VIEWPOINT

FOUR QUADRANTS

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Private Debt

To put it optimistically, the private debt market is “on pause”. While some lenders are still working to complete deals that were already in the pipeline, very few are looking at new business with a serious eye – certainly it is rare to find term sheets completed – and the majority of activity at lending institutions is now very much inward-looking rather than outward. Financial institutions are spending far more of their time worrying about existing loans than new ones, and stress testing their exposure to understand resilience under different macro-economic scenarios is the absolute priority. If there is a second focus, it is likely related – seeking to shape Government policy on the unintended but unavoidable consequences of business closure feeding through to technical loan default via non-payment of rent and hence interest.

Lenders’ reluctance to peruse new business is understandable. On the one hand, transactional activity is tumbling, so there is less of it to source. But on the other determining a price at which to do any business has become more challenging. With swap rates, risk free rates and corporate bond spreads all volatile, it is hard to say with precise conviction where key benchmark rates stand and where true cost of funding lies. And with income streams on the property side disrupted in the short-term and likely subject to increased uncertainty in the medium-term, assessing the correct margin to apply to compensate for what is now an unknowable level of risk is similarly challenging. Add to that the fact that the effective closure of the CMBS and syndication markets means many lenders’ preferred exit routes have vanished, and the current decline in activity is understandable.

Lending institutions are generally conservative, and although the sector is arguably in a better place than going into the GFC – nominal levels of LTV have typically been lower, and the pool of lenders is larger and more diversified making it less reliant on fewer larger players – the collective culture will likely ensure that any recovery is followed by equity rather than driven by debt . Lending activity will resume once transactional activity has picked up and is maintained a steady level, once valuations are no longer “uncertain”, and once occupational markets have shown their return to equilibrium via the supporting of rent and hence interest payments on existing loans.

But as always there is an opportunity. Lenders prepared to move first will have a clear field and will be able to have their choice of deals and still secure excellent terms from a market in need of debt finance. While on the investor side, those able to move without the need for financing will be at a clear advantage over those reliant on the availability of debt.

Contacts

For more information, please contact our Capital Advisors team:

Richard Dakin
Global Head
Capital Advisors
t: +44 (0)20 7182 2030
e: richard.dakin@cbre.com

Paul Coates
Executive Director
Debt and Structured Finance
T: +44 20 7182 8050
E: paul.coates@cbre.com

Paul Robinson
Executive Director
Alternative Investment
t: +44 20 7182 2740
e: paul.robinson@cbre.com

Tim Ryan
Executive Director
Real Estate Investment Banking
t: +44 20 7182 2775
e: timothy.ryan@cbre.com

Graham Barnes
Executive Director
Corporate Finance
t: +44 20 7182 2516
e: graham.barnes@cbre.com

Mark Evans
Executive Director
EMEA Equity Placement
t: +44 20 7182 2964
e: mark.evans@cbre.com

Clarence Dixon
Executive Director
Loan Services
t: +44 20 7182 2917
e: clarence.dixon@cbre.com

Anthony Martin
Executive Director
Investment Advisory
t: +44 20 7182 2466
e: anthony.martin@cbre.com

Dominic Smith
Senior Director
Research
t: +44 20 7182 2369
e: dominic.smith@cbre.com