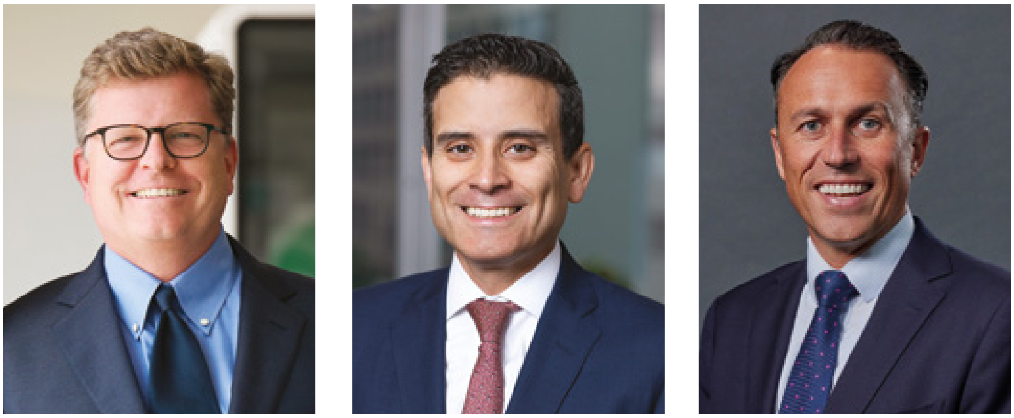
EXPERT Q&A

Three regional heads of real estate debt at Nuveen – Christian Janssen, Jason Hernandez and Dugald Marr – give their perspectives on why this is such an exciting time for the asset class



A global perspective on growth opportunities

Market consensus says this is an exciting and propitious time for real estate debt. With commercial real estate (CRE) values repricing, new opportunities have emerged across many regions, with these assets potentially set to benefit from mega-trends such as deglobalisation, artificial intelligence and a return to office-based employment. However, nuance is necessary when evaluating these themes, with opportunities that are distinct to different regions.

Private Debt Investor spoke with Christian Janssen, Jason Hernandez and Dugald Marr – Nuveen's heads of real estate debt for Europe, the Americas, and Australia and New Zealand respectively – to gauge where they expect the best opportunities to emerge and what they are most excited about within their respective regions.

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Q Following the repricing of CRE values since mid-2022, what opportunities are you seeing, and where?

Christian Janssen: With real estate debt, the best time to invest is after the rebasing of values. The market has bottomed out in Europe. We've seen increased transaction volumes, improved liquidity and capital rates are tightening. Meanwhile, the general occupational market has been strong, even in some asset classes that had fallen out of investors' favour in recent years.

CRE and CRE debt might be underweight areas for some LPs that were spooked by past experiences with the market. However, CRE debt can be an astute way of re-entering the asset class with instruments that provide greater risk mitigation and stability, while achieving equity-like returns.

Jason Hernandez: We believe this is the best time in the past decade to invest in real estate debt. Values have reset in the US, with lending at lower leverage levels and higher spreads on offer, offering a three-pronged opportunity.

The ability to earn value-add returns for core-plus risk is particularly attractive to investors right now. The investments we're making today would have generated returns of 6.5-8.5 percent three years ago – our research shows that those deals are now generating anywhere from 10-13 percent for similar risk profiles.

Dugald Marr: From my seat in Asia-Pacific, I'm seeing a lot of depth and liquidity around real estate debt. Australia has the highest proportion of non-bank and private debt lending in APAC and maps this global trend with double-digit annual growth. CBRE forecasts suggest the size of Australia's real estate private debt landscape is set to increase from $50 billion to $90 billion by 2029 as banks focus on core lending and non-banks take advantage of a funding gap in a growing market with quality borrowers.

Q How is deglobalisation changing your investment selection process and how does it affect the risk and opportunity profile for your asset class?

JH: Global markets are currently exposed to heightened risk. Regarding deglobalisation specifically, there's more political volatility coming out of the US under the current administration. Tariffs clearly impact imports and if you look at our value-add strategic debt strategy, we have been selective with regard to logistics and have very little exposure to port markets. We prefer to access that sector across diversified portfolios and avoid individual asset risk.

> *"The senior housing segment is closely aligned to ageing demographics in Europe"*
>
> **CHRISTIAN JANSSEN**

CJ: We look at certain dynamics we think are going to be prevalent through the whole economic cycle, rather than focusing solely on the short term. One asset class that we haven't historically focused on in Europe, but that we are actively evaluating, is senior housing. We haven't previously done so because, at least in Europe, we've decided to invest where we have significant expertise on the equity side as well as the debt side. The senior housing segment is closely aligned to ageing demographics in Europe and this is a mega-trend we are watching with interest.

DM: I would just add that, from an APAC perspective, there's certainly an argument for increased selectivity around real estate sectors in a period of deglobalisation, such as infill industrial versus big-box, neighbourhood retail versus discretionary retail and the need for more residential product.

Q With corporate private credit default rates climbing to 5.7 percent in the US and concerns growing about covenant-lite loan structures, how does the risk-return profile of CRE debt compare with corporate credit today?

JH: LPs consistently compare CRE debt with direct lending and broadly syndicated loan funds, and we emphasise several key differentiators. First, we're lending against essential property types such as housing, logistics and grocery-anchored retail in growth markets – fundamental demand drivers that transcend economic cycles. This contrasts with corporate credit exposure to business model risk.

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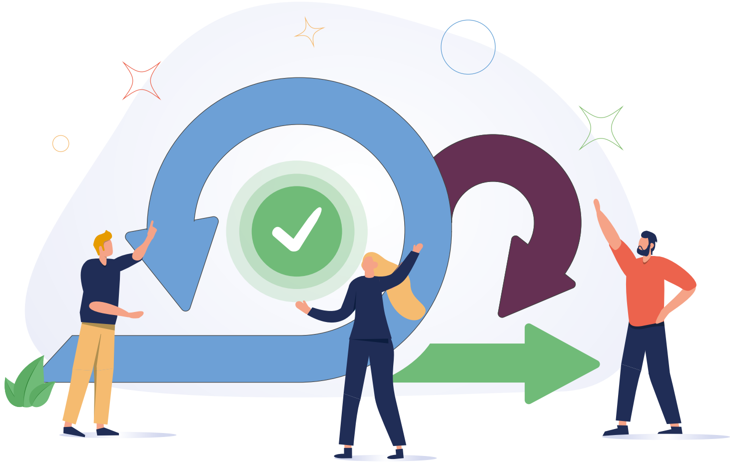
>
> **JASON HERNANDEZ**

Second, market conditions have created exceptional relative value in CRE debt versus corporate credit, as illustrated in research by Nuveen which looks at the MSCI Europe Quarterly Private Real Estate Debt Fund Index and JP Morgan Long Term Capital Market Assumptions. The research showed that real estate debt outperformed corporate credit over the past year, driven by higher initial yields and only modest spread compression when compared with corporates. We're also lending at reset valuations in the wake of a market correction, which provides additional risk-mitigating qualities.

CJ: Regulation has had an impact on these practices in Europe. Regulators changed many of the financial and capital adequacy rules in a bid to avoid a highly levered banking sector. Banks reacted to these changes in turn. The US has had an active back leverage market for decades, and in Europe it's only starting to become more common. Liquidity has increased dramatically as there are more players active in this market and pricing is steadily declining.

DM: Leverage in the APAC real estate debt markets remains modest compared with historic standards. The sector still benefits from strict financial covenants that should maintain equity buffers, as well as a highly regulated financial system. Private debt takes on more risk



Q Which themes remain attractive – or have become less so – in the current environment of policy change, AI innovation, and 'mini cycles'?

CJ: We are starting to finance asset classes that have, until recently, been seen as unfinanceable. We see offices as a slightly contrarian play but research indicates that over the next couple of years there will be minimal new supply in key cities like London and Dublin. If you back the right type of assets, then you can benefit from returning demand. For example, we closed a €107 million senior loan in November for a 69 percent loan-to-value (LTV), fully let, income-producing office in Dublin.

JH: In the US, we're seeing tremendous opportunity in the housing space despite lingering issues within the sector. Specifically, we're finding exceptional value in lease-up opportunities within high-delivery sectors, where properties are working through elevated supply and extended lease-up periods. These transitional assets are backed by quality sponsors in growth markets, offering attractive risk-adjusted spreads while benefiting from stabilising fundamentals.

DM: Valuations in the living sector across APAC will be supported by rental growth, in large part due to a lack of supply relative to demand. Retail is also well placed to benefit from these tailwinds due to low occupancy costs, sub-5 percent vacancy, resilient retail sales and modest online growth – all of which point to positive re-leasing spreads.

CJ: There's also the impact of AI to consider. This technology is driving demand for data centres but these assets face a categorisation crisis – are they real estate investments, or are they considered infrastructure? And, quite frankly, is this a bubble?

In the early 2000s, there was a rush to lay down fibre broadband networks, leading to an oversupply that was underutilised for a long time. At least fibre can still be used 10 years later, but a lot of these AI chips and infrastructure could be obsolete down the road, given the rapid pace of innovation and exponential performance improvement. We are cautious of investing too heavily in assets that might not stand the test of time, even if the fundamental trends are sustainable.

than banks, so manager selection is becoming increasingly important, but private debt still represents only a very small portion of the total market.

One thing worth mentioning is that real estate is secured on hard assets. All loans can have defaults, the important question to consider is how those defaults would translate into the loss rate. The risk-adjusted performance of real estate loans can be better than that of corporates. While default rates are important, it's worth remembering they can add unnecessary noise to an investment.

Q How does the focus on the sustainability profile of assets alter lending risk?

DM: The importance of sustainability for real estate and private debt is more pronounced in Europe and Asia versus the US. Nevertheless, in all geographies, the more 'sustainable' the underlying transaction, the more stable the underlying collateral for value, income and liquidity. This is why we target loan investments supporting projects and refurbishments with ESG credentials.

CJ: We always ask ourselves, how will this investment be repaid? If you're unclear on how you are going to make your money back, then you shouldn't be lending. You certainly want to avoid a stranded or obsolete asset. You want assets to be attractive, not only from an investor perspective, but also to tenants, because that is the pre-requisite for a greater ability to generate rental income.

JH: We should acknowledge there's been less push for sustainability efforts on the investor side, particularly here in the US, but we shouldn't paint the entire country with one brush. Views vary by region.

Buildings with strong sustainability aspects are cheaper to run and should trade at better cap rates, while less sustainable buildings are going to trade at a wider cap rate. ■