

Back on the block: Real estate debt returning to favour



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The commercial real estate (CRE) landscape has profoundly transformed since mid-2022, creating compelling investment opportunities for institutional investors. Rising interest rates and macroeconomic uncertainty have driven capital values down by approximately 20-25% across Europe and other developed markets, according to the CBRE Prime Capital Value Index.

The current environment presents factors that make real estate debt particularly compelling: attractive entry valuations, conservative lending structures and meaningful portfolio diversification benefits.

Foundation for growth

Private markets have demonstrated remarkable resilience and growth, expanding approximately 7.8% annually since 2012, more than double the 3.5% growth rate of public markets over the same period, according to EY. This sustained expansion reflects institutional investors' ongoing search for yield enhancement and portfolio diversification, particularly during the prolonged low-interest-rate environment that characterised the decade leading up to 2022's rate hikes.

Despite the elevated inflation and interest rate environment since mid-2022, investor appetite for CRE debt remains strong. Recent INREV surveys show 62% of investors plan to increase allocations to real estate debt, with public and private pension funds showing the largest increases in planned allocations.

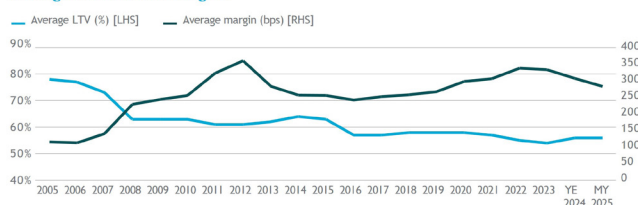
The appeal of backing bricks and mortar becomes particularly relevant when macroeconomic uncertainty is affecting investors. Unlike corporate credit, where recovery depends on often intangible business assets, real estate debt provides lenders with the ability to either force asset sales or take direct control of underlying properties, holding until market conditions improve.

Optimal entry point

The CRE market correction has created an attractive entry point for debt investors. MSCI data shows most repricing appears to have already occurred, with early signs of stabilisation and even recovery emerging in some market segments. The current correction of 20-25% in European prime capital values, while significant, remains moderate compared to historical downturns such as the early 1990s recession (-36%) or the GFC (-34%).

This valuation reset has coincided with significantly more conservative lending practices compared to pre-GFC standard, according to Bayes U.K. Lending Survey data. Average senior loan-to-value ratios tightened from approximately 80% before the GFC to around 55% by the end of 2024, providing lenders with substantial equity cushions.

Average LTV rates vs. margins



Source: Bayes CRE Lending Report, October 2025

Structural evolution

Europe's CRE lending landscape has undergone significant structural evolution since the GFC, creating opportunities for alternative lenders and more diverse financing markets. Regulatory reforms including Basel III/IV and Solvency II increased capital requirements for banks and insurers, curtailing their appetite for higher-leverage and non-core CRE lending.

This regulatory-driven retreat created space for alternative lenders to establish meaningful market presence. Current estimates suggest that alternative lenders now provide approximately 40% of U.K. CRE lending, with growing market shares in France, Spain and Germany. Further growth is expected as Basel III Endgame implementation continues across European markets.

Portfolio benefits

Real estate debt's risk-return characteristics are well positioned for institutional portfolios, offering returns potentially similar to higher-risk asset classes while maintaining lower volatility.

This favourable risk-return profile stems from several structural factors. The senior position within the capital stack provides cushioning against defaults, while contractual income obligations built into loan structures deliver steady cash flows. The typically shorter duration of CRE loans compared to traditional fixed income investments can help mitigate exposure to inflation and interest rate cycles.

From a portfolio construction perspective, CRE debt's low correlation with traditional fixed income provides strong diversification benefits. Portfolio optimisation analysis from Nuveen Real Estate suggests allocating just 10% of a diversified portfolio to CRE debt can potentially reduce overall portfolio volatility while maintaining or improving expected returns. This diversification advantage becomes particularly valuable during periods of market stress, when correlations between traditional asset classes often increase.

Seizing opportunities

Current market conditions present a compelling case for increased allocations to real estate debt. Attractive entry valuations following market corrections, conservative lending structures providing substantial downside protection and meaningful portfolio diversification benefits represent a strong real estate environment.

Institutional investors can capitalise on these market conditions. Real estate debt offers the rare combination of defensive characteristics during uncertain times and certainty of income returns as markets stabilise, all while providing the portfolio diversification benefits that sophisticated institutional investors increasingly value.

All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. Past performance does not guarantee future results.

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