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(formerly Cass)

The Commercial Real Estate Lending Survey

December market update

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The CRE Lending Survey

- December 2021 -

- Loan books, originations and lenders
- Underwriting – interest rates and margins, book LTV
- Future pricing and lending impacts
- Q&A

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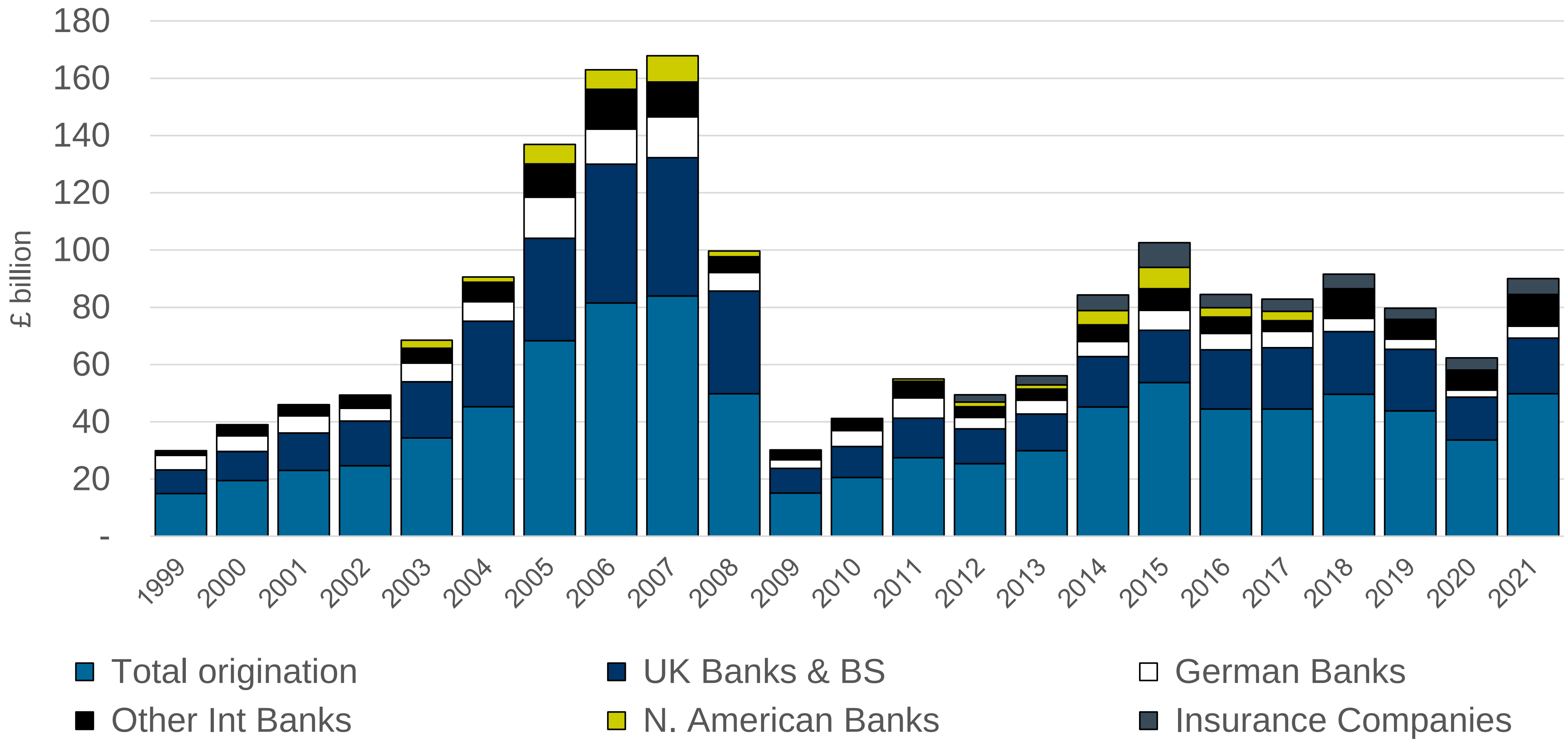
Origination and lender distribution



- After a 23% decline in originations between 2019 and 2020, there has been a 48% increase in 2021. UK Banks were responsible for 39% of origination, followed by International Banks with 22%.

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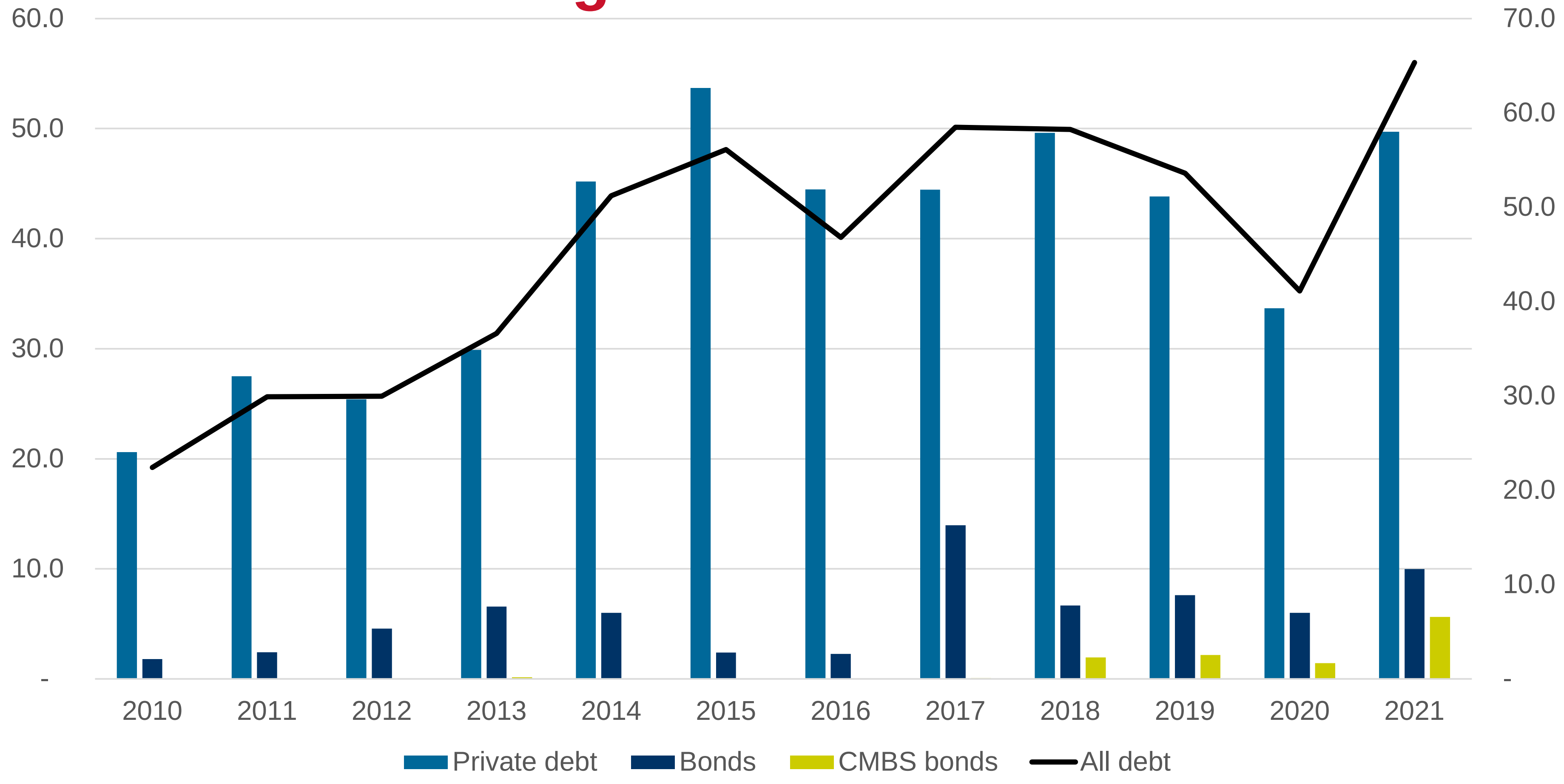
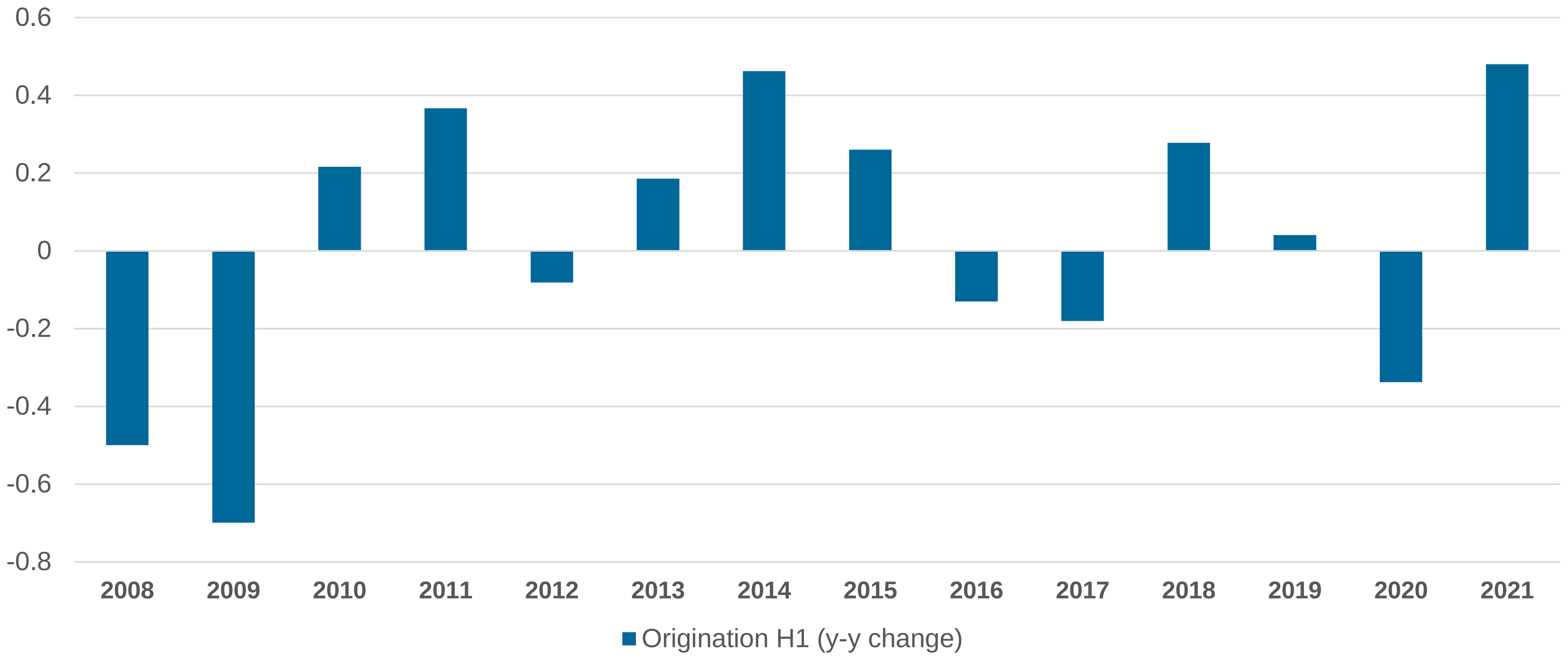
Loan origination CRE debt sources



- Bond origination has grown by 66% in 2021, close to £10bn
- total debt origination was £49.7bn for 2021, but also CMBS issuance was strong with £3.1bn

Loan origination % change y-o-y, 2021



- Loan origination increased by 48% during 2021, over the last 14 year period y-o-y origination was negative in only 6 periods.

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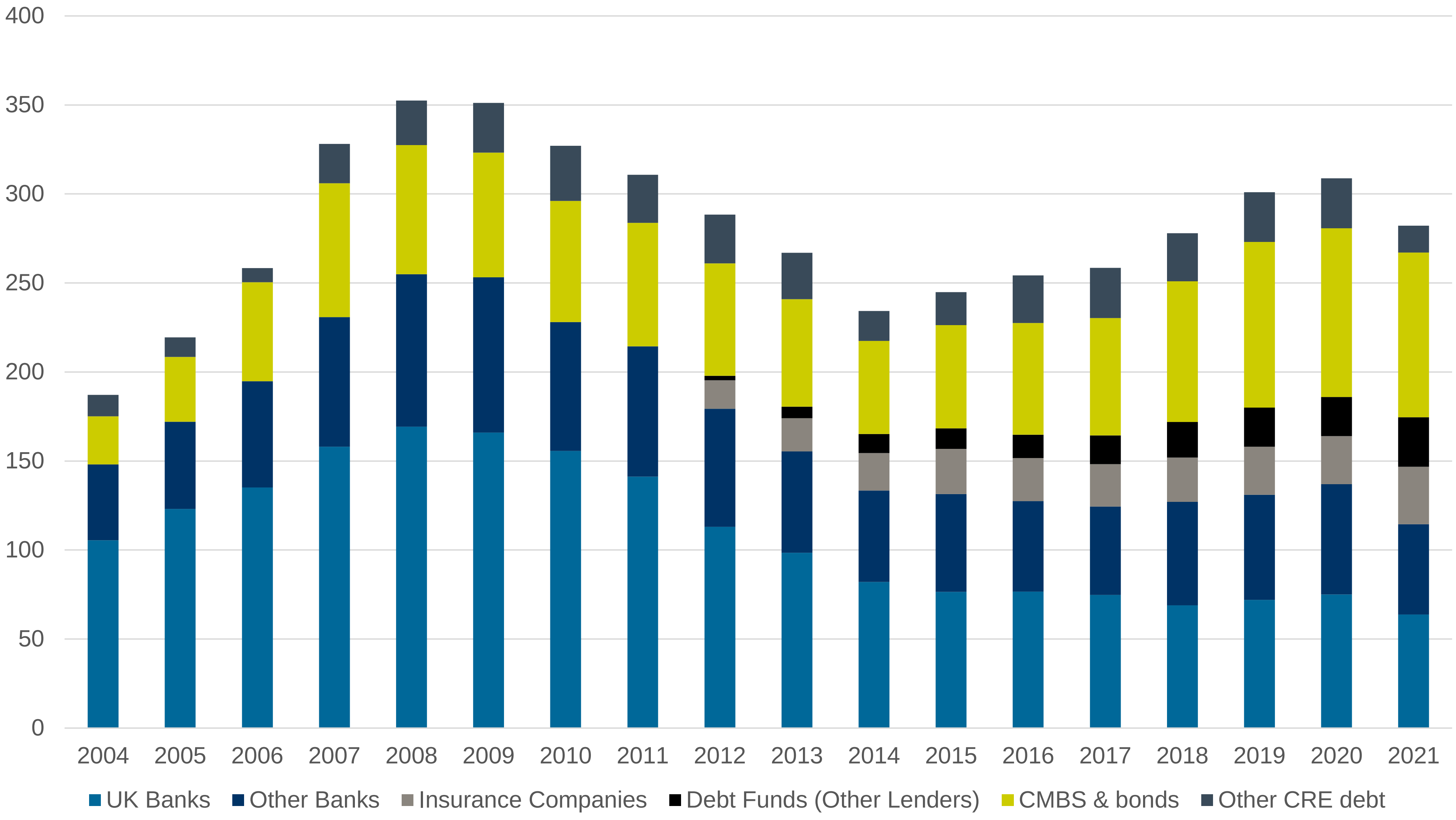
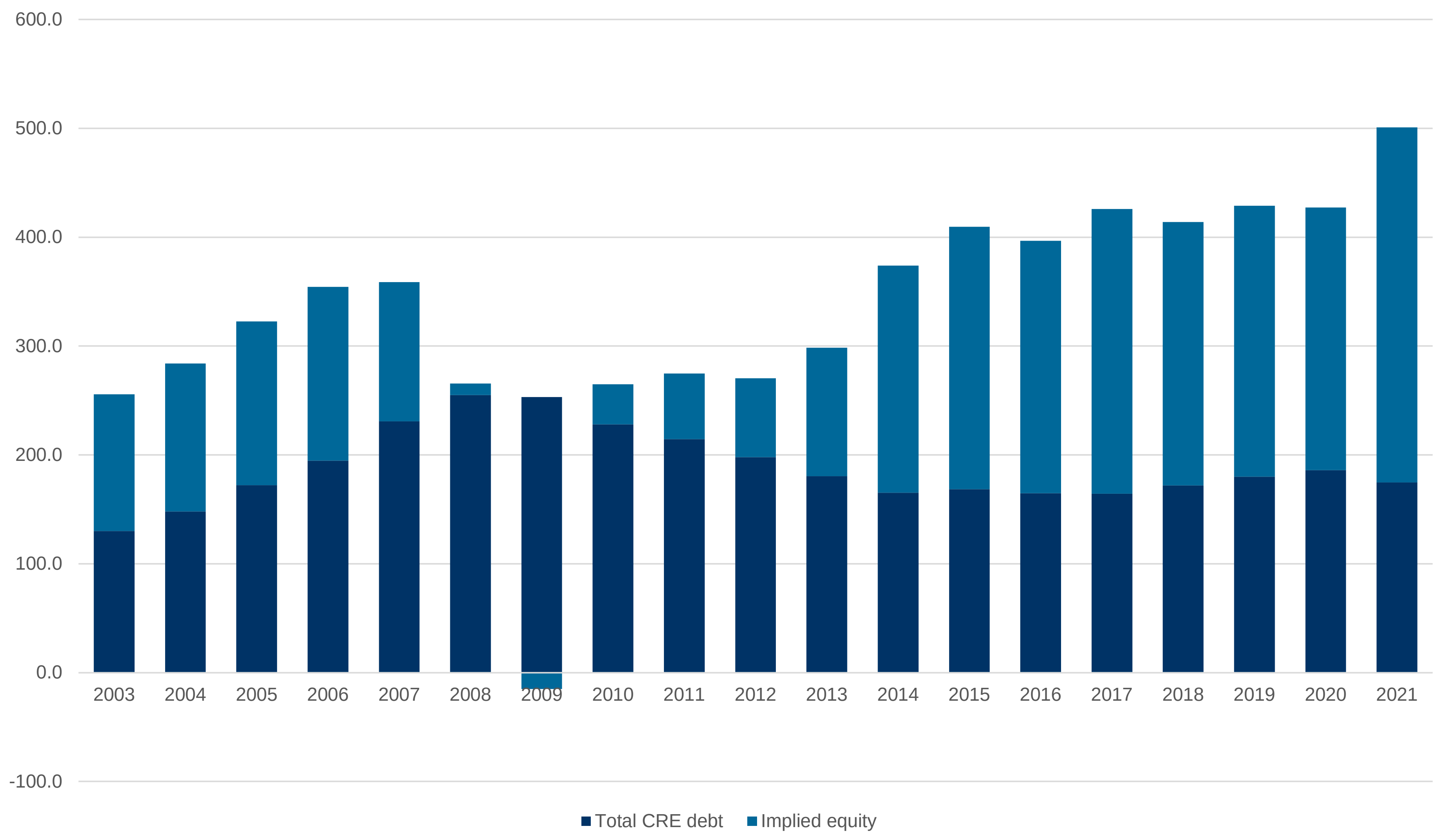
Long-term debt cycle - £ bn



Implied equity cycle - £ bn



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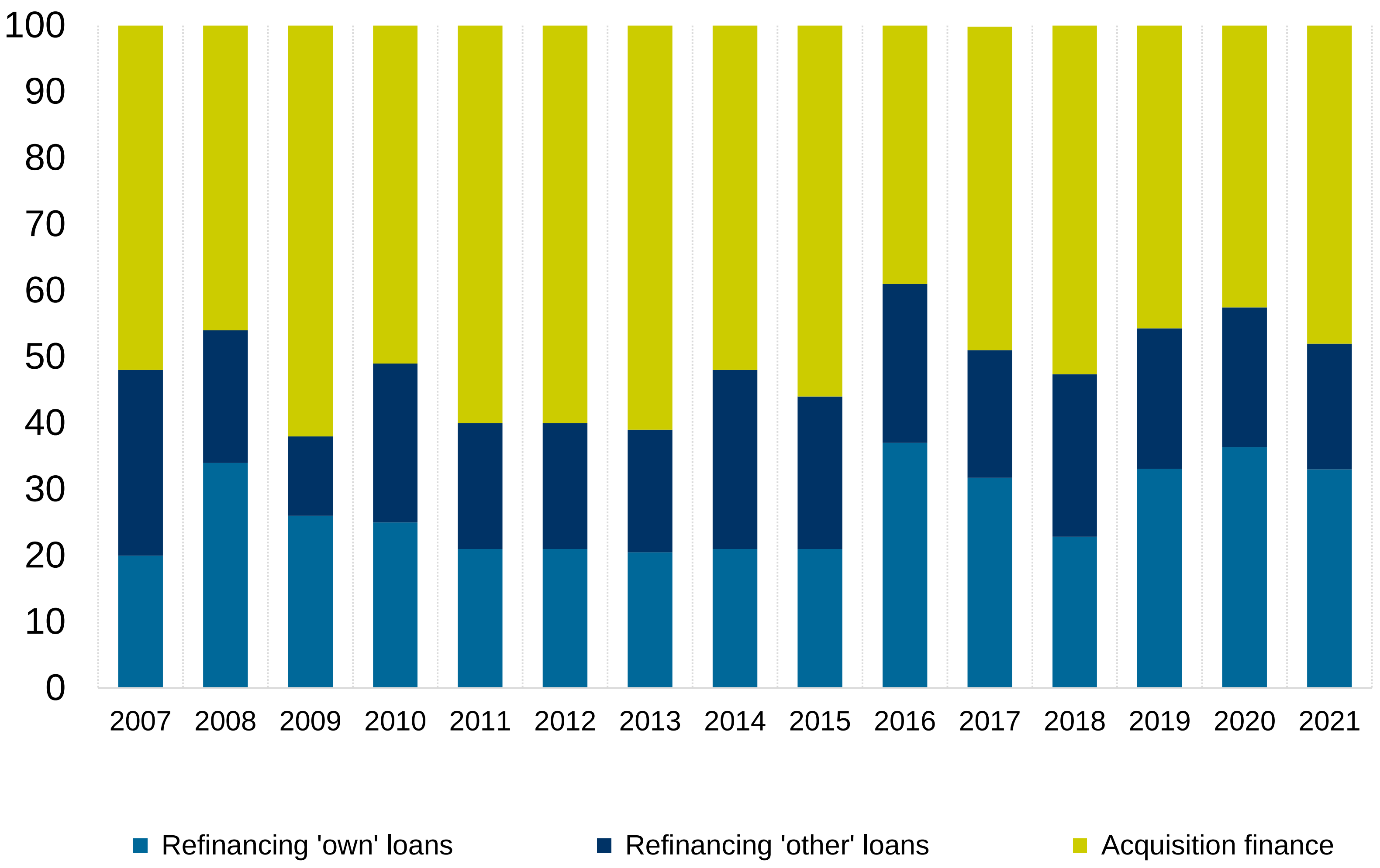
Loan purpose, new originations, 2021



- Acquisition financing was strong with 48% of total origination.
- As a lender group UK Banks take 60% of their new business from existing client refinancing. Other Lenders only 7%

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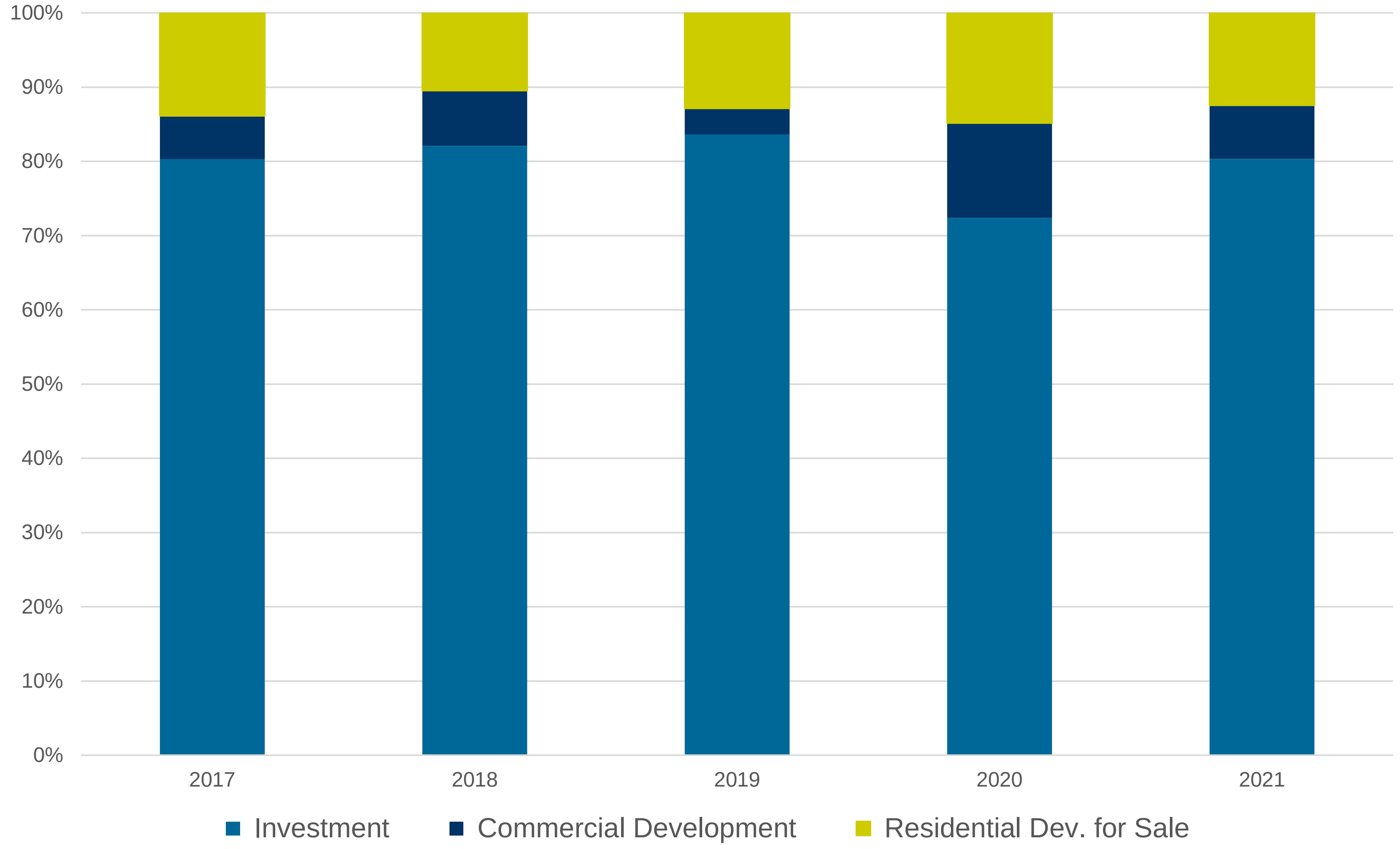
Loan origination of development finance, 2021



- In 2020 the market experienced an expansion of development finance especially focusing on residential development, but 2021 the pipeline is back to normal

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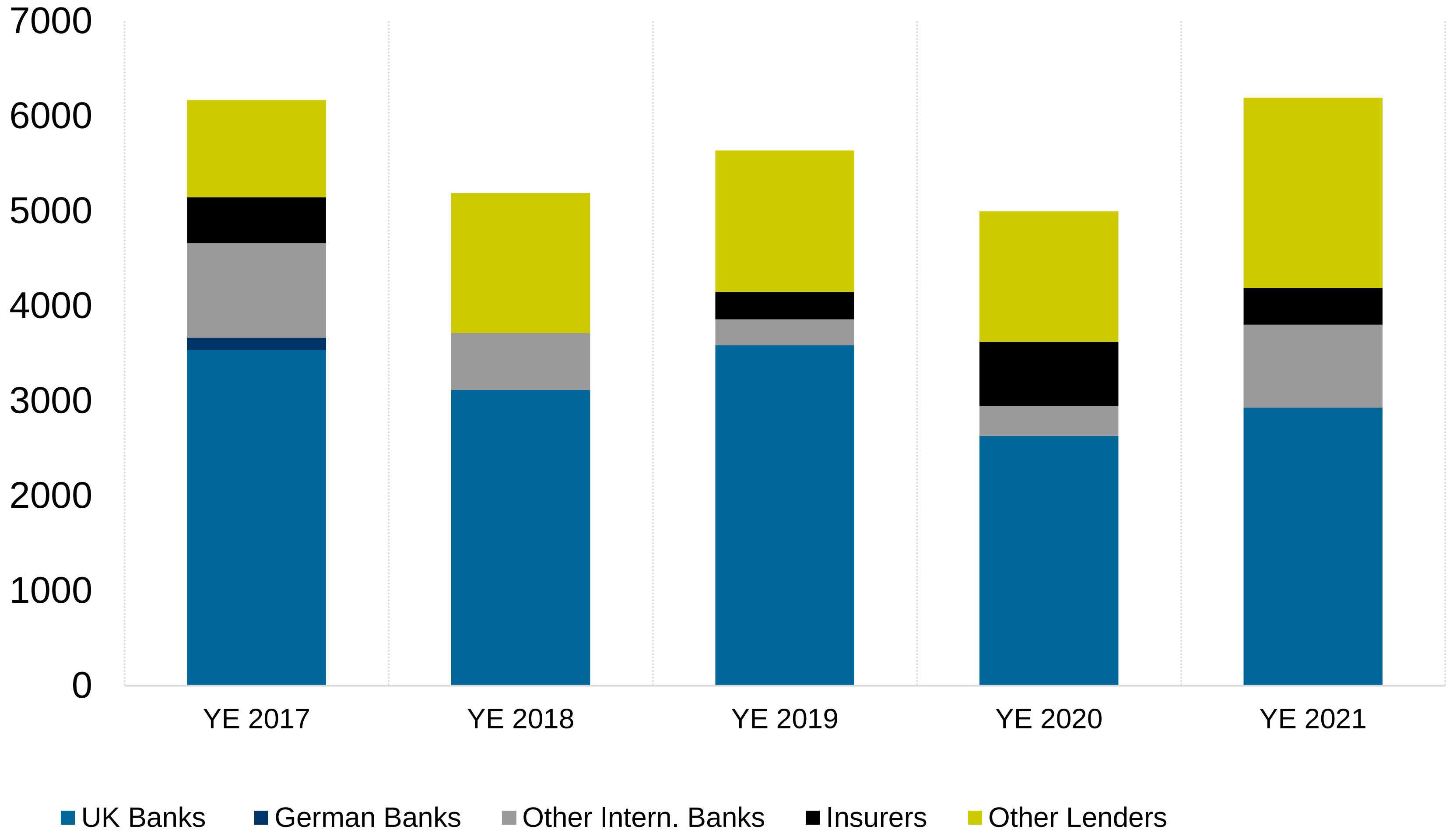
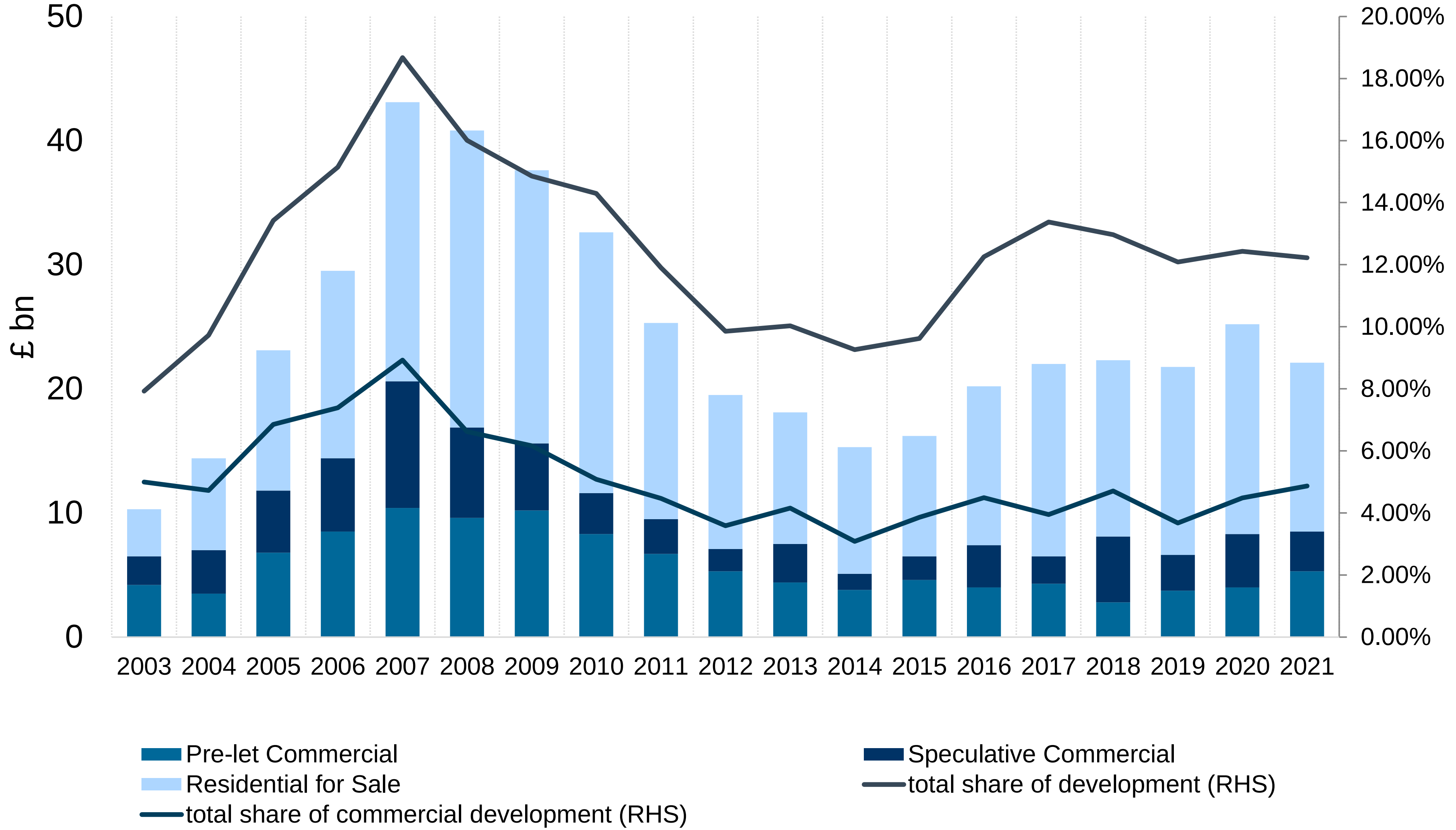
Residential development origination, 2021, £m

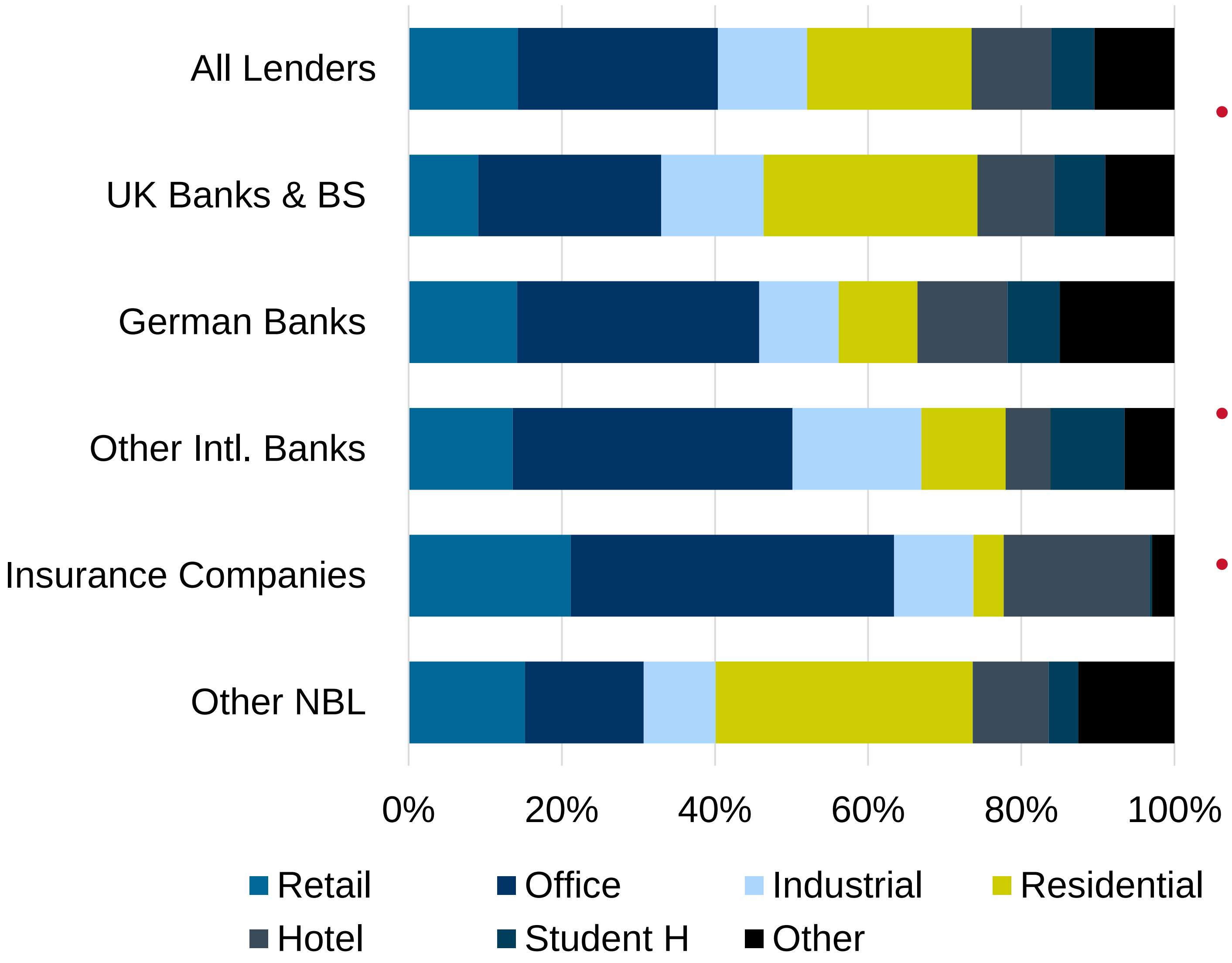


- Development finance accounted for 20% of new loans in 2021.

Development cycle of loan books, 2021, £bn



Property type distribution of loan book, % by lender 2021



- UK Banks concentrated their lending in 28% residential properties, whereas International Banks focused on the Office sector with 37%.
- Residential schemes often have sustainability angle.
- Difficulties financing hotel and retail assets.

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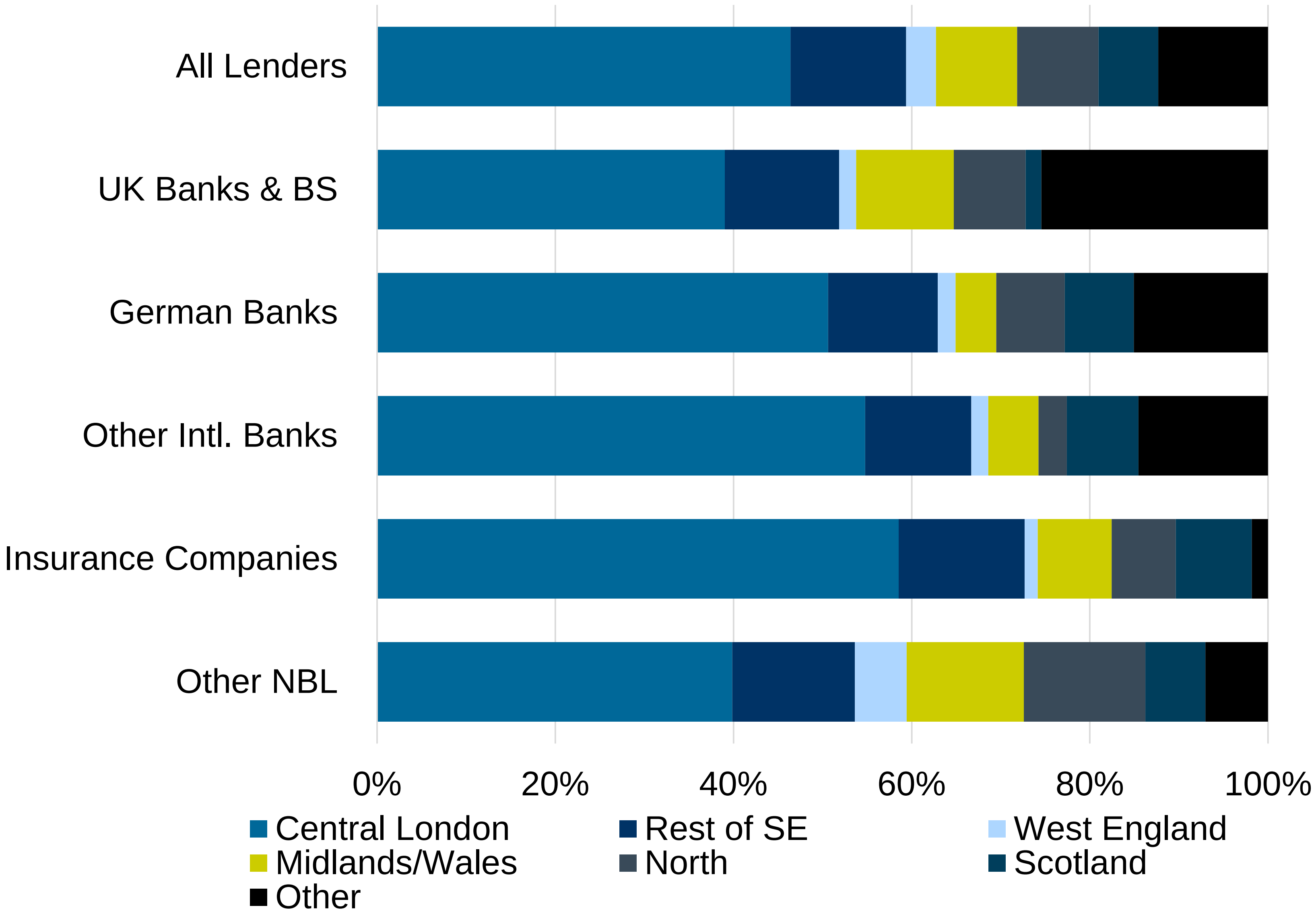
Geography of loans, % by lender 2021



- Central London loan book exposure is slightly down with 46%.
- UK Banks and Other Lenders show strong presence in the Midlands and other regions.

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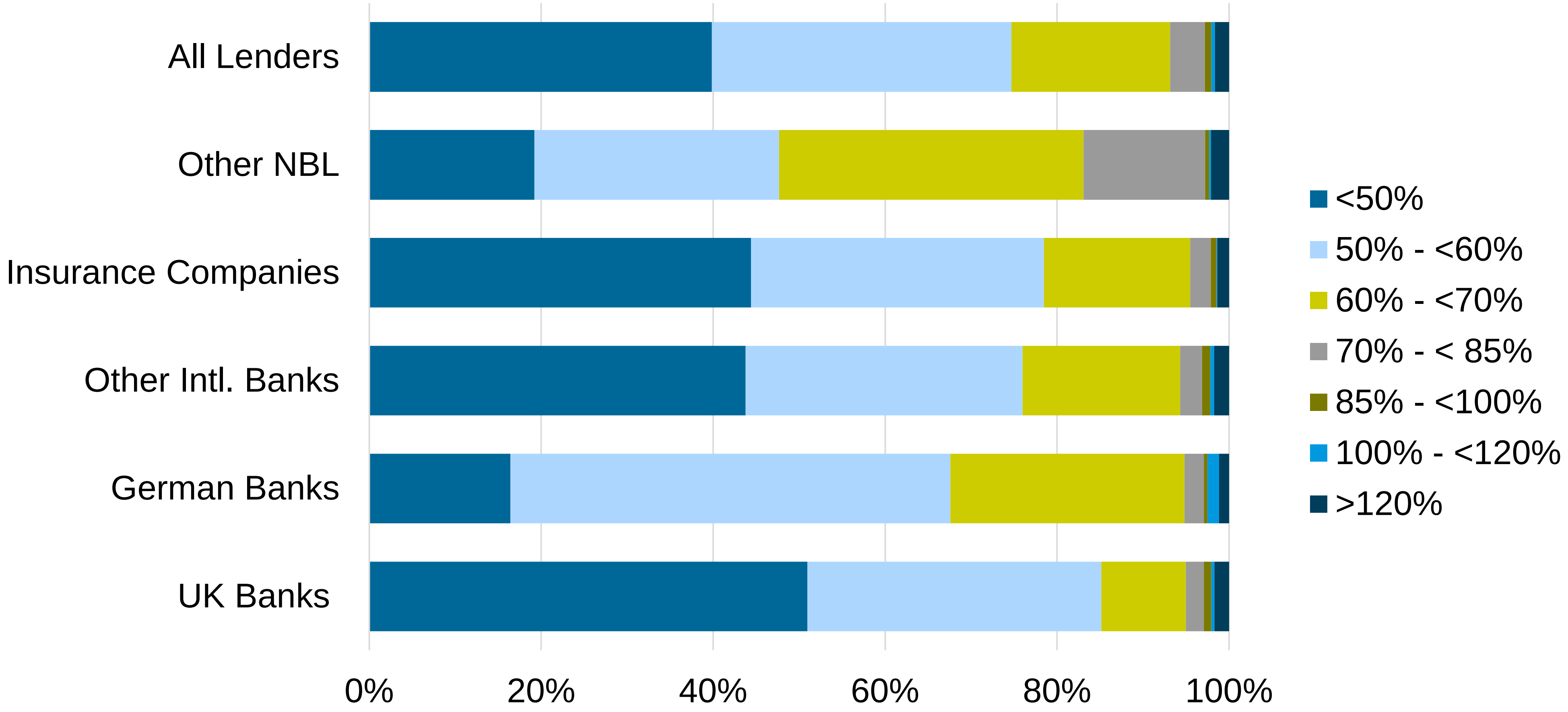
Loan-to-value of loan books, 2021, % by lender



• Other Lenders have 47% of their loan book below 60%. For all other lenders this share represents 70 – 85%. German Banks have been expanding their LTV range with 27% of loans between 60 – 70% LTV.

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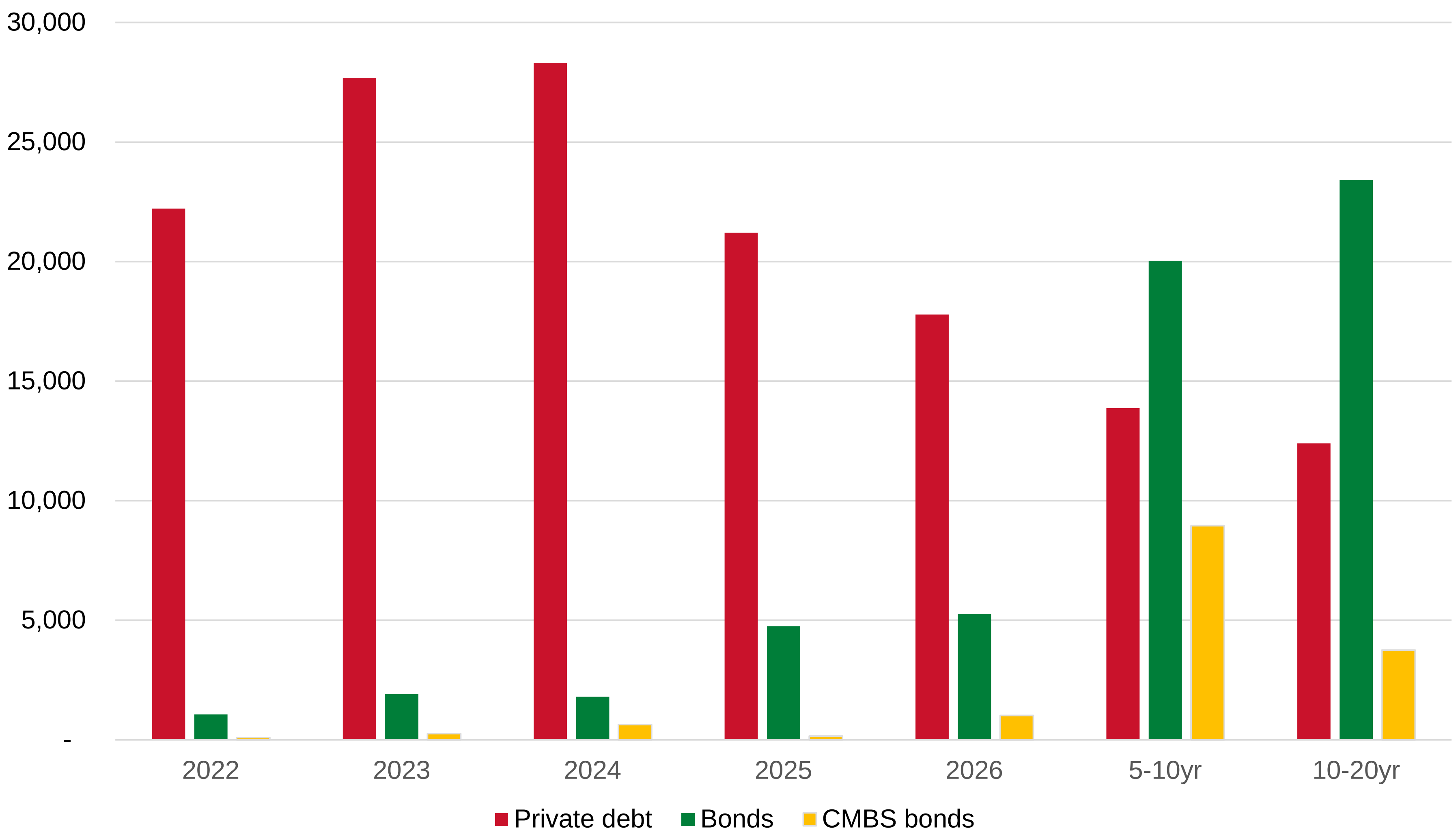
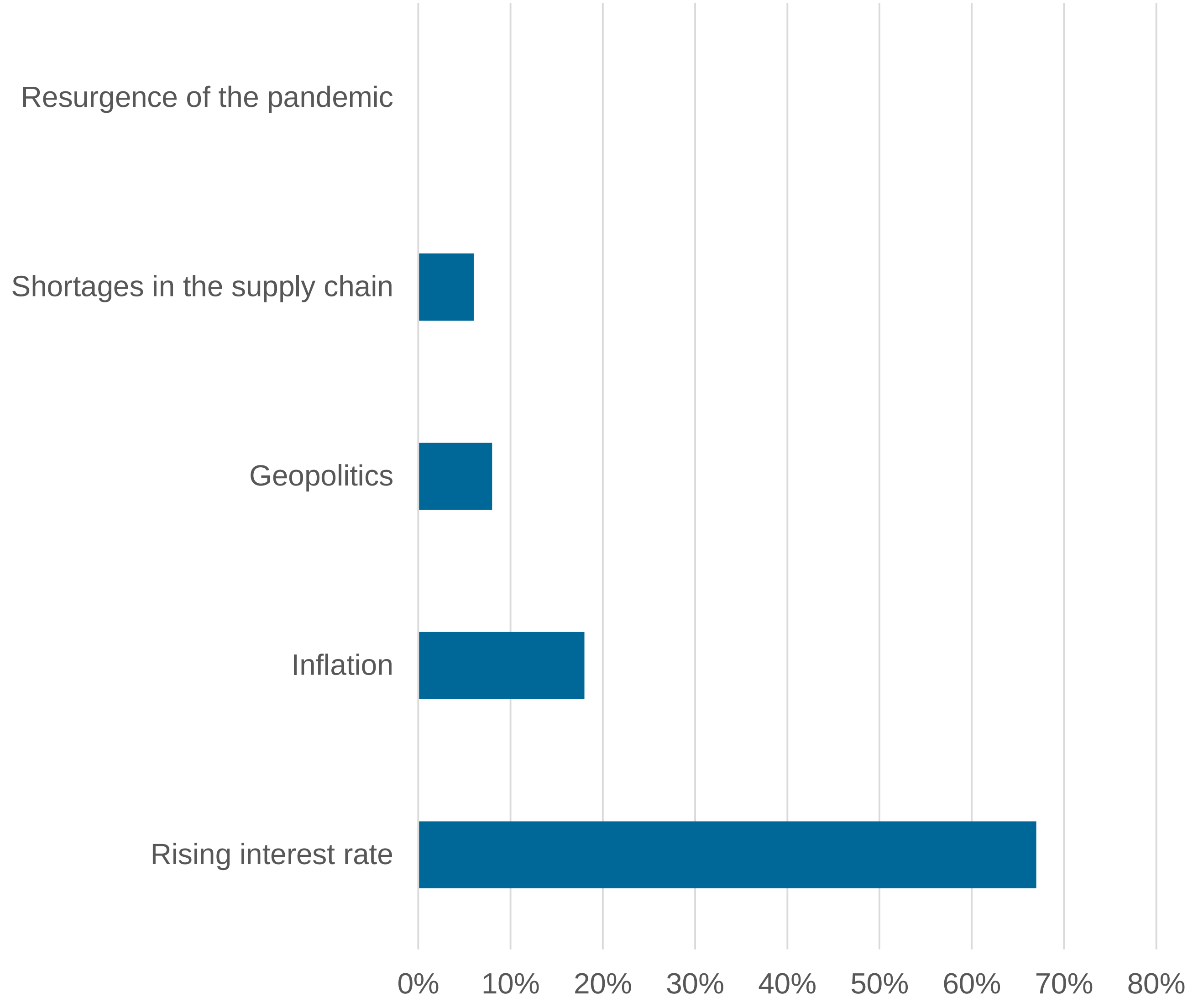
CRE debt maturities - £ m



What are the most important risk factor impacting the lending market over the next 12months



1. Geopolitics (Russia/Ukraine)
2. Resurgence of the pandemic
3. Inflation
4. Rising interest rates – economic recession
5. Shortages in the supply chain of materials and general economic goods

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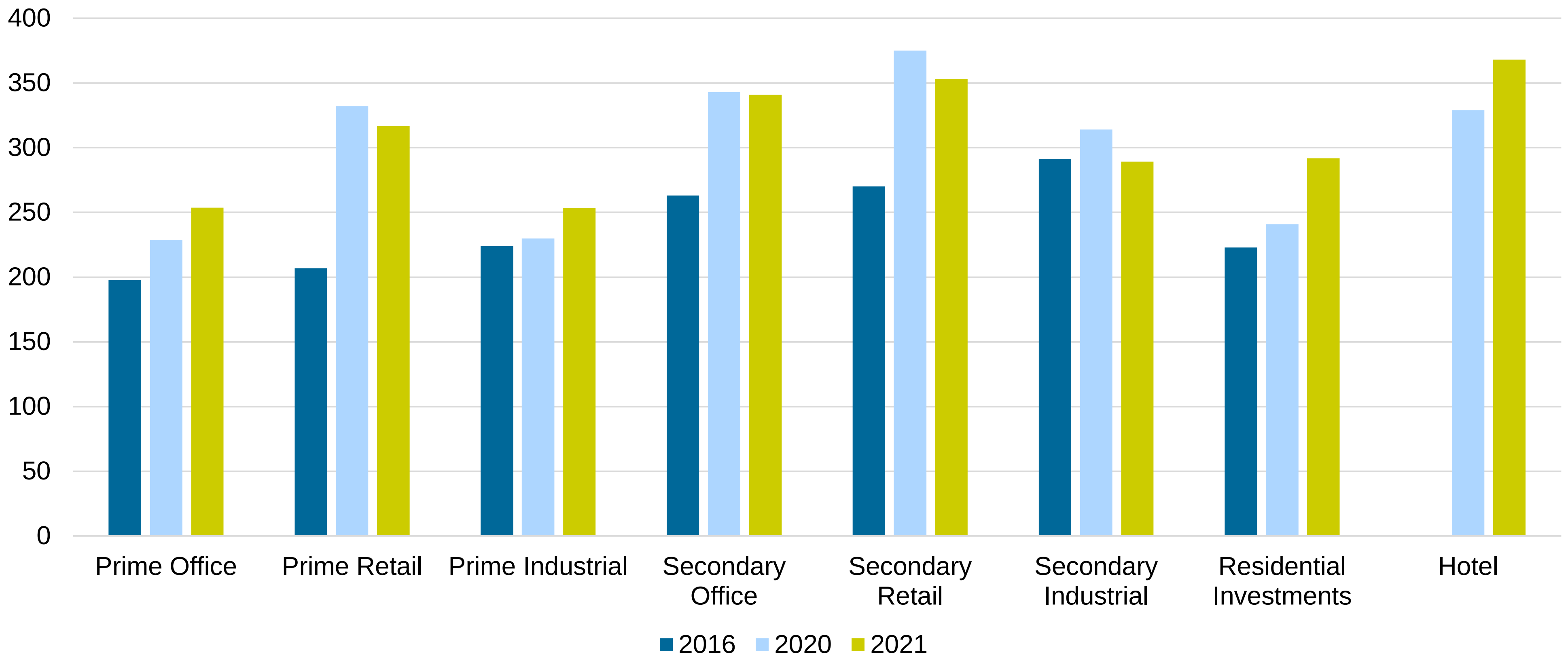
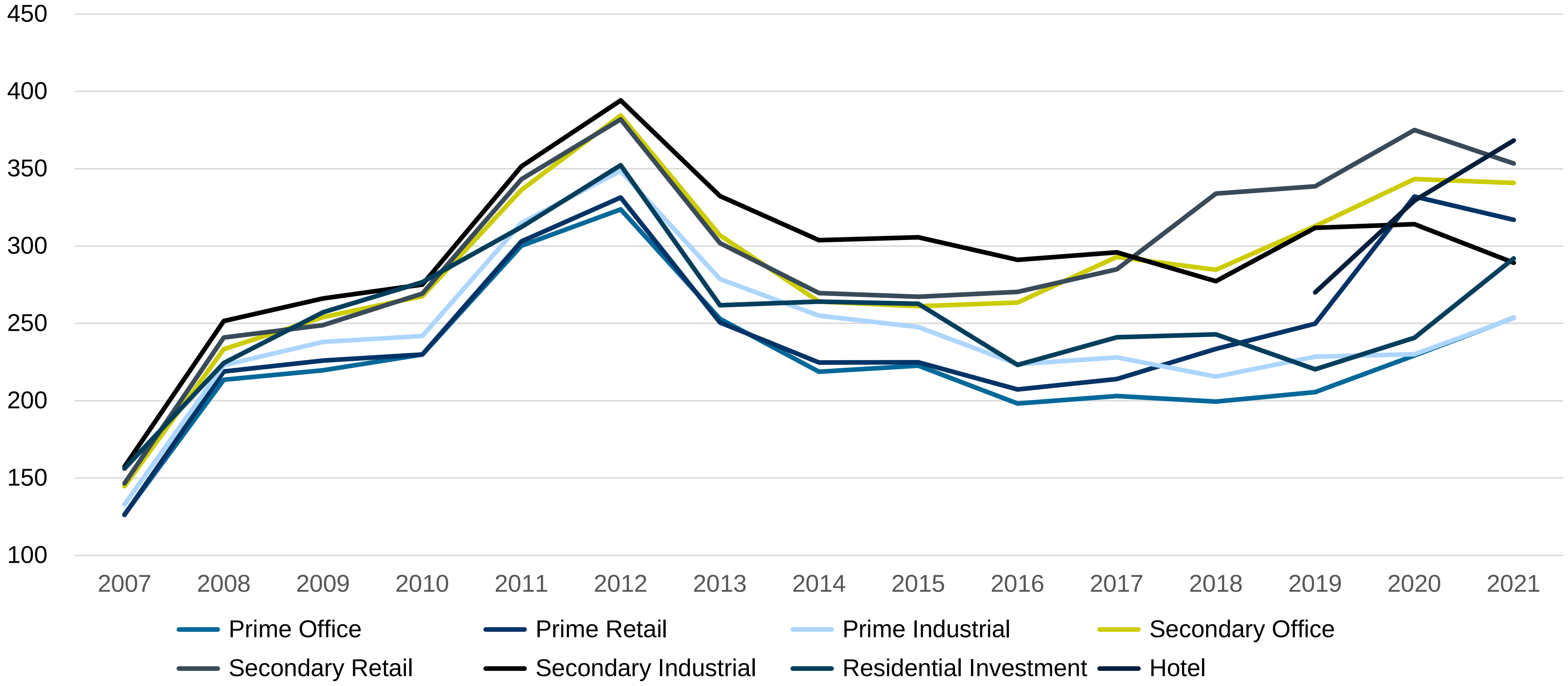
Underwriting – average target lending margins bps



- Lending margins across all major property types have increased since 2016.
- Lenders have further incorporated other fees and mechanisms into the loan structure, such as extension fees, cash reserve accounts, etc.

Historic lending margins - (bps)



- Since 2017/2018 onwards loan pricing by asset types has widened with a clear pricing gap between prime and secondary.
- From 2019 prime retail margins have been widening.

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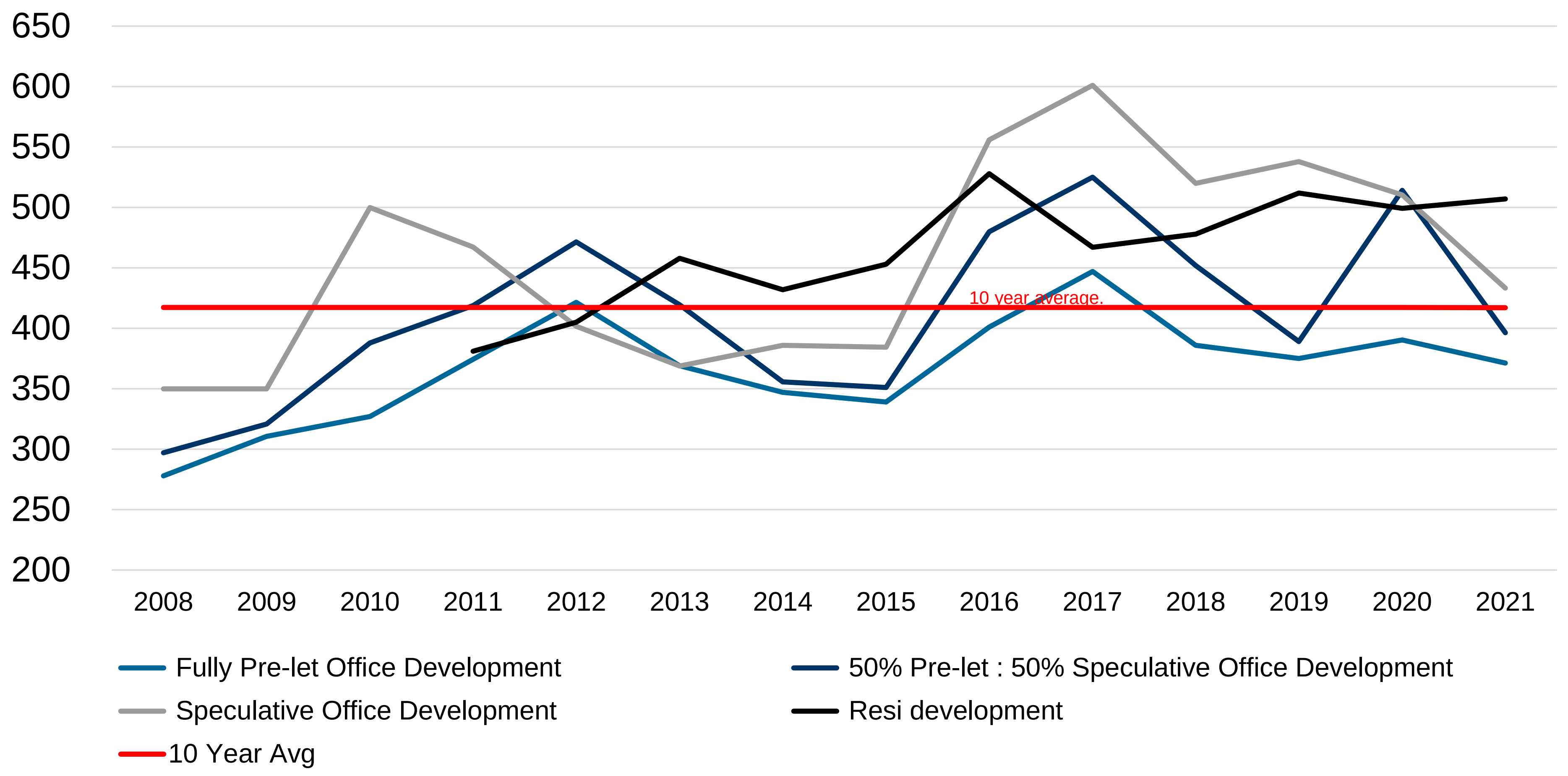
Underwriting – average target lending margins (bps)



- Despite strong demand, pricing for residential development remains high.
- The figures for 2021 show that the pricing converge back to the 10-year average.

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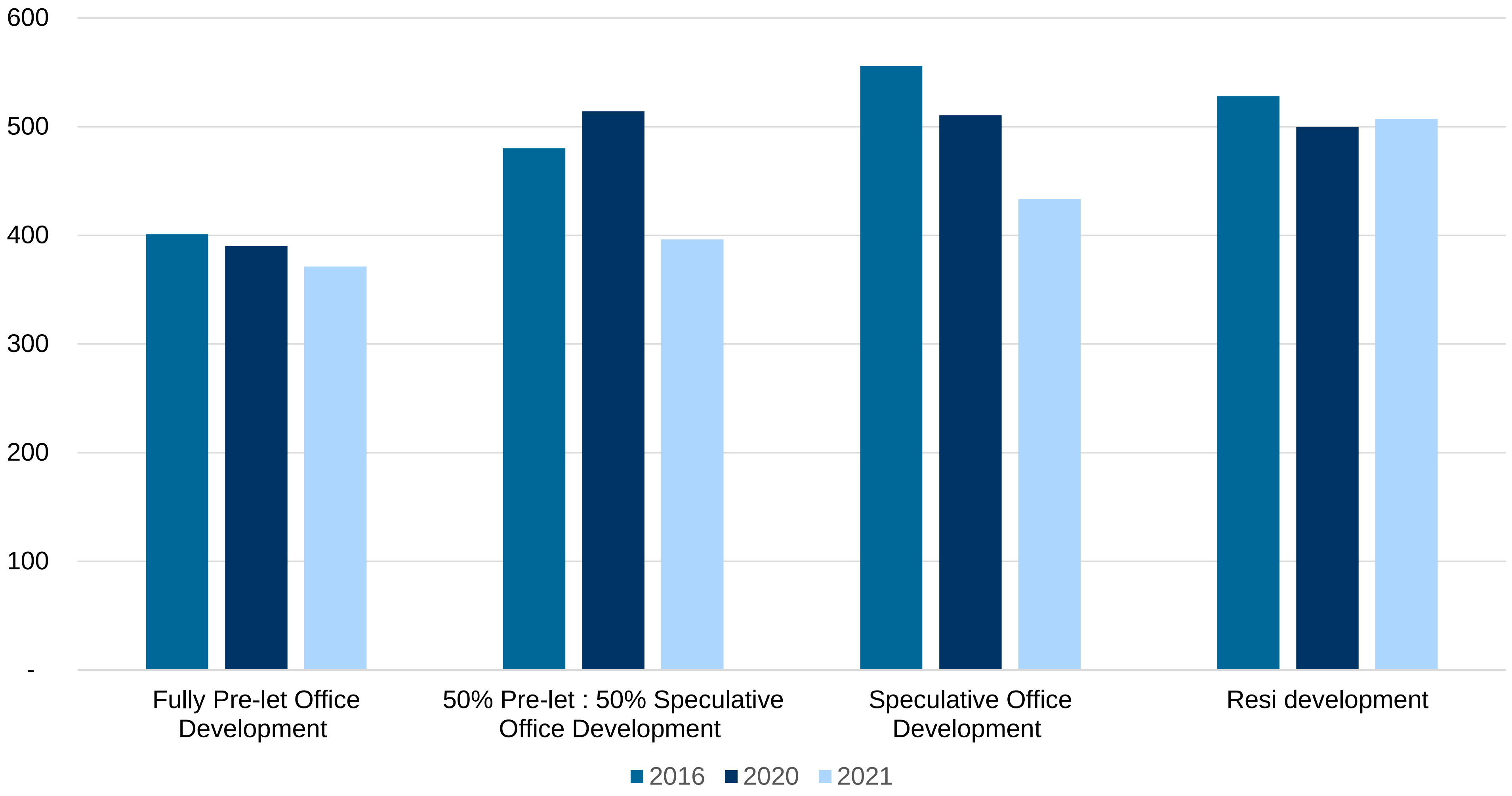
Underwriting –lending margin ranges bps



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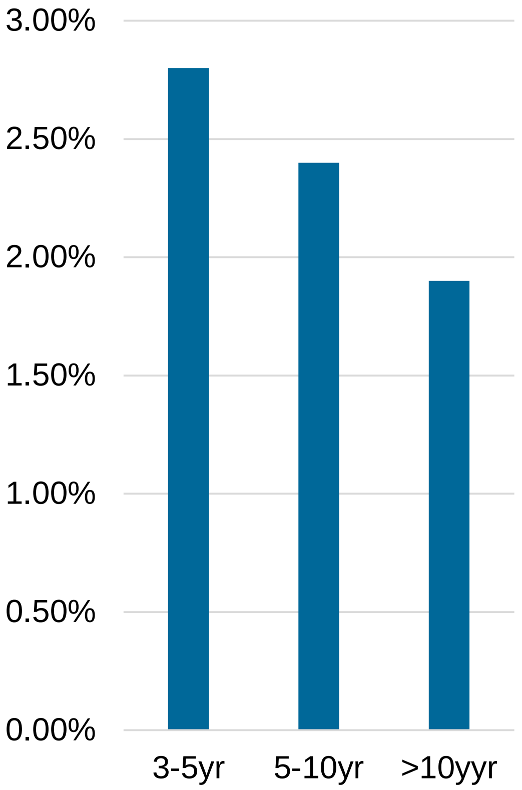
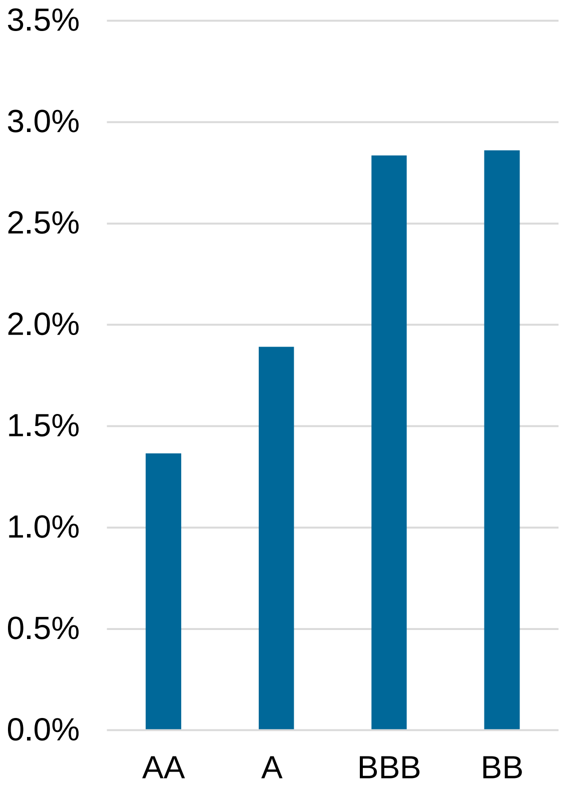
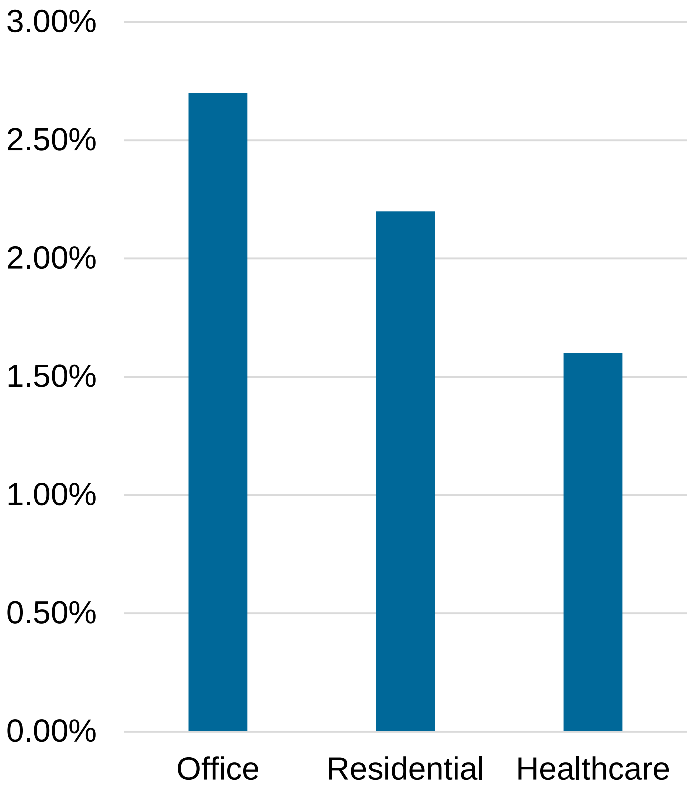
Underwriting – lending and borrowing rates REITs/REOCs

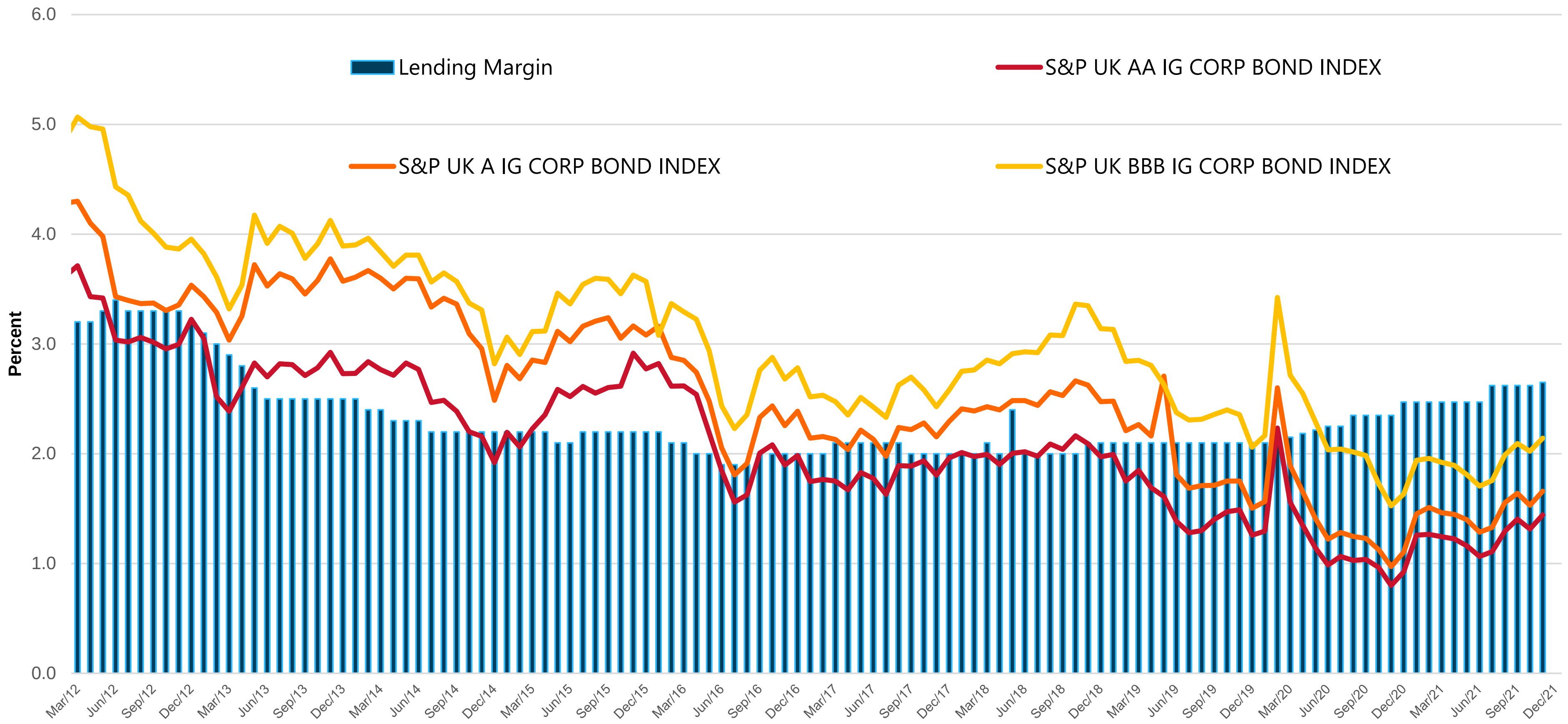






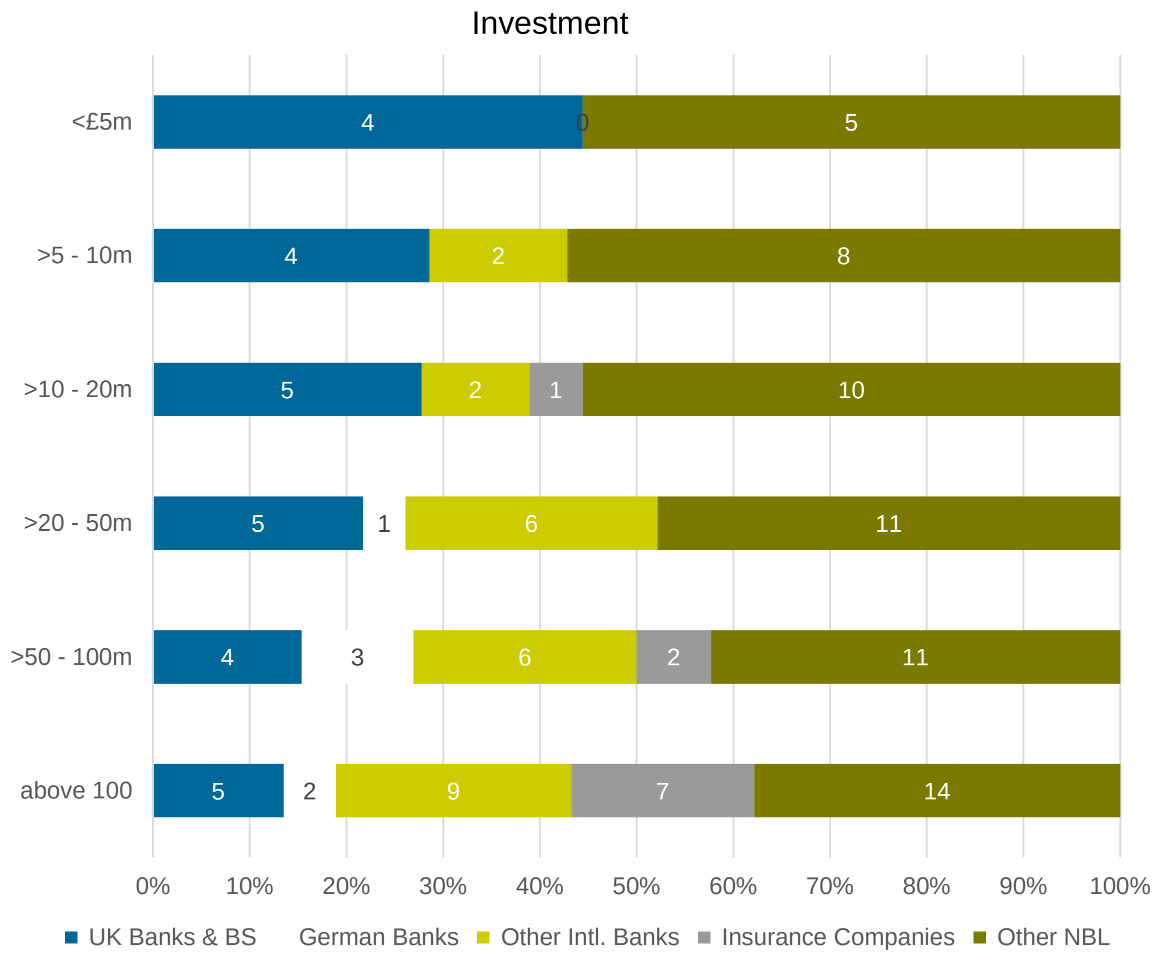
- Borrowing costs in the public bond market

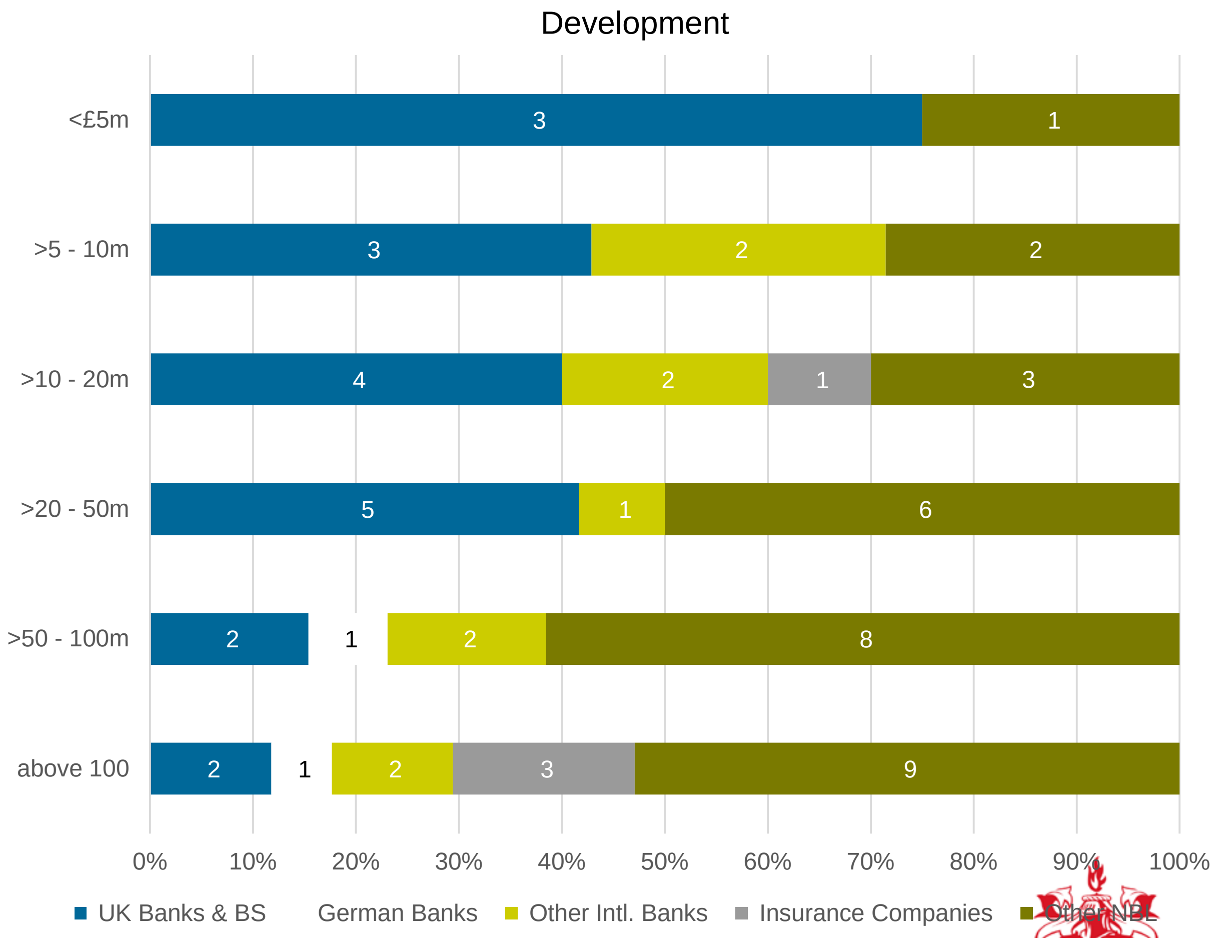
Lending margins vs bond yield indices %



- Compared with various bond yield indices, property risk has been priced above AA – A corporates since 2016, however below BBB corporates. Most bond REITS are priced A-BBB.

Preferred loan size





- Other Lenders (debt funds) have been focusing on increasing their average loan size and there is now a large number of Other Lenders, which finance loans over £100m

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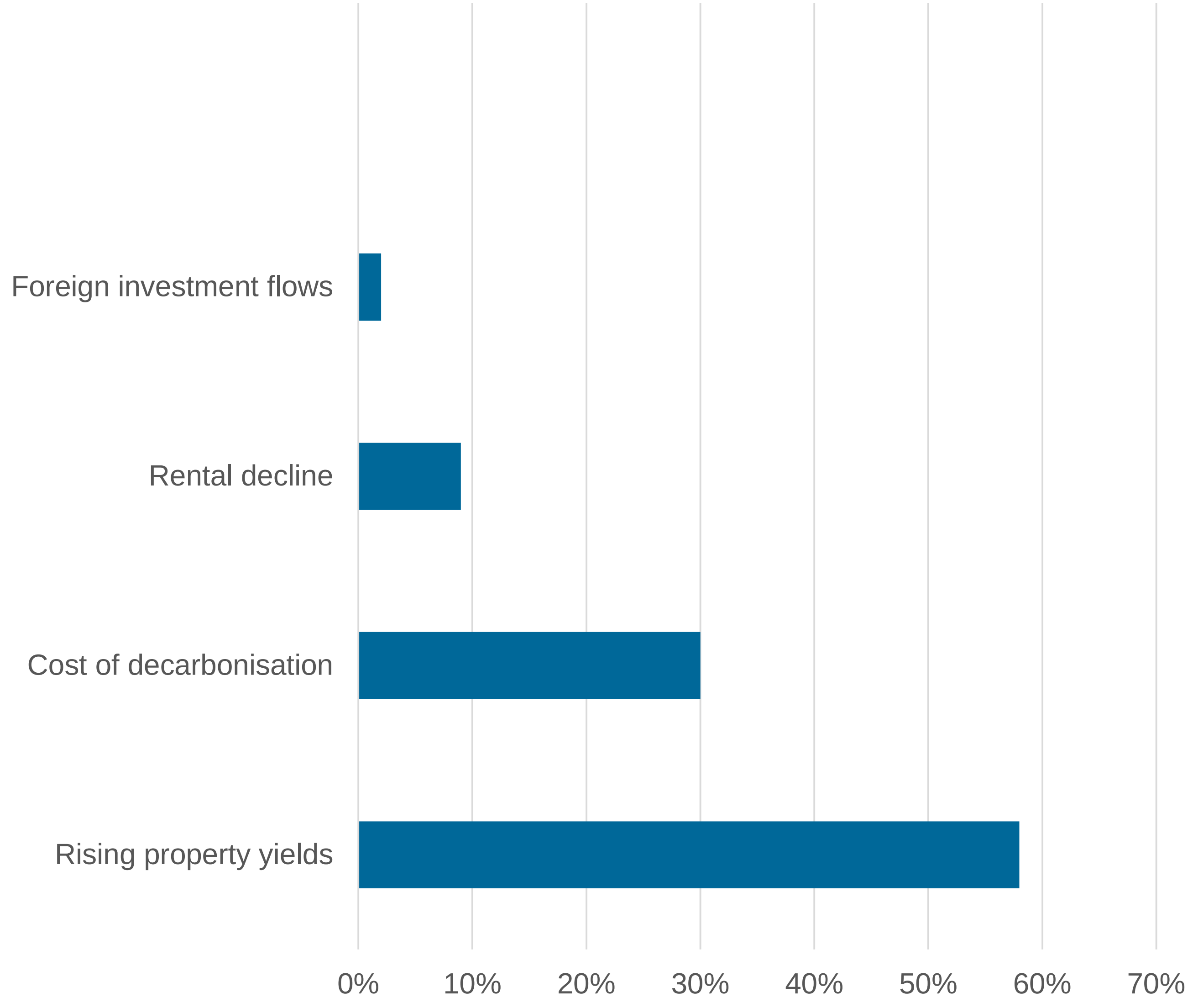
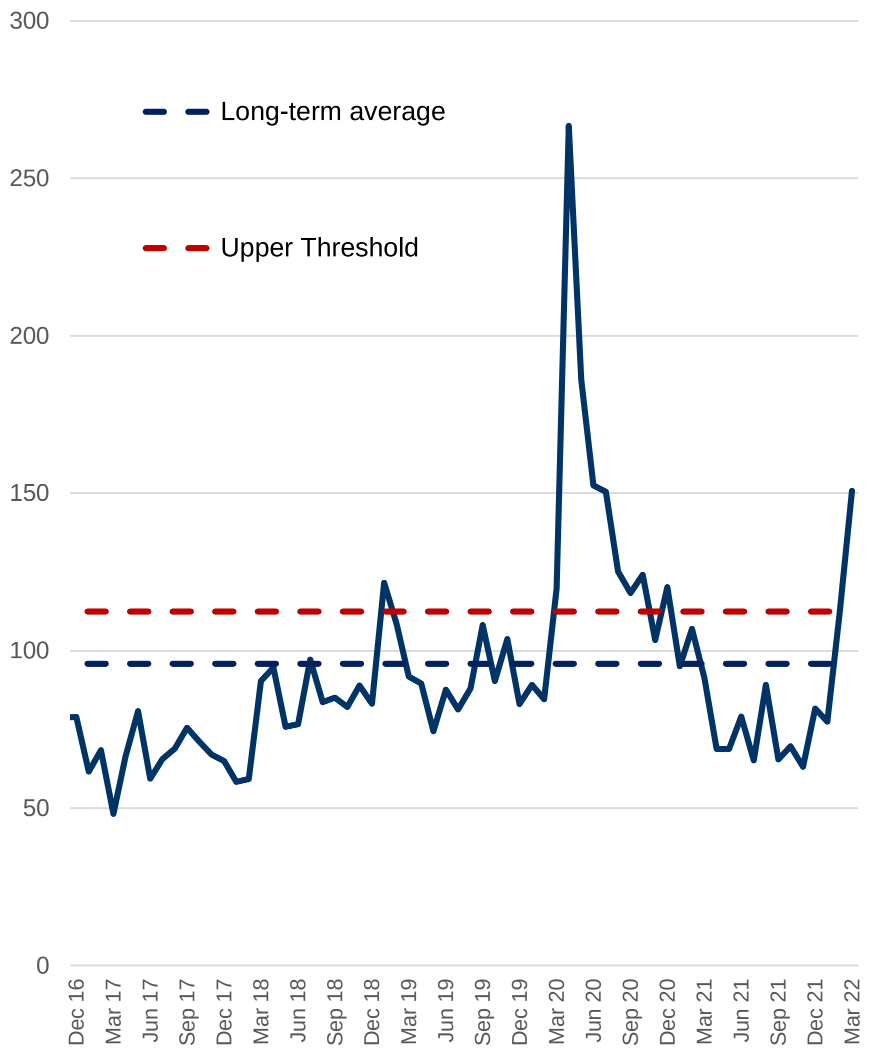
What will have the largest negative impact on real estate investment returns/profits over the next 12 – 24 months



1. Rising property yields
2. Cost of decarbonisation
3. Foreign investment flows
4. Decline in rental values

Systemic risk in the UK Real Estate sector



- The systemic risk index captures the exposure of the UK financial system to the Real Estate market, based on the Conditional Value-at-Risk method.

- **The second half of 2021, systemic risk had fallen sharply (-15.8%) due to the reduced COVID-19 related uncertainty.**

- In December 2021, the SARS-CoV-2 variant (Omicron) resulted in turmoil in the stock markets and increased risk by 30%. The pattern was similar to the 2020Q4-2021Q1 period when the Delta variant dented optimism over economic recovery. However the magnitude of the shock this time was weaker driven by the cautious optimism over the new variant.

- **The first three months of 2022, Real Estate systemic risk increased drastically due to the Russia - Ukraine war.** In March 2022, the index reached 151bps, the highest since the beginning of the pandemic.

More about systemic risk in our Monthly CRE Monitor.

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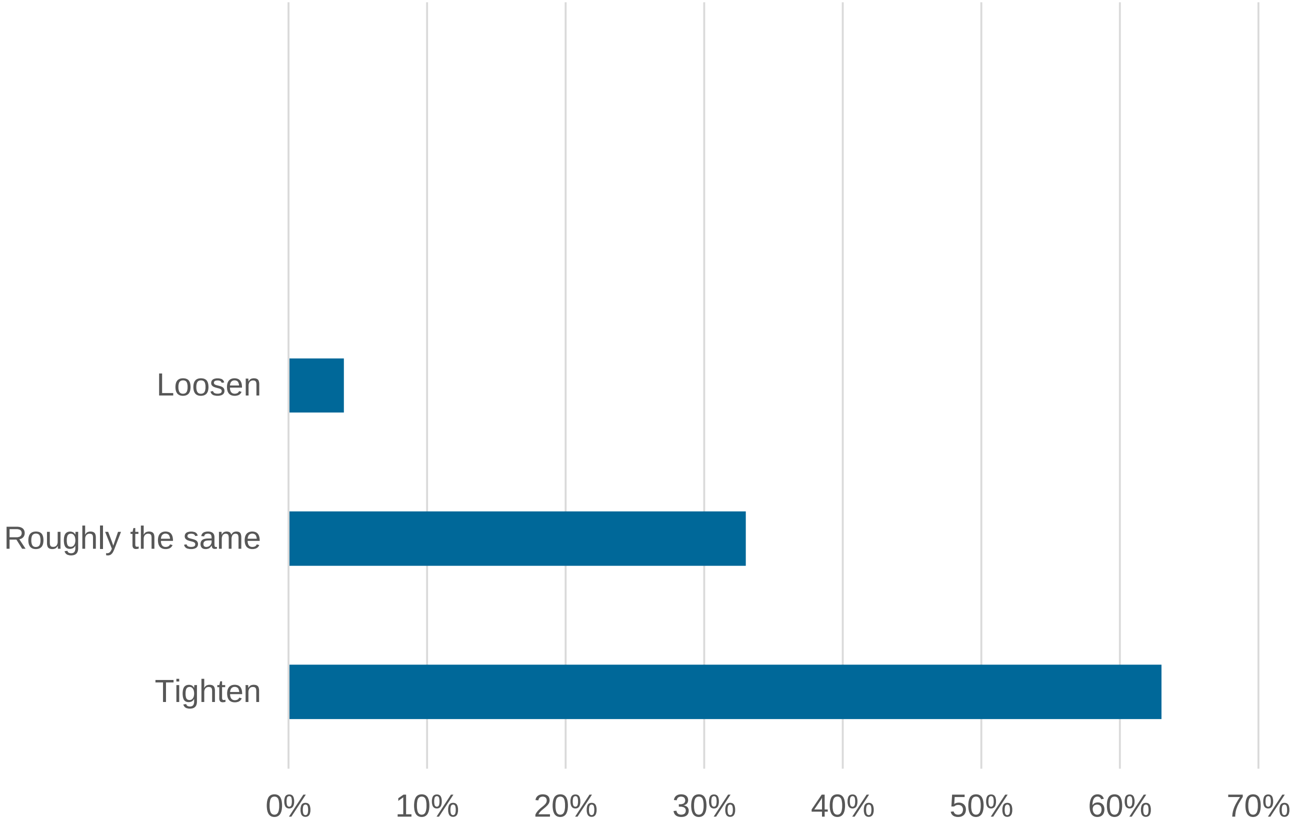
Over the next 12 months, do you think we are generally likely to see credit liquidity (availability and cost):



1. Tighten
2. Stay roughly the same
3. Loosen

Summary

- New loan origination recovered 2021, 48% increase from 2020
- Loan defaults have decreased significantly, realising some losses
- Margin for prime office and industrial increased as well as for hotel and residential. For other asset types, where pricing was already high margins have declined slightly.
- Lenders continue to be cautious about the asset they lend to, very few are willing to lend to retail property (except for food retail), and hotels.
- UK Banks concentrate strongly in residential development finance as well as financing existing PRS schemes, while the office sector is financed by international banks. There has been some new financing for speculative office development
- Other Lenders have increased their loan books by 17%, while UK Banks have decreased their loan books by 20%. Together with Insurance Companies the alternative lender segment had an origination share of 30%.

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Additional Information

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

  https://www.bayes.city.ac.uk/faculties-and-research/centres/real-estate/research

- More about Bayes Business School real estate research & consulting:
  - Ask for bespoke data extracts
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