EUROPEAN REAL ESTATE LENDING SURVEY

A Cushman & Wakefield Publication

MARCH 2013

KEY HIGHLIGHTS

Number of active European lenders increases by 29% over the past year…

- C&W estimates that the amount of capital available for European real estate lending in 2013 will be 22% higher than last year.
- Whilst the number of active lenders has increased considerably over the past 12 months, lending criteria remains cautious, with lenders proving selective in who, where and against what they lend.
- Supportive government policy in some markets - such as the UK's Funding for Lending initiative - is adding to liquidity, which should ultimately benefit pricing.
- Lenders continue to be focused on core assets and their own markets, with the UK, France and Germany remaining top targets for non domestic lenders.
- Encouragingly, some appetite seems to be returning for certain Southern European markets, such as Italy, Spain and Portugal.
- C&W recorded ten new entrants into the European lending market, and a further ten lenders re-entering the market.
- Approximately 28% of lenders are willing to underwrite loans of over €100m, up from 18% in Q1 2012.
- Maximum LTV's for senior debt across most core Western European markets remained fairly static over the year, whilst margins tightened in some core markets.
- There is a greater readiness to provide development finance in some core markets, however pre-lets are a prerequisite.
- Although the securitisation market was subdued in 2012, sentiment amongst lenders indicates volumes will increase this year.
- European debt funds are currently targeting €24bn of capital raisings, which could significantly increase the supply of real estate debt available in Europe.

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INTRODUCTION

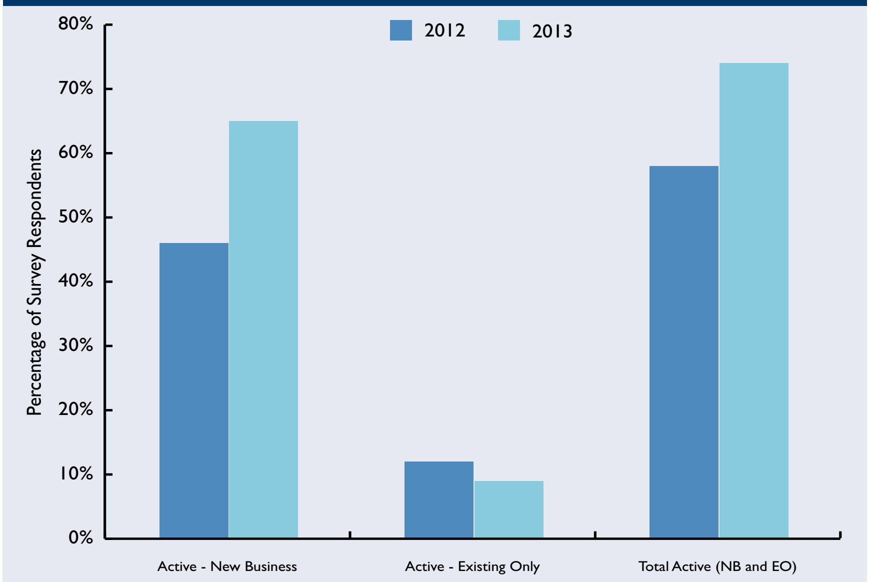
As part of this year's European Real Estate Lending Survey, C&W spoke to 109 lenders – encompassing senior, stretch senior and mezzanine debt lenders – based in multiple markets across Europe. Increasing from last year's sample of 78 lenders, this represents a broad and diverse cross section of the European lending landscape. The purpose of this research is to identify key trends, lending criteria and appetite through analysis of the survey results.

Against a backdrop of economic and fiscal uncertainty, the European real estate lending market continues to evolve. Non-bank financial institutions have now cemented their place in the European financing landscape and are increasingly seen as mainstream lenders. With over 35 real estate debt funds raising capital, and a plethora of insurance companies from both sides of the Atlantic capitalising on debt opportunities - both through direct origination and participation - the lending landscape has changed dramatically.

Regulators continue to closely monitor the risk weightings and exposure of European banks and financial institutions to real estate debt. During 2012, C&W recorded total commercial real estate (CRE) loan and real estate owned (REO) sales of €21.7bn across Europe. With €1.1bn already closed so far this year, and a further €16.3bn transactions which are live or in the planning stages, C&W is predicting transactions volumes will increase by 15% to reach €25bn in 2013. Despite this acceleration in the deleveraging process and reduction in CRE exposure, traditional lending sources remain a key pillar of the lending landscape.

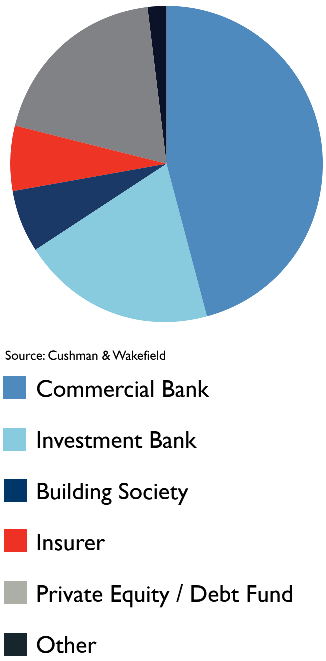
The property securitisation market has had a quiet twelve months, hindered by weak property fundamentals and investor scepticism. However, following the publication of the CMBS 2.0 guidelines and a surge of activity in the US, there is a feeling that greater activity within the European CMBS market could be on the horizon.

STATUS OF LENDERS



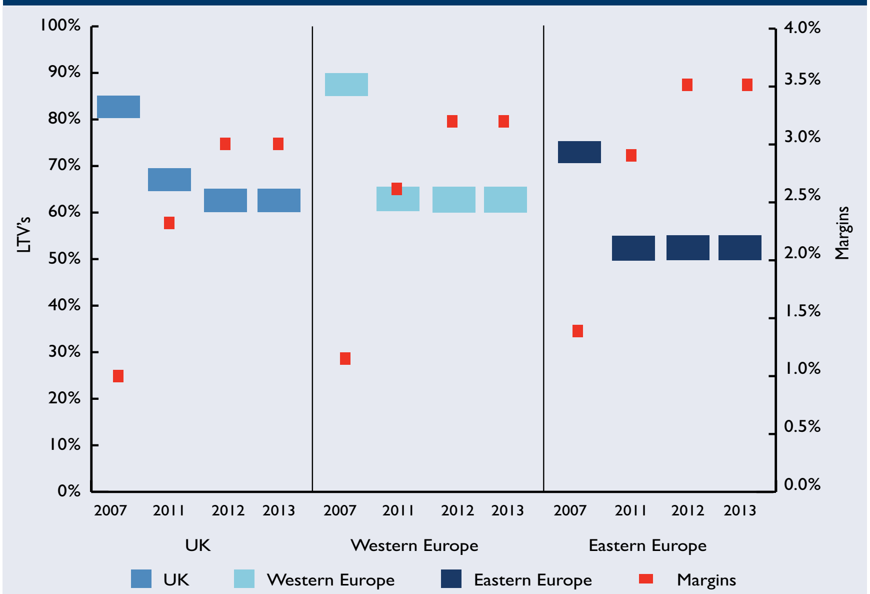
Source: Cushman & Wakefield

TYPE OF LENDER



Source: Cushman & Wakefield

LTV RATIOS AND MARGINS



Source: Cushman & Wakefield

"Since Q4 2012, we have witnessed a significant improvement in lending conditions across Europe; for the right assets healthy competition exists amongst lenders, which is often delivering pricing not seen since the financial crisis"

Michael Lindsay
Partner
Head of EMEA
Corporate Finance

LENDER STATUS

Of the 109 lenders surveyed this year, 65% said they would be willing to lend to new customers with whom they had no previous relationship, representing an increase of 40% since last year, whilst the number of lenders only willing to provide finance to existing customers declined by 20%. On balance, the data suggests that the number of active lenders open for both new business and to existing customers has increased by almost 30% since Q1 2012.

Despite the increase in the number of active lenders across Europe, many continue to focus on prime assets located in core and/or domestic markets, with lending criteria remaining rigid and selective. Some lenders are willing to consider non-core markets and sectors, but the margins demanded are considerably higher.

The survey also shows that the number of inactive lenders is declining. Of those surveyed this year, only 22% declared themselves inactive, whilst 4% merged with other lenders. This marked a notable decrease on the number of inactive lenders from last year's survey.

TYPE OF LENDER

Notwithstanding the retrenchment of many traditional lenders and the acceleration in the CRE deleveraging process amongst banks, balance sheet lenders remain the dominant constituent of the European real estate lending landscape. One notable feature of this year's survey was the increasing number of investment banks, now willing to use their balance sheets to lend against real estate.

Undoubtedly, the range of lenders has become more diverse over the last 12 months, with the proliferation of senior debts funds, insurers and private equity houses creating a varied and increasingly liquid lending market.

The number of active senior debt lenders has shown a significant increase over the year, with 85% of active lenders looking to provide senior debt. This includes ten new entrants to the market and ten lenders who were inactive in Q1 2012. C&W recorded only five new mezzanine lenders with discretionary capital, suggesting that this market – given the intense competition within this space – could be beginning to plateau and mature.

TARGET ASSETS

Despite the 29% increase in active lenders, the majority continue to have a preference for prime assets in good locations across all sectors. Given recent high profile failures, particularly in the retail sector, lenders are increasingly focused on covenant strength when assessing their lending opportunities.

Another noteworthy trend is the greater willingness amongst lenders to provide development financing where a pre-let has been secured. The percentage of active lenders willing to lend against pre-let commercial development increased from 31% to over 37% over the year. However, this greater readiness to assume development risk often comes with extremely selective and strict lending criteria, with the quality of the tenant and location being paramount.

Appetite for certain sectors also showed significant regional divergence. In the UK and Germany, residential lending gained popularity, while in Central and Eastern Europe, office and retail remained target sectors.

LOAN SIZE

Last year, the average loan size was fairly consistent across lenders in all markets, with €20m – €50m being the typical 'sweet spot'. The results this year indicate less concentration in the €20m – €50m range, with greater divergence across the lending spectrum. Whilst most lenders are still content lending small lot sizes, the average upper range rose to €65m - €70m, providing welcome liquidity in the market and potentially helping borrowers seeking finance for larger transactions.

In recent years, the number of lenders willing to underwrite loans over €100m has been declining, with a greater preference for club deals for transactions of this size. This has now reversed, with 23 lenders stating they would be willing to underwrite €100m+ deals and assume post closing syndication risk. Of these lenders, 70% are commercial and investment banks.

PREFERRED LOT SIZES

Source: Cushman & Wakefield

"A noteworthy trend in this year's survey is the 20% increase in lenders who will consider pre-let commercial development finance. Whilst this is encouraging, lenders will be looking very closely at the quality of sponsor and location"

Mike King
EMEA Corporate Finance

The survey also revealed the potential increase in available capital for European real estate debt in 2013. C&W took a cross section of lenders (including traditional and non-traditional lenders) and examined the difference between the level of loans completed in 2012 and their 2013 targets. Based on this analysis, we predict there will be a 22% increase in new debt available as compared with last year. However, with the wall of loan maturities this year, in both conventional loan and CMBS markets, it can be expected that a significant amount of this capital will be allocated to refinancing, as opposed to new lending.

TARGET MARKETS

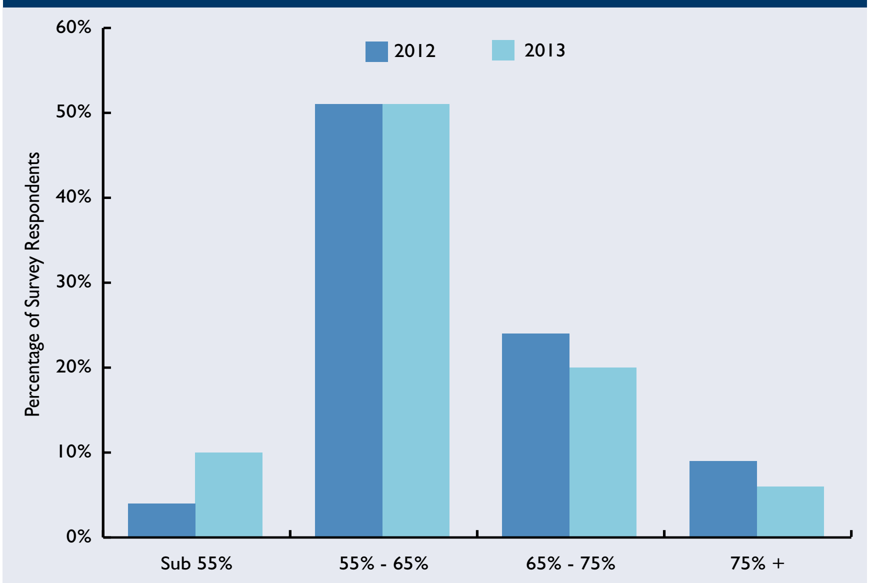
Over the past year, core markets within Western Europe – namely the UK, France and Germany – have remained the top targets for lenders, with each recording a growth in the percentage of new business lenders over the year. Appetite for the Nordics, Poland and Czech Republic has also held up relatively well over the year.

Whilst the majority of cross border lenders are reluctant to provide finance outside of their core markets, a handful are showing interest in the less liquid markets of Southern Europe. Given the depth of opportunities expected to emerge in countries such as Spain, Portugal and Italy, the level of lending within these markets has the potential to pick up over the year. The question remains though, whether the lending terms available in these countries will be attractive to borrowers and accretive to returns.

LENDING TERMS

On average, maximum LTV's for senior debt in the UK and other core Western European markets remain within the 60% - 65% range, although a small proportion of lenders are willing to go to 75% on core product. The increased risks and uncertainty associated with providing financing to Central and Eastern European markets means that senior debt is typically offered at maximum LTV's of 50-55% in this region.

SENIOR DEBT LTV'S



Source: Cushman & Wakefield

"Boosted by an increasing number of active lenders, liquidity is returning to the debt market. It remains to be seen whether this liquidity will result in a further crowding of the prime end of the market, or whether some may start to move up the risk curve and target higher yielding assets further afield. We certainly believe that debt funds have a significant role to play in this space"

Edward Daubeney
Partner
EMEA Corporate Finance

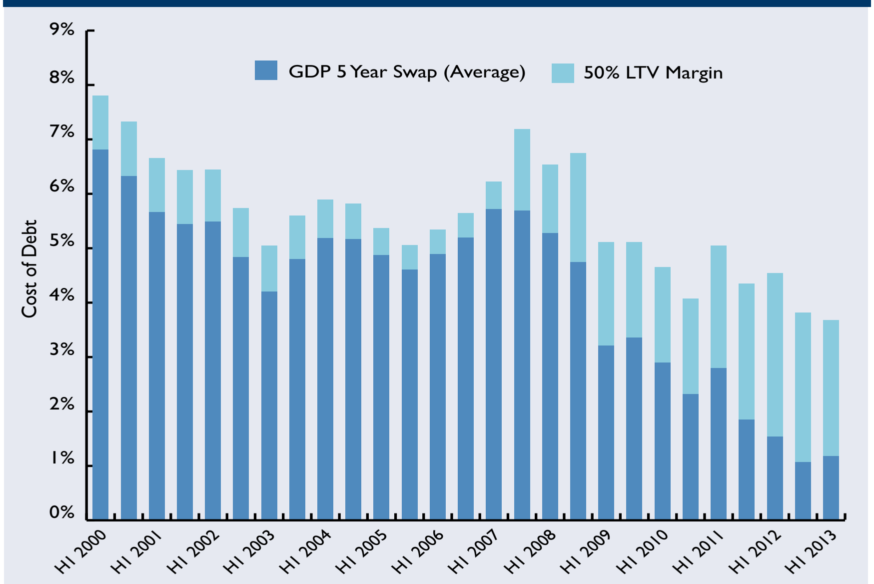
The regional differences in margins was also a notable feature of this year's survey. In the UK and across most of Western Europe, margins ranged between 275bps to 325bps, with 50% of active senior debt lenders in the UK confirming that average pricing is above 300bps. Some lenders in Germany confirmed they would be willing to go as low as 150bps. Amongst those lenders willing to provide finance in non-core markets, the margins quoted were typically in the region of 400bps to 600bps.

As part of this year's survey, C&W analysed the change to the all-in-cost of financing since H1 2000 for a 50% leveraged transaction, secured on a prime UK asset with a strong covenant. This analysis combined the historical margin and five year sterling swap rate since H1 2000. Whilst there is a focus on increased margins since the financial crisis, this has been more than offset by the fall in swap rates, resulting in the current all-in interest cost for this type of loan being at an all time low. As illustrated the all-in cost has fallen from 7.8% in H1 2000, to 3.7% in Q1 2013.

Based on survey results and current expectations, C&W anticipates a gradual tightening of margins in 2013 in the deeper markets of the UK, France and Germany, but this could be offset by a marginal increase in reference interest and swap rates.

In certain less liquid European markets, decisive government action such as Spain's creation of its national management agency ('SAREB'), Ireland's placing of IBRC into special liquidation and the nationalisation of SNS REAAL in the Netherlands, are expected to lead to improved sentiment over time and could bring investors and lenders back to the market, improve liquidity and lower debt pricing.

UK SENIOR DEBT ALL-IN COST OF FUNDS



Source: Cushman & Wakefield, Bloomberg

EUROPEAN CMBS

Approximately €31.5bn of CMBS were issued in the US during 2012. Whist this is far short of the €172.7bn issued in 2007, the pace of activity has increased. By contrast, combining the five years since 2008, European CMBS issuance has totalled just €31.4bn, on par with US issuance in 2012.

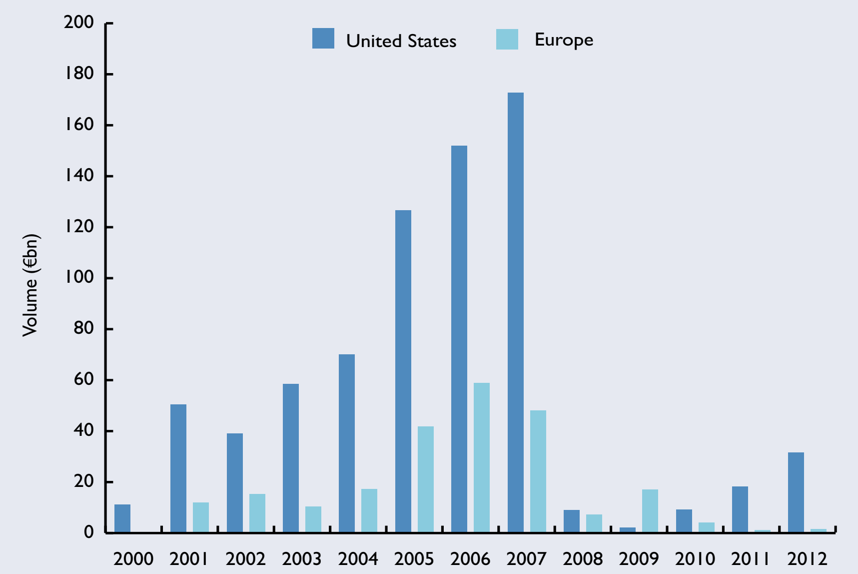
The clarification from the CRE Finance Council on the new European CMBS guidelines ("CMBS 2.0"), coupled with the pickup in activity in the US CMBS market, bodes well for the European CMBS market. Historically, European CMBS volumes have lagged the US, suggesting that Europe may be set to experience a pick-up of activity. Of those active lenders surveyed, 17% saw the CMBS market as a viable exit route, compared to just 11% last year.

While this creates potential for more activity in the European CMBS market, respondents had widely differing views. Several prominent financial institutions believe there will be a significant increase in the number of new issues this year, with some lenders confirming they are actively looking at structuring new CMBS. In contrast, other respondents thought the market in Europe for new issues would remain dormant for the next 12 – 24 months.

"With so many debt funds announced, their success in raising capital will significantly impact the supply of real estate debt. Whilst many investors are actively contemplating allocating to debt strategies, it remains to be seen how many will make commitments in 2013."

Luca Giangolini
Partner
EMEA Corporate Finance

CMBS ISSUANCE



Source: CRE Finance Council, Bloomberg

NEW LENDING SOURCES

Over the past 12 months, European property funds have played a key role in helping fill the void left by many retreating banks and will undoubtedly continue to be a valuable source of finance going forward. C&W is currently tracking 38 senior and mezzanine debt funds open for investment or in the pipeline. Based on the maximum target size, these debt funds have an estimated fire power of approximately €24.6bn.

C&W is aware of an extensive pool of potential investors who have expressed an interest in investing into debt funds. However, the number of investors who will ultimately commit capital is unclear. Ongoing uncertainties in the euro zone have resulted in many investors focusing their opportunistic capital allocations on Asia, and core allocations on the US and Australia. Thus, the success of the European debt fund market will hinge on managers' ability to present a compelling and deliverable investment case.

Insurance companies have also developed their lending strategies across Europe. Whether the strategy has been direct (lending to customers directly) or indirect (lending through a third party advisor, or through a debt fund), they continue to be a vital source of CRE debt.

2013 PREDICTIONS

- Central Bank intervention across Europe and localised initiatives, such as the UK's Funding for Lending Scheme, will have an ongoing positive impact on European debt markets.
- Growing competition amongst the expanding universe of active European real estate lenders could lead to a tightening of margins.
- With more lenders looking for significant growth in their loan books for 2013, the number of larger, single underwrites will grow.
- Given increased liquidity across real estate lending, this will lead to larger single underwrites and the syndication market becoming more active.
- The debt fund market will continue to provide a valuable source of real estate finance. Further success will depend on the ability of fund managers to secure additional investor capital.
- With a number of alternative lenders seeking high single digit returns, appetite for risk will increase, leading some to look at second tier assets.
- The European CMBS market will become more active from its modest base.
- The total volume of commercial real estate loan sales will increase by 15% to reach €25bn this year.

About the Report

The underlying data was researched by Cushman & Wakefield's Corporate Finance team, who interviewed senior finance professionals from 109 leading global real estate finance providers in January and February 2013 to assess the level of appetite for lending and what trends will shape the European finance market in 2013. This research exercise has been undertaken annually since 2007 and is a targeted and personalised approach, built on our long established relationships with lenders in the European market.

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