ROUNDTABLE

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Alternative lenders gain in Spain

Six industry experts tell Alicia Villegas why non-bank lenders are a growing presence in the country's real estate market

It is a good time to be a non-bank lender in Spain's real estate market. Institutional investors are allocating capital to European real estate debt as they search for yield against a backdrop of historically low interest rates. Spain, which is in the expansion phase of its economic cycle, offers lending opportunities to managers of that capital.

However, as six industry executives met in Madrid for our inaugural Spanish roundtable in October, the Spanish government lowered its growth forecasts to 2.1 percent for 2019, down from its previous forecast of 2.2 percent. The government said the lower growth projections were linked to increasingly uncertain international conditions, marked by a slowdown in the global economy and persistent commercial and geopolitical tensions.

"Spain's economy is slowing down slightly but the country is growing above the European average," says Álvaro Alonso, managing director of corporate finance at property consultancy Colliers International. "This means there is still room for value and rent increases for Spanish property assets. I don't think we will see growth rates as high as in the last three years, but I expect sustainable growth."

Indeed, the 2019 forecast for Spain is well above the projected 1.1 percent growth rate for the eurozone. This reinforces real estate investors' confidence in the currency bloc's fourth largest economy at a time when other countries, such as Germany and Italy, are faltering.

"With some of the largest countries in Europe nearing recession, social unrest, and significant political issues, Spain, from a relative value point of view, is still a very good option for investors," says Gerardo Manrique, an independent debt advisor and former director at investment manager Rivercrown in Madrid. Alejandro Moya, partner at Incus Capital, a Spanish private capital firm with a focus on special credit, adds that Spain has become a focus for global institutional investors as they search for yield: "Investors need to allocate their capital and Spain is no longer seen as a risky country."

2.1%

Spanish government's forecast for growth in 2019 is a percentage point higher than that for the eurozone

Debt in vogue

Spanish real estate debt fund managers do not want to miss the opportunity created by institutions' demand for real estate credit, which is often perceived as a reliable income generator and a defensive strategy during the late stage of a property market cycle.

Cristina García-Peri, partner at investment and asset management firm Azora Group, says institutional capital accounts for a relatively small proportion of Spain's real estate debt market because the country's banks have traditionally dominated lending activity.

"These banks, however, are under pressure to generate profits, and low-risk real estate loans do not generate a sufficient return on capital for them," she says. "As real estate debt is no longer profitable for banks, I expect to see more alternative financing in

PHOTOGRAPHY: **NANI GUTIÉRREZ**

Manuel Enrich

Investor relations director, SAREB

Enrich serves as a link between investors and the product offer of SAREB, the state-owned company responsible for managing assets transferred by four nationalised banks. He previously worked for consultancy King Worldwide Investor Relations. He also founded consultancy Logical IR Solutions.

Álvaro Alonso

Managing director of corporate finance, Colliers International

Alonso specialises in advising on mortgage loan transactions, debt-restructuring, financial advisory for insolvencies and corporate deals. He has been involved in restructuring more than €8.5 billion of debt, as well as advisory services to banks and funds.

Gerardo Manrique

Independent debt advisor

Manrique was responsible for the origination, structuring and execution of deals in Spain for commercial real estate advisor and asset manager Rivercrown.
He also spent 13 years at investment bank Citi, where he was involved in more than €3.5 billion of real estate debt deals in Europe.

Alejandro Moya

Founding partner, Incus Capital

Moya oversees all real estate-related investments across the Madrid-based private credit advisory firm's target markets of Spain, Portugal, Italy and France. He previously worked at asset manager Hipoges Iberia, at Morgan Stanley Real Estate Funds and at ING Real Estate Investment Management.

Cristina García-Peri

Head of corporate development and strategy, Azora Group

Before joining the independent Spain-based investment manager, García-Peri worked at JP Morgan from 1991 to 2004, where she led the EMEA corporate equity derivatives business.
She is also an independent board member at Evo Banco.

Alberto López

Co-founder and managing partner, Urbania International

López has overall responsibility for alternative investments and debt strategies and is involved in the execution of deals, origination, underwriting and asset management for the Spanish private equity firm. He previously owned a real estate investment company in Brazil.

Spain. Given the advanced state of the cycle, investing in real estate debt makes perfect sense."

García-Peri adds that real estate debt is starting to flourish as an asset class in Spain. Interest is coming mainly from international institutions looking for managers capable of generating debt portfolios in the Spanish market, rather than from local players.

Incus's Moya agrees. "Our investor base is comprised of international players who invest in different countries," he says. "They consider that in Spain, as a market which is not institutionalised, it is important to partner with someone that has a local presence."

Competitive backdrop

Alberto López, managing partner at Spanish multi-asset private equity firm Urbania International, says there is demand from real estate borrowers for finance for deals of less than €50 million, which he says represents an opportunity for alternative lenders.

"Fund managers raising macro debt funds and searching for deals of €100 million to €150 million should note this size of deal is not found as often as in the UK," he says. "In Spain, the opportunity is in smaller transactions."

> *"Given the advanced state of the cycle, investing in real estate debt makes perfect sense"*
>
> **CRISTINA GARCÍA-PERI**
> **Azora Group**

Sourcing direct lending opportunities can be difficult in a competitive market driven by the local banking industry.

"There's a lot of debt liquidity for rented assets," says Colliers' Alonso. "So far, Spanish banks are very competitive, particularly in the senior space. International banks tend to lend at higher margins, while alternative lenders have an increased presence."

Azora's García-Peri argues that transactions involving income-producing, well-located assets are the most difficult to source, as local banks have "traditionally been extremely aggressive".

However, she says domestic banks have limits as to what they will finance: "There are sectors which are underserved by Spanish banks, such as hotels, assets in transition and land purchases. This is where banks don't lend, and it is where the opportunity lies for alternative lenders."

Manrique notes that banks are becoming more aggressive as they aim to source deals, including by increasing leverage levels. This is affecting alternative lenders' ability to secure whole loan transactions.

"Alternative lenders trying to source whole loans of up to 75 percent loan-to-value are having a hard time as local banks are now willing to underwrite more aggressive structures," he says. "A sponsor now says: 'If banks provide loans of up to 65 percent priced at 2-2.5 percent, is the incremental cost of a whole loan to 75 percent worth it?'

"It is easier today to find mezzanine deals than whole loans, as banks are increasing their risk appetite and still offering very low margins. For sponsors, it's difficult to digest a whole loan. They prefer to source senior debt from banks and then a mezzanine loan with alternative lenders."

Banks' unwillingness to fund land acquisitions for developments, particularly in the residential sector, means alternative lenders are also seeing opportunities in development and bridging loans. However, competition among non-bank lenders in this space has increased in recent months.

"We started providing bridge loans at double-digit margins for residential developers," says Colliers' Alonso, referring to the firm's €200 million debt mandate from investment manager Marathon Asset Management to fund the acquisition of land for Spanish residential developments. "But the market evolves very fast, margins are decreasing and, if you don't adapt, you don't lend. Today, bridge loans for development finance can be priced around 10 percent, while mezzanine finance can provide a margin of 7-8 percent depending on the asset,

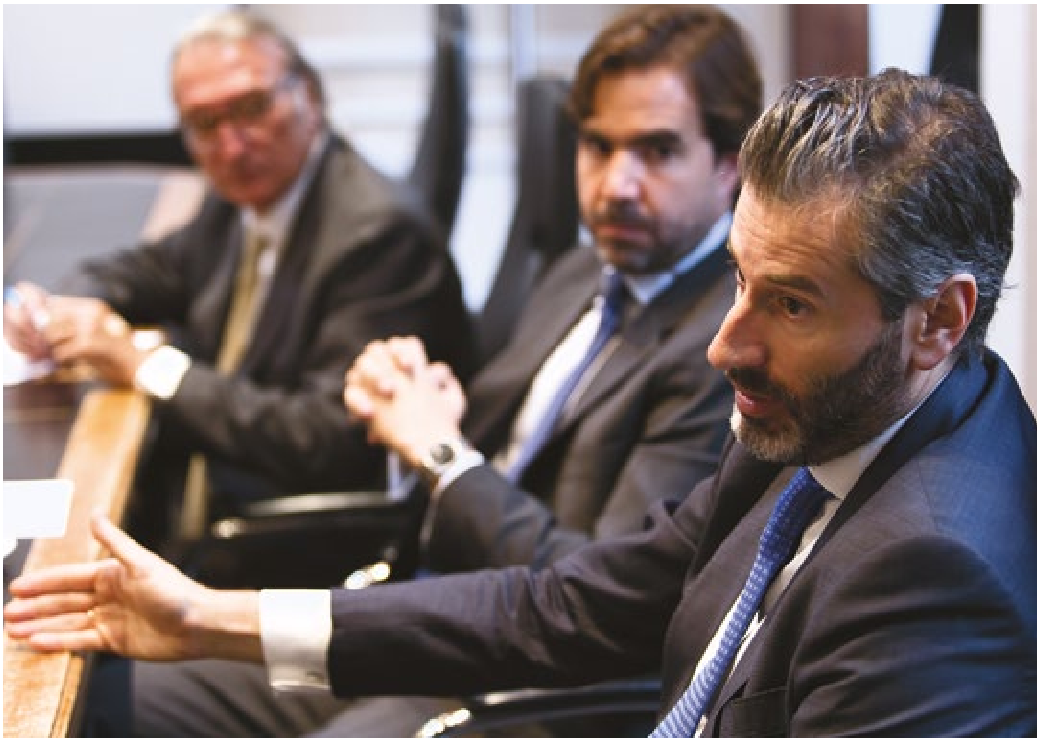
Are NPL sales losing momentum?

Spanish non-performing loans have recorded large transactional volumes in recent years.

Sales of NPLs and real estate owned by banks as a result of defaults accounted for €90.8 billion in 2017 and 2018. However, only €4.5 billion of legacy Spanish assets changed hands during the first half of 2019, according to investment banking firm Evercore. Does this mean investors are no longer interested in the Spanish loan sales market?

"There's still investor interest in Spain," says Manuel Enrich, investor relations director at Spain's 'bad bank' SAREB. "It's true there's competition from Italy and Greece, but NPLs in the Italian market, despite its size, don't have the same quality of collateral as Spain. On the other hand, the Greek market is increasingly attracting interest from investors, but the volume of NPLs in Greece is lower than in Spain."

Álvaro Alonso, managing director of corporate finance at Colliers International, says that although local banks have already carried out most of the relevant NPL sales in Spain, moderate volumes of non-core transactions are expected in the coming years. "Banks will continue to be active, especially Santander," he notes, adding that large funds may put smaller portfolios up for sale in the Spanish market.



Roundtable participants (left to right): Manuel Enrich of SAREB, Alejandro Moya of Incus Capital and Alberto López of Urbania International which I think is attractive."

"Mezzanine opportunities allow you to have a good risk/return nowadays," says Azora's García-Peri. "We prefer mezzanine to development loans, because in developments you become almost an equity provider without any upside."

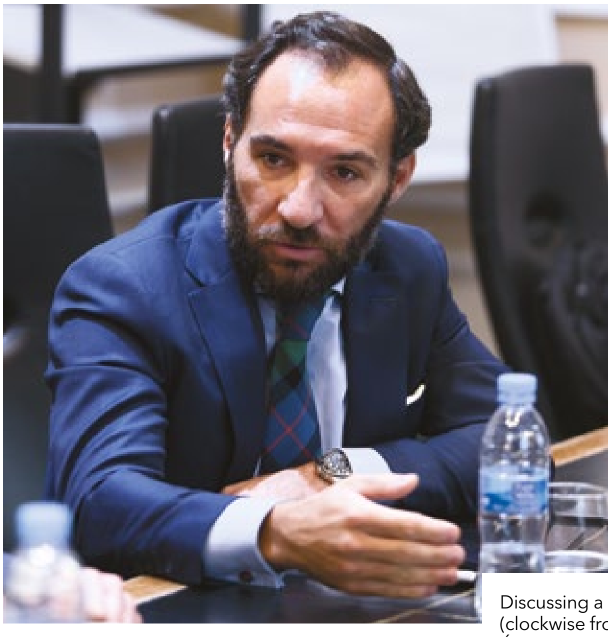
Let's go to beds

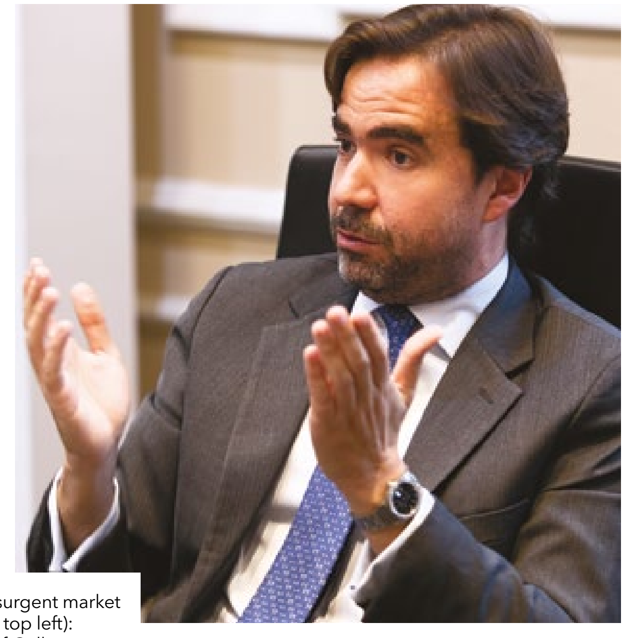
Participants agreed that residential is a sector with significant appeal to alternative lenders. According to consultancy CBRE, Spain's housing market attracted €819 million of investment in Q3, up from €578 million of capital invested during the same period a year ago. Investors and debt providers are willing to back housing schemes as the sector undergoes a robust recovery from the last banking crisis.

"We clearly believe in the residential sector," says Manuel Enrich, investor relations director at Spain's 'bad bank' SAREB. He explains that SAREB, as part of its new strategy, is focusing on creating value for its real estate-owned assets, rather than selling sizeable non-performing loan portfolios at "huge" discounts of up to 70 percent. Last year, it announced a partnership with US manager Värde Partners and its developer, Aelca, to manage and develop plots of land and residential works in progress with a total value of more than €800 million.

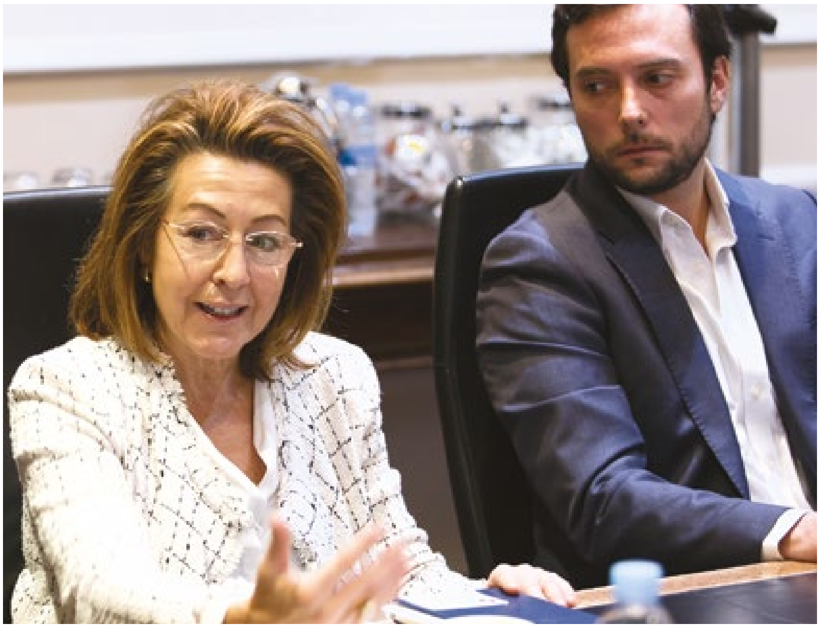
"In residential, we see a lack of product," says Enrich. "While this situation continues, the risk of a bubble is limited."

Urbania's López agrees, noting the in-





Discussing a resurgent market (clockwise from top left): Álvaro Alonso of Colliers International, Moyal, Enrich and López



creased investment flows not only into residential, but also into the broader 'beds' sector, which includes build-to-rent apartments and student accommodation.

"Spanish developers have changed their approach," he says. "Before, we developed houses just for sale and now we also develop to rent. On the other hand, investors have a strong appetite to create new build-to-rent and student accommodation portfolios. These two segments are now driving investment in Spain.

"I remember when we started to build student accommodation in Spain, traditional banks weren't providing finance. But now this asset class has normalised and it's seen as having a similar risk profile to offices but with operational risk. While it's true that this sector was first backed by international debt funds, Spanish banks are already refinancing student housing."

Azora's García-Peri says that properties outside the traditional sectors of offices, retail and industrial are gaining traction in Spain. "We really like alternative asset classes," she says. "From an equity point of view, we are investing a great deal in build-to-rent and resort hotels. We also see opportunity in senior housing and the hotel segment targeting millennials, through models such as hostels, as well as in experience leisure-focused assets.

"For our lending business, our focus is to leverage our knowledge of equity so we are focusing on these alternative segments always with an eye on the market gaps, where banks are not that active and we can find good risk/return opportunities."

"It is easier today to find mezzanine deals than whole loans"

GERARDO MANRIQUE
Independent debt advisor

Incus's Moya is also investing in alternative properties, but he believes the space needs to develop further. "In Spain, the issue in the alternative property market, often operational by nature, is its fragmentation," he says. "Operators are run by family businesses, and higher professionalism and consolidation in this segment are needed."

Colliers' Alonso also regards the lack of transactional volumes in the alternatives space as an issue: "It's difficult to find product in niche segments like student housing or senior living. In build-to-rent, by contrast, we have seen a consistent number of transactions in the last year. We see potential in this asset class."

Unloved sectors

Retail, by contrast, is a sector many are wary of. As more goods change hands online, brick-and-mortar shops carry less appeal, and therefore attract less investor interest.

"We have not seen the same level of transactions in retail as in previous years," says Incus's Moya. "The number of active equity players with interest in buying has decreased significantly. Still, for the established and dominant shopping centres, banks are providing liquidity at reasonable levels."

For Manrique, co-working is a segment that is "difficult to digest", particularly when it comes from operators that rely heavily on leased real estate: "I like the co-working sector, but it needs to be backed by operators with a strong track record and which own good quality real estate.

"Some large operators are taking long-term leases of office space and then renting it on a short-term basis. This mismatch worries me."

Although Spain's real estate debt market is dominated by banks, alternative lenders operating in the country are trying to capture high-yielding opportunities targeting segments where they see growth potential, such as alternative properties, or where banks do not lend, such as mezzanine finance.

The expectation is that banks will need to de-lever due to tighter regulation, and that demand for real estate debt will remain robust as investors look to diversify their portfolios. Against this backdrop, alternative lenders are pinning their hopes on many more years of strong activity in Spain. ■