

Q+A: Bain Capital Special Situations is ready to navigate distressed waters

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Fabio Longo, head of the European division, discusses the new structure and why the market correction is just beginning

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Fabio Longo, partner at Bain Capital Special Situations

High interest rates, inflation and retrenching of banks are creating the real estate perfect storm that opportunistic investors have been waiting for. Bain Capital Special Situations is ready to navigate the distress opportunities, deploying both equity and debt for real assets, loans portfolios and corporate investments.

For 25 years, Special Situations has been a part of Bain Capital Credit, which was launched in 1998 as Sankaty Advisors and rebranded in 2016. With the growth and differentiation of the businesses, earlier this year the divisions were split. Now, Bain Capital Special Situations is on its own as one of the 12 business units of \$160m Boston-based private equity firm Bain Capital.

The division has \$16bn in global assets under management and a team of 110 professionals, about half of whom are in Europe. A first fund, focused on special situations in Europe, raised €1.22bn at its final close in 2019. Currently, a second fund is targeting €1bn, with €473m raised at the first close in August 2022, Preqin data shows.

React News sat down with Fabio Longo, partner and head of the European division of Bain Capital Special Situations. Having been at Bain Capital for 10 years, Longo talked about the new structure, partnerships across Europe and how, with €1.3tr to €1.5tr of real estate debt due between now and 2026, the market correction is just beginning.

What is the new structure of Bain Capital Special Situations?

Bain Capital Credit and Special Situations was founded in 1998. These businesses comprise three strategies: liquid & structured credit (CLOs, bonds, loans), private credit (senior & junior corporate direct lending) and special situations, with total assets under management of \$59bn.

Earlier this year, we began operating as Bain Capital Special Situations, a discreet business within our global platform with \$16bn in assets under management globally, 110 investment professionals and 15 offices around the world.

How big is the team in Europe?

Our Europe Special Situations team comprises about 50 professionals. Since inception in 2003 to date, we have invested about €9bn across Europe.

The European business is structured into three groups. The first is our portfolio group which includes non-performing loans, non-core assets, sub-performing loans, and everything else that is transacted through a portfolio. Nikolay Golubev heads up this effort.

“Since inception in 2003 to date, we have invested about €9bn across Europe”

The second is hard assets, which mainly invests in real estate. Rafael Coste Campos focuses on buying assets and David Cullen spends his time lending against assets. David also heads up our asset management team, which works across all our investment teams.

Finally, we have corporate investments. Sandro Patti heads up activity in this area excluding financials while Elena Lieskovska for financial services.

Since our inception, we have evolved our teams to create more specialisation and depth in the major investment focus areas.

In all this, what's your role?

I manage the Europe team on a day-to-day basis. Typically, I split my time between forward-looking deal flow, fundraising and supporting the asset management activity. We continuously review our portfolios, so I also spend significant time there.

In the current market, where do you see more opportunities?

I see three main different catalysts for opportunities. First, the interest rates cycle, which is driving defaults or at least stress. Second, inflation is compressing margins. And third, which is very idiosyncratic of Europe, is the retrenching of banks. We view these opportunities as catalysts to provide liquidity to those that need it, or to buy assets or businesses from those that are either incapable or unwilling to cater to them.

We have a broad focus, but where the stress is most pronounced in the real estate sector. If you look at how much debt needs to be rolled in real estate, there is between €1.3tr to €1.5tr of real estate debt coming due between now and 2026.

There are multiple pressure points reshaping real estate including interest rates, inflation and banks pulling back.

So you look at real estate from each separate vertical?

Yes. We look at real estate in all the forms, as part of a NPL portfolio, as a lending opportunity and as an owning opportunity.

Starting from NPLs, what is the total amount of investment so far?

In Europe, we have acquired €40bn GBV, across NPL, UTP, REOs, SPL in the UK, Ireland, Portugal, Spain, Italy, Cyprus, Greece, and, to a lesser degree, Eastern Europe. This equates to \$5.5bn of equity deployed, which makes us a top buyer of NPLs in Europe.

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We typically buy secured loans usually from corporate borrowers because we like the downside protection created by the asset collateral. At times, we create value by taking possession of the asset and converting it. We conduct single name analysis and review every position, every loan, every piece of real estate. We are also quite mindful of reputation risks related to repossession of properties from individuals, so we aim to avoid these circumstances where possible.

Are you still expecting a new wave of NPLs?

Pre-Covid, NPLs on European banks' balance sheets had dropped to circa €400bn from €1.3tr after the GFC. Stage two (quasi-performing) loans were about €1.8tr, for a total of €2.2tr. Now the estimates are that the combination of Covid and recent interest rate hikes will generate €1.3tr of stressed loans. We estimate the total stock will be €3.5bn of which €900bn are stage three and the remaining €2.6bn stage two loans.

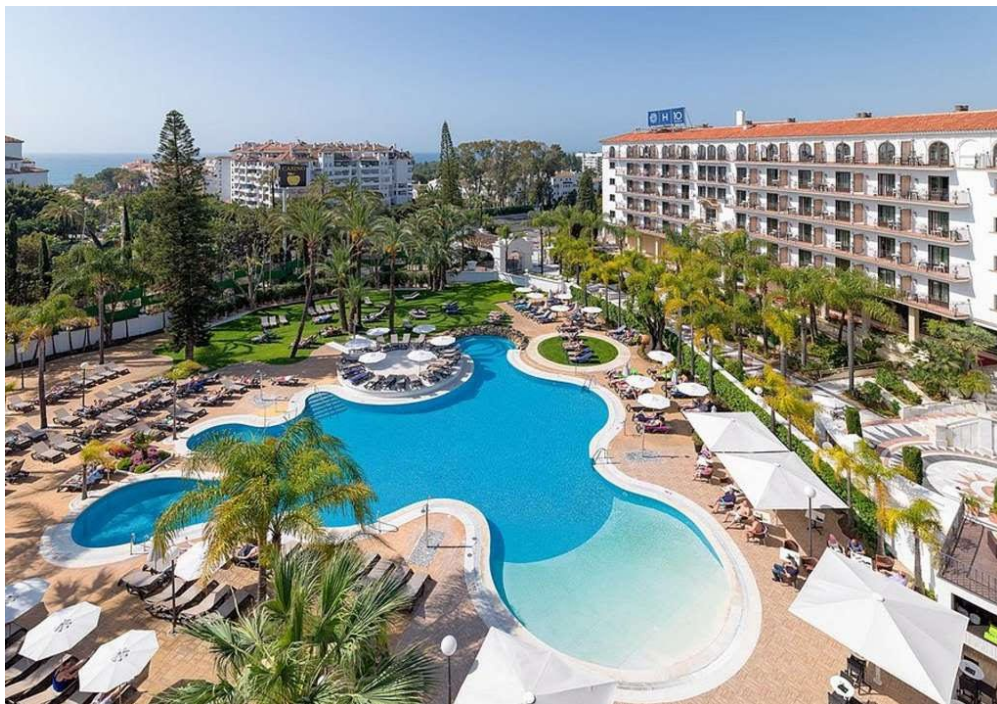
Because of IFRS 9 calendar provisioning rules and banks' ability to be more cashflow generative, NPL portfolios will continue to be disposed but it will take time before defaults go through and portfolios are created and sold.

As a result, we believe there is still a good pipeline of traditional NPLs but the opportunity is more with stage two loans – loans that are stressed, not yet distressed – that banks might be interested in curing and having back to keep the client relationship. And that is where NPLs meet the ABS market. To buy them, you need to think as an ABS investor in terms of how you create the capital structure, the liability side.

We are also seeing the creation of a secondary market where people are trading their NPL portfolios.

Which markets are you most active in?

In Italy, Greece and Spain, banks are still deleveraging their NPLs. And because the deleveraging process took longer, people that bought those portfolios still have tails in those markets, so the secondary and the primary NPL sales tend to still be in Southern Europe.



Andalusia Hotel in Marbella was the first hotel bought in a JV with Stoneweg

For stage two loans, however, banks in UK, Ireland and also Spain are addressing potential issues. We haven't seen many trades yet, but we're seeing more interest from banks to engage with buyers like us.

For buying and lending on real estate, are you focusing on the same geographies?

We are special situations and therefore opportunistic by nature. We are agnostic, we look at whatever the opportunities are.

We seek complexity because that's where fewer people put their hat, there is less competition, and you can create value more effectively. Among the countries where currently we see big opportunity, there is strong flow in the UK. And within the UK we particularly like London because of the large assets,

effective credit system, effective ownership system and liquid market. Additionally, banks in the UK are more worried about lending against real estate.

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We’re also seeing good flow in Germany due to over leverage and falling valuations from peak levels. We also see activity picking up in Ireland, France and the Nordics as well. Southern European is reacting and repricing less and more slowly.

How about sectors?

We tend to focus on asset classes where we believe the supply-demand imbalance is such that we can drive the topline and track inflation. For instance, we like everything residential-related including build-to-rent or build-to-sell.

“Across Europe, we invested in approximately 150 hotels. And within hotels, we very much like lifestyle, luxury, hospitality”

In Spain, we are invested in a residential home developer called Habitat Inmobiliaria where we focus on build-to-rent, co-living and student hubs, in a JV with an operating partner.

We also like hospitality. Across Europe, we invested in approximately 150 hotels. And within hotels, we very much like lifestyle, luxury, hospitality.

How are the partnership for specific sectors decided?

We don’t choose an operating partner to grow across Europe. With our local teams on the ground, we can slice and dice it very finely and seek to select the

best team for the best project.

In Italy, much of the hotel work we've been doing came from NPLs or from a JV with Omnam with whom we have invested in Lake Como and with whom we are exploring a number of other investments.

In Greece, we work with Zeus Hospitality. Portugal is a market where we would like to pursue hotels, so we will find who we believe is the best operating partner to do so in Portugal.

For hospitality we focus very much on high-end and luxury leisure assets because it's a good inflation hedge. It is much less affected by inflation given daily repricing opportunity, and rates, because people that pay over a €1,000 a night will pay €1,000 a night whether or not there's inflation. There's less pressure and rebound is faster across cycles for luxury tourists. We focus on assets that are leisure-led as opposed to business and in unique established locations. Our waterfront asset on Lake Como is a good example. You can't build new, you can only reform existing assets.

You expect to open an [Edition hotel on Lake Como in 2024](#)?

Yes. [We bought this asset from private individuals](#) who had owned it for many years. They had other assets they decided to focus more on, and this property became non-core. It was a large asset with 260 rooms on Lake Como, which is not an easy place to manage or operate.



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It was the combination of dealing with a big asset, need of capex for a long time in a place where it's not straightforward to do business. And there was Covid. So again, complexity.

Another example is the Park Lane Mews Hotel in Mayfair. During Covid, the prior owner had issues with liquidity. This asset was non-core to them and they wanted to transact quickly to generate cash for the group. Because we also have a large team in Asia, we could do due diligence on this and decided to purchase the asset. It is a 72-room hotel, 16 apartments and a couple of mews, all freehold in Mayfair. We brought in an operating partner to convert it into a high-end boutique hotel and are now implementing our business plan.

What about other sectors?

We have also spent time on logistics in countries where e-commerce penetration has been faster than logistic development. We see a buying opportunity in selected logistics sub-markets across Europe where fundamental tailwinds remain strong and the current environment allows for an entry repricing. We're working in markets where we think there is that kind of asymmetry.

Another sector we explore on a more selective basis is what I call build-to-core office space. We see these opportunities primarily in core office submarkets in European capital cities where the demand-supply imbalance remains strong and there is a clear focus on grade A, ESG-compliant stock from both tenants and investors.

What are you expecting for the office market in London?

Our office investments are primarily in Southern Europe where we bought assets to convert into top level ESG compliant scheme, with best-in-class amenities, which is what tenants want these days.

London is not a single market. The predictability of value in Mayfair is very different from the City, Kings Cross or Canary Wharf. In terms of opportunities, we find the West End interesting given strong steady demand from tenants, close to 0% grade A vacancy and scarce supply. I think the City is more complicated given the low usage of office spaces since Covid.

Do you follow the same approach for buying and lending?

When we pursue an investment, we always ask: do we want to own this asset? If the answer is yes, where do we generate the best return? And this is also very different from typical real estate investing.

“Over time with more visibility on where interest rate will end up, people will pivot more towards equity and growth, as will we”

Right now, attractive risk adjusted returns are in credit because people pay for liquidity. You have maturities pending, or technical defaults such as LTV or ICR, you can't roll your debt, but you want to keep the assets so you end up paying a premium for that. Over time with more visibility on where interest rate will end up, people will pivot more towards equity and growth, as will we.

We have seen a lot of new debt funds. What makes you competitive compared to others?

First, we have local presence across Europe with Bain Capital offices in six cities. Our team consists of European nationals, so our counterparts can communicate with people who speak their language. This enables more granular and deeper understanding.

Second, because we are part of a scale, global organisation with a large US real estate business, we have the benefit of understanding cross-pollinating trends.

Third, as a firm, we have a large private equity business. We know how to own and operate businesses.

Fourth, we have a flexible capital base. We can own the asset, we can buy, we can lend, we can create creative structures, we can deliver preferred equity and creative investments in the middle of capital structures. So, we can always try to find a solution to a problem which more cookie cutter strategies might just dismiss.

Specifically for the real estate sector, do you see an increasing amount of opportunities for corporate investment?

In the UK, we see it in the pubs industry, suffering the impact of Covid and inflation. There were big nursing home issues in France. Hotels, are also, in a way, corporate.



Pubs in the UK have suffered from the impacts of Covid and inflation

Amusement and entertainment centres is another sector where we spent a lot of our time. And then there are several REITs that have LTVs that are now very high and will seek short term solutions.

When you look at a business that is a combination of real estate and operations, having the mindset of knowing how to own and operate a business together with creating value on the assets is extremely powerful.

In general, are you expecting an increasing amount of activity?

Absolutely. Our view is that interest rates will continue to be higher for longer and therefore it will continue to have an impact over time. It will be some time before we get back to free money. This is not Covid where markets went down and back up pretty quickly.

This is going to be a fairly protracted, slower correction, but it will be there for longer. And I think we are just seeing the beginning.