PROPERTY REPORT

What Bust? European Banks Are Loading Up on Real Estate

Availability of debt financing is a sign of health in the European real-estate market

Coima SGR obtained a €56.4 million ($69.5 million) loan from Banco BPM for the redevelopment of the former Unilever headquarters in Milan's Porta Nuova neighborhood. **PHOTO:** PLP ARCHITECTS

By Peter Grant and Jeannette Neumann

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When Spain's Bankia SA received a bailout in 2012, it was prohibited from making the kind of real-estate loans that triggered the bank's implosion.

That ban expired on Jan. 1 and, like other Spanish lenders, Bankia is now jumping at the opportunity to finance real-estate projects again.

"It's a good time to be in the sector—in terms of growth, the cycle still has upside," said Alberto Manrique, head of real-estate development finance at Bankia, Spain's fourth largest bank by market capitalization.

It is game on again in the real estate lending business among European financial institutions.

With the European economy growing and most of their balance sheets finally restored to health, many banks are boosting loan volume and competing aggressively on rates.

BNP Paribas SA increased its portfolio of commercial real-estate loans by double digits in 2016 and again in 2017, according to Gilles Polet, head of European real estate finance for corporate and institutional banking at the Paris-based bank. Its 40 deals last year included a €625 million ($775 million) refinancing of the Dundrum Town Centre, one of Ireland's largest shopping malls.

Paris-based Natixis SA, meanwhile, has emerged as one of the most active lenders in the U.S. market. Late last year, for example, it led a group that provided a $480 million construction loan to Cottonwood Management for the development of a more than 800,000-square-foot mixed-use project in Boston's Seaport District.

Some financial institutions in a few countries, such as Greece, remain basket cases, and the stocks of even well-capitalized banks are being shunned by investors because of low profitability. But real estate lending is back in vogue among banks that have restored their balance sheets to health.

"We have capital and we have appetite," said Roman Kogan, Deutsche Bank AG's European head of commercial real estate.

Bankia is building up a pipeline of loans to finance residential construction in Spain. Mr. Manrique anticipates that within about three years, Bankia will capture up to an 8% market share of what he estimates to be the country's €5.5 billion annual real estate financing sector.

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The availability of debt financing is a sign of health in the European real-estate market. Sales of commercial property are strong, pushing values in some markets to record highs. Last year, investors purchased €312 billion worth of commercial property in Europe, up from €281 billion in 2016, according to data firm Real Capital Analytics.

Values have risen so high that some bank regulators are starting to get the jitters. In his remarks to the European Parliament in February Mario Draghi, the president of the European Central Bank, said commercial property was a segment that needed "close monitoring" to protect against a possible asset bubble. "We actually see stretched valuations," he said.

The health that has been restored to many banks' balance sheets comes after a long slog stemming back to the 2008 global financial crisis. For years, many European banks reined in their real estate businesses because of a weak European economy and pressures from regulators and others to beef up their capital.

"Banks have been managed for the regulators for the last 10 years rather than for the shareholders," said George Karamanos, an analyst at Keefe, Bruyette & Woods.

Some banks got back into real estate lending before others. ING Groep NV did so in late 2013 partly because, as a deposit-taking bank, it was under pressure by the ECB to deploy cash and diversify, according to Mike Shields, ING's head of real estate finance for the U.K, U.S. and Asia.

Domestic banks in the euro area had €947.3 billion worth of real-estate loans on their books at the end of 2016, the last year for which statistics are available, according to the ECB. That is up from €910.7 billion at the end of 2014.

European bank lending also is rising sharply in the U.S. For example, U.S. branches of German banks held $24 billion of U.S. commercial real-estate loans in the third quarter of 2017, compared with $14 billion in the third quarter of 2015, according to data firm Trepp LLC.

Some market participants report signs that some lenders are trying to win business by increasing loan sizes relative to property's value. "Banks try to stick to 65% to 70% loan-to-value," said Torsten Pokropp, a lawyer in DLA Piper's Frankfurt office. "However, we now see 80% again."

Many European bank executives say they are trying to learn by past mistakes and avoiding softening underwriting standards. Rather, they say they are primarily dealing with increasing competition by cutting rates. That is reducing borrowing costs for many real-estate investors even in a rising interest-rate environment.

Still, some borrowers are able to obtain bank financing fornew construction, renovations and other projects that involve more risk. For example a new €650 million development fund raised by Coima SGR obtained a €56.4 million loan from Banco BPM SpA—an Italian bank formed by the merger of Banco Popolare and Banca Popolare di Milano—for the redevelopment of the former Unilever headquarters in Milan's Porta Nuova neighborhood.

Coima was able to get such a loan thanks to its history of paying off its debts, said Manfredi Catella, Coima's chief executive. It would be tougher without such a track record, he said.

"Even if banks are in better shape, they're still very, very selective," Mr. Catella said.

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