

A Scalable Platform for Direct Lending

Stockholm (HedgeNordic) – Real estate direct lending, the provision of credit directly to companies without intermediaries such as an investment bank or a broker, has gained prominence in recent years, benefiting both investors and property developers. But perhaps the biggest drawbacks of direct lending in real estate projects are the illiquid nature of these investments – which warrants an illiquidity premium – and the difficulty of building a well-diversified portfolio of such projects.

Stockholm-based asset manager **Alfakraft** has joined forces with **Tessin**, Scandinavia's leading direct lending platform for real estate, to launch **Fastighetsröntefonden**, an alternative investment fund that offers investors access to direct lending projects while enabling them the opportunity to sell their participating loans on demand. "Fastighetsröntefonden is an open-ended senior secured direct lending fund providing short-term financing of real estate projects, managed by very well-documented small and mid-size enterprises in Sweden," explains Bengt Lindblad (*pictured*), the CEO of Alfakraft.

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Three-Component Value Chain

Fastighetsröntefonden relies on a value chain consisting of three main components. "We see the investment process as a value chain, with Tessin taking care of the first component – the sourcing," explains Lindblad. "If you do not have the sourcing, you do not have any good loans to give your investors," he continues. As the leading direct lending platform for real estate projects in Scandinavia, Tessin has access to a large pool of real estate players seeking financing for their projects. "In the end, you need to have a lot of loans to get the best ones," emphasizes Lindblad.

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"Sweden was outstanding at tennis on the international arena because there were a lot of young tennis players out there," Lindblad provides an analogy describing the sourcing of real estate deals. "When a lot of players play tennis, some of them are getting very good," he continues. "It's the same story in the private debt space."

The Other Two Components



Oscar Hakenäs

Whereas Tessin takes care of the first component of the value chain, the team at Alfakraft, with a long history in the Nordic hedge fund industry, is responsible for the other two components: portfolio and risk management and connection to the market (e.g., distributors, investors, service providers, etc.). Describing the second component of the chain, portfolio manager Oscar Hakenäs says that “after getting a batch of loans from the actual loan sourcing, we, as the portfolio manager, then decide what loans to choose.”

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With many years of experience in quantitative investing, the Alfakraft team relies on a quant-focused points-based system to assess, score, and rank the loans sourced by Tessin. “But points are not everything,” points out Lindblad. “We also need to make sure that we have good liquidity in the fund, that we have different types of loans in the portfolio, and that we get a very good diversification in the portfolio.” The ultimate goal is to build a well-diversified portfolio of short-term real estate loans across different regions in Sweden, across different developers, and various types of properties and projects.

“We come from the hedge fund space, so a tight risk management is always our priority,” highlights Hakenäs. “We don’t chase returns, we prioritize good collateral,” he continues. According to Hakenäs, the critical element of Alfakraft’s loan selection process is the quality of the collateral. Lindblad goes on to emphasize that the underlying real estate and property are controlled by Lantmäteriet, the Swedish mapping, cadastral and land registration authority, which helps guarantee secure ownership of real estate properties in Sweden.

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“We also look at other financial ratios that are important such as the loan-to-value ratio,” continues Hakenäs. “The loans need to offer attractive interest rates and have a maturity that fits our portfolio,” he adds. “But first and foremost, the quality of the pledged asset, the actual collateral, is one of the main things we look for.”

Covid-19 Impact

With the Covid-19 crisis triggering one of the deepest liquidity squeezes since 2008 during the spring, some direct lending and fixed-income funds faced redemption requests that could not be

fulfilled due to their holdings' illiquid nature. The coronavirus pandemic has also affected the ability of some borrowers to meet their obligations. Partly because of its focus on the real estate market, Fastighetsröntefonden did not face significant problems due to the coronavirus pandemic. "We did not register a drawdown during the Covid-19-triggered March crash, we only got positive reports from our projects, and there were no write-downs in the projects," says Hakenäs.

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According to Hakenäs, the resilience of its loan portfolio partly stems from the strength of real estate-focused SMEs. "A lot of these property developers are a little bit smaller companies that are very committed to their projects and do what's necessary to complete the projects," he continues. "We have seen a few delays, but those were mainly due to import or export difficulties due to the pandemic or a labor-related issue, for instance, experts abroad not being able to come to Sweden at a certain stage of the construction projects."

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Fastighetsröntefonden also did not face any issues with redemption requests from investors. "We have had net positive inflows every month," points out Hakenäs. Lindblad goes on to say that "as we have been building up the portfolio, it was important for us not to struggle with redemptions." Investors, therefore, could only redeem on a quarterly basis, reflecting the defensive approach due to the still young nature of the portfolio. "In October, we changed the fund's liquidity terms to allow monthly liquidity," as the portfolio got more well-diversified. Fastighetsröntefonden performed well during 2020 and returned 6.05 percent net of fees, in line with the annual target return of 6-8 percent net of fees.

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The Alfakraft team managing Fastighetsröntefonden aims to build and maintain a well-diversified portfolio containing about 50 different real estate loans, with the fund currently housing between 30 and 40 loans. The payback time on the current portfolio averages at nine months, with approximately 70 percent of the portfolio loans expiring within 12 months. With Fastighetsröntefonden maintaining a growing asset base of over SEK 100 million, the fund is working towards reaching its optimal diversification target of 50 loans. "What makes a player in direct lending successful is a scalable platform to find loans," points out Lindblad. "When we started this fund, it was important for us to have that value chain, to have a partner like Tessin that could source all the loans."