A fresh start for the real estate debt market?
Private Debt Investor
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Featured

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The real estate debt market dusts itself off and seeks to put capital to work.

Hannah Roberts - 29 mins ago

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The real estate debt market has faced a tumultuous few years. The end of the 'lower-for-longer' interest rate environment intensified the withdrawal of investors from this corner of the market, which was already wrestling with the impact of the covid-19 lockdowns.

Private Debt Investor figures show that real estate debt-focused funds raised $22.5 billion in 2024, down from $27.2 billion in 2023 and $47.4 billion in 2022 – though the latter was a high point in recent years. In a similar trend, the average size of a real estate debt-focused fund in 2024 was $264.5 million – in 2023 the figure stood at $362.6 million and at $474.5 million in 2022.

However, several areas of the market show bright spots for investors seeking a return to the market, and lenders are preparing to meet this demand accordingly. Here, we run through some of the key trends set to impact the sector over the coming months and years, and look at how investors and lenders can best position themselves for growth.

Office views

It's no secret that office managers have struggled to make their offices fit for purpose since the covid-19 pandemic. Indeed, the Office for National Statistics reports that more than one-quarter of UK adults still use a hybrid working pattern. As office workers continue to adhere to remote or hybrid working schedules, the onus remains on office managers – and therefore, their lenders and investors – to keep abreast of fresh challenges in such a beleaguered sector.

Kimberley Gates, director of client partnerships at real estate lender Karis Capital, says: “We’ve been witnessing the ‘death of the traditional office’, making it more challenging for developers to prove ongoing demand to secure lender-approved valuations. To entice people back to the office, spaces now need to offer more than just desks, microwaves and water coolers.”

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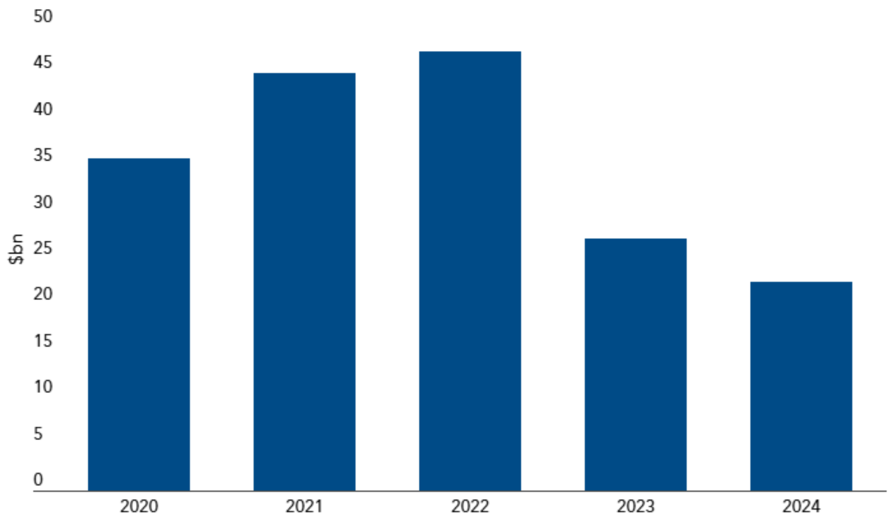
Offices that have amenities are still a huge boon to office workers and therefore represent solid assets for lenders to back, according to Ben Barbanel, head of debt finance at OakNorth Bank. Hans Vrensen, head of research and strategy at AEW Capital Management, meanwhile, projects that European office markets will recover in 2025 – “In fact, over the next five years we project office vacancy rates to come down to 7 percent,” he says.

Finding premium office stock has historically been a challenge for investors and lenders in the wake of the covid-19 pandemic, but market onlookers say that the upgrading of office spaces to account for changing worker needs will lead to a long-desired uptick in demand.

That’s not to say that investors are likely to dive headlong into the sector even five years after the first lockdowns took effect. Vincent Nobel, head of asset-based lending at Federated Hermes, says that “many investors are still nursing their wounds from the heavy valuation declines in offices” and that “it may be hard to step back in”.

“It requires full conviction when other offices in the portfolio are held 50 per cent below their peak values from just a few years ago,” he adds.

Capital raised by real estate debt-focused funds ($bn)



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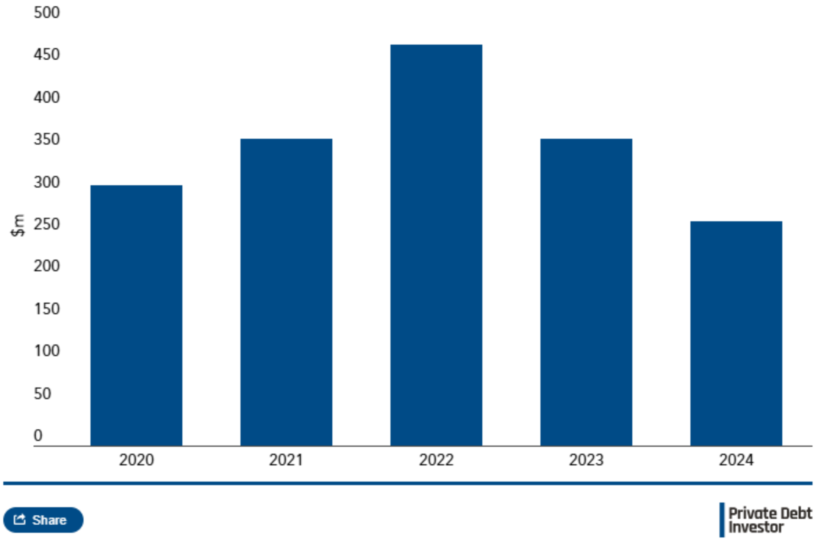
Average real estate debt focused-fund size ($m)



Raising the roof

Residential property is becoming increasingly popular among lenders as the debt market heads into 2025, in large part driven by the need to house the US and European populations. "People are living longer, the housing stock is ageing, energy regulations are becoming stricter and household formation is increasing, largely because people are getting married later or not at all," says Ellis Sher, chief executive of Maslow Capital, Arrow Global's real estate financing business.

"Residential is probably the most competitive part of the lending market at the moment, in terms of supply of credit, alongside logistics," adds Phil Moore, partner and head of European real estate debt at Ares Management. Environmental, social and governance requirements are also playing into this dynamic, according to Moore, amid growing pressure from regulators and buyers to see more environmentally-friendly and economically viable housing.

According to Leo Wong, partner and head of loan strategy at Waterfall Asset Management, some 80 percent of the US housing market was refinanced in the two years immediately following covid due to low interest rates. Wong says that around $8 trillion of mortgages originated in that period and, since then, a strong and resilient housing market, driven by undersupply, has driven investment in the space.

However, lenders looking to further ingratiate themselves in this space would do well to exercise caution when it comes to their approach, according to Maslow Capital's Sher. "By its nature, private credit is a fishing expedition. To find opportunities, you need a large team originating deals from multiple sources, and you must delve deeply into the underwriting process."

A golden opportunity

In the UK, an ageing population and a contracting care sector has highlighted the need for real estate debt funding. According to the UK government, more than 1.42 million UK households will be headed by someone 85 or over by 2037 – a 161 per cent increase over 25 years.

Guy Brocklehurst, relationship director at Leumi UK, says he is seeing a "clear uptick" in the demand for later living investment opportunities. "There is an increasing supply-demand imbalance in later living; while on the one hand there is a shortage of quality stock, on the other, we have an ageing population in the UK, with a relatively affluent and healthy older generation looking for developments that allow them to maintain their independence and lifestyle.

"In that context, the decision to downsize tends to be more needs-based rather than discretionary, so there is clear demand for high-quality, aspirational sites that provide a sense of community."

However, lenders will need to have a solid understanding of changing lifestyle habits and demographics to effectively invest in this sector, according to Brocklehurst, who adds that lenders would do well to recognise that older people are becoming more selective when it comes to their later living facilities.