Non-Bank Lenders Are on the Rise To Fill the Gap

Traditional Banks Are Cautious and Housing Sector Needs Innovative Solutions

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By Ellis Sher

4 July 2024 | 9:14

In the European residential real estate market, the emergence of non-bank lenders is significant. The traditional banking sector's cautious approach to real estate lending, combined with a rising need for various housing options – including affordable homes, student accommodations, healthcare and senior living facilities–has paved the way for alternative and innovative lending solutions. This shift is particularly notable as cities across Europe contend with demographic changes in addition to an ageing, energy-inefficient property stock.

The resilience of the residential sector, highlighted during the pandemic, has significantly bolstered investor confidence. Government initiatives across Europe have supported homeowners and renters, ensuring stability in rent payments as evidenced by data from residential real estate investment trusts. Furthermore, demographic trends, such as ongoing immigration, are driving a sustained demand for housing, which is underpinned by a constrained supply. Moreover, the shorter duration of residential leases allows for rents to dynamically adjust to inflation. This, coupled with the downside protection offered by investing in senior secured private debt has fuelled interest in this investment class. The opportunity has been amplified by banks retreating from real estate that is more operationally intensive and inefficient from a capital efficiency point of view under the finalised Basel 3.1 rules.

Property developments, especially those secured against high-quality liquid assets, are particularly appealing due to their high-yielding potential. This aspect of real estate investing, combined with the security that physical assets provide, makes it an attractive option for those looking to balance returns with risk as part of a diversified portfolio. This was reflected in a recent Investment Intensions report from INREV, the European Association for Investors in Non-Listed Real Estate Vehicles, where over 90% of investors say they will be targeting residential real estate in 2024.

Arrow Lending Opportunities lends across the European residential sector, but we see particularly strong opportunities in the rental sector, ranging from studios to two-bedroom apartments. Our loans range from two to four years and span from £1 million to £300 million for larger schemes. Most recently in the UK, we have found considerable value in cities such as Salford, Manchester, Liverpool, Leeds and Birmingham, which have enjoyed significant price growth compared with many London boroughs. This attractiveness was reflected in a recent study by Swedish bank Handelsbanken that reported the East of England, the North East and the North West have overtaken both London and the South East in a ranking of the most popular hotspots for UK property investors over the next 12 months.

The European markets present both complexities and opportunities, with nuances in countries like Spain, Portugal and Italy necessitating tailored approaches. The importance of having knowledgeable local teams to navigate these complexities, such as regulatory restrictions on non-bank lending, caps on fees and interest rates, and prohibitions on personal guarantees, cannot be overstated. These local teams are crucial for sourcing and managing local investments.

The non-bank sector has the flexibility to offer quicker response times on equity, gearing and asset classes than traditional banks. The shift towards personalised service and rapid, entrepreneurial responses in lending has become more pronounced since the global financial crisis. Borrowers increasingly value relationships with lenders who can provide clear and timely decisions along with flexible loan terms.

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