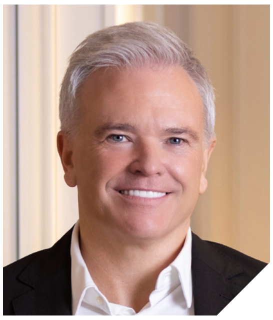
Q&A - Chris Gardner & Dr Nicole Lux

Going into 2024, what do astute lenders and developers need to know about the latest data from the Bayes CRE Lending Survey?



Chris Gardner
CEO, Atelier

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For **Dr Nicole Lux**, Senior Research Fellow and compiler of the Lending Survey, developers who will fare best in 2024 will: have well-structured equity and debt; be able to launch projects quickly; be selling and letting into the 2025/2026 market, all against the backdrop of a restricted development pipeline which will underpin values and supply. She highlights several themes in the latest data.

- Evidence of the ongoing transformation of the lending landscape since the GFC, characterised by the retreat of traditional banks, the emergence of other lenders, and most recently a marked increase in newly launched debt funds joining the survey
- A shift away from office and retail to residential and logistics, when it comes to lender priorities, and greater segmentation of property portfolios
- Macro forces affecting property, including the environmental agenda and decarbonisation, and cultural changes e.g., demand for flexible work and online shopping

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Here's what Dr Lux told Atelier CEO Chris Gardner at the end of 2023, when they sat down to discuss the latest report.

CG. How does this current lending market compare to other periods of economic turbulence, notably the GFC, given the survey is now in its 25th year?

NL. The market has fundamentally changed. While the total outstanding debt seems to have been constant, the debt providers behind it are not the same.

Before the GFC, 75 out of 85 lenders were banks. Now, we have about the same number of lenders, but only 46 are banks. Many names have disappeared completely. I guess the younger analysts would have never heard of these institutions.

The GFC was really a credit squeeze, with large institutions not willing to lend to each other anymore, and this ultimately had an effect on the economy overall and we went from high interest rates and high asset pricing to ultra-low interest rates.

Now, it is the economic turbulence together with high inflation and increasing interest rates, which is affecting the real estate market. But after the GFC, real estate market values recovered fairly quickly; now, I have my doubts.

Property is the centre of many fundamental changes taking place such as meeting the Government's environmental agenda, ESG, energy efficiency and decarbonisation. All this is changing how we use and build property.

Also, our working requirements are changing, affecting the use of office buildings. Retail property has had to deal with increased online shopping, and we haven't even started fully understanding the demands on buildings when it comes to our requirements for data capacity or 5G, and how and where to host our giga-watt data volumes. A lot of capital will be required to change the buildings we have today.

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out of 85 lenders are now banks, compared to 75 before the GFC.

CG. Conditions for this reporting year are vastly different to recent years. What key points in the data stand out for you?

NL. We have seen an increase in new debt funds being launched joining the survey, so there is definitely growing interest from debt investors, providing increasing diversity to borrowers.

However, there is also a clear trend towards growing concentration on specific asset types, namely residential, logistics and to a lesser extent student housing. These are the key asset types prioritised by lenders. This is a fundamental change in market segmentation of property portfolios. Historically office and retail were the strongest sectors.

CG. Alternative lenders' new loan originations are down by 34% - do you think this is the bottom of the market or are you predicting more of the same in 2024, and how does this decrease compare to previous property cycles?

NL. The decline in new lending during 2008 was 41% followed by 70% in 2009. This is of course extreme. The reduction during the pandemic in 2020 was only 23% and volumes already recovered in 2021. Everyone is currently waiting for the transaction market to re-start in 2024, once that happens, the debt maket will automatically follow.

CG. Are there any obvious niches or pockets of opportunity for lenders to consider, particularly alternative lenders?

NL. Well, given current interest rates, the story seems to suggest to move from private equity into private debt, or into high-yield bonds >9%.

There is a huge opportunity in real estate debt for private credit investors, but many opportunities will be complex, management-intensive, and will require specialist expertise. So don't try to spread yourself across all areas, stay focused.

CG. **Do you expect liquidity in the market to tighten in the next 6-12 months?**

NL. Yes, we will see more insolvencies and problems, but also a lot of opportunistic investors willing to find solutions and work with these – majority ownership shares may change hands in the process. Banks will continue to cherry-pick the prime lending opportunities and remain cautious. Non-banks committed to the development finance marketplace will continue to take market share.

CG. **Based on this lending landscape, where do you think the key opportunities for SME developers are?**

NL. There are good opportunities for those developers who already own land and can start a new project. Governments still have to consider the housing shortage, so there may be further incentives coming up, playing into the hands of developers launching new projects. Those who are capital/cash rich will also have clear advantages to make projects happen.

CG. **What are the headline factors behind the development funding pipeline 'rebounding' since 2020?**

NL. This was mainly driven by government incentives, such as stamp duty and help-to-buy etc.

CG. **With the Bank of England remaining cautious on interest rate cuts, what are the arguments for pushing ahead with residential schemes now?**

NL. If you are a developer with well-structured equity and debt, can launch projects quickly, and are selling and letting into the 2025/2026 market, then there are opportunities available at a time when the development pipeline is restricted, impacting on values and supply. As with any time in the cycle, the key is not to rely too heavily on debt. Where debt is required, it is essential to work with the right lender who can optimise the debt structure for the scheme.

CG. **Obtaining data on the commercial and residential lending sector tends to be difficult due to the opaque nature of the market. How does this report overcome these challenges and fill this gap?**

NL. I think we have been lucky that the survey has built up a long-standing reputation since 1998. Back then data collection was very much based on personal relationships, today we sign a lot more NDAs to receive the data.

From the start, the University had been selected as an independent, non-biased host, which was important for the Founding Committee. In 25 years, we have never had any data breaches. Of course, we would like to increase the level of detail in our analysis and improve data quality even further, but we always have to find a balance with regards to the time and effort our lenders put in to deliver the data. This is probably the only survey that has carried on for so long on a voluntary basis with long-term sponsors.

Our participation in the **CRE Lending Survey**, and analysis of its data is one of multiple inputs we use in our business planning to ensure we are positioned exactly where we need to be to support SME developers, at every turn of the cycle.

If you're a developer scoping opportunity for 2024, please don't hesitate to get in touch.

With thanks to **Dr Nicole Lux** for her time and expertise.

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