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Alternative lending market braces for volatility

The participants in Real Estate Capital Europe's roundtable discuss the fallout from tariffs and assess the prospects for non-bank lending. Stuart Watson reports

The *Real Estate Capital Europe* alternative lenders roundtable meets almost a month after the US administration's 'Liberation Day' tariffs sparked consternation in global markets. The unenviable task facing the panel of two non-bank lenders, two borrowers and a lawyer: interpret what the chaotic macroeconomic backdrop means for European private real estate credit.

The market has gone from a "business as usual" situation in the first quarter of the year to one that is "nervous" both on the lender and borrower side, says Vishal Kumar, managing director, real estate, at New-York headquartered credit specialist Värde Partners.

He identifies five factors he believes will determine what impact tariffs will have: whether an economic slowdown will hit occupier demand, plus the effect of tariffs on credit spreads, on the supply of real estate, on capital flows and on interest rates.

He suggests there could be a positive impact from global capital that would otherwise flow towards the US being redirected in Europe's favour. Meanwhile, spreads have begun to move out in the US, but not yet in Europe, he adds. Much of the back leverage deployed in Europe's private real estate credit market originates with US banks, so the impact on the cost and availability of that source of capital could be significant for both lenders and borrowers.

"Non-bank lenders have talked about back leverage possibly pricing out another 25-plus basis points," says Matthew Phillips, head of finance and operations at London-headquartered industrial property manager Valor Real Estate Partners.

However, he believes that in most

PHOTOGRAPHY:PETER SEARLE

Vishal Kumar

Managing director, real estate, Värde Partners

Kumar is a managing director at New York-headquartered manager Värde. The firm is a global credit specialist with approximately $17 billion of assets under management in real estate, asset-backed finance and corporate credit strategies. Its European team invests in all real estate segments across Europe.

Aparna Sehgal

Chair of the UK and European structured and real estate finance practice, Winston & Strawn

Sehgal joined the US-based law firm in February to build its structured and real estate finance team in the UK and Europe. She has more than 20 years of experience representing parties across the capital stack, advising on the financing of multijurisdictional transactions.

Aparna Gupta

Executive finance director, Edge

Gupta joined Edge in 2021, becoming executive finance director the following year. The developer and investment manager was founded in the Netherlands by Coen van Oostrom and has delivered 80 projects totalling over circa 22 million square feet of office space in construction, realised and managed in the Netherlands, Germany, UK and US.

Alexander Oswatitsch

Head of real estate debt, Europe, DWS

Frankfurt-based Oswatitsch has led the 10-strong European real estate debt team at DWS since 2019. Investing in real estate for more than 50 years, the firm's pan-European debt fund business offers a full spectrum of credit strategies, including senior, stretch-senior, whole and mezzanine loans for investment and development.

Matthew Phillips

Partner, head of finance and operations, Valor Real Estate Partners

Phillips joined Valor in 2017 and is responsible for finance and operations. The London-based manager specialises in the European last mile logistics sector. It has more than 200 assets under management in the UK, Germany, France and the Netherlands with a gross asset value of more than €4 billion.

instances only limited price increases are now beginning to come through in the terms that are being offered.

"Even then, we haven't yet seen substantial change. The start of this year was one of the most competitive financing markets that I have experienced in the last decade," he says. Because the volume of deals is lower, lenders are vying to offer the most attractive terms. "There always seems to be one lender who is willing to push a bit harder."

Widening spreads

The effect of widening spreads on back leverage arrangements will vary between existing facilities with headroom for new assets and facilities that are being newly established, says Aparna Sehgal, chair of the UK and European structured and real estate finance practice at US law firm Winston & Strawn, host for the discussion. "We continue to see considerable interest in the back leverage product, so it should remain a reasonably competitive space," she says.

Where back leverage becomes more expensive, European alternative lenders may need to pass on the increase to borrowers, says Kumar. On the other hand, he believes US banks will look to allocate more capital to Europe. "For example, if Europe was 18 percent of their book last year and they want it to be 22 percent this year, that is quite a big move because these banks have large balance sheets, so that is helpful."

Not all European alternative lenders will be impacted by widening spreads, because some investors still prefer debt investments to be unlevered, says Alexander Oswatitsch, head of real estate debt for Europe at Frankfurt-headquartered real estate investment manager DWS. "It can be a way to increase your return by not taking too much asset risk. But some investors take the view that it increases risk by creating a synthetic mezzanine position. It depends on the investor's perspective whether a manager chooses to run a levered or unlevered strategy, or to combine the two by using a bit of back leverage on their safer assets."

> *"What will demand be like when leases expire in three or four years? What will happen to rents? Those second-order impacts will take more time to play out"*
>
> **VISHAL KUMAR**
> **Värde Partners**

The second borrower at the table, Aparna Gupta, executive finance director at sustainable real estate developer and investment manager Edge, says her firm's lenders have indicated that they are paying similar rates for back leverage before and after Liberation Day. "It's business as usual for them."

"People are still trying to assess the full impact of tariffs," she says. "But we have gone through a lot of turbulence and volatility over recent years, so you need to take a view on whether this is just short-term noise or is it really a long-term shift. Ultimately, there is a lot of capital that needs to be deployed. For the right sort of deals, returns, projects and sponsors, there are lenders that are happy to back them."

Second order impacts

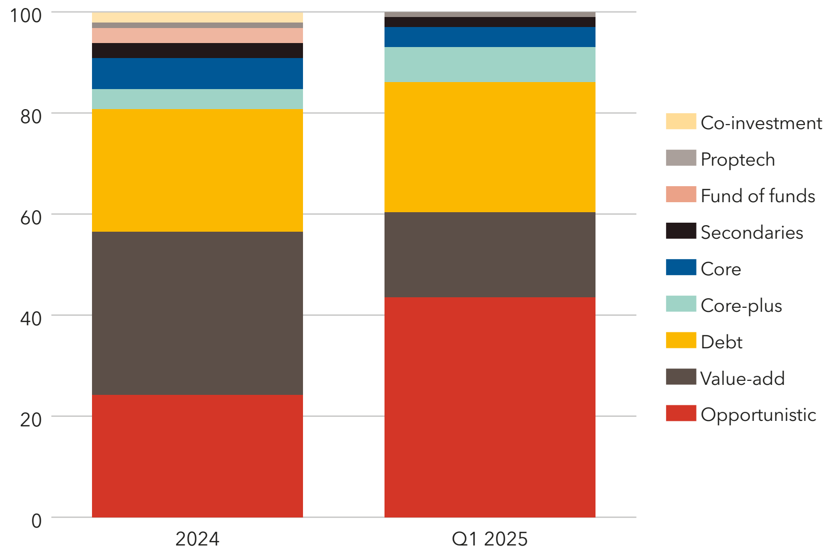
The effect of tariffs on industries and on individual businesses will take time to emerge, says Kumar. "What will demand be like when leases expire in three or four years? What will happen to rents? Those second-order impacts will take more time to play out."

That should lead to some market participants adopting a wait-and-see approach. But for lenders with a deep understanding of assets it may be an opportunity to pick up additional business if borrowers look to secure terms in advance of an anticipated market downturn, he notes.

Real estate debt is derived from the underlying asset class, says Oswatitsch, "and if you look at the fundamentals of European real estate, in our opinion they are still fairly robust. After Liberation Day, we might have become a bit more cautious on the rental growth outlook, but there will be even more reluctance to start new developments, putting more pressure on supply, which is supporting rents."

Moreover, there is likely to be greater scope for interest rate cuts in Europe than the US, which will support prices. "From that perspective, we believe lending against European real estate

Proportion of capital by strategy focus (%)



Source: PERE

"There was real momentum early this year. People wanted to get going, and I think that's still keeping the commercial real estate juggernaut moving to some extent"

APARNA SEHGAL
Winston & Strawn

continues to be attractive, with the potential to provide investors with a cushion in a macro environment that remains volatile," Oswatitsch adds.

Have recent events undermined what appeared to be a largely positive start to the year in European real estate markets? It is still too early to tell, says Sehgal. "The deals that are closing now probably weren't committed to during Trump's first 100 days in office. For a while, everyone was talking about 'staying alive to 2025' and so there was real momentum early this year. People wanted to get going, and I think that's still keeping the commercial real estate juggernaut moving to some extent."

Interest rates

There is consensus among the participants that UK and continental European bank rates are likely to fall over the coming year. Forecasts of three interest rate cuts in 2025 have been downgraded to two, says Gupta. The three-month EURIBOR forward curve indicates rates will land between 2.25 percent and 2.5 percent in the next two years, she says. "So long as there is a heightened risk of recession, the projection is that interest rates will be coming down."

That remains the most likely scenario, but there is a risk that rates could stay higher than expected, warns Phillips. "I can see a case where inflation increases more than anyone would like, particularly in the UK, where we have seen increases in national insurance contributions and energy costs."

Together with other factors, that could mean it is difficult for the Bank of England to decrease rates quite at the level the curve is indicating, he says.

Short-term fluctuations in rates can comfortably be factored into underwriting deals, says Kumar, but the potential for medium-term increases is more difficult to account for. "You have to ask, if the interest rate is 4 percent when we are exiting a deal two or three years from now, will the debt yield be sufficient? Is there enough buffer in the deal for that exit to happen? Or at that point can we hold on longer before exiting?"

Loan terms

The widening of US credit spreads will also inevitably have an impact on pricing and/or loan terms available from alternative lenders that are borrowing from US banks, says Kumar. That means either lending on a higher-risk situation at a higher rate, or a less risky one where the rate stays the same. "For now, everyone is taking the second option. For example, we might ask for a

Industrial lending: Will tariffs bite?

European manufacturing could be hit by levies, but other demand drivers could compensate

Transaction activity in the logistics market showed signs of recovery at the end of 2024, says Valor's Phillips. "There were indications that sellers, both high-net-worth individuals and institutional investors, felt that they could see some exit liquidity, which gave us the opportunity to buy because we saw value."

But could the fallout from US tariffs stall the industrial market recovery? While consumer-driven logistics assets serving domestic consumption are expected to be unaffected, borrowers are becoming "a little nervous", says Kumar, "especially in sectors that are expected to be badly hit, like manufacturing-focused and portside logistics, because they don't know what the impact on demand will be".

Consequently, some sponsors are keen to close on financing deals now rather than run the risk that the occupier market weakens and lending dries up.

Oswatitsch agrees that there is a "little bit of a mixed picture", in the sector because of its potential vulnerability to tariffs on manufactured goods. However, he adds that from a lending perspective it remains "a relatively straightforward asset class to underwrite".

Phillips notes that while industrial demand has slackened since the market's peak, supply remains low in gateway markets such as London, Paris, Berlin, Amsterdam and Rotterdam, which underpins prospects for rental growth. Furthermore, he argues that there are also a variety of factors at play that will support occupier demand in the long term.

"The region should be a net beneficiary of onshoring of the supply chain, particularly from Asia to Europe as a gateway to America. Defence spending is also set to increase in Germany and elsewhere. On top of that, e-commerce trends will continue, with much of Europe still at materially lower levels of market penetration than the UK and US."

Quantum computing will speed up the process of supply-chain analysis, leading to the reconfiguration of distribution networks, he adds. "Our research suggests that will empower the last-mile sector."

bit of amortisation on our loans instead of being interest-only or ask for a lower loan-to-value or a shorter tenure."

Hedging costs have also risen for lenders, he notes, although falling EU interest rates have helped to cushion the potential impact on borrowers: "Even if the spread goes up by 25 basis points, the net rate to the borrower is roughly the same."

In the early part of the year, as the geopolitical and macroeconomic landscape evolved, Sehgal noted changes to headline loan terms for deals under discussion. She says borrowers and lenders are engaging in constructive dialogue over LTV levels and loan tenures in light of larger uncertainties.

Depending on asset class, cash traps have in cases been replaced by cash sweeps, as part of negotiations on amortisation. In development deals, cash reserve amounts, in percentage terms, have been nudging upwards to mitigate construction cost inflation and completion risk. However, she says it is too early to call this a thematic change arising from US tariffs.

"We look to alternative lenders for our UK acquisitions because they are willing to underwrite more risk. But my counterparts in Germany and the Netherlands have a very different perspective on sources of lending"

APARNA GUPTA
Edge

"Most lenders and most borrowers are taking a longer-term view of their relationships even as they weigh up being responsive to what's happening in the market right now," she says.

Valor has no amortising loans in its portfolio, says Phillips. "We reject it as much as possible on the basis that we are adding value at the asset level. Lots of lenders ask for amortisation, but we typically manage to make it conditional, if we agree to it at all."

Serious discussions around amortisation have only recently been on the table, says Kumar. "In March onwards, when everybody got more worried about what was going on, lenders started trying to get some risk off and it was something that was easy to let go of, but less so now. It is still more of a talking point"

Scope for growth

The European alternative real estate debt market has had a meteoric rise in recent years, but there remains considerable scope for growth, says Sehgal. She sees new entrants each year and growing interest in the sector. "If you look at the level of market penetration by private credit lending in the US, it is enormous. The UK market has also grown massively in the last 10-15 years and Europe is starting to properly pick up some momentum."

The sector has become much more diverse and experienced through the covid-19 pandemic and beyond, with many executives who gained experience working in the big banks joining debt funds, she adds. "They bring real sophistication to the underwriting, which leads to speed of execution, which is very compelling for borrowers."

Non-bank lenders account for around 20 percent of the real estate lending market in the UK, but still only 10 percent across Europe, where the

overall volume for debt funds is around €100 billion a year, notes Oswatitsch. "If you take that market share to 20 percent, that is a €100 billion growth market for alternative lenders in the next seven to 10 years."

Fundraising remains challenging, however, with *REC Europe* data recording no new European debt vehicles closed in Q1 2025, and only $3.4 billion committed in 2024. However, debt remains a relatively popular strategy within the private real estate suite of products, according to *PERE* data. Global private real estate fundraising reached $57.15 billion in Q1, up from the $32.47 billion in Q1 2024. Debt strategies accounted for 26 percent of the total in Q1, compared with 24 percent across 2024.

In that context, the prospect of even a relatively modest reallocation of capital from the US towards Europe could have a "big impact", says Oswatitsch. "Europe now seems more attractive than the US, not just for European investors but also APAC capital."

Competition from European banks, which are currently "super aggressive" and able to offer spreads substantially lower than debt funds will limit the scope for alternative lenders in continental Europe, argues Gupta. "We look to alternative lenders for our UK acquisitions because they are willing to underwrite more risk. But my counterparts in Germany and the Netherlands have a very different perspective on sources of lending."

Another barrier to growth will be the lack of transactions as market turmoil dampens acquisitions activity, suggests Phillips. "I anticipate this year will be stable, not particularly high growth, because of the uncertainty. There continues to be a lot of competition to refinance assets though, and that's what's really going to drive the market in the next couple of years."

He also questions whether the return levels anticipated by debt fund managers are sustainable in the medium term. "The capital stack needs to work so that the debt is not achieving higher returns than the equity."

> *"We believe lending against European real estate continues to be attractive, with the potential to provide investors with a cushion in a macro environment that remains volatile"*
>
> **ALEXANDER OSWATITSCH**
> **DWS**

As the sector matures further, the development of a commercial real estate collateralised loan obligation market should become an increasingly urgent priority, says Kumar. "That requires a certain volume of credit and a degree of standardisation which is not there in Europe yet. But it will be needed to get debt off lenders' books and bring the cost down for borrowers."

Back leverage should also play an increasingly pivotal role, allowing banks to take less risk by reducing their direct lending while retaining exposure, and simultaneously opening up opportunities for more nimble alternative lenders. "Those two factors will play an outsized role in the next three years," he predicts. ■

Office lending: Sustainability is the keystone

European alternative lenders and borrowers are still focused on ESG, despite US pushback

Edge is set to deliver more than one million square feet of office space in London over the next five years. On the eve of the roundtable discussion the developer was granted planning consent at 125 Shaftesbury Avenue in the West End, and it also has projects under way at EDGE London Bridge and EDGE Liverpool Street in the City of London.

While office cap rates have moved out, growing rents for the best quality, high-specification space have partially compensated, says Gupta.

Meanwhile, the firm's financing arrangements are "covenant-light", so that while values have fallen "in the short term" there is no danger of defaulting on LTV covenants.

Lenders are still comfortable financing long-leased office space, especially if it is Grade A accommodation, says Värde's Kumar. By contrast, older, lower-quality buildings in fringe locations struggle to secure financing and will continue to do so, he predicts.

Oswatitsch takes a similar view: "There is still tenant demand for prime, well-located offices with strong ESG credentials," he observes.

High sustainability standards are essential for successful office buildings, argues Gupta. Tenants want to offer the best possible environment to entice remote workers back to the office, while the EU taxonomy regulations on sustainable activities and the CRREM [Carbon Risk Real Estate Monitor] standards are both driving office owners toward achieving improved environmental performance.

Meanwhile, despite the anti-ESG pushback in the US, there are still commercial imperatives for sustainable office construction.

"Investors and lenders want to invest in something that's going to hold value, that is resilient in nature," she says.

"The start of this year was one of the most competitive financing markets that I have experienced in the last decade... There always seems to be one lender who is willing to push a bit harder"

MATTHEW PHILLIPS
Valor Real Estate Partners