Insight

Debt advisers **Intermediaries eye opportunities as the recovery begins**

As members of a profession where knowing your market is essential to success, the rapid change and dislocation of the past 18 months have presented particular challenges for real estate debt advisers in Europe, ***writes Stuart Watson***.

"It is a full-time job keeping tabs on the market," admits Adam Buchler, managing director at London-headquartered boutique advisory firm BBS Capital. "It is so diverse in terms of the number and types of lenders, and the different financing structures on offer, that it requires a lot of resource to stay on top of what everyone is doing. Covid has added to that complexity because of the greater uncertainty and fluctuation in lender appetite at certain times or toward particular asset classes."

David Yeadon, executive director at UK multidisciplinary adviser SPF Private Clients, recalls that liquidity, and therefore market activity, suddenly dried up for around three months after the onset of the pandemic, before lending activity bounced back relatively strongly. However, the profile of the most active lenders had changed in the meantime.

"UK banks are very conservative and selective about new transactions," says Yeadon. "Insurance companies have remained active, but only in certain markets and sectors. International banks have continued to lend, but are also being very selective and offering slightly lower leverage than they were pre-pandemic. However, there is a great deal of liquidity in the debt fund market, where we have continued to see new players emerge. And the majority of transactions we are involved with, whether they are development or stabilised investments, are being financed by debt funds."

> "Sometimes dislocation in the market leads to more opportunity"
>
> Adam Buchler
> BBS Capital

Overall liquidity has returned to pre-pandemic levels, suggests Damien Giguet, founder of Paris-headquartered adviser Shift Capital, but is more targeted towards popular sectors, principally residential and logistics. "We do not see any credit crunch in lenders' balance sheets," he says. "But they are rarely contrarian, betting on an unpopular asset class like investors do. So if there are issues with a sector, they stop lending or reduce their exposure. When covid happened, suddenly there was very little liquidity for hospitality and retail."

Market activity, and therefore dealflow, is much better than it was in 2020, says Buchler, but still lower than one would normally expect. He attributes that not to a lack of liquidity in the debt market, but to a shortage of opportunities to buy: "A lot of the investors we speak to are struggling to find value. But as we progress through the post-pandemic reopening, we are becoming increasingly busy."

Difficult sectors

Buchler believes some owners that have been sitting on their hands as they wait for the gap in pricing expectations to close will not be able to wait much longer. "If you are an institution with return targets

you need to churn assets," he says. "And more product available will flow down to more activity for us to advise on. In the meantime, refinancing for our existing clients is a key source of business."

Although institutional investors with defensive mindsets have gravitated toward core and core-plus assets during the pandemic, Giguet admits that such transactions are rarely a major generator of business for advisers. "We do not bring much value to somebody who already knows the lending market and wants to finance a long-leased core asset in the central business district of Paris or Munich at 50 to 60 percent loan-to-value," he says. "Those are the deals sought after by the banks right now, so call five of them and you will have five competitive term sheets."

He argues that advisers always add the greatest value to transactions where debt is harder to secure and, since the pandemic, that category has included most value-add situations: "Before covid, we were working on smaller, difficult-to-structure deals. But institutional clients did not usually need us for their value-add deals because it was comparatively easy for them to find finance. Since covid, we have onboarded more big clients for more institutional situations that involve value-add. The overall market share of debt advisory has increased as a result of the covid crisis because we are working on bigger deals with bigger clients."

"We have the expertise to operate in sectors where others find it really difficult to secure debt," says Morris Rothbart, founding and managing partner at UK boutique advisory business Seaford Finance. "So currently, activity is more development-led than anything else. That means speculative industrial and office development,

> "Eventually, Europe will go the way of the US, and everybody will work with advisers"
>
> Damien Giguet
> Shift Capital

but we are also structuring loans for housebuilders so that they can retain ownership of build-to-rent assets rather than forward-funding them."

Rothbart says hard-to-finance asset classes will also provide a source of business for advisers. He cites the example of three retail portfolios on which Seaford Finance is advising. "They have performed well through the pandemic, and the owners want to increase their leverage to 55 or 60 percent to release equity for other opportunities. As long as the valuations are not too aggressive and the debt yields are comfortably at 9 percent, the debt funds will provide that," he says.

Another sector adversely impacted by the pandemic is hotels, which rely on international tourism and business travel. Yeadon says there are still lenders prepared to finance such situations if the deal is correctly structured: "There is a liquidity gap that needs to be filled either from additional equity or a deposit to service the period of recovery, so lenders look for a lower LTV, and they protect themselves by asking for interest deposits of one or two years."

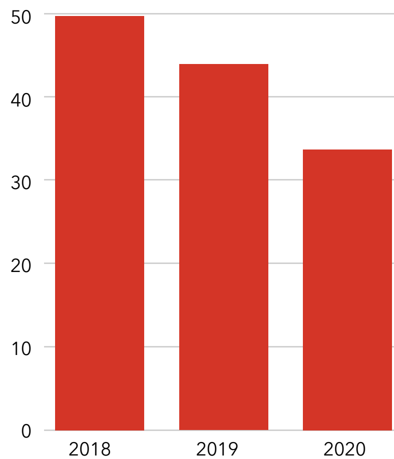
Restructuring opportunities

A period of widespread market dislocation might be expected to throw up restructuring opportunities as sponsors breach their debt covenants. However, advisers agree that thus far such activity has been limited.

"We are just starting now to see the first restructuring deals," says Giguet. "It is not yet a massive trend. For distressed situations, such as hotels that have been highly leveraged, we are seeing borrowers needing to find replacement lenders. We are not at the point where they need to find solutions at any price, but where their current loans are at least technically in default. So they are looking at alternative situations to refinance assets."

A few distressed deals are

UK real estate lending volumes dropped sharply in 2020, resulting in fewer advisory mandates for loan intermediaries (£bn)



Source: The Business School at City, University of London, UK Commercial Real Estate Lending Reports 2018, 2019, 2020

beginning to filter through, says Buchler. "They are typified by situations in either the hospitality or the retail sector, where there needs to be a wholesale repositioning of a strategy and, as a result of that, it needs a whole different and creative funding solution. There will be opportunities that come out of that and, as debt advisers, we are often quite well placed to spot that at an early stage."

Yeadon adds: "The irony is we need a more buoyant market before there can be some distress, because lenders start putting clients under pressure when they know that there is likely to be an exit, and at the moment in certain areas there probably is not. Apart from in retail, we have not seen massive reductions in valuations. There is a lot of equity out there wanting to deploy in property, which is supporting pricing. At some stage there will be some casualties, but it is difficult to predict how substantial that will be."

Dealflow in the advisory world depends not only on market activity, but on increasing market penetration. The use of debt advisers in arranging finance for European real estate transactions has become more widespread in recent years, but Giguet says there remains considerable scope for growth: "There is a slow process underway, in which investors are moving from doing everything themselves to using specialists to optimise their capital raising. It is driven by big private equity funds that have imported that approach from the US. My guess is that eventually Europe will go the way of the US, and everybody will work with advisers."

He argues that a more complex lending landscape will generate greater demand for advice: "To make sure you do not miss an opportunity and that you optimise the terms, you have to make sure that you speak to everybody in the market that is relevant. And if you are a smaller investor, you do not have time. Only capital brokers can do that."

New entrants

Buchler notes that more widespread use of advisers has encouraged new entrants to the market: "You would expect that, as the percentage of deals that is executed through advisers continues to rise. At the smaller end, there are always new outfits popping up – people who leave banks and debt funds very often decide they want to turn their hands to advising."

> "We focus on sectors where others find it really difficult to secure debt"
>
> Morris Rothbart
> Seaford Finance

However, debt advisory is not an easy space in which to become established. This is because much of the value that an adviser adds will depend on the depth and quality of its relationships with lenders. "It is not just knowing who is out there," says Buchler. "You build up relationships with lenders over a long period of time. You need to know how that lender operates so you can have confidence they will deliver what they say they will deliver."

Providing a full end-to-end advisory service is increasingly essential to attract some types of client, adds Rothbart.

"The role of large debt advisers usually finishes post-credit committee because institutional borrowers often have their own in-house finance team directors who review legal documentation and valuations," he says.

"Many family offices do not have that expertise and level of sophistication within their own entities. Our strength lies in providing a full execution service, handholding the transaction all the way to completion."

Buchler says advisers have good reason to be optimistic about the next year or two. "We have been through shocks before – the global financial crisis, Brexit. After the UK referendum, the market was very difficult, but we ended up having our best year in the 12 months following that initial wobble. Sometimes dislocation in the market leads to more opportunity."

In this period of uncertainty an increasing proportion of deals will be closed with the assistance of debt advisers, predicts Giguet: "This may be the moment when we emerge as a recurring actor in the market – not just as the firemen that you use when you have no other choice, but as a more stable part of the landscape." ■