"There is significant lender appetite for what many consider to be attractive risk-adjusted returns in the debt space"

BBS Capital is an independent real estate debt advisor based in the Mayfair area of London. In 2019, the boutique firm sourced around £650 million (€758 million) of debt across 34 transactions in the UK market, as well as advising on deals in continental Europe. Its UK deals included sourcing a £21 million short-term bridging loan against a consented mixed-use development site in Hertfordshire and a £55 million refinancing of a development facility for a hotel near Heathrow Airport. Co-founder and director Adam Buchler offers his insight into current UK real estate debt market conditions.

Q Which UK real estate sectors are borrowers focused on in 2020?

A Our clients typically invest across a broad range of market sectors. In the past year, we have seen a predictable shift away from retail, but also from industrial and logistics, which have attracted far more institutional investment. Our clients, which tend to be private property companies, family offices or private equity funds, have gravitated towards offices and residential for their core investments. They are also focusing on alternative sectors including hotels, care homes, student accommodation and co-living.

Over the past five years, the biggest growth area for our UK clients has been hotels – in the regions as well as in London – for ground-up development, repositioning or stabilisation. Hotels have become a core component of lenders' loan books and the asset class is better understood by UK clearing banks, foreign banks and debt funds alike. This has resulted in increased liquidity, with debt available to borrowers seeking either low leverage, low cost terms, or those seeking higher leverage at commensurate pricing.

Q Has the availability of real estate debt been impacted by the political uncertainty the UK has experienced in the past year?

A The political backdrop had a relatively limited impact on the availability of

Adam Buchler
Director
BBS Capital

debt in the past year. Given we are late into the cycle and in a low interest rate environment, there is significant lender appetite for what many consider to be attractive risk-adjusted returns in the debt space.

Although investment volumes were significantly down year-on-year in 2019, which impacted lenders' ability to deploy capital, many investors took advantage by refinancing their existing portfolios at historically low rates.

We saw German banks pull back from the market last year, due to uncertainty over Brexit, but debt funds and other non-bank lenders stepped in to fill the gap. Banks increased their margins slightly last year, but we do not anticipate any material change to pricing over the coming year.

Q Are lenders prepared to finance retail?

A Retail continues to be a tricky sector which is highly dependent on the location, age and income profile of the specific asset. At a macro level, the retail market is facing its biggest ever challenge, but there continue to be opportunities at the micro level.

There is limited appetite among the traditional banks for the sector, even for best-in-class retail – as demonstrated by the retailer Arcadia borrowing senior debt from private equity firm Apollo Global Management on a prime asset on London's Oxford Street. Higher cost debt is available for projects where there is a credible plan by the sponsor to reposition the asset.

Undoubtedly, the retail sector will continue to face challenges in 2020, and lenders must be mindful of structural changes caused by the evolution in how we live and shop. However, there will certainly be opportunities created by this paradigm shift because the entire sector is being re-evaluated.

Entrepreneurial investors will seek out repositioning opportunities and the more creative lenders will look for opportunities to lend where sensible business plans are in place.

Q What are borrowers doing when faced with the need to refinance their retail assets?

A This really depends on the nature and location of the asset and the degree of stress in the existing capital stack. Where there has been material value erosion, fresh capital may well be required as part of the solution. Either way, the onus will be on borrowers to present a credible business plan for the asset and prove their ability to deliver.

In a transparent marketplace, lenders will prefer to work collaboratively with diligent borrowers, where possible, and pursue more aggressive options only as a last resort. Some lenders are building strategies focused around recapitalising distressed assets, where there is potential to find strong risk-adjusted returns.

The co-founder and director of independent real estate debt advisory firm BBS Capital discusses lending market conditions

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Q How are borrower and lender attitudes to co-working tenants changing?

A Regardless of the challenges posed by the fall in valuation of WeWork, there is no doubt that there has been a shift in the office leasing sector towards flexible space, which is likely to continue to grow.

Many lenders are open to funding against flexible office space, as long as it is well-managed and the underlying rental levels are commensurate with traditional estimated rental values, subject to gross-to-net operational deductions.

Q Are borrowers and lenders looking at the UK regions in a meaningful way?

A Yes, we have seen growing activity from both borrowers and lenders in the UK's main regional cities and we expect this to continue. Several large companies have committed to relocating their divisional headquarters north, such as HSBC in Birmingham, TalkTalk in Salford and JPMorgan in Glasgow. Investors are picking up on this trend across all sectors to capitalise on regional growth and lenders are following suit.

Q How do you expect the profile of borrowers and lenders to change in 2020?

A Over the past year, we have witnessed listed property companies and other institutional investors borrowing from the non-bank sector. Historically, such investors would only consider borrowing from the traditional banking sector.

We expect to see the continued rise of non-bank lenders. This is largely driven by borrowers wanting faster speed of execution, greater certainty and more flexibility in the terms and structuring of deals – something the traditional banking sector often struggles with. ■