EXPERT Q&A

Allocations to private credit backed by real estate are growing in Australia, especially for commercial property, say MaxCap's Wayne Lasky and Bruce Wan

Australian real estate: A scalable, sustainable opportunity

Q How would you describe the current real estate credit market in Australia, and what have been the trends in the past 12 months?

Bruce Wan: We are seeing a very strong real estate credit market in Australia at the moment. From an investor's perspective, it is a challenging environment in various asset classes, with a lot of stagflation across the developed world, and rising interest rates. That creates a difficult environment for equities and bonds, but real estate credit is holding up globally quite well, especially in Australia. We expect this to last for the foreseeable future.

As for trends, we are witnessing a migration boom in Australia at a pace we have never seen before. That has fuelled housing demand, driving an upswing in residential markets that you might not expect in an environment of rising interest rates. There is strong demand for housing and various credit solutions, encouraging more investors into the space.

SPONSOR
MAXCAP

Wayne Lasky: Zooming out, allocations to private credit backed by commercial real estate in Australia are increasing quite dramatically. It is important to understand that regulatory intervention and the structural dislocation of the banks that happened after the GFC and permeated Europe and North America really only commenced in Australia in 2017, so we are early in the cycle. Less than 15 percent of commercial real estate lending is done by the non banks, so the growth will be immense and the size of the investible universe vast.

Fund managers like ourselves currently have too many quality assets to allocate to and not enough capital. Allocations are increasing but cannot keep in step with the market opportunity, and that structural shift away from bank lenders being profoundly felt by borrowers.

Q How does that Australian environment compare with the broader global market?

BW: When we look domestically and

get concerned about the below-average pace of economic growth, we have to remember that Australia is outperforming the global market. We are not looking at a Europe-style recession and there are not the recessionary concerns felt in the US.

Population growth in Australia means there is still a lot of demand, and we are also looking at a trade surplus at a record level, exporting much more than we are importing. The sheer volume of raw commodities that we export to China, Korea and Japan is holding up the economy well.

Rising interest rates create positive tailwinds for real estate credit as a hedge. When rates go up, returns in real estate credit also go up, and there are not many asset classes offering that hedge right now.

There has been this wholesale reallocation of capital into real estate credit globally. Whereas other markets are turning some of that attention into office and retail equity, where there has been quite dramatic repricing, the Australian markets have not repriced to the same extent. Here, there is not that distraction of people buying value office because it has reached the bottom.

WL: Taking a different lens, I think of this as being about timing. In Australia, there are fundamental structural and generational trends underpinning the opportunity to invest in Australian commercial real estate credit and generate outsized returns. That creates predictable, reliable income with an absolute focus on capital preservation, and that opportunity is scalable and sustainable.

This is somewhat different to what is presenting in North America and continental Europe right now, where there are some challenges at a macroeconomic level that present opportunities subject to what the entry price might be on any given trade. It comes down to good timing. We are talking about something very different, which is not subject to timing but is longer term and is something that large European investors are now starting to actively engage in.

Q What should LPs consider when assessing managers in this space?

WL: Track record is obviously the starting point, and that is not just numbers on a page but also reputation in the market, which is sometimes difficult to assess from thousands of miles away. Still, understanding who is first choice in the market is important. Real estate credit managers need to originate loans from borrowers, so LPs should be looking at how much repeat business they are getting as that tells you quite a bit about a manager. It also helps a manager manage risk if they have a deep appreciation for the sponsor.

I would look carefully at specialisation and embedded local market expertise: what type of infrastructure they have, how close to the asset they are on the ground and how deeply they are rooted into the ecosystem.

BW: Some of that is captured by the umbrella of an institutional platform, looking at whether a manager is doing things as an investor would expect of an institutional platform. The sourcing platform is very important – having people on the ground and being first port of call for people sourcing finance.

Q What are the most compelling aspects of the asset class in Australia today?

BW: Certainly, front and centre would be that interest rate hedge. The world has got used to near-zero interest rates and is a bit shocked to see more historically normal rates, so real estate credit is attractive.

At the same time, higher interest rates are pushing the attractiveness of other asset classes down, so where there is a lot of concern about equity markets and earnings growth, we are insulated from that. For investors looking at global portfolios, it is about looking at returns versus equities, bonds and direct real estate. Most pension fund returns are highly correlated to equities and have almost zero correlation to real estate credit. So, in a world where it is difficult to find growth and find that hedge, real estate credit is standing out.

WL: The size of the Australian market opportunity surprises European investors and there is zero tax leakage in real estate credit with experienced managers. And, critically, banks continue to retract in this market – they are not competing. The opportunity to engage in high-quality underwriting with strong risk-adjusted returns at scale is an absolute feature today.

Q What appetite do you currently see from institutional investors for this strategy? Why does Australian real estate credit make a good addition to global portfolios?

BW: We are still seeing growth in Australia compared with other parts of the developed world. Investors from the UK and Germany are looking to Asia-Pacific for growth, but some of the other markets in Asia are going through challenges. So, when people have set aside money for Asia-Pacific, they are finding it difficult to deploy in East Asia. There are a lot of geopolitical concerns holding people back from going more deeply into different parts of Asia. It is not for us to comment on those concerns, but we do witness investors seeing Australia as a safe haven and targeting their Asia-Pacific allocations here.

WL: Investors are telling us that they have seen the largest European investors in Australia succeed, and in Australian real estate credit specifically, which was alongside real estate equity for a significant period of time. They recognise the value of a pivot to real estate credit at this point in the cycle.

They also recognise that Asia-Pacific is not a homogenous marketplace and Australia is one of the core markets in the region that is a safe entry point.

Q Finally, what is the outlook for Australian commercial real estate credit, and what do you expect to be the big themes in the next few years?

BW: I would point to three themes. First, we are seeing a population boom in Australia create a dramatic undersupply of housing and a rental boom. People complain about a lack of affordable housing and the only real way to solve that is to build more homes, which requires more capital.

Second, we now have a more normalised interest rate environment, so rates will be higher for longer. What worked when interest rates were really low will no longer work, so investors need to make that dramatic and permanent shift, with a key solution being commercial real estate credit.

Finally, investors are making that switch from equity to credit, particularly in real estate, for legitimate reasons. If you own real estate, you have no shock absorber and you feel every bump. When you are the credit provider, you have many more buffers so you can deliver more consistent, resilient returns.

Over time, we expect all three of those trends to drive more capital into real estate credit in Australia.

WL: In addition, my sense is the banks will continue to retrench. MaxCap as a fund manager and non-bank lender is complementary to the banks, partnering with them to offer a seamless transmission of credit to credit-worthy sponsors and assets. In an asset class like real estate, which is heterogeneous, you need to have multiple solutions for each asset at different stages of its life cycle.

I foresee pension funds, insurers and high-net-worth investors will increasingly seek out the opportunity in Australia based on risk-adjusted returns that are too strong to ignore. Our vision is to ensure we have a breadth and depth of capital across the real estate credit spectrum in the country, up and down the risk curve, to allow us to lean into the market and allocate to where we see the biggest need and the optimal returns for investors. ■

> *"Rising interest rates create positive tailwinds for real estate credit as a hedge"*
>
> **BRUCE WAN**

> *"The size of the Australian market opportunity surprises European investors"*
>
> **WAYNE LASKY**

Wayne Lasky is executive chairman, and Bruce Wan is head of research, at MaxCap