EXPERT Q&A

Understanding the key real estate trends emerging from the pandemic leads to credit opportunities that investors can benefit from, argues BentallGreenOak's Jim Blakemore

Betting on the right trends

BentallGreenOak's global presence and singular focus on real estate strategies – including debt – has been crucial for evaluating business plans and execution risk amid the pandemic, says Jim Blakemore, the firm's global head of debt. That, he explains, has given the property asset manager a reputation for delivering through covid, which, in turn, has helped it originate more loans.

"Last year, in the really dark days of covid, when there wasn't much clarity, being able to draw upon the company's experienced equity investors and putting that into our lending mix was really helpful," Blakemore notes. After developing a "strong consensus" on the opportunities in the market, he feels the firm was in front of a lot of the trends coming out of the crisis.

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Additionally, Blakemore sees this real estate expertise as a clear advantage as BGO continues to grow its debt investment business both in Europe and the US.

Q What are the benefits of positioning capital into real estate debt and why is now the time to do so?

Real estate debt offers current income, which is increasingly important to many investors. It has also been able to generate increasingly attractive returns versus other fixed-income alternatives, whether that's listed bonds or some types of private credit.

Today, we also see more opportunity in real estate credit than we have seen historically. It varies by market, but, particularly in Europe, there is less involvement by the banking sector in parts of real estate credit than there had been prior to the covid-19 pandemic. And that has been helpful to deploying capital efficiently in transactions we like, both from a credit point of view as well as those producing attractive economics for BGO's fund investors.

The other interesting thing for real estate credit today is the impact of the global pandemic on property versus what the asset class experienced during the global financial crisis. In the previous downturn, the real estate assets themselves – the buildings and how people use them – were fundamentally unchanged. So, a lot of buildings operated the same way from the beginning to the end of the crisis. They had the same demand from tenants and the same attraction to investors. Obviously, there were differences in price and leverage, but the fundamentals of a building really didn't change.

By contrast, this global pandemic has led the property markets to re-evaluate how tenants utilise certain real estate assets. This will result in the transformation of some of these assets to current uses that are relevant for today's tenants and for today's equity property investors. A lot of retail, for instance, isn't fit for purpose today, and needs to be converted to something that is relevant for the needs and demands of the market. This is a good example of how this crisis accelerated opportunities that are different than what came out of the GFC.

Q Which real estate opportunities have you seen from the crisis?

We have seen equity investors keen to take advantage of what they view as discounts in pricing. Also, investors that are interested in developing or purchasing logistics properties, which are very much in favour today and are the forefront of what a post-covid economy looks like.

Similarly, we've seen equity investors keen to be involved in data centres, and investors who believe there's an opportunity to provide offices that meet or far exceed the latest environmental standards. By doing so, they believe that those buildings will be attractive to tenants as they increasingly focus on ESG considerations when making their occupancy decisions. We've therefore been involved in financing these property types.

In the US, asset classes that were once considered 'niche' – such as cold storage, production-oriented space and life science property – have all become attractive to institutional investors as their demand drivers have held up during covid.

Some sectors will undergo other changes – for example, student housing. Now that people globally, albeit not by choice, have become very familiar with distance learning, what role does it play and how does that change the dynamic and the value proposition for university education? That varies a lot by region.

So, we're seeing a lot of change at the property level and, as non-bank lenders with a broad property type and geographic reach, we think we're well placed to invest with real estate owners and operators that are participating in these trends and executing on these business plans. By doing so, we're generating attractive risk-adjusted returns for BGO's LPs.

Q Given all of the volatility with covid-19, are the risks around debt too high?

We've been really happy with what we have been able to lend on. As a firm, we have about $16 billion AUM globally in credit and manage three underlying strategies. One of them is a senior, investment-grade lending strategy, in which we were able to lend throughout the pandemic. Another is a transitional lending strategy, and we have been able to lend at lower debt per square foot or debt per square metre during the pandemic than we had before, as well as lend to a broader range of borrowers and to larger transactions than we had pre-covid.

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And then the area that is increasingly relevant – but we were probably more cautious about during the depths of the global pandemic – was the higher-yielding, tactical strategy. We felt the risk-reward equation wasn't opportune and that there was too much uncertainty to deploy significant amounts of capital in a strategy that employs a bit more property risk.

Our pace of investing in that space has started to increase now, though. Some of the risks that we saw in the depths of covid have begun to fall away, especially with increased vaccination, and with the understanding of how all this is playing out. So, we've definitely been seeing increasing dealflow in what I wouldn't call distress – maybe some pockets of distress – but in transactions where there is the opportunity to get these almost equity-like returns while remaining in the credit space.

We anticipate this trend to also emerge in the US, as the dislocation to primary markets like San Francisco and New York requires debt solutions to recapitalise projects and provide runway as these markets begin to recover. We believe BGO is particularly well positioned to access these opportunities given its on-the-ground presence in these markets.

Q In a post-covid landscape, what shifts are you seeing in lending terms?

We didn't see a significant shift in margins during covid, but we've been able to reduce our debt basis on many assets, lending at a lower debt per square metre or per square foot than we had been pre-covid. Likewise, we've been able to do larger loans with well-capitalised sponsors.

And in BGO's higher-yielding tactical strategy, we are now seeing opportunities to take equity participation in some of the loans we're making. So, the loan still produces a strong return just on its debt characteristics, but we are able to get some element of equity upside to generate additional alpha. That wasn't the case a year ago during covid, but today, there are pockets of distress where borrowers need capital, and we're able to have more leverage on negotiating these opportunities.

Q Are you concerned about distress in the market? And how does that influence your strategy and outlook?

We haven't seen a whole lot of distress, but hospitality is one sector where we've seen more financial distress. However, in our minds the fundamentals of hotels didn't change a lot. In fact, perhaps some of the ways hotels have been operating during covid will result in savings for the hotel operator, where some of the efficiencies they have created will make hotel investment more attractive in the future.

The other place we see distress is in the retail sector. In certain markets – the UK is a good example – a lot of retail centres really weren't fit for purpose, but you had tenants in place that were paying rent on what had been long leases. The big question was, what would happen when those leases expire? We've seen that, in many cases, those assets need to be repurposed because they're no longer fit to attract tenants.

During covid, for example, we've closed two transactions where borrowers are converting retail assets to mixed-use assets, with some element remaining retail and the remainder changing to residential or offices. We continue to see this trend across markets, including in the US, and it's one we will continue to participate in if the credit and return metrics make sense. ■

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Q What do you think about ESG from a lending perspective?

We're pleased that it's becoming increasingly a topic that people are talking about. We focus primarily on lending on value-add projects where a borrower acquires a property, improves it and looks to sell it. If we look back at our lending in general, most of the lending we've done has had some element of ESG as borrowers seek to bring properties up to the most current environmental standards or beyond.

We also believe that ESG integration is good business from a lender's point of view. One, it's the right thing to do. Two, being a prudent lender today requires you pay great attention to the sustainability of a building and how it sits in the context of the market – just as we look at the location of a building and the building's physical attributes and its tenancy. ESG factors, in our minds, should be basic considerations taken into every lending decision.

At BGO, we believe that measurement and accountability are two of the keys to any meaningful success on the ESG journey. Going forward, in partnership with our clients and borrowers, BGO's investment strategies will be much more explicit about how they are addressing ESG and offering metrics to investors to illustrate the impact that their investment is having.