

Redevco sees private debt opportunity as banks retreat from financing transitional assets

The real estate manager's Richard Craddock tells *Insight* about the locations and sectors – and the type of assets – its debt platform is targeting across Europe

Richard Craddock, head of real estate debt at Redevco, is an experienced property lender with close to 20 years of experience across European and Asia-Pacific markets. He now leads Redevco's expanding pan-European debt platform, directing its push into transitional and development finance. He tells Jason Mitchell where private lenders can gain ground as banks retreat and property markets continue to adjust.

How would you describe Europe's real estate lending market? Is there enough capital available, and how are banks and private lenders competing?

At the start of the year, we saw quite a pronounced pickup both in terms of market optimism and deal volume. Then we had the Iran conflict and the subsequent inflationary pressure and elevated rates, which have no doubt had an impact on investor confidence, risk appetite and ultimately transaction volumes.

As lenders, we rely on transaction volumes, but there is still market activity out there which, coupled with refinancings, means there is enough deal flow. It's not a complete stasis.

There's definitely no shortage of debt capital available across pretty much every European market, coming from both the bank and non-bank lending markets. It is competitive out there for lenders to deploy, and that, coupled with lower transactional activity, means the deals that are around are generally getting a depth of bids.



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On the question of banks versus non-banks, I think the market is finding its rhythm. There are obvious types of transactions where it makes more sense for banks to be involved: where it's low leverage and the asset is stabilised, that's where banks have a competitive advantage given their low cost of capital

and can more naturally win those deals. But anything with a bit more complexity – transitional assets, developments, or a borrower looking for higher leverage – is where non-banks are more relevant. I don't think there's as much friction on deals between bank and non-bank lenders as people perhaps think.

Data centres are attracting enormous investment, but Redevco appears more cautious. Why is the debt case difficult to justify?

Data centres are interesting – they're a bit Marmite at the moment. Certain lenders really like them and are very active, but other lenders are more wary. We lean towards the latter category, for a whole host of reasons, not least that they're typically very large ticket sizes which can get quite competitively bid.

If you are in the equity, then you of course get the upside, whereas the debt story from my perspective is harder to justify. There remains quite a lot of downside risk given the lot sizes, challenges around power requirements, and the obsolescence question around how data centres will operate and where they need to be located over the longer term. If you are balancing that downside risk with the equity upside, then that's more symmetric, but as a lender you of course have capped upside but material downside since they're highly specialised assets with limited alternative use or residual value.

It's one of those sectors where the boundaries between infrastructure and real estate start to blur.

Rather than lending against data centres, which property sectors does Redevco believe will prove most resilient as AI develops?

I guess there are several approaches to play AI. One might be: AI requires data centres, so lean into data centres. The other, which we'd probably slightly favour, is to focus on sectors that are irreplaceable even in a world where more is automated. That clearly includes living assets that people need to reside in – no matter what AI does, people need a home or somewhere to stay while they study or travel.

Logistics assets ought to be resilient as well. You're always going to need to store physical products, and people are always going to want physical products, so distribution supply chains will still be required. That's a sector we favour, along with anything serving human and physical interaction, which will remain relevant.

Offices are where it gets greyer and you have to be very focused on stock selection. The office will still serve a function in terms of people working together, collaborating and learning from one another, but there's no doubt it will affect certain functions that can be better undertaken by AI at a cheaper cost base.

That favours prime offices in core CBD locations, well-amenitised, with highly sustainable specifications, close to transport hubs, where occupier demand will concentrate – versus larger, secondary, commodity assets, which could suffer from lower absolute workforce requirements catering for more process functions.

Why is Redevco concentrating on transitional and development finance, and what opportunity is being created for private lenders?

Our debt strategy is focused on what we call transitional financing – we support the acquisition and refurbishment of existing buildings, and we also support development financing for ground-up construction of new-build, future-aligned assets.

There's a strong sustainability overlay and framework around how we look at deals. The reason for that focus is that we see it



as the strata of the lending market with the most favourable supply-demand dynamics. On the supply side, banks are increasingly hamstrung by regulation which is pulling bank capital back most acutely from those types of transitional assets. On the demand side, when you look at the European energy transition, there are massive capital demands to retrofit or build the European built environment so that it aligns with the Paris Agreement decarbonisation targets.

That creates a really interesting supply-demand imbalance for private credit to grow market share on attractive risk-adjusted returns. Obviously, supporting the decarbonisation of the built environment is also the right thing to do, but we think it makes commercial sense too.

Coupled with that, from a downside risk perspective, we think regulatory aligned, energy efficient buildings that, once complete, are suitable for a core buyer universe, offer better exit liquidity and are more value defensive.

How do you approach the living sectors, from senior living to build-to-rent, and are some student-housing markets beginning to reach saturation?

We look across a pretty broad spectrum of living asset classes – I wouldn't say we're sector-agnostic, we do have particular areas of focus.

For senior living, we don't have a hugely strong focus, but we will certainly look at opportunities there. We understand the demographic reasons why the asset class ought to fare well, but it's multifaceted and fractured in terms of what the product actually is, and it varies by jurisdiction. It might be for-sale residential with some kind of retained management fee model; it might be leased to care home operators; or it might be individually let.

The regulations and funding differ by jurisdiction too – the Netherlands has a completely different dynamic and way of funding senior living versus the UK. You've got to take it jurisdiction by jurisdiction and look at what the underlying model actually is. We look at it case by case.

Build-to-sell or build-to-rent residential are definitely a focus. We recently completed a €57m loan in Dublin for a build-to-sell product. That's a market that, like many European capital cities, is chronically undersupplied, so the dynamics there are very attractive to lend into.

When you get to the other beds-based sectors, like student housing, the picture is a bit more nuanced. A few years ago most markets were chronically undersupplied – it was a nascent, emerging sector. We're now at a point where we're starting to see saturation in certain cities or micro-locations, so you have to be more selective.

The UK is a good case in point – it led the charge on student housing, so it's been faster to reach that saturation point in certain cities. Other European markets are behind the curve, including Germany and Ireland, where the PBSA market is developing but remains behind the UK.

We've also seen a decline in foreign student demand for UK university places, particularly at the upper end – the higher-price-point product has seen dampened demand. So you've got to be selective, and pick the right schemes with the right borrowers in the right markets.

Why do you regard Germany as an attractive recovery opportunity, despite its relatively weak economy?

Germany was the market with the tightest yields at the peak when rates were ultra-low so its yield and value correction has been most notable. That makes the German entry point really interesting from a through-the-cycle perspective. It will always be a deeply liquid and institutional market – it is the largest economy in Europe and one of the largest globally, so the recovery is just a question of timing.

Where you've seen that value correction, that's quite an interesting recovery play, from both a debt and an equity perspective. It will always be a core market for global capital. Much like Europe's role in the global real estate market, Germany within Europe is not really about high growth; it's about size, stability and liquidity.

Is your logistics focus more on big-box distribution centres, or smaller, last-mile-style units?

From a debt perspective, we'll look at both, but we've recently favoured what I'd call mid-box – unit sizes of 5,000 to 10,000 sq m, where you're less reliant on a smaller number of large 3PL or retail occupiers. That's where leasing demand has been more resilient over the last few years. With big-box space, a number of large retailers and 3PLs took a lot of space during Covid-19, and some of that space is now coming back to market, so we're a bit more cautious there.

Within the debt strategy, we tend to favour slightly smaller unit sizes that can still be used by 3PLs, potentially for last-mile, but



Class A Mid-box logistics developments in Frankfurt financed by Redevco

that also have multiple demand drivers, including light industrial – we prefer that more granular leasing optionality, rather than being reliant on one occupier for a very large floorplate.

From an equity perspective, we have a high conviction in Industrial Outdoor Storage (IOS) – a growing subsector of logistics – because it provides mission-critical, hard-to-replicate infrastructure for modern supply chains, while strong occupier demand and a structural shortage of well-located industrial land supports resilient income and long-term rental growth.

Can you explain in more detail what kind of financing Redevco actually provides?

We focus on retrofit, heavy retrofit, or development financing. In the case of the recent logistics transactions, we've been providing ground-up construction loans, but we have also supported retrofit projects in offices. Given that sustainability focus, all our loans are structured as green loans.

We're looking to back best-in-market product achieving high sustainability specifications and low embodied-carbon impact. We favour those types of assets because occupiers want to lease buildings that are energy efficient and aligned with their own corporate net-zero objectives. Focusing on new-build, future-aligned, energy-efficient buildings offers, we

believe, favourable risk because we think that's where occupational and capital markets demand will continue to focus.

And indeed, that's what we've seen on the transactions we've been involved in, with leasing performance having been strong despite macro-headwinds.

In terms of other sectors, we selectively look at offices – again, focused on well-amenitised assets close to transport hubs in core gateway European cities, where we think occupational demand will continue, particularly for highly sustainable assets.

Which European markets is Redevco concentrating on, and how do you view Poland and Spain?

We focus on core Western European jurisdictions, and that includes the UK, Ireland, Germany, Benelux and France. In Iberia, our focus is more on Spain but we also operate in Portugal. We have a brilliant team based in Madrid, and we've been very active there on the equity side, so it's a market we understand well.

From an equity perspective, we invest a lot in retail and retail parks in Spain, and we're very active in retail parks across Europe. From a debt perspective, I don't think Spain has fundamentally different dynamics in terms of which sectors we're more or less focused on. The build-to-rent sector is still a market that's fundamentally undersupplied in places. Student housing has clearly had some favourable tailwinds

over the last few years, and there have been some big trades on the equity side. On offices, similar to our thesis elsewhere, we'll be very focused on Madrid, and probably also Barcelona.

When it comes to Poland, from a size and macro perspective a lot of the fundamentals are strong – it remains one of the fastest growing economies in the EU and institutional capital is increasingly going there. I'd say it's not been a big focus market of ours purely because it's a jurisdiction we're not that familiar in – we are more Germany westwards to the UK and Ireland, then down into Iberia, and selectively into the Nordics. But it's a market we acknowledge is becoming increasingly in focus, particularly for sectors such as logistics.

After the repricing of recent years, are shopping centres and other retail assets becoming attractive again?

Retail is multifaceted so you have to look at performance across its sub-classes. On the equity side, we've been very active investors in and owners of retail parks for a long time, and we'll continue to be active in that space. We like the retail park dynamics across Europe.

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a lot, which makes for quite an interesting entry point, both from a debt and equity perspective. Other forms of retail – high street, high-end – are still showing pretty reasonable trading performance if you're in the right micro-location within European cities. But those prime pitches are narrow; there is little room for error.

From a lending perspective, we're probably a bit more constrained in terms of the number of transactions we do, because there isn't a lot of development and heavy refurbishment which is our focus for debt. No one's really developing brand-new shopping centres now and there's limited ground-up retail park development. We might look at deals with a retrofit angle, some capex and refurbishment to drive energy efficiency, performance and occupational demand. But our lens of focusing on retrofit and development leads us more heavily towards other sectors, like light logistics and residential.

How do geopolitical and interest-rate volatility affect lending decisions, and what underwriting

discipline is required in the present market?

Clearly there's volatility in interest rates and the market swings based on what news comes out of the Iran-US conflict, corresponding oil prices and inflation prints. That makes it harder for value realisation and for the market to function properly.

From a lending perspective, however, we don't underwrite yield compression – we don't look at the upside, we look at the downside. We look at income, and where we think income is going to stabilise on assets, and then we look at what the debt risk metrics are based on projected stabilised income.

So, we focus on stock selection, income underwriting and sponsor capabilities. Near-term fall-out from the Middle East conflict makes it more challenging, but we're underwriting business plans that run three to five years, and we will always underwrite assets through-the-cycle against peaks and troughs to ensure our loan basis is defensive, even in a more challenged market. ●



Redevco invests a lot in Spanish retail, says Craddock, including Abadía Retail Park in Toledo