UK Senior Lending Market

2011

Quick Stats

	2011	2010
Max LTVs	↓	→
Margins	↑	↑

Hot Topics

- Of the 113 senior lenders with a UK commercial real estate loan book, 70 are currently open to new business
- Increased cost of financing highlighted by lower LTVs, with higher margins
- The imminent tier one capital ratio requirement for eurozone banks has significantly reduced lending capacity
- Insurance companies exception to the overall trend. The Solvency II directive encourages insurers to lend against real estate, and on competitive terms

OVERVIEW

- **Changing lending landscape**
  The number of lenders in the actively lending category has fallen to 45 in 2011. The category shrank by 11, whilst the number of those only lending selectively has almost doubled since 2010 to currently stand at 25. This demonstrates a significant change in sentiment. Lenders remain very risk averse, with a strong preference for good assets and simple, conservative finance structures backed by strong sponsors.

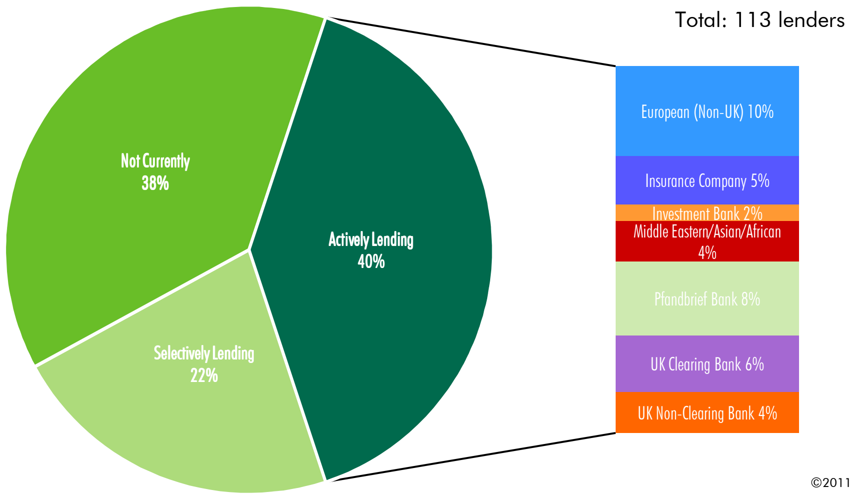
- **Polarised market**
  The entry of six new lenders in 2011 was offset by the exit of five lenders. At one extreme of the market we see increasing confidence and opportunity to grow exposure to real estate lending, especially amongst insurance companies. They now make up 14% of lenders (2010: 13%) and will become more prominent as others enter the market in 2012. The other end of the market, however, is characterised by weakening sentiment, highlighted by the recent exits of EuroHypo and Société Générale.

- **Diverse market**
  The exit of three German pfandbrief banks has resulted in a more diverse lending market. At the end of 2010, German pfandbrief banks were the largest single group of lenders representing 20.3% of the total. European banks now make up the largest group at 17.1%, followed by the pfandbrief banks and UK non-clearing banks, each accounting for 15.7%.

- **Lower LTVs and higher margins**
  During 2011, the average maximum LTV fell to 66.2% (2010: 68.5%), while typical average margins increased to 2.6% (2010: 2.5%). These changes are partially due the uncertainty under the new Basel III regulations. However, economic uncertainty, weaker real estate market fundamentals and the credit downgrades of major UK and European banks have also had a significant impact on current lending strategies.

- **Insurance companies offer competitive edge**
  Insurance companies are being incentivised by Solvency II to provide senior debt to the UK commercial real estate market. As a result, they can offer an average max LTV of 69.0%. The margins offered by insurers are also very competitive at an average of 2.4%, both these metrics compare favourably to the market overall.

UK Senior Commercial Real Estate Lending Market, 2011



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ABOUT THE REPORT

This report examines the UK Senior Lending Market in terms of the market's lending appetite and parameters. Of the 356 institutions with banking licence present in the UK (according to the FSA's regulatory list), 113 have a commercial real estate loan book. This report has been compiled by CBRE's Debt Advisory team to monitor the capacity of the UK senior lending market.

MARKET ACTIVITY

Since the last analysis the number of players actively or selectively lending in the UK commercial real estate market increased to 70 (from 69 in 2010). During the year, five lenders closed their loan book, while six new lenders (of which two are European banks) entered the UK in the same period.

It is very important to highlight that, while the overall number of total lenders increased slightly, those in the 'actively lending' category has actually fallen to only 45 in 2011. Particularly, investment banks and UK non-clearing banks became more selective in their lending strategies during the year, and CBRE is seeing this trend accelerating more broadly across all lender categories.

The entry of two new European lenders makes this the largest category of active lenders, with 17.1% of the market, closely followed by the German pfandbrief banks and UK non-clearing banks holding 15.7% each. This is resulting in a more diverse lending market, with a wider range of lender types.

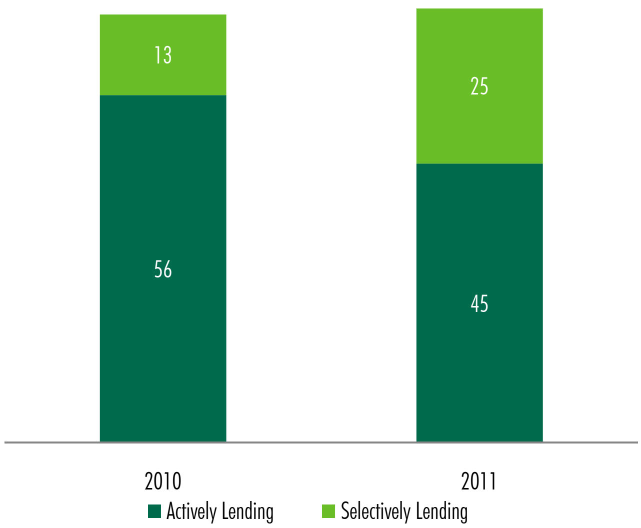
As with most lenders today, European banks have a strong preference to lend against prime real estate, predominately in Central London. For instance, ING Real Estate Finance together with DekaBank provided a £338 million 5-year senior debt facility to Westbrook Partners, from which they refinanced the iconic Shell-Mex House in London's Strand.

Domestic lenders also stayed fairly active. Between them, UK clearing and non-clearing banks account for around a quarter of lenders in the market. This is in line with the numbers reported back in 2010.

UK Senior Lending Market by Lender Type, 2011

LENDER TYPE	ACTIVELY LENDING	SELECTIVELY LENDING	TOTAL LENDING	AS %	MARKET SHARE v 2010
Building Society	-	5	5	7.1%	▼
European (Non-UK)	11	1	12	17.1%	▲
Insurance Company	6	4	10	14.3%	▲
Investment Bank	2	5	7	10.0%	▼
Middle Eastern/Asian/African	5	2	7	10.0%	▼
Pfandbrief Bank	9	2	11	15.7%	▼
UK Clearing Bank	7	-	7	10.0%	▼
UK Non-Clearing Bank	5	6	11	15.7%	▲
Total	**45**	**25**	**70**	**100.0%**	

Shift in Sentiment: Number of Lenders 2010 v 2011



So far in 2011, we have seen a number of deals by UK clearing banks secured against high-quality assets. For example, in May UK Commercial Property Trust purchased the Rotunda leisure centre in Kingston upon Thames in south-west London for £50.7 million. This is a fully-let prime scheme that benefits from being located in an affluent London suburb. The acquisition was partially funded through the remaining £37.9 million of debt facility with Lloyd's and £15.0 million from a new debt facility provided by Barclays.

However, insurance companies remained the "hot topic" in the UK commercial real estate lending market during 2011. They continued to expand their lending capacities throughout the year, albeit heavily focusing on very prime assets and larger lot sizes. For example, Aviva, a long time provider of senior debt in the UK, transacted over £650 million in loans during the first half of the year alone. Recent transactions include the £205 million portfolio refinance for Peel Land & Holdings secured on 53 assets and the £22.5 million facility to Development Securities secured against five assets.

One new insurance company has entered the UK market so far in 2011, bringing the list of active insurers to ten. The Solvency II directive, still under revision, is likely to make real estate lending more attractive than direct real estate investment due to differences in the risk capital requirement. Under the directive, we expect more insurers to enter the debt market and strengthen their commercial real estate lending platforms, as well as allowing insurers to offer very competitive lending terms. CBRE is already seeing this demonstrated in loan terms offered by insurers, which currently stand at an average max LTV of 69.0%, above the market average of 66.2%.

The insurers expected to enter the market in the near future are Legal & General, Standard Life and a few others who remain confidential at this point. Aside from the incentive created by Solvency II, the benefits of increasing margins and asset diversification offered by UK commercial real estate is encouraging these insurers to launch a senior debt lending platform.

As their lending strategies are still evolving, the number of deals executed by these new entrants to the market will remain fairly low in the short term. However, their loan terms should be very competitive once the lending models are in place. Over the medium-to-long term, we expect insurance companies could account for as much as 15-20% of the UK lending market, as is the case in the USA.

The activity of Middle-Eastern, Asian and African banks remained similar to that in 2010. Even more so than the rest, these lenders remain exclusively focused on the Central London market and predominately prime assets. Recent examples include the £115 million senior debt facility provided by Bank Hapoalim to Park Plaza Group for the refinancing of an existing facility secured against the Park Plaza Westminster Bridge, London. As reported, the interest on the loan is 2.65% per annum over 3-month Sterling Libor, which will increase by 2% on any part of the loan that causes the LTV ratio to exceed 70%.

The debt facility builds on the existing relationship between the parties. This is similar to other players in this group, where existing relationship between the lender and its client is as important as the property against which the loan is secured. Right now the market is very polarised. As discussed above, there are lenders who will only lend to clients they have an existing relationship with, and/or who have a strong connection to their domestic market. On the other hand, there are a number of larger, established lenders employing more aggressive strategies, and who are more open to building new relationships if the transaction and asset is right.

For instance, German lender pbb Deutsche Pfandbriefbank provided a £39.1 million financing facility to Almacanter in June for the £80 million purchase of Marble Arch Tower. This is the first transaction between the two and demonstrates the flexibility and openness to new partnership when the asset in question has strong fundamentals. The mixed-use property is one of the most prominent buildings in London's West End.

SOME SENIOR LENDERS EXIT

In total 43 lenders, or 38% of those with a UK real estate loan book, are now closed to new lending. Since the start of the year, five previously active lenders either withdrew or temporarily closed their books.

The most significant lender to temporarily suspend all new lending in the UK was the German pfandbrief bank EuroHypo. For the year to date and prior to its withdrawal, the bank provided loans in excess of £650 million (with commitment to provide additional loans to transactions that passed through credit approval prior to its withdrawal). High profile deals completed this year include the £86.7 million, five-year loan to Max Property Group for the acquisition of London's St. Katherine Docks and the £180 million senior debt secured against Westfield's Stratford City shopping centre.

The decision to suspend all new lending was part of its parent company Commerzbank's wider strategy to meet the revised capital requirements of the European Banking Authority's Basel III regulations. All Eurozone banks are required to raise a 9% tier one capital ratio by the end of June next year.

EuroHypo's exit follows the withdrawal of another major German pfandbrief lender - DG Hyp. At the start of the year, DG Hyp announced it would cease its foreign lending business to focus on its home market. The upcoming Basel III regulations were cited as the main reason for this withdrawal. Going forward, the bank's international loan portfolio will be managed from Germany, with the intention to continue selective issuance of new international financing for its German clients.

The other categories of banks that remain inactive in the current market include:

1. Irish banks who are focused on trying to recover their "bad" loans;
2. Investments banks who are in a standstill position as the syndication and distribution market in which they act as intermediaries remain virtually non-existent;
3. Certain European banks who are overly exposed to Southern European debt, or themselves facing wider problems as their domestic economies face fiscal crisis.

Inactive Senior Lenders, 2011

LENDER TYPE	NOT LENDING	AS %
Building Society	10	23.3%
European (Non-UK)	14	32.6%
Insurance Company	3	7.0%
Investment Bank	3	7.0%
Middle Eastern/Asian/African	2	4.7%
Pfandbrief Bank	6	14.0%
UK Clearing Bank	4	9.3%
UK Non-Clearing Bank	1	2.3%
Total	**43**	**100.0%**

Currently many banks are reviewing their activities and for those who are over-exposed, there will be an imminent need to face capital adequacy issues relating to Basel III through other means. Possible solutions range from balance-sheet restructuring and disposing of legacy assets to, ultimately, a withdrawal from new lending, at least on a temporary basis.

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LTVs AND MARGINS

During 2011, maximum LTVs fell to an average of 66.2%, compared to 68.5% at the end of 2010*. While appetite to finance prime assets remains strong, activity outside this segment of the market is limited. Considering the level of uncertainty in both the economy and banking sector, and the upcoming regulatory changes, we do not expect this trend to change in the medium term.

The impending Basel III regulations have also restricted many banks from lending above 65% LTV. The impact was clearly noted across all lenders, especially German pfandbrief banks who, less than a year ago, were offering an average max LTV of 69.5%. Insurance companies were the sole exception, offering more competitive max LTVs of 69.0% on average, a marginal increase on the 68.8% at the end of 2010. In addition to lower LTVs, the overall margin offered against UK real estate has continued to rise. Currently it stands at an average of 2.6%, compared with 2.5% at the end of 2010 - the increase is a reflection of a less liquid senior lending market, coupled with the increase in the cost of financing*.

Appetite to finance prime offices and retail assets remains strong, with average max LTVs offered of up to 66.9% and 66.4% respectively. Good quality office and retail assets are perceived to be generally less risky, and this is reflected in the low pricing of loans, with average margins between 2.5% and 2.6%.

Many lenders are looking at the same type of quality assets, resulting in greater competition and a convergence in loan terms on offer. On closer inspection, it is insurance companies who offer the most competitive terms against good quality office and retail, with maximum LTVs of 70.0% and at a typical price of 2.3%, some 20-30 bps below the market average. Interestingly, under their current strategies, insurance companies are not lending against residential or development assets. The accrued income aspect associated with residential development assets does not match their risk-return profile.

Financing "more risky" residential and development assets is generally more difficult in the current environment, with relatively few lenders active in these segments at the moment. Reflective of the risk and the unpredictability of future cash flows, the typical margins are high at around 3.4%. The majority of lenders active in this category are UK banks, who have a proven track record and a deep understanding of the local residential development markets.

Overall Market: LTVs and Margins, 2011

LENDER TYPE	AV MAX LTV	TREND	TYPICAL MARGIN	TREND
European (Non-UK)	61.9%	▼	2.8%	▲
Insurance Company	69.0%	▲	2.4%	▲
Investment Bank	77.1%	▼	4.0%	=
Middle Eastern/Asian/African	65.0%	▼	3.1%	▲
Pfandbrief Bank	67.0%	▼	2.4%	▲
UK Clearing Bank	66.5%	▼	2.5%	▲
UK Non-Clearing Bank	64.2%	▼	3.6%	▲

Lending Terms for Offices, 2011

LENDER TYPE	AV MAX LTV	TYPICAL MARGIN
European (Non-UK)	63.3%	2.6%
Insurance Company	70.0%	2.3%
Middle Eastern/Asian/African	65.0%	2.6%
Pfandbrief Bank	68.5%	2.3%
UK Clearing Bank	68.2%	2.3%
UK Non-Clearing Bank	67.0%	3.3%
Overall	**66.9%**	**2.5%**

Lending Terms for Retail, 2011

LENDER TYPE	AV MAX LTV	TYPICAL MARGIN
European (Non-UK)	63.3%	2.6%
Insurance Company	70.0%	2.3%
Middle Eastern/Asian/African	66.3%	2.9%
Pfandbrief Bank	68.0%	2.3%
UK Clearing Bank	66.3%	2.5%
UK Non-Clearing Bank	65.0%	3.3%
Overall	**66.4%**	**2.6%**

Lending Terms for Logistics, 2011

LENDER TYPE	AV MAX LTV	TYPICAL MARGIN
European (Non-UK)	63.1%	2.8%
Insurance Company	67.0%	2.5%
Middle Eastern/Asian/African	62.5%	2.8%
Pfandbrief Bank	65.0%	2.4%
UK Clearing Bank	63.8%	2.6%
UK Non-Clearing Bank	65.0%	3.4%
Overall	**64.4%**	**2.7%**

Lending Terms for Residential/Development, 2011

LENDER TYPE	AV MAX LTV	TYPICAL MARGIN
European (Non-UK)	52.5%	3.1%
Insurance Company	n/a	n/a
Middle Eastern/Asian/African	64.3%	3.4%
Pfandbrief Bank	55.0%	3.5%
UK Clearing Bank	63.8%	3.5%
UK Non-Clearing Bank	61.3%	3.5%
Overall	**60.7%**	**3.4%**

** excluding investment banks and residential assets*

LOAN SIZE

Even in the current market, there are still numerous lenders who have the appetite to underwrite large ticket transactions in a single tranche. For instance, insurance companies have stated that, on average, they could provide loans as high as £150 million, with some prepared to go as high as £200 million against the right asset.

Lending Capacity, 2011

LENDER TYPE	AVG MIN	AVG MAX	AVG TICKET SIZE
European (Non-UK)	£16.8m	£91.5m	£56.7m
Insurance Company	£20.8m	£150.0m	£65.0m
Investment Bank	£30.0m	£179.2m	n/a
Middle Eastern/Asian/African	£3.1m	£24.2m	£8.0m
Pfandbrief Bank	£16.8m	£83.2m	£44.7m
UK Clearing Bank	£6.5m	£76.3m	£32.5m
UK Non-Clearing Bank	£1.4m	£20.0m	£9.5m

Investment banks are also prepared to look at similar ticket sizes. However, whilst most lenders hold their loans to maturity, investment banks traditionally tend to "lend-to-distribute" through securitisation or syndication, retaining only a small percentage on their balance sheet. However, as the securitisation and syndication markets are still generally closed, they are currently limited to issuing much smaller tickets.

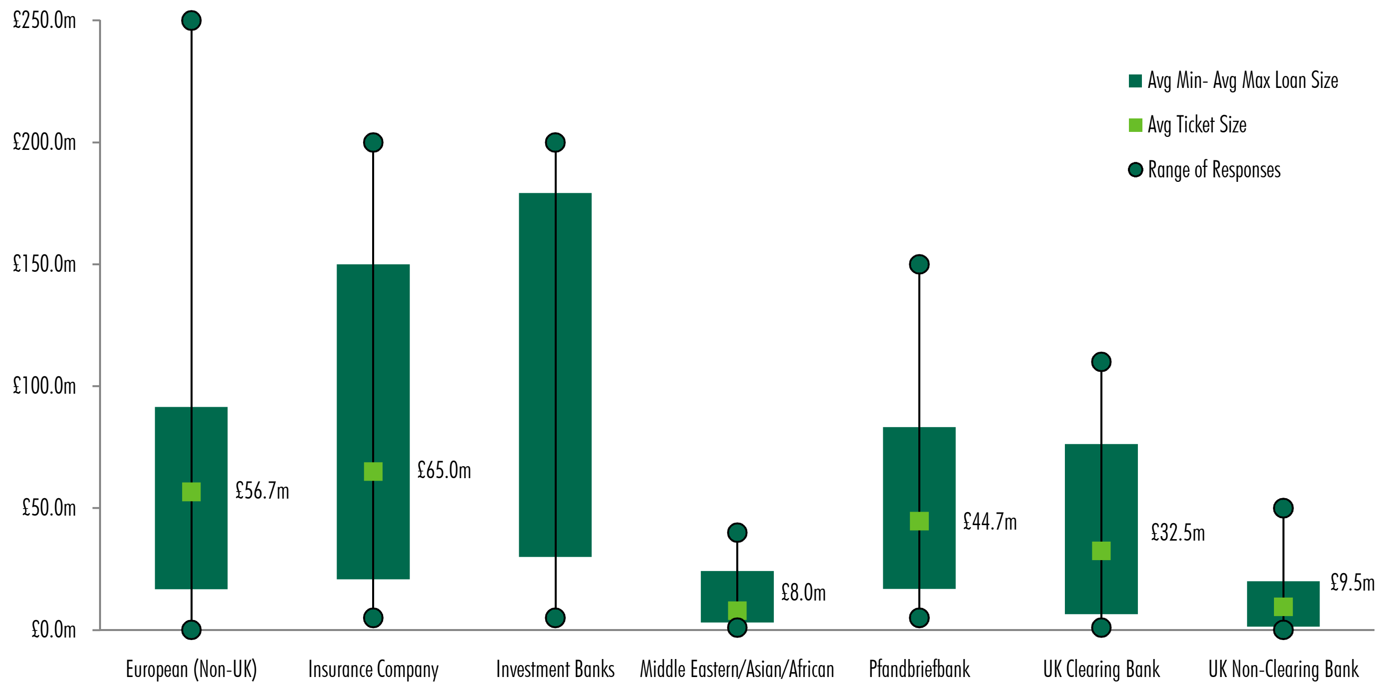
Even insurance companies, currently providers of the largest loans on the market, are looking at a wide range of deals, starting from as small as £5 million up to £200 million. Loans at the upper end of this scale can only be offered against larger exceptional assets.

The senior loan of £150 million provided by MetLife to Beacon Capital Partners for the refinancing of MidCity Place, London is one such example. M&G have also provided a £100 million unsecured loan to residential developer Grainger for its Newlands Common development in Waterlooville, Hampshire.

The situation becomes more difficult for borrowers looking for more than £150 million in a single tranche and usually means that the borrower will need to pull together a club deal with several senior lenders. This, however, is only achievable with the right asset, and at the right pricing and leverage. A recent success story includes the £550 million club debt package secured against Westfield's Stratford City shopping centre. The deal was signed with Eurohypo, HSBC and Credit Agricole Corporate – acting as joint lead arranger – each providing a third of the six-year senior debt package.

Since then, the lead arrangers have successfully completed the syndication of the senior debt package with an additional seven senior lenders. It has been reported that the ten senior lenders are each holding a final stake of £52 million to £58 million. Secured against a very prominent asset, this is clearly one of the few very exceptional deals where the lead arrangers have been confident in lending a large ticket size with the associated syndication risk. It is believed to be the largest UK property senior debt issuance so far this year.

Min, Max and Average Loan Size Offered, by Lender Type, 2011



Average Max LTV in Regional Cities, 2011

LENDER TYPE	BIRMINGHAM	GLASGOW	MANCHESTER
Building Society	62.5%	-	65.0%
European (non-UK)	61.3%	60.0%	61.3%
Insurance Company	67.8%	67.5%	67.2%
Pfandbrief Bank	65.8%	65.0%	65.8%
UK Clearing Bank	65.0%	64.5%	65.4%
UK Non-Clearing Bank	-	55.0%	-
Avg Max LTV	**64.5%**	**62.4%**	**64.9%**

Typical Margin in Regional Cities, 2011

LENDER TYPE	BIRMINGHAM	GLASGOW	MANCHESTER
Building Society	3.5%	-	4.0%
European (non-UK)	2.8%	3.0%	2.7%
Insurance Company	2.5%	2.7%	2.5%
Pfandbrief Bank	2.5%	2.8%	2.7%
UK Clearing Bank	2.6%	2.5%	2.6%
UK Non-Clearing Bank	-	5.0%	-
Avg Margin	**2.8%**	**3.2%**	**2.9%**

REGIONAL CITIES

The availability of senior debt in regional cities remains difficult to come by, especially in locations where economic fundamentals are weaker. During the year lenders continued to be very risk averse, even more so since the summer. Generally, very few banks are prepared to take on any secondary risk, and those who do structure loans to include high amortisation costs to protect themselves from adverse market movements.

The majority of banks with regional offices are UK clearing and non-clearing banks, who have close relationships with their regional clients and a good working knowledge of the local property market. For instance, in August Barclays provided an £8.3 million loan facility to W.P. Carey for the refinancing of the National Express headquarters and coach terminal in Birmingham.

On one side, the benefits of having local branches have encouraged other lenders, who wish to gain exposure in the UK regional markets, to set up provincial offices. Handelsbanken recently opened a branch in Solihull, which is to be followed by two further openings in the West Midlands. Each branch is to be decentralised, with capacity to provide mortgages of up to £100 million. Overall, however, we expect the new lenders in the regions to provide finance conservatively until they gain a deeper understanding of the local markets.

Nevertheless, the market suggests that there has been a slight increase in the number of deals transacted by London-based lenders in the regions. In June, pbb Deutsche Pfandbriefbank provided a £94.3 million facility to EPISO LP fund to refinance the acquisition of the Sapphire Properties Portfolio, consisting of three shopping centres located in Bumley, Cardiff and Harlow. This follows the £34.5 million facility provided by the bank to AREA Property Partners, F&C REIT Asset Management and ESAS Holding to fund the acquisition of the Halton Lea shopping centre in Runcorn, Cheshire and a parade of retail units and office suites in Stevenage, Hertfordshire.

OUTLOOK

Going forward, we expect there to be a further reduction in senior lending market liquidity in the near-to-medium term. In 2012, we will see an even greater change in lender sentiment, with a more pronounced shift from 'actively lending' to 'selectively lending'. This will deteriorate further over the mid-to-long term, with more lenders moving into the 'not currently lending' category. The recent announcement of EuroHypo and Société Générale's suspension of all new lending activity have generated uncertainty in the market for both borrowers and other lenders.

Along with increased financing costs and the political and economic instability of the eurozone, there are also renewed concerns over the UK economy and the possibility that property values might fall once again. This, combined with upcoming regulations and higher capital adequacy requirements, means that lenders will remain very risk-averse, providing more conservative finance structures against prime assets in core UK markets that demonstrate strong fundamentals and stable cash-flow.

Since the beginning of the year, insurance companies have already gained a larger market share, with further increases expected as these new entrants continue to build up their senior lending platforms. The pricing and loan terms offered by insurance companies are already competing with those provided by pfandbrief banks and UK clearing banks. With the UK lending market becoming more diverse in terms of types of lenders active, we expect there to be an even greater competition, especially when it comes to financing prime assets. Ultimately, we expect insurance companies to hold near to one-fifth of the lending market, similar to the position of insurers in the US lending market.

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The UK and EMEA team is led from London and has a local presence in Paris, Frankfurt, Amsterdam, Madrid, Birmingham, Manchester and Glasgow. There are 19 members across five jurisdictions. All have a strong investment and real estate banking background, having previously held senior positions at major financial institutions such as Goldman Sachs, Anglo Irish Bank, Citi, Barclays, Lloyds, ING, ABN AMRO, and BBVA.

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