

The Investment Podcast



Episode 10: Tailor made: structuring real estate development loans to suit unique requirements

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Riccardo [00:00:34] A quick Google search tells me that UK Real Estate lending has been around for at least nine centuries. You would think that after nine centuries, all financing needs are well taken care of. Well, you would be wrong. As we will hear, there are corners of the market that are still underserved and offer attractive opportunities for investors with the right set up. Even better, these are ESG friendly opportunities. My name is Riccardo Cumerlato, and I am the Client Director of the Restructuring and Debt Solution team at M&G. In this podcast, I want to bring you inside the investment team and give you a front-row view of the investment process, giving you a sense of the highs and lows of the life of an investment and all of the hard work that goes into it. Today, I will sit down with Natalie Mills and Mike Walker, Natalie and Mike are Senior Investment Analysts for our distressed and special situation strategies. I will ask them a few questions about an investment they are leading - a UK real estate lending platform called Atelier Capital Partners. Let's see what they have to say. Hello, Natalie and Mike, thanks for joining me today. Let's start with the basics. What is Atelier?

Natalie [00:01:53] Thanks, Riccardo, it's good to speak with you. So, Atelier is a specialist asset manager that provides underserved real estate professionals with bespoke financing underpinned by a reliable source of finance. Atelier's offering includes loans for ground-up development, permitted development, lending on land with planning permission and bridging. It is able to provide financing of up to 50 million pounds with rolled and serviced interest options. Through providing these types of finance Atelier focuses on helping small and medium-sized enterprises make a difference through urban regeneration, upcycling, and brownfield development. However, Atelier doesn't do set products. Instead, it differentiates itself by tailoring loans to the unique requirements and circumstances of the product and the product stakeholder's, which is in fact Atelier got its name. This approach also means Atelier is able to get involved in more complicated and challenging projects in the space.

Riccardo [00:02:58] I love your mention of tailoring there, it reminds me of life before t-shirts and shorts, but let's go back to Atelier. I'm always fascinated by how you find and develop these investment ideas. How did you find this one and what did you have to do to make it investable?

Natalie [00:03:17] Yeah. So, this investment idea came to fruition during some exploratory research we were carrying out in the short-term lending sector. Through this work, we identified a gap in the market for an institutionally funded at-scale lender and identified a founding team who had the required expertise, relationships, and experience to make the business idea a reality. To test the thesis, though, we first conducted a pilot phase to ensure that the opportunities we had identified were investable on a wider scale. This pilot was a success and helped us to understand and to mitigate the various challenges that we would be faced with when contemplating a more material investment. One of the benefits of carrying out the pilot phase was that we are able to work with the management team to ensure that a scalable approach to good governance, financial rigour, reporting and ESG concepts were all part of the fabric and culture of the company from day one. This has now truly become part of Atelier's Day to day operations and brand. Also, Atelier's various stakeholders not only understand but really recognise the value of these aspects of Atelier's DNA.

Riccardo [00:04:39] Thanks, Natalie. So, if I understand correctly, the underlying driver of the investment is the fact that this particular segment of the Real Estate market is underserved by banks. I find that quite intriguing. Mike, so far, you've been listening to the answers so, this one for you. Can you help me understand why this is the case?

Mike [00:05:00] Sure. Thanks, Riccardo. That's a really great question, a bit of history is probably helpful here, although, don't worry, I'm not going to go back nine centuries. It was certainly the case that before the financial crisis, this type of lending was predominantly provided by banks and developers were reliant on banks to fund their projects. Post the financial crisis, banks' lending appetites changed, and the regulation introduced meant that bank funding for this type of lending was reduced. What's happened since then is that the market has mainly been funded by alternative lenders. What you see is lots of smaller funds, private equity and high net worth individuals who provide capital to the market and so it's probably not right to say the market is underserved anymore. However, lots of the funding is for vanilla assets and relatively straightforward developments, with certainly less appetite from funders to provide more complex lending and lending on development sites where there might be some element of environmental remediation or other complexity that make it difficult to underwrite. This is where Ateliers product-less approach, which Natalie touched on before, really comes into its own, that they have the ability to structure the loans to suit the project rather than having to pigeonhole development into certain products. The only reason why that's

possible is because we've invested in in-house specialists rather than outsourcing some of these competencies. This includes in-house legal teams, surveyor's, portfolio managers, risk experts and finance who all work together. This means that Atelier has the ability to underwrite and service these more complex loans. We ultimately think that this drives better portfolio performance and better protects capital at risk. An interesting consequence of it being a non-bank and non-institutional market is that very few lenders have experience with ESG investing, so M&G is using its experience in this area to support Atelier as it continues to develop its approach to sustainable lending.

Riccardo [00:06:58] OK, you mentioned ESG at the end, so it might be a good time to look behind the ESG label. Which step is Atelier taking to focus on ESG? Also, can you give me some examples of loans made by Atelier that have strong ESG credentials? Who would like to take this one?

Natalie [00:07:24] I'll take this one, Riccardo, thanks. So, there are some astounding statistics out there when it comes to the current state of carbon emissions. Now, according to Savills, the built environment contributes 40% of the UK carbon footprint. Carbon emissions are present at all stages of a property's life, which means that in order to really make a difference, we need to reduce emissions from construction through to operation and then finally to the end of a building's lifespan. As I mentioned earlier, Atelier has really taken this message on board and as a result, it has steered its lending to focus on projects that include urban regeneration, upcycling, and brownfield development. Currently, almost 90% of Atelier's development loans are for these types of projects. Atelier's internal lending processes also factor in relevant wellbeing considerations, including matters like excessive density or natural daylight, suitability for location and un-similar - even where planning and building regulations have already been adhered to. So, by way of example of the types of projects Atelier is involved in, Atelier has recently provided a development finance facility for a project to demolish and decontaminate a derelict petrol service station which had been unused for over a decade. This plot has now been revitalised through the construction of an attractive terrace of six modern four-bedroom houses with gardens and allocated parking spaces, which all qualify for the Help to Buy scheme. On another project, Atelier's financing is enabling the construction of eight sustainable family homes in a London brownfield site. The properties have been intelligently designed with excellent green credentials, which meet the RIBA 2030 standard and use the latest energy-efficient materials and features. This means that the finished homes will be at least 40% more energy efficient than the current building regulations require. There's actually one more example I'd like to share with you, if that's OK, as it's a really great way of demonstrating how a company like Atelier can facilitate really impressive upcycling work in the Real Estate market. So in this 12 million lend, Atelier provided a senior development facility to a season property developer in the home counties. The developer had purchased a large, complicated site which included a mid-century office building, period residential building and a car park and gardens, Atelier's loan helped to transform the site into 49 new homes while preserving the original features and local heritage. The recycling of the existing structures and putting them back into use greatly helps to reduce the bodied carbon. Now, often complicated, mixed-use sites like this can be too challenging for lenders, but Atelier's bespoke approach and deep bench of expertise that they have meant that it was able to find a solution for this project. I should also add that Atelier is equally focused on ESG from an operational perspective and has a target to achieve net zero carbon emissions from operations by 2025 and from lending activity by 2030 amongst other measures. It has hired a dedicated ESG manager to help achieve these goals.

Riccardo [00:11:04] Thanks, Natalie, very impressive examples. Nearly as good as my recycling skills, if I may say so. But joking aside, this takes us to an obvious follow-up question. Do you have to sacrifice investment returns in order to support this focus on ESG? Mike another one for you.

Mike [00:11:24] Yeah, thanks, Riccardo. That's another good question. As you know, M&G is committed to providing financial returns, was also having regard for the needs of society. We believe that by integrating ESG concepts throughout the investment lifecycle, we ultimately drive better outcomes for our clients and also better outcomes for society. In the short term, a loan that Atelier makes to a project are the strongest credential and earns typically earns the same return as the wider market. In addition, by focussing on the key on the G in ESG so that is governance, Atelier is creating a robust process, independently monitoring the performance of the business, which should help to provide better downside protection. In the longer term, by fairly moving ESG and sustainable development loans Atelier and M&G are creating a competitive advantage over other lenders and hopefully a higher valuation for the business.

Riccardo [00:12:18] Thanks, Mike. So, we are talking about an attractive investment story with a great ESG angle and not a bad one. This was extremely interesting, Natalie. Mike, thanks for your time today. Take care.

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