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APRIL 2019 | perenews.com

FOR THE WORLD'S PRIVATE REAL ESTATE MARKETS

THE DEBT FUND REPORT

A special supplement to *PERE* magazine

Gränbystaden Galleria, Uppsala: 'exceptional' retail assets are worth financing in Sweden

Playing the long game

Swedish banks' short-term focus has created an opportunity for alternative lenders backed by more patient capital, says Brunswick Real Estate CEO (debt) Pontus Sundin. Stuart Watson reports

The availability of finance for commercial real estate in the Nordics has historically been volatile, based on the appetite of a small number of banks. Moreover, in Sweden those banks are already heavily exposed to lending against property. That has created a segment in the financing market for debt funds, argues Pontus Sundin, CEO (debt) at Brunswick Real Estate, an investor and lender in the Nordics which manages around €2.3 billion of assets and has provided €1 billion of credit financing in the region.

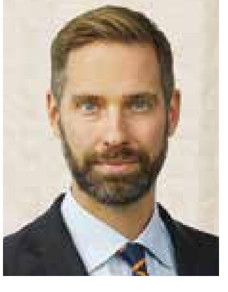
***PERE*: What is the opportunity for investors to place capital via the commercial real estate debt market in Sweden?**

Pontus Sundin: The Swedish CRE debt market has been dominated by Swedish banks and there are no other CRE debt funds solely targeting Sweden, so the scope for investors to gain access to this market has been limited. One option has been to invest in the capital markets. However, Brunswick is the only debt fund focusing on Swedish CRE debt. We offer long duration to clients, backed by prime real estate that implies investment-grade risk with focus on sustainability. Senior lending backed by sustainable real estate is a defensive strategy that provides investors with stable returns and a positive environmental impact. We have provided a green loan to Fabege and we are currently developing our green loan framework. We are aiming to make an impact from where we operate, both in financing certified buildings but also through greening facilities (reducing environmental impact).

Brunswick's funds provide investors with a unique opportunity to get access to a market historically dominated by banks. In Sweden, four major domestic banks account for most of all real estate lending. The Swedish commercial real estate finance market is roughly SKr1,000 billion ($107 billion; €95 billion). Before the global financial crisis, most lending was bilateral loans from banks to borrowers, but afterward there was a transition to a situation where roughly one-third of all lending is done in the capital markets and two-thirds in the banking market.

The Swedish central bank, the Riksbank, issued a report in the fall stating that more than 60 percent of the exposure on Swedish banks' balance sheets is to real estate of which 20 percent is commercial real estate. Therefore, the four banks that dominate the scene are fully loaded with real estate exposure.

The balance sheets of those banks are more than 300 percent of Swedish GDP, which means you have a small country with a large financial sector that has a very big exposure to real estate. The Swedish Financial Supervisory Authority is monitoring Swedish banks closely because it is worried that if something happens with the real estate market it will affect the banks and therefore the national economy.



Sundin: opportunity for debt funds to provide longer-term loans

To prevent them from becoming more overweight in real estate, banks are increasingly forced into matching up their funding and their lending. If they have a five-year loan out, they need to have a five-year bond in, and the Swedish krona bond market is typically a three- to five-year market. That means the banks tend to be competitive on shorter-term loans, but there is an opportunity for debt funds to offer attractive terms on tenures longer than five years.

Sweden has more than 20 listed real estate companies. They are eager to maintain their credit ratings, in particular from Moody's, because that enables them to pick up competitive financing. If you read Moody's comments regarding many of these companies, it says they are too dependent on banks and on the capital markets, and that the capital commitments they have from the banks are too short. Debt funds can offer them up to 10-year money, which fits well into that segment in the finance market in Sweden.

SKr1,000bn ($107bn; €95bn)

Estimated size of the Swedish real estate finance market, according to the firm

***PERE**: Is it difficult to find lending opportunities?*

PS: Given that you have SKr1,000 billion in commercial real estate debt overall with an average tenure of around five years, the annual dealflow is around SKr200 billion of loans that must be financed or refinanced. We may also see dealflow from smaller companies that have issued bonds in the past, but maybe do not really belong in the capital markets. Those could be smaller companies with good property portfolios and track records, but which might have issues now in refinancing their bonds at a reasonable level. However, to secure the right deals, it is important to take a more proactive approach to finding the kind of borrowers you want and fitting the offer around their needs. We have a strong pipeline of opportunities and it is not hard for us to find deals.

***PERE**: Is there scope for real estate debt investment in other Nordic countries?*

PS: The Finnish market is extremely interesting and we keep a close eye on it. That could be a market for exposure in a euro-denominated fund. It is a liquid market with lots of international capital seeking exposure there, and it is pretty straightforward to do business. Norway could also possibly be interesting, but less so than Finland. Denmark is a very domestic market. They have many small banks and a system similar to the Pfandbrief in Germany, where you have secured bonds. As in Germany, that makes it very efficient for domestic banks to lend to real estate, so it does not make sense for debt funds like ours to operate in Denmark. It is also a small country.

***PERE**: Which asset types offer the best potential?*

PS: We usually lend against core and value-add assets. We do finance development projects, but they never represent the majority of a fund. We can do all asset classes and we are split roughly evenly between offices, retail and logistics. On retail, we are extremely cautious, but we will finance exceptional assets.

In November, for example, together with Allianz Real Estate, we provided a loan to one of Sweden's biggest listed property companies, Atrium Ljungberg, backed by the Gränbystaden Galleria shopping center in Uppsala, Sweden's fourth largest city. In the office market, we see very high rents and low yields right now in Stockholm, but there is also a record low vacancy level in the central business district, so that sector will continue to perform. Logistics is a very sought-after asset class as it is in the rest of Europe and worldwide. We will not finance residential development. That is a market that has taken a plunge and there is no market for developing apartments in Sweden right now.

***PERE**: Are foreign investors interested in Nordic real estate debt?*

PS: Typically, our investors are from Sweden or other parts of the Nordics. We will probably be fundraising for our third debt fund later this year and that could certainly involve international investors. We currently lend in Swedish krona and our funds are currently SKr-denominated, however as stated before we see interesting opportunities in Finland as well, so a euro-denominated fund is something we consider. Furthermore, the Nordics is stable and transparent with both GDP and population growth, which makes the market attractive to invest into as well as providing diversification for many international investors.

***PERE**: What is the outlook for real estate debt fundraising in the year ahead?*

PS: We position our funds as an investment-grade fixed-income product with a return that would be higher than if an investor were to buy an equivalent senior unsecured bond, which would typically produce a return of roughly 100bps and we are seeing conditions in the equity and capital markets favorable to strategies like ours.

At the moment, equity markets are not performing as well as one could hope, and many hedge funds are not doing well either. If you are an institutional investor, senior real estate debt offers a stable, secure income year in and year out. In particular, for insurance companies operating under the Solvency II framework, investing in a senior, secured debt fund produces a higher return on equity than a private equity fund because the regulations require you to allocate less capital to a debt investment. CRE debt is a defensive strategy. □