Real Estate Debt Investing Jumps as Private Equity Giants Hold Off on Buying Property

Investors Show More Interest in Making and Buying Loans Than Embarking on Acquisitions

Ares Management, based in Los Angeles, raised $1.1 billion in capital for financing real estate or buying property loans. (CoStar)

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Major private equity firms are reporting a rebound in raising capital across most of their investing strategies, with commercial real estate loans collecting the most by far to fill the void as banks reduce property financing.

Real estate debt just posted the strongest quarter-on-quarter growth as investors pour capital into funds that finance property deals or buy existing loans. That amount surged to $9.1 billion in the second quarter from $2.3 billion in the prior three months, according to Preqin, a London-based investment data company.

Raising capital for any type of real estate investment has been depressed since the Federal Reserve started increasing interest rates in 2022. Commercial property deals dropped off sharply as investors moved to the sidelines to wait and see where the market would eventually reprice properties to reflect reduced demand as a result of the increased borrowing costs.

“The real estate debt business has been a bright spot for us obviously, as we've seen in other parts of the private credit landscape,” Michael Arougheti, CEO of Ares Management, said on the company’s latest earnings call. “As the banks are derisking the private markets, [we] have been able to come in and be a pretty reliable capital provider at some pretty attractive rates.”

Private equity firms Blackstone, KKR & Co., Ares and Carlyle Group each reported sentiment shifting in their favor in the second quarter as they noted a pickup in deal activity.

For Los Angeles-based Ares, April through June was its single best quarter of fundraising ever with $26 billion in gross capital raised, Arougheti said. Of that amount, $1.1 billion was specifically marked for real estate debt investing in the United States alone.

While it's a relatively small part of the capital raised, real estate debt is showing more investor momentum**.** Overall real estate capital raising for equity investments, or taking ownership in properties, only increased slightly in the second quarter to $33 billion from $32.4 billion in the first three months of the year, according to Preqin, less than the big jump in the amount allocated to debt.

More Debt Investing

Commercial real estate debt investing has gained favor in the past two years of higher interest rates, Harris Trifon, partner and portfolio manager with investment management firm Lord Abbett, told CoStar News in an interview.

“The lack of clarity on the [property] fundamental side just gets people to a place where they feel more comfortable with the return profile" of commercial real estate debt in relation to equity.

Investors "are expecting to earn more on the debt side than they can on the equity side,” Trifon said. “Not to mention actual operational and management challenges that exist particularly for certain markets and office buildings.”

Even if interest rates start falling, Trifon added, debt investing is likely to hold on to its appeal because the process "is going to be much longer than probably what people expect and certainly what the experience has been in other periods of market stress.”

For its part, Lord Abbett, focusing mainly on securitized debt bonds, is looking at opportunities that might emerge next year on whole loans and bank debt, Trifon said.

Property Funds Awaken

While raising capital for loans is growing, funds that invest in buying property have yet to catch up fully, but they're becoming active again.

“The sentiment for investors on real estate has been pretty negative given what's happened in much of their portfolios,” Jonathan Gray, Blackstone's president and chief operating officer, said on the company’s earnings call last month. “I think in real estate specifically, investors are still waiting."

Blackstone managed to raise more than $8 billion for an opportunistic European fund and a little more than $5 billion for a real estate debt fund. Blackstone also reported its nonlisted Blackstone Real Estate Income Trust had its best quarterly inflow of money in a year.

Blackstone REIT accounted for $1.1 billion of the $3.1 billion raised by public nontraded real estate investment trusts in the first half of 2024, according to investment banking firm Robert A. Stanger & Co. Ares followed Blackstone REIT with $650.7 million raised.

Scott Nuttall, CEO of KKR, said both investment sentiment and prices appear to have bottomed.

“I'd say the fundraising is going to lag that reality a little bit, but we're starting to have more conversations with investors that understand, although it may be perceived as a bit contrarian, this is a really good time to invest in real estate equity,” Nuttall said.

Carlyle meanwhile reported its best real estate fundraising since the third quarter of 2021, pulling in $3.4 billion in the second quarter.

“In terms of our latest real estate fund, we closed on an amount materially higher than what we disclosed in our earnings release, and we are progressing quickly to a final close,” John Redett, Carlyle's chief financial officer, said on the firm’s earnings call. “In a challenging real estate market.”