KEYNOTE INTERVIEW

Opportunities outweigh challenges ahead

Lending in German markets will remain a core focus for the firm, according to PIMCO's Roman Kogan and PIMCO Prime Real Estate's Roland Fuchs

Lenders and investors across Europe's varied commercial real estate markets need to rely on broader resources, such as macroeconomic analysis, credit research and risk management processes, to navigate the current headwinds, distress and dislocation in the property sector.

Roland Fuchs, head of European real estate financing with PIMCO Prime Real Estate, an affiliate and wholly owned subsidiary of PIMCO, and Roman Kogan, European head of private commercial real estate debt at PIMCO, discuss the trends, challenges and opportunities they are seeing in the market.

SPONSOR
PIMCO

Q What was the operating environment like in 2023 and what were the challenges facing the industry?

Roman Kogan: The past two years have represented the greatest period of dislocation that we have seen since the global financial crisis, and naturally, the real estate market has been impacted by this. In the financing space, we saw better relative value compared to equity, though there was still a lack of new core investment capital leading to a reduced primary deal pipeline.

We have also seen a large number of refinancings, and this will likely remain a dominant theme looking forward. As stated in our *Real Estate Reckoning* outlook, which was published last year, there will be around €650 billion of real estate loans maturing in Europe through to 2025, and this continues to represent an opportunity for well positioned, active lenders such as PIMCO.

Furthermore, there remains a distinct lack of capital from many traditional sources, such as banks, debt funds and mortgage real estate investment trusts, making this a particularly attractive time to be a client-centric solutions provider. A good example of this is the growing number of opportunities to finance transitional assets – supporting sponsors as they transform and upgrade buildings to meet, for instance, the highest sustainability standards.

Given the highly dynamic environment, it was very important in 2023 to maintain strong relationships with partners, such as sponsors. This proved to be a powerful means to navigate the environment of value corrections facing the commercial real estate sector while at the same time pursuing new loan opportunities.

Q Your firm won Alternative Lender of the Year: Germany. To what do you attribute your success in this market?

Roland Fuchs: Our capabilities in both equity and debt gave us a very good perspective in 2023, particularly in a mature, historically core market such as Germany, where we have had an established local debt franchise since 2010. In addition, having a locally present and experienced in-house loan asset management team has been fundamental to the success of our lending platform in the region.

Germany is also home to many of our borrowers and institutional stakeholders, and in this context, the use of sophisticated data analytics and the role that data quality plays in enhancing outcomes has worked very well with our clients. We complement our approach with many high-quality, analytical tools when we assess corporate public and private debt. For example, we leverage our analytics to include the implied option-adjusted spreads embedded in various parts of the capital structure.

Lastly, our highly active exposure in core markets where we lend, including Germany, gives us real-time information that forms our bottom-up credit views. We feel this is superior to relying on borrower or even broker information, and this has helped navigate volatility more effectively.

> *"Germany… is one of the largest and most dynamic real estate markets in Europe on both a short- and a long-term perspective"*
>
> **ROLAND FUCHS**

> *"The recapitalisation of loan structures and balance sheets will likely provide attractive points of entry in a value-corrected market"*
>
> **ROMAN KOGAN**

Q In what ways did German market conditions differ from other European markets?

RF: While Germany has had some high-profile challenges, much of the sector-wide uncertainty has been pan-European in its impact. That being said, in Germany, a more localised issue we were seeing was over-leveraged loan structures and developer balance sheets triggering accelerated insolvency cases in 2023.

Q Do you expect to lend in Germany this year?

RF: Yes, we absolutely expect to continue lending in Germany in the coming year. Despite the current cyclical headwinds, Germany continues to be a core market for us – it is one of the largest and most dynamic real estate markets in Europe, on both a short- and a long-term perspective.

Q Across Europe, what do you see as the main challenges and opportunities for real estate markets in 2024?

RK: In terms of challenges that we are seeing in the market, one would be the ongoing value corrections, in particular, on the office side. The European office sector remains, generally speaking, under stress, given the post-pandemic normalisation of work-from-home and the need to upgrade assets to meet new sustainability and energy efficiency requirements.

We see a trifurcation of the office sector. Best-in-class assets – buildings with low carbon footprints, appealing amenities, alluring locations and high occupancy – will likely weather the storm. We also see opportunity in 'brown-to-green' investments that target Class B+ and A properties in prime locations across Germany's Big 7 cities.

However, we expect mid-quality structures will require upgrades in order to survive, while the lowest-quality assets will become obsolete, leaving owners of those properties facing big losses.

Having said that, we see more opportunities than challenges in the year ahead. The constraints in bank underwriting capabilities, in particular on the transition lending side, for instance, are potentially strong tailwinds for PIMCO.

In addition, the recapitalisation of loan structures and balance sheets will likely provide attractive points of entry in a value-corrected market, and we believe that we are well positioned to capitalise on that. ■