PERE
Credit

By: Samantha Rowan
PUBLISHED: 19 June, 2024

NEWS & ANALYSIS

Barings' Alamgir counsels caution as real estate market moves toward reboot

Barings is taking a measured approach as the commercial real estate market takes the first steps toward a recovery.

Barings is taking a measured approach to commercial real estate debt lending in today's market, looking at a situation in which there is both a strong relative value opportunity but also some level of uncertainty.

Nasir Alamgir, Barings' head of US and European real estate debt, told PERE Credit the firm is focused on what market participants have come to call "the three Bs" – building, borrower and basis – when looking at new loans.

"While loan structures have been better over the past 15 months," Alamgir said, "we've started to see pricing compress in the first half of the year and when that happens, it often leads to allowances for higher cap rates, greater prepayment flexibility, or loosening of other covenants."

While these changes have started to come through the market in dribs and drabs, Alamgir believes in the current maturity wall – estimated at about $930 billion by Washington, DC-based trade group the Mortgage Bankers Association.

"These are things we should not be compromising on at this stage," Alamgir said. "As a lender, we need to take into consideration the uncertainty that continues to reside within our assets."

From a production standpoint, Barings was optimistic going into 2024 and so far has been roughly on track with its goals, Alamgir said. As of Q1 2024, Alamgir oversaw nearly $30 billion in global real estate debt across over 440 investments and an investment team of more than 60.

"We had set our origination expectations approximately 25 percent higher than where they were in 2023 and I would say we're on pace to meet those origination goals," Alamgir said. "What's interesting is that from a broader market perspective, we continue to see a decline in financing activity across sectors. But for our pipeline specifically, and I think for private lenders in general, that pipeline isn't down as much as the broader market simply because of the absence of competition from bank lenders."

Coming into the year, Alamgir believes his research team at Barings had a different perspective on the potential for interest rate cuts than other market participants.

"We believed there would be fewer rates cuts than what the market was projecting," Alamgir explained. "So far that has played out. Based on the commentary [around the June 11 Federal Reserve meeting], we can expect one rate cut for the balance of the year but I wouldn't be surprised if we had none."

A higher risk-free rate means the market will see a decline in valuations, Alamgir added. "We are seeing declines in valuations; however, our research team is also projecting a flattening of that decline. Right now, we are forecasting equity valuations bottoming out toward the end of this year or early next year."

There are caveats to that, however, because of clouds on the horizon, which could include monetary policy or geopolitical unrest.

"The banking sector continues to be problematic and those are all factors that could alter when the market bottoms out. But at this point, we should start to think we will see some stabilization of property values over the next 12 months," Alamgir said.

From a lending perspective, the most attractive thing to Barings right now is construction lending, and Alamgir anticipates continuing to execute loans in this space. "It is a highly complicated product with significant barriers to entry from a lending perspective. We can execute in that space with wider spreads, better loan structures and lower leverage and are typically [working with borrowers] on energy efficient and highly amenitized products."

Overall, Alamgir believes transaction activity will be muted. "Equity sales activity will pick up slightly, but I don't expect it to revert back to pre-rate-hike levels until we start to see rates come back down. There are, however, some people who need to transact, which is why we are seeing a slight uptick, but I don't foresee that significantly changing this year or next."

A final factor that will affect the alternative lending market is the continued pullback from banks. According to research from the Mortgage Bankers Association, there are about $5.8 trillion of outstanding commercial mortgage loans. About half of these loans were originated by banks.

"I think we can continue to see our volumes grow this year and next year. If banks make up half of those loans and are being less active, then clearly other capital will step in from across the board: insurance companies, agencies, CMBS and private lenders," Alamgir added.

© PEI Group. All rights reserved. Content on this site may not be reproduced, distributed, transmitted, displayed, published or broadcast without the prior written permission of PEI Group or in the case of third party content, the owner of that content. You may not alter or remove any trademark, copyright or other notice from copies of the content. You may download material from this site (one machine readable copy and one print copy per page) for your personal, non-commercial use only.