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Looking past the chaos: the time for European real estate debt



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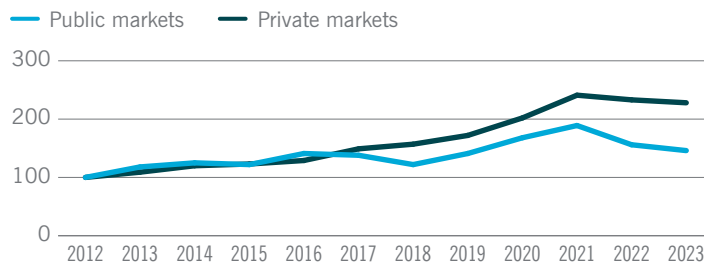
The global commercial real estate (CRE) market has undergone a profound transformation since mid-2022, driven by rising interest rates, macroeconomic uncertainty and evolving structural dynamics in occupational and ownership patterns. These shifts have led to a significant repricing of real estate assets, with capital values correcting by approximately 20–25% across Europe and other developed markets. The debt secured on CRE has since emerged as an attractive proposition for institutional investors seeking stable, risk-adjusted returns, portfolio diversification and risk mitigation.

THE PRIVATE MARKET BACKDROP

Real estate lending sits within the private debt subset of the wider private market, which describes a broad range of investment strategies across debt and equity that are typically not listed or traded in the much larger public markets. In absolute size, public markets are significantly larger than private markets. However, private markets have grown at around 7.8% annually since 2012, exceeding the growth of public markets at 3.5% over the same period. Investors searching for higher yields reflecting the reduced liquidity of the private markets as well as improving portfolio diversification during the low-interest rate environment of the decade leading up to the 2022 rate hikes have been the key driver for private market growth.

Figure 1: Growth in private vs. public markets

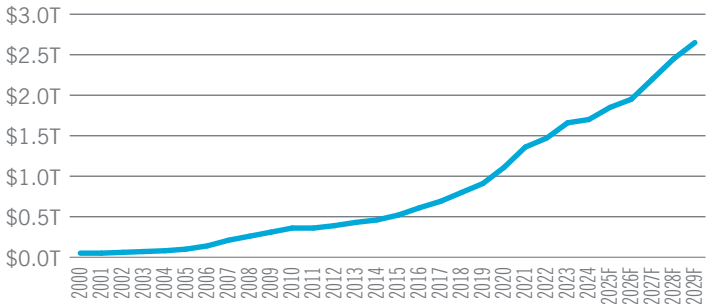
Private markets AUM vs. public equity market capitalization growth, 2012 = 100



Source: EY, April 2024

The high inflation and interest rate environment since mid-2022 have negatively impacted strategies across public and private markets. Despite this, investors continue to be attracted to private debt markets instruments including CRE debt, with most investor types choosing to allocate more to CRE debt relative to 2019, and public and private pension funds showing the largest increase in allocations.

Figure 3: Global private debt AUM (% trillion)

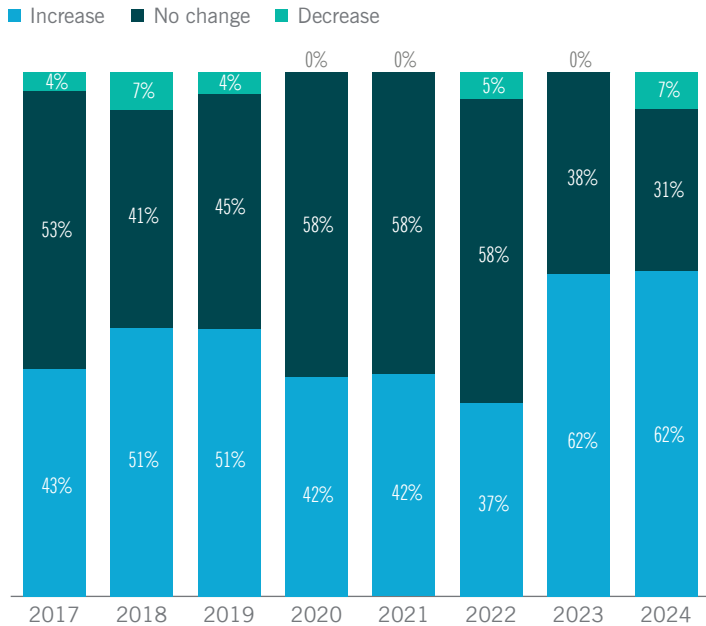


Source: Preqin (Actuals), Preqin – Future of Alternatives 2029 (Forecasts)

the macroeconomic outlook and seeking resilience against future economic/market shocks.

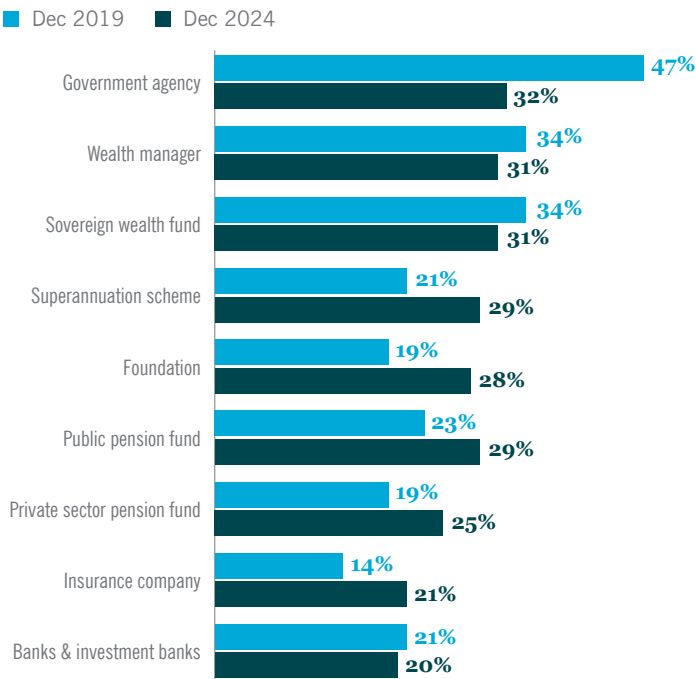
Risk mitigation remains a particularly attractive feature of real estate debt as all secured loans will be underwritten with a physical asset as collateral. Investors can either force the sale of the underlying asset to recover their principal or take control of the asset and hold it until market conditions improve. Against the backdrop of global market volatility over the last two years, investor intentions to allocate to real estate debt have increased.

Figure 4: Investors intend to increase allocation to real estate debt



Source: ANREV/INREV/PREA Investment Intentions 2024

Figure 2: Average allocation to private markets by investor type



Source: Preqin Insights+, September 2025

Within private markets, private debt accounts for around 12% of global asset under management (AUM) and has been one of the fastest growing segments at approximately 12% annually since 2012. This growth is forecast to continue, with global private debt AUM reaching \$2.64 trillion by 2029.

Beyond the search for higher yields over the last decade, investors are also attracted to private debt for the risk mitigation it provides relative to equity strategies. In the event of loan defaults, lenders are typically lower down the risk curve with the equity holder being the first to lose its investment. This is appealing for investors concerned about

EVOLUTION OF EUROPEAN REAL ESTATE DEBT

The European CRE lending landscape has evolved markedly since the global financial crisis (GFC). Regulatory reforms — Basel III/IV¹ and Solvency II,² as well as slotting³ in the U.K. have increased capital requirements for banks and insurers, curtailing their appetite for higher-leverage and non-core CRE lending. As a result, alternative lenders, have stepped in to fill the gap, particularly in the U.K. and, increasingly, across continental Europe.

Banks still account for 84% of CRE lending in Europe, but their market share is declining. Nuveen Real Estate analysis estimates that alternative lenders now provide around 40% of U.K. CRE lending, 10% in France and Spain and 5% in Germany, with further growth expected as the Basel III Endgame⁴ is implemented. This transition is creating a more diverse, competitive and resilient lending market, with a wider array of funding solutions across the capital stack.

WHY REAL ESTATE DEBT?

Consequently, investors interested in deploying capital into private markets or increasing their current allocation have a wide variety of asset types and strategies to choose from, all with varying degrees of return/risk profile, diversification benefits and covenant strengths. So why would investors consider real estate debt over competing strategies?

Real estate debt versus private corporate credit

The story and evolution of real estate debt in some ways mirrors that of private credit; rapid growth post-GFC from niche strategy to mainstream — private corporate credit was an almost \$2 trillion market by 2024 — thanks to investors searching for yield and banks retreating from middle-market lending. This rapid growth occurred during the low-interest rate era when defaults were scarce.

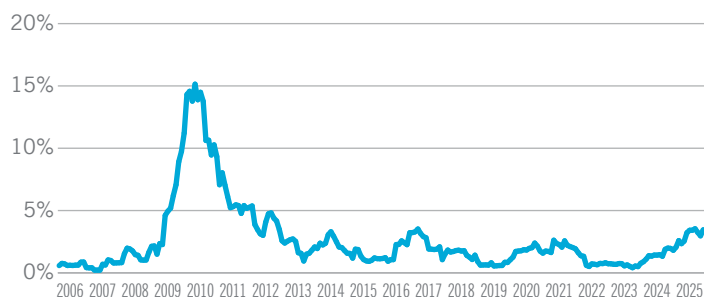
Private credit opportunities require the right manager

At market level, corporate private credit is showing signs of higher risk than has been previously seen. In this environment, it becomes increasingly important to identify managers which have a track record of effective investment. Consider managers who successfully navigate middle market lending in the Europe and the U.S. with established track records of identifying borrowers which are largely insulated from macro volatility and creating lending opportunities that perform well despite overall market uncertainty.

That benign backdrop has now changed as interest rates spiked and macroeconomic conditions deteriorated. Signs of distress are emerging in private corporate credit; Fitch reports U.S. private corporate credit default rates have climbed from almost 0% in 2022 to 5.7% at the start of 2025, and ICE Data Indices report a rise in European speculative-grade corporate bond default rates to an average of 3.3% between January and August 2025.

These increases in corporate default rates are approaching levels typically associated with periods of recession and any further market shocks or extended periods of weakness are likely to impact corporate credit performance relatively more than the already rebased real estate market.

Figure 5: European speculative grade default rate

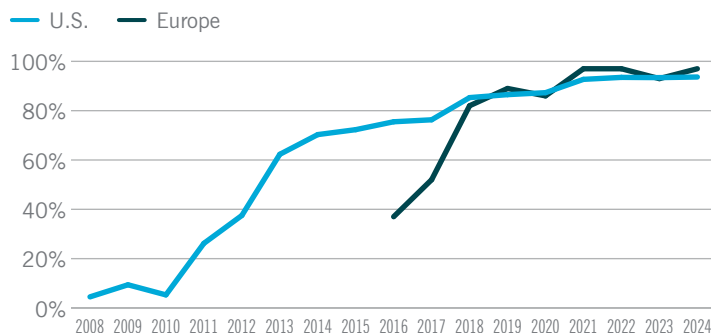


Source: ICE Data Indices, September 2025

The rise in corporate default rates will likely be further compounded by the significant growth of covenant-lite (cov-lite) loans over the past decade, which provide fewer restrictions on the borrower and reduced protections for the lender. Cov-lite loans typically omit the periodic loan tests such as leverage and/or interest coverage ratios that give lenders early signs of potential risks and the opportunity to work through these proactively with borrowers.

This rapid rise in cov-lite issuance was driven by fierce competition among lenders to deploy the large volumes of capital raised during the low-interest rate era. The new higher interest rate environment since mid-2022 could potentially leave some portfolios vulnerable.

Figure 6: Cov-lite issuance as a percentage of total leveraged loans



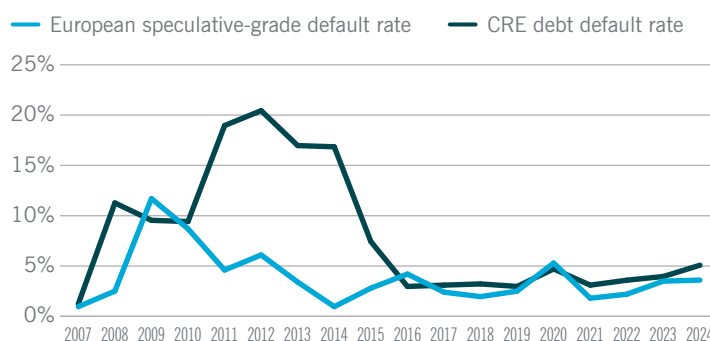
Source: Pitchbook, AFME, July 2025

CRE debt, by comparison, experienced downturns during and immediately after the GFC, where the reduced liquidity in the market resulted in lenders acting on the principle of “extend and pretend” as the prospects for selling on enforced assets were low. This pushed the bulk of loan defaults and arrears into the period between 2011–2014, when the possibility of realising delinquent or defaulted loans returned as liquidity recovered.

At the same time, regulatory pressures reduced banks’ appetite for lending into the CRE debt market, with non-bank lenders filling the gap left behind. Consequently, the number and diversity of real estate lenders have improved significantly since the GFC. This has been particularly the case in the

U.K. where large scale bail outs of some domestic banks led to the regulator imposing tight conditions on property lending in the form of the U.K. slotting regime for allocation of regulatory capital to the sector. The recently implemented Basel III Endgame in Europe has the potential to have the same impact on continental European banks, requiring the allocation by banks of significantly more regulator capital against CRE loans and those secured against higher leverage positions.

Figure 7: Corporate and CRE debt default rates



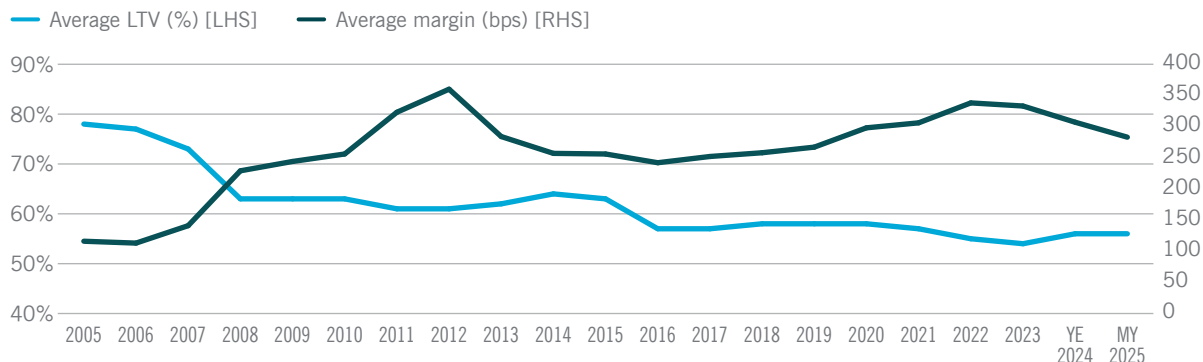
Source: S&P Global Ratings Credit Research & Insights, September 2025 & Bayes CRE Lending Report, October 2025

Tighter regulation has led to lending terms across real estate debt providing extra protections for investors. Average senior loan, loan-to-value (LTV) rates tightened from close to 80% pre-GFC to around 55% at the end of 2024, providing lenders with a significant equity cushion.

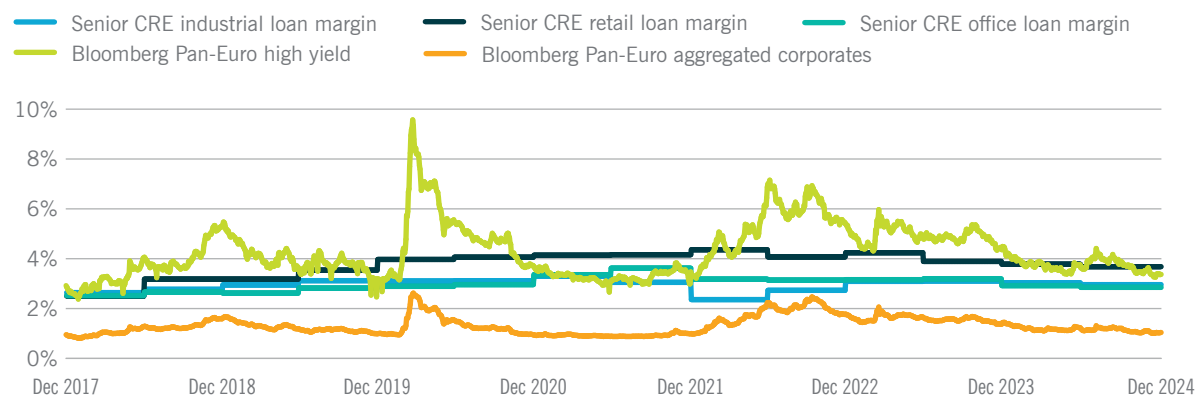
Over the same period, investors have been rewarded with increased margins relative to the period up to and including the GFC. Interest coverage ratios (ICR) have also dramatically improved during this period, although the higher interest rate environment since mid-2022 applied downward pressure on this. Average ICRs look to have stabilised during 2024, helped by interest rate cuts, and that trend is likely to continue as the path to further interest rate easing become clearer.

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The number and diversity of real estate lenders have improved significantly since the GFC.

Figure 8: Average LTV rates vs. margins

Source: Bayes CRE Lending Report, October 2025

Figure 9: Changes in average credit spreads*Average credit spreads and margins (%)*

Source: Bloomberg, Bayes CRE Lending Report, October 2025

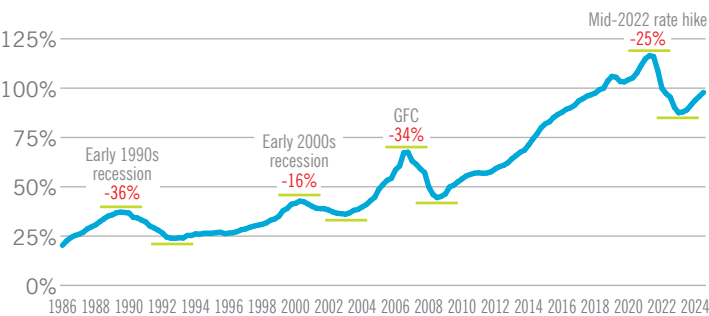
While the rise in risk-free rates since 2022 have led to lending returns increasing across most debt markets, credit spreads in real estate debt have remained elevated, while spreads in the liquid corporate credit market have tightened. As a result, senior real estate lending now offers yields comparable to, or even exceeding, high-yield corporate bonds, but with superior collateral in the form of “bricks and mortar” and therefore recovery prospects.

Since mid-2022, commercial real estate capital values have rebased lower, reflecting both cyclical and structural pressures. Prime assets across Europe have corrected by around 20–25%, with notable divergence by sector and geography. The office sector has faced headwinds from the shift to hybrid working and changing occupier demand,

but this is not the largest peak-to-trough movement in history. Importantly, most of the repricing appears now to have occurred, and early signs of stabilization — and even recovery — are emerging in some segments. With average LTVs at around 55%, most assets will still have plenty of equity remaining and the positive average ICR rates mean borrowers are incentivised to maintain loan commitments and hold on to their assets.

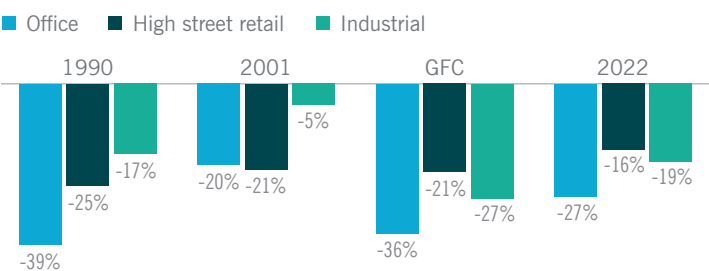
Furthermore, the asset-backed nature of real estate debt means average recovery rates remain significantly higher than the private debt market, including periods of significant shock such as the GFC, where average LTVs were higher and peak-to-trough capital values declined by 35% in the office sector.

Figure 10a: Peak to trough capital value declines



Source: CBRE Prime Capital Value Index, September 2025

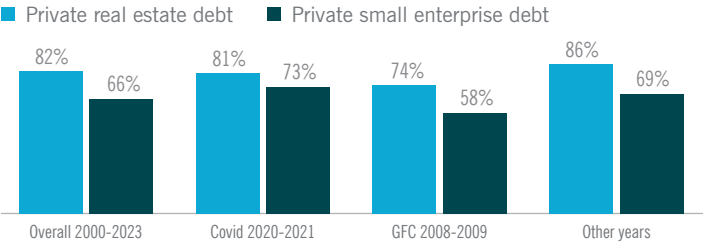
Figure 10b: Historic peak to trough change in European prime capital value



Source: CBRE Prime Capital Value Index, September 2025

For lenders, this rebasing creates an attractive entry point today. New loans are now structured on current, lower valuations, providing a substantial equity cushion. Any subsequent recovery in capital

Figure 11: Global recovery rates



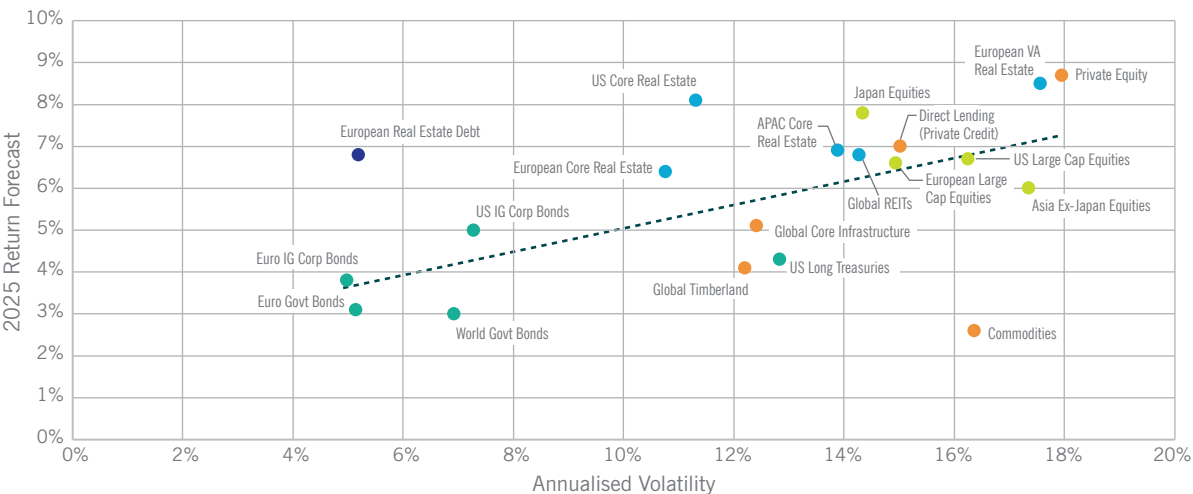
Source: GCD Bank data, July 2025

values should further enhance the security of these loans. New senior secured loans written today could withstand market-wide capital value declines in excess of 50% – greater than any downturn since 1989 – before eroding their equity buffer. This will be particularly appealing for investors concerned about the macroeconomic outlook and seeking resilience against future shocks.

LOWER VOLATILITY, SIMILAR RETURNS

Data from MSCI Europe Quarterly Private Real Estate Debt Fund Index demonstrates the lower volatility nature of CRE debt compared to other segments of the real estate market, and wider public and private markets, while delivering similar returns to asset classes higher up on the risk scale.

Figure 12: Global asset return estimates and volatility



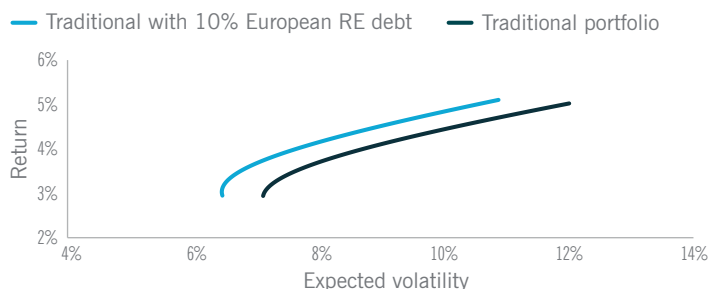
Source: Nuveen Research, JPMorgan Long Term Capital Market Assumptions and MSCI Europe Quarterly Private Real Estate Debt Fund Index. Note that the MSCI European RE Debt Index used is for data between 2020-2024. Return forecasts for 2025 is the average of 2023-2024. Any target data or other forecasts contained herein are based upon subjective estimates and assumptions; if any of the assumptions used do not prove to be true, results may vary substantially. **Past performance is no guarantee of future returns. It is not possible to invest in an index.**

This insulation from shocks is driven by a number of factors, including:

- The position CRE debt investors have within the capital stack, which provides a cushion to investors in the event of defaults.
- CRE debt loans provide steady income, backed by obligations built into deal structures. This consistent income offers stability to investor portfolios.
- The physical nature of real estate assets can offer risk mitigation to debt investors. Meanwhile, the shorter duration of these loans, compared to other fixed income assets, can help to mitigate the impact from inflation and interest rate changes.

This low volatility helps to maintain CRE debt's lower correlation to public fixed income, offering effective diversification for investors. Figure 13 demonstrates the positive impact CRE debt investment can have on the volatility of a diversified investment portfolio. Allocating 10% of a portfolio to real estate debt can potentially bring the overall risk profile of a diversified portfolio down, according to our analysis.

Figure 13: Adding CRE debt to traditional efficient frontier



Source: Nuveen Research, Bloomberg Euro Treasury index represents Bonds, MSCI Europe Index represents Equities. RE Debt is represented by the MSCI Europe Quarterly Private Real Estate Debt Fund Index.

REAL ESTATE DEBT RETURNING TO FAVOUR

As markets and investors continue to juggle uncertainty and volatility, the diversification offered by private markets continues to grow in significance. Amid this growth, CRE debt has emerged from a challenging period, offering compelling conditions for investment.

The correction seen in valuations has created attractive entry points for investors new to CRE debt, and those returning to the asset class. Meanwhile, CRE debt continues to offer portfolios important risk mitigation characteristics, aligned with its strong position at the bottom of the capital stack.

The conditions CRE debt are now operating under are creating new opportunities for investors, which seek to further diversify away from public markets uncertainty, while also working to diversify their allocations to private markets.

For more information, please visit nuveen.com.

Endnotes

Sources

- 1 Basel III/IV and Basel Endgame refers to the final set of international banking regulations developed by the Basel Committee on Banking Supervision, completed in 2017. These rules represent the culmination of post-2008 financial crisis reforms and establish stricter capital requirements, leverage ratios, and risk management standards for banks. The framework aims to strengthen bank resilience by requiring higher quality capital buffers and more standardized approaches to measuring credit, operational, and market risks.
- 2 Solvency II is the European Union's regulatory framework for insurance companies that sets capital adequacy and risk management standards. It requires insurers to hold sufficient capital reserves to cover their risks and liabilities, with the goal of protecting policyholders and ensuring the stability of the insurance sector. The framework uses a risk-based approach to calculate capital requirements and emphasizes governance, transparency, and supervisory oversight.
- 3 Slotting is a credit risk assessment approach used by banks under Basel regulations for specialised lending exposures where traditional probability of default models are difficult to apply. Each slot corresponds to specific risk weights for calculating regulatory capital requirements, providing a standardised method for measuring credit risk when detailed borrower financial data may be limited or unavailable.

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