20 February 2024

HARDMAN&CO.

REAL ESTATE CREDIT INVESTMENTS

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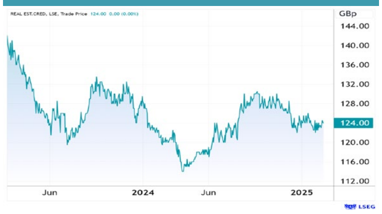
Diversified Financial Services



Source: LSEG, 2025

Market data

EPIC/TKR	**RECI**
Price (p)	**123.5**
12m high (p)	131.0
12m low (p)	112.0
Shares (m, Exc. Treasury)	221.9
Mkt cap (£m)	274.0
NAV p/sh (Jan'25, p)	145.2
Disc. to NAV (%)	-14.9
Div. yield (FY'24)	9.7%
Country/Ccy of listing	UK/GBP
Market	Premium equity closed-ended inv. funds

Description

Real Estate Credit Investments (RECI) is a closed-ended investment company that originates and invests in real estate debt secured by commercial or residential properties in the United Kingdom and Western Europe.

Company information

Chair	Andreas Tautscher
NEDs	Susie Farnon, Colleen McHugh, Mark Thompson
Inv. Mgr.	Cheyne Capital
Main contact	+44 (0)207 968 7328

www.realestatecreditinvestments.com

Key shareholders (Mar'24)

Close Bros.	9.35%
Bank Leumi	8.02%
Hargreaves Lansdown AM	6.42%
Canaccord Genuity	5.91%
Premier Miton (Jun'24)	5.52%
Evelyn Partners (May'24)	4.90%
FIL (Apr '24)	4.64%

Diary

Mid-Mar	Feb NAV

Analysts

Mark Thomas	+44 (0)203 693 7075
	mt@hardmanandco.com
Mike Foster	+44 (0)203 693 7075
	mf@hardmanandco.com

The rise of private credit: threats and opportunities

One of the key trends in global financing markets has been the rise of private credit. In this report, we consider the implications for RECI. On the upside, we note i) the disintermediation of banks reconfirms the drivers to its business model, ii) this should be positive for sentiment, and iii) most of RECI's competitive advantages relative to banks also apply to private credit funds. On the downside, we note i) competition will increase, especially for higher-end loans and staff, although RECI is in a niche position where the biggest funds are unlikely to be active, and ii) credit losses in large private credit funds are likely to adversely affect sentiment.

- **Why private credit is growing:** Private credit gives borrowers an alternative and guaranteed source of funding. Investors get an illiquidity (and often intellectual capital) premium, floating rate instruments, and a targeted but diversified portfolio with specialist expertise managing risks. All these factors apply to RECI.
- **Read across:** RECI should benefit from positive sentiment to private credit. However, it is in a niche sub-set of direct lending, which currently accounts for just half of private credit outstandings. Its performance will be driven by trust-specific factors rather than whole private credit market macro factors.
- **Valuation:** RECI traded at premiums to NAV in the five-year, pre-pandemic era. The current discount to NAV is 15%. The dividend has been a consistent 3p per quarter for many years and generates a 9.7% yield. RECI is moving to lower-risk, but higher-margin, exposures, which should improve dividend cover.
- **Risks:** Any lender is exposed to credit risks. We believe RECI has appropriate policies to reduce default probability. Positions are illiquid. Its average total commitment to expected value LTV is 65%, and most loans (all of the top 10) are senior-secured, providing a downside cushion.
- **Investment summary:** RECI generates an above-average dividend yield from well-managed credit assets. Directors and management have demonstrated their confidence in its sustainability through share purchases. Market wide, credit risk is currently above average, but RECI's strong liquidity and debt restructuring expertise should allow it time to manage problem accounts. To date, £9.1m buybacks have been completed since August 2023. A new £10m programme was announced on *27 September 2024*.

Financial summary and valuation

Year-end Mar (£m)	2022	2023	2024	2025E	2026E
Interest income	27.0	31.9	30.3	37.0	49.6
Operating income	32.4	30.7	31.4	37.0	49.6
Management fee	(4.4)	(4.3)	(4.2)	(4.1)	(4.0)
Performance fee	-	-	-	-	-
Operating expenses	(5.8)	(6.1)	(6.0)	(6.0)	(6.1)
Total comp. income	24.6	20.6	21.9	26.5	35.0
EPS (p)	10.7	9.0	9.6	11.7	12.1
NAV per share (p)	150.0	146.9	144.9	145.0	145.2
S/P prem./disc. (-) to NAV*	0.4%	-9.1%	-20.7%	-14.8%	-14.9%
Debt to equity	29%	24%	7%	33%	32%
Dividend (p)	12.0	12.0	12.0	12.0	12.0
Dividend yield	9.7%	9.7%	9.7%	9.7%	9.7%

**2022-24 s/p historical, 2025-26E NAV to current s/p. Source: Hardman & Co Research*

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The rise of private credit

RECI operates in a small sub-set of the private credit market; however, in our view, the key drivers to growth in that market, and sentiment to it, are relevant to RECI and its share price.

Near trebling of private credit market 2020-28E

Private credit has been growing, rising rapidly from $1tr in 2020 to $1.6tr at the start of 2024; it is expected to increase to $2.8tr by 2028.[1,2] It is currently ca.10x the level it was in 2009.[3] As we detail below, private credit fills a void where there is real demand and can do so without the capital costs incurred by banks.

Helped by bank capital requirements and large-scale but specialist sector borrowing

In our view, at heart, one of its key competitive advantages lies in the regulatory capital burden that banks face on certain types of lending, which, in some cases, has become so onerous that banks have significantly withdrawn from that element of the market. Disintermediation of banks is not new. Additionally, the rise of more specialist lending (e.g. to private equity backers/infrastructure) allows for intellectual capital premium as well as economic risk spreads.

Private credit comes in a range of forms, including:

Direct lending makes up half of private credit

- ► Direct lending (approximately half the total)
- ► Special situation finance (e.g. M&A)
- ► Project and structured finance (forecast to be a strong growth market)
- ► Distressed debt
- ► Junior capital (mezzanine, second lien, preferred equity)

Multiple sources of information on the market

Investors can find out more from the multiple market review sources, including rating agencies (e.g. Fitch), brokers and investors (e.g. Deutsche Bank, e.g. Blackrock), advisers (e.g. McKinsey) and regulatory bodies (e.g. IMF).

[1] https://www.morganstanley.com/ideas/private-credit-outlook-considerations
[2] https://www.fitchratings.com/research/insurance/private-credit-risk-not-systemic-yet-structures-asset-classes-evolving-10-02-2025
[3] https://www.mckinsey.com/industries/private-capital/our-insights/the-next-era-of-private-credit

Opportunities it presents

Reconfirms business model drivers

Benefits that private credit brings to both borrowers and investors all apply to RECI

If we consider the underlying factors driving private credit, they all apply to RECI and reconfirm the validity of its business model. In particular, we note:

- it provides borrowers with an alternative and guaranteed source of finance;
- specialist risk assessment and deal structuring are required to limit credit losses; and
- investors get:
  - a targeted but diversified portfolio
  - most lending is floating rate, generating outperformance in high interest rates environments and a positive income outlook should rates stay higher for longer,
  - an illiquidity premium spread (of up to 400bp[4] across private credit generally).
  - proponents of private credit highlight returns above leveraged loans, and fewer losses during COVID-19.[5]

Positive for sentiment

Greater levels of press and investor interest in private credit should generate interest in RECI

In our view, as the private credit market grows and generates increasing acceptance as a source of funding, investors will be looking for opportunities in that market. With RECI trading at a discount to NAV and having a long-established track record, it is likely to gain more interest because of the growth in private credit as a whole.

RECI's competitive advantages relative to banks also apply to private credit funds

RECI has competitive advantages over banks and most private credit providers

We have outlined, in multiple previous reports (see Appendix), why we believe RECI has competitive advantage in each of the following:

- **The assessment of credit:** Pages 10-15 of our *initiation report* (28 August 2019) gave a detailed review of how Cheyne assesses credit, with some of the key outcomes reviewed in detail in our reports *Why rising rates should not hurt RECI* (8 November 2021), *Positioned for the current crisis* (17 November 2022) and *Why CRE equity worries should not apply to RECI* (30 August 2023).
- **Cheyne, RECI's manager, is active in the ongoing monitoring of accounts** because it has a relationship model, not a transactional one, with borrowers. Cheyne managers continually interact with borrowers rather than simply agreeing a deal and then simply checking that payments are received. In our view, the closeness of the lender and borrower is critical to identifying problems early and so reducing ultimate losses.
- **The management of problem accounts:** Given, RECI's exposure to complex situations, the management of problem accounts is deeply embedded through

[4] https://flow.db.com/trust-and-agency-services/private-credit-a-rising-asset-class-explained
[5] https://www.morganstanley.com/ideas/private-credit-outlook-considerations

its process. This starts before any exposure is committed by taking strong security (see, for example, *Double tangible security*, 13 June 2023), through ongoing monitoring and then to the active restructuring of deals, where required. We consider it a testament to the respect that Cheyne is held in that it has been asked to lead renegotiations even where it is not the lead creditor.

These advantages just as valid against significant elements of private credit market, in our view

Overriding all three issues is a cultural point where the manager's (Cheyne) lenders own their loans and are directly responsible for the ongoing relationship and restructuring of facilities, where required. We highlight these competitive advantages because they also apply, to a significant degree, to private credit providers. While some adopt a similar relationship model (indeed, some private equity houses are using the techniques they do on company due diligence to both private equity and to private credit, but these providers are not competing directly with RECI), we think there is a danger that many adopt a more transactional approach. A deal is seen as a deal to deploy raised capital, and not the start of an ongoing relationship.

Threats

Competition

Scale and focus of most private credit funds means competition will be at the margin

As the Deutsche Bank report[6] highlights, typically, US private credit has been $10-$250m facilities for a three- to seven-year term. However, recent raises have been biased towards mega funds (in 2024, with five $10bn+ funds raising $89bn – two-thirds of all direct lending fundraising for the year and more than 40% of all private credit fundraising).[7] In the main, we believe that the largest private credit funds will be directed to infrastructure and private equity (direct lending fell from nearly 60% of raises in 2023 to less than 50% in 2024)[8], and the scale of the mega funds means they are unlikely to be in competition with RECI whose manager, Cheyne, manages $6.5bn in real estate funds. We also note (above) Cheyne's competitive advantages in risk assessment, monitoring and management.

Much of the growth in private credit has come to finance private equity and so has no overlap with RECI

We believe RECI is addressing a very niche market in that it is not only providing finance for commercial real estate but does so in complex deal structures. In our view, borrowers are paying above-average spreads, not only reflecting the economic risk but also the intellectual capital that Cheyne brings to the table. The risk analysis that RECI provided in its *December 2023 investor presentation* (slides 17-18) is indicative of the complexity of many of its deals.

May see more competition for staff

We believe Cheyne has a strong corporate culture, which is one of the attractions of working there. However, as the range of private credit providers increases, it is probable that there will be competition for staff at the margin.

Credit losses adverse for sentiment

Previous bank disintermediation (*inter alia* securitisation, P2P, many debt investment companies) has incurred material losses for investors and uncertain how future losses will impact sentiment

The current round of bank disintermediation is just one of many times that markets have tried to take out the spreads that banks earn on lending. Indeed, this analyst's first piece as a sell-side UK analyst in 1996 was called *The Death of Banking*. Disintermediation has seen a string of failures, with for example: i) securitisation, arguably, one of the major causes of the GFC: ii) peer-to-peer lenders – Funding Circle's current market capitalisation £0.4bn vs. £1.5bn on IPO in 2018, Zopa's morphing into a bank and Ratesetters's acquisition by Metro Bank, and *inter alia* the failure of FundingSecure, Lendy Limited, Collateral and Moneything; and iii) many debt investment companies have been closed/restructured, including in RECI's closest peers LBOW and SWEF. In our view, the common theme is that the lender has a transactional, distant relationship with the borrower and limited, if any, ongoing relationship with them. There is a further risk that the flood of money in private credit products will see a rush into deployment and, with that, poor credit decisions.

In April 2024, the IMF blog entitled *Fast-Growing $2 Trillion Private Credit Market Warrants Closer Watch* noted "*the migration of this lending from regulated banks and more transparent public markets to the more opaque world of private credit creates potential risks. Valuation is infrequent, credit quality isn't always clear or easy to assess, and it's hard to understand how systemic risks may be building given the less than clear interconnections between private credit funds, private equity firms, commercial banks, and investors.*" and "*pressure on private credit providers to deploy capital, leading to weaker underwriting standards and looser loan covenants—some signs of which have already been noted by supervisory authorities.*"

[6] https://flow.db.com/trust-and-agency-services/private-credit-a-rising-asset-class-explained
[7] https://www.withintelligence.com/insights/private-credit-outlook-2025/
[8] https://www.withintelligence.com/insights/private-credit-outlook-2025/

We believe the impact on RECI is primarily one of sentiment. Losses by private credit funds could see greater uncertainty over RECI's portfolio's own creditworthiness. We emphasise the impact on sentiment rather than real credit losses, as, for reasons outlined in multiple previous notes, we believe RECI's underwriting approach is robust.

Other debt investment companies

Nearly two thirds of debt investment companies have been put into wind down/merged since our sector report in February 2019

While private credit as a whole has been growing, it has been a challenging time for many debt investment companies. The property debt companies have suffered from both adverse sentiment to real estate in a rising rate environment and adverse sentiment across the whole investment company space (all investment companies ex 3i current average discount 15% to NAV).[9] We note the winding down of both ICG-Longbow senior secured UK property debt investments (LBOW) and Starwood European real estate finance (SWEF). Limited scale across debt investment companies has also been an issue, with no opportunity to grow by issuing new shares, given large discounts to NAV. Across the wider space, of the 32 debt investment companies in our February 2019 report, nearly two thirds have been put into wind down or merged:

1. Alcentra European Floating Rate Income Fund Limited in liquidation 2024
2. Axiom European Financial Debt in liquidation 2023
3. Blackstone/GSO Loan Financing announced winding down 2025
4. Carador Income Fund wind down 2019
5. Funding Circle SME Income Fund wind down 2019
6. GCP Asset Backed wind down 2024
7. Hadrian's Wall Secured Investments put into wind down 2020
8. Honeycomb Investments merged into Pollen Street 2022
9. ICG-Longbow senior secured UK property debt wind down 2021
10. JPMorgan Global Convertibles Income wind down 2019
11. NB Distressed Debt wind down 2023
12. NB Global Floating Rate Income wind down 2023
13. P2P Global Investments taken over by Waterfall Asset Management 2020
14. Ranger Direct Lending – wind down started 2018
15. SQN Secured Income wind down 2023
16. Starwood European Real Estate Finance wind down 2023
17. TOC Property Backed Lending wind down 2021
18. Twenty Four Income/UK mortgages – merged 2022
19. VPC Speciality Lending wind down June 2023

In part, we believe the divergence between debt investment companies and private credit has been due to the investment companies being part of investors' portfolios while, typically, private credit is classified within their debt/fixed income holdings. This may also be an issue for RECI.

[9] https://www.theaic.co.uk/aic/find-compare-investment-companies?sortid=Name&desc=false

Valuation

Absolute

Current NAV likely to be on conservative side

We have, in previous reports, considered how the NAV is assessed (see pages 23-24 of our initiation report, *7%+ yield from well-secured property debt portfolio,* published on 28 August 2019). The critical issues are how conservative the culture of the organisation is, and the independent checks and controls that are in place to review the process. As we noted in that report, RECI's approach to both issues appears to be in line with best practice.

Yield

12p annual dividend expected

Through the COVID-19 crisis, when RECI took large, early MTM hits in 2020, and then steadily released them throughout the rest of the year, it maintained a consistent 3p quarterly dividend. The yield was covered largely by stable monthly interest income, and the bond MTM saw capital gains/losses feeding through to NAV noise. With the intermittent but regular market recession uncertainty, and the hiatus in the gilt and bond markets following the September 2022 UK mini-budget, we saw the same happening, and, again, RECI followed the same, consistent policy: a stable 3p quarterly dividend. The trust appears very committed to this dividend, which is covered largely by interest income, and the noise from MTM losses and gains will reduce with a smaller bond portfolio. The current yield is 9.7%, and a 12p annual dividend is expected with recurring interest income forecast to cover the dividend at this level.

Relative

Close peer comparisons weak given their wind down status

Comparisons of RECI with a close peer group are no longer relevant given the wind down status of LBOW and SWEF; although, for what it is worth, the AIC average discount in the property debt sector is 14%. Looking at the other AIC debt sectors, the direct lending average discount is 17%, loans and bonds average premium 2% and structured finance average discount 4%. Latest reported ratings are available on the AIC website *here*.

Reversion to historical average levels would see discount close significantly

We reviewed the historical discount in detail in our note, *Why the discount has been closing and its outlook*, published on 15 October 2024. The key conclusions from that note were that RECI's discount had halved over the prior six months and that we believe this is due both to actions taken by the trust (with an active buyback programme, changing asset mix and enhanced disclosure of highest-risk positions) and more favourable markets. Interestingly, not all debt investment companies have benefitted from the more favourable markets. By historical standards, the current level of RECI's discount is very high, ca.10% above the 10-year average. RECI was at an average 2% premium in 2015-19, and traded at premium again in 2021-22, leaving room for investor concerns to moderate considerably by just reverting to historical average levels.

Financials

Our forecasts are unchanged.

Profit and loss					
Year-end Mar (£m)	**2022**	**2023**	**2024**	**2025E**	**2026E**
Interest income bonds	3.2	5.0	1.5	0.2	-
Interest income loans	23.7	26.7	28.4	36.3	49.1
Other interest income	0.0	0.2	0.4	0.4	0.4
Interest income	**27.0**	**31.9**	**30.3**	**37.0**	**49.6**
Net (losses)/gains on investments	5.4	0.8	0.6	-	-
Net losses on options	-	-	-	-	-
Net gains on foreign exchange instruments	0.0	(2.1)	0.4	-	-
Total net gains on fin. assets at FV through P&L	5.4	(1.3)	1.0	-	-
Operating income	**32.4**	**30.7**	**31.4**	**37.0**	**49.6**
Management fee	(4.4)	(4.3)	(4.2)	(4.1)	(4.0)
Performance fee	-	-	-	-	-
Other operating expenses	(1.5)	(1.8)	(1.8)	(1.9)	(2.1)
Operating expenses	(5.8)	(6.1)	(6.0)	(6.0)	(6.1)
Profit before finance costs	**26.5**	**24.5**	**25.4**	**31.0**	**43.5**
Finance costs	(2.0)	(4.0)	(3.5)	(4.5)	(8.5)
Net profit	**24.6**	**20.6**	**21.9**	**26.5**	**35.0**

Note: classification bonds and loans restated in 2021, Source: RECI Report and Accounts, Hardman & Co Research

Hardman & Co adjusted profit & loss					
Year-end Mar (£m)	**2022**	**2023**	**2024**	**2025E**	**2026E**
Statutory profit	24.6	20.6	21.9	26.5	35.0
Capital gains & FX movements	5.4	(1.3)	1.0	-	-
Profit excl. capital gains & FX	**19.2**	**21.8**	**20.8**	**26.5**	**35.0**
Adjustment to management fee	1.0	0.4	0.5	(0.8)	(1.8)
Adjusted profit	**20.2**	**22.2**	**21.3**	**25.7**	**33.2**
Cost of dividend	(27.5)	(27.5)	(27.4)	(27.0)	(34.4)
Statutory cover	0.89	0.75	0.80	0.98	1.02
– excluding capital gains cover	0.73	0.81	0.78	0.95	0.96

Source: RECI Report and Accounts, Hardman & Co Research

Balance sheet					
@ 31 Mar (£m)	**2022**	**2023**	**2024**	**2025E**	**2026E**
Bonds	98.5	49.2	7.9	0.0	0.0
Loans	295.9	351.5	321.5	419.4	544.4
Financial assets at FV through P&L	**394.3**	**400.7**	**329.4**	**419.4**	**544.4**
Cash and cash equivalents	47.4	14.1	18.3	4.9	4.7
Cash collateral at broker	5.2	2.4	4.5	4.5	4.5
Derivatives	0.0	1.8	0.0	0.0	0.0
Other assets	0.0	0.0	0.1	0.1	0.1
Receivables for investments sold	0.0	0.0	0.0	0.0	0.0
Total current assets	52.6	18.2	22.9	6.3	10.8
Total assets	**447.0**	**419.0**	**352.3**	**428.8**	**553.7**
Current liabilities					
Derivatives	1.1	0.0	0.0	0.0	0.0
Financing	100.4	80.2	23.8	105.0	135.0
Cash collateral due to broker	0.0	0.0	0.0	0.0	0.0
Preference shares	0.0	0.0	0.0	0.0	0.0
Other liabilities	1.6	1.9	2.1	2.1	2.1
Total liabilities	103.0	82.0	25.9	107.1	137.1
Net assets	**343.9**	**337.0**	**326.4**	**321.7**	**416.6**
No. shares (m)	229.3	229.3	225.2	221.9	286.9
NAV per share (p)	**150.0**	**146.9**	**144.9**	**145.0**	**145.2**

Source: RECI Report and Accounts, Hardman & Co Research

Appendix: list of Hardman reports

Given the regulatory restrictions on distributing research on this company, the monthly book entry for RECI can be accessed through our website, *Hardman & Co Research*. More detailed research reports are listed below. Each link contains a click-through to our *Directors Talk* audio interviews, summarising each report. Company announcements, including buybacks, can be found on *RECI's* page on the LSE website.

- Our *initiation report* (28 August 2019).
- *Delivering on its promises* (17 December 2019).
- *Getting a balanced view on outlook* (21 May 2020).
- *Improving returns on new opportunities* (14 September 2020).
- *Portfolio repayments fund enhanced return pipeline* (18 January 2021).
- *Experience shows resilience of the model* (6 May 2021).
- *Experience shows resilience of the model (2)* (12 August 2021).
- *Why rising rates should not hurt RECI* (8 November 2021).
- *Vive la difference* (15 February 2022).
- *New faces, same resilience* (20 May 2022).
- *Marks taken in uncertainty, released thereafter* (5 August 2022).
- *Positioned for the current crisis* (17 November 2022).
- *Looking at the current opportunities* (9 February 2023).
- *Double tangible security* (13 June 2023).
- *Why CRE equity worries should not apply to RECI* (30 August 2023).
- *Portfolio management to optimise risk/reward* (16 November 2023).
- *French and German exposures in perspective* (27 February 2024).
- *Capital Markets Day* (25 July 2024).
- *Why the discount has been closing and its outlook* (15 October 2024).

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research@hardmanandco.com

9 Bonhill Street
London
EC2A 4DJ

www.hardmanandco.com