Insuring stability

PGIM Real Estate wants to further scale its lending platform. But the firm does not want to be all things to all borrowers, Randy Plavajka writes

PGIM Real Estate, already the largest alternative lender in the US, sees room to grow market share as traditional lenders scale back.

But the Newark, New Jersey-based manager sees growth as a way to enhance its existing lending programs and relationships, rather than entering areas that are not part of its expertise, says Bryan McDonnell, head of the US debt business and chair of global debt at PGIM Real Estate.

"Our goal is to almost be a market-clearing house. I do not want to originate CMBS, and PGIM Real Estate is not a bank, so I am not going to get those sorts of products," McDonnell says. "But everything else from mezzanine, preferred equity, transitional lending, senior financing, short, fixed, float, construction – I want to have the ability to do most of it."

This kind of selectivity has been key as PGIM Real Estate has grown its business globally, McDonnell notes. And part of scaling a platform includes offering the right products to the right borrowers. In Europe, for example, the firm has the most conviction on senior mortgage and higher-yielding loan opportunities, he adds.

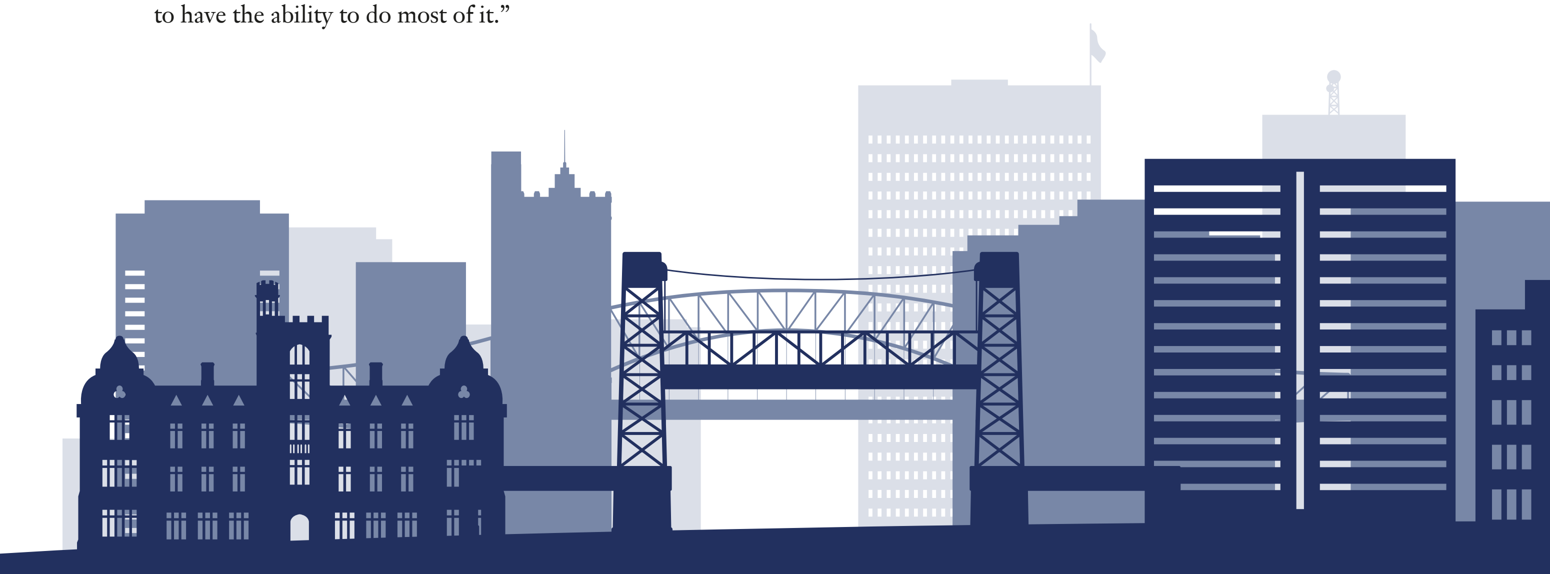
"There is a mistake in trying to be everything to everyone," McDonnell says. "We do not want to be that. What we want to do is when we go into something, have the conviction that we can build market share and scale, and that has really played out now."

Platform edge

PGIM Real Estate, which holds the top spot in *PERE Credit*'s annual ranking of real estate private credit managers, has made substantial efforts to build up its origination platform over the past few years. The initiative has meant the manager was able to step in as banks and commercial mortgage-backed securities conduits scaled back their lending.

The manager originated about $12 billion in loans in 2023, a period in which transaction flows were nearly halved compared with their historical annual average, notes Melissa Farrell, a managing director and the head of US debt originations at PGIM Real Estate.

PGIM Real Estate is starting to see banks return to the market on a limited basis for high-quality sponsors or for



> *"There has been an enhanced focus on portfolio risk management and oversight"*
>
> **KELLY FOLLAIN**
> **PGIM Real Estate**

Maintaining agency

PGIM's Freddie Mac and Fannie Mae ties are an advantage, but market conditions remain challenging

PGIM Real Estate has long been a Freddie Mac and Fannie Mae lender, designations that have allowed the manager to remain active during periods of distress. This is due in part to the support the government-sponsored agencies provide for the financing and development of housing each year, says Kelly Follain, head of agency lending.

Fannie Mae and Freddie Mac each committed $70 billion for the housing markets in 2024, and PGIM Real Estate's agency business includes proprietary bridge-to-agency products, a selective equity book and collaborations with the Federal Housing Administration. PGIM Real Estate's $61.9 billion multifamily servicing portfolio has a roughly $45 billion concentration in Fannie Mae, Freddie Freddie and the US Department of Housing and Urban Development loans.

"Our [agency] capital partners provide liquidity during all market conditions," Follain says. Current market conditions, however, remain challenging. "There has been some market acceptance of the higher for longer interest rate environment, with most agreeing that we are anticipating only one rate cut for this year. Still, deals are complicated and require creative solutions, resulting in more conversations with the agencies, prolonging turnaround times."

PGIM Real Estate has observed that borrowers that own and operate multifamily assets are often seeing significant pain points with taxes and insurance costs. The availability of insurance is an additional concern, Follain notes. Another issue is the need for flexibility and the underwriting and structuring of loans.

"Looking historically at the agencies' long-term stable debt, 10-plus years was the primary long term to get. They started shifting to allowing more shorter-term, five-year and seven-year deals with greater pre-pay flexibility," Follain adds.

Long road to the top

Key milestones in PGIM Real Estate's debt platform

1875	1878	1970	1997	2000	2001
Prudential Friendly Society is founded	Begins investing in US commercial real estate mortgages	Launches first open-end commingled real estate strategy for US investors	Forms Prudential Mortgage Capital Company	Adds Fannie Mae DUSTM and FHA programs	Establishes mortgage servicing platform

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> **MELISSA FARRELL**
> **PGIM Real Estate**

specific opportunities, like construction lending. But this continued stasis in the bank market has meant PGIM Real Estate has been able to expand its lending in the core, core-plus and niche sectors.

"We all have to go back to our basics in terms of [the old real estate adage of] 'Location, location, location' and 'Your sponsorship, your market, your product type,'" Farrell says. "It is one thing when all boats are rising, but in a market like this, you really start to differentiate."

The manager has a network of 34 offices globally, which translates into on-the-ground real estate investment professionals with a strong understanding of regions and borrowers. The firm can invest via its debt funds, make balance sheet loans and originate both Freddie Mac and Fannie Mae loans, Farrell adds.

Constructing a portfolio

Having headcount is one critical part of scaling a debt business. Anticipating shifts in market trends is another, McDonnell notes. There have been times when PGIM Real Estate was moving in one direction while the market was moving in another, he adds.

"I remember being in Europe in 2015 and people were laughing at me for lending on a depreciating asset class in industrial," McDonnell explains. "And we were happy to do that, because I saw the world going in that direction."

At the time, McDonnell saw the potential for outperformance resulting from rising online shopping, which affected industrial and logistics demand. PGIM Real Estate first saw the trend play out in Los Angeles and the broader West Coast, shift to the East Coast of the US, move onward to Europe and eventually make its way around the world.

The manager was also an early adopter of the sentiment that the office market could face challenges. To balance that, PGIM Real Estate began allocating more to smaller multifamily and industrial deals.

"In early 2011, we started underweighting office. Because we have so many people out there seeing deals, we could clip off $20 million to $25 million multifamily and industrial deals and do that well," McDonnell adds.

That shift ultimately meant that PGIM Real Estate has fewer legacy issues in its own portfolio, McDonnell notes.

The experience of the firm's investment professionals also can play into its activity. McDonnell, who was based in Washington, DC from 2010 to 2015 and again from 2019 onward after working in London,

2008
Obtains Freddie Mac affordable license

2009
Establishes one of the first European dedicated real estate debt strategies

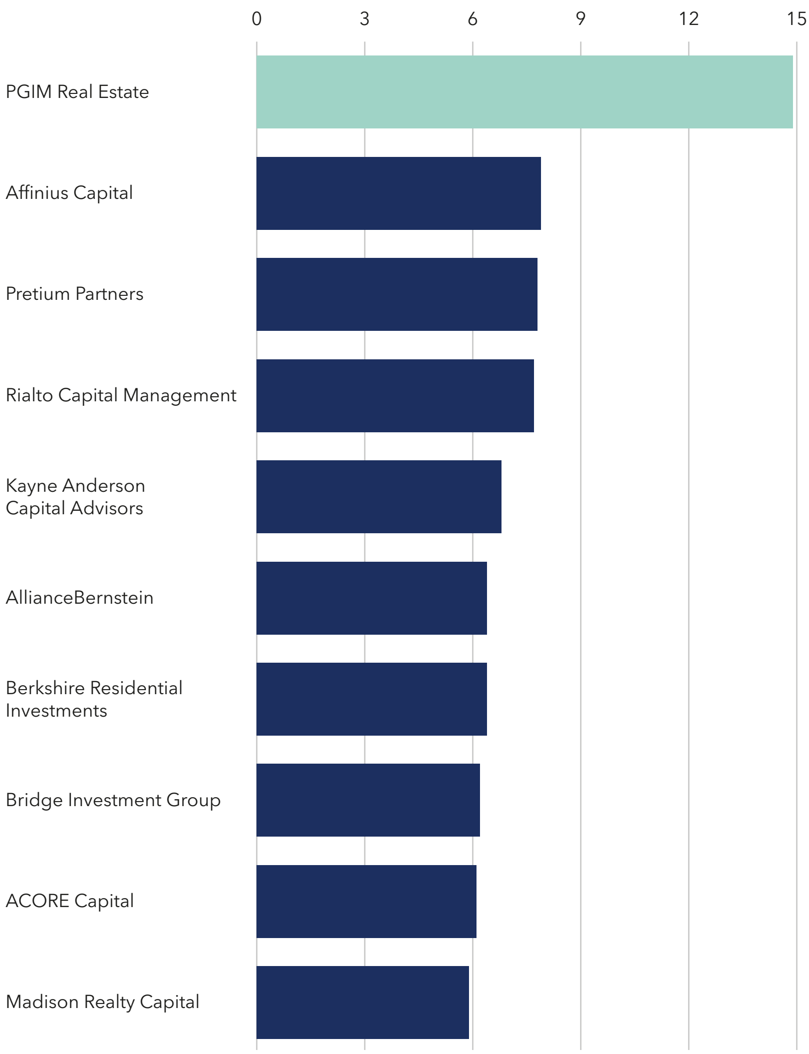
2017
Launches US core-plus financing strategy

2020
Debt and equity businesses merge, with $188.5 billion in assets under administration

2021
Launches US core financing strategy

2023
Launches affordable bridge program

PGIM Real Estate took the top slot in PERE Credit's annual ranking of the 50 largest commercial real estate debt fund managers, moving up from second place (Five-year capital raising, $bn)



Source: PERE Credit

was able to figure out first-hand why some of its assets in the market were underperforming.

"We had a period of time where we did not have someone on the ground [in Washington, DC], and the deals we picked were all underperforming," McDonnell says. "It was very easy to see why, when we looked at it. Every single deal was underperforming because it was someone coming from outside of the market into the market."

Competition now

Despite a depressed market, competition among lenders with capital to deploy remains fierce. "People are fighting – lenders are fighting," McDonnell says. "There is more capital out here than is advertised."

The core problem with deploying capital today is the lack of available transactions and slowed dealflow. Lenders are having to dig deeper into the multifamily and industrial worlds or play in more niche sectors outside their typical themes.

"As it plays out, we are starting to see a thawing on sales," McDonnell adds.

From the equity side of PGIM Real Estate's business, McDonnell says the firm is starting to see sponsors transact – and a wider pool of potential buyers emerge. "People are saying 'We may not be at the bottom, but we do not need to be perfect' or 'The bottom is close' or 'The bottom is here.'"

Farrell says PGIM has not limited its loan size parameters in the current market, because the firm wants to keep sights open beyond the largest of opportunities. On the core side of the business, the majority of the manager's loans clock between $30 million and $100 million, even if the outsized loans are more widely publicized.

"We are reliable," Farrell says. "And in a market like this, you do not want to go with the new lender, or someone you have never dealt with before."

"There is a mistake in trying to be everything to everyone. We do not want to be that"

BRYAN MCDONNELL
PGIM Real Estate

$12bn
Approximate volume of loans the manager originated in 2023

34
Number of PGIM offices globally

$30m-$100m
Majority of manager's loans in the core side fall in this size range

Adapting in absence

To move forward, PGIM Real Estate has had to adapt.

McDonnell says because the firm is not pushing a singular product, loan term or loan-to-value percentage in deals, PGIM Real Estate is able to add and alter deal structures in a more bespoke way. "That allows us to be more of a safe space for borrowers," he explains.

Lending partnerships are also proving more meaningful now, especially when agency financing can help fund a more complex financing situation, adds Kelly Follain, head of agency lending.

"There has also been an enhanced focus on portfolio risk management and oversight," Follain says. "I think that is expected during market downturns, but it's also a function of the FHFA's oversight of Fannie and Freddie."

Runway ahead

Despite near-term headwinds, PGIM Real Estate is not reducing its ambitions or lending appetite. But the manager is concerned about the deterioration of underwriting, Farrell says.

"In 2023, we were able to be conservative. We were not pushing in terms of the underwriting [or leverage]," Farrell says, noting the manager has observed standards eroding this year. "We will lean in where we feel it is appropriate in terms of the market or maybe the business plan for the asset, but we are seeing some people really lean in."

As life insurance companies are increasing their exposure to real estate lending, investment managers are raising new debt funds and institutional investors are allocating to the asset class – and investors are responding, Farrell says.

"Credit is now a great investment, versus historically it has been equity," she says. "So now everyone is thinking, instead of going into the equity where there is higher risk, they could still be at a great risk point and get a great return for that."

The key for PGIM Real Estate ultimately boils down to always being in the market. Although the markets have felt frozen in recent quarters, this is starting to change as borrowers need to handle near-term maturities. "I know that flow is ready to go," Farrell says. ■