TiteStreetCapital

A changed market: hot to exploit private credit opportunities after Covid

By Guido Lang, CIO of Tite Street Capital
First published in React News on October 18, 2021

The anticipated big distress never quite hit, but opportunities are rife for those in the know

Since the start of the pandemic, there have been both eager anticipation and nervous speculation about the opportunities it might bring to the real estate market.

The first UK NPL sale of the cycle has now taken place, following Attestor Capital and Ellandi's purchase of a portfolio of UK shopping centres from NatWest. However, the level of distress that many expected due to the pandemic has not yet come to the market.

Does this mean that the opportunities many said would be created by Covid never happened? Not quite.

For a start, the opportunity set for private capital in illiquid assets had already been growing for some time due to increasingly stringent regulation on the banking sector and the consequential reduction of risk limits, de-leveraging, and disposal of assets from bank's loan portfolios. Covid has amplified these trends, further curtailing the amount of traditional finance available to the asset class.

It is human nature to focus on the big numbers and the prime, recognisable assets. It is true that, by this measure, there hasn't been the pricing dislocation that many expected, but nor does this paint the full and complex picture that makes up real estate and private credit.

"The pandemic has decimated businesses that were otherwise strong and future proof, meaning good investments have found themselves in unexpected trouble"

Levels of distress are unlikely ever to reach the scale that we witnessed post-global financial crisis in 2008, when the IPD index for UK commercial property dropped a shocking 22.1%. Yet the behavioural changes that were triggered by the lockdown measures in March 2020, and that still linger on in our collective mindset today, have undoubtedly created a changed market environment – and with it, a unique set of opportunities for those who know how to identify and take advantage of them. This is because the pandemic has equally decimated the revenue streams of businesses that are otherwise strong and future proof, meaning good investments have found themselves in unexpected trouble.

Savvy investment or falling knife?

When considering these opportunities, it is crucial to know when you have a savvy investment with downside protection and when you might be catching a falling knife. The primary considerations here must be a focus on liquid markets, established locations and a thorough understanding of the dynamics at play in the micro-location. Historically, these markets have always recovered the fastest in previous downturns, while continued distress is more significant in secondary and tertiary locations.

These circumstances provide businesses with a lucrative opportunity to provide financing to stressed capital structures of fundamentally sound assets and sponsors, plugging funding gaps and thereby bridging the path to value recovery. By offering transitional capital, debt investors can participate in the value creation of transforming non-core opportunities into core assets, capitalising on the current flight-to-quality mindset. We should also expect to see opportunities on the left-hand side as well as the right-hand side of the balance sheet.

On the property level, an asset might have had the appropriate use for its location when first conceived, but the changes brought about by Covid and the emerging requirements and expectations from occupiers mean that it might now be a square peg in a round hole.

With the appropriate capital, these assets can be transformed into desirable assets that meet those updated expectations for example, by providing facilities for active commuting, having an improved ecological footprint, or incorporating the latest air hygiene technology. Another example could be the repositioning of well-located but underutilised business hotels or retail buildings into Grade A offices or full or partial residential developments.

"An asset might have had the appropriate use for its location when first conceived, but Covid might now have made it a square peg in a round hole"

On to the debt level. A notable characteristic of challenging market conditions, which we are again witnessing today, tends to be the withdrawal of banks and the reduction of lending into less liquid projects. This plays straight into the hands of non-traditional lenders. We expect those with cash to see the current market as an acquisition opportunity and to provide finance for asset owners looking to either unlock liquidity from their balance sheet, refinance, or bridge the gap until market normalisation.

There is no doubt that Covid has stimulated an interesting landscape of opportunities for private credit and real estate. However, distressed opportunities are, by their nature, complex and not always easily uncovered; an ability to source off-market transactions and solve issues through creativity will be crucial. For those who know where to look, the opportunities are there.

***

About Tite Street Capital: Tite Street Capital is an independent investment advisor, operating partner, and asset manager focused on opportunistic Real Estate and Asset Backed Investments. Our investment philosophy is defined by an emphasis on preserving capital, while providing attractive risk adjusted returns to our investors and partners. Tite Street Capital is backed by a team with strong investment capability, and execution experience, across a variety of European markets. www.titestreetcapital.com