KEYNOTE INTERVIEW

Finding attractive deals in times of turmoil

Small-ticket and mid-market lending have felt the pain of a difficult end to 2022. But when volatility strikes, so does opportunity, say Daniel Austin and Doug King, co-founders of London-based specialist lender ASK Partners

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Q How was the small-ticket, sub-€20 million lending market impacted by 2022's economic uncertainty?

Doug King: Higher rates combined with higher inflation has really impacted developers and borrowers' appetite to transact. In H1 last year, everything was carrying on pretty much as usual; the market was very active and in Q3 dealflow was good. However, towards the end of Q3 everything changed around the time of the UK government's mini-budget, before we saw a definite decline in Q4.

We know from speaking to other lenders and those on the buying side that many decided to wait and see what would happen. That was the case in the small-ticket as well as the mid-market lending space. Everyone stopped and deals collapsed. Although we didn't ourselves, other lenders withdrew their terms. Before that, many lenders were offering 65 percent loan-to-value, but suddenly they were pulling back 20 percent. In those circumstances, there has got to be a readjustment between what price sellers are willing to take and what people are willing to pay.

Daniel Austin: We need to see values in line with today's prices and are seeing valuations starting to come down. In some cases, for example a poorly located asset which had been previously overpaid for, we were already factoring in a 25 percent discount to market values last year and are probably still factoring in another 10 to 15 percent. So, I could see from the peak in mid-2022 maybe as much as a 40 percent discount on values of certain assets or classes.

Q Which sectors were less affected by this discount?

DA: Some sectors are obviously holding up much better than others.

Purpose-built student housing, for example, is more robust because there are still a lot of offshore students who want to study in the UK. When the economic cycle turns, people tend to study longer. So, there are many factors that are driving positivity around student housing.

Some of the affordable housing models and the later living housing models are still doing well because we have an ageing population. Build-to-rent is also appealing because people are going to find it harder and harder to get mortgages. That means they are still going to be renting, which is going to drive the creation of BTR platforms.

Q Within the small-ticket lending space, where did you find opportunities?

DK: In the small-ticket market a lot of loans that we have written to date have been repositioning or value-add loans, where a borrower or developer wants to buy a site, obtain a change of use and turn it from a less valuable site to, hopefully, a more valuable one. That model works really well in the good times, but it becomes harder for the developer when finance costs increase and inflation goes up.

DA: Going forward, the small-ticket market for lenders will be quite busy because, as a function of these changing macroeconomic conditions, certain pots of capital that borrowers were using aren't the right pots of capital for where the market is today. Therefore, they need to make changes, they need to refinance, they need to pay some lenders back. There will be a lot of opportunities for lenders created by this turmoil.

Q Regardless of deal size, where else have you been lending in light of market changes?

DA: We have done a number of deals in life sciences, which is a growing sector. The UK is always positioning itself as a genomic sequencing global leader, but it has a very small amount of purpose-built laboratory space.

There are lots of biotech and life science businesses that are operating in the UK and want to be here around the knowledge quarter – in Kings Cross, Oxford and Cambridge, for example. We have underwritten and closed three transactions in the space, and we have three or four deals we are looking at currently. So, we expect to see more opportunities there.

Q Was the mid-market, €20 million to €70 million lending space hit differently by last year's economic turmoil?

DK: It was very similar to the small-ticket market. But, for the right deals, it probably performed a bit better than the small-ticket market did. Generally, in the mid-market, sponsors have a bigger balance sheet and are still able to transact. They have got access to the equity to actually go into a deal.

We saw that with the House of Fraser deal in Richmond, for instance. The sponsor, Sheen Lane Developments, not only has the firepower, if required, to put more money in, it is well capitalised, has a brilliant track record and is also effectively the contractor. That removes what we perceive as one of the development risks, which is the contractor going bust.

Q Besides the strength and track record of the sponsor, why did the financing of Richmond's House of Fraser revamp appeal to you as a lender?

DA: Richmond is a very quaint, period town with a beautiful green. And this building is unique because it is very large, it has got very deep floor plates and high ceilings. It is almost like a warehouse building that you would find in a more industrial location.

To take a building of that scale and convert it into a mixed-use leisure and office scheme in a town centre surrounded by little Georgian buildings and greens is an almost unique opportunity in real estate. It is the type of building you would expect to see next to the CBD of a city, rather than in an almost semi-rural lifestyle town centre, like Richmond.

If you want something prime and that is a little bit unique, in the mid-market you are much safer, because when markets get tougher, buildings that are rare or have some differentiating characteristics tend to trade much better. A historic piece of property like this building is a much more secure investment than something more vanilla.

Q You did the deal alongside OakNorth Bank, which has bought a 50 percent stake in ASK. How does this partnership change your lending outlook and growth strategy?

DA: We will see a slight change in areas of growth. OakNorth has done more development finance than we have. Together, we will be looking to do more development finance – subject to market conditions, the right borrower, the right contractor and the right development – than we have done before.

Also, partnering with a balance-sheet lender who is a deposit taker provides more certainty to sponsors. We will be looking to move up the ticket size. So, we will be looking to do more mid-market and even large transactions, but not totally abandoning the small-ticket market.

DK: As partners, our finance offerings sit well alongside each other. OakNorth, as a bank, has a lower maximum LTV, which allows ASK to top that up for borrowers, giving them the flexibility of finance that they require. This very much opens up the market for us as a partnership and creates an opportunity for us to really own the mid-market lending space. ■