FIERA REAL ESTATE

APRIL 2024

Pan-European Real Estate Credit

An Immediate, Compelling and Expanding Investment Opportunity

A whole loan real estate credit strategy provides investors with a compelling and sustainable long-term investment thesis. Supported by an existing €2.0 trillion[1] market, real estate credit looks particularly attractive at this stage of the market cycle.

The fundamentals which make the strategy appealing are:

- An expanding opportunity set due to mainstream bank funding supply constraints
- A wave of impending borrower refinancing requirements (forecast to total over €200 billion[1] over the next 2 years) which provide for longevity and liquidity of investment thesis
- Superior risk adjusted returns in the current heightened interest rate environment
- Downside protection in the current climate of volatile valuations
- Portfolio diversification benefits

1

Changing commercial real estate funding supply dynamics

The European Commercial Real Estate ("CRE") debt market totals ca. €2.0 trillion[1] and annual new debt origination amounts to ca. €310 billion[1], representing an already substantial, yet growing, market.

Historically, European CRE debt funding was provided almost exclusively by banks. However, this landscape has changed over the past 10 years, with insurance companies, pension funds and private debt funds now also providing funding.

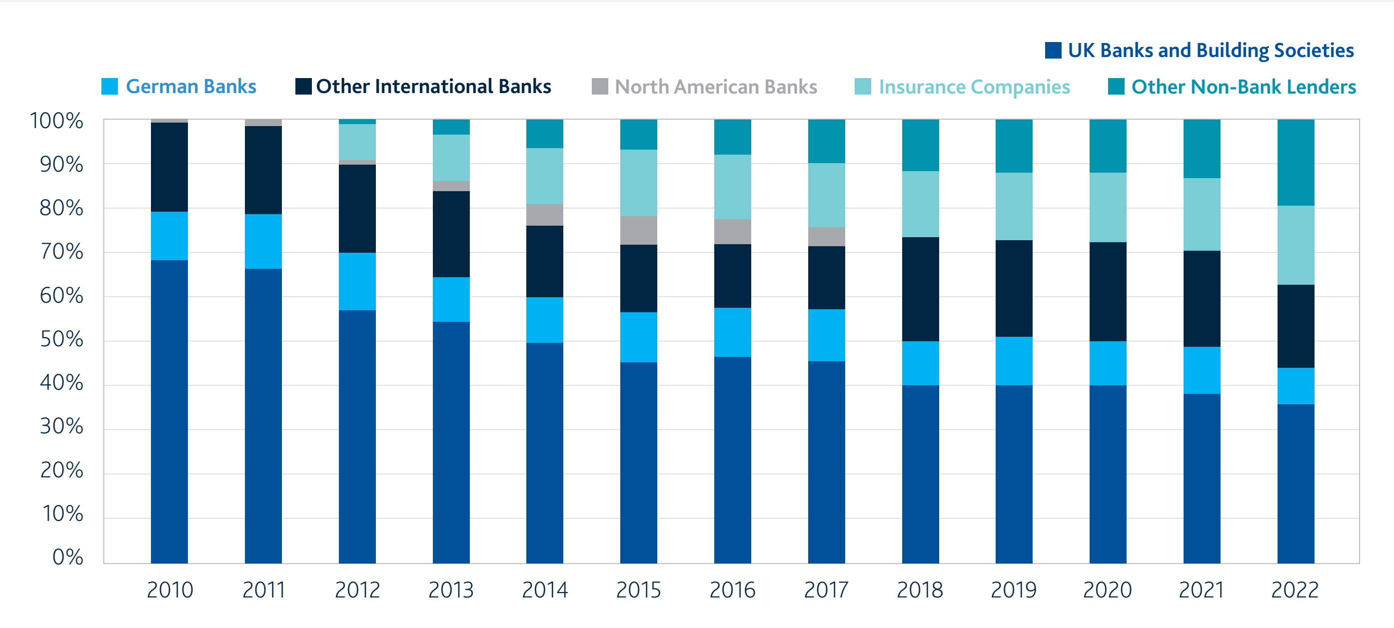
Since the Global Financial Crisis ("GFC"), European banks in particular have become less active and are typically constrained across certain types of CRE funding due to regulatory requirements, specifically Basel III.

Under Basel III, CRE lending has a higher risk weighting versus other types of bank lending (e.g. corporate lending), which in turn requires banks to hold higher equity capital against these risk-weighted assets. In addition, banks incur high origination costs on shorter duration CRE loans and have suffered from low returns on shareholder equity since the GFC. This has created **an opportunity for private debt funds to exploit as the banks are dialling down their appetite for CRE lending (reduction in traditional funding supply).**

As such, non-bank lenders, including CRE debt funds, have grown their share of the UK CRE funding market year-on-year since the GFC.

Chart 1

UK Market Share by Lender Profile



Source: European CRE Lending Report; Bayes Business School.

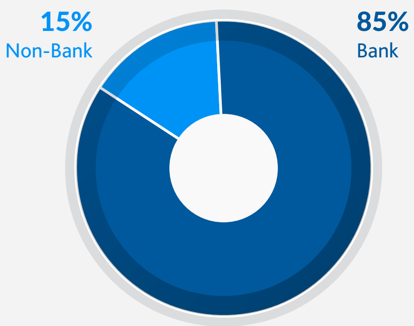
There has been a steady growth in alternative CRE lending in the UK and the EU in recent years, although the alternative lending segment remains less mature compared to the US market.

In the UK, non-bank lenders (including debt funds) account for ca. 40% of CRE debt outstanding today. In European markets excluding the UK, this figure is even lower, standing at ca. 15%.[3]

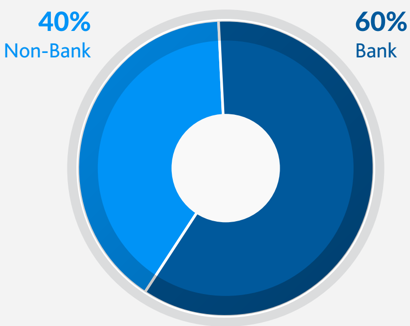
By contrast, non-bank lenders in the USA, which is considered the most mature funding market, account for 55% of total CRE debt.[4]

Provided European markets continue to evolve and non-bank lenders take market share in line with the US markets, the readily available share of the market opportunity available to non-bank lenders in Europe represents ca. £560 billion.

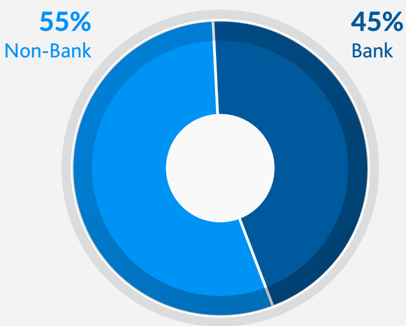
European Funding Market Composition



UK Funding Market Composition



USA Funding Market Composition



Source: Refinancing Gap Crisis & Opportunities - Green Street (September 2023)
& The Commercial Real Estate Debt Market: separating fact from fiction – Cohen & Steers (March 2023)

2

An impending wave of refinancing demand exacerbated by a growing funding gap

Over the coming years, a large wave of impending CRE debt will mature which will lead underlying sponsors or asset owners to refinance. Given the regulatory factors facing mainstream European banks (as alluded to in section one), there will be an opportunity for debt funds to take advantage of this increase in financing demand by tapping in to an existing and substantial market.

€390 billion of loans against real estate are estimated to have reached maturity during 2023 in the UK and Europe,[2] whilst it is forecast that over €100 billion a year of CRE loans in 2024 and 2025 are due to mature across the core markets of the UK, Germany and France alone. Many of these loans were underwritten during 2018 and 2019.[5]

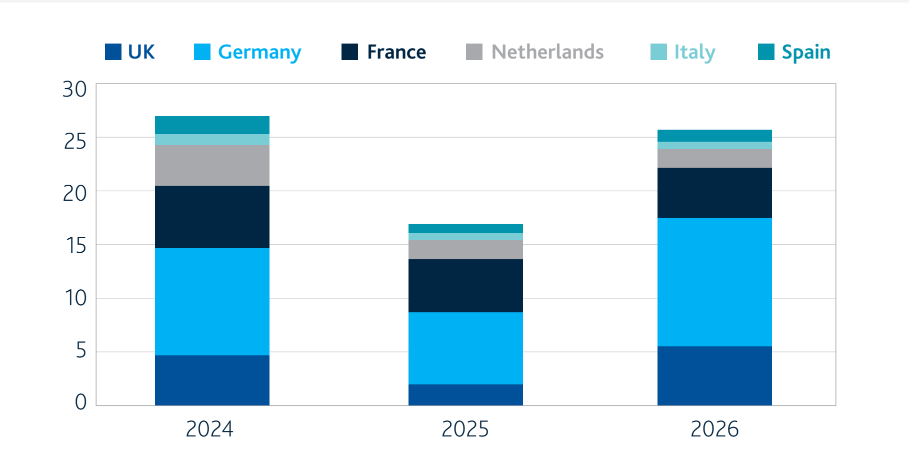
The refinancing opportunity set is further enhanced by the so-called "funding gap", which is effectively the gap between the existing or outstanding debt on a property and the (lower) amount which a bank is willing to lend at the point of refinance.

Funding gaps have increased over the last 12 – 24 months as a result of: (i) elevated base rates increasing the cost of finance to a borrower and directly affecting debt service cover ratios – a key metric banks use to determine the amount they are able to lend; (ii) lower property valuations driven by widening property yields leading to lower absolute amounts banks are willing to lend versus what was originally lent; and (iii) lenders reducing loan-to-value ratios (increased risk aversion) again leading to a decreased loan refinancing quantum.

The debt funding gap is forecast to increase to €90bn funding gap across 20 European Countries.[6]

Chart 2

Market-wide Debt Funding Gap Across Selected Markets (EUR bn)



Source: https://www.aew.com/site-assets/images/2023_Aug_AEW-Research-Report-ENG-vfinal.pdf

Chart 2 represents an increased opportunity set for whole loan debt strategies to take market share by lending against good quality assets, backed by strong sponsors at leverage points which mainstream lenders won't reach, whilst benefitting from senior security packages and bespoke covenants. Furthermore, many real estate borrowers will be compelled to tap into private credit as there will be diminished mainstream funding options due to the factors outlined.

Private credit will continue to act as a cornerstone function of the financing landscape which will support transaction activity and investment flows.

3

Heightened risk-adjusted returns

A significant rise in base rates both in the UK and across the Eurozone over the last 24 months has been driven by an effort to tame inflationary pressures. Coupled with increases in margins charged on loans, this has substantially increased the returns available on commercial real estate debt on broadly a like-for-like basis.

Loans are typically structured with reference to benchmark rates (SONIA in the UK and EURIBOR in the Eurozone) which are directly linked to central bank base rates.

Both SONIA and EURIBOR have risen sharply over the last 24 months in an effort to tame inflation by both the Bank of England and European Central Bank.

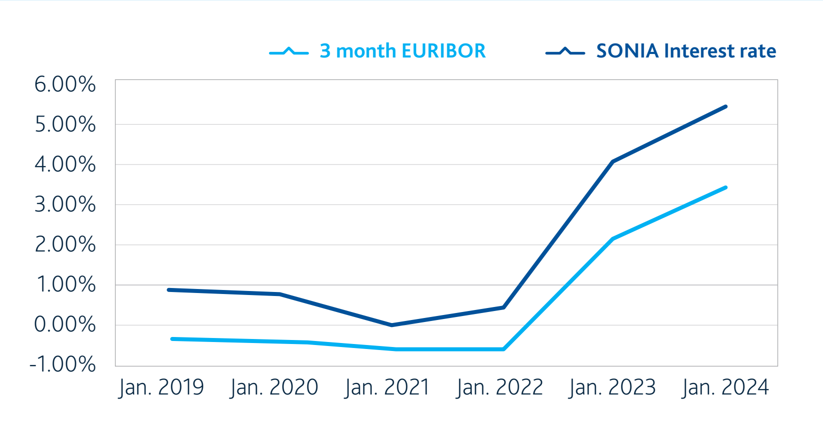
Furthermore, central bank policy makers are starting to set expectations that rates will remain elevated (versus where they were two years ago) for a longer period of time. This is reflected in forecast SONIA and EURIBOR forward curves which summarise where the market is pricing future rates.

Current market projections forecast that EURIBOR is expected to remain above 2.5% over the mid- to long-term, whereas SONIA is expected to remain above 3.5% over the same period. Whilst future rate projections are subject to change, at the time of writing (April 2024), this mirrors what central bank policy makers are communicating.

In turn, this allows for European real estate credit strategies, which are priced with reference to SONIA / EURIBOR, to make higher returns versus those available over the last decade and crucially, this opportunity set is set to remain for at least the mid-term.

Chart 3

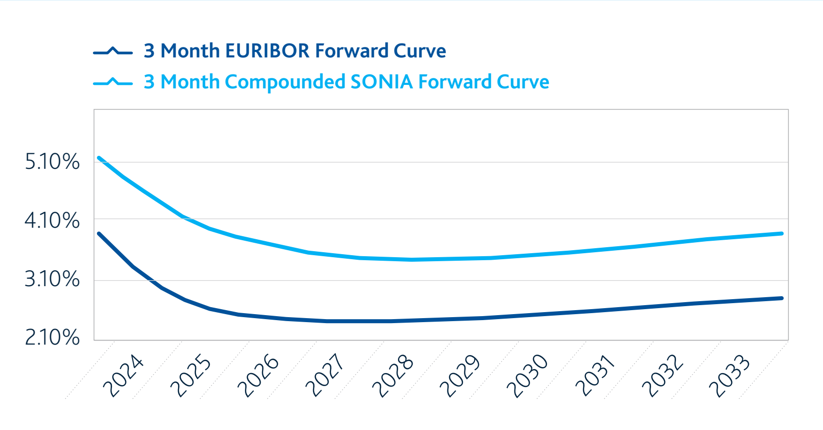
Historical Benchmark Rates – EURIBOR vs. SONIA



Source: www.euribor-rates.eu & www.global-rates.com – European Market Projections – 11/04/2024

Chart 4

European Market Projections



Source: https://chathamdirect.com/rates/market-rates/europe/sonia/forward-curves 11/04/2024

Table 1

Heightened Risk-Adjusted Returns Example – Development Financing Key Assumptions

	Q1 2022	Q3 2023	Change
Loan-to-Cost	65.00%	65.00%	-
Loan-to-Gross Development Value	55.00%	55.00%	-
Arrangement Fee	1.50%	1.50%	-
3M SONIA	0.60%	4.25%	**3.65%**
Margin	4.50%	4.75%	**0.25%**
Commitment Fee (Undrawn Funds)	2.00%	2.00%	-
Exit Fee	1.50%	1.50%	-

Table 1 and Chart 5 summarise a like-for-like three-year senior development financing at ~65% LTC / 55% LTV, priced in Q1 2022 versus what is achievable in the CRE debt markets today.

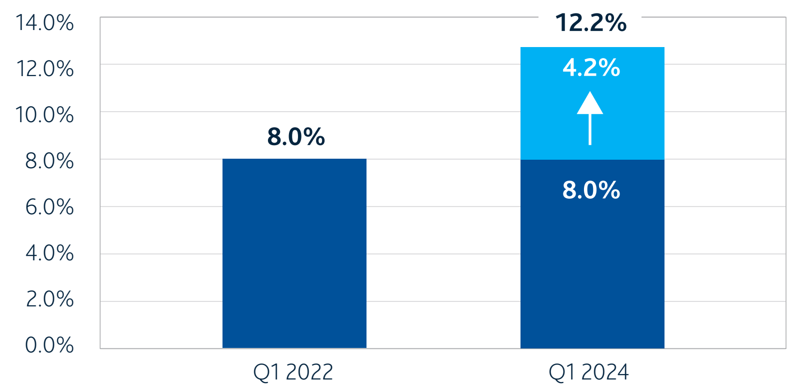
As shown in Chart 5, unlevered deal returns have increased by ca. 4.2% from ca. 8.0% in Q1 2022 to ca. 12.2% in Q1 2024 on a broad like-for-like basis.

Significant heightened returns can be made from senior secured, whole loan real estate investment strategies versus what was achievable 24 months ago. Furthermore, loans are typically structured with hedging in place for the floating rate component (in the form of interest rate caps) so that a borrower has certainty over maximum interest payments over the life of a loan. In addition, lenders are often structuring synthetic interest rate floors so that if base rates and in turn reference floating rates drop over the life of a loan, a lender is able to guarantee a minimum return.

Clearly not all real estate business plans will be able to support higher financing costs. The lenders which back best in class assets and best in class sponsors and who have the ability to cure issues as when they arise will be best placed to take advantage of heightened debt returns.

Chart 5

Heightened Risk-Adjusted Returns



Source: Fiera Real Estate Debt Strategies.

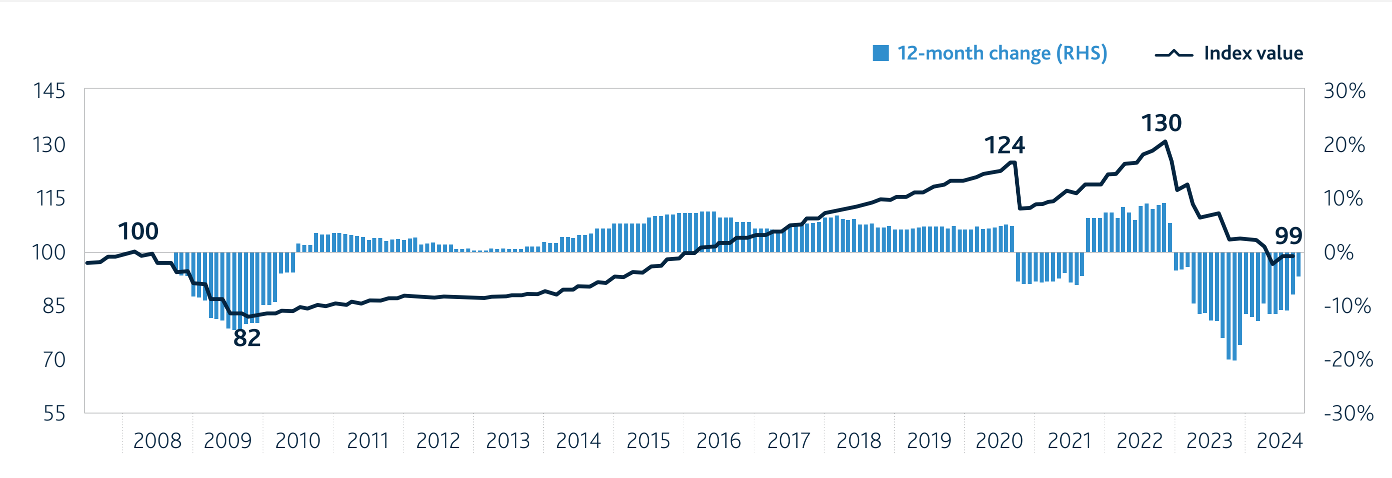
4

Senior secured whole loans favourable in the current environment

We believe that in the current volatile economic environment, where private market valuations are still fluctuating and liable to potential further decreases, a senior secured whole loan real estate credit strategy provides for a compelling investment case on a risk-adjusted basis.

Chart 6

Green Street Pan-European Commercial Property Price Index (Local Currency)



Source: https://insights.greenstreet.com/hubfs/GSCPPI20240404-EU.pdf

Increased interest rates have pushed out yields on commercial real estate, which in turn has caused valuation declines, with some sectors suffering more than others. It is estimated that pan-European commercial property prices (across industrial, residential, office and retail) have fallen by ca. 5% over the past 12 months[7] with some estimates being higher.

A senior secured CRE whole loan will typically be sized at slightly higher leverage points compared to banks, who are constrained due to regulation at higher LTVs and are further hamstrung by debt service cover ratio considerations in a heightened interest rate environment.

Debt funds can take advantage of this by lending against re-based valuations (as of today) and offer whole loan solutions at slightly higher leverage points (for example, 65% LTV) and achieve extremely attractive returns.

Senior secured whole loan strategy

Advantages of a whole loan senior secured strategy from a lender perspective include:

Control

- Whole loans benefit from 1st ranking security including mortgages, share pledges and bespoke covenants.
- Being a single lender leads to having unilateral control in adverse scenarios including controlling enforcement proceedings and / or deciding on exit strategies.

Equity subordination

- Whole loan solutions at 65% LTV have significant equity subordination and even material valuation declines / asset deterioration should not impact debt basis and debt recoverability.

Efficient capital deployment

- As opposed to deploying a senior / mezzanine strategy which involves negotiating with multiple counterparties, whole loan strategies are simpler to execute due to dealing directly and unilaterally with an underlying borrower.
- As an investment strategy, this can lead to efficient capital deployment and easier scalability.

Funding Gap Opportunities

- As referenced previously, decreasing valuations coupled with rising interest costs are leading to funding gaps at a point of borrower refinance.
- A whole loan strategy can refinance funding gaps and choose stronger assets and sponsor groups to refinance at elevated returns.

Regardless of the above, the most successful whole loan real estate credit strategies will be executed by those managers who lend against assets which are more insulated from the wider volatility in the real estate markets, either where valuations are re-based and / or by backing asset classes which have favourable occupational demand dynamics over the mid-term.

5

Portfolio diversification benefits

An allocation to senior / whole loan real estate credit can act as a complement to direct property equity investment, is a natural diversifier to fixed income and in the present environment provides good relative value versus corporate debt.

Table 2

Correlation Between UK Real Estate and UK Whole Loans (5 year IRR)

The below table shows the correlation of returns between UK real estate equity strategies and private whole loan and mezzanine debt strategies, measured on a 5 year IRR basis.

	UK Real Estate, Retail	UK Real Estate, Office	UK Real Estate, Industrial	UK Real Estate, Residential	**UK whole loans**	UK Mezzanine Loans
UK Real Estate, Retail	1.00	0.81	0.80	0.41	**0.28**	0.37
UK Real Estate, Office	0.81	1.00	0.79	0.40	**0.36**	0.44
UK Real Estate, Industrial	0.80	0.79	1.00	0.39	**0.23**	0.31
UK Real Estate, Residential	0.41	0.40	0.39	1.00	**0.20**	0.25
UK whole loans	**0.28**	**0.36**	**0.23**	**0.20**	**1.00**	**0.90**
UK Mezzanine Loans	0.37	0.44	0.31	0.25	**0.90**	1.00

Source: Aviva Investors, March 2023.

UK whole loans have strong diversification benefits when set against UK real estate equity investment strategies and also mezzanine investments. This is in addition to the outperformance currently offered by senior secured CRE credit as eluded to earlier and the significant benefit of downside protection offered by this type of strategy.

Furthermore, whole loan CRE credit strategies offer compelling and a more stable and predictable returns profile relative to major corporate credit indices

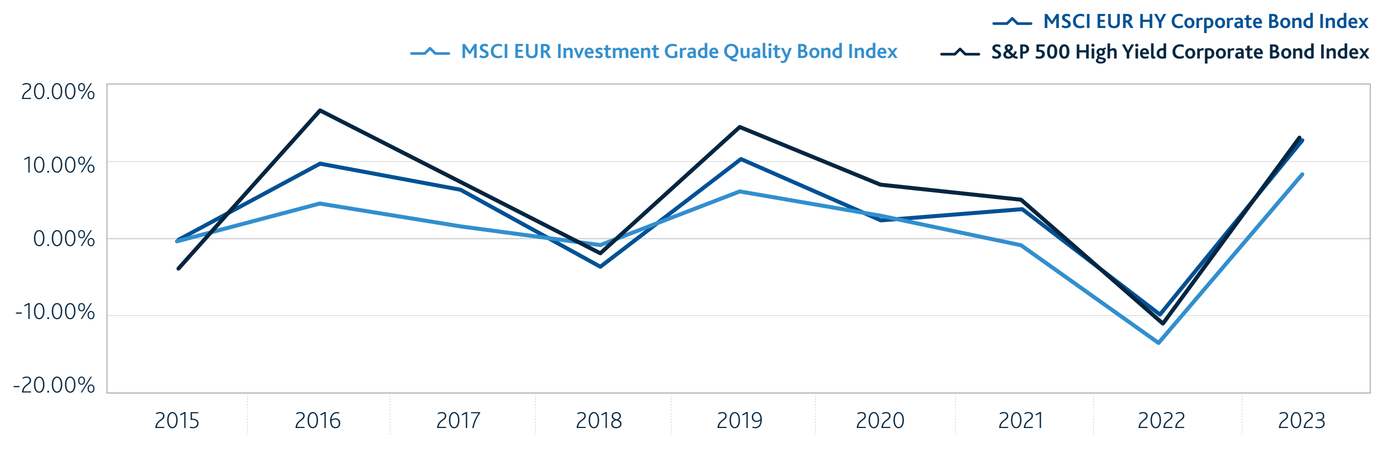
Annualised returns of:

1. MSCI EUR High Yield Corporate Bond Index
2. MSCI EUR Investment Grade Quality Corporate Bond Index
3. S&P 500 High Yield Corporate Bond Index

	1	2	3
1 year	10.38%	6.69%	7.13%
3 years	1.31%	-2.29%	0.48%
5 years	2.59%	-0.49%	4.28%
10 years	3.23%	1.09%	4.89%

Chart 7

Year on Year Corporate Credit Indices (Annual Returns)



Sources: 1) https://www.msci.com/documents/1296102/57c60027-8df4-6f41-1d87-5d84acdf512f
2) https://www.msci.com/documents/1296102/52702add-5a87-3380-9cbb-d3445cbd523c
3) https://www.spglobal.com/spdji/en/indices/fixed-income/sp-500-high-yield-corporate-bond-index/#overview

Major corporate credit indices, as evidenced by the MSCI HY Corporate Bond Index and the Investment Grade Bond Index and the S&P 500 HY Corporate Bond Index, have provided mixed returns over the last 8 years, as shown in Chart 7.

Whole loan CRE credit strategies provide diversity to real estate equity strategies and can provide compelling and more stable returns when set against major corporate bond indices, particularly in today's heightened interest rate environment. This is in addition to the core fundamentals of the asset class, being stability and non-volatility of returns and strong downside protection benefits.

6

Fiera's pan-european real estate credit platform

Fiera Real Estate is wholly owned by Fiera Capital Corporation, a leading multi-product investment management firm with more than USD $124.1 billion AUM globally.

Within Fiera Real Estate sits Fiera European Real Estate Debt Strategies ("FREDS"), containing a dedicated team focussing on creating and managing real estate credit strategies for Fiera's clients.

Sitting within the real estate division allows FREDS to take advantage of a vertically integrated business model which manages over USD $7 billion of commercial real estate through a series of investment funds and accounts.

The European real estate credit team is part of Fiera's private markets platform, which manages USD $4 billion AUM of real estate credit globally.

Furthermore, Fiera Capital provides Fiera Real Estate with access to global investment market intelligence, which enhances its ability to innovate within a framework that emphasises risk assessment and mitigation.

Table 3

Fiera European Real Estate Debt Fund (the "Fund") – Key Terms

Fund Format / Liquidity	Open-ended w/ 24-month lock-up, quarterly redemptions on a "best efforts basis"
Jurisdiction	Luxembourg (SCSp AIF)
Loan Types	Senior secured whole loans – min 80% of NAV
Target Geographies	UK (min 50% of NAV) Developed continental Europe (incl. Germany, Netherlands, Spain) (max 50% of NAV)
Target Asset Types	Diversified loan portfolio across residential, hotels, PBSA, Grade A logistics, Grade A offices
Fund Diversity	Target # of positions: 15+ Target ticket sizes: £25m - £75m
Target LTC / LTV	Target Weighted Average LTC: 60 – 65%, Target Weighted Average LTV 55%, Maximum LTC: 75%
Target Returns	Net Investor IRR of 10%+
Target Liquidity	> 4% p.a. (subject to variance as the strategy grows)
Currency	GBP

The Fund is marketed as an Article 8 vehicle under SFDR and has developed its own proprietary lending framework which assesses and reports on investments both at Sponsor and at asset level.

There is no guarantee the targets will be achieved.

Conclusion

Private real estate credit as an asset class has been through a period of sustained growth since the GFC, driven by private funds taking market share from banks as a result of increased regulation.

There is significant market share which can be taken by private credit if the European market continues to evolve and look more akin to the more mature US market.

The opportunity set is amplified by both a wave of refinancing over the coming years and an increasing funding gap driven by valuation declines and interest cover shortfalls.

A senior secured whole loan CRE credit strategy looks particularly compelling in the current climate as a result of the heightened returns available to lenders, strong downside protection mechanisms through hard collateral and first ranking security leading to control of the capital stack. Finally, private real estate credit can offer diversity and complement real estate equity strategies and can offer good relative value and stability of returns when set against high yield corporate credit.

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Please find an overview of registrations of Fiera Capital Corporation and certain of its subsidiaries here: https://www.fieracapital.com/en/registrations-and-exemptions.

Footnotes

1. Bayes Business School, European CRE Lending H1 2023
2. Bloomberg – Europe is bracing for a sharp, abrupt real estate reversal- January 2023
3. Refinancing Gap Crisis & Opportunities – Green Street – September 23
4. The commercial real estate debt market: Separating fact from fiction - Cohen & Steers (cohenandsteers.com)
5. https://cdn.pficdn.com/cms/pgim-real-estate/sites/default/files/PGIM%20Real%20Estate_European%20Real%20Estate%20Debt.pdf
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7. Green Street Pan-European CPPI

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