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Firms Dig Deeper Into Debt Markets

Related Cos. unit, Kayne Anderson to raise money for new debt funds, hoping to gain from global market turmoil

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By PETER GRANT

Two well-known managers of private-equity funds are pushing further into debt investments in a bid to take advantage of the opportunities created by recent upheaval in the global capital markets.

Related Fund Management, an arm of Stephen Ross's Related Cos., will soon start raising a closed-end debt fund that could be as large as $2 billion, according to people familiar with the matter. New York-based Related started making debt investments focusing on junior debt two years ago mostly in partnership with Highbridge Principal Strategies, a unit of J.P. Morgan Asset Management.

Meanwhile, Kayne Anderson Real Estate Advisors, of Boca Raton, Fla., is looking to raise more than $500 million for a new debt fund, according to people familiar with the firm. Like Related, Kayne Anderson has been focusing its debt investments on junior, or so-called mezzanine, debt that is more risky but pays a higher interest rate than senior debt.

Both funds are hoping to capitalize on turmoil in global stock and bond markets. For example, Related executives believe that some real-estate investment trusts that invest in mortgages may be more willing to sell this debt because their shares on the stock market have fallen so far, according to people familiar with the matter.

Related's thinking is that many REITs would be willing sellers because their shares have fallen far more in value than the assets they own. As a result, these Related executives believe, the REITs would be open to selling assets and buying their stock back, providing a buying opportunity for Related, the people said.

Kayne Anderson executives see buying opportunity from hedge funds and others that have been active investors in mezzanine loans as well as other forms of high-yield debt, the people said. The sharp decline in the junk bond market is creating liquidity problems for some of these firms, making them more willing sellers of their real-estate debt, Kayne Anderson executives believe.

The new fundraising by Related and Kayne Anderson represents a shift in the role that nontraditional lenders are playing in the commercial real-estate industry.

In the early years of the recovery, this new crop of lenders became an important provider of debt capital to landlords, replacing traditional lenders like banks and insurance companies that were wary about reentering a business that had caused them high losses. These nontraditional lenders have included mortgage REITs such as Starwood Property Trust Inc. and private-equity firms like Colony Capital LLC and Mesa West Capital LLC.

Lately, banks and insurance companies have regained their appetite for real-estate debt. At the end of the third quarter of last year, banks and thrifts had a record of $1.79 trillion worth of commercial real-estate debt on their books and insurance companies had a record $380 billion worth of commercial real-estate loans outstanding, according to data firm Trepp LLC.

Indeed, fundraising by real-estate debt funds declined to $15 billion by 30 funds in 2015, compared with $25 billion by 37 funds in 2014, according to data firm Preqin.

But traditional lenders have continued to stay clear of junior loans and most construction lending. “People are still pretty leery about going that far out on the risk curve,” said Matthew Anderson, managing director of Trepp.

Also, concern about the rising volume of commercial real-estate lending has been growing at the Federal Reserve, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency. In December, the three agencies released a joint statement noting that some institutions were showing “a greater number of underwriting policy exceptions and insufficient monitoring of market conditions to assess the risks associated with these concentrations.”

Nontraditional lenders say they are happy to fill the void if banks and insurance companies pull back. “Regulated commercial banks have become more nervous,” said Brian Sedrish, managing director of Related Fund Management. “As a result, you see more activity moving over” to nontraditional lenders.

Related, whose real-estate fund business has about $3 billion in assets under management, got into the high-yield debt and preferred equity business in 2013 when it hired Mr. Sedrish from Deutsche Bank. Since then its venture with Highbridge has raised about $800 million primarily to provide junior debt to developers of new projects and investors in fixer-upper buildings. About 80% of that has been invested, Mr. Sedrish said.

For example, Related has provided a $17 million mezzanine construction loan to Chicago developer Steve Fifield for 347 West Chestnut, a 310-unit rental apartment building with 6,000 square feet of ground floor retail. Related also is helping to finance a 399-unit project in Los Angeles’ Koreatown neighborhood known as Sixth and Virgil, that is being developed by Century West Partners.

Highbridge is expected to join Related in the new fund, according to people familiar with matter. It will be structured more as a private-equity fund than their current investment vehicle, enabling the fund to take on more leverage, the people said.

Kayne Anderson, which has about $3 billion in real-estate assets under management, has made about $225 million in debt investments since the first quarter of 2015. The firm’s debt strategy up until now has been to buy the most junior pieces of pools of first mortgages.

Kayne Anderson's new debt fund will pursue a similar strategy of buying the riskiest pieces of first mortgages. It also plans to target real-estate debt held by hedge funds and others that are facing liquidity problems and need to sell assets, according to people familiar with the matter.