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The UK Commercial Property Lending Market Research Findings 2009 Year End

AN EXTRACT FROM

**The UK Commercial Property
Lending Market: Year-End 2009
Research Findings**

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Bristol & West Property Finance	Lloyds Banking Group
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Canada Life Ltd	Mitre Capital Partners
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Deutsche Bank AG	National Australia Group Europe Limited
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Deutsche Pfandbriefbank	Newcastle Building Society
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DG Hyp AG	Northern Rock plc
Dunbar Bank plc	Principality Building Society
Dunfermline Building Society	Prudential M & G
Erste Group Bank AG	Santander Corporate Banking
Eurohypo (UK) Ltd	Société Générale
Europe Arab Bank plc	The Cooperative Bank plc
GE Real Estate	The Royal Bank of Scotland
Helaba Landesbank Hessen-Thüringen	West Bromwich Building Society
HSBC Bank plc	Westdeutsche Immobilien Bank

EXECUTIVE SUMMARY

Market Size

- The research covers total property lending (commercial property and lending secured by social housing) of £247.7bn held by 59 lending organisations as at 30 December 2009. A total of 68 responses from individual lending teams were received which represents a 100% response rate. (see page 1)
- The aggregated value of outstanding debt secured by UK commercial property only, rose from £225.5bn (2008) to £228.3bn (2009 year-end), an increase of 1.2%. (see pages 6 and 7)
- On the assumption that this research captures between 90% and 95% of the specialist commercial property lending market, and using the £228.3bn reported above, it can be estimated that the market size is in the region of £240bn to £254bn without social housing at year-end 2009. (see page 3)
- In addition, a further £42.5bn of loans were committed but not drawn at year-end 2009. (see pages 1 and 2)
- Fitch Ratings provided data on the balance of outstanding CMBS issuances that they had rated and that included loans secured by UK commercial property. At year-end 2009 this amounted to £42bn. Fitch Ratings estimates that the total outstanding balance of UK CMBS at year-end 2009 was approximately £50bn. (see page 4)
- UK organisations (UK Lenders and UK Building Societies) held 64% of outstanding debt retained on balance sheet, Other International Lenders 23%, German lenders 11% and North American Lenders 2%. (see pages 1, 2 and 8 and Appendix A)

OTHER HEADINGS INCLUDED IN THE EXECUTIVE SUMMARY OF THE FULL REPORT ARE:

Loan Maturities

Loan Originations and Loan Extensions

Future lending Intentions

Problem Loans

Structure of Loan Book

Loan terms

1. INTRODUCTION

This report analyses the lending patterns of the major commercial property lenders operating within the UK for the year-ended 31 December 2009.

This is the twelfth such report to be published by De Montfort University and is the most recent addition to a series of annual and half yearly reports that commenced in 1997.

The continuing difficult circumstances in the financial markets both nationally and internationally continue to impact on this research and the organisations that contribute to it. Since the report for year-end 2008, two major UK Lenders have completed their merger and will now be recorded in this data as a single organisation. Another two UK lenders have merged and have become part of a major overseas lender. In this and subsequent reports these organisations will also now be recorded as a single organisation and their data reported in the category of Other International Lenders. Organisations that have received support from their respective Governments have undergone a substantial internal restructuring during 2009. In some instances this has resulted in the reclassification and description of current and historic data provided to this research. These revisions have been incorporated into the evidence presented in this report. It has also been well documented elsewhere that a small number of organisations from across the categories adopted in this research have merged and/or have completely withdrawn from commercial property lending. These organisations, however, continue to report their value of outstanding debt to this research.

In December 2009, questionnaires were sent to 59 lending organisations that had contributed to this research in previous years. A response rate of 100% was received from the 59 organisations (68 lending teams).

The rate and detail of response to individual questions varies between organisations due to reasons of confidentiality and availability of data. Thus, 100% response rate may refer to a different total from one question to another

Throughout the research complete anonymity is maintained. No lending organisations are named anywhere in this report other than in the list of Acknowledgements.

Presentation and methodology

This report is divided into 2 parts followed by 10 appendices.

The first part gives a brief summary of market activity during 2009. This gives the aggregated value of debt outstanding at 31st December 2009, together with data on the value of new loans that were originated during the year.

The Main Findings of the research for 2009 are presented in the second part, together with data from previous years so that market trends can be identified. Data for both mid-year and year-end 2009 will be presented where this has an impact on trends previously identified.

The following 10 appendices provide detailed information on the topics included in the Main Findings. Each appendix has its own index for easy reference to any particular item of information. The final appendix, J, records the comments made by lending organisations in respect of current issues and concerns within the UK commercial property lending market.

The findings of this research are presented mainly in graphical form supported by brief summaries that highlight the pattern and the features most relevant to the analysis. The summaries are largely descriptive making no attempt at this stage to explain the research findings in detail.

To accompany this report, there is a Technical Supplement available in pdf format by request from cplr@dmu.ac.uk, that sets out the detailed lending terms that would be offered for senior debt by the different categories of lenders used throughout this research. No lending organisations are named.

Definitions and classification of lenders

Definitions

Throughout this research, “commercial property lending” is taken to mean all lending secured on UK commercial property including residential investment and development but excluding owner occupier residential mortgages.

Where reference is made to the commercial property loan books of lending organisations, this is taken as the net exposure to UK commercial property excluding equity finance (i.e. net of any loan amounts sold down to other lenders and net of any securitised loans unless otherwise stated).

Classification of lenders

In order to show the variety of lending patterns and the differences between lending organisations a categorisation of lenders has been devised which is applied throughout the analysis. With effect from this report, data from Building Societies and UK Lenders have been combined. This is to guard against identification of individual active Building Societies within the shrinking numbers within this category.

The NEW categories are as follows:

All: *refers to all lending organisations that have responded to a particular question.*

UK Lenders and Building Societies: *comprises those lending organisations where the head office is located in the UK and includes Building Societies in the UK. During 2009 two organisations that previously were included in UK Lenders have merged with and have become part of an Other International Lender. Consequently in this and subsequent reports these lending organisations will be reported under Other International Lenders*

German Lenders: *comprises all lending organisations, the head office of which is located in Germany.*

North American Lenders: *refers to all lending organisations, the head office of which is located in North America. These organisations are recorded as a separate category since 2003. Prior to this, they were included with Other International Lenders.*

Other International Lenders: *refers to all lending organisations, the head office of which is not located in the UK, Germany or North America. It includes lending organisations whose head office is located in Eire.*

MARKET ACTIVITY 2009

1. Loan book size and gross lending recorded by the research in 2009

This introductory section provides details of the value of outstanding loan books at 31st December 2009 and the value of loan originations undertaken during 2009.

1.1 Value of outstanding loan books

A total value of £247.7bn of outstanding debt, including mezzanine finance and loans of approximately £19.4bn secured by social housing was recorded by the survey as at 31st December 2009. In addition, a further £42.5bn of loans were committed but not drawn at this date.

Table 1 presents the categories of lending organisations adopted throughout this report and the amounts of outstanding debt, mezzanine finance, undrawn amounts and equity reported to the survey.

Table 1: Category of lender and type of finance

Categories of Lender	Reported UK outstanding loans including social housing	Mezzanine	Equity	Reported UK outstanding loans including social housing, mezzanine and equity	Reported amount of committed funds not yet drawn
	£m	£m	£m	£m	
UK Lenders and Building Societies	£158,905	£394	£548	£159,847	£32,567
German Lenders	£ 25,972	£183	£ 0	£ 26,155	£ 8,249
Other Int Lenders	£ 57,454	£261	£ 25	£ 57,741	£ 1,562
North American Lenders	£ 4,556	£ 22	£ 40	£ 4,618	£ 135
All Lenders	£246,887	£860	£613	£248,360	£42,514

The data from Table 1 is shown proportionately in Figure 1.

1.2 Estimation of market size year-end 2009

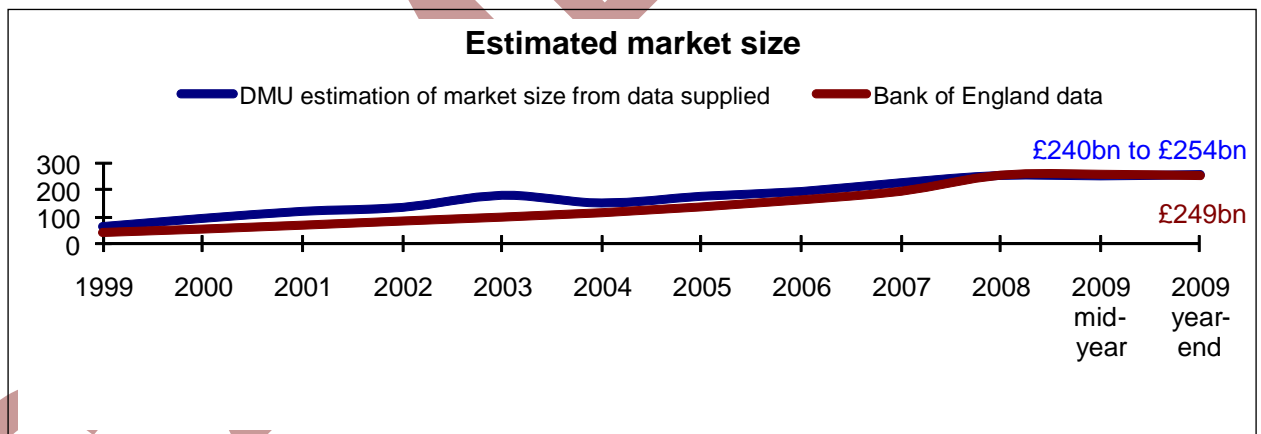
When estimating the total size of the specialist commercial property lending market, the following factors are considered:

1. This research has always targeted those organisations that have specialist commercial property lending teams. Consequently, lending to commercial property on a smaller scale undertaken at branch or regional level by UK Clearing Banks is not necessarily captured in its entirety by this research;
2. It is recognised that some lending into the UK commercial property market is by organisations neither located nor domiciled in the UK and thus is not captured by the research.

Detailed returns continue to be received from the largest organisations despite the recent market dislocation. It is contended that the data collected for this research represents a high proportion of lending undertaken by these specialist property lending teams in the UK. On the assumption that this research captures between 90% and 95% of the specialist commercial property lending market, and using the £228.3bn reported above, it can be estimated that the market size is in the region of £240bn to £254bn without social housing at year-end 2009.

Figure 3 plots the range in estimated market size of outstanding commercial property debt retained on the balance sheet of organisations that have responded to this research between 1999 and 2009 year-end. It can be seen that the value of outstanding debt has remained broadly unchanged between 2008 and 2009.

Figure 3: Estimated range of market size of specialist commercial property lending market 1999 to 2009



It should be noted that the Bank of England data is not exactly comparable to that collected by this research. The Bank of England data include some lending to both social housing and lending secured by overseas property.

Figure 3 does not include any assumption as to the size of the market not captured by this research as detailed in points 1 and 2 above nor the value of undrawn funding of £42.5bn reported to this research at year-end 2009.

A feature of the data is the amount of outstanding undrawn finance of £42.5bn. This has declined from £51.8bn at year-end 2008. Approximately 57% of these undrawn amounts are held by just two organisations. Importantly, significant proportions of the value of these commitments are 'historic'. These commitments were mainly put into place between 2006 and 2008 and in conditions when both the commercial property market and lending market were far more buoyant. These loan commitments would have been for development (commercial and residential) and commercial investment projects. Thus, for example, the amounts outstanding were committed in order to complete developments and/or to undertake developments where the start dates has been delayed awaiting an improvement in the current property market. Commitments are also made to investors.

MAIN FINDINGS

2. UK commercial property lending 1999 to 2009

This part summarises the main findings of the research for year-end 2009. This is presented together with data collected from previous years to identify trends in the market.

The organisations reporting to the annual research in later years will be slightly different from those reporting in earlier years. This is due to new organisations entering the market, others dropping out, and takeover and merger activity.

When organisations participate in this research for the first time, their historic data on volume of lending and loan book size is also requested. Consequently the historic trends presented in this report will differ slightly from those published in earlier reports.

2.1 Aggregated value of outstanding debt recorded in loan books (and excluding the value of loans securitised into the CMBS market)

Figure 5: Aggregated value of outstanding debt

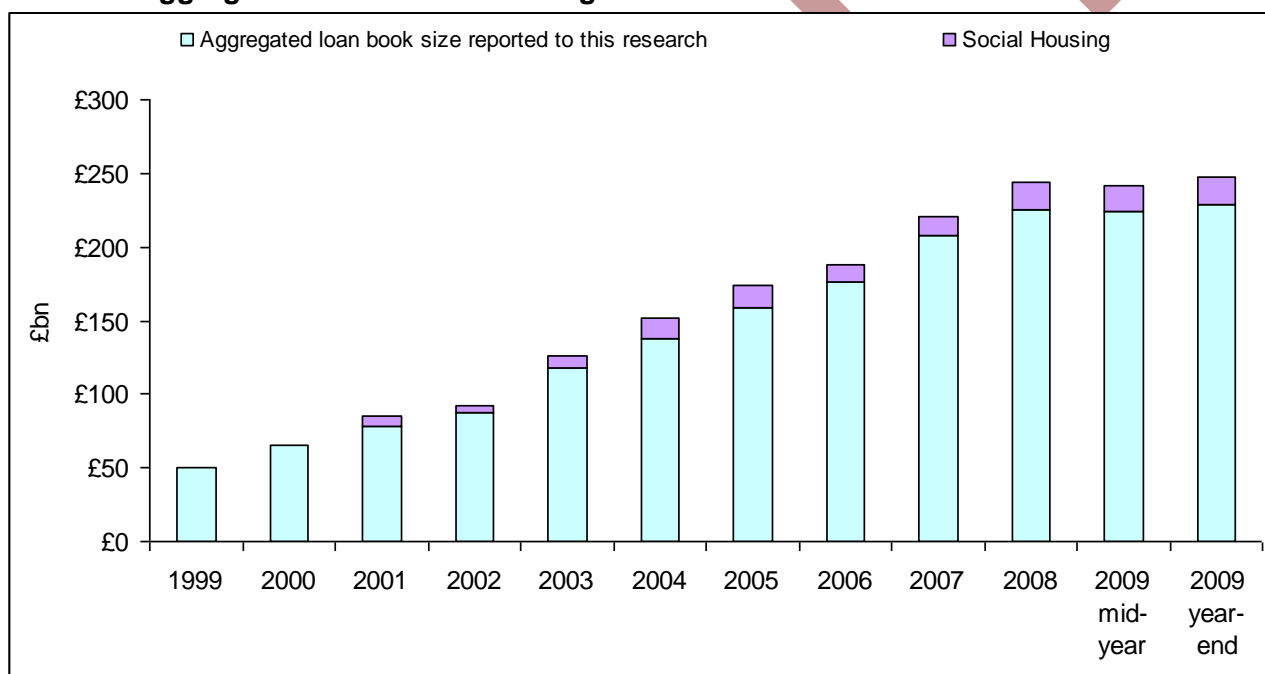


Figure 5 presents the net aggregated value of outstanding debt recorded in loan books and secured by commercial property and social housing that has been reported to this research since 1999. By year-end 2009 this stood at a total of £247.7bn. In comparison with year-end 2008, the comparable value was £243.3bn and thus the total value of outstanding debt had increased by 1.18% during the year.

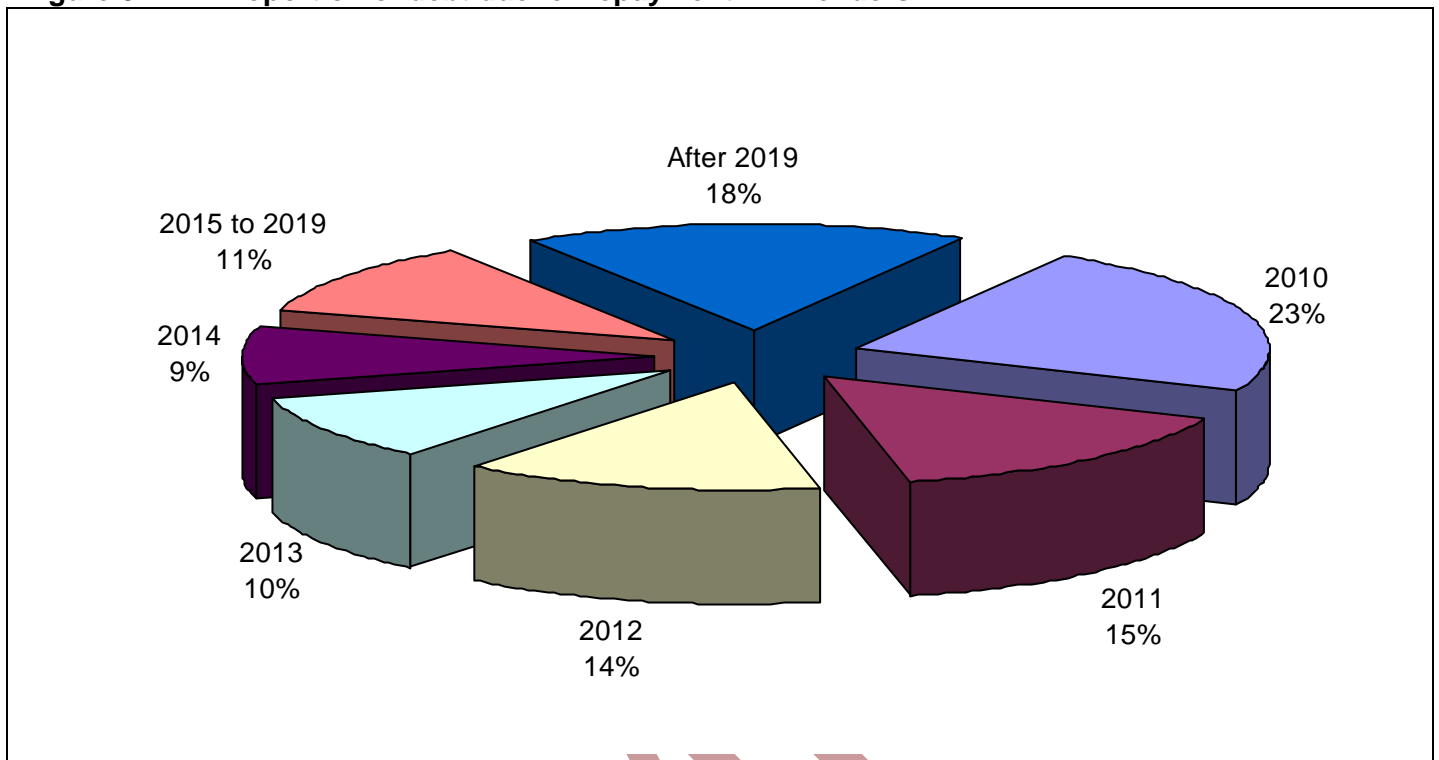
At the end of 2009, organisations that held 74% of this outstanding debt, estimated that this lending represented 15% of their total lending in the UK. Table 3 below shows the corresponding proportions reported at previous year-ends since this data was first collected in 2004.

Table 3 demonstrates that the proportions have declined since 26% was recorded in 2006. It should be noted that this research captures data from a wide spectrum of organisations, including overseas lenders whose only business activity in the UK is secured lending to commercial property.

2.2 Repayment

Figure 9 shows the proportion of outstanding debt due for repayment in each of the next five years individually from 2010 to 2014, from 2015 to 2019 and finally after 2019.

Figure 9: Proportion of debt due for repayment: All Lenders



During the next five years between 2010 and 2014 inclusive, 71% of all outstanding debt is due for repayment. At 71%, this proportion is higher than that recorded by previous years-end surveys. For example, at year-ends 2006 and 2007, the proportion of debt due to mature within the following five years was 61% and 60% respectively. Also, the volume of lending maturing in each year was distributed fairly evenly across the five year period. This trend was interrupted in 2008 when 69% of debt was due to mature within the following five years. It is suggested that the reason for this change in maturity profile is that in many instances loans that were due to mature in 2008 and 2009 have been extended because of the borrowers' inability to refinance their loans.

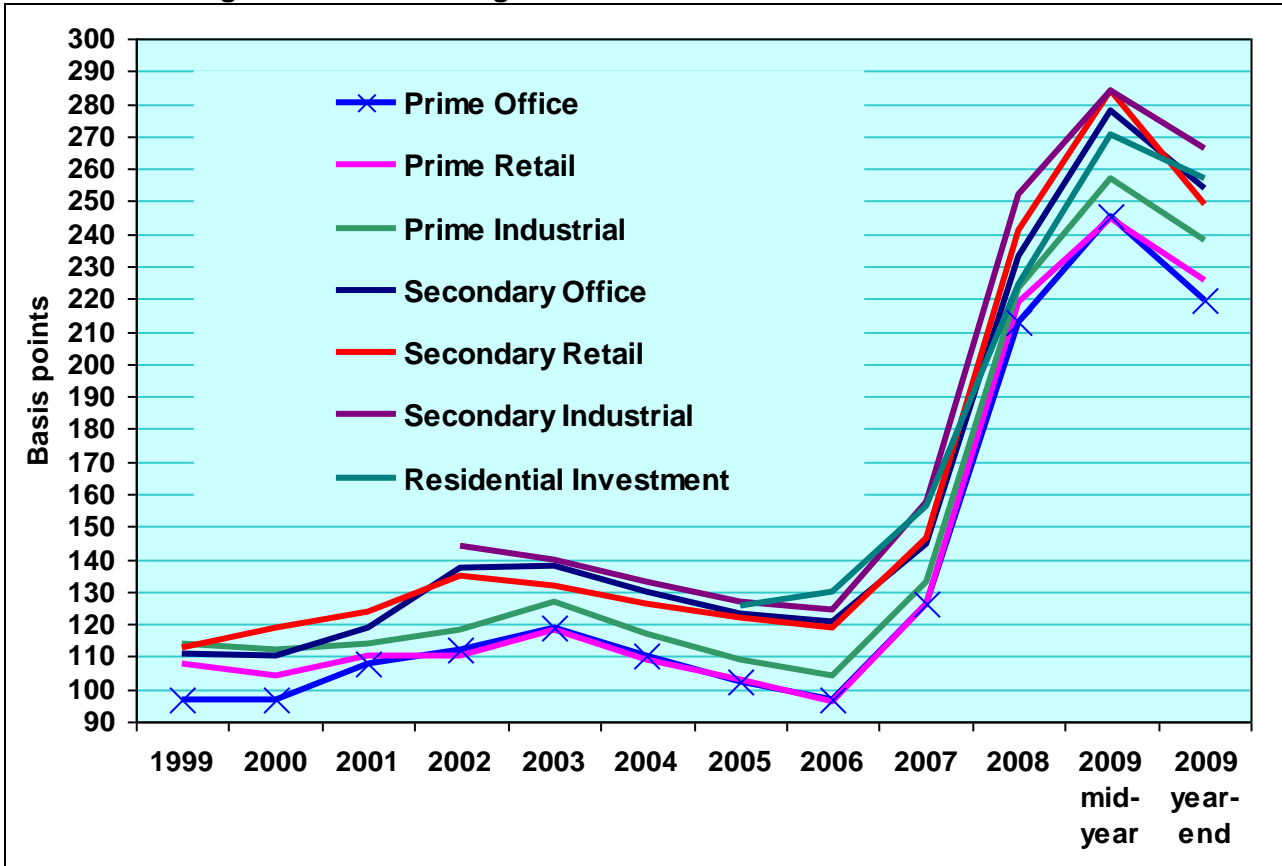
This trend is identified in Table 5 which compares the expected loan maturities for years 2010 to 2012 inclusive recorded at year-end 2008 with those recorded at year-end 2009. It shows at year-end 2009 that an additional £30.4bn of debt was recorded as maturing compared to the value recorded at year-end 2008. Thus, it appears that potentially up to £30bn of debt from £43.8bn that should have matured in 2009 has been extended with particular concentrations in 2010 and 2012.

3 Loan terms

3.1 Average interest rate margins

Figure 15 shows the average senior debt interest rate margin for investment loans secured by the different property sectors from 1999 to 2009 year-end. Data for secondary industrial property has only been collected by this research since 2002 and that for residential investment since 2005.

Figure 15: Average interest rate margins for different sectors: 1999 to 2009



Average interest rate margins for loans secured by all commercial property sectors generally increased between 1999 and 2002/2003 but declined thereafter until year-end 2006. Increases were recorded during 2007 that continued throughout 2008 and to mid-year 2009. Average margins at mid-year 2009 are the highest recorded by this research for each property sector. The second half of 2009 saw a decrease in levels of average margins from those recorded at mid-year but the year-end 2009 average margins are higher than those recorded at year-end 2008. This is demonstrated explicitly in Figure 15 where, for example, the average margin on loans secured by prime office property increased from 213.5 bps at year-end 2008 to 245.2 bps at mid-year 2009 and then declined to 219.7 bps at year-end 2009. Similarly for secondary offices, average margins increased from 233.4 bps at year-end 2008 to 277.9 bps at mid-year 2009, and then, declined to 254.0 bps by year-end 2009.

Allocation of annual loan originations by organisation

Figure 36 below presents the allocation of new loan originations, of £15.1bn (excluding extensions to maturing loans) completed in 2009 by individual organisations compared with that presented at year-end 2008. The segments coloured red represent the twelve largest organisation measured by the value £bn of their outstanding commercial property loan books.

Figure 36: Lending in calendar year 2009 allocated by organisation



As previously mentioned in this research, direct comparison with year-end 2008 is not possible because of the unknown value of extensions to loans contained within the 2008 data. However, the figure indicates that, in 2009, approximately 67% of the value of 'new' loan originations was undertaken by eight of the 'top twelve' organisations. This compares with approximately 58% of gross lending being undertaken by seven of the 'top twelve' during 2008. Six organisations are represented in these groups in both years. The three organisations that completed the largest amounts of lending accounted for 38% of the value of loans in 2009. This is lower than the 44% recorded at the end of 2008 but greater than recorded in previous surveys when the 'top' three loan originators accounted for between 30% and 35% of annual lending.

Respondents' comments

Comments were invited of a general nature on how the continuing financial crisis had impacted on lending organisations' commercial property lending policies and activities. Comments were also invited on current issues facing the UK commercial property lending market.

These comments are presented below. It should be noted that these will relate to the market at the time when the questionnaire was being completed which was during the first four months of 2010.

Attitude to lending/lending policy

- We are largely engaged in legacy book management and are unlikely to re-enter the market before late 2010. If and when we do re-enter it will be strictly for capital markets type transactions.
- As of December 2007, the bank would not provide residential development or investment finance, the bank would not provide junior/mezzanine development finance and the bank would not provide 100% speculative development finance.
- We continue to reduce our loan book, however, there is now increasing eagerness to retain sound loans or restructured facilities with good economics, which provide income going forwards. The UK book should be to steady state by Q3 2010 and we expect limited further reserves being required over and above those taken in the 2010 planning. Stabilisation of the European book remains behind the curve and is unlikely before mid 2011.
- Generally, we are very conservative; the UK is still seen as a relatively high risk country.
- Still mainly working on our existing book and reducing overall exposure where possible. Limited appetite for new deals but should have some capital availability.
- Stakeholder pressure to reduce concentration risk in particular has and will continue to drive down our appetite for larger deals and large exposures and to be very cautious generally but especially in respect of speculative deals and unproven counterparties.
- Inability to syndicate debt has meant we are prepared to take no underwriting risk.
- Only do vanilla lending now with clients that we know.
- The only lending we are doing at the moment is to developers to complete development that we are financing.

IN THE REPORT FOR YEAR-END 2009, 16 PAGES OF COMMENTS WERE PRESENTED IN RELATION TO THE FOLLOWING ISSUES:

DISTRESSED LOANS

LOAN TERMS

LENDING MARKET

PROPERTY MARKET

ECONOMIC ISSUES

CURRENT ISSUES AND GENERAL COMMENTS

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Acreal Bank

ALLEN & OVERY



The Association of Property Bankers



Canada Life



FitchRatings



SAMPLE