Proceed, with caution

Guest comment by **Dean Harris**

Lenders are increasingly looking at continental Europe but are becoming more cautious, says loan servicer Trimont's EMEA executive managing director

A review of recent pan-European loan activity demonstrates a continued change in the origin and type of lender most active in the commercial real estate finance market. Alternative lenders have been swift to fill the void created when banks reduced their lending during the onset of the pandemic in 2020 and through 2021.

As market volumes and competition increased in 2021, we observed that alternative lenders are increasingly prepared to consider transactions on the continent, with loans originated in continental Europe accounting for around 37 percent of 2021 European activity from such lenders. Office and logistics were the dominant sectors. To date in 2022, the geographic split has remained at a similar level, with the same sectors remaining dominant.

Looking ahead, we anticipate that alternative lenders will continue to be active and maintain their market share across the eurozone, as banks remain constrained by regulatory and internal policy restrictions. We also believe that alternative lenders will more readily consider opportunities in other markets such as Italy, Spain and Portugal, outside of the more creditor-friendly countries, such as Ireland and the Netherlands, and the larger markets of Germany and France.

It is likely that borrowers will also continue to be prepared to pay a slight premium of 25 to 40 basis points for the flexibility, speed and certainty of closing that the alternative lenders are able to provide.

Slowdown

We would, however, add a cautionary note or two. We have witnessed a slowdown in development loan term sheet activity, as lenders and borrowers consider the effects of cost inflation on all projects across all sectors. This is driven by a significant and seemingly unstoppable increase in material and labour costs since the turn of the year.

We have also noted that it is taking longer for deals to close, as all lenders adopt a more cautious approach to pre-closing underwriting and due diligence. In addition, lenders are starting to undertake reviews of their existing operational loans, to understand the impact cost inflation might have on these loans for the next 24 to 36 months. The number of CRE loans maturing during 2022-24 is sizeable, making these reviews all the more important.

Further, we are seeing the increase in interest rates since the beginning of the year starting to impact dealflow, with lenders and advisers re-assessing their origination assumptions to ascertain whether transactions are still viable. Interest rate caps have been the preferred method of interest hedging during the current cycle, but the rise in forward curves, across GBP and euro currencies, has already had a marked impact on the cost of interest rate caps. This is likely to cause some lenders and borrowers to re-visit their hedging strategies and assumptions in the coming months. This is particularly relevant for those lenders who are looking for leverage financing to fund their positions. ■