt as well as preferred equity, used for construction, acquisition and refinancing of commercial real estate.

This firm is currently in the midst of raising its fourth real estate credit fund with a $1 billion target according to an SEC filing. Madison Realty Capital Debt Fund IV, once fully closed, will be significantly bigger than its predecessor fund, which raised $695 million in May 2016. ◻

30

Värde Partners

$1.41 billion
Minneapolis, Minnesota

Värde Partners lends to commercial entities that develop or manage property assets, including NPL and REO portfolios, in residential, multifamily, commercial and industrial real estate.

The firm recently led a group of investors along with Guber Banca in the acquisition of an NPL portfolio originated by 22 mutual, rural and cooperative banks throughout Italy. The gross value of the book is about €734 million. ◻

31

Brunswick Real Estate Capital

$1.33 billion
Stockholm

Brunswick began focusing on providing senior lending in the Nordic region, and most specifically in Sweden, in 2013.

It is currently investing out of Brunswick Real Estate Capital II, which closed in June 2018 on €640 million. Its first fund closed in March 2016. It makes loans in the range of SKr400 million ($43 million; €38 million) to SKr1 billion, with a term of up to 10 years. The team, is led by CEO Pontus Sundin. ◻

32

Square Mile Capital

$1.24 billion
New York

Square Mile Capital's debt investment strategies include first mortgages and mezzanine loans. The firm also focuses on the acquiring, restructuring and resolution of commercial mortgage debt originated by other lenders.

In 2018, the firm launched Square Mile Credit Partners II, a mezzanine fund focused on real assets special situations. The firm is led by CEO Craig Solomon. Jeffrey Fastov is a senior managing director leading credit strategies. ◻

RED 50

A highly sustainable market

Michael Kavanau, senior managing director at HFF, looks at UK and European real estate debt and makes his predictions for the year ahead

There are no overwhelming challenges or headwinds impacting the real estate debt market in Europe at the time of writing in March, but there are several key observations that can be highlighted, which make today's debt environment significantly different from the past.

While technically late cycle, amid the longest bull market for real estate in recent history, debt markets are not exhibiting 'traditional' late-cycle characteristics – primarily loose underwriting and pricing compression in early-late cycle or ultra-conservative underwriting and pricing expansion in late-late cycle. Indeed, instances of these conditions are periodically apparent, but they are still only anecdotal and not yet 'market.'

Debt observations

The current debt markets in the UK and Europe are currently highly liquid, functional and competitive, and the observations below suggest they should remain that way for the foreseeable future.

First, the availability of capital vastly outweighs the amount of attractive investment opportunities in the market. Global dry powder in the equity markets now stands at a record $300 billion, according to data by Preqin and HFF, and while highly disciplined is ready to deploy even into small market corrections. This is resulting in transaction volumes approaching record highs. The outcome of this has been shorter and shallower cycles – mini-cycles if you like – over the recovery's decade-long expansion.

It is also no longer accurate to label real estate an alternative investment sector, having been named the 11th Global Industry Classification Standard (GICS) back in August 2016, and independently it now makes up a meaningful and critical investment class of around 15-20 percent of institutions, family office and retail investors' portfolios. Similarly, real estate debt is a better-defined investment class, so most institutional investors do not have the choice but to support a credit strategy.

Structural shifts in how lenders are monitored – think bank stress tests, Basel III and Basel IV, for example – and the tranching of debt, so that appropriate risk resides with investors most likely to be able to survive a downturn, should mean the current real estate debt market is sustainable for a very long time and is also able to withstand significant internal or external shocks.

Another observation is that a more diverse lending base should further allow for the sustained health of the debt market. In the UK, for example, there has been a marked shift in annual volume by 'alternative' lenders from around 10 percent to 20 percent in just three years, according to Cass and HFF data, and the universe of lenders has increased to some 250 plus sources, including domestic and international banks, insurance companies, alternatives and debt funds and investment banks. And because of the pure amount of capital available to deploy, these sources are embracing diversification, choosing to lend across all real estate investment strategies from core to opportunistic.

These trends also mean that there has been a rise and acceptance of the role of debt advisors in helping sponsors navigate the vast amount and various sources of debt capital to optimize their borrowing strategies.

My final observation of the European debt market is that there is a focus on financing lower cap-ex assets such as logistics and residential. Higher cap-ex assets like retail are either out of favor or in favor but at lower gearing levels, which applies to office and hospitality properties. ◻

Five predictions for European real estate debt in 2019

1. Expect a retail bounce, with more interest in the sector from both debt and equity investors. The US enjoyed this bounce about six to nine months ago.
2. A continued drift toward covenant-lite loans for best-in-class sponsors, creating extra protection for borrowers in a downturn.
3. New entrants – around three to five per quarter – will join the debt markets, including additional equity players creating credit products.
4. Further expansion of traditional sources carrying out non-traditional lending – think debt funds pursuing more core pricing and insurance companies pursuing more value-add and opportunistic plays.
5. Pfandbrief banks continuing to take less risk. This could increase margins and drag up other sources' debt pricing, although more capital than deals will counter this and win, resulting in margin compression.

33

Qualitas

$1.24 billion
Melbourne

Qualitas is one of Australia's largest alternative real estate debt and equity investment groups. With 77 professionals across offices in Melbourne, Sydney and New York, Qualitas' investment activities are predominantly focused on Australia and New Zealand. The firm manages several debt funds including: Qualitas Real Estate Opportunity Fund; Qualitas Senior Debt Fund; Qualitas Real Estate Income Fund; and Qualitas Mezzanine Fund. ◻

34

Diamond Realty Management

$1.19 billion
Tokyo

Part of Japanese asset manager Mitsubishi Corporation Group, the firm provides private real estate funds and mezzanine debt funds to institutional investors in Japan and overseas.

Since 2011, the firm has launched six mezzanine debt funds in Japan, the latest in March 2018. The firm has also launched a $64 million fund specialized in mezzanine debt collateralized by a US real estate asset under construction in Brooklyn, New York. ◻

35

SCOR Investment Partners

$1.07 billion
Paris

Founded in 2008, SCOR Investment Partners is the asset management company of global reinsurance firm the SCOR Group. SCOR Real Estate Loans Fund III, closed in January 2018 on €550 million. The fund focuses on the financing of assets under development, restructuring or repositioning that benefit from the latest environmental labels or welfare certifications.

The team is led by Gilles Castiel, head of real estate, and Sandrine Amsili, head of real estate debt. ◻

36

Walton Street Capital

$1.07 billion
Chicago

Walton Street invests in debt of office, multifamily, hotel, industrial and retail real estate. Rich Ratke leads the 15-member team. Walton Street Real Estate Debt Fund I closed in April 2016 on $654 million in commitments and is nearly fully invested.

The firm, which is headquartered in Chicago and has offices in Mexico City and Mumbai, has $11.8 billion in assets under management. ◻

37

Laxfield Group

$1.04 billion
London

Through Laxfield LLP, a £750 million ($1 billion; €880 million) vehicle, the firm provides whole loans of £7 million to £100 million, while Laxfield National offers senior loans of £4 million to £20 million.

Recent financings through the Laxfield LLP fund include an £80 million loan of a mixed-use scheme in Scotland and a £20 million financing of a newly completed hotel in London. ◻

38

Latitude Management Real Estate Investors

$963 million
Beverly Hills, Los Angeles

LaSalle Investment Management acquired a $1.2 billion majority stake in the commercial real estate debt fund business of Latitude Management Real Estate Investors in 2018. Renamed LaSalle Mortgage Real Estate Investors, the group focuses on the US market, providing short-term, floating rate loans to mid-market commercial real estate sponsors. ◻

RED 50

Top three Brexit risks and how to mitigate them

JCRA's Shripal Shah unpicks the risks posed by Brexit to the UK real estate debt market

The nature of the UK's departure from the European Union is still defined by uncertainty, leaving businesses precariously positioned in no-man's land. What might come next is preoccupying the domestic real estate debt market, including private equity investors.Uncertainty and the potential for an economic contraction are the fundamental risks posed and threatens the sector in three specific ways.

1. Reduced lending appetite

Conventional sources of capital – clearing banks – are increasingly reluctant to lend against projects outside the London prime real estate market or beyond hot sub-sectors like the private rented sector, student accommodation and logistics. This applies even to borrowers with which they enjoy longstanding relationships. Liquidity is tight. Banks are re-evaluating their lending and the risk they are willing to take, and not just for new deals. Refinancing is not easy; borrowers are being asked to accept higher pricing and/or to inject further equity to reduce lenders' exposure to assets.

The solution for private equity investors is to seek out alternative lenders that may have more lax risk appetite, including challenger banks, insurance companies and private debt funds that offer the additional benefit of being generally much speedier in gaining credit approval and ultimately executing a transaction. Choice presents a further test to borrowers: how to access and assess this large pool of sometimes unknown players that offer a variety of unfamiliar financing solutions. Getting it wrong might not be obvious at the outset, but is a high risk further down the line. To mitigate this risk, borrowers need to be crystal clear on their business plan for the asset and their borrowing objectives, including flexibility, timeline and key assumptions in order to devise a well thought-through debt structure. Then their task is to match this to a provider's offering.

2. Rising FX risk

Since sterling plummeted in the wake of the Brexit referendum in June 2016, currency exposure has posed a risk to any real estate investor with exposure to pound sterling, including the numerous private equity real estate funds that invest cross-border. The risk for those that acquired sterling-denominated assets is currency depreciation and its impact on asset valuations, irrespective of the performance of the underlying portfolio. This is a high priority concern. The private equity debt funds that have stepped into the real estate lending market to fill the gap left by banks are particularly sensitive to FX risk. They promise returns to investors that will not tolerate a negative impact from a currency move.

The answer for borrowers, and debt funds, is to define an FX management strategy. There is a range of hedging tools available: FX forwards, swaps/rollovers, options and collars. Sometimes the best outcome is to retain an unhedged position, but this can only be judged in hindsight. The key is to validate this decision through detailed analysis. In our experience, investors are increasingly asking asset managers to justify their approach to managing FX risk. Asset managers need to be prepared to substantiate their position.

3. Interest rate unknowns

Should crashing out of the EU or the prospect of extended negotiations precipitate a recession, how will the Bank of England respond? Or, conversely, if the economy 'bounces,' would that mean interest rates are more likely to increase? Anticipation of rising interest rates prompted a wave of refinancing in 2018, when we saw our clients either seek to extend their debt or enter a new hedging to take advantage of current rates, and so future proof their financing on a five-year time horizon.

"The private equity debt funds that have stepped into the real estate lending market to fill the gap left by banks are particularly sensitive to FX risk"

While these risks are very real, they can also offer opportunity. Future-proofing debt costs via active refinancing and smart interest rate hedging provides certainty on a five-year horizon, leaving asset managers to focus on their portfolio management and originating new investments. Often, FX hedging can result in enhanced returns instead of being a cost, due to the interest rate differential between different markets; euros vs US dollars, for example.

The doomsday commentary about Brexit chaos and a slowing global economy is only one side of the story. The weight of capital investing into European real estate remains positive, and debt liquidity for well-positioned investments is high. There are many bright spots, and you don't need to look too hard to find them. ◻

39

Omni Partners

$947 million
London

Omni Partner focuses on loans to professional property investors that fund refurbishment projects or the acquisition of buy-to-let properties. In 2017, it closed on Omni Secured Lending III with £340 million ($452 million; €400 million). Its predecessors, OSL I and OSL II, raised $45 million and $240 million, respectively.

The firm was founded by Steve Clark in 2004 and has also has an office in Irvine, California. ◻

40

JCR Capital

$942 million
Denver

JCR Capital's latest fund, JCR Capital Income Plus Fund IV, closed in November 2018 on $306 million, surpassing its initial target of $130 million. The fund focuses exclusively on mid-market properties valued at $50 million and less in the multifamily, industrial and office sectors, as well as select retail.

The firm is managed by Jay Rollins and Maren Steinberg, both managing principals. ◻

41

Incus Capital

$911 million
Madrid

Incus Capital focuses primarily on asset-backed lending, real estate credit and leasing, and has raised more than €1.2 billion and deployed over €1 billion since inception in 2012. Its third fund closed on €500 million in 2018 and is about 20 percent deployed, while the firm plans to launch Fund IV in 2021.

Incus is owned and operated by its five partners: Andrew Newton, Martin Pommier, Estanis Carvajal, Alejandro Moya and Alvaro Rivera. ◻

42

Mesa West Capital

$900 million
Los Angeles

The firm provides non-recourse first mortgages for core, core-plus, value-add and transitional properties in the US. In 2017, it was acquired by Morgan Stanley Investment Management, although it continues to operate as a separate entity within MSIM's real assets group.

Mesa West Real Estate Income Fund IV, the firm's largest closed-ended real estate debt fund, closed on $900 million in 2017, beating its target of $750 million. ◻

43

GAM Holdings

$806 million
Zurich

GAM Holdings' real estate finance business has accumulated about £1.1 billion. The firm is led by Andrew Gordon and Martin Farinola, who jointly manage GAM Investments' real estate finance team.

The firm is currently investing out of its GAM Real Estate Finance Fund II, which launched in April 2018 and invests in whole loans and junior loans across the UK and Europe. ◻

44

RCG Longview

$793 million
New York

RCG Longview's recent transactions include the refinancing of a multifamily condo building in New York City's East Village through a $34.2 million mezzanine loan, and a $70 million mezzanine loan to fund the acquisition, renovation and conversion of two Class A stabilized multifamily rental towers into condominiums in Manhattan. It has also financed several suburban apartment complexes in the US. ◻

RED 50

45

Calmwater Capital

$740 million
Los Angeles

Calmwater Capital provides senior and mezzanine financing and focuses on office, retail, industrial, hospitality, multifamily, student housing, healthcare and special-use assets in the US. Currently investing out of its US Real Estate Credit Fund III, a $636 million vehicle, the team is led by Larry Grantham, co-founder and senior portfolio manager. Recent transactions include the financing of the Thompson Hotel in Hollywood. ◻

46

Oz Management

$736 million
New York

Oz Management focuses on North American real estate credit investments across multiple asset classes and security types, including first-lien loans, mezzanine loans, subordinate notes, B-notes, loan portfolios, preferred equity, ground leases, sale-leasebacks and other credit instruments.

Steve Orbuch is the New York-based firm's executive managing director and founder. ◻

47

Quadrant Real Estate Advisors

$714 million
Alpharetta, Georgia

Quadrant Real Estate Advisors primarily focuses on debt investments collateralized by commercial real estate in the US, Ireland and the UK. Recent transactions include a $175 million first mortgage loan to finance the acquisition a Class A life science office building with retail in Boston, and a $48 million construction to permanent loan for a 230-unit multifamily building in Chicago. ◻

48

Pacific Investment Management Company

$697 million
Newport Beach, California

Pacific Investment Management Company invests in real estate debt in Europe and in the US through several fund families. Recently, it has been raising PIMCO Commercial Real Estate Debt fund. Its Bank Recapitalization and Value Opportunities, or BRAVO, fund series targets residential real estate, commercial real estate and specialty finance assets. ◻

49

AEW

$674 million
Paris

AEW is a real estate asset manager, investing through separately managed accounts, and open- and closed-end funds. In June 2018, it closed its second fund from a joint venture with Ostrum Asset Management, raising €549 million for Senior European Loan Fund, SELF II. AEW has offices in Boston, Los Angeles, London, Paris, Hong Kong, Singapore and Sydney, and additional offices in nine European cities. ◻

50

KSL Capital Partners

$671 million
Denver

Since forming in 2005, KSL Capital Partners has raised four private equity funds and two credit funds with about $9 billion in commitments, ranging across travel and leisure businesses such as hotels, resorts, clubs, fitness, family entertainment, skiing and resort real estate. With offices in Denver, Stanford and London, the firm is led by Michael Shannon, chairman, and CEO Eric Resnick. ◻

Gränbystaden Galleria, Uppsala: 'exceptional' retail assets are worth financing in Sweden

Playing the long game

Swedish banks' short-term focus has created an opportunity for alternative lenders backed by more patient capital, says Brunswick Real Estate CEO (debt) Pontus Sundin. Stuart Watson reports

The availability of finance for commercial real estate in the Nordics has historically been volatile, based on the appetite of a small number of banks. Moreover, in Sweden those banks are already heavily exposed to lending against property. That has created a segment in the financing market for debt funds, argues Pontus Sundin, CEO (debt) at Brunswick Real Estate, an investor and lender in the Nordics which manages around €2.3 billion of assets and has provided €1 billion of credit financing in the region.

***PERE**: What is the opportunity for investors to place capital via the commercial real estate debt market in Sweden?*

Pontus Sundin: The Swedish CRE debt market has been dominated by Swedish banks and there are no other CRE debt funds solely targeting Sweden, so the scope for investors to gain access to this market has been limited. One option has been to invest in the capital markets. However, Brunswick is the only debt fund focusing on Swedish CRE debt. We offer long duration to clients, backed by prime real estate that implies investment-grade risk with focus on sustainability. Senior lending backed by sustainable real estate is a defensive strategy that provides investors with stable returns and a positive environmental impact. We have provided a green loan to Fabege and we are currently developing our green loan framework. We are aiming to make an impact from where we operate, both in financing certified buildings but also through greening facilities (reducing environmental impact).

Brunswick's funds provide investors with a unique opportunity to get access to a market historically dominated by banks. In Sweden, four major domestic banks account for most of all real estate lending. The Swedish commercial real estate finance market is roughly SKr1,000 billion ($107 billion; €95 billion). Before the global financial crisis, most lending was bilateral loans from banks to borrowers, but afterward there was a transition to a situation where roughly one-third of all lending is done in the capital markets and two-thirds in the banking market.

The Swedish central bank, the Riksbank, issued a report in the fall stating that more than 60 percent of the exposure on Swedish banks' balance sheets is to real estate of which 20 percent is commercial real estate. Therefore, the four banks that dominate the scene are fully loaded with real estate exposure.

The balance sheets of those banks are more than 300 percent of Swedish GDP, which means you have a small country with a large financial sector that has a very big exposure to real estate. The Swedish Financial Supervisory Authority is monitoring Swedish banks closely because it is worried that if something happens with the real estate market it will affect the banks and therefore the national economy.

Sundin: opportunity for debt funds to provide longer-term loans

To prevent them from becoming more overweight in real estate, banks are increasingly forced into matching

up their funding and their lending. If they have a five-year loan out, they need to have a five-year bond in, and the Swedish krona bond market is typically a three- to five-year market. That means the banks tend to be competitive on shorter-term loans, but there is an opportunity for debt funds to offer attractive terms on tenures longer than five years.

Sweden has more than 20 listed real estate companies. They are eager to maintain their credit ratings, in particular from Moody's, because that enables them to pick up competitive financing. If you read Moody's comments regarding many of these companies, it says they are too dependent on banks and on the capital markets, and that the capital commitments they have from the banks are too short. Debt funds can offer them up to 10-year money, which fits well into that segment in the finance market in Sweden.

SKr1,000bn
($107bn; €95bn)
Estimated size of the Swedish real estate finance market, according to the firm

***PERE**: Is it difficult to find lending opportunities?*

PS: Given that you have SKr1,000 billion in commercial real estate debt overall with an average tenure of around five years, the annual dealflow is around SKr200 billion of loans that must be financed or refinanced. We may also see dealflow from smaller companies that have issued bonds in the past, but maybe do not really belong in the capital markets. Those could be smaller companies with good property portfolios and track records, but which might have issues now in refinancing their bonds at a reasonable level. However, to secure the right deals, it is important to take a more proactive approach to finding the kind of borrowers you want and fitting the offer around their needs. We have a strong pipeline of opportunities and it is not hard for us to find deals.

***PERE**: Is there scope for real estate debt investment in other Nordic countries?*

PS: The Finnish market is extremely interesting and we keep a close eye on it. That could be a market for exposure in a euro-denominated fund. It is a liquid market with lots of international capital seeking exposure there, and it is pretty straightforward to do business. Norway could also possibly be interesting, but less so than Finland. Denmark is a very domestic market. They have many small banks and a system similar to the Pfandbrief in Germany, where you have secured bonds. As in Germany, that makes it very efficient for domestic banks to lend to real estate, so it does not make sense for debt funds like ours to operate in Denmark. It is also a small country.

***PERE**: Which asset types offer the best potential?*

PS: We usually lend against core and value-add assets. We do finance development projects, but they never represent the majority of a fund. We can do all asset classes and we are split roughly evenly between offices, retail and logistics. On retail, we are extremely cautious, but we will finance exceptional assets. In November, for example, together with Allianz Real Estate, we provided a loan to one of Sweden's biggest listed property companies, Atrium Ljungberg, backed by the Gränbystaden Galleria shopping center in Uppsala, Sweden's fourth largest city. In the office market, we see very high rents and low yields right now in Stockholm, but there is also a record low vacancy level in the central business district, so that sector will continue to perform. Logistics is a very sought-after asset class as it is in the rest of Europe and worldwide. We will not finance residential development. That is a market that has taken a plunge and there is no market for developing apartments in Sweden right now.

***PERE**: Are foreign investors interested in Nordic real estate debt?*

PS: Typically, our investors are from Sweden or other parts of the Nordics. We will probably be fundraising for our third debt fund later this year and that could certainly involve international investors. We currently lend in Swedish krona and our funds are currently SKr-denominated, however as stated before we see interesting opportunities in Finland as well, so a euro-denominated fund is something we consider. Furthermore, the Nordics is stable and transparent with both GDP and population growth, which makes the market attractive to invest into as well as providing diversification for many international investors.

***PERE**: What is the outlook for real estate debt fundraising in the year ahead?*

PS: We position our funds as an investment-grade fixed-income product with a return that would be higher than if an investor were to buy an equivalent senior unsecured bond, which would typically produce a return of roughly 100bps and we are seeing conditions in the equity and capital markets favorable to strategies like ours.

At the moment, equity markets are not performing as well as one could hope, and many hedge funds are not doing well either. If you are an institutional investor, senior real estate debt offers a stable, secure income year in and year out. In particular, for insurance companies operating under the Solvency II framework, investing in a senior, secured debt fund produces a higher return on equity than a private equity fund because the regulations require you to allocate less capital to a debt investment. CRE debt is a defensive strategy. ◻

Debt investment stacks up in China and Australia

Investor interest in Asia-Pacific real estate debt is increasing, but these two markets stand out. Mark Cooper reports

Structural and cyclical factors are driving a new wave of interest in Asia-Pacific real estate debt.

The region's largest markets have become more sophisticated, so a broader range of investment avenues is developing, while changes in several markets have affected the supply and demand for debt. There is also a perception that, with real estate deemed to be late in the cycle, debt offers extra security.

China and Australia are by far the preferred markets. Japan and Singapore remain well supplied with bank lending, while smaller South-East Asian markets are generally considered too risky. India has been a focus for non-bank real estate lending, but the market has come to a halt following the default of IL&FS's non-bank finance company in October. Non-banking financial companies, including some backed by foreign private equity, have been major lenders in India, including to each other as well as to developers, but the market is currently frozen.

Fergal Harris, head of debt capital at JLL, says: "A lot of people are looking at Asia-Pacific debt at the moment, including US and European pension and insurance funds."

Most commentators agree that China and Australia offer the biggest opportunities for real estate lending. Harris says: "We are seeing growing interest in China offshore lending; the government-driven deleveraging is making people rethink the opportunity there. There is also growing interest in non-performing real estate loans. The China NPL market is huge and there is a significant percentage of real estate loans."

"China's deleveraging is creating an attractive investment environment for us resulting in a healthy pipeline of mezzanine and value-add deals"
Stuart Jackson

The China NPL market has acquired something of a Holy Grail status among investors, as it offers enormous potential in theory, but grasping it has been difficult. A number of private equity investors, such as Oaktree Capital, Lone Star, Bain Credit, PAG and Blackstone, have acquired China NPLs.

A recent report from PwC estimates foreign investors have spent around $1.5 billion on NPL portfolios, with 70-80 percent of the loans backed by real estate. However, this is tiny compared with the size of the market: as of June 2018, China's banks reported 2 trillion yuan ($298 billion; €263 billion) of NPLs on their balance sheets and 3.4 trillion yuan of 'special mention' loans, stressed loans which are likely to end up as NPLs.

Financing Chinese real estate: short-term mezzanine lending to domestic developers is especially popular with investors

Harris says: "A lot of the loans are secured on assets in second- and third-tier cities which makes debt recovery, especially within a fund's timeline, difficult."

An NPL portfolio might include hundreds of loans on smaller assets, some of which will retain little value and others where lengthy, expensive and possibly fruitless legal action might be required. The right pricing is important in mitigating these risks, but so also is a large enough portfolio to offset the bad against the good.

Tom Moffat, head of capital markets, Asia, at CBRE, says: "Everyone is looking for the NPL market to develop but so far investors face challenges in the execution of deals, particularly in a scalable manner."

The most popular China debt strategy with private equity investors in recent years has been short-term mezzanine lending to China developers. China is undergoing a program of deleveraging, which is causing a credit squeeze for developers. Previous sources of non-bank finance – the various 'shadow banking' options – are now largely ruled out for developers, which has put some in urgent need of finance.

However, this investment is perceived to have a limited window. Moffat says: "The China debt deals we tend to see involve mostly private equity investors targeting opportunistic returns, at least mid-teen IRRs. There is a feeling that there is a time limit to this opportunity, as a lot of groups believe the tighter domestic liquidity will ease later this year."

Infrared NF has been an active mezzanine lender in China, placing a total of $650 million in 10 deals, seven of which have been fully repaid. In February, it announced the closing of a $92.2 million financing investment with Hong Kong-listed Fullsun International, a unit of China developer Fusheng Group. The lending is secured by two partially completed developments in Changsha.

Stuart Jackson, CEO of InfraRed NF, says: "A window of opportunity has arisen for InfraRed NF from the well-publicized contraction of available credit within China. China's deleveraging is creating an attractive investment environment for us resulting in a healthy pipeline of mezzanine and value-add deals."

Unlike private equity players, which have extended loans to credit-squeezed smaller developers as part of their opportunistic strategy, CapitaLand's new China real estate debt fund is operating in a different strata of the market.

CREDO I China, the Singaporean group's first discretionary real estate debt fund, has raised $556 million from its target of $750 million. It will provide offshore, dollar-denominated mezzanine loans for assets in China's first- and second-tier cities and Hong Kong.

Credo offers "augmentation of the capital which is made available by senior lenders," says James Lim, chief executive of CapitaLand Investment Management. Typical loan to value ratios for China senior real estate loans are 50-55 percent, while the new fund will lend in the 50-70 percent range. "We are providing added gearing to high-quality borrowers and assets," he says.

The fund will lend from $25 million upwards for each deal. Most loans will be backed by stabilized assets but Lim says the fund will focus on lending to "value-add or transitional assets." "With these projects, rising values will decrease the gearing of our loan, which can then be refinanced by bank debt," he says.

Since joining CapitaLand from HSBC in 2017, Lim has recruited a team of former real estate bankers with "deep and wide" experience and great relationships with both borrowers and senior lenders in China.

He expects market conditions to support CapitaLand's debt business in the longer term. "Real estate is cyclical," he says, "however [banking regulatory initiatives] Basel III and IV will not be more lenient on banks and will support more opportunities for non-bank lenders."

The fund has been supported by large institutions with experience of China real estate, although CapitaLand will not give further details about its investors. For investors, Lim says, the fund offers China real estate exposure without equity risk. Mezzanine funds of this type are common in the US and relatively widespread in Europe, but CREDO is unique in Asia, says Lim. □

Australia's A$30bn opportunity

A flurry of new non-bank lenders is emerging to fill the gap left by the country's 'big four' banks

Fergal Harris, head of debt capital at JLL, says: "The biggest opportunity in Asia-Pacific debt may be in Australia, as the big four banks there pull back from real estate finance. Over the next three years we expect there will be A$30 billion ($21 billion) of loans on their balance sheets which they will sell or simply opt not to refinance."

Australia's banks are under fire from a Royal Commission and are becoming weighted down with regulation. However, the Australian commercial real estate market continues to perform and remains one of the world's most transparent markets.

There are opportunities for senior lending and for shorter-term mezzanine loans, although participants say the latter opportunity has shrunk in recent months. Tom Moffat, head of capital markets, Asia, at CBRE says: "You can lend beyond three to five years, as there are long leases with indexed rental uplifts – there is a lot of certainty when you are underwriting these deals and in some cases we have seen groups interested to provide up to 10-year senior loans.

"Typical returns for good quality income producing assets in Australia would be low 4 percent for senior and into the high single digits for mezzanine. Rates in the construction finance space would be roughly double these levels."

Most of the activity has come from private equity firms, such as Partners Group, Invesco Real Estate and PGIM Real Estate, while both Blackstone Group and KKR have invested in non-bank lending platforms.

Some large global investors are also participating: last year Canada Pension Plan Investment Board awarded a A$500 million ($351.6 billion) mandate to Challenger Financial Group.

Speaking at the PERE Asia conference in Hong Kong in March, François Trausch, chief executive of Allianz Real Estate, which has $20 billion of real estate debt investment in the US and Europe, said: "The obvious market for us [for real estate lending in Asia-Pacific] would be Australia."

Good communication: a vital component in the debt manager and investor dynamic

Investors want information faster

Technology solutions must step up to meet demand, says Yardi Systems' Chris Barbier, industry principal of investment management, and Paul Fiorilla, director of research, Yardi Matrix

Virtually anyone can log on to an online 401K account for complete up-to-the-minute information about account performance, because modern technology solutions provide immediacy, accuracy and transparency in investor reporting. Yet, oddly, a level of reporting that includes those three vital elements remains a rare commodity in one of the fastest-growing segments of the commercial real estate capital markets: debt fund investment. Also lacking in the communication between investor and fund manager is a holistic view of the commercial real estate debt market that provides the backdrop for fund manager performance, so it is good news that supporting technologies are now emerging to keep pace with the growing number of fund investors' demand for transparency and communication that far exceeds the traditional 90-day reporting window on which the industry was built.

"The market is ready for systems that will bring the debt investor and manager together in a synergistic way"

Brand-new world

That the real estate capital markets are evolving at an accelerating rate is a given. So it is with sources of debt, as more players enter the arena against the twin backdrops of a shifting lending picture and late-cycle economic dynamics.

Debt is taking on a dramatically expanding role in real estate, particularly for services like construction financing and loans on transitional properties. Debt fund originations have climbed steadily over the past few years, from $32 billion in 2016 to $67 billion in 2018, according to data reported in February at the Mortgage Bankers Association's (MBA) annual commercial real estate finance convention in San Diego. That rising profile is noteworthy at a time when overall originations remain robust but basically unchanged from year to year. MBA estimates that originations will total $530 billion in 2019, similar to 2018 ($526 billion)

and 2017 (a record $530 billion). Last year's total accounted for 10 percent of total mortgage origination with some 140 debt funds currently plying their trade. On closed-end funds alone, some 70 vehicles were actively pursuing deals or raising capital in the US in 2018, Real Estate Alert noted. That represents a significant jump from the 49 that were active just four years ago.

There are several reasons for the ascendency of debt funds. Abundant capital, domestic and foreign alike, is looking to invest in US real estate. On the theory that a rising tide lifts all boats, that bodes well for all categories of lending. The twist is that many major conventional sources of real estate capital — notably, commercial banks — face increased regulatory scrutiny. New rules aim to restrict lending on real estate assets regarded as high risk and require lenders to have more skin in the game. Not surprisingly, some lenders have cut back on certain types of lending, raising the visibility of other debt sources, despite their relatively higher cost of capital.

Debt funds are among the chief beneficiaries of this trend, which is largely a function of this late phase in the economic cycle. Not that a downturn is expected anytime soon, but the consensus among investors is that debt can match, or nearly match, the yield of equity without sweating as much risk.

Of course, if there is a downturn, it will be bad for all concerned, and we can never discount a quick shift in the investment landscape. One need only look at the upheavals in the retail market to get a sense of how vital it is to stay on top of market shifts – and how volatile the market can be.

Tech is answering the call

In a late-cycle environment of accelerating change, investors' expectations of accurate, timely and transparent reporting from fund managers is also evolving rapidly. Technology must step into this breach, frankly, because the quarterly reporting upon which the industry was built no longer seems fast or transparent enough.

At Yardi, we hear that call with increasing frequency from investment clients seeking assistance in managing debt funds as an asset. Whether they are increasing their debt positions or starting funds themselves, investors are looking for reliable tools to help them gauge their exposure to every adjustment of the market. More than ever, investors want timely insights into how the latest real estate news will affect their dealings with managers.

Barbier: debt managers are significant players now

Products addressing that issue are available, but to the extent that the goal of those products is solely debt fund management, the picture is incomplete. Crucially, these investors also want another dimension: sophisticated, timely reporting of performance and other information. It is the kind of visibility that they can already find in other realms, notably in the securities environment. That degree of self-service access and understanding is now migrating into commercial real estate.

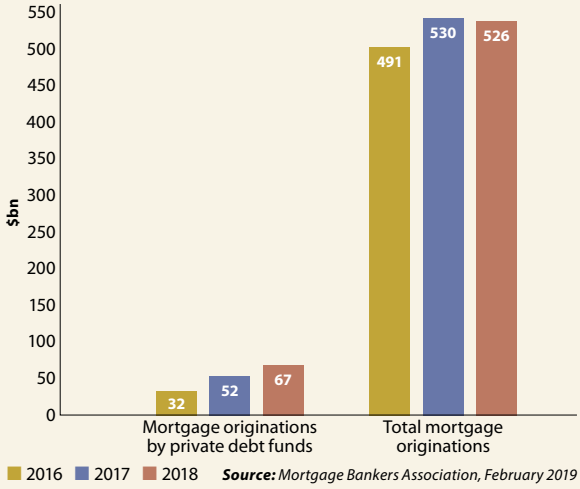
Fiorilla: quarterly reporting no longer fast or transparent enough

Providers of accounting capabilities for core real estate must bring their experience to the debt space. With that in mind, Yardi is partnering with a select group of clients that share a strategy of taking an expanded debt position. The exercise is part of the preparation for debuting a more holistic version of debt management software later this year. The creation of debt management software is a natural evolution of our experience managing debt as an asset in the trust accounting space. The market is ready for systems that will bring the debt investor and manager together in a synergistic way.

The continued growth of debt fund activity is as close to a sure bet as one can get in the real estate capital markets. As growth accelerates, the tools for effective, real-time analysis of fund performance become ever more essential. Debt fund managers are significant players now. They not only deserve tools fitting that market position, they demand them. And so do their investors. ◻

Private debt on the rise

While still a small proportion overall, originations by private debt funds have climbed over a short time period in the US market



Source: *Mortgage Bankers Association, February 2019*

Why debt fund managers must consider their regulatory position carefully

As private real estate debt grows, regulatory oversight will ramp up too, writes Steven Cowins of Greenberg Traurig

In 2018, for the first time, our firm advised on as many real estate debt fund launches as equity. This shift exemplifies the wider theme of real estate debt becoming a fully established and accepted asset class in its own right in terms of fundraising. Participants finding opportunities through debt funds to fill the gap left by the banks has created a more diversified market of lenders and private credit being a part of investors' portfolios. Regulations like Basel III, the Volcker Rule and 'slotting' in the UK continue to affect the supply of credit to the markets, which offers wider opportunity for debt fund managers. Such regulation is likely to increase, despite certain populist governments advocating to de-regulate in some jurisdictions.

Lending activities may not become more straightforward from a regulatory perspective than they are currently and it is challenging to originate debt in some jurisdictions. There is a requirement to have a banking license in certain jurisdictions, or at least an exemption or notification to the national bank or regulator. Some regulators, notably in Germany, have stated that AIFs and AIFMs are exempt from the requirement to have a license for certain activities. This creates some structural issues; the AIF itself may be exempt, but with debt funds the sub structure and lending platform are generally devised at the same time, as opposed to the propco and holdco approach, common in the structuring of equity funds. That said, the sub structure is inherently a different entity to the actual AIF, which complicates the issue of banking and credit licences.

March to Luxembourg

The drive to domicile funds in Luxembourg continues, and this is especially true for credit funds. But care should be taken with certain Luxembourg structures. Luxembourg securitization vehicles are a well-established entity and may be useful, but while their inability to originate debt may not be a significant issue, their inability to enforce a security package without the risk of it no longer being passive, and thus tainting its status, is potentially problematic.

Be aware of conflicts of interest

Managers are launching a wider range of products, resulting in traditionally value-add or opportunistic managers seeking to launch core-plus products, and core-focused financial institutions looking to launch value-add funds. This is also true of equity funds managers launching debt products. Conflicts of interest must be considered to avoid any issues, but this may be handled if the manager implements an appropriate internal structure to its organization. At present, there does not appear to be a significant commonality between investors across these products. However, given the time and effort it takes for investors to perform operational due diligence, some managers may try to attract larger investor commitments and allocate them across their broader product range in the future, depending on the investors' requirements and risk appetite.

BEPS impacts everything

The much talked about base erosion and profit shifting (BEPS) initiative and the EU's ATAD and ATAD II directives are now affecting all fund structures. These regulations will affect underlying debt transactions and returns on risk. For example, there is a new rule restricting interest deductibility in the UK, which goes further than the existing interest deductibility rules in jurisdictions such as Germany and will, from 2020, be extended to cover not only onshore but also offshore propcos.

The effects of further restrictions on deductibility of interest on loans will also affect underwriting of the sponsors and the financial covenants on such transactions. It may also affect how sponsors structure these transactions. For example, the so-called 'public infrastructure exemption' in the UK does not apply to shareholder debt. This means that structural subordination, a common structure where the senior lender and mezzanine lenders each lend to completely separate borrowers rather than a single borrower with an intercreditor arrangement, would be less attractive.

Private credit has been one of the fastest areas of growth for fundraising, a trend likely to continue, partially fuelled by managers now offering more and broader products, including debt and equity in the same house. However, it is also likely that this sector of the market will continue to receive scrutiny from regulatory authorities, and the global tax changes being introduced will also affect how debt funds are structured and how they do business.□

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