EMBARGOED UNTIL WEDNESDAY 1ST MAY 2019

Lending market more active than property investors in 2018

New loan origination reached £49.6bn in December 2018, a 12 per cent rise, against a drop in property transactions by 13 per cent year-on-year.

Average five-year senior lending margins continue to be under pressure, falling to 174 bps from 188 bps for loans secured against prime office property.

Junior pricing has adjusted upwards by 30 -40 bps across property classes, offering yields of 9.2 per cent.

According to the Cass Business School UK Commercial Real Estate Lending Report**,** new lending for 2018 was 12 per cent ahead of volumes reached twelve months earlier, at £49.6bn. Against this Costar recorded £54bn of property transactions over the same period.

Report author, Dr Nicole Lux, Cass Business School, said the industry had been watching this lead indicator, which has previously marked significant turning points in the market. Dr Lux said:

"Debt supply usually lags borrower demand by one year and 2017 was a strong year for property transactions. It remains to be seen if the debt market was just catching up in 2018. Historically a relationship of 1:1 could easily lead to an overheating market and 2019 needs to be carefully monitored. This is also confirmed by an increasing share of new loan origination against outstanding loan books, which reached 29 per cent of turnover in 2018 compared to a ten-year average of 20 per cent. A relatively large amount of 26 per cent of new loans was distributed via loan syndication, showing market depth and breadth are widening."

The report shows new development finance reached £8.8bn, of which the majority of £5.2bn was for residential development supplied by UK Banks and Other Lenders. This is £1 bn less new residential development finance than in 2017. Lenders also mentioned that developments of PRS projects are still difficult to finance and these made up £1.7bn.

While loan pricing was stable with some slight downward pressure for loans secured by prime property and low LTV ratios, pricing of loans secured by prime retail property increased to 233bps from 214bps over twelve months to December 2018 and for secondary to 334bps from 285bps. This leaves loans secured by retail property to be the most expensive property type to finance, due to credit concerns over the quality of retail income.

This provides lenders with a 3.2 per cent yield to maturity on a five fixed rate CRE senior secured loan compared to a five-year gilt with 0.9 per cent and UK BBB rated corporate bonds with 2.2 per cent. Junior debt offered a YTM of 9.2 per cent.

The total weighted average default rate for secured CRE loans was 3.2 per cent and write-down provisions were at 8 per cent of the value of defaulted loan value in 2018. In comparison, on an annual basis the marginal default rate for project finance loans was 1.3 per cent, 0.7 per cent for RMBS securitised loans and 0.18 per cent for BBB corporate loans. This leaves secured CRE loans slightly more risky than other similar secured asset financing.

Paul Coates, Head of Debt and Structured Finance, CBRE commented:

"The Cass report continues to provide a very useful window into the CRE lending market. The market in 2018 remained robust, despite continued political and economic uncertainty, with increased capital looking to deploy into the debt space. This in turn has created greater competition amongst lenders with borrowers seeing more favourable terms across many asset classes. However, how long this lasts remains to be seen. Conversely, where higher market and sectoral risks are evident, we are seeing lenders being more selective and setting wider pricing parameters, which can provide opportunities to achieve higher returns. This quality selection is key to robust underwriting but whether we are seeing the correct level of risk adjusted pricing in these sectors is as yet unclear."

Peter Cosmetatos, Chief Executive, CREFC Europe, said:

"As ever, there is a lot of very interesting material in the latest commercial property lending report. The headline seems to be that the UK property lending market is stable and sober, providing the credit the UK market needs without lenders taking on undue levels of risk. If there is to be any serious Brexit impact on this market, it certainly hasn't emerged yet. What is already clear, on the other hand, is the demise of Retail property, which now accounts for just 15 per cent of the collateral for the debt covered by the report – it remains to be seen how investors and lenders can work their way through a very challenging situation."

Neil Odom-Haslett, President of the Association of Property Lenders said:

"The survey clearly demonstrates that the lending community is managing its commercial real estate lending books in a responsible and disciplined fashion and that the capital regulations imposed on lenders by the authorities following the global financial crisis, are actually working. The peaks and troughs of the lending market, with the peaks usually at the wrong end of real estate cycles, are hopefully in the past and history will not repeat itself (well, not during this cycle at least!). In this respect "benign" is good."

The report is available to be purchased here.

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Media enquiries:

Dr Nicole Lux, Cass Business School
M: (0)789 4420 446, E: Nicole.lux@city.ac.uk

Amy Ripley, Senior Communications Officer, Cass Business School
T: +44 (0) 20 7040 3134 M: +44 (0) 7794 053 384 E: amy.ripley@city.ac.uk

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