Taking a global view

ING is leveraging its international client base to grow in target markets, explains real estate finance boss Michael Shields

Buyers of commercial real estate are taking an increasingly global approach to business, prompting the need for the provision of finance to also be geographically diverse. That is the opinion of Michael Shields, the head of real estate finance for ING across the UK, continental western Europe, the US and Asia-Pacific.

During the past 12 months, the Dutch bank has been an active player in the core and core-plus segments of several European markets, winning financing deals for a variety of international sponsors. The heavily banked German market is a target growth area for the bank, which currently has a €3.6 billion portfolio in the country. Among the 15 deals done there in 2017, were leading roles in the €625 million financing of Berlin's Sony Center and the €400 million-plus funding of Frankfurt's Commerzbank Tower.

ING's real estate financing business is also expanding outside the region, with the US and Australia key targets, while diversification of its financial products offering has also generated additional business. *Real Estate Capital* caught up with Shields to find out his views on the markets.

Real Estate Capital: *How liquid are European real estate markets?*
Michael Shields: There is good liquidity across the board – even in peripheral markets we're seeing increased competition and a reduction in margins. Germany, Paris and London are most competitive, but we are also seeing increased liquidity in smaller markets such as the Netherlands and Belgium. There is a lot of equity searching for real estate, especially the core and core-plus segment in which we operate. Banks are under pressure to generate income and so we are seeing new entrants into peripheral markets and pricing coming down accordingly.

"More and more clients with large exposures to London are shifting some capital to Paris and Germany"
Michael Shields, ING Real Estate Finance

REC: *What is happening to senior margins?*
MS: In the past 12 months, we have seen margins come in by 50 to 75 basis points in places such as Spain, Portugal and Italy. It's a good time for investors and property owners. There is less liquidity in the value-add space as the traditional banks are staying within the stabilised, core markets, with some value-add business.

REC: *Will we see many big-ticket transactions in 2018?*
MS: Yes. It could be portfolio deals or large single assets. There is still a lot of equity aiming to deploy in Europe. If yields stay as low as they are and with rates not going down anymore, this could be a good time for property owners to sell. They will be thinking about the impact of rising interest rates, so there will be a healthy buyer and seller market. In the US, borrowers prefer to refinance at an appraised value rather than go out to market. I don't see so much of that in Europe – maybe in the UK a little. If you have a stabilised asset, you will attract a lot of interest from several types of buyer and the financing is available to make deals happen. We might see more concern from the sell-side due to stock market volatility, which might close the bid/ask spread a little.

REC: *Are your clients concerned about the political risk in Europe?*
MS: Those fears have subsided to a degree. Last year's Dutch, German and French elections have led to a relatively calm period. However, we did see the Catalan crisis cause some investors to back away from deals and Italy has elections coming up, so there continue to be concerns about the political situation. But, although investors remain cautious, they are not as fearful as they were a couple of years ago.

REC: *As sponsors diversify their portfolios, will Europe benefit?*
MS: There is a global trend towards diversification from high-net-worth investors and sovereign wealth, plus Asian insurance companies and pension funds are seeing the benefits of geographic and currency diversification. That trend will continue. In Europe, core yields are very tight – with Paris and Berlin approaching some of the low yields seen in the Asian markets. So, some investors are waiting to see rental increases to justify buying at such low yields. I'm bullish on Europe because I don't see a lot of construction and this is a normal cycle, so when vacancy rates

get low, we'll start to see rents go up. We have already seen that happen in certain sub-markets. London is the only place where rents have come down, but I'm not pessimistic about London; the fundamentals need to catch up and then we'll see rents start to increase.

REC: *Why are you targeting growth in Germany?*
MS: Our online banking model is very successful there, so we have an extremely low cost base in Germany. We do have Pfandbriefe capability, but it has not been necessary to raise money through that market for commercial real estate lending because of the growth in deposit inflows. We can do pan-European financings from that loan book, but we want it to be a predominantly German book. The client base we have been most active with in Germany is our international clients. More and more clients with large exposures to London are shifting some capital to Paris and Germany. So, clients which we are banking globally are looking at Germany and coming to us. We would like to do more with domestic investors, but they have firm, entrenched banking relationships.

REC: *How do you ensure German banks do not win business from your international clients?*
MS: Our pricing needs to be at market. Whatever the margin is on core properties in Germany, we can compete, if we like the deal and the sponsor. We are looking for the right deals for us in Germany, not just any deal. They need to be relationship-enhancing deals. We can also be competitive for a global client in Germany by speed of execution, because our process is very streamlined. So, being competitive is a combination of factors, including pricing.

REC: *What is driving your expansion outside Europe?*
MS: Europe is our home market and we have considerable market share in the core and core-plus segments of a lot of countries, so the potential for growth is limited, although there is continued scope in some countries such as Germany, France and the UK. The US is such a massive market that we can be selective and still grow there. We have also been impressed by the number of clients doing business in Australia. It is a smaller market than the US, though, which has uncapped growth potential.

$3.6 billion

ING Real Estate Finance's current German loan portfolio

REC: *How can you win business in such a competitive market as the US?*
MS: It isn't easy, but pre-crisis we had a €7 billion-plus loan book and a sizeable team there. We are rebuilding. The US book will be €2 billion soon and the pipeline is strong. The European platform is a huge benefit to us in that regard. Our US clients that are active in Europe will give us American deals because they want to buy in, say, Portugal or Poland and we can make one call and get a financing done for them. Our competitors in the US don't have that ability. There are deals we wouldn't get a look at if we were a pure-play US platform.

REC: *What is happening to pricing is the US?*
MS: It has come down over the past six months, especially in the past three months. There is a lot of competition among banks and some did not make their numbers in 2017, so have come out strong in Q1. What makes the US market so attractive is that yields are higher than in Europe, so if an investor buys at 3.5 percent in Europe and yields come out by a percentage point, that is a large shift compared with the US market where yields might move from 5 percent to 6 percent. We are seeing rental growth in the US and our clients are able to put mezzanine on to our deals, so there are lots of options for winning deals.

REC: *Why is Australia attractive?*
MS: The regulatory environment is similar to the UK, so local banks tend to limit lending to four years and their pricing tends to be higher. For us, coming in fresh with a small book, we are able to grow and do five- to seven-year deals. International clients are not getting what they are looking for from the established Australian banks. The challenging thing is the small size of the markets. In Sydney and Melbourne, we are all over every deal that comes up, so we need to be quick and use our international network to win deals. Our Australian book will reach a natural balance; we have around €1 billion now and I can see it doubling or tripling. An ambitious goal would be to maintain that. Pricing is in the same ballpark as the UK. We are seeing fierce competition from international investors in Melbourne for core and core-plus product, including from Japanese pension funds.

REC: *You have also diversified the financial product offering to real estate clients.Where has that proved most successful?*
MS: We are seeing a lot of activity in Spain, with the SOCIMIs buying up quality assets. They are all trying to grow and find their optimal capital structure. Belgium has also been a strong market for us, with a lot of corporate financing business, and our French REIT clients have also been active in the debt capital markets. We would like to do more corporate-style lending in Germany. Overall, it is definitely becoming a larger part of our activities; 10 percent to 15 percent of our €30 billion-plus portfolio is in unsecured lending to real estate corporates. In Asia it is probably more than that because corporate financings are more common. For us, it is about growing the fee income we generate from non-lending deals. We rolled out our European equity capital markets coverage a year ago and it is a huge priority for us. ■

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