KEYNOTE INTERVIEW

A lending market in transition

Roland Fuchs, head of European real estate finance at Allianz Real Estate, winner of Alternative Lender of the Year: Europe and Alternative Lender of the Year: Germany, discusses the market's challenges and opportunities

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Q How would you describe 2021 in the European real estate lending market?
The last two years have represented the start of what we think will be a decade of transition in the real estate market, and consequently in the lending space. In the past decade, investment and debt markets were driven by cap rate compression, rental growth and a broadening investor base. Now, the driver is transition across all property types. It is a result of factors including occupiers' changing needs for offices, new retail formats, the decentralisation of residential hotspots. There is transformation and transition all over the place, and it has been accelerated by the pandemic crisis.

Q How has this impacted your lending activity?
As an asset manager that provides loans, it has shaped our portfolio. Although we still like writing long-term, fixed-rate loans, around half of our €2.2 billion of European lending last year was to transitional properties and developments. We expect this part of the loan book to grow further.

Buildings that have strong cashflow now are not necessarily suitable assets for the next 10 or 15 years. The safer bet can be an asset which is undergoing change. Our investors, including conservative pension funds, appreciate this. So, we always think about the business plan for a property, whether we are buying or lending against it.

It is also having an impact on debt returns. In cases, they are close to cash-on-cash equity returns for comparable assets in the same market. Our focus is still on maintaining an investment-grade book, but transitional loans can generate returns of between 2 percent and 4 percent. That is why our investors often move their allocations between equity and debt.

Q Around two-thirds of your 2021 loans were eligible to be classified as green. Why is this important?

For two reasons. First, we believe a focus on energy efficiency and carbon footprint will become more crucial for occupiers and in the investment market. So, we are ultimately managing our exit risk as a lender. We need to be comfortable any building we finance will make the grade in the coming years.

Second, our investors expect us to help steer their investments towards the net-zero targets they have set across their whole portfolios. Through debt, you can quickly position a portfolio towards such targets by selecting the right type of assets to finance. Sustainability performance can be managed by provisions in the loan documents, and by collecting data on an ongoing basis. Most borrowers are collecting data for their own investors and tenants already.

Selecting the right buildings, the right business plans and collecting data are the ways to embed sustainability into the operational day-to-day business of lending.

Q You grew the volume of third-party capital in your debt fund by €610 million in 2021. Why?

Total third-party commitments to our debt strategy now stand at almost €1 billion to invest alongside Allianz capital. We are broadening our investor base. For our origination team, this means more capital to lend. It also means there is a more diverse range of investment needs to be met, creating potential for lending in different parts of the capital structure. We will still do long-dated, fixed-rate loans, but we can also explore other financing structures.

Eventually, we will have different investment mandates and debt programmes that, while sticking to lending against prime property, will allow us to operate core, core-plus, value-add, or even build-to-core strategies. The composition of investors will differ from bucket to bucket.

The diversification of investors has been the biggest story of the alternative lending market for 10 years. A decade ago, the market was binary: investors either wanted 10-year, fixed-rate senior loans, or high-yield mezzanine debt. Now, there is an interesting middle piece – what I would call the sustainable investment grade space. The best comparison is core-plus or value-add equity, in the 2-5 percent range. This is the space where alternative lenders are becoming dominant in Europe.

"There is transformation and transition all over the place"

Q One of your standout 2021 loans was in Germany. Why did you take on the financing?

We liked this transaction [In February 2021, Allianz provided €300 million to finance Arminius Group's acquisition of the Grand Campus office complex in Frankfurt, currently occupied by Commerz Bank]. It is a well-located building with 654,000 square feet of space next to Frankfurt's main station, backed by Asian capital. There is a transitional story to it. Frankfurt has been long dominated by banking, but it is one of Europe's most transitional markets. While there is a long-term tenant in the building, the owner plans to hold it long-term and has a business plan, which we like.

Q Which other markets do you like?

In Germany, we also like Berlin and Munich. Elsewhere in Europe, we like London, and Paris. We lent almost €1.4 billion in France last year, of which half was for developments and redevelopments. In Grenoble, we provided a €130 million development loan for a new retail, leisure, and office scheme – the only ground-up scheme of its type last year. We like backing the office and retail premises of the future.

Q How do you see lending conditions for the rest of 2022?

The range of debt providers is wider than ever. But less wide is the range of lenders that can do the big, transitional loans. That will be a big part of our focus this year. Our European loan book today is €12 billion, with an average loan size of €200 million. We are focusing on large transactions where we can offer a full underwrite. In that segment of the market, we still see interesting pricing. ■