Real Estate Capital USA

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NEWS & ANALYSIS

PGIM's Farrell outlines large loan, preferred equity opportunity amid bank pullback

Lack of money center banks is creating more space for private credit lenders with multifamily, industrial and construction lending.

PGIM Real Estate has identified larger loans and taking preferred equity positions as areas of opportunity for the firm to increase its market share as some money center and regional banks remain sidelined by interest rate hikes and volatility across major asset classes.

"It's a great opportunity to jump in here and try to fill that void – even though it's a very large void in terms of the banks," Melissa Farrell, head of US debt originations at the Newark, New Jersey-based manager, told Real Estate Capital USA. "But it's also difficult to do in a market where overall transaction volume is down by 62 percent from last year's transaction volume."

Dialing up loan sizing

The firm is seeing more large loan opportunities compared to prior quarters in part from the pullback of national and regional bank lenders. "We think the air is thinner on these larger deals and we get better returns overall and better lending terms on some of those transactions," Farrell said.

As an example, she noted PGIM's core loan size back in 2021-2022 was closer to the $40 million range and in the first half of 2023 clocked closer to the $60 million range for loans the manager is originating. "It is a trend we like and a trend we can play in because we are large," Farrell said. "So, we can take down a $200 million-plus [loan] whether it is single asset, or a portfolio and we think that is a really great space that we play well in."

Farrell said there is some give and take happening on the lending side. While PGIM is seeing more business available to be done, the manager still must contend with the wall of maturing loans coming due.

"There's a real shift that is occurring from floating-rate in the marketplace to fixed-rate and that plays better for at least our capital sources in a lot of respects," Farrell said, noting PGIM's core product which offers both fixed and floating rate loans. With Term SOFR reaching levels as high as 5.3 percent in prior weeks and the five-year Treasury trading at around 4.3 percent, the firm's borrowers are trending toward fixed-rate financings.

Farrell said most borrowers and lenders are expecting lower rates going forward, meaning borrowers want full flexibility to prepay akin to what they are used to getting with bank lenders. "I think banks definitely offered more flexibility on floating-rate deals so we have to fill that void by crafting a five-year, fixed-rate loan with some prepay flexibility for when things get better down the line," she said.

Originations on deck

PGIM's pipeline is primarily geared toward industrial and multifamily deals across the firm's core, non-core and agency platforms. Farrell said the firm is still looking for diversification atop the more stable property types, delving into data centers, self-storage and other niche alternatives.

Farrell noted about 80 percent of PGIM's current pipeline is also geared toward refinance. With maturity coming due for some loans or interest rate caps expiring, the firm is working more closely with borrowers to refinance either for the sake of recapitalization or liquidity.

"At some of the larger sponsors, some of the REITs and some of the big core funds, they are looking for liquidity so they are taking unencumbered assets or really lowly levered assets and levering them up so they can create liquidity possibly for opportunities that are coming up in the market," Farrell said.

That liquidity serves as funding fuel if sponsors see distressed opportunities worth vying for or more flexibility within their existing portfolio.

Construction lending opportunities have also been cropping up more for PGIM, a trend also visible in Real Estate Capital USA's Lending Data Snapshot, which shows more private credit lenders are filling the top ranks for large construction loans originated this year. Farrell said more equity is coming into play on current construction deals, particularly with attachment points dropping from 80-85 percent down to 60-65 percent.

Stepping up to the plate

Despite the change in terms, interest rates and volatility levels, Farrell said PGIM still wants to be an active lender in today's market. "Whether it is us or other lenders, and especially the banks, everyone is watching their current exposures and their portfolios but for us we have a lot of appetite still and debt we are trying to get out the door," she said. "We look at debt as being just a really attractive place right now to get returns and in some cases, we are seeing debt returns greater than what people are anticipating equity returns to be."

While capitalizing on lending deals in the absence of banks is a top priority for private credit lenders such as PGIM, deal flow has still been generally muted as sponsors, asset owners and other debt managers play a waiting game.

In an August report, CBRE data showed private credit lenders are gradually gaining market share even with lending down 52 percent between the second quarter of 2022 and 2023. Private credit lenders accounted for 26 percent of second quarter loan closings, up from 20.1 percent in the first quarter. The top spot notably still belonged to the banks, who accounted for 43.4 percent of non-agency closings in the second quarter, a slight tick up from 41 percent in the first quarter.

"We're a little bit constrained with the actual deal flow that's in the market right now and even the loans that we're looking at now, they just take a long time to get done," Farrell said. "There's just a lot of people not able to make decisions, because everyone is looking at the interest rate market and trying to play the rate game."