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SCHRODERS JOINS THE DEBT TRAIN

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Schroders joins the debt train

Fund manager sees better risk-returns in debt than buying property, reports **Jane Roberts**

Schroder Real Estate Investment Management is the latest fund manager to add investing in property debt to its offer to clients, highlighting a growing trend for institutional investors to include debt investments in their portfolios.

Schroder REIM's indirect investing arm, Schroder Real Estate Capital Partners (SRECaP), has launched the Income Plus Real Estate Debt Fund exclusively for SRECaP clients, with £100 mln (€114 mln) of commitments at first close, from 11 mainly UK pension fund investors.

Targeting 6-7% net returns, the clue to the strategy and its timing is in the fund's name. Schroder REIM, led by Duncan Owen, believes that at this stage in the UK property market cycle, debt can offer more attractive risk-adjusted returns and low entry costs than buying many real estate assets.

Graeme Rutter, head of SRECaP, says Schroders' house view for UK real estate is 4-5% a year over the next few years on average, with industrial being the exception and expected to perform more strongly.

Owen told journalists last week that in growth periods of property markets, debt can underperform equity. 'So you can read into this that, structural changes apart, we are cautious about some parts of the wider (UK) property market, while there is very significant demand (from investors) for asset-backed debt,' he said.

Investing in debt now, he added, means 'you can generate returns without taking equity risk at mid to high single digits, from a risk in the capital structure that is lower than equity'.

Schroders joins a growing list of institutional investment managers now offering real estate debt as well as equity investing to clients, including Aberdeen Standard, Amundi (see p8), Aviva Investors, AXA Real Assets IM, Hermes, Legal & General, LaSalle Investment Management, M&G Investments, PGIM Real Estate, TH Real Estate and UBS Asset Management.

SRECaP has appointed Venn Partners as debt adviser to the fund which will make bilateral whole loans of £20-£30 mln (€23-€34 mln) and up to 75% loan-to-value, offering loan maturities from six months to five years.

Venn has its own discretionary Commercial Real Estate Debt Fund which launched in 2015 with £185 mln (€211 mln) and is now fully invested. It also manages the government's £3.5 bn (€4 bn) Private Rented Sector Housing Guarantee Scheme which issues bonds providing long-term finance for newly-completed UK private rental residential.

Beatrice Dupont, Venn's deputy portfolio manager of commercial real estate, says: 'We provide borrowers with a complementary lending solution to banks, targeting value-add opportunities with strong real estate fund fundamentals. As a result we get delevered through the loan's life as our borrowers reposition their assets to core.

She said Venn is 'cautious' regarding retail and City offices: 'We like the regions and operating assets such as hotels, care homes and student housing.'

'Income Plus' is the eighth partnership fund that Rutter has structured for Schroder clients (see panel). Most are partnerships with specialist managers and SRECaP ran a process before picking Venn which involved reviewing 10 debt fund managers. Rutter expects Income Plus to grow by a further £75-£100 mln (€85-€114 mln), to an eventual size of £200 mln (€228 mln).

So far, all SRECaP's investing is in the UK. 'The UK has performed incredibly well over the last five years and clients have been happy,' Rutter explains.

But with the UK indirect investing business maturing Schroders' division is considering expansion into continental Europe.

SREIM/SRECaP'S BESPOKE PARTNERSHIP FUNDS

SREIM had assets under management of £13.2 bn (€15 bn) at December 2017, of which SRECaP AUM is £3.7bn (€4.2 bn) (28% of SREIM AUM). In turn, £1.3 bn (€1.5 bn) (35% of SRECaP AUM) is invested/committed to SRECaP partnership funds.

The first six funds are open-ended, the latter two are closed-ended. 'RLP is the only product that we have marketed to external investors. The other funds are all exclusive to clients that have a mandate with SRECaP,' Rutter says.

The funds are:

2010 Mayfair Capital PUT (core/balanced fund advised by Mayfair Capital IM)
2011 Motor Retail PUT (car showrooms advised by Automotive Property Consultancy)
2012 Local Retail Fund (convenience retail advised by Waypoint Asset Management)
2013 Metro PUT (core/balanced fund advised by Hermes IM)
2014 Multi-Let Industrial PUT (advised by JLL)
2015 Regional Office PUT (advised by Schroders REIM)
2017 Residential Land Partnership (advised by Palmer Capital Partners)
2018 Income Plus Real Estate Debt Fund (advised by Venn Partners)