Distressed Property Breakfast: Local, asset expertise, new equity to help

PIE's first Distressed Property Breakfast brought together five experts in London to discuss the theme: Distressed portfolios are emerging in Europe this year. How big is the problem? Can it be handled? Held in the offices of DLA Piper in London, PIE welcomed (left to right): Philip Burns, CEO, Corestate Capital Advisors, London; Nassar Hussein, Managing Partner, Brooklands Partners, London; Anders Palmgren, Head of Corporate Finance, Catella, Stockholm; PIE's Allan Saunderson; Bjorn Sjoeberg, Partner, DLA Piper, Stockholm; and Michael Walton, CEO, Rynda Property Investors, London.

Half of €1.2tr RE debt to mature by 2014

All of the panellists agreed on the figures regarding the distressed property market in Europe, cited by Brookland's Nassar Hussein as roughly half of a total €1.2tr of commercial debt maturing in the next three years and needing refinancing. Only about 10%-15% comprises CMBS, most notably in the UK, Germany and France, and the rest is bank debt.

"Whilst there has been a strong recovery for prime assets in core metropolitan locations," this represents only the tip of the iceberg, Hussein said. Anecdotal evidence suggests that "banks have been liberally extending in the hope that there'll be some recovery but the vast majority of real estate is secured on secondary and tertiary assets, and there's no light at the end of the tunnel in the short to medium term that these will recover quickly." With no senior debt available, "at the moment it looks bleak."

Rynda's Michael Walton agreed, seeing €500bn of loans needing refinancing over the next four years. "That's €25bn per week, and if you think of the withdrawal of senior debt lenders and how many hundred million-plus transaction that is an hour, you can sense the scale of the problem." He thinks the banks' current 'extend and pretend' approach will only work until June, "when the European Banking Association equity core ratios come into effect and they will need to take action."

Corestate's Philip Burns feels that 'extend and pretend' will become 'amend and extend'. While he sees recovery in financial markets, it is, "not enough for rights issue after rights issue to increase their Tier 1 Ratios." He also sees no climate for bargain hunting yet. "The problem is huge, but the banks won't be addressing it with discounted sales - they don't have the willingness or the desire to do it. In Europe, there's a cultural aversion to taking big losses, only for a buyer to come in and make the banks look less than clever later on if he is then doubling his money." ■ **pie**

New debt restructuring strategies emerging

Much is to be gained by primary servicers on distressed property being pro-active, and reaching out to investors and funding streams able to deal with the collateral before portfolios reach maturity, the panel

agreed. As Catella's Palmgren emphasised, refinance requires liquid debt capital markets and real estate transaction markets and these are not in place at the moment.

"If you look at Spain, one of the more troubled regional markets, the real estate turnover in the country was less than that of Stockholm - in a country with thirty times the population," Palmgren said. Given facts like this, he sees bank extensions as inevitable. Hussein's experience in CMBS is that things are getting hard-nosed in a jittery market. "What we saw in a recent deal was the first CMBS transaction to go beyond loan maturity and hit 'note maturity' - and this really is unknown territory." The scenario seems to be that "senior bondholders demand a heavy price to agree an extension. This is prevalent in Germany and France when you don't have other options, but even here you're seeing servicers take a harder line - and you are likely to see more enforcement action taken across continental Europe," said Hussein. With no new senior debt facilities, and new debt offerings and products in the market, the shortfall will be difficult to make up for. ■ **pie**

DLA's Bjorn Sjoeberg and Rynda's Michael Walton at PIE's first ever Distressed Property Breakfast (top left). Catella's Anders Palmgren on Nordic resilience (top right). Audience participation (middle) and Corestate's Philip Burns (bottom left) and Brookland's Nassar Hussein (bottom right) on 'extend & pretend' strategies.

European equity to help plug distressed gap

All experts agreed that there is no shortage of equity in the market to try and deal with the distressed real estate and loans in Europe, however the market in such assets and loans is highly diversified so not all situations will attract such new funding.

"There is incredible bifurcation," said Corestate's Burns. "You have the core super-prime luxury gateway assets that are trading - lots of people, like sovereign funds want them… At the other end, there's super distressed stuff; tertiary locations and obsolete assets that people will take severe write downs for - but there is no end game. Ultimately, it's not about equity but the value, the bid ask spread."

Hussein believes there is available equity but, "without leverage equity can't get the needed returns, and there's no leverage on secondary assets across most of Europe" - a sector he calls "not viable in the short term." Sjoeberg sees equity for the right kind of distressed asset in Sweden, but on more realistic terms: "There'll be de-leveraging where many of the deeds done in 2007 were aggressive in terms of LTV 80-85% - someone will need to replace the shortfall, as senior lenders will now only replace up to 60%."

Record attendance at PIE's Distressed Property Breakfast (top). Rynda's Michael Walton (middle left) answering questions from the audience (bottom). DLA's Bjorn Sjoeberg: "Looking to Swedish banks for distressed opportunity in Sweden is not really a way forward."

Palmgren said private equity funds experience the most difficulty raising debt, but that for a portfolio of good means, even institutional investors may make up the shortfall. "Smaller institutions are keen to fund those vehicles because they are prepared to pay a higher coupon for the debt, and a coupon of 6%-7% is not bad," he added. Walton concludes that with so little bank debt available, secondary and tertiary asset values "have to materially fall." He cites a recent Royal Bank of Scotland deal as a case in point - £2bn of loans it wished to sell with the idea of bringing in private equity and having new banks refinance the rest. Of this, 25% went to Blackstone, 75% remained with RBS and it kept all the debt as well. "It was originally a sale with no vendor equity," said Walton. ■ **pie**

Past experience may help Nordic resilience

The panel sees Nordic countries as relatively stable compared with the rest of Europe, perhaps due to lessons learned from its financial crisis 20 years ago, said Palmgren and DLA Piper's Bjorn Sjoeberg.

Palmgren said any problems experienced in local markets were with international investors and banks. "It has been an active market - we have €5bn worth of transactions on distressed real estate," he said. "In the future, there won't be as much in Sweden, some in Denmark and Finland, and a little in Norway."

Sjoeberg agreed about international banks needing to sort out their problems in Sweden, and said it is not a buyers' market. "Looking to Swedish banks for distressed opportunity in Sweden is not really a way forward if that's what you're looking for - our market has dealt with its major problems." The Swedish Enforcement Authority has been set up by the state to enforce on real estate in a distressed situation. It comes in and conducts an auction to sell the properties, ensuring that much of these assets are not stuck on bank balance sheets. He added that market circumspection on this has changed.

"There have been some examples of pre-packed portfolios that have realised good values." Palmgren added that they have even managed to pique risk-averse local institutions, arguing that, "the opportunity lays in sweeping up distressed assets and making money out of them." Catella acquired €2bn of assets in two years - significant size for that type of asset. ■ **pie**

Bespoke approaches, local expertise needed

Burns sees potential in the flip side of the equity capital scenario, seeing the RBS-Blackstone Isobel Deal as the kind of innovative thinking required from property investors in a challenging, debt-starved environment. This goes in hand with local level expertise to drive asset values.

Of the Isobel Deal he said: "What they were doing was getting a committed, capable asset manager to come on board, put in equity and work with RBS; if and when the asset recovered, RBS would participate in the upside and look over the next few years to selling off the remaining 75%." In contrast to the past where property bundles were purchased off a spread sheet analysis, a bottom-up view of the distressed property market is best. "To successfully invest in assets, you need to understand real estate on a local level so you can drive value, make the asset 'sweat', persuade the banks and work with them," he said.

Walton said his firm's diversification into direct real estate management across their global portfolio ensures that they know exactly how their clients' portfolios are performing on a daily basis. Hussein sees opportunity in unpicking deals. "A lot of them are now highly structured and with so many participants, you need to understand them and their motivations," he said. "Are they 'in the money' or 'out'? Strategic investors or balance sheet lenders? Understanding this is key to unlocking and resolving a deal." But dealing with self-interested counterparties he concludes, "you'll need patience and a thick skin." ■ **pie**