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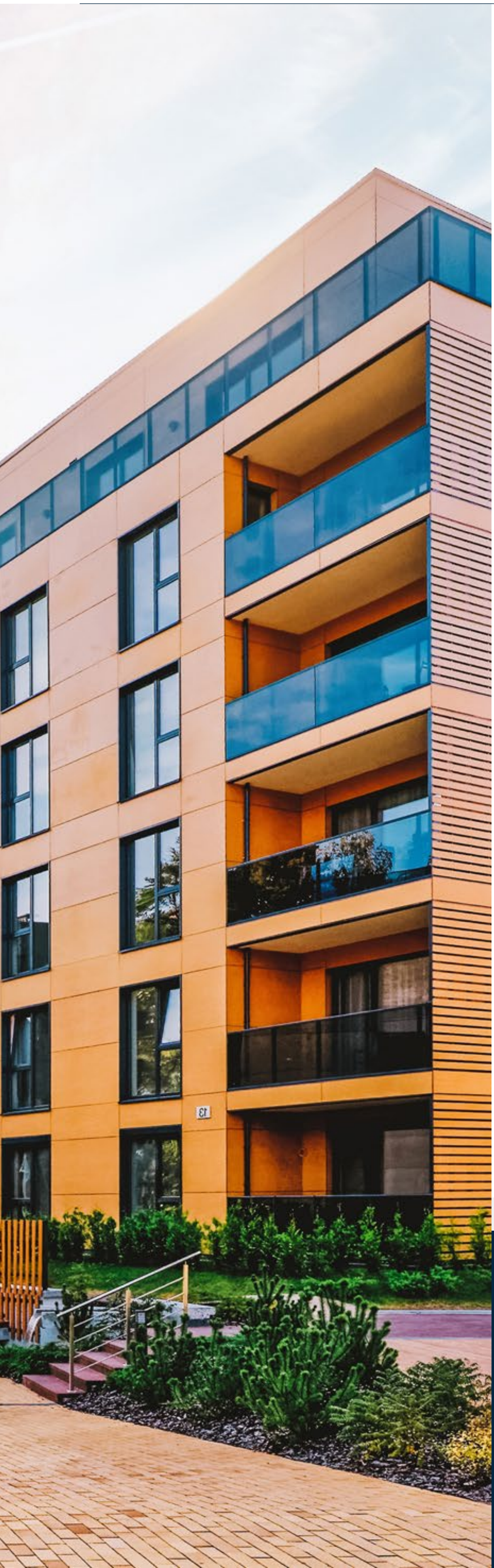

# Seizing 2025: LGPS Opportunities in European Real Estate Debt

Room151 sits down with David Renshaw, co-head of the Fiera European Real Estate Debt Strategy, to discuss the outlook for the European real estate debt market for 2025 and the consequent opportunities for institutional investors.

David Renshaw
Managing Director and Co-Head of
Fiera Real Estate's European Debt Strategy

## Can you talk to us about the real estate debt market outlook for 2025?

2025 will be both a continuation and intensification of last year. The ongoing retrenchment of major banks from real estate debt sharpens the focus on alternative lenders, where a bolstered role in the market means they can invest in assets that are of an extremely high-quality and with leading sponsors.

Regulatory pressures, coupled with the wall of imminent maturity dates, has created a growing funding gap that alternative lenders can take advantage of – especially in the refinancing space. Furthermore, the higher interest rate environment means LGPS funds can invest in lower-risk (Core and Core+) assets but achieve higher returns to historical norms of the last decade.

Sustainability will remain defining as the built environment continues its green transition. Green lending volumes are breaking records, and I expect we'll see more of that this year as investors target ESG-compliant assets benefitting from strong demand, that are future-proof and can contribute towards future portfolio liquidity.

## Does this mean that the opportunity in real estate debt is a short-term, cyclical one?

No. We are not going to return to interest rates of the pandemic years for a very long time; 'higher-for-longer' will be the rate environment's modus operandi for the foreseeable future.

The regulatory backdrop – namely the long-awaited introduction of Basel IV – is also favourable for lending solutions. Basel IV requires banks to increase their capital balance sheet, which will translate into higher equity raises and/or reduced lending capacity. Real estate has historically been a leading source of debt investing for banks. This means that even if they wanted to re-enter or expand in a fast-recovering real estate market, the regulatory framework will act a headwind.

## What is your view on the LGPS facing calls to invest more in their domestic markets?

The Labour government has accelerated what the previous government was (arguably) doing on a piecemeal basis. It's an understandable policy stance to take; if the consolidation programme is structured correctly, LGPS funds have the potential to be vital capital sources for the delivery of housing and infrastructure programmes that will underpin the economic growth being promised by government.

Domestic investment through public capital is a sensible monetary policy, in principle. But the Government mustn't be too heavy-handed. We've spoken before about how they would do better to endorse rather than instruct; that is, creating favourable investment conditions through a focus on regulation, planning, capital structuring, and the public-private partnership framework in a more general sense.

They need to recognise that local government pension schemes are ultimately committed to their members and will be guided not by borders, but opportunities offering the best investment performance prospects. This partly explains why LGPS are increasingly turning to international managers and mandates, as they can now access opportunities that were hitherto inaccessible due to a lack of local origination capability.

With this barrier to entry significantly lowered, they are now, more than ever, alive to investment opportunities in major European economies. Here, superior returns can be achieved by capturing early-mover advantage in inflation-hedging sectors that are structurally supported by need-based demand drivers and where supply is low – from both a live stock and construction pipeline perspective.

> "Finally, targeting real estate debt opportunities in select European economies provides LGPS funds with diversification in their investment approach which can provide risk mitigation in a balanced investment portfolio."

## What are your preferred sectors and markets and why?

We target lending into highly defensive sectors with supply-demand imbalances, and which are structurally supported by changes to demography, the economy and wider societal trends. By lending into sectors which are structurally undersupplied, we are able to support the build of best-in-class real estate which has maximum exit / refinance liquidity. Whole loan senior debt solutions, which we favour, also offer the maximum level of downside protection and control by benefitting from first ranking mortgage security, share pledges and bespoke covenants as well has having sizeable subordinated equity cushions to mitigate against any valuation declines.

Purpose-Built Student Accommodation, Build-to-Rent and urban logistics are a selection of our favoured chosen sectors. Within all of these we're seeing strong demand at both the occupier level, due to clear supply / demand imbalances in our chosen investment jurisdictions and investor level, where institutional capital is looking to take advantage of this imbalance. Of crucial importance to us is the underlying borrower's track record and competency where we only look to lend to those with the right pedigree and experience.

In terms of jurisdictions, we are currently seeing the strongest debt investment opportunities in the UK, Spain and Portugal. The UK is a market in which private real estate debt already plays a significant role and this will continue. On the other hand, Spain and Portugal have consolidated banking systems which is creating an opening for private real estate debt. We expect this to grow over the coming years. Germany is another market which we believe will suit private real estate debt as the real estate market has undergone a significant correction and the previously market dominant banking sector has pulled back.

## Where have you been able to add most value when it comes to ESG?

Regulatory change and the prospect of asset obsolescence means that demand for best-in-class, Grade A space is at unprecedented levels. We can support the creation of these assets by providing debt to support the refurbishment of legacy stock, but capex requirements are often a high barrier to entry on these schemes and viability of these schemes can be challenging.

On the other hand, by lending against ground up development, we can incorporate ESG – and sustainability-linked value creation – into our lending process, ensuring that both the debt and the equity are aligned in achieving the highest ESG standards. The developments we fund are best-in-class and by extension appeal to an occupier base willing to pay the highest rents. Like all investors, LGPS can benefit from 'the flight to quality' we're seeing in real estate.

Ground-up development is also a natural suitor to the future-proofing of portfolios. Institutions need to be reassured that the buildings they invest in won't fall on the wrong side of environmentally-focused regulatory change that is evolving at a rapid pace. This is what the industry means when it talks about a portfolio of stranded assets.

Finally, our debt strategy is classified as Article 8 under SFDR regulations and has a net zero carbon target of 2035 across scope 1, 2 & 3 emissions. In order to meet these requirements and targets, our proprietary Sustainable Lending Framework ensures we only lend against assets that meet a minimum threshold for ESG performance.

# uk.fiera.com

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