

# Is now the right time to invest in commercial real estate (CRE) debt in the U.K.?

November 2020



**Christian Janssen**

*Head of Debt, Europe*

*Based in London, Christian oversees the origination, portfolio management and business development activities for Nuveen Real Estate's debt platform in Europe. Here, Christian gives his view on why now is the right time for investors to engage in CRE debt in the United Kingdom.*

---

## WHAT IS CRE DEBT?

CRE debt is typically structured as a loan secured on commercial real estate. It offers income-focused returns through periodic interest (and principal) payments, culminating with the repayment of the remaining principal at maturity.

---

## WHY COULD INVESTING IN CRE DEBT BE A GOOD INVESTMENT STRATEGY?

Well-managed CRE debt provides performance protection through diversified, stable income streams. CRE debt benefits from a substantial degree of downside protection provided by the 'buffer' of the sponsor's equity. While there is typically no additional upside to debt returns in a rising property market, the sponsor's equity will absorb the first loss in a falling market. In addition, contractually agreed periodic interest payments insulate the lender from the volatility of a changing rental income profile. As real estate market cycles become shorter and more difficult to predict, this insulation and higher degree of certainty is increasingly regarded as highly attractive by investors.

U.K. CRE loans usually include substantial performance covenants, put in place to protect the lender in the event of capital value or income declines. These typically include ‘cash trap clauses’, where any surplus income not required for debt service or property management can be retained by the lender and used to reduce the loan, and default clauses, which allow the lender to enforce its security and sell the property if the default loan to value (LTV) ratio or interest coverage ratio (ICR) is breached. These covenants are typically triggered at thresholds long before the deterioration of income or capital value would expose the lender to a risk of loss.

### WHY IS NOW A GOOD TIME TO INVEST IN CRE DEBT?

Real estate markets are currently experiencing significant volatility and heightened uncertainty. Investors’ focus on income, given the low interest rate environment, is now paramount.

As such, the relatively high current income return combined with potential downside protection aspect of CRE debt is becoming increasingly sought after, alongside stability, diversification and contracted income. CRE

debt presents very competitive relative value, compared to fixed income investments and direct real estate.

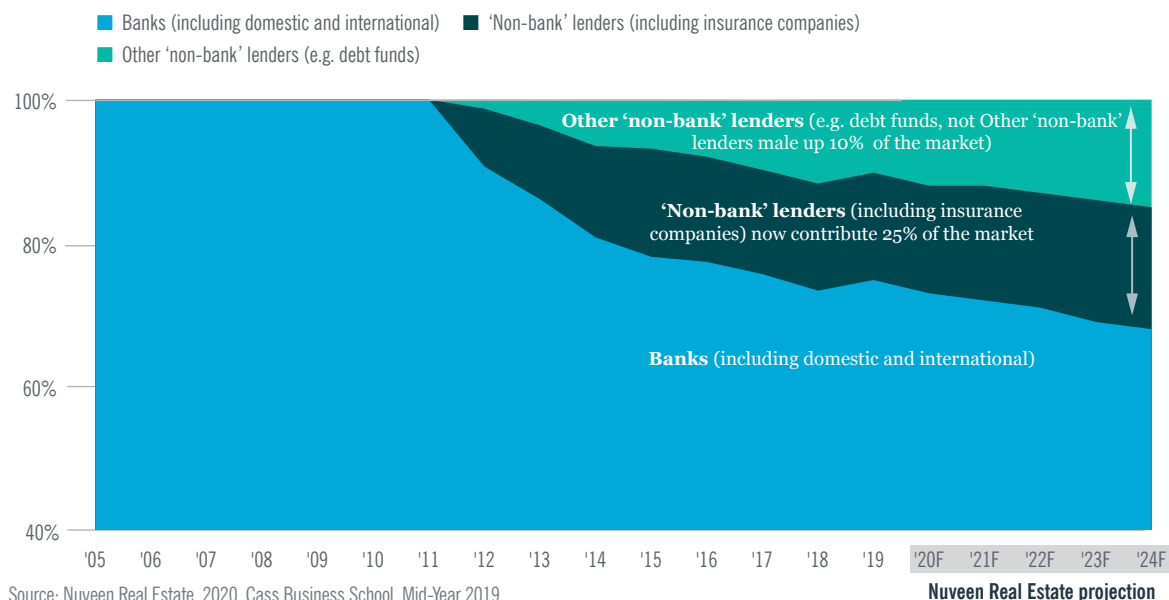
### WHO ARE THE MAIN PLAYERS IN THE CRE DEBT SPACE?

Although CRE debt has always been a fundamental part of the U.K. real estate market, the dominance of banks, until the global financial crisis (GFC), heavily restricted investment opportunities in CRE Debt for traditional investors. Since the GFC and, more recently, the COVID-19 pandemic, stricter regulatory, capital and liquidity requirements have increased the burden on banks’ balance sheets, which has led to a tightening of underwriting standards, significant reductions in the leverage of loans and substantial increases in loan pricing.

The resulting retrenchment of traditional lenders, as well as the reduction and repricing of available debt capital, has created a permanent, attractive and executable investment opportunity for non-bank lenders and debt funds to provide a meaningful share of future CRE debt finance requirements in the U.K.

## The rise of non-bank CRE lending in the U.K.

U.K. outstanding debt (lender composition)



---

## HOW HAS BREXIT AND COVID-19 IMPACTED THE SECTOR?

With the U.K. approaching its exit of the European Union and the COVID-19 pandemic economic shock, real estate market performance has a challenging and uncertain short-term future. Given the political and economic complexities of any European negotiation and the uncertain path of the post COVID-19 recovery, market forecasts vary significantly and largely still imply a degree of pricing correction as markets are expected to gradually ‘normalise’. Tellingly, most anticipated valuation declines would remain well within the buffer offered by the borrower’s equity in a sensibly structured loan.

Brexit and the pandemic have reinforced the bank retrenchment away from commercial real estate, with a slower, more selective approach to origination of new lending transactions. This has opened up further opportunities for non-bank lenders to achieve higher returns on the same quality of asset, with speed of execution increasingly held at a premium. Direct investor activity had been buoyed by the prolonged low-yield capital market environment, but with parts of the U.K. real estate market firmly late cycle and well-documented geo-political uncertainties, in our opinion, CRE debt’s future returns look very compelling. A CRE debt strategy offering potential downside protection and income-focused returns is well positioned to offer investors competitive relative value.



*The investment attributes of CRE debt are becoming increasingly sought after, offering stability, diversification and contracted income.*

---

## WHAT ARE THE CURRENT OPPORTUNITIES IN THE SECTOR?

In the context of retrenching traditional lenders and the persistent narrow focus on prime assets, increased opportunities for well-capitalised, specialist, alternative finance providers exist. Investment opportunities can be found in those assets currently ‘off the radar’, particularly core-plus assets in established markets. With robust underwriting, ideally informed by direct real estate expertise, these underserved markets present the most appealing prospect for a selective ‘cherry-picking’ of transactions, backed by strong fundamentals and robust return characteristics.

**For more information, visit us at [nuveen.com/realestate](https://nuveen.com/realestate)**

Important Information:

This material is provided for informational or educational purposes only and does not constitute a solicitation of any securities in any jurisdiction in which such solicitation is unlawful or to any person to whom it is unlawful. Moreover, it neither constitutes an offer to enter into an investment agreement with the recipient of this document nor an invitation to respond to it by making an offer to enter into an investment agreement.

This material may contain “forward-looking” information that is not purely historical in nature. Such information may include projections, forecasts, estimates of yields or returns, and proposed or expected portfolio composition. Moreover, certain historical performance information of other investment vehicles or composite accounts managed by Nuveen may be included in this material and such performance information is presented by way of example only. No representation is made that the performance presented will be achieved, or that every assumption made in achieving, calculating or presenting either the forward-looking information or the historical performance information herein has been considered or stated in preparing this material. Any changes to assumptions that may have been made in preparing this material could have a material impact on the investment returns that are presented herein by way of example. This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by Nuveen to be reliable, and not necessarily all-inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will come to pass. Company name is only for explanatory purposes and does not constitute as investment advice and is subject to change. Any investments named within this material may not necessarily be held in any funds/accounts managed by Nuveen. Reliance upon information in this material is at the sole discretion of the reader. Views of the author may not necessarily reflect the views of Nuveen as a whole or any part thereof.

Past performance is not a guide to future performance. Investment involves risk, including loss of principal. The value of investments and the income from them can fall as well as rise and is not guaranteed. Changes in the rates of exchange between currencies may cause the value of investments to fluctuate.

This information does not constitute investment research as defined under MiFID.

**nuveen**  
REAL ESTATE