

In Conversation with Industry Experts: Recap of Mount Street's Advisors Roundtable

Following on from our previous Roundtable events focussing on Real Estate Investors and Lenders, we are delighted to conclude the series with a focus on Real Estate Advisors and hear their views on a wide range of topics including Lending conditions, the German market, valuations, where they would advise clients to deploy capital and interest rates.



DAVID GINGELL - CUSHMAN & WAKEFIELD

David joined Cushman & Wakefield in September 2022 as an International Partner in its EMEA Equity, Debt & Structured Finance team responsible for leading financing activity in the UK and Ireland as well as focusing on significant European mandates. Prior to joining the firm, David was Head of European Senior Debt at PGIM Real Estate where he spent 10 years across London Chicago and Frankfurt offices. He has directly closed loans over \$5 billion in nine different European markets across senior and mezzanine strategies and co-founded the European arm of the US commercial real estate lender in London and Frankfurt.



NICK HARRIS – SAVILLS

Nick has over 20 years of experience working in the UK real estate finance market. He has spent the last 17 years at Savills joining in 2007 to establish the cross-border valuation service line and currently heads the UK and cross border valuation teams. Nick has expertise and international experience across all sectors, loan security valuations and stock exchange/capital rising valuations allowing him to act as a single point of contact for Savills' clients including lenders, private equity investors, real estate funds and REITS, corporates, and loan servicing companies. Nick also chairs the Savills EMEA Valuation Strategy Board, is a RICS registered valuer and holds a BSc (Hons) from the University of Reading.



MARK THOMAS – TLT LLP

With over 25 years' experience in structured finance regularly acting for a wide range of clients in relation to UK and cross-border transactions. Prior to joining TLT as a partner in 2022, Mark held roles at Clifford Chance, Dechert LLP, Mayer Bown and was a partner for Addleshaw Goddard and Squire Patton Boggs. Mark has extensive experience with particular emphasis on areas such as commercial real estate and residential mortgage loans, auto loans and trade receivables with a number of his transactions shortlisted for the Financial Times Innovative Lawyers Awards.





BEN SMITH – JLL

Ben is a key member of the Value and Risk Advisory team at JLL. JLL combine innovative technology, data intelligence and expertise to help buy, build, occupy and invest in a variety of assets including industrial, commercial, retail, residential and hotel real estate. Ben is co-head of Retail Value and Risk Advisory specialising in retail warehousing and ecommerce. Prior to joining JLL in 2013, Ben was a at Cushman & Wakefield undertaking a wide range of valuations in the UK and Europe gaining experience across all the major commercial property sectors including logistics, multi let industrial estates, retail, offices, and leisure. He also holds an MA in Property Valuation and Law from the Cass Business School.

The external attendees were joined by Mount Street employees Jim Gott and Matt Murray from our Asset Surveillance desk. The discussion was moderated by Matt Murray.



JIM GOTT – SENIOR DIRECTOR, HEAD OF EMEA ASSET DILIGENCE AND ASSET SURVEILLANCE

Jim has over 25 years' experience in the real estate, engineering, environmental and power and energy markets. Over the last ten years Jim has managed hundreds of CRE debt and equity projects amounting to many billions of £'s / €'s / \$'s of loans, acquisitions and divestitures. Jim's experience includes assisting clients with managing risk, negotiating acquisition and divestiture price adjustments, ESG, technical and environmental due diligence and brownfield development.

Website: mountstreet.com



MODERATOR - MATTHEW MURRAY – EXECUTIVE DIRECTOR, ASSET SURVEILLANCE

Matt re-joined Mount Street in 2022 as Executive Director in Asset Surveillance having previously led the Primary Servicing Team. Matt has 20 years' experience in Real Estate Finance and Corporate Credit including roles at Hudson Advisors, Deutsche Banks, Mizuho Corporate Bank and Puma Property Finance as a Development Finance originator. Prior to joining Mount Street, Matt was Head of Loan Servicing EMEA at CBRE.

Website: mountstreet.com



Is there any indication of a thaw in new lending in H1 2024 and if so, what sectors and products are Lenders focusing on?

Moderator - Matthew Murray (MM), “Just to add some further colour to the question, we have good visibility across most CRE markets here at Mount Street and it’s fair to say deal volumes are still materially down on ‘normal’ conditions, but we also feel availability has increased versus 2023. Where is the money generally coming from and what is the mix of lending these days?”

David Gingell (DG) starts off, “I started my career about a month into the credit crisis and back then it was banks, banks and more banks, and that model broke. You now look today and over the last eighteen months the credit market has functioned how it should and there has been money available from everyone, including the banks. Lending volumes are down, but that’s more to do with deals not necessarily adding up in the same way so it’s more demand led than supply side.

In terms of sectors obviously the living sector, but you can now get financing for Canary Wharf offices or fringe City offices. That wasn’t possible six months ago necessarily, not at a sensible price.”

“The best liquidity you could get was on the more value-add side, so if you want to develop a PBSA asset or a residential asset you can get financing and you’re going to have ten Lenders competing on it with economics compressing. So, yes, I think that in 2024 now, today is actually a healthier position than it was in December.”

Nick Harris (NH), “It’s totally different to the financial crisis because this time around we do actually have a lot of available capital from a huge number of sources, more sources than ever before in fact.

Moderator - MM, “ In terms of deal flow, after an initial burst of activity at the start of 2024 things seem to have eased off a little?

DG, “I still feel it’s more of an owner-led freeze rather than a lender freeze. There’s money available and it sits there, and it’s not being used. Lenders are frustrated because they want to get stuff done, but there’s a base rate and there’s risk tolerance.”

Mark Thomas (MT) agrees “It’s quite interesting because at the end of last year everything seemed so bad. And then at the start of 2024, everyone seemed to be really excited and wanted to do lots of deals. That sentiment seems to have just tailed off and a lot of deals are taking a lot longer.

Jim Gott (JG) also feels completion timetables have slipped “We certainly saw things pick up in Q4 and Q1 has been busy as well but all the deals are taking a lot longer to close, and a lot longer than they actually need to.”

MT, “I think people are wanting to drag it out. The borrowers are trying to renegotiate and deals are going away from term sheets. I’ve seen some of the most ridiculous nit picking reasons that I’ve seen in years, just seemingly to find a way to delay...because I think, by now, a lot of borrowers thought interest rates would have come down. Many borrowers are still thinking that interest rates are going to come down but I think the likelihood of that happening in a meaningful way this year is very very low’

DG, “And what are we looking at as an interest rate fall 25bps/50bps? Is that really going to change the world? Especially when your asset was bought at zero rates. That’s not sufficient. Not all Borrowers want to take a six or seven percent coupon, especially not on four percent real estate. But in terms of new money there are lots of new debt funds, but they are targeting very specific price points. I also think if you’ve got North American decision makers, that’s been quite challenging in the office space the last twelve months. This year, the clearing banks have come out really strong, on office, on retail, and amongst new business.”

MT, “Let’s face it, we’ve got an undersupply of resi, an undersupply of student, there’s still all the issues around social housing that aren’t going to be fixed anytime soon. I’ve seen a lot of people looking at doing a combined equity/debt. So finding that value and somehow finding a return that works across the property.”

Moderator - MM, “ Adding value and repurposing assets seems to be a general theme for 2024 and is often advertised as a solution to difficulties in the office market. Does that match what attendees are seeing?”

DG, “If you’re looking around here [City of London] or somewhere near here, where does your capital value have to go down to for some of that to make sense if they had bought it for £800/1000 per square foot?”

NH agrees, “Absolutely, for repurposing of an asset to work capital values need to get down to a certain level and the type of building has to be appropriate too. We’ve seen this working for ex-office buildings being turned into hotels in the City and it’s happening regularly.”

DG, “For its capital value to go down to around 400 per square foot, that’s significantly lower than the original owner bought it for.”

JG, “It feels as though the market has trifurcated, you’ve typically got one band of an asset class that works very nicely as it is, then you’ve got one band that’s a development capex led piece, it needs work, it’s a classic value-add, and that is very attractive, I think it’s arguably the best return in a market, and then you’ve got the assets that are effectively obsolete no matter what you do to them.”

Ben Smith (BS), “On offices specifically, JLL’s research team put out a figure there’s around sixty million square metres across Europe that’s potentially obsolete, around one third of the total stock. It feels like capital values need to come down to reflect structural change in the middle market and I don’t think we’ve seen the full extent of that capital depreciation yet. We put out a biannual investor perspectives report asking some of JLL’s top clients how sentiment has changed towards sectors. Interestingly London offices are top of that list as the sector offering the greatest opportunity. That has really shifted up the order over the last six months as best in class London offices probably over corrected.”



DG, “Operating across Europe, we see vacancy rates across major office markets including London at sub-5 percent for Grade A. That’s a really interesting statistic and one that generally implies rental growth.”

NH, “Prime London office figures have historically been at that level so it would be a mistake to ignore it as a sector.”

If you could only pick one sector or product, where would attendees recommend investors deploy capital?

Moderator - MM, “On the sector side is it still very much the beds and sheds focus or have other sectors opened up recently?”

BS, “Beds and sheds tends to dominate the conversations we’re having but Data Centres is also an interesting sector for me.”

“It’s a CAPEX intensive sector, with very high energy demands and ESG challenges, but you look at the amount of money going into the sector and the platforms that have been built. It doesn’t take a rocket scientist to work out how much data we’re all using, following the advent of cloud computing and more recently AI. It’s a good long term bet for growth.”

“Life Sciences is another sector on the rise, but it is specialist and it’s therefore nuanced. You must understand the occupier requirements and the cluster effect of companies being located in the area. Great examples of where clustering has profited include Oxford, Cambridge and Kings Cross”

NH, “Similar theme. Most of our valuation work is loan monitoring and updates, it’s not new lending work necessarily but where we do see the new lending, it’s focused heavily on industrial or living sectors for sure. It would certainly make up a significant majority of the new lending work we see already.”

“The main theme in activity is the focus on the UK versus continental Europe. Buyers are targeting the UK market, seeing that it is somewhere near the bottom of its cycle, and in general they are buying into those sectors that we have just talked about”

“You’ve got the likes of data centres that are rising fast, but Life Sciences and Self-storage are still very small sectors. Yes they’re interesting to look at it but they’re not comparable in size to retail for example.”

BS, “Retail has had a tough time, but it’s a resilient sector. The retailers today are generally well capitalised and right sized, after riding the impact of structural changes, Brexit, Covid and the costs of living squeeze. You get the sense that those structural risks have diminished the benefit of stores is much clearer now.”

DG, “I like Retail. Over the next 24 months I think that’s a seriously interesting space that’s repriced and been through every stress test imaginable and it’s still standing. Income stories and prime office are also looking very attractive.”

BS, “In terms of investment volumes, retail had a decent year last year at around £6bn which is close to the long term average, compared to wider UK direct investment which was 40% off the 10 year average.”

“We all know retail warehouses and food stores have outperformed over the last two or three years. In the shopping centre market, the fundamentals actually look really solid in the top 10% of centres, they’re going to get more dominant, a concept that has been around for a while now. If you’re buying in at eights and nines and adding in leverage, on increasingly competitive terms, then the geared returns start to look very attractive and that could result in yields hardening later in the year. We are having conversations with the likes of Barclays, Lloyds and Natwest about funding shopping centres and that hasn’t been the case for some time

Moderator - MM, “Mark and Jim, do you agree?”

MT, “I would have to say high-end care and the data centres / warehouses, particularly the super warehouse level and bigger data centres and there’s plenty of repurposed brownfield sites that works for these assets. There’s availability, and I don’t think there’s much governmental opposition to it. Particularly on the data centres as an encouragement to stop everything offshoring.”

JG, “I’d go in a slightly different direction, I like unloved assets and developments with heavy cap ex. I particularly like self-storage. I like that you can effectively take an unloved asset, fill it full of little boxes and all of a sudden you get an NOI that is fantastic. And it’s not necessarily just that sector, I like the development and the cap ex piece of anything that results in a ridiculous looking NOI.”

NH, “We’ve now been through a challenging valuation period, we’ve been giving difficult news to clients for eighteen plus months and finally we are seeing some green shoots.”

“The real estate crisis has been caused by an increased cost of capital not by occupancy, not by rental and that doesn’t normally happen in a downturn.

“So we’ve got good news and now just need the capital markets to stabilise, which as we’ve discussed earlier they are starting to do so. We have more lenders than ever before, it’s a very balanced market and hopefully rates will start to come down, maybe not towards zero percent ever again, but come down slightly. So, my feeling is that it’s generally a green shoot story and if I had to choose one sector I would go to central London Office because I think you’re now buying in at a price point which you haven’t had a chance to do for a long time. World buyers don’t often get a chance to buy in central London so now would be their time.”

Potential and actual distress in the German market has been in the news a lot recently, I believe all attendees work on a pan-European basis, what's your view of CRE conditions in Germany?

Moderator - MM, "David, as someone who was living and working in Germany until fairly recently, maybe you could lead us off on this.

DG, "Yes I was living in Frankfurt until about two years ago and so I saw it during what was quite a big boom period or at least the end of the boom period. Obviously, that's ground to a halt, and the way their economy's structured very different to ours with a high weighting towards manufacturing. What's happened with the energy shock has really affected their ability to produce and there's a lot of structural questions about what they should do going forwards. When it comes to lending, a lot of mid cap developers have gone bust but the lenders are still quite aggressive. Pricing for prime is around twenty-five to thirty-five bps wide of where it was in the peak cycle and they have inherent comfort with office lending. For twenty or thirty years, people have been saying the German banking system is due a consolidation and it never happens. So they have a lot of regional banks with a local stake holding mentality allowing access to finance. There's still pretty good regional liquidity in Germany for projects."

MT, "I think the pfandbrief lending is probably fairly sound because costs of funds are such that pfandbrief lenders can keep going and haven't got shareholders who desperately need yield. But there are some big issues in Germany because a lot of property is starting to go vacant. There's quite a lot of NPL activity already starting that we're seeing, much more so than here [UK market]. That will probably grow this year so I can see a little bit of trading activity that then will give the opportunity to refi because you've taken out some of that value already, but I think Germany is going to have a difficult time."

NH, "Transaction volumes are low, particularly in office and multifamily, their mainstream sectors, and part of that reason is that the market has been slow to react to price declines. So, there is no trading and therefore hardly any comparable evidence"

Germany is seen as this amazing safe-haven in Europe such that everything else goes wrong, at least Germany will be fine - and that isn't the case now.

"It's hard to comment on the local banking network because they don't use external valuation firms and have in-house daughter companies that do the valuations for them, so you never really get a feel for how much activity there is and how much is going to be distressed, so that's really an unusual market in European context."

JG, "It feels very different from the GFC because then southern Europe was a basket case you wouldn't even look at. But now, we're probably seeing more good deals in Spain and Italy than we are in Germany, which is quite a reverse. I have to say that when COVID hit we had some development projects in Spain and Italy that I thought may struggle but they stayed broadly on budget, they stayed on time, and they performed better than development projects just about anywhere else. Whilst we saw some inflation, it seemed to be lower than other markets and flattened more quickly."

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Markets appear confident that the rate environment will improve in 2024 with material rates cuts priced in to forward curves. Do attendees agree with market sentiment and what impact do you expect to have on Commercial Real Estate?

Moderator - MM, “Mark you made some points earlier you think assumptions around large rate cuts are pie in the sky thinking, so what are your views?”

MT, “I think there’s still too much uncertainty at the back end of the year and there’s too much wage inflation. You’ve also got other macroeconomic factors such as Ukraine and Brexit, which haven’t gone away. So I don’t see how any central bank can drop rates without meaningfully risking huge inflation again and I think they saw how crippling that was.”

JG, “You always get a second inflation wave; every time in history, you get inflation, you raise interest rates, inflation drops the central banks will say ‘Hey look at us, we’ve managed it, we’ve done this really well’. They start taking the controls out and then you get a run-up into a second peak that’s usually higher”

MT, “I think people who are a bit older and remember the twelve, sixteen, eighteen percent interest rates of the 80’s and there’s an awful lot of people who have never experienced anything other than that the ridiculous zero rate. That’s been abnormal. But people are still expecting rates to come down to two, two and a half percent quickly. But given all the uncertainty I don’t think we’re going to see much movement this year. We’ll see a little bit, but I think people are expecting it to go down to below four”

Moderator - MM, “A quick-fire round the room, where do you expect to see interest rates a year from now?”

JG, “3.75% (wishful thinking!)”

DG, “4.75% BOE base rate”

BS, “4.50%”

MT, “Where do we actually want to be. What is the ideal space where BOE base is at which really means we have inflation under control but not so much we’re in recession or struggling, its stable, lending is good: to me that’s around 3.5% and that’s going to take more than a year due to all the other pressures and the instability that you’ve got. If we can get the global macro pictures sorted, 3.5% is probably realistic for 26/27.”

NH, “I agree you don’t want rates pushing down to where they were as that just stores up problems. You just want a stable environment and a functionalising lending market where people can make money on RE with clever asset selection and asset management as it should always have been, and that’s what we’ve got away from recently.”

DG, “You’ve got people ten, twelve years through their careers now running funds on behalf of global money and they’ve never seen anything like this before. Coming out of MIPIM if there was one key takeaway, it’s that if you have prime anything in real estate, you’re seeing rental growth in all of those markets. So its quite an interesting question, what’s the problem? I guess the problem is that we’ve priced to perfection with zero cost of capital.”

MT, “We have a more stable lending environment than we have had for a very long time. I would probably say, in the twenty-eight years I’ve been doing this, this is the most stable lending environment in terms of how strong the banks are and what checks and balances exist”

“ We talked earlier about how Germany has one bank to every fifty thousand people, we [in the UK] don’t actually need that because we have our alternative lender space. I’d say that stability, people knowing where their money is, what they’re putting their money against, is stronger than it’s been in at any time in my career. ”

JG, “I think there’s loads of opportunity out there, particularly in the value add space. But at the same time a lot of the existing lending out there, the legacy deals, really don’t work, you’ve got people who have got used to very low rates and therefore the debt cover is slim or non existent and that becomes a really hard refi story. We [Mount Street] saw 67% of loans that hit maturity last year extend rather than refi and of that 67%, 59% have needed to extend again. The problem in the market is LTV and debt cover and the borrowers are going to need a good business plan and potentially a big lump of cash to make a paydown to make any refi work.”

NH, “Are they holding on in the expectation of rates coming down?”

JG continues, “I think there has been a reticence to enforce, I was always surprised when I read something like the CREFC survey, people seemed to think it was going to be over really quickly, everything was going to sort out really quickly, personally I was sat there thinking this isn’t going to be quick. I can’t see how it will be quick, there’s no quick fix. Ukraine is not a quick fix, the middle east is not a quick fix, trade wars aren’t a quick fix. The massive amount of money people need to spend on decarbonisation isn’t a quick fix. The on-going increase in online shopping, which is still happening... none of it is a quick fix.”



Here is our quick summary of takeaways from the meeting:



Of the three Roundtable events we've hosted over the last year, it would be fair to say this was the event with the most positive sentiment:

- Debt markets are broadly functioning as they should and Lenders, particularly the banks, are in a strong position.
- The Living sector continues to lead investment and lending volumes.
- We may be in a once-in-a-generation opportunity to invest in central London office assets at compelling pricing.
- The German market has serious structural challenges and attendees expected distressed conditions to continue.
- Rate cuts will come but the ZIRP environment is unlikely to ever return, and nor should it if we want properly functioning capital markets.

Thanks again to the attendees and to everyone has participated and in our three-part series of Roundtable events.

About Mount Street:

Mount Street manages over €155 billion of assets, including €95 billion in commercial property, with a team of over 200 professionals in 10 offices across EMEA and the US. We offer expertise across the debt life cycle through our core loan management business, Europe's largest third-party manager, Mount Street Mortgage Servicing. Our regulated portfolio management and advisory business, Mount Street Portfolio Advisers, manages €22.7 billion of debt instruments.

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