

"You need to be a little paranoid in a market like this"

In July 2019, Bentall Kennedy, the \$36 billion property management business of Canadian insurer Sun Life Financial, merged with real estate manager GreenOak Real Estate to create BentallGreenOak – an investment platform with \$47 billion of assets.

Jim Blakemore, a former real estate lawyer and Lehman Brothers banker, joined GreenOak in London in 2012 to lead a European debt strategy, focused predominantly on lending against transitional real estate. With the merger, Sun Life's North American mortgage book was added to the debt business and plans were made for expansion in the US.

We caught up with Blakemore to discuss high-yield lending strategies in a time of crisis.

Q How is the covid-19 crisis affecting your industry?

A Investors really want to dig into what managers have done in recent years. Pre-crisis, investors would of course do their due diligence of a manager, but now they demand a greater understanding of every loan in their manager's book. They want to know what is on your watchlist, if there are any loans you are concerned about. If, as a manager, you have done any lending that has not been consistent with your strategy, that is going to become clear to your investors.

Q Is now a difficult time to be a lender against transitional assets?

A We have stuck to our guns on our value-add lending strategy and we believe that will benefit us. For example,



Jim Blakemore

Global head of credit investing
BentallGreenOak

loans against stabilised hotels look hugely value-destructive in market conditions like today. By contrast, we have a couple of hotel loans where the asset is in the process of being refurbished. The fact there is value-creation in the deal provides an extra cushion when market conditions deteriorate. That is not to say we aren't nervous about things. You need to be a little paranoid in a market like this and continually scrutinise your loan book. But operating a value-add strategy has, so far, proved helpful to us.

Q Will you change your underwriting?

A We are definitely thinking about post-covid-19 underwriting. We are looking at assets that could have a variety of uses if this health crisis persists. We are stress-testing the supply chain and ensuring necessary building materials are already in the country. We have covenants around the sponsor's business plan performance.

Q Where do you see high-yielding lending opportunities?

A There will be a need to recapitalise certain assets and it may be cheaper for sponsors to raise high-yielding debt capital than to recapitalise with equity. We also expect to see more activity from those entrepreneurial real estate investors, such as family offices, which tend to take higher leverage, especially when they feel property is cheap. Some of those buyers came back to the UK after the Brexit referendum.

The need for reinvention in the retail sector will become clearer, so we may become more active there. We are wary of operational assets, but we may do a hotel loan or two. I would much rather be a hotel lender six months from now than one who lent six months ago.

Q How will the current crisis affect fundraising?

A Investors have recognised that there will be dislocation as a result of the coronavirus crisis, and so debt



BentallGreenOak's global head of credit investing discusses high-yielding debt strategies in times of crisis

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might be a better place to be than equity. I do worry about the denominator effect. If the value of listed equities is down materially, does that mean investors' other allocations also shrink or do they decide to become overweight in certain sectors?

If a vaccine is found, we could return to a market resembling that of two or three years ago, because interest rates are low, and investors will be looking for yield again. But there will be credit losses in the private debt space, so that will determine the appeal of the asset class to some investors such as pension funds.

Q Is there potential for growth in the private real estate debt industry?

A We are already seeing some investors take the view that a supply/demand imbalance in the real estate debt space will create an opportunity for

lenders. Certainly, debt assets in the US are priced much wider than they were before this crisis. In the US, we noticed since mid-2019 that some pension funds with their own loan books were much more cautious because spreads were very low and credit conditions were getting a little looser. However, there are investors out there that have stayed out of the real estate debt market but are now interested because they see better pricing and more ability to dictate terms on credit.

Q Where do you see potential problems?

A In the past 18 months, there has been an increase in the number of debt funds taking leverage. We are not one of them because we are not comfortable with the idea of a bank lender being able to make margin calls on our loans. Some loan-on-loan lenders may need to act over time. However, there is much more leverage in the US debt fund market than in Europe.

Debt funds are slow and steady businesses which require you to do a good job across a cycle. They work best as part of an integrated real estate investment business. Those managers that only have a debt fund may have taken on more risk as they pursued growth. Some of the smaller managers may have made some mistakes in their lending, and that will make it difficult for them to raise future capital.

Q You were at Lehman Brothers in 2007-08. How do you rate real estate's chances in this latest crisis?

A There is less gearing overall, so that is a big plus-point. Banks are better capitalised this time round. Europe also has fewer commercial mortgage-backed securities transactions than in 2007 – fixing a broken CMBS is very challenging. The fact there are businesses like ours that hold loans to maturity is important because we are not subject to mark-to-market pricing. That is a much better model for illiquid assets. ■