KEYNOTE INTERVIEW

Non-bank lenders gain ground amid tight scrutiny

Alternative lenders are thriving in mid-to-large loans while banks dominate larger deals, says Trimont's Dean Harris

In the first six months of 2024, Trimont experienced a significant uptick in the number of deal closings versus the previous calendar year, driven mainly by non-bank lenders continuing to expand their market share in the mid-to-large loan space, says Dean Harris, executive managing director for the loan servicer.

While investors and lenders remain very selective about the sectors and jurisdictions that they want to participate in, there is still a healthy amount of liquidity and appetite to transact in the market.

However, the underwriting and credit analysis that goes into these potential transactions is more robust, and better informed, than ever, believes Harris. He discusses the evolving landscape for alternative lenders.

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Q Banks have retreated from some areas of European real estate lending. Has this resulted in an increased market share for non-bank lenders?
Non-bank lenders have definitely been more active in the first half of the year. In terms of activity levels, approximately 75 percent of the loans that we closed during the first half of 2024 were with non-bank lenders, and these lenders have increasingly moved into the mid-to-large loan space (£50 million to £150 million – €58 million to €175 million – loan size).

That said, banks are still active, but with perhaps more focus on larger loans. For this segment of the market, they are able to either club together with other banks or utilise their distribution networks and strategies for onward syndication.

We have also started to see a gradual increase in refinancing activity, and non-bank lenders are active participants in this market. We expect activity to increase even more in the second half of the year and into 2025, as more loans reach maturity. The recent base rate reduction, and the relative stabilisation of yields across some asset classes, should certainly help with some of these refinancings.

However, we also believe that lenders will continue to be selective about the sectors and jurisdictions that they lend in, and there will continue to be competitive tension among lenders for those deals that are financeable, which in turn will cause downward margin pressure for the most attractive deals.

Q With interest rates falling in Europe, potentially boosting transactions, how selective are lenders becoming?

We have certainly seen a good level of activity in Europe this year. Whilst I think that interest rates are a factor, I don't think they are the sole reason. Non-bank lenders and their investors are more discerning about the sectors and jurisdictions that they want to lend in, but there are certain sectors and asset classes in Europe where the risk-adjusted returns are appealing.

The research and diligence that goes into these potential transactions is much more robust and better informed than ever before. And I really believe that this analysis is one of the main drivers behind some of the non-bank lenders finding opportunities in these sectors and jurisdictions.

Some European banks have retrenched from the market for a number of reasons and this has created opportunities for non-bank lenders across the continent, similar to what the UK has experienced during the last few years. We believe that non-bank lenders will continue to increase their market share on the continent.

Q Where are non-bank lenders finding the best opportunities today?

Right across the continent. We have seen good levels of activity in Spain and Portugal – the PRS and PBSA sectors are popular in these jurisdictions – and we continue to see activity in the logistics sector in the Netherlands and in parts of Germany. We have also seen a reasonable level of activity in the hospitality sector across the entire continent, especially in southern Europe.

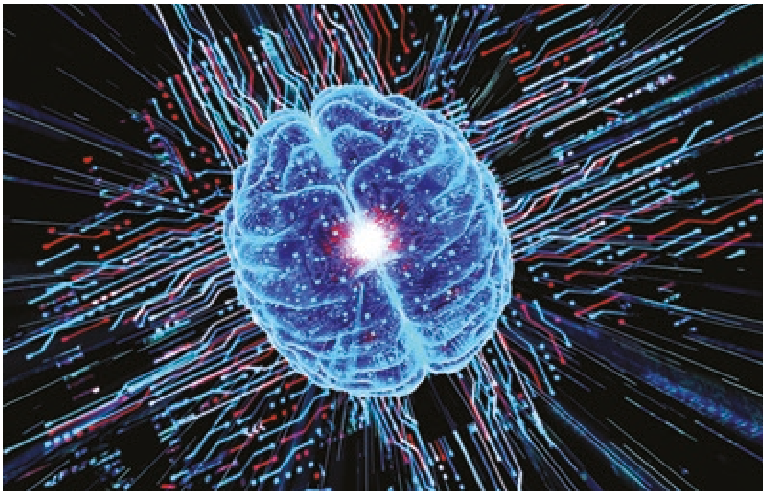
The market remains subdued for development finance, but we have started to see an increase in deal flow in recent weeks. However, there is a strong bias towards residential (build-to-rent/build-to-sell/living sector/retirement, etc) and purpose-built student accommodation, and, to a lesser extent, logistics assets, for these transactions.

Q Has demand for third-party loan servicers increased in 2024?

It has, without a doubt. We are starting to see more lenders than ever before engage third-party providers to service their loans. Non-bank lenders have been willing to appoint and work with third-party service providers for quite some time, but we are now starting to see more banks adopting the same approach and strategy, especially where loans are syndicated, but also for bilateral loans as well.

I believe we will continue to see an increase in the use of third party services, mainly given the complex structures that are now more commonplace on the borrower and lender side. At Trimont, we strongly believe that a proactive and communicative servicer or loan manager can add value, consistency and efficiencies for lenders and borrowers in a transaction.

We are also seeing more lenders



Q How are managers using data right now and investing in data solutions for their credit investments?

We are starting to see more investment into technological solutions and platforms to help with data collection and management. There is still a long way to go, but we will see significant developments in the efficient collection and analysis of data over the next two-to-three years, and the continued evolution of artificial intelligence will accelerate this.

At Trimont, we have invested in our own servicing system, which will have embedded loan management capability. This in turn will feed into our proprietary platform, which our clients can then access to view their individual positions and data on those underlying loan positions. Our clients want to be able to review and analyse that data, and access it in real time. We are well placed to serve our clients' needs in this respect and I am excited for what the future holds.

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"We are starting to see more lenders than ever before engage third-party providers to service their loans"

using third-party loan management teams, sometimes exclusively and sometimes working alongside their existing teams. Understandably, given where we are in the current cycle, lenders remain focused on the management of their existing loans and we anticipate that this trend will continue.

As we move through the current economic cycle, more analysis on loan performance is required. Third-party loan managers provide a focused and unbiased view of loan performance, often highlighting triggers and trends, such as cost-inflation on construction loans, which are critical in risk management.

I also think that we will see more third-party subject matter experts in, for example, development finance, where you will see third-party project monitors working more closely with lenders. And I think we'll see more third-party involvement on other advisory services, for example, in diligence and ESG reporting.

Q Amid a tough fundraising environment last year for non-bank lenders, have you seen higher demand for back leverage?

We are not seeing signs of any liquidity issues; sovereign wealth funds continue to be active in the market, either through direct investment or through investment in specialist vehicles, and we are certainly aware of lenders with capital to deploy. However, some of these lenders have been unable to find the right opportunity, and that is mainly because the market continues to remain bifurcated.

CMBS and CLO market activity obviously remains muted in EMEA, as it has been for some time now. That, together with the lending market remaining extremely competitive for certain transactions, creates pressure on lender returns. As a result of that, certain non-bank lenders are able to consider different financing structures in order to drive their IRR's, and back leverage finance is one of those options.

Some banks also find the provision of back leverage loans attractive, due to gearing, stronger credit metrics and, in some cases, more advantageous balance sheet capital management than for direct lending transactions. Taking all of this into consideration, I anticipate that we will continue to see healthy levels of back leverage loans made available through the current cycle. We have been involved in more back leverage transactions during the last 12 months than in the previous two years combined.

Q What are the key factors that LPs are focusing on when it comes to committing capital to a credit fund?

LPs are looking at returns, the sector, sponsor quality and performance against plan. There is also more focus and attention from investors on lenders' existing loan books; investors will want to scrutinise existing loan books to understand the challenges being experienced by their lenders.

Investors also want to know more about the processes and procedures for managing the positions that lenders have in place as part of the discussion for the next round of fundraising. Investors have more questions and, therefore, the underlying lenders will be having much more of a focus on their loan reporting and their credit metrics as part of the fundraising discussion.

Additionally, ESG remains important. We're seeing more ESG language being included in finance documents. It very much remains, though, a carrot rather than a stick approach; lenders are prepared to offer financial incentives linked to ESG improvements rather than penalties for failure to deliver.

We are also seeing annual reviews of the borrower's performance against plan, with an eye on exit yields at loan maturity. ■