Debt funds chase bank lending market share

LONDON (Reuters) - Banks keen to boost European commercial property lending in 2010 are under pressure to mend key client relationships that soured in the downturn, as a new crop of debt funds eye the sector, Brookland Partners said.

Nassar Hussain, managing partner of the real estate investment banking boutique, said banks are at risk of shedding more market share this year as funds set up to offer alternative access to credit upped efforts to lure one-time bank borrowers.

"There are some funds coming to market where managers who originally wanted to launch mezz (mezzanine finance) vehicles were asked by their investors to reduce the risk-return profile and launch senior debt funds instead," Hussain told Reuters.

"They are still in the structuring phase but they are likely to provide significant new sources of capital over time," he said.

After a tricky 2008, real estate debt funds and private equity-backed bank start-ups began to attract cash from investors from mid-2009, after asset values began to stabilise.

Last month, reports said Blackstone (BX.N) was mulling the launch of a new bank to plug the gap left by bailed-out banks such as Lloyds Banking Group and Royal Bank of Scotland.

Now, as investor demand for prime commercial real estate rallies, banks are actively looking to do new business, but many are still battling to shrink multi-billion pound bad loan books that have relegated them to the fringe of recovering capital markets.

De Montfort University data showed the volume of UK commercial property loans in breach of covenants rose 75 percent to 18.7 billion pounds in first-half 2009, taking the volume of distressed commercial mortgages over 30 billion pounds.

"If you talk to the banks, a number of them will tell you they cannot meet their lending quotas," Hussain said.

"Besides the emergence of new competitors, the biggest reason for this is because they are still very restricted on the type of assets they can lend to," he said, describing a general reluctance to lend against non-prime real estate at loan-to-value ratios or more than 70 percent.

In order to offer more competitive terms that will beat these new rivals, Hussain said banks needed to accelerate joint venture plans on troubled property assets, which would free up capital for new business.

"Banks are starting to become much more transparent about their problems, which is refreshing and they're building huge teams to resolve these legacy issues but the refinancing task is growing daily," he said.

"It may be some time before we see banks lending on secondary assets again and until they do this and work through their problem loans they will struggle to regain their familiar position in the market."

(Editing by Andrew Macdonald)