

# PERE Credit

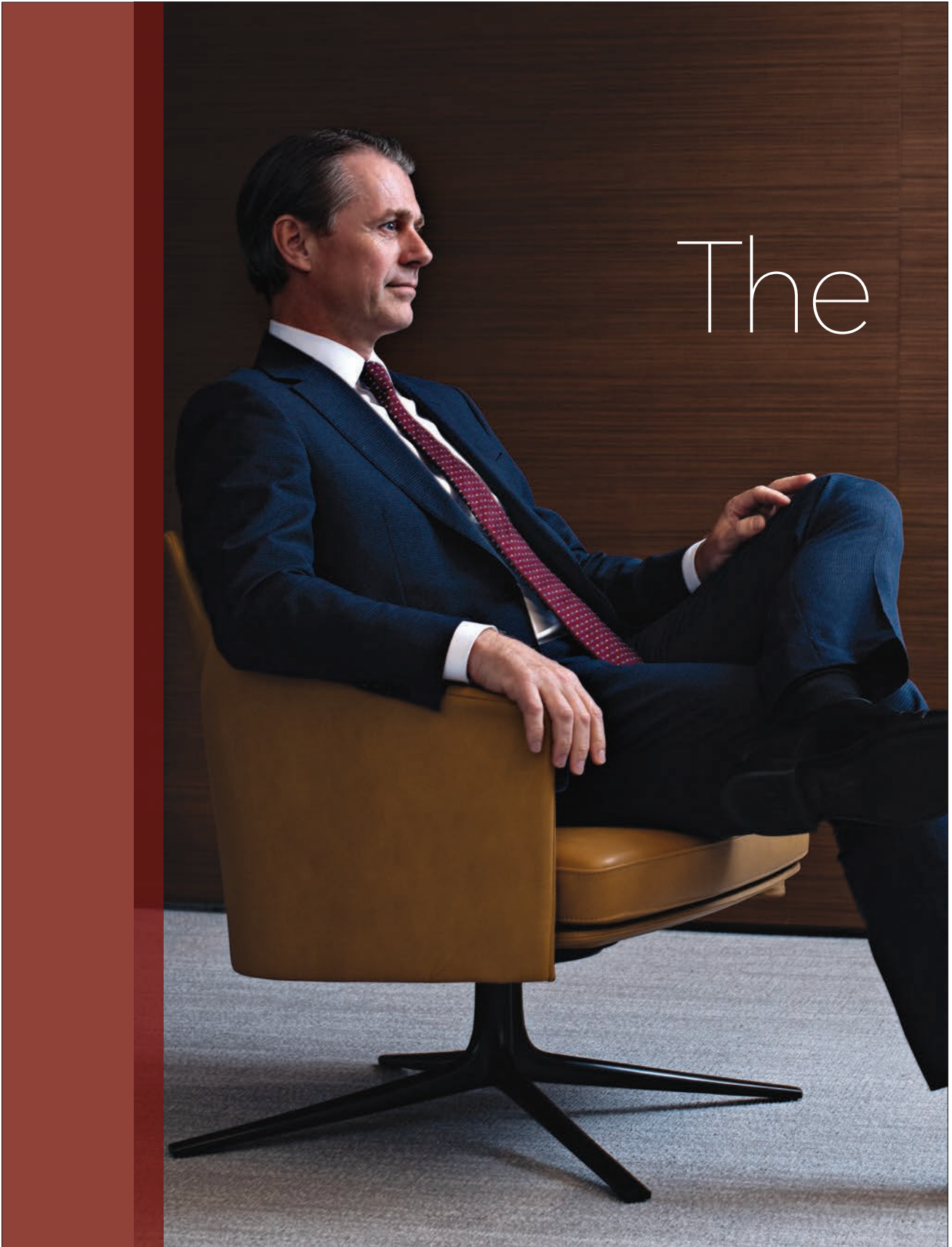
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**EXTRA**  
Alternative  
lender  
roundtable

**BROOKFIELD'S  
KINGSTON**  
The future  
is debt



**PEI**



# future is debt



## Cover story

*Brian Kingston believes  
real estate private credit  
could become the biggest  
part of Brookfield's  
global property business.  
By Samantha Rowan  
and Randy Plavajka*

PHOTOGRAPHY BY DANNY SANTOS

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**B**rian Kingston, chief executive of Toronto-based manager Brookfield's real estate business, has a bold prediction for the firm's real estate private credit business.

It currently has approximately \$30 billion of assets compared with the firm's overall \$270 billion real estate platform. But, by Kingston's reckoning, it could become the biggest part in the future.

"When I look forward over 25 years, this business is going to be enormous compared to what it is today – potentially dwarfing our equity business," Kingston tells *PERE Credit*.

There are several factors influencing Kingston's call: regulatory changes will make it more difficult and costly for banks to hold commercial real estate debt; in conjunction, the US banking sector, which comprises 4,500 banks, is consolidating. An aging demographic needing more fixed-income investment options will help.

And while there is the obvious near-term opportunity to make hay thanks to a current market dislocation, Kingston, who was part of the team when Brookfield launched its first debt fund 25 years ago, believes it is critical to look further down the line.

"The time period, in my mind, is 25 years," Kingston says. "I don't think this is a matter of three or four years and then we're back to where we were. What we see is a fundamental shift, and it's a healthy thing for the market. You're seeing a broadening of capital

sources – behind us, there are hundreds of capital sources that are changing and evolving over time as opposed to a more concentrated system in the banks."

### Charting expansion

Brookfield has significantly expanded its real estate credit platform via traditional private equity funds and insurance capital since launching its first debt fund. Part of this expansion included the acquisition of a majority stake in Los Angeles-based real estate debt manager Oaktree Capital Group in 2019.

These moves have been about sharpening a focus on the opportunity set Brookfield sees in the private credit markets, says Nailah Flake, a managing partner in Brookfield's real estate group.

"We have been investing in real estate credit since the early 2000s and the vision, even back then, was for us to take advantage of attractive risk-adjusted returns in debt relative to direct real estate equity investments and leverage Brookfield's experience as an owner-operator to lend against high quality real assets at a significant discount to equity," Flake says. "The debt business is an extension of our equity business."

Future growth is likely to be fueled by Brookfield's funds and insurance businesses as well as the potential for new separately managed accounts. "Those are the primary ways we see funding the growth and expansion of our business," she says.

Historically, Brookfield has not been a significant user of repo financing, instead opting to leverage individual positions with banks, insurance companies or pension funds. "We implement this strategy as it enables our investments to be independently financed, which poses lower risks compared to using repurchase financing," Flake notes. Occasionally and selectively, the firm will entertain back leverage, including loan on loan and crossed facilities.

### Senior thesis

The role Brookfield plays in the credit space has evolved substantially over the past 25 years. While the firm focused on the mezzanine market with its first fund, the greatest need today is for senior mortgages. Banks, the traditional providers of senior loans, are scaling back their lending in this space and are expected to accelerate this shift as more regulatory changes come into play, Kingston says.

"Our business is matching capital with opportunities," Kingston says. "[Twenty-five years ago], it was very much that equity returns were uncertain, and the cost of debt had gone up quite a bit. A lot of people looked at the situation and thought, 'Why would I buy the equity when I can get the same return in credit?' And that is very much what is happening today."

He continues: "That is how we came into the business. We were getting priced out of transactions so we thought, 'Why don't we lend at a level where we are happy with the basis we

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*“There is no benefit for us to be aggressive on our underwriting, we want to make sure we get paid off”*

**NAILAH FLAKE**  
Brookfield

have, and we think we will have the same kind of returns?”

How will this thesis translate into action? The firm is taking a “broad view” of senior lending, looking across markets and sectors with the aim of originating loans of \$50 million to \$1 billion, Flake says.

“Our ability to play in scale and our access to capital really has allowed us the flexibility to handle large transactions which may be out of reach for other lenders but also be flexible when the opportunity in the market is in smaller deals,” she says. “There are sometimes gaps in the market where, even though we typically wouldn’t focus on smaller deals, we could do so.”

Brookfield’s edge, Kingston

believes, is its ability to combine its perspective as an owner and operator with its knowledge of the lending market. This gives the firm what he views as a unique perspective on the long-term viability of an asset and its business plan. Generally, across its business, Brookfield tries to avoid anything which looks like financial engineering, he says.

“We follow a simple formula: we own real estate, we collect the rent, and we pay back the banks when we borrow. A lot of [financial engineering] can work when things are going your way. But often, there are unintended consequences when the market turns,” Kingston says. “For the kind of capital we are managing for pensioners or insurance companies, our investors are getting a 6 or 8 percent return, and they’re happy with that. They don’t need us to risk getting zero just to get them a 9.”

The firm focuses on deals in which it has a good understanding of the sector and the market, Flake says.

“We want to be an extension of our equity business and not enter a new

asset class in which our equity business does not have expertise. We are focused on constructing a well-diversified portfolio across all asset classes,” Flake says.

By geography, Brookfield looks for areas in which there is net migration, jobs growth and investment. When it comes to sectors, Kingston points to common wisdom around asset classes like multifamily and logistics, which have strong demand drivers including stable rent growth, low vacancies and increasing renter demand.

Even for assets with all these points of attraction, in addition to originating new loans for their sponsors Brookfield can recapitalize their broken capital stacks.

“The issue is that many people got excited and paid and borrowed too much [when rates were low]. They are now going through a period where new capital needs to be introduced. In some cases, that could be mezzanine debt and, in some cases, it is equity,” Kingston says. “We think you can buy a good asset with a bad capital structure and since there is less capital available today than there was, it’s less competitive. It is not really a time to reach for risk when you can get the same returns for less risk.”

#### **Substantial capital**

While real estate private credit funds were a rarity when Brookfield launched its first vehicle, there has been substantial capital formation since then. Over the past five years, the 50 largest real estate private credit managers have raised about \$168 billion for US-focused strategies, per data from *PERE Credit*.

The level of capital raised illustrates how the scale of investing has changed over the past two decades, Kingston adds. “Twenty-five years ago, we were dealing with institutional investors that were very large if they had a \$25 billion portfolio. Today, we are dealing with institutional investors that are



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in the trillions,” Kingston says. “The scale of the capital that they are trying to deploy has changed, along with the entire industry. The fundamentals and the story of credit is similar.”

Meketa Investment Group, a Westwood, Massachusetts-based advisory, has indeed seen more of its clientele shifting toward real estate private credit as part of their overall strategy.

“Real estate credit investments potentially offer a very good risk-adjusted return and now, as property values have come down and traditional lenders are capital-constrained, it is possible to earn attractive returns,” says Colin Hill, managing principal.

Investors include large credit funds [like those offered by Brookfield] within their debt allocations, Hill notes.

The shift toward private real estate credit has been happening gradually over the past 18 to 24 months, Hill adds. “We have seen some investors moving out of equities and moving into debt as a way to better match liabilities and get returns with lower volatility and more current income. I wouldn’t say it is a pendulum swing, but there has been a shift for a lot of our clients to take a couple of points out of equity and reallocate to fixed income,” Hill says.

On the borrower front, sponsors which spoke with *PERE Credit* are expecting to see more private credit lenders scale. Since the financial crisis, large multi-strategy alternative asset managers have become key players in real estate finance, says Matthew Pestronk, co-founder and president of Philadelphia-based multifamily manager Post Brothers.

“Most institutional quality real estate is debt-financed at some point in its life cycle by less-regulated lenders than banks. This ‘private credit’ is now viewed by market participants much like traditional credit.

“Big real estate firms like Brookfield have increasingly become prime destinations for capital, with investors

*“We have capital;  
we need opportunities  
to put it to work”*

**BRIAN KINGSTON**  
Brookfield

**The evolution of a debt platform**

- **2002**  
Brookfield establishes its real estate credit team
- **2004**  
Brookfield launches its first closed-end real estate debt fund
- **2018**  
The firm launches its open-end real estate debt fund
- **2019**  
Brookfield acquires a majority in Oaktree Capital Management
- **2021**  
The firm acquires American National Group for \$5.1 billion
- **2024**  
Brookfield closes on acquisition of American Equity Life, increasing its insurance AUM to over \$100 billion

preferring fewer, larger manager relationships. The real estate market’s capital structure is predominantly leveraged, enhancing the scale of lending opportunities compared to equity investments,” he adds.

**Two houses**

Key to Brookfield’s strategy and ability to scale its debt and equity platforms is the interaction between the two parts of its business.

“It has always been a big part of our thesis: we can’t have two parts of the business acting in a vacuum from each other,” Kingston says.

“The businesses are very integrated, and our views are very integrated across our investment committee. The same investment committee approves our loans and approves our equity investments.”

There is also the impact of on-the-ground market knowledge when the firm is lending and investing. “As we are making loans, we can use real-time market intelligence, not third-party reports that are out of date,” he adds.

Having a debt and equity business



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also means that in situations where Brookfield is a lender and a situation turns south, it is easier for the firm to restructure a loan.

“As part of that, you may need to underwrite a new business plan. To do that properly you need to understand if the borrower’s plan makes sense and if we want to extend [the borrower’s] credit or not. And in extreme situations, we sometimes get the keys back on an assets, and we need to be able to take those assets and operate them,” Kingston says.

Wearing the hat of an owner-operator, Flake says the manager underwrites assets with an equity-like approach. “We are coming up with our own underwriting assumptions that are informed by our boots on the ground, with real-time market data. Brokers are great, but there is no substitute for the views from our equity counterparts and the operating professionals we have across the world,” Flake adds.

Consequently, as Brookfield underwrites loans, the firm can formulate its own views of value. “We are using that to inform our decision-making from both the deals we want to pursue, and we are thinking through asset management. And, if something goes wrong, we are an operator that is well-prepared and capable of bringing the asset back to realize the maximum recovery for our investors,” Flake says.

At the start of the covid-19 pandemic, Brookfield observed a short-term freeze in the credit markets that eventually led to a flood of liquidity. But the firm sensed a material change.

“Notwithstanding all the dislocation happening, we had quite a robust period of activity, particularly in 2021 and into 2022. In our equity business, we were putting capital to work, and we were actively selling. Through that period, we sold \$10 billion of US multifamily in a six-month period,”

Kingston says. “From a credit perspective, there was more transaction volume than there were new loans getting originated, which meant we were quite busy.”

As rates rose, equity and debt transaction activity slowed dramatically. “Things were quite muted in 2023,” Kingston says. “What we are seeing now, coming into this year, is that rates are stabilized in an area that is allowing deal activity to pick up again in both our equity and credit pipeline. We think as we progress into 2024 and into next year, it will be a busy time.”

Thanks to its real estate equity portfolio, Brookfield understands opportunities in large part because of its familiarity with the refinancing obstacles cropping up in the current market environment.

It is worth noting that the office sector especially has proven to be a challenge for all lenders and borrowers to navigate with properties upended by the impact of prolonged work from home policies following the covid-19 pandemic. As one of the world’s major office landlords, and therefore borrowers, Brookfield grappled heavily with the issue.

### Outlook

Brookfield and other private credit providers are clearly increasing their market share as banks retreat, notes Douglas Weill, co-founder and managing partner of New York-based advisory Hodes Weill & Associates.

“The private equity managers are commanding a higher and higher percentage of the pie, especially as many of the banks have retreated. They were the fastest to come back to the market and to be pretty active, especially as transaction volumes, pick back up.”

Still, it has been harder for some of the capital raised to get put to work because there has not yet been as much

transaction volume as anticipated or many forced recapitalizations. “Right now, the appetite is a bit higher octane and looking to take advantage of dislocation and illiquid situations in the market,” Weill adds.

“The expectation is that there will be a pretty quick bounce back of capital. There is liquidity out there, whether it is institutions that are poised to put money to work, or private funds that have dry powder to put to work, [or] REITs that have reasonably healthy balance sheets. These are all signs of embedded liquidity that suggest that when the market sees transparency on pricing, it will find a bottom.”

But as the opportunity for commercial real estate private credit grows, Brookfield must contend with a number of residual risks stemming from the broader financial markets over the past few years. “In an environment like we are in now, with plenty of uncertainty around macro-outlook, geopolitics and interest rate direction, there is plenty of risk in the system. If you find ways to invest in things that are less risky but still meet our return objectives, that is what we are trying to do,” Kingston says.

Another facet of the market Brookfield is looking to navigate is around the evolving relationship with banks. It is Kingston’s sense banks will stay involved in the transactional part of lending, including loan originations and transactions advice.

“Increasingly, where they are looking for solutions is where to park that capital long-term,” Kingston says. “The banks will continue to be active in short-term bridge lending and transactional loans. But what we hear them say is, ‘We want to be in the moving business, not the storage business.’”

Brookfield’s bank lending relationships are multi-pronged, given the

## The insurance angle

### Capital from major insurers is increasingly finding its way into commercial real estate

Brookfield, like many of the largest real estate private equity managers, has multiple pools of capital for investment, including insurance capital.

This capital can be deployed in a flexible way, notes Michael Haas, a partner and global co-chair of the real estate practice at New York-based law firm Latham & Watkins.

“Private equity platforms will seek ways to utilize insurance capital in different places in the capital stack in a way that matches the risk, return and the duration required by the markets,” Haas says. “This will allow them to grow massive businesses.”

Latham & Watkins is expecting to see more insurance capital from private investment managers come into play in the commercial real estate debt space, Haas says.

“There is really no difference between a [major real estate private equity firm] originating loans that use insurance capital through their large distribution systems and a life insurance company,” Haas says. “The difference is the distribution model.”

Additionally, insurance capital has been a major contributor of AUM growth for private investment managers, notes Douglas Weill, co-founder and managing partner of New York-based advisory Hodes Weill & Associates.

“Capital is beginning to find its way into real estate, just as it has in private credit, and that’s only going to add to the liquidity over time,” Weill says. “When you look at flows into real estate credit in addition to LP-backed funds, companies – including joint ventures and affiliate relationships – are going to be a huge feeder of capital and support liquidity in the market over time.”

firm’s own use of the group as a capital provider, Kingston adds.

“There are multiple touchpoints with banks, including distributing our products through their retail channels. We’re a large borrower, and we are doing derivative transactions. It is in all our interest to work collaboratively,”

he says. “We have capital; we need opportunities to put it to work. They have opportunities and it is harder for them to use their own balance sheet capital and they are looking for other sources.”

At the end of the day, a good loan is a loan that pays off, Flake says. “There is no benefit for us to be aggressive on

our underwriting; we want to make sure we get paid off. We are not just analyzing a business plan; we are using our capital markets expertise to recognize that in five years, we need to be comfortable that where we are lending there will be a capital markets exit at the end of that loan term.”

For Kingston, Brookfield’s ability to expand as a lender is tied in part to the work it has done on both the debt and equity side of its business. “This is the kind of environment where we can distinguish ourselves from the pack. This is really where we are going to be able to demonstrate that if you have that operating capability and can execute better, you will do well,” he says.

Brookfield is not a capital allocator in the lending or investing space, and Kingston believes this will be critical as the firm seeks to grow its lending business.

“Our competitive advantage has been the same for many years, and that is Brookfield as a platform. Because of the scale and access we have to capital, the way we conduct our underwriting and due diligence – we can offer ease, speed and certainty of execution once we decide to pursue a deal,” he says.

“We think that will continue to present opportunities for us to be a preferred lender that can play up and down the capital stack and provide different sources of capital and serve our borrowers well. We also need to maintain strong relationships with banks and those will be at the forefront as we collectively deploy capital into the real estate space.” ■

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