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The Cass Commercial Real Estate Lending Survey

Mid-year 2018: the lending cycle - 10 years on from the GFC

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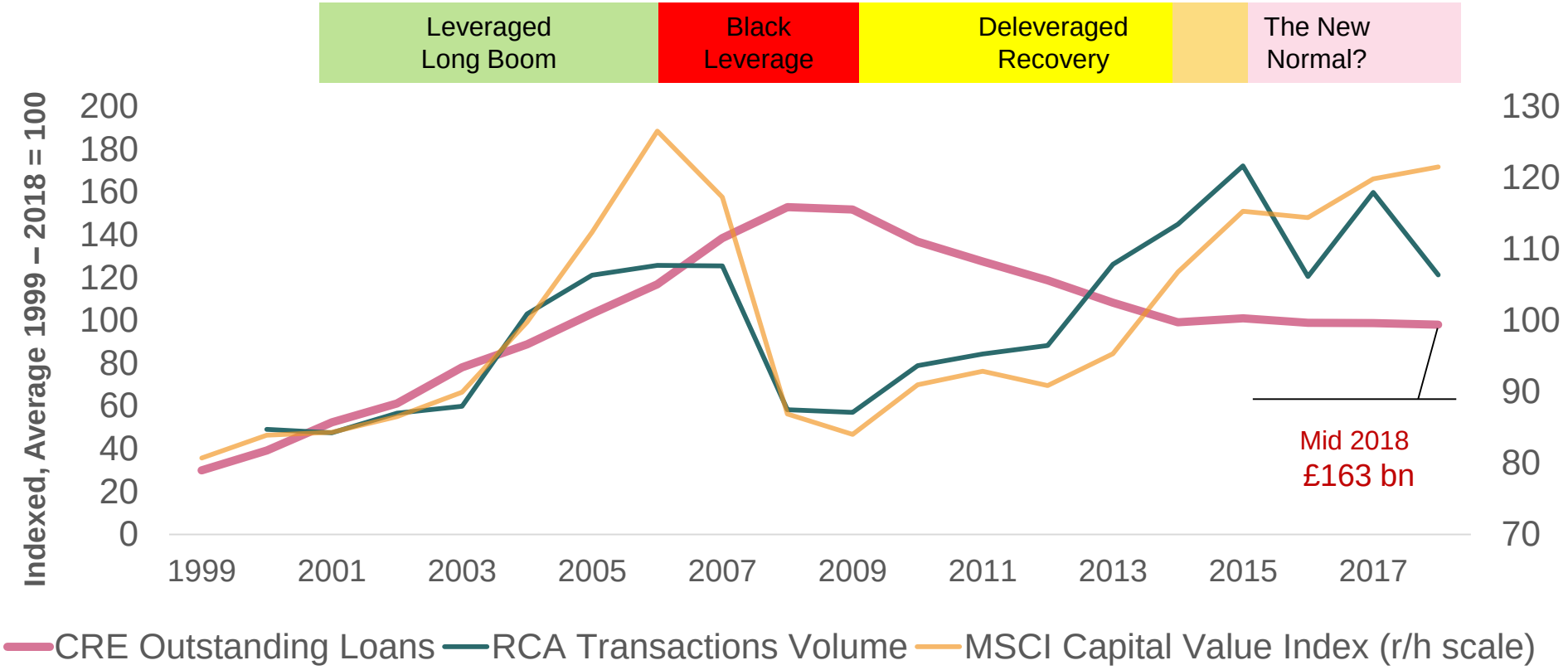
The Cass CRE Lending Survey – mid-year 2018

- The lending cycle – a retrospective
- Loan books, originations and lenders
- Underwriting – interest rates and margins, book LTV

The lending cycle – loan books, a 20 year retrospective



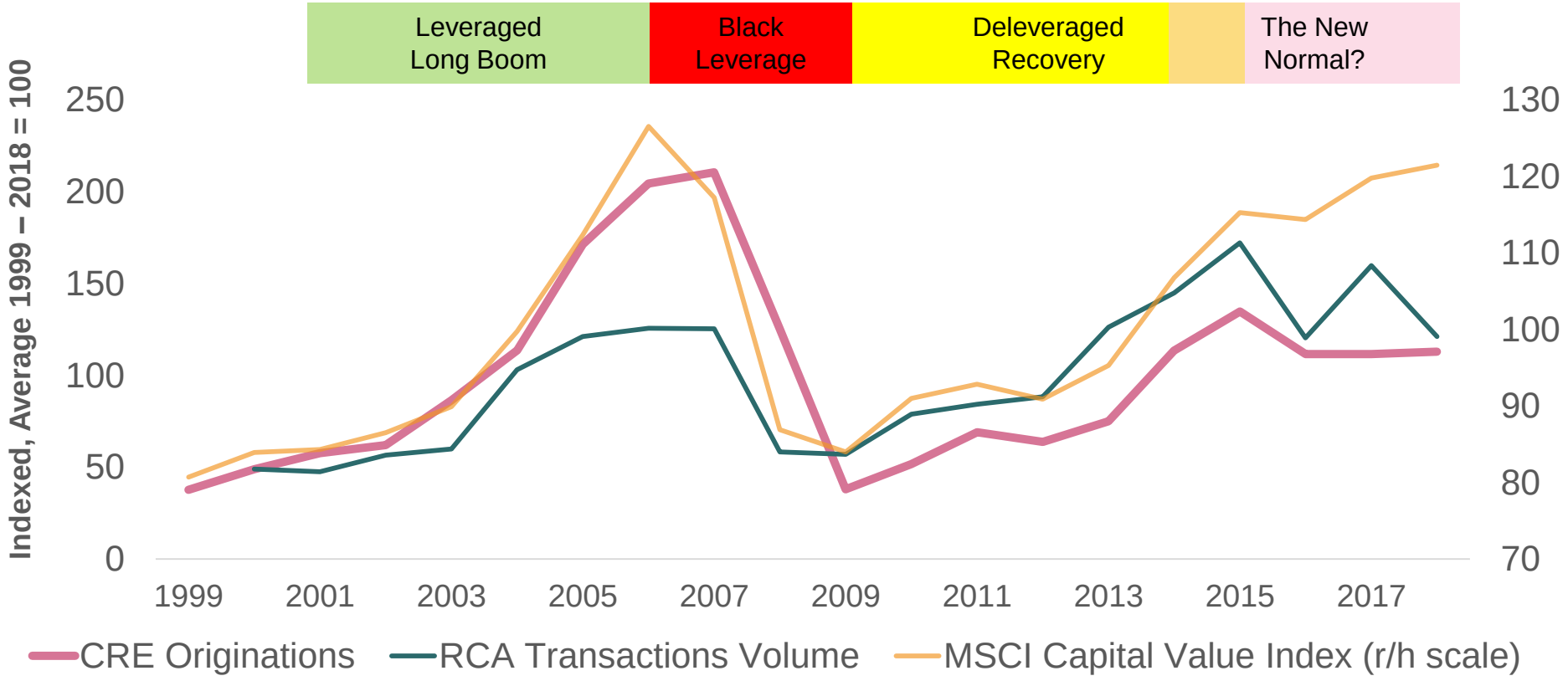
Measured by outstanding loans, CRE lending has had only three states – up, down, and flat.

Through the long boom, capital values rose by 50%, loan books by 120%.

Through the deleveraged recovery, capital values rose by 27%, loan books fell by -35%.

It seems linkages between lending, market value and market activity are highly variable.

The lending cycle – originations, a 20 year retrospective



Measured by origination volume, links between lending, value and trading are much clearer.

Loan books were cut back by write offs and debt sales; origination has tracked the recovery.

Over the full history, originations correlate at 0.82 with values, 0.60 with trading.

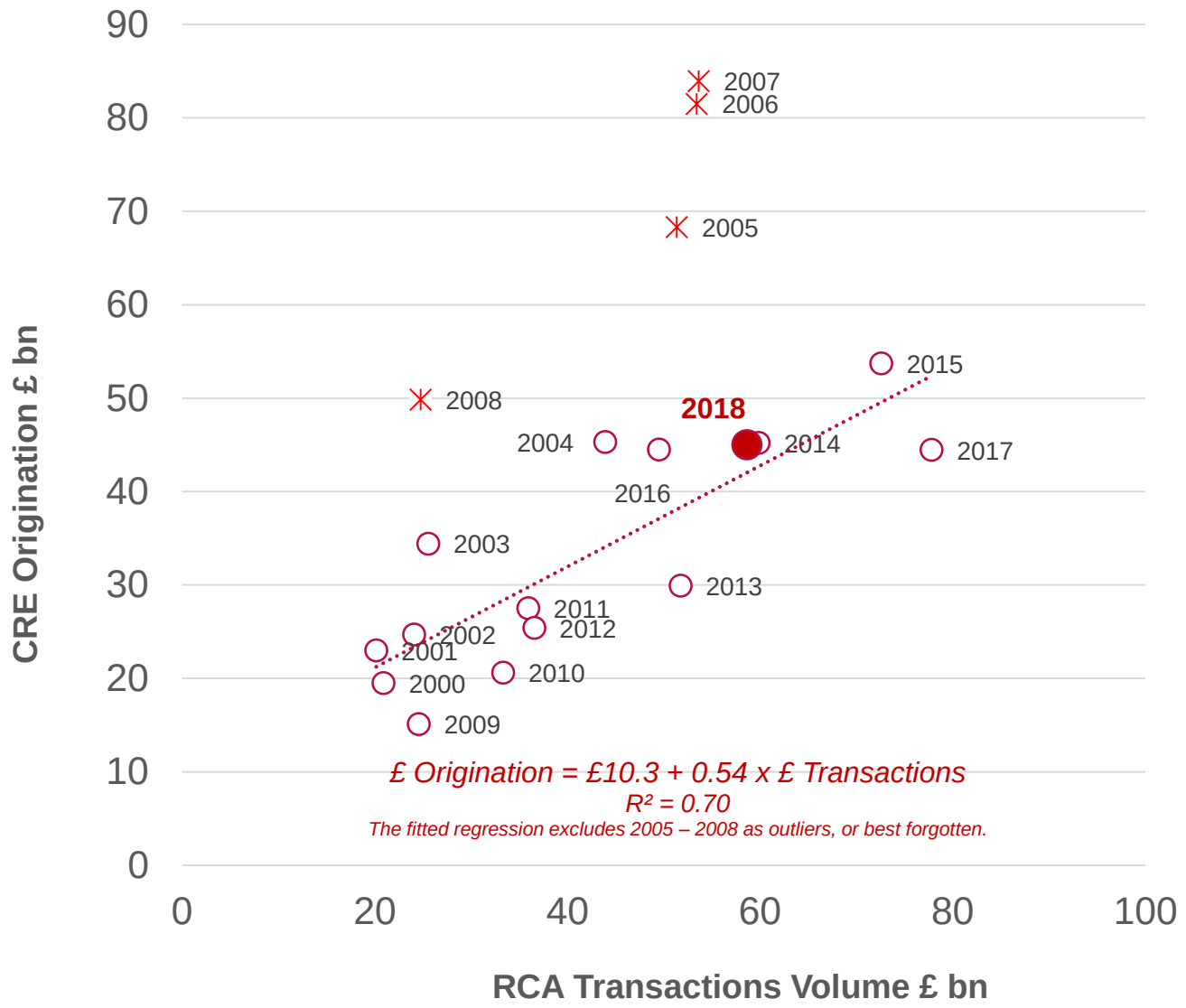
You may note that in from 2005 to 2007, origination and values looked decoupled from trading

The lending cycle - originations vs transactions volume

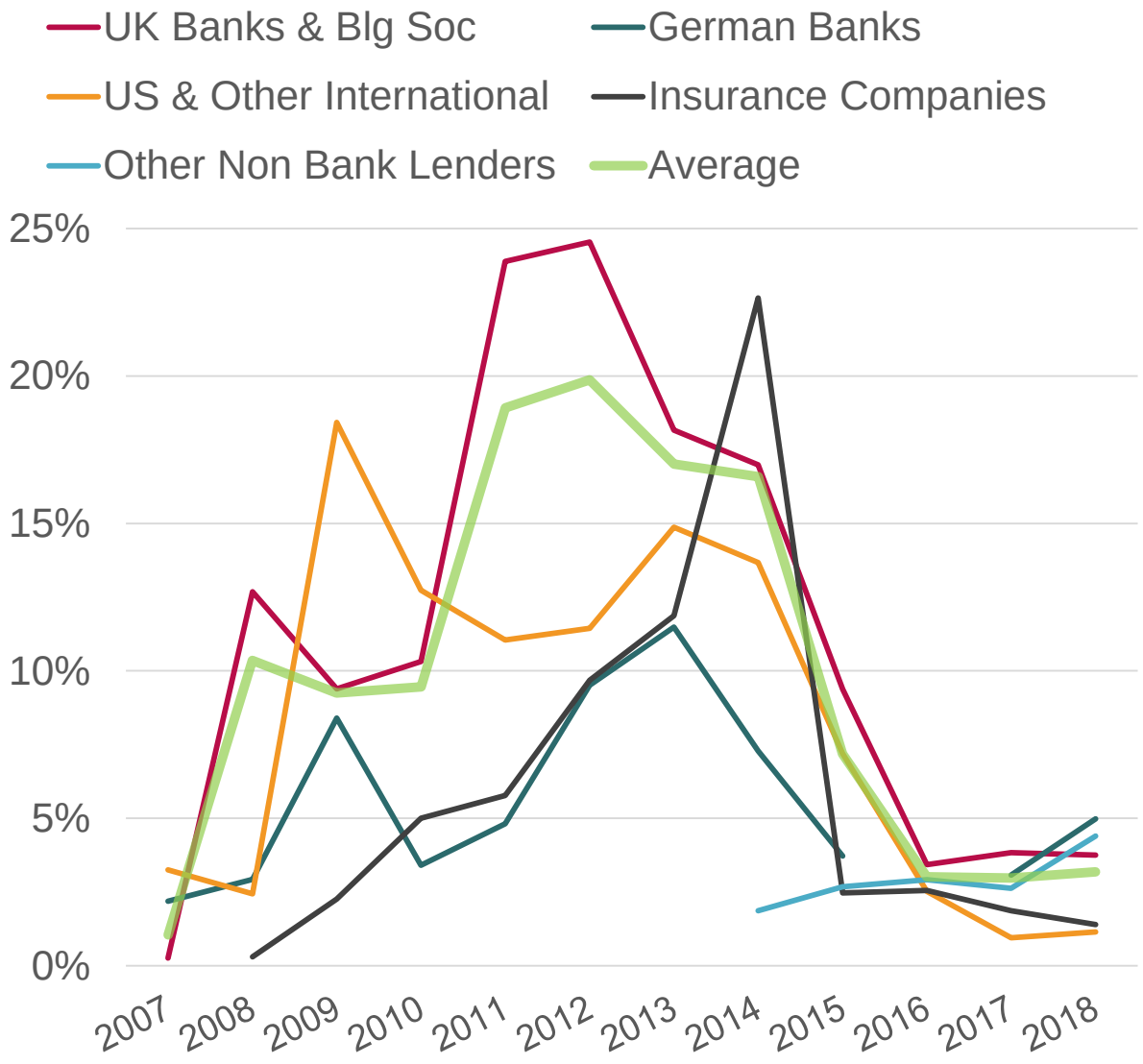
Fairly static loan books across a range of capital values does not mean lending is disconnected from market conditions.

The chart plots loan originations against trading, and show a fairly consistent linkage through most years. All years since 2010 fall close to the “predicted” origination volumes.

Perhaps we can add a drift in origination above the levels indicated by trading to the list of amber to red signals for CRE lenders.



The lending cycle – % loan book in default by value



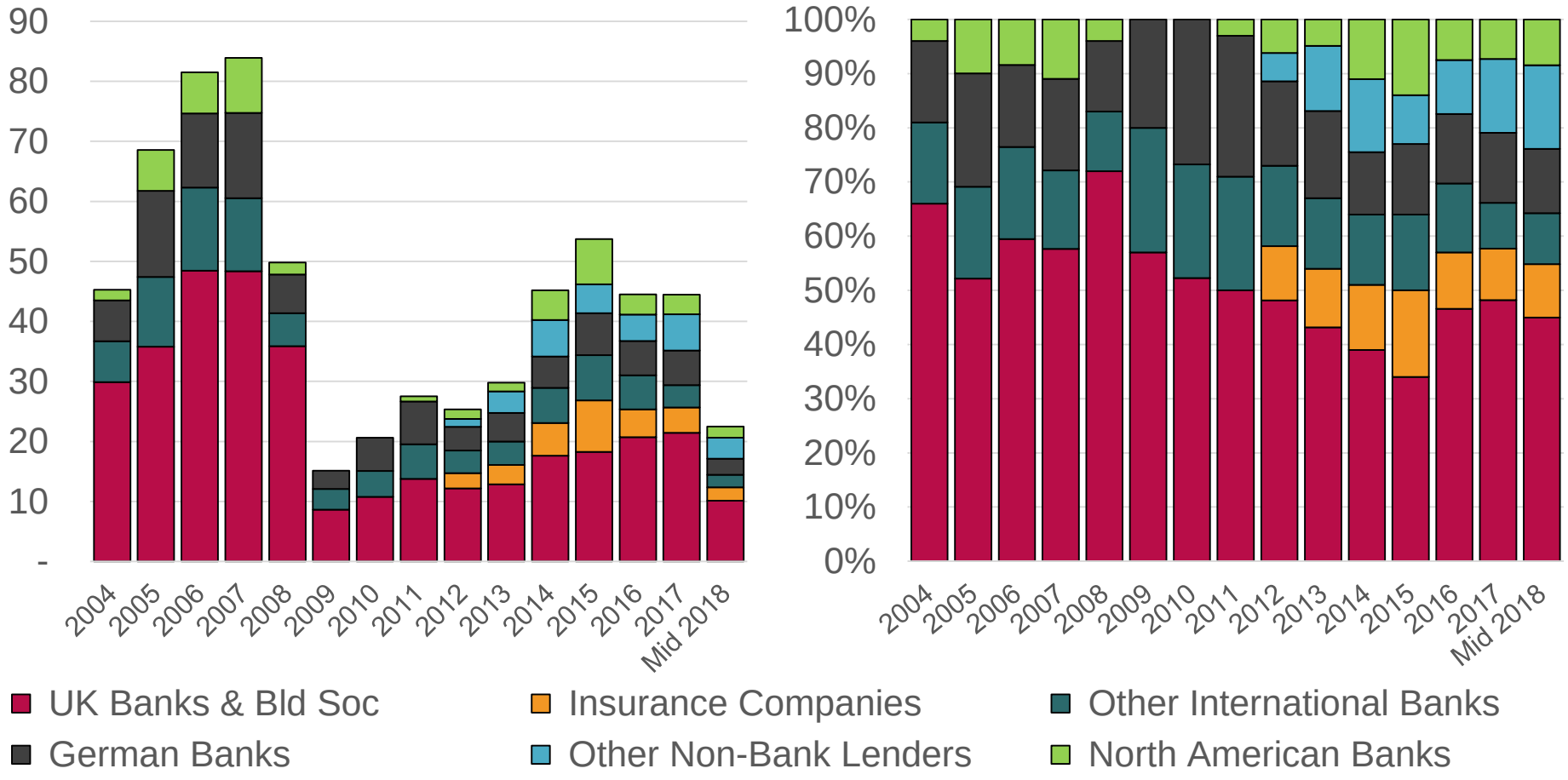
The end-product of misjudged borrowing and lending through the middle 2000s was a wave of defaults.

Default here is defined as payment beyond 90 days overdue, covering £155 bn in defaulted loans since 2006.

Across lenders, defaults varied widely in both severity and timing.

Our more detailed analysis suggests the main factors explaining variation in default were the concentration of originations in the mid-2000s, plus loan book exposure to developments and provincial markets.

The lenders – originations 1st half 2018 £ bn & % of total

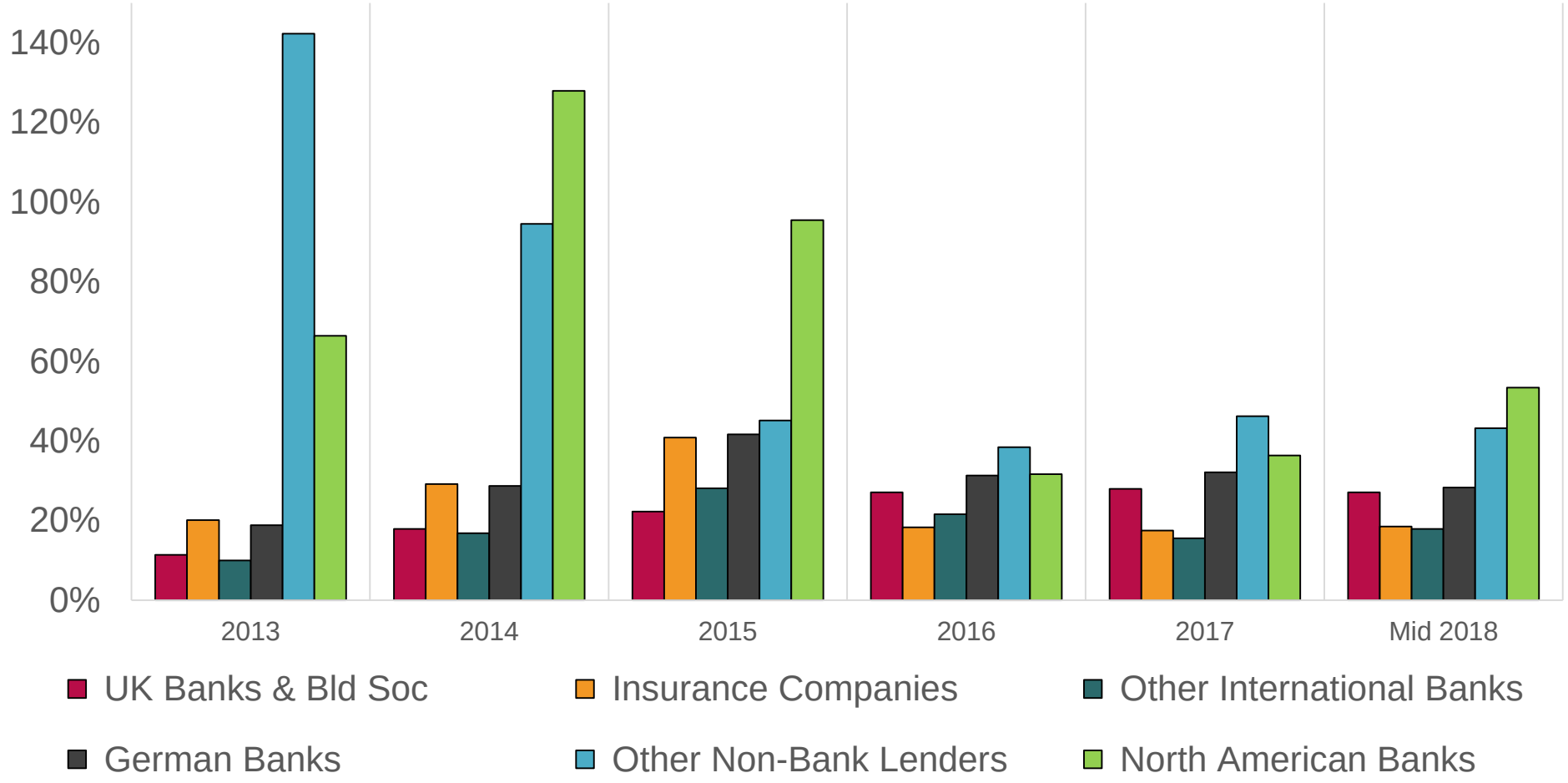


Loan origination was £22.5 bn in the first half of 2018 – 27% up on the same period last year.23

So the total for 2018 is likely to exceed the £45-£55 billion in each of the previous four years.

UK Banks share in origination ended a long decline in 2016, and has settled close to 50%.

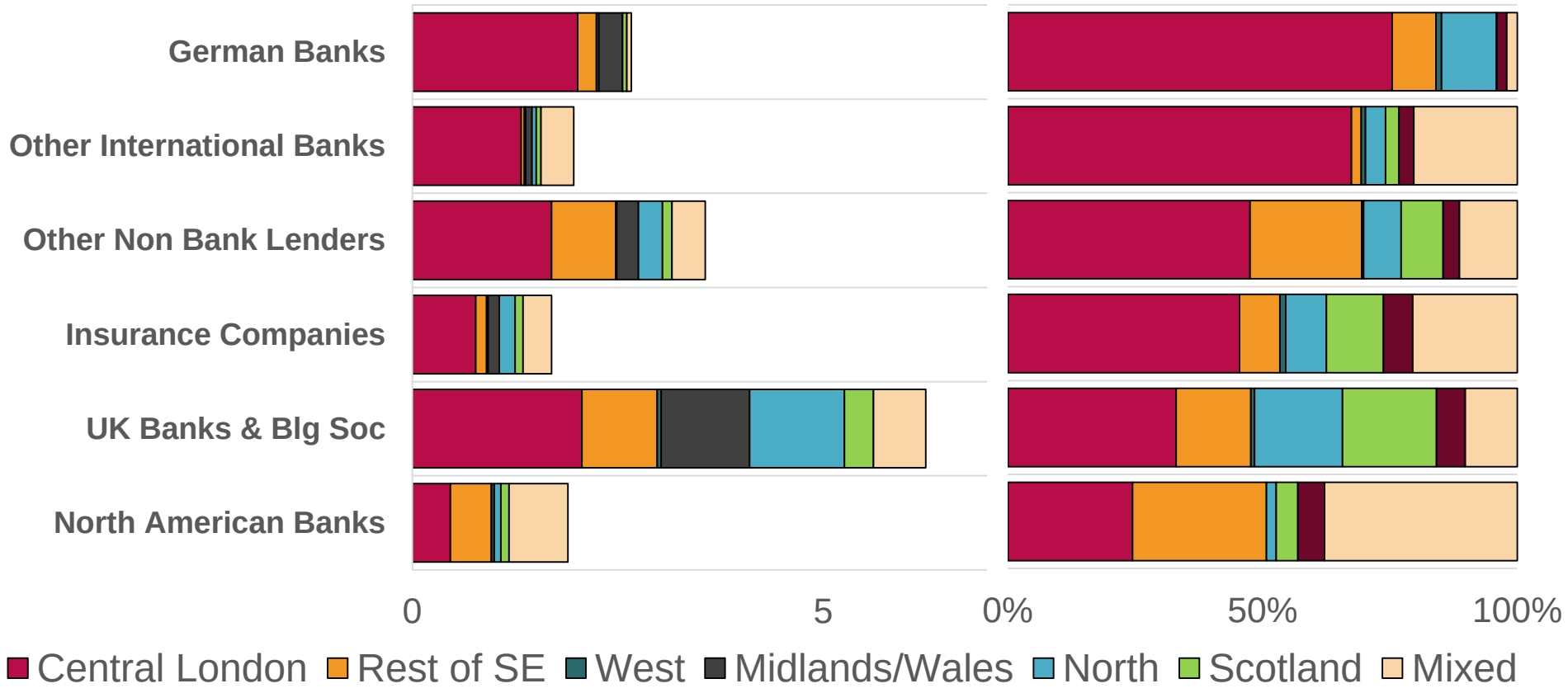
The lenders – originations as % of outstanding loans



Up to 2016, the most rapid book-building was by North American and Non-Bank lenders.

Who have remained the most active lenders, but at a distinctly slower pace.

Collateral – originations 1st half 2018, £ bn & % by lender

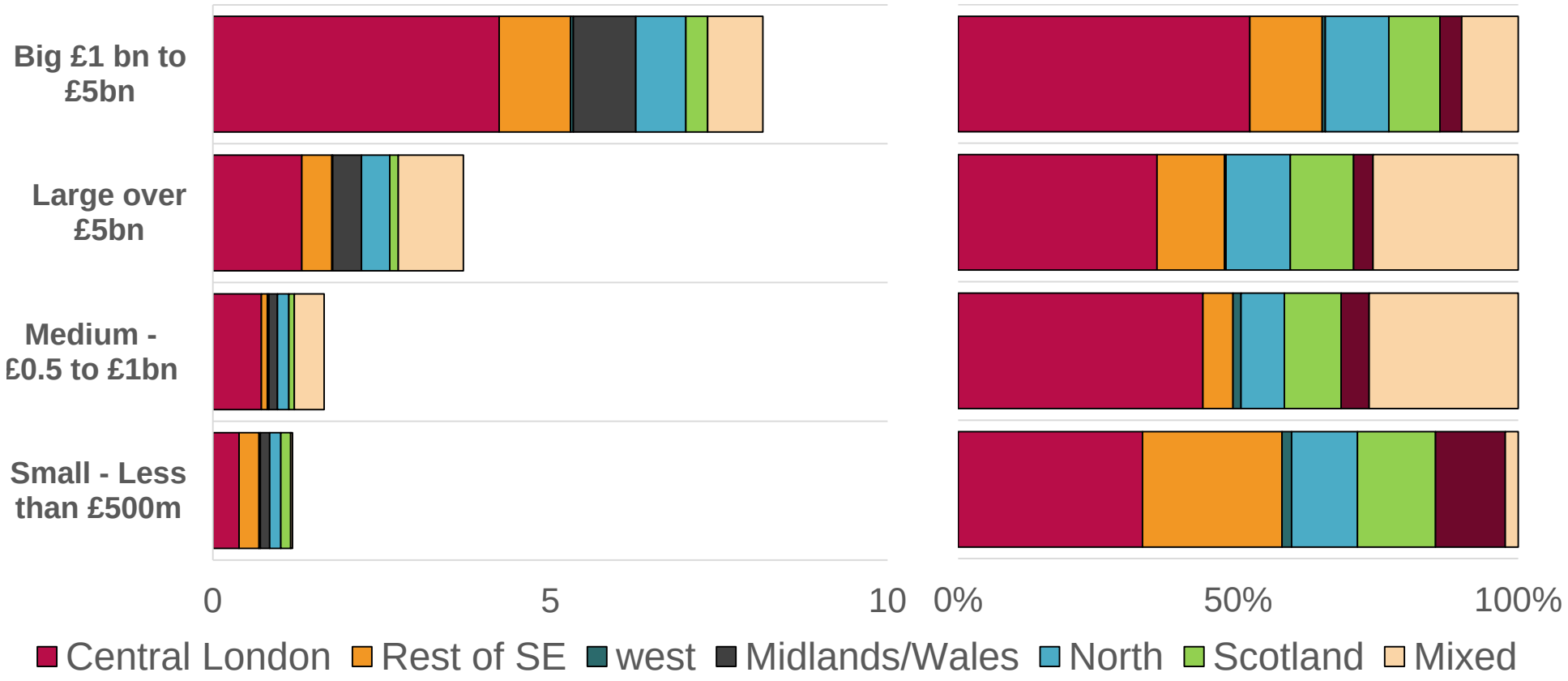


46% of loans originated were secured by Central London assets – 75% for German lenders.

This compares with around 30% of RCA transactions, and 20% of MSCI Annual Index value.

The spreads show German lenders the least, North Americans the most, diversified.

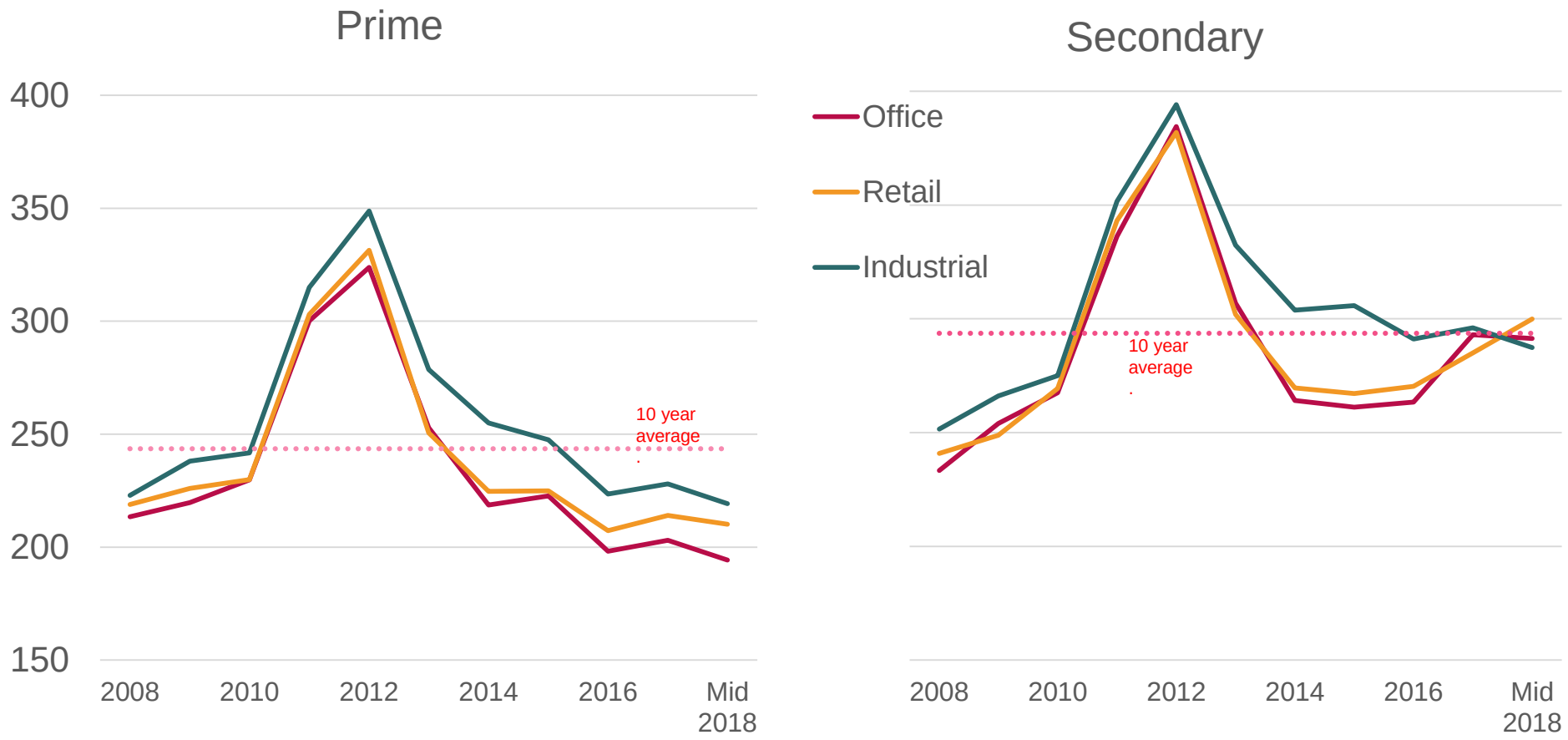
Collateral – origination 1st half 2018, £ bn & % by lender size



The spread of lending also varies across lenders with different sizes of loan book.

The most diverse lending patterns appear at the extremes of the large and small lenders.

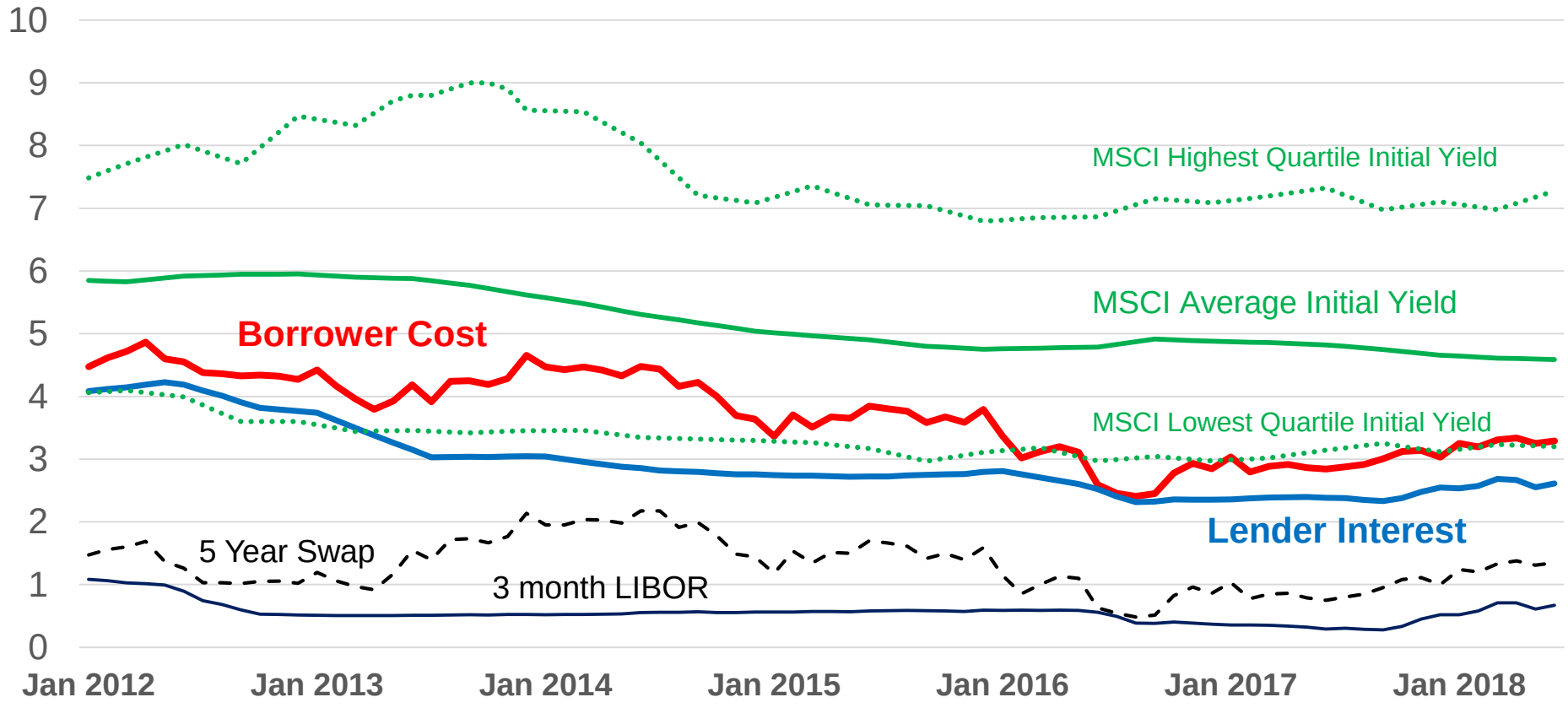
Underwriting – average target lending margins bps



Lending margins on prime assets have moved little since 2016, at 10 year lows.

On secondary assets spreads across sectors have almost disappeared, as retail margins continue to drift out.

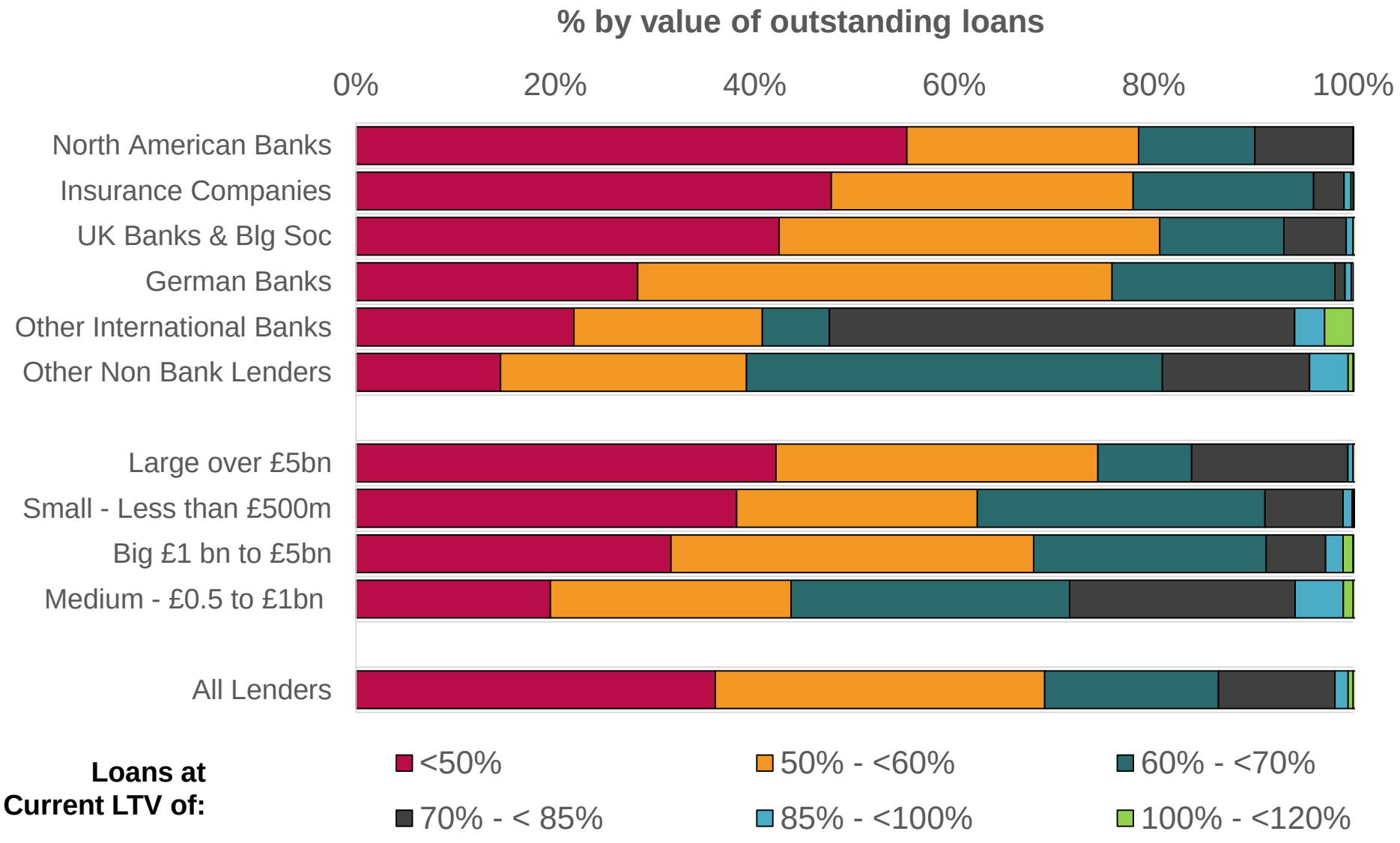
Underwriting – lending and borrowing rates vs yields %



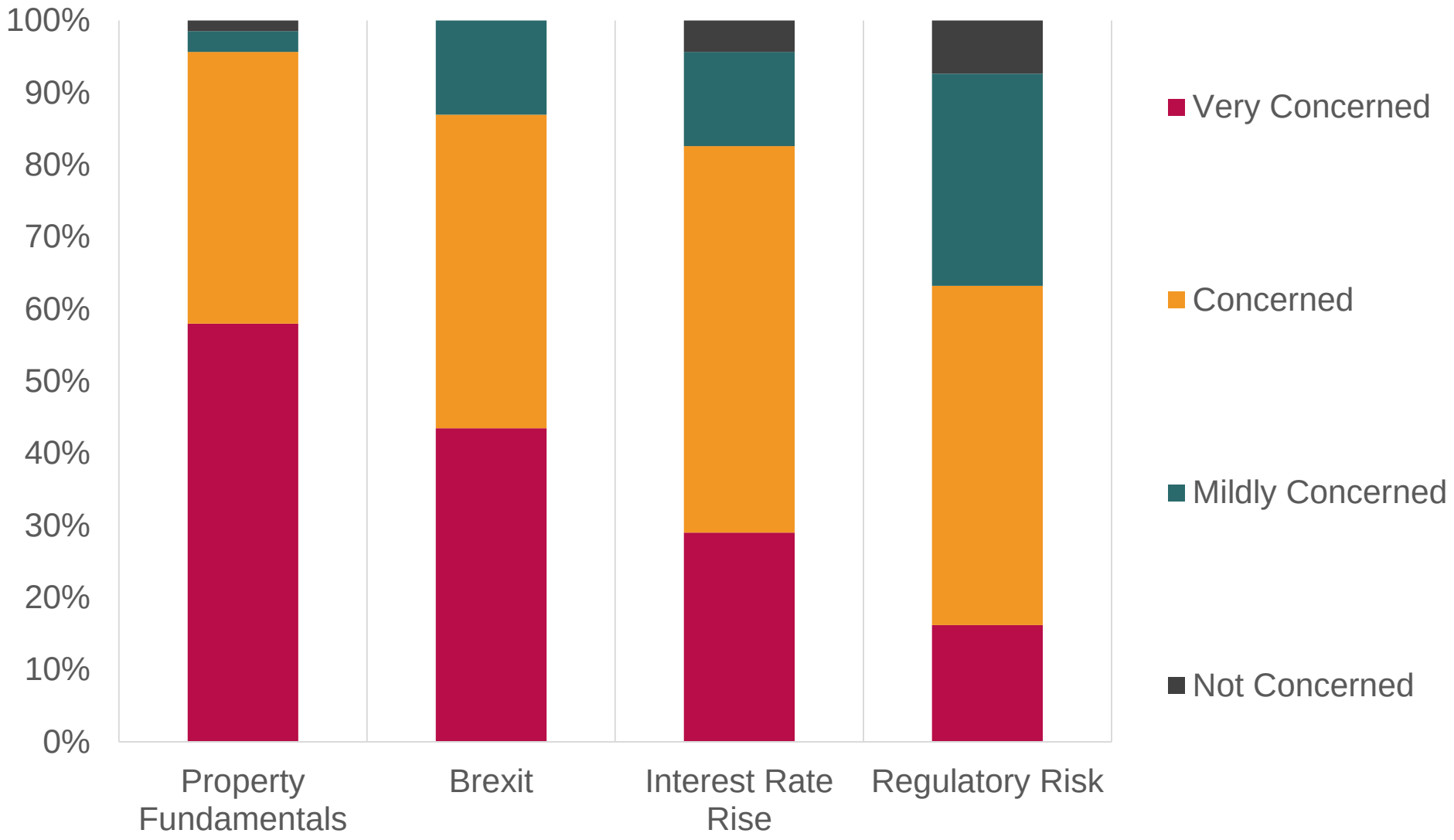
LIBOR rates, tracked by Swap rates with static spreads, have moved out since late 2017.

Against a small fall in market yields, so the 130 bps margin between borrower's cost and average yield is still below the 150 bps average for the last six years.

Book quality - % of outstanding loans by current LTV



Respondent views on main risks ... % of responses



Summary

- The Lending Survey tracks 20 years of market history.
- New originations £22.5 bn in the first half, take loan books to £163 bn.
- Originations 27% up on 2017 H1 likely total for 2018 in line with recent years.
- A new normal? - lender mix, target markets fit the pattern of last three years.
- Prime lending margins push below 10 year lows.
- Secondary margins remain higher, with no spread across sectors.
- Book LTV and ICR varies, small / medium / new lenders on weaker figures.
- Lender worries: Brexit of course, market cycle, interest rate drift.

With thanks to the Cass CRE Lending Survey sponsors:

Additional information

- The full report & data are available for purchase from Cass Business School
  - from this link

- More about Cass Business School real estate research & consulting
  - from this link

- Or contact Nicole.Lux@city.ac.uk