Private debt: an alternative solution for property financing

Demand, opportunities, and challenges in the current market environment

EMPIRA

Contents

Dear Reader,

The real estate market is undergoing profound upheaval. After a long period of extremely low interest rates and generous lending policies, banks became increasingly restrictive, adapting their lending to higher policy rates and tougher regulatory requirements. Although the interest rate situation has now eased somewhat, current interest rate levels are resulting in significant funding gaps in many sub-markets, with conventional loan structures no longer able to fully cover demand. For investors and project developers, this creates a tension between rising capital costs, heightened risk awareness, and the simultaneous need to continue ongoing projects or realize new ones.

In this situation, attention is turning to private debt instruments. As an alternative financing solution, they offer both greater flexibility and more individualized conditions that respond to the specific needs of a changing market. That begs the question of what return potential private debt offers and what risks investors need to take into account – especially amid a more complex macroeconomic environment and increasing regulation. This makes systematic risk management key to maximizing the opportunities posed by these alternative forms of debt capital.

Against this backdrop, this study seeks to analyze the current situation in real estate financing and to assess the importance of private debt as a key element in future capital supply. It first examines the current market environment and the drivers behind the funding gap. Next, it considers the role of private debt as an alternative source of capital, going on to identify specific opportunities and areas of action for private debt investors. Finally, a summary brings together the main findings and outlines implications for future developments in real estate financing.

Regards

Lahcen Knapp
Founder and Chairman of the Board of Directors, Empira Group

1. The market environment for real estate private debt

The real estate market is facing a significant funding gap, exacerbated by rising interest rates, more restrictive bank financing, and appreciation in real estate values. While expansionary monetary policy made it easier to raise capital during the period of low interest rates, rate hikes have dramatically tightened conditions since 2022. Banks are lending more restrictively, setting lower loan-to-value ratios, and are subject to stricter regulatory requirements.

These structural changes are directly impacting demand for financing and making alternative forms of financing such as private debt increasingly important. The following section analyses the causes of this trend and describes the impact on investors, project developers, and the financing market as a whole.

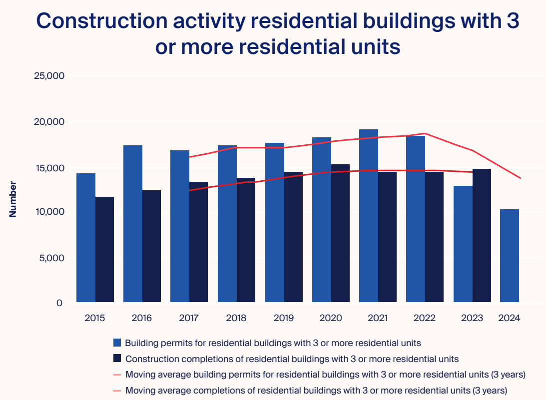
Financing requirements from investment activity win the real estate market

There are two main sources of financing in the real estate market: New investment in real estate (purchases or projects) and existing credit that is redeemed or extended at the end of its term (refinancing). Demand is subject to cyclical fluctuations, influenced by various macroeconomic and industry-specific factors. Many backers have recently found their planned exit dates coinciding with a weak market phase (caused by interest rate hikes, valuation discounts, and reluctance among buyers). Schedules for the corresponding business plans were frequently adjusted, resulting in an increase in sales on the real estate and financing market after a time lag.

The following section considers key parameters of the real estate market, including building permits, completions (of three or more residential units), portfolio deals in the residential segment, and office investments.

The trend in building permits and completions provides an indication of the investment activity in the new-build segment. According to data from Destatis, the number of construction projects approved each year fluctuated significantly between 2015 and 2025. The peak for the last ten years was reached in 2021, with 19,165 permits. Since then, there has been a steep decline: Just 12,931 permits were recorded in 2023, falling to 10,287 in 2024. This equates to a decrease of around 46 % from the 2021 high.

The completion figures follow the permits with a time lag, representing the point at which newly developed space actually becomes available for use. Cyclical patterns can also be seen here: High completion figures follow periods of high permit issuance, with a typical delay of one to two years. There has been a significant decline in building permits since 2021, followed since 2022 by a fall in construction completions. These can be attributed to rising construction costs and increasing challenges in project financing.



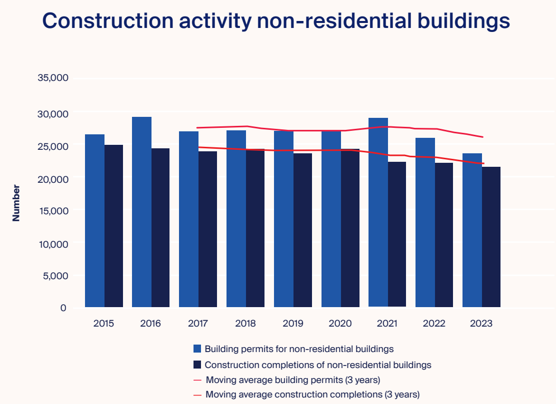
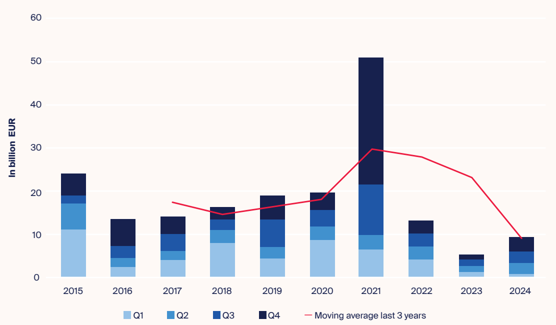


Figure 1: Change in building permits and construction completion, residential buildings (three or more residential units) and non-residential buildings, Germany; 2015–2024 (source: Destatis)

Investment activity in the German real estate market follows a cycle, influenced by factors including macroeconomic conditions and general investor sentiment. This is particularly evident in large residential portfolios (30 or more residential units) and office properties. While an era of low interest rates led to high transaction volumes in the past, rising financing costs and economic uncertainty have brought about a significant decline from 2022 onward.

The transaction volume in large residential portfolios peaked in 2021 at EUR 50.98 billion. However, the interest rate pivot that began in 2022 resulted in a significant decline, with volumes falling to EUR 13.09 billion in 2022 and a mere EUR 5.23 billion in 2023. In addition to rising financing costs, market performance was hampered by falling valuations and temporary restraint on the part of buyers and sellers. There are signs of stabilization for 2024, with an expected increase to EUR 9.29 billion. Over the long term, the annual transaction volume typically ranges between EUR 13 billion and EUR 20 billion, so normalization at this level is expected in the medium term.

Investment volume of residential portfolios



Investment volume of office properties

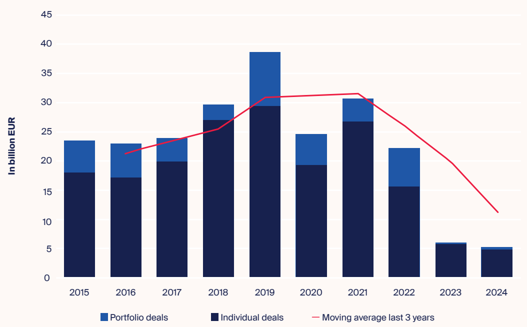


Figure 2: Change in investment volume in residential portfolios (30 or more residential units) and office properties; Germany; 2015–2024 (source: BNP Paribas)

The investment volume for office properties also fluctuated sharply. After periods of economic growth and low interest rates led to high transaction volumes, structural changes caused by working from home trends and the economic uncertainties following the Covid-19 pandemic produced significant restraint from 2022. Higher financing costs and unclear prospects for demand for office space resulted in a sizeable drop in investment volume from 2022. Nevertheless, this market segment remains relevant for institutional investors due to its size.

In all, the total annual transaction volume for 2024 – across the two major market segments, residential portfolios and office properties – is EUR 14.51 billion. On top of that are other market segments, such as logistics, retail, and hotel investments, illustrating the diversification opportunities for investors.

The fluctuations in investment activity described above require flexible financing strategies across the entire market. While large institutional players generally have access to large bank loans and capital market instruments, there is a growing funding gap, especially in the mid-market segment of transactions with a volume of around EUR 30 to EUR 75 million. Many banks are increasingly focusing on first-rate major clients with highly conservative loan-to-value ratios or very small loan volumes that are a good fit with their risk management systems. By contrast, medium-sized projects often remain undersupplied. Alternative financing instruments such as private debt fill this gap by providing capital for investment projects that do not attract traditional bank loans due to strict loan-to-value limits or complex project structures.

Financing requirements due to maturing loans (maturity wall)

A key problem is the looming "maturity wall" in commercial real estate financing in particular. Many existing loans taken out during the period of low interest rates are due for refinancing in the coming years. At the same time, banks have tightened their lending criteria, meaning that a significant financing need can no longer be met by traditional bank loans alone.

The term "maturity wall" thus describes a situation in which a large number of loans mature within a short period of time, resulting in significant volumes of refinancing coming into the market. This can be particularly problematic if financing conditions have deteriorated compared with the original loans, for example due to higher interest rates, stricter lending policies, or general market uncertainty. For commercial real estate financing, this means:

- High demand for refinancing: A large proportion of existing loans will expire over the coming years and will need to be extended or replaced by new loans.
- Rising financing costs: Many of these loans were taken out when low interest rates were low, but must now be refinanced at significantly higher rates.
- More restrictive bank policies: Banks have lowered their LTV requirements and are only prepared to lend under stricter conditions, leading to a funding gap.
- Pressure to sell: If owners cannot obtain refinancing on acceptable terms, they must sell assets – often at unfavorable market prices.

A March 2024 study by PwC Germany indicated that the volume of non-performing commercial real estate loans had already increased by 56 % in 2023.[1] This is also creating a significant need for refinancing in a limited timeframe, which may be aggravated by the situation at the banks.

Pressure on the refinancing market will remain high in the coming years. According to recent data from AEW-Research, Moody's, and MSCI, commercial real estate loans (CRE) in Europe with a volume of more than EUR 100 billion are set to expire in each of the coming years. 2025 and 2026 stand out in particular, with around EUR 130 billion set to mature in 2025 and around EUR 185 billion in 2026. Only in the medium term will the annual refinancing volumes of current known loans gradually decrease, reaching around EUR 25 billion in 2030. The figures are based on loans that exist today and can be estimated; new loans will have an additional effect in the short term.

Broken down by type of use, we see that office properties will account for the largest share of refinancing requirements in the coming years. In this segment alone, loans totaling some EUR 50 billion will mature in 2025, rising to around EUR 65 billion in 2026. The residential and logistics segments are also affected by the maturity wall to the tune of tens of billions each year. On top of that are the classic hotel and retail use types, along with senior apartments and nursing homes, where the refinancing requirement is lower but still significant.

The high concentration of maturities in a relatively short period increases the competitive pressure on sources of capital. As banks continue to tighten their lending standards, it is no longer possible to meet every financing requirement from maturing loans through traditional bank loans alone. Additional pressure comes from the significantly higher interest rates that are now a reality following the reversal in interest rates in 2022/2023. As a result, there is often a gap between the debt capital originally committed and the volume that owners can now raise on acceptable terms.

From a macroeconomic perspective, this can lead to further market distortions: Those that cannot find follow-up financing or cannot afford the higher interest rates may be forced into with an emergency sale. This increases the risk of falling property prices – especially for already volatile use types such as hotels and retail. Conversely, alternative investors see an opportunity to position themselves with mezzanine financing or other debt instruments.

In the US, the volumes of maturing commercial property loans are expected to be significantly higher. According to an estimate by S&P Global, the figure for 2025 will be around USD 998 billion, peaking at around USD 1,257

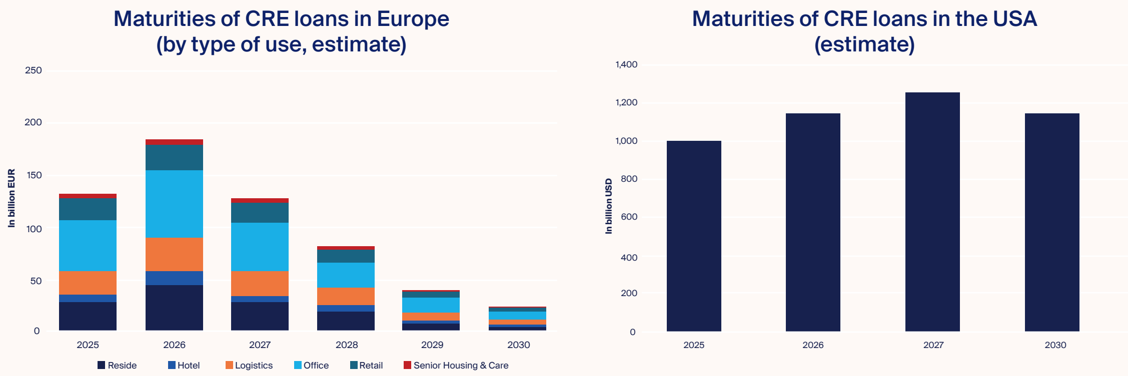


Figure 3: Estimated commercial real estate (CRE) loan maturities in Europe and the US in EUR billion and USD respectively; from 2025 (source: AEW Research/Moody's/MSCI-RCA/S&P Global)

billion in 2026.[2] Although the figures are expected to start falling from 2028, the refinancing gap will remain high, at around USD 1,138 billion.[3]

Limits of bank financing – the example of housing construction in Germany

Traditional real estate financing through banks is increasingly coming up against its limits. Lending to companies in general in the eurozone and Germany is subject to heightened risk perceptions in relation to pessimistic market and economic expectations.[4] The lower real estate values are also driving up lending requirements.[5]

A key parameter is banks' refinancing costs. In 2015, the average interest rate for mortgage bonds with a residual term of five years was just 0.39 %, whereas by 2024 it had risen to over 2.94 %. Yields are typically somewhat higher in the longer-maturity segment.

As a result, residential mortgages are becoming more expensive. Interest rates on loans with an initial fixed rate period of 1–5 years increased from an average of 1.90 % in 2014 to over 4.01 % in 2024. The result is that banks have to lend at higher interest rates, which in turn is limiting the affordability of real estate loans for investors and households. At the same time, it is becoming harder for banks to step up their lending, as higher interest rates are intensifying risk management and capital requirements.
Stricter regulatory requirements under Basel III and IV are also increasing the pressure on banks. To minimize their balance sheet risks, they are tightening their lending guidelines, particularly for project developments, and applying higher loan-to-value ratios. According to various impact studies by consulting firms and banking supervisors, the capital requirement for commercial real estate loans (CRE) could increase by around 10% in the medium term – or even more, depending on the risk class and maturity. This is making it harder to finance projects that had previously relied on high leverage.

It is interesting to compare changes in bank balance sheets with real estate financing requirements, which – assuming a roughly stable number of properties – are significantly influenced by house price movements.

Analysis of the total assets of German banks shows a steady increase over the last few years. It should be noted that the total assets do not consist solely of real estate loans; they also include other types of credit and financial instruments. Nevertheless, they provide as an indication of the general trend and of banks' financial strength, which in turn have an influence on real estate financing. The volume of housing loans in issue to private households with a maturity of more than five years shows a constant upward trend, with the trend softening slightly from 2022.

While banks' total assets expanded significantly between 2015 and 2024, property prices rose even faster. The Europace House Price Index (EPX) tracks the change in prices of existing homes, new-builds, and condominiums on a monthly basis. Since the index was launched in September 2015 (baseline of 100 points), it had risen by more than 70 % by 2024, while banks' total assets increased by around 30 % over the same period.

Another relevant indicator is the House Price Index (HPI), which measures the general trend in property prices. It is compiled by the Federal Statistical Office and is based on transaction data for residential properties. Since September 2015, the HPI has also risen by around 55 %, further underscoring the strong increase in real estate values. This suggests that the financing needs of the real estate sector are growing faster than banks' lending capacity.

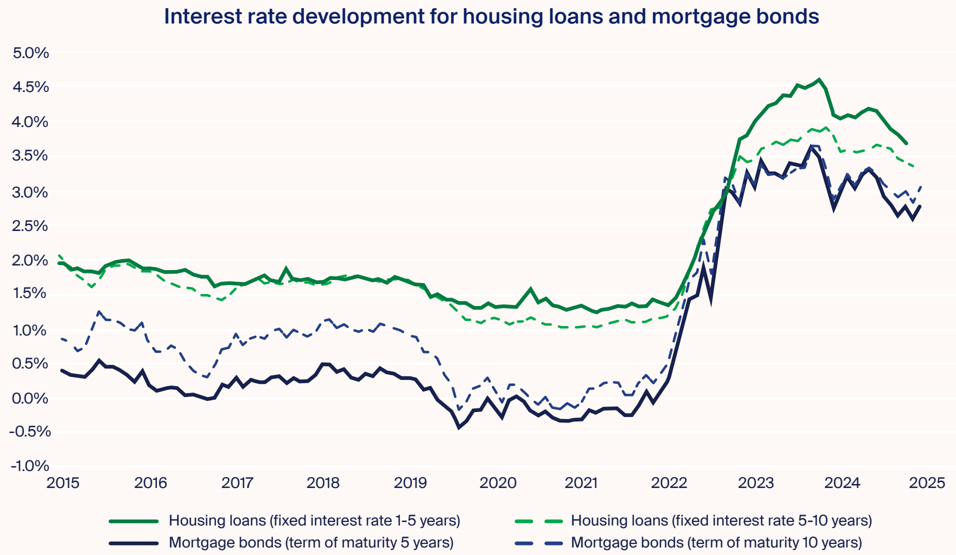


Figure 4: Change in interest rates on mortgage bonds with a residual term of 5 or 10 years and change in interest rates for residential loans with 1–5-year and 5–10-year fixed rates; 2015–2025 (source: Deutsche Bundesbank)

Performance of the banking market vs. the real estate market (Germany)

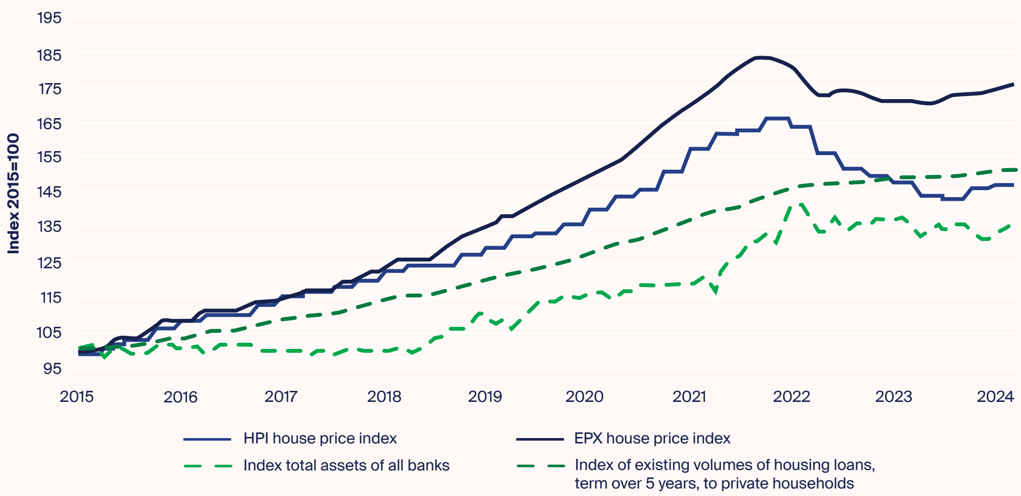


Figure 5: Change in total assets of German banks and House Price Index; Q3 2015–Q3 2024 (source: Europace, DESTATIS, Deutsche Bundesbank)

Limits of bank financing – the example of CRE Europe

The European market for commercial real estate loans has also traditionally been dominated by banks. 85 % of outstanding loans are granted by monetary financial institutions (MFIs).[6] At the same time, however, lending has declined significantly, especially when comparing the 2021–2023 period with 2016–2018.[7]

This trend is also borne out by the European Banking Authority (EBA). It conducts semi-annual risk assessment interviews with 85 major banks from the 27 EU countries. The conclusion reached is that the participating banks are more skeptical about CRE loans than about other investments. Loans to small and medium-sized enterprises, loans to large corporates, consumer loans, and residential mortgages are significantly more popular with financial institutions than lending to the CRE sector, as the survey shows.[8]

The reduced interest in CRE is not a one-off, but a trend that has been evident for several years. 20 % of banks want to increase their investment volume in CRE loans (as of fall 2024), 20 % to reduce them, and around 50% to keep them stable.[9] At the same time, ever-fewer banks want to increase their volume of CRE loans. In the fall of 2022, 28 % were looking to increase this figure.[10]

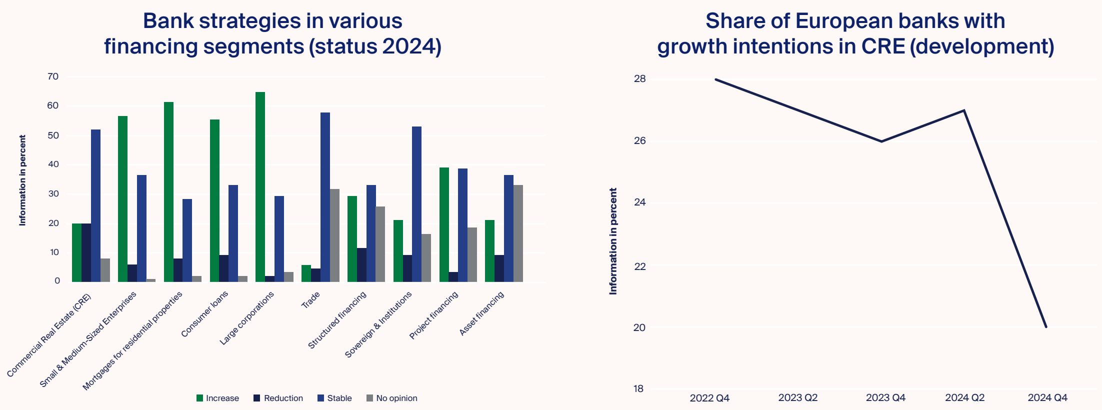


Figure 6: Change in lending plans: Banking strategies in various financing segments, as of 2024; Change in expansion plans: Proportion of European banks intending to grow in the CRE sector, as of 2024 (source: European Banking Authority)

Financing gap (financing needs not covered by banks)

The real estate market is facing a significant funding gap, characterized by higher interest rates, higher refinancing costs for banks, and more restrictive lending. The shift away from a zero-interest policy has forced a revaluation of real estate assets and at the same time significantly increased banks' refinancing costs. While this trend has been softened by recent interest rate cuts, these extra costs must be passed on to borrowers. As a result, many investment plans will prove uneconomic and will not come to fruition. However, there remains intense competition between banks for financially strong customers with first-rate projects, resulting in an economic dilemma: Either margins are reduced, or growth opportunities are restricted. This limits overall willingness and ability to grant new loans.

In addition, banks are becoming increasingly cautious about lending at high loan-to-value ratios. Whereas LTVs of up to 80 % were common pre-crisis, today only a conservative 50–60 % is generally financed. This makes many investments considerably more difficult, as companies and investors are forced to postpone or re-evaluate projects. The uncertainty and uneconomic nature of financing are inhibiting market dynamics and preventing the transition to the next phase of the real estate cycle.

Refinancing maturing loans is a challenge. According to estimates by the investment manager AEW, the credit financing gap in Europe in the third quarter of 2024 was EUR 86 billion – equivalent to 13 % of all real estate loans maturing in the 2025–2027 period.[11] The survey is based on the difference between the initial secured debt raised in the 2016–2023 period and the expected refinancing volume at maturity of the loans in the next three years. The total refinancing volume in 20 European countries stands at EUR 650–700 billion. Germany and France are under particular pressure, with refinancing challenges of 19% and 18% respectively – the highest proportion among the countries studied. The UK is at the lower end of the scale, at 6%, while Italy and Spain at 12 % are just below the European average of 13 %.

The combination of rising property prices, higher refinancing costs, and regulatory restrictions is creating a growing financing gap. Banks are no longer able to cover the industry's entire capital needs and often charge unscheduled repayments or high fees for refinancing. This makes alternative sources of financing increasingly necessary to ensure an adequate supply of capital and avoid a slowdown in investment activity.

Mid-market transactions in the EUR 30–75 million range are particularly hard-hit. While large institutional investors and debt funds in English-speaking countries are focusing on larger deals and banks are limiting themselves to lower-risk exposures, this sector remains under-served. It is all the more critical, however, given that a significant wave of refinancing is on the horizon. Many existing low-interest loans cannot easily be extended through bank financing, further increasing the need for alternative sources of capital.

2. The role of private debt as a financing solution

Private debt is changing the structure of real estate financing forever. While banks are increasingly focusing on lower-risk exposures, alternative investors are growing in importance. This change is not only affecting individual investments, but is also influencing the entire supply of capital in the real estate sector in the long term. Material structural changes and their implications for the market are examined in greater detail below.

Non-bank financial intermediaries (NBFIs) are becoming increasingly important as an alternative source of financing, particularly in real estate financing. They offer capital strength and flexibility that traditional bank loans often cannot guarantee.

Capital strength and flexibility of NBFIs

NBFIs comprise a variety of financial institutions that are not traditional banks, but perform similar financial intermediation functions. The Financial Stability Board (FSB) categorizes NBFIs into different economic functions (EFs):

- EF1: Open-ended investment funds, such as money market funds, pension funds, and real estate funds, which offer units with short notice periods and are therefore vulnerable to sudden cash withdrawals.
- EF2: Finance companies that issue mortgages or consumer loans and are not integrated into banking groups.
- EF3: Securities and derivatives dealers acting for their own account, including market makers and high-frequency traders
- EF4: Companies that facilitate credit intermediation, for example through credit insurance or financial guarantees.
- EF5: Special-purpose vehicles that engage in credit intermediation through securitization, such as asset-backed securities (ABSs) or collateralized loan obligations (CLOs).

NBFIs' capital strength and flexibility enable them to offer financing structures that are individually tailored to the needs of borrowers – a key advantage for complex real estate projects. As they are subject to less stringent regulatory requirements and have flatter decision-making structures, they are often able to make financing decisions faster than traditional banks. They are also willing to take higher risks, enabling them to make investments that banks may consider too risky. By using a variety of financing instruments and strategies, NBFIs also succeed in diversifying risks widely and generating stable returns.

In recent years, the regulatory environment for banks has been made tougher by tighter regulation and changed market conditions, which has led to a reluctance to lend. This has paved the way for NBFIs to fill the funding gaps that have arisen. Particularly in the area of private debt, i.e. non-public debt financing, NBFIs have grown in importance and can make up in part for the weakness among traditional banks. Overall, their capital strength and flexibility mean that NBFIs offer a valuable alternative to traditional bank loans and help fill funding gaps in the market.

Increasing regulation of the banking sector, in particular by Basel III and Basel IV, has restricted bank lending. This has led to increased demand for alternative sources of finance, in particular from private debt funds and other non-bank lenders.

The volumes held by NBFIs in Germany have increased sharply in recent years. Alternative financing loans with a value of around USD 5,072 billion were granted in 2014. The equivalent figure for 2024 was around USD 8,237 billion, an increase of 62 %. Over the same period, the value of economic functions (EFs) also increased significantly, from around USD 1,514 billion in 2014 to around USD 2,479 billion in 2023 (+64 %). EF1 to EF5 represent subsets of the total volume.

The EF1 category is very dominant in Germany. It accounted for a 89.5 % share in 2023, followed by EF2 at 6.5 %, EF5 at 2.8 % and EF3 at 1.1 %.[12] The sub-segments EF1–EF5 performed as follows in Germany in a comparison between 2014 and 2023:

- EF1 – Investment funds:
  2014: USD 1,420 billion → 2023: USD 2,219 billion (+56 %)
- EF2 – Debt financing companies:
  2014: USD 45 billion → 2023: USD 162 billion (+259%)
- EF3 – Securities and derivatives dealers:
  2014: USD 0.6 billion → 2023: USD 27 billion (+4,340 %)
- EF4 – Credit intermediation via insurance companies: There are no figures relating to this area for Germany, as hardly any volume is traded in this segment.
- EF5 – Special-purpose entities for credit securitization (ABSs, CLOs, etc.): 2014: USD 48 billion → 2023: USD 70 billion (+47 %)

EF3 grew particularly strongly, with total growth in value of over 4,000 %; however this segment had not yet achieved a significant volume in 2014. The EF2 category also posted strong growth, increasing by more than 250 %. Meanwhile, the EF1 segment remains dominant with a volume of USD 2,219 billion.

Growth in the total volume of NBFIs in Europe was on a par with levels in Germany. Here, the FSB evaluates selected European countries representing not the EU, but the euro area (Austria, Belgium, Croatia, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain). Between 2014 and 2023, the NBFI volume (total) grew by around 43 %, from USD 39,588 billion to USD 56,436 billion.

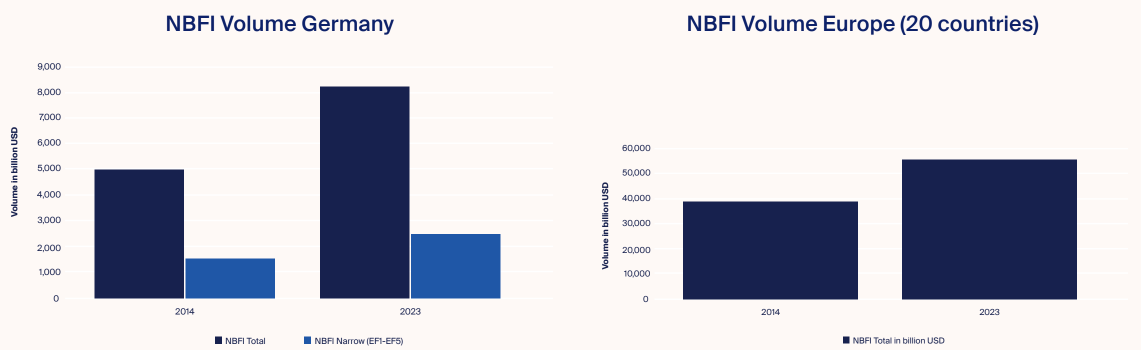


Figure 7: Total volume of non-bank financial intermediation (NBFI), Germany, Europe – 20 countries covered, 2014 vs. 2023 (source: Financial Stability Board)

Characteristics of private debt

Alternative financing instruments such as private equity and debt are becoming increasingly important in plugging the emerging financing gap. Institutional investors, insurance companies, and debt funds offer capital outside of the traditional banking sector, enabling flexible and needs-based financing. This is key to keeping the real estate market stable in the long term and maintaining investment activity despite more restrictive bank lending.

Private debt offers crucial solutions in this respect. Alternative financing instruments such as private debt funds can react faster and more flexibly to borrowers' needs and are not bound by the same strict regulatory framework as banks. Private debt instruments are opening up new avenues, particularly at a time when traditional financing is becoming more restrictive. By providing capital outside of traditional banking channels, they can bridge the emerging financing gap in a targeted manner. One innovative strategy is to combine private debt with bank capital, known as "back leverage". Some of the financing is provided by private debt funds, topped up by additional "low-cost" bank capital. This improves the allocation of capital and allows for competitive financing that benefits both investors and borrowers.

The current market environment therefore offers ideal conditions for the increased use of private debt. The combination of restrictive bank lending, increasing financing needs, and a post-crisis upturn in market activity makes alternative financing central to the stabilization and future growth of the real estate market. Particularly in the medium-volume segment, there are attractive opportunities for agile lenders that can act flexibly and efficiently. Private debt is proving an indispensable tool for successfully overcoming the challenges of the current market environment.

Basic financing options

A real estate investment can be financed internally (using equity) or externally (using debt). Capital is classified as either equity or debt depending on its nature and accounting treatment. A key distinction is therefore whether an investor provides equity or debt capital.

The amount of equity available for real estate financing is limited. Adding new shareholders leads to issues regarding the resulting participation rights, profit claims and corporate structures. The availability of debt capital – in the traditional form of a bank loan – is also limited, particularly due to regulatory requirements and tougher bank ratings. This means various optimizations are needed to create an efficient financing structure suited to the individual circumstances.

Debt financing is carried out via different capital structures, which vary in their seniority, risk, and return:

- Senior loans are secured loans with a priority repayment claim and a comparatively low interest rate.
- Junior loans are subordinated loans with higher risk, as they are only serviced after senior loans. Banks lend these less often, so alternative investors such as debt funds fill this gap.
- Whole loans combine senior and junior loans into a single loan instrument. This allows for a higher leverage ratio and offers institutional investors a flexible structure with a single counterparty.

Mezzanine financing – a hybrid of equity and debt capital – is an alternative to traditional loans. It serves to close financing gaps and is often used for high-yield real estate developments. Mezzanine capital is subordinated to debt, but takes precedence over equity. The higher cost of capital results from the increased risk, linked to its subordination, collateral, and default risk.

Mezzanine capital is usually provided in the form of profit participation loans or subordinated loans. These debt-adjacent forms include contractual agreements under the law of obligations with a fixed term. Information, control, and joint decision-making rights are limited to those of a lender. Profit participation loans offer profit-sharing or revenue-sharing instead of fixed interest rates, supplemented by a base interest rate.

Participation rights are a flexible form of financing not standardized by law. They enable participation in profit and equity and are often sold in the form of securities. Their structure can range from a form that resembles a promissory note to a form that resembles shares. In the real estate sector, participation rights can be combined with special rights such as mortgages or subscription rights, resulting in an optimized risk-reward profile.

Silent participation is another form of financing. A typical silent participation is subordinated to debt capital, without a say in business decision-making. A silent partner has a right to receive information, a right of monitoring, and a right of veto, but no further influence. An atypical silent partner, by contrast, has a say in management and bears entrepreneurial risk. Its status as a partner is based on loss sharing and liability, the extent of which is governed by a contract.

Bonds securitize debt claims. Companies use them to raise capital. Bonds are an important source of financing and – unlike bank loans – are publicly issued and are often tradable on an exchange. Warrant bonds and convertible bonds contain additional rights for investors. Warrant bonds combine a bond with the option to purchase shares at a certain price. Convertible bonds allow the bond to be converted into share capital.

These instruments allow the real estate company issuing them to broaden its capital base, and offer investors a combination of a low return and the opportunity to participate in the company. Risk considerations also play a role here.

Equity capital	Mezzanine capital	Debt capital
Private equity - Forms of cooperation: + Consortia + Interest groups + Syndicates + Joint ventures - Levels of ownership: + Majority shareholdings + Minority shareholdings	**Equity-based structure** - Participation rights - Atypical silent participations	**Traditional debt financing** - Real estate loans (mortgage-backed) - Personal loans (according to the borrower's creditworthiness) - Combinations involving different degrees of collateralization (senior, junior, whole loan)
Public Equity - IPOs, share issues	**Debt-based structure** - Typical silent participations - Vendor loans - Subordinated loans/ profit participation loans - Hybrid bonds	**Modern debt financing** - Bonds - ABSs/securitization - Leasing (finance leases)
	Intermediate form - Convertible bonds and warrant bonds	

Figure 8: Classification of different equity and debt financing options

A reorientation of the real estate private debt market is reflected in the changed risk structure of the financing products that are being selected. While high-yield mezzanine financing with loan-to-cost (LTC) values close to 100% was commonplace before the interest rate pivot, the market environment has since changed dramatically. There is currently a clear trend towards senior secured loans, including senior, senior stretched, and whole loans, characterized by more conservative loan-to-value ratios (LTVs) and higher collateralization. This trend is the result of several factors:

- Banks remain active, but with stricter lending guidelines and lower LTVs.
- Mezzanine investors have learned from the past that high-risk structures with high leverage ratios are vulnerable to market fluctuations.
- Investors are looking for more stable, less risky financial instruments with predictable medium-term returns.

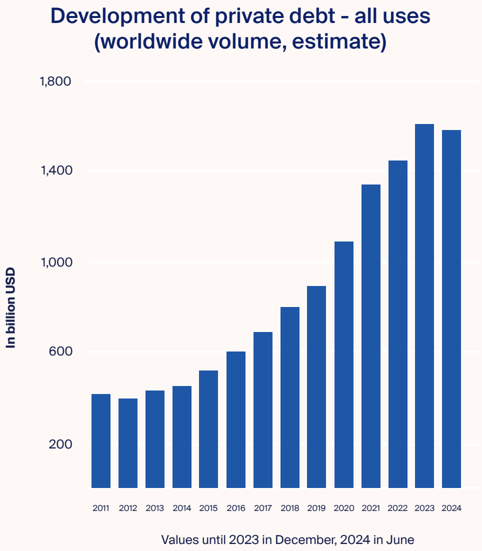
The focus on secured senior credit structures means that private lenders are increasingly acting as a direct alternative to banks. The ability to provide capital flexibly and quickly is becoming a decisive competitive advantage over traditional banks, whose decision-making processes are often more complex and subject to more regulatory restrictions.

Growing potential of private debt

Banks' more restrictive financing policies and generally waning interest in CRE debt are making it necessary to rethink traditional financing structures. Financing via the non-bank capital market is gaining in importance.

Global private credit financing as a whole has grown significantly in recent years. The global financing volume rose from around USD 365 billion in 2011 to over USD 1,500 billion in 2024. The period from 2015 onward was particularly striking, with the volume growing from around USD 520 billion (2015) to around USD 1,090 billion (2020) in just five years. This indicates that private debt is increasingly becoming established as an alternative source of financing, especially in markets with more restrictive bank lending. The strongest increases were observed between 2016 and 2020, suggesting that institutional investors, not only in the real estate sector, are increasingly relying on non-bank lending solutions. Demand for private loan financing remained high even after the Covid-19 pandemic, with further growth in 2021 to 2024. By 2024, the figure had risen to around USD 1,590 billion, an increase of around 77% over the past five years.

In addition to the rapid growth of the private debt market as a whole, there has also been a steady increase in capital acquired for real estate financing by non-MFIs. In 2014, global capital raised in this sector was around EUR 70 billion; this had already increased to around EUR 110 billion in 2015 and reached a new high of EUR 210 billion in 2021. This growth underscores the increasing relevance of private debt as an alternative source of financing in the real estate sector. Particularly noteworthy are the significant increases from 2015 to 2016 and from 2019 onward, indicating increased demand for financing solutions beyond the banking sector. Debt capital acquired globally in 2023 is estimated at around EUR 180 billion, a slight decrease versus 2022. Despite short-term fluctuations, the trend remains clear: Institutional investors and debt funds are continuously acquiring higher capital volumes in order to position themselves in a market environment characterized by regulatory restrictions in the banking sector and changing financing requirements.



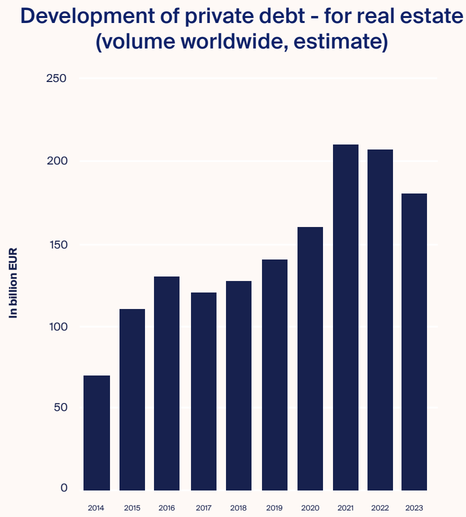


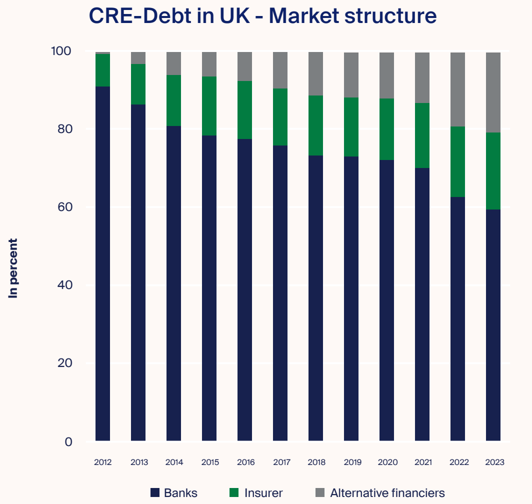
Figure 9: Private loan financing for all uses, global estimates, 2011–2024 (source: Handelsblatt based on Preqin); Private loan financing for real estate investments, global estimates, 2014–2023 (source: Savills based on Preqin)

Example market – CRE debt in the UK

The UK is a prime example of how the market for commercial real estate lending has changed dramatically. While banks have traditionally been the main source of CRE lending, their market share fell from around 90% in 2012 to around 60% in 2023. At the same time, the proportion of (private) insurers and alternative providers of finance has increased significantly.

The growth of alternative providers of finance – including private debt funds, debt funds, and other non-bank lenders – is particularly noteworthy. Their market share increased significantly over the period under review, from a marginal share in 2012 to over 20% in 2023. This points to a structural shift in the financing market in the UK: Investors are increasingly looking for more flexible and individually tailored credit structures that traditional banks can no longer offer on this scale. Alternative providers of finance selectively close funding gaps that have arisen because of more restrictive banking regulations. The increasing professionalization of this segment and the growing acceptance of non-bank financing instruments indicate that private debt has become a mainstay of real estate financing in the UK.

In parallel with the growing importance of private debt in commercial property financing in the UK, the cost of financing these products has also changed. Between 2014 and 2017, the cost of capital declined, indicating growing market acceptance and increased competition among lenders. Alternative providers of finance in particular benefited from this environment, as they were able to offer increasingly competitive terms and thus grow their market share. However, as a result of higher interest rates and increased risk aversion among investors, financing costs began to stabilize, and in some cases increase, from 2017.



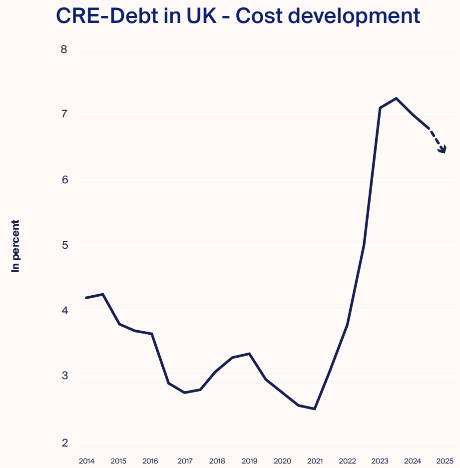


Figure 10: Market structure and change in cost of CRE debt in the UK, 2012–2023 and 2014–2024, respectively (source: Savills based on Bayes Business School; Barings based on Bayes Business School, OEF)

3. Opportunities for private debt investors

At a time when financing needs remain high and banks are increasingly restricting their lending, private debt investors can gain market share through innovative financing models and flexible structures. Attractive investment opportunities are arising in the mid-market segment in particular, because there is a high capital requirement that traditional bank loans no longer fully cover. This is opening up space for private debt instruments that not only diversify investors' portfolios, but also offer stable return opportunities. Despite regulatory requirements and a competitive environment, private debt funds have the opportunity to establish themselves as reliable partners in real estate financing over the long term – provided they apply consistent risk management and use instruments such as back leverage to further strengthen their competitive position.

Private debt in the unlisted real estate vehicles segment

The global market for unlisted real estate assets has grown strongly in recent years. This becomes particularly clear when comparing assets under management (AuM) in (unlisted) debt instruments with the total volume of (unlisted) AuM. Data from the INREV Fund Manager Survey 2024 demonstrates that AuM in (unlisted) debt instruments increased significantly between 2015 and 2023. The total volume of (unlisted) AuM in debt instruments went from around EUR 78.3 billion in 2015 to over EUR 400 billion in 2023. This corresponds to growth of almost 421% in eight years. By way of comparison, total (unlisted) AuM also increased over the same period, but at a more moderate rate. The total volume rose from EUR 1,606 billion in 2015 to around EUR 3,060 billion in 2023. This corresponds to an increase of around 91%, i.e. significantly smaller than the growth in AuM in (unlisted) debt instruments.

This divergence between the growth of AuM in (unlisted) debt instruments and total (unlisted) AuM can be attributed to several factors. In particular, banks' reluctance to grant real estate loans as a result of increased regulatory requirements and higher refinancing costs has led to alternative forms of financing gaining in significance. (Unlisted) debt instruments are able to close this financing gap and support investors with flexible, individually tailored credit structures.

Another reason for the faster growth in AuM in (unlisted) debt instruments is the rising demand for non-traditional financial instruments. In an environment of higher interest rates and more restrictive banking regulation, investors are looking for more flexible and more profitable alternatives to traditional real estate financing. (Unlisted) debt instruments enable investors to use capital more efficiently and adopt a diversified structure of financing models.

The change in AuM in (unlisted) debt instruments shows that the market for alternative forms of financing is continuing to grow dynamically. The significant increase in AuM in debt instruments (unlisted) compared with total (unlisted) AuM indicates that this sector has established itself as a key source of financing for real estate investments. Future trends will largely depend on the extent to which banks maintain their restraint or whether the regulatory framework eases in favor of broader lending. However, given the current market conditions, it is expected that AuM in (unlisted) debt instruments will continue to grow strongly in the coming years.

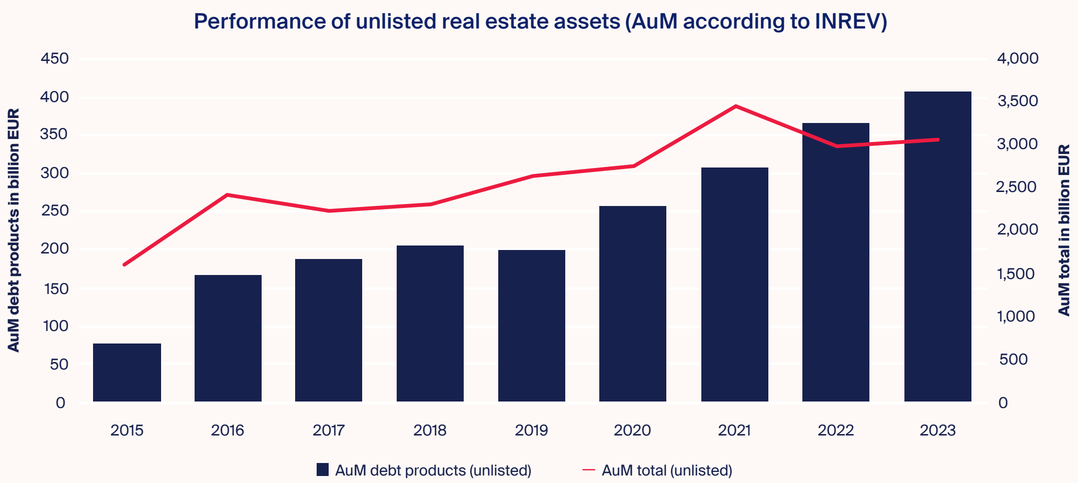


Figure 11: Performance of unlisted real estate assets, AuM total vs. debt instruments, period: 2015–2023 (source: INREV Fund Manager Survey 2024)

Return potential vs. risk management

In a changing financing environment, the strategic composition of portfolios is becoming increasingly important for investors. Banks' continued reluctance to lend for real estate and the increased cost of financing have not only changed market conditions, but have also influenced the decision-making basis of institutional investors. A key question here is to what extent private debt makes a suitable supplement or alternative to traditional equity investments in the real estate sector.

Debt investments are a form of investment with a more stable and predictable return structure than traditional equity (private equity). While equity investments are characterized by potentially higher but more volatile returns, private debt offers comparatively constant cash flows with a lower risk profile.

Typical expectations of debt investments are:

- Predictable income from contractually agreed interest payments
- Greater security through collateralized structures (e.g. senior loans, whole loans)

- Less dependence on market cycles, as returns flow back in the form of ongoing interest payments

- Potential to hedge against fluctuations in value by using real estate assets as collateral

- Limited but stable potential returns

Return ranges vary accordingly: While private debt funds in the real estate sector often generate returns of 6–12% p.a., private equity real estate investments can generate significantly higher double-digit returns if successful – albeit with much higher risk.

Private debt offers a favorable risk structure, particularly in a market environment with rising financing costs and more restrictive bank lending. Senior, secured credit structures (e.g. senior mortgages) reduce default risk. In addition, private debt funds are able to react to market fluctuations through flexible financing models.

For institutional investors, the advantage lies in not having to choose between private debt and private equity alone, but being able to achieve the ideal mix of both types of investment. The benefits of a balanced allocation include:

- Reduction in portfolio volatility through more stable flows of returns from debt financing

- Greater stability during market fluctuations, as interest income from private debt flows independently of short-term value adjustments on the real estate markets

- Optimization of liquidity management, as debt structures generate regular distributions, whereas private equity has more capital tied up

- Flexibility in financing strategy to adapt to changing market conditions

Private debt thus offers institutional investors an opportunity to diversify portfolios in a targeted manner and to optimize their risk-return structure. Whereas traditional equity investments enable higher returns, they are associated with significant market risks and longer capital commitments. By contrast, private debt is a more defensive form of investment that combines stable returns with predictable risks.

Back leverage as a tool to increase efficiency

Back leverage is one potential lever for increasing the efficiency and return of a debt fund providing real estate financing. This instrument involves debt being raised at the level of the fund, enabling it to leverage its own capital. This makes it possible to grant additional loans without having to immediately increase the equity base.

The advantages of this structure are:

- Efficient capital allocation: Back leverage enables private debt funds to cover a larger volume of financing with less equity.

- Improved returns: As the cost of borrowing is generally lower than the credit margins achieved, this results in a positive leverage effect.

- Increased flexibility in liquidity management: The ability to raise additional capital at short notice enhances a fund's ability to react to market changes.

In practice, the fund refinances itself by integrating back leverage at standard market conditions. As a result, more effective use is made of the investors' capital, as it can be used multiple times through borrowing. This leads to higher return on equity (RoE). There are significant competitive advantages for the fund, particularly in markets with a low margin base, as the costs of back leverage are generally lower than the interest earned on the loan.

In addition to improving returns, back leverage also offers liquidity management benefits. The targeted use of debt capital enables the fund to react flexibly to changes in demand and to make new financing commitments on an ongoing basis. This tactical flexibility is strategically important, particularly in volatile markets, in order to fully exploit market opportunities and offer investors a reliable payout.

In summary, back leverage is an effective tool for increasing the efficiency of a debt fund. It not only allows a higher return for investors, but also improves the fund's operational flexibility and market position without unduly burdening the risk profile. A prerequisite, however, is strict risk management in order to avoid potential negative effects, such as an increase in borrowing costs during periods of stress.

Particularly in an environment with high demand for financing but limited supply of capital, back leverage represents a strategic complement to traditional private debt structures.

Scenarios for development potential

The real estate private debt market is undergoing a dynamic transformation characterized by macroeconomic developments, regulatory adjustments, and structural changes in the banking sector. The coming years present various scenarios that will provide investors and market participants with both new challenges and opportunities.

1. Baseline scenario: Private debt becomes established as a core component of real estate financing

In a stable interest rate environment with a moderate economic recovery, financing requirements for commercial real estate remain high. Banks adhere to restrictive lending criteria, leading to increasing standardization of private debt as an alternative source of finance. Investors benefit from stable cash flows and growing demand for flexible financing structures, especially in mid-market transactions.

- Opportunities: Sustainable market growth through the progressive institutionalization of private debt.
- Risks: Ongoing uncertainty due to regulatory adjustments and market fluctuations.

2. Growth scenario: Expansion through the increased integration of alternative financing models

If the trend toward further restructuring of bank financing continues, private debt could replace traditional forms of financing to an even greater extent. New financing instruments, such as tokenized promissory notes and hybrid credit structures, could gain in importance. The diversification of capital sources, in particular involving institutional investors and debt funds, could significantly increase the market volume.

- Opportunities: Expansion of the private debt sector through innovative financial instruments and new investor groups.
- Risks: Increased competition for attractive borrowers and potential increase in risky transactions.

3. Crisis scenario: Market distortions caused by economic recession or regulatory intervention

In an environment of rising interest rates, economic slowdown, or unforeseen regulatory intervention, private debt volumes could grow more slowly or even decrease. Stricter capital requirements and changed refinancing conditions could lead to less capital being available for private debt investments. In a worst-case scenario, non-performing loans (NPLs) could increase.

- Opportunities: Selective investment strategies and crisis-resistant loan portfolios could cushion risks.

- Risks: Rising refinancing costs and liquidity bottlenecks could hurt the market.

4. Regulatory scenario: Tougher capital market regulation and a revival of the banking sector

In this scenario, policymakers would push for greater regulation of the private debt market to ensure the stability of the financial system. This could lead to more restrictive capital requirements and increased reporting requirements for alternative lenders. At the same time, regulatory incentives could allow banks to regain a larger role in real estate financing, which would reduce the market share of private debt.

- Opportunities: Stabilization of financial markets and improved risk transparency.

- Risks: Limitations on the flexibility of alternative forms of financing and possible capital shortages for non-bank investors.

The future of the private debt market depends heavily on external factors such as interest rate trends, regulation, and macroeconomic stability. While the baseline scenario is that this becomes gradually established as a standard form of financing, the growth scenario offers the prospect of significantly expanded market penetration. At the same time, crisis scenarios cannot be ruled out, particularly in the event of economic shocks or stricter regulatory requirements. Possible regulation of the private debt sector could also lead to a return to more banking dominance, which would represent a new test for alternative financing models.

Strategic focus on mid-market transactions

A significant funding gap is particularly evident in the mid-market segment, i.e. for transactions in the EUR 30–75 million range. While large institutional investors are increasingly investing in mega deals and banks are clamping down on their lending, the mid-market remains structurally undersupplied.

Alternative financing instruments such as private debt fill this gap by providing capital for investment projects that do not attract traditional bank loans due to strict loan-to-value limits or complex project structures. Mid-market deals can be structured in such a way that multiple lenders – for example, a bank in the senior segment and a private debt fund in the junior or mezzanine segment – together provide the financing. These flexible structures allow investors to remain liquid despite periods of general market uncertainty and to continue ongoing projects.

The relevance of the mid-market segment for the real estate market is often underestimated, as public attention is focused primarily on large transactions. However, mid-market transactions are often the mainstay for medium-sized companies, family offices, and specialized real estate funds that purchase or plan real estate portfolios of this size. This is precisely where the advantages of private debt come into play: Short decision-making paths, individual structures, and precisely targeted risk diversification. As such, private debt not only provides capital in market phases during which banks tend to exercise caution, but also contributes to the long-term liquidity of the overall market by stabilizing mid-market deals.

This market area offers attractive opportunities for private debt investors, as there is a need for capital that is no longer fully met by traditional bank financing. The increasing reluctance of banks to grant loans of this magnitude has led to the emergence of alternative investors as a major source of finance. Advantages of specializing in mid-market transactions are:

- Less competition: Large institutional investors focus on large-scale transactions, while smaller projects remain underfunded.
- High demand for flexible financing structures: Companies in this segment in particular benefit from tailored financing models that banks are often unable to offer.
- Attractive risk/return profile: Conservative LTVs and selective lending allow risk-adjusted returns to be realized.

Looking ahead, this market segment is expected to stabilize further, with targeted private debt strategies set to remain a key element of financing solutions.

4. Conclusion

The ongoing upheaval in the real estate market is opening up new opportunities for real estate private debt: Banks are increasingly reluctant to act, while alternative investors are able to fill financing gaps and offer flexible solutions, especially in the mid-market segment of transactions ranging from EUR 30 million to EUR 75 million.

Despite this dynamism, strict risk management remains crucial. Private debt investors need to carefully assess creditworthiness, project quality, and collateral in order to achieve stable returns over the long term. Alongside senior secured loans, broad diversification makes risk management easier.

There is significant growth potential in co-lending models with banks and in the use of back leverage, which funds can use to leverage their capital efficiently. This makes it possible to achieve attractive returns and at the same time expand the scope for financing.

Future developments will depend heavily on interest rates and regulatory requirements: Rising capital requirements could further restrict banks' room for maneuver and give an additional boost to private debt. Conversely, a possible reduction in interest rates or relaxation of regulation would increase competition.

Overall, private debt will become an indispensable part of real estate financing in the long term, as long as professionalism, flexibility, and risk awareness are maintained. Particularly in the mid-market sector, this will provide significant impetus for future growth and stability.

Sources and references

[1] See PwC 2024, Commercial real estate loans in a crisis: Is Germany facing a non-performing-loan wave?, p. 15, at https://www.pwc.de/en/real-estate/real-estate-institute/pwc-whitepaper-real-estate-npl-march-2024.pdf, last accessed 20 February 2025.

[2] See S&P Global 2024, Commercial real estate maturity wall $950B in 2024, peaks in 2027, at https://www.spglobal.com/market-intelligence/en/news-insights/research/commercial-real-estate-maturity-wall-950b-in-2024-peaks-in-2027, last accessed 10 February 2025

[3] See S&P Global 2024, Commercial real estate maturity wall $950B in 2024, peaks in 2027, at https://www.spglobal.com/market-intelligence/en/news-insights/research/commercial-real-estate-maturity-wall-950b-in-2024-peaks-in-2027, last accessed 10 February 2025

[4] See Association of German Banks 2024, Unternehmensfinanzierung aktuell (Corporate financing report), p. 7, at https://bankenverband.de/finanzierung/unternehmensfinanzierung-aktuell-november-2024, last accessed 31 January 2025 (available in German only)

[5] See PwC 2024, Commercial real estate loans in a crisis: Is Germany facing a non-performing-loan wave?, p. 9, at https://www.pwc.de/en/real-estate/real-estate-institute/pwc-whitepaper-real-estate-npl-march-2024.pdf, last accessed 31 January 2025.

[6] See AEW Investment Management 2024, Monthly Research Report, October 2024, p. 2, at https://www.aew.com/research/is-the-worst-of-the-refinancing-challenge-behind-us, last accessed 10 February 2025

[7] See AEW Investment Management 2024, Monthly Research Report, October 2024, p. 2, at https://www.aew.com/research/is-the-worst-of-the-refinancing-challenge-behind-us, last accessed 31 January 2025

[8] See European Banking Authority 2024: Risk Assessment Questionnaire, at https://tools.eba.europa.eu/interactive-tools/2024/powerbi/256109/raq24q4_visualization_page.html, last accessed 14 February 2024

[9] See European Banking Authority 2024: Risk Assessment Questionnaire, at https://tools.eba.europa.eu/interactive-tools/2024/powerbi/256109/raq24q4_visualization_page.html, last accessed 14 February 2024

[10] See European Banking Authority 2024: Risk Assessment Questionnaire, at https://tools.eba.europa.eu/interactive-tools/2024/powerbi/256109/raq24q4_visualization_page.html, last accessed 14 February 2024

[11] See AEW Investment Management 2024, Monthly Research Report, October 2024, p.2, at https://www.aew.com/research/is-the-worst-of-the-refinancing-challenge-behind-us, last accessed 31 January 2025

[12] See Financial Stability Board (FSB), Global Monitoring Reporting on Non-Bank-Financial Intermediation: Data, at https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/non-bank-financial-intermediation/global-nbfi-monitoring-report-data/, last accessed 4 February 2025

Authors

PROF. DR. STEFFEN METZNER

Head of Research Empira Group
steffen.metzner@empira-invest.com

NOAH-DAVID SCHWILL

Research Analyst Real Estate Empira Group
noah-david.schwill@empira-invest.com

Contact

Empira Group
Gubelstrasse 32
6300 Zug
Switzerland

Tel. +41 41 72875-75

Empira Asset Management GmbH
Kurfürstendamm 213
10719 Berlin
Germany

Tel. +49 30 221 8499-10

info@empira-invest.com / www.empira-invest.com

As of: März 2025
Disclaimer: All information is provided without guarantee. Changes are subject to change.

Additional research reports are available on the Empira Group website at empira-invest.com.

DISCLAIMER

This information is provided to discuss general market activity, industry or sector trends, or other broad-based economic, market or political conditions. Economic and market forecasts presented herein reflect our judgment as of the date of this presentation and are subject to change without notice. These forecasts are subject to high levels of uncertainty that may affect actual performance. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Any references to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only.

NOTICE TO RECIPIENTS