Bayes Business School

Commercial Real Estate Lending Report

MY 2024

Bayes Business School Commercial Real Estate (CRE) Lending Report

Survey and analysis by Dr. Nicole Lux, Project Director. Report designed and written by Dr. Nicole Lux & Dr. Alexandros Skouralis

The authors thank all sponsors for the making this research possible.

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The authors are grateful for the on-going financial support for this work provided by the firms listed on this page. The analysis relies on the commitment of time and effort in providing information from the staff of 81 lenders, listed in Appendix 4.

The CRE Lending Survey was commenced in 1999 by Bill Maxted and Trudy Porter of De Montfort University, who continued the work until 2015. We are indebted to the original authors for the historic data, analysis and insights underpinning the current results.

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Summary

This summary provides the headline results from the mid-year 2024 update of the Bayes CRE Lending Survey. It summarises the main points derived from the detailed breakdowns and time series analyses available in the main report. The survey sample consists of 71 lending organisations responded, comprising 39 banks and building societies, 11 insurers and 31 Debt Funds.

- **Loans outstanding:** The total outstanding loans stood at £162 billion, a 5% decline over the six month in H1 2024 as lenders were struggling to replace repaying loans with new ones. Since Brexit and the pandemic the UK CRE lending market has changed its key profile. International Banks have been reducing their overall share 33% to 21%, the share of UK Banks has reduced to 37% from 40%. The winners of this process have been Debt Funds, which have increased their total loan book from 12% to 23%. In total alternative lenders including Insurance Companies are now holding 43% of outstanding CRE loans.

- **Loan Origination:** The first half of 2024 was another difficult year for lenders originating new loans. Between MY 2024 (£16.8bn) and MY 2023 (£ 18.6bn) new lending was down by another 9.8%. This comes after a decline of 22% from MY 2022. However, this is the result of low real estate transaction activity, not the lack of willingness to finance from lenders' side. Lenders tried to find sufficient financing flow, and 45% of new lending was generated from property acquisitions, and 35% from internal refinancing. Although total loan book share has declined slightly, UK Banks are the strongest lender group writing 49% of new loans during H1 2024. They are followed by Debt Funds with a new loan share of 20%.

- **Development Finance:** The development funding pipeline has rebounded since 2020 and continues to grow, with 22% of new loans originating from financing development projects. At June 2024 the development pipeline stood at £28.7bn, up 15% y-o-y, together with the amount of undrawn loan facilities, which accounted for another £25.5bn. Commercial development projects, including office, logistics and also hotel and student housing are accounting for £11.8bn another £16.8bn was reported for residential development. In total development loan facilities including undrawn facilities amounting to 28% of total lenders' loan book, providing a high amount of dry powder to the market of SME developers. This is not yet including any large corporate lending facilities to national housebuilders, or social housing.

- **Loan Portfolio Quality:** All categories of lenders are reporting instances of loan defaults and breaches, leading to a slightly elevated average loan default rate of 4.9%. Banks, on average, exhibit default rates ranging from 2% to 4%, while debt funds have seen their rates climb to 14%, albeit having slightly different reporting guidelines. Smaller institutions tend to report a higher average default rate of 10% compared to larger entities, which have a notably lower rate of 2-4%. Loan book side matters when scaling up the lending business, which allows lenders to gain access to higher credit quality assets and borrowers. Banks books mostly contain loans below 60% (79% of total book), Debt Funds hold 50% of loans with up to 60% and another 32% of lending is from loans between 60 – 70% LTV.

- **Lending Terms:** Senior lenders have been competing for a small amount of new acquisition transactions during H1 2024. This has led to a sharp decline in senior loan margins, expansion of LTV terms and low ICR covenants to minimise the risk of loan breaches due to tight covenant

levels. Some capital is available for LTVs in the 70% - 75% range (whole loans), often offered by Debt Funds, but as these are backed by private equity, they require minimum returns of 9-11%. There are many lenders, who will offer interest only rate loans for loans up to 55% LTV. Presently, 59% of UK Banks loans are floating rate loans, however, these are mostly linked to development loan facilities. International Banks typically offer hedging with their loan facilities, which account for 60% of their lending. On the other hand, 55% of loans from Debt Funds are fixed rate loans. This is because, a hedging facilities would need to involve an external derivative party adding extra loan costs, which borrower would have to pay.

- **Sector Appetite:** There continues to be strong interest in financing prime office and industrial properties, with more than seven out of ten lenders expressing willingness to provide financing for these assets. Another 63% are financing prime residential investment assets and 66% are financing student housing. When it comes to more secondary assets, lenders' interest falls quickly to 15- 20% of lenders offering financing. Only secondary logistics and residential assets are acceptable by 49% and 41% of lenders respectively. The two key assets lenders provide development finance for are residential and student housing, 49% and 46%. Still, one is three lenders provide commercial development finance for office and logistics assets.

- **Investment Borrowing Costs:** Intense competition for lending to prime assets have led to overall loan margins against office financing drop to 259bps (from 275pbs) in just six months to June 2024. Logistics financing, which was already below office financing, dropped by another 11bps to 256bps. Student housing investment financing is available at an average of 275bps. These margins are comparable across asset classes for an average of 55% LTV. Loan margin compression for secondary office financing was 43bps reaching 336bps.

- **Margin Trends by Lender Type:** In the first half of 2024 (H1 2024), UK Banks have adjusted their Prime Office lending margins by 15bps to 294bps, and are at a similar level as Debt Funds with 292bps for 55% LTV. International Banks can be slightly more competitive with 214bps. However, for prime asset types, Debt Funds are charging higher margins than UK Banks or other International Banks.

- **Development Borrowing Costs:** Obtaining development finance has been difficult for many borrowers in 2023. In 2024, the development pipeline has restarted for office developments with new ground-up projects and lenders are showing more interest. Development financing margins have significantly compressed, by 44bps to 414bps for pre-let commercial development assets, and by 68bps for residential development. Also speculative financing has reduced slightly by 4bps to 477bps. For prime commercial and residential development assets average LTC available is 62%, but one quarter of lenders offer LTCs of 70%. It is normal for debt funds as well as banks for charge arrangement and exit fees as well as reservation fees for undrawn commitments.

Sponsor quotes

Peter Cosmetatos, Chief Executive of CREFC Europe, said:

"This latest report from Dr Lux confirms both the market's continuing preference for beds and sheds, and the poor state of the underlying investment market during the first half of 2024. There are nevertheless positives to take from a lending market that is clearly both competitive and selective, with a good part of what is often termed the 'debt funding gap' clearly and rightly having been funded by equity. Meanwhile, the diminished role of international banks in the UK market is striking evidence of the challenges many overseas firms see in their home jurisdictions. It is to be hoped that we will see signs of recovery in the second half of 2024."

Chris Gow, Head of Debt and Structured Finance, CBRE Capital Advisors Ltd

"Total loan market volumes are down year on year due to a lack of new Acquisitions in the market but at CBRE we are starting to see Acquisition volumes gradually recover from cyclical lows. In H124, CBRE Debt & Structured Finance placed more than 2.5x the loan volume we advised on H123, suggesting a growing chunk of the UK Loan Market is moving towards Debt Advisors or Brokers to get refinancings and other loans closed. We believe this is part of a long-term trend and further growth is anticipated."

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

The last couple of years has seen a pretty challenging environment for Commercial Real Estate Lending, as interest rates rose, values declined along with reduced transactional activity . However H1 24 saw some green shoots and value stability (across most asset classes) and the report shows that whilst some lenders are still taking stock of their portfolios, the UK Banks came back strongly with new originations. With this added competition, chasing fewer deals, it has driven margins down and LTV's up – good news for Borrowers and hopefully lenders won't start chasing deals and compromising underwriting discipline. There hasn't been as much stress or distress as some commentators were predicting, which suggests that lenders and Borrowers are working together, however the polarisation of secondary properties seems to continue – those lenders with legacy portfolios, may find themselves with continued headwinds.

Ben Thomason, Director & Head of Debt Advisory, Colliers International

H1 was a strong half for the non-bank lenders who were able to step in to refinance many of the loans the UK and International Banks were either unable to renew or simply write. We expect to see some rebalancing of this in H2 as the forward curve softens and stronger sentiment returns to the market more generally. Development finance has led the way in the 'beds and sheds' sector and we expect to start to see more activity within the office and retail sectors towards the year end and into Q1 2025.

Nick Harris, Head of UK and Cross-Border Valuation, Savills, comments:

"The mid-year 2024 CRE Lending Survey highlights the ongoing challenges in the commercial property lending market. The continued gap between buyer and seller expectations in terms of pricing has caused a further 10% contraction of new lending year on year. However, with lenders struggling to replace loan volumes following repayments, there is an abundance of liquidity chasing prime product (which remains limited), resulting in squeezed margins, slightly higher LTVs and more flexible debt structures. Looking ahead, the 5 year Sonia Rate has compressed by approximately 100 basis points over the last 12 months and borrowers should therefore benefit from a liquid and competitive debt market once transaction levels pick up once more. The position could potentially improve further if the Bank of England moves faster than anticipated in cutting borrowing rates."

1. Introduction

This report brings the results from the Bayes Commercial Real Estate (CRE) Lending Survey up to June 2024, extending into its 25th year the continuous series from the study started at De Montfort University with the support of a group of firms engaged in commercial real estate market.

All results in this report are based on responses from the real estate teams of lenders active in the UK market. Up to 2011, 50 to 60 lenders – dominated by large UK Banks and Buildings Societies, International Banks, and Insurance Companies – provided information to the survey each year. Since then, the entry of new lender types from 2013/14 onwards – principally debt funds run by large asset management businesses – have increased the survey sample to 70-80 lenders. A total of 69 lenders contributed to the mid-year 2024 data.

The rate and detail of response to individual questions varies between organisations due to reasons of confidentiality and data availability. Thus, a 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 within this report other than in the list of Acknowledgements.

1.1. Survey methodology

Information is collected for the Survey primarily via an extensive data form, in spreadsheet format, completed by the participating lenders. Data on loans focus on key aggregates– outstanding loan books, new originations – collected either in that form or from loan-by-loan records which are subsequently broken down into sub-totals by type of loan, type of collateral, and underwriting metrics such as Loan-to-Value (LTV) ratio and income cover. This record of loan books is supplemented by questions on current lending terms for several types of loans and collateral. More qualitative insights into lending policies and practices are added through free-form sections of the questionnaire and a round of face-to-face interviews with senior executives among lenders and other market participants.

Therefore, the report's analysis is limited to the categories and sub-categories for loans and lending terms prescribed by the data collection. It does not have the flexibility that would come from more granular data on individual loans. Over time, the data specification questions have evolved with the lending market structure, so a continuous time series is available only for the main aggregates. In this report and the accompanying full data spreadsheet all series are traced back as far as information is held consistently.

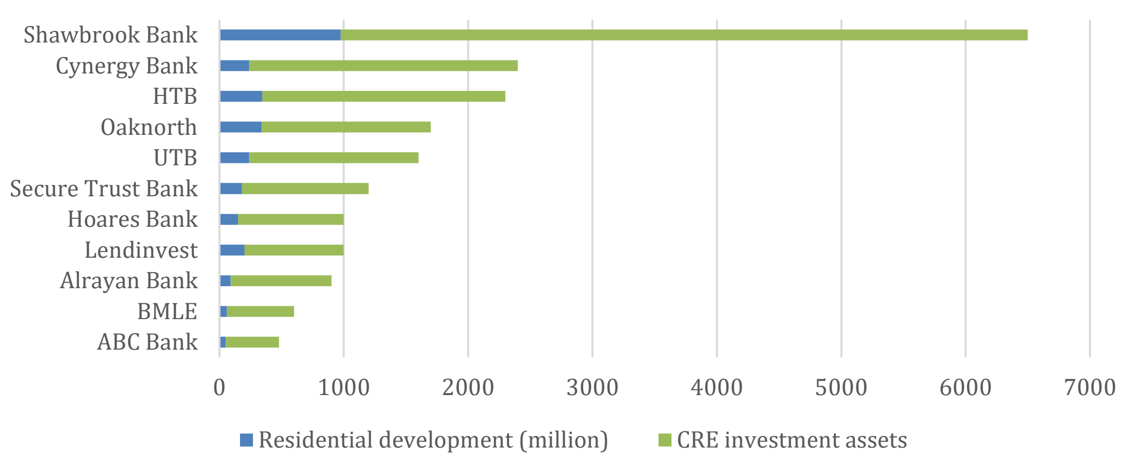
The CRE Lending Survey has gathered information at each year-end since 1998. Since 2002, an interim update Survey has gathered information in June each year using an abbreviated form of the full year-end data specification. This Update Report shows, accordingly, analyses to the extent possible given the data collected. For June 2024, responses were received from 69 CRE lenders who held a total outstanding loan book of £161 and originated £17bn in new loans. The lenders held a further £26bn in loans committed on their books but not yet drawn down by borrowers which were excluded from the forthcoming analysis. Throughout the report commercial real estate lending is defined as loans secured by real estate investments or developments (for further definitions see Appendix 3).

The analysis is based on Survey data collected from institutions we might term “mainstream lenders.” These provide loans secured against real estate assets, advanced by businesses with dedicated lending terms, which are recurrently in the lending market. While the Survey provides the most comprehensive and detailed picture of those lenders, we recognise it does not capture the totality of debt finance for the UK CRE sector.

These include for example:

- Secured & unsecured corporate lending to real estate firms – in the form of corporate debt or bonds – is beyond the scope of the survey.
- Some loans originated by mainstream lenders have escaped the survey sample by passing into “bad banks” such as Ireland’s National Asset Management Agency or via sales of distressed debt to private equity firms (relevant for the period 2008 – 2015).
- Loans provided under “corporate lending facilities” to real estate debt funds.
- Loans that have been taken outside conventional lenders’ books through Commercial Mortgage-Backed Securities (CMBS).

Figure 1. Non-included UK institutions, total outstanding CRE loans, £million



Source: Pillar 3 Disclosure reports, annual audit reports, et al.

While we do not undertake a comprehensive review of those other pools of real estate leverage, £92bn have been issued as bonds and UK lenders currently not reporting to the survey but identified to contribute fair amount of CRE lending account for £20bn of which an estimated £2.8bn is lending to SME residential developers.

1.2. Report structure

The Report is divided into seven main sections:

- Section 2 begins the analysis of the current Survey results with headline figures on the lending market – new originations –, which split across the type and size of lender to profile the lending market's current structure.
- Section 3 provides an overview of lenders' loan books and the current market structure.
- Section 4 turns to the form that loans take and the collateral against which they are secured, highlighting lenders' overall exposure, lender types, risks of different underlying project types, level of loan security and real estate markets.
- Section 5 looks in detail at the terms achieved on new lending over time with key indicators, such as LTV, income cover and how they vary in the current market across types of projects and underlying property assets.
- Section 6 concludes with an overview of lending risk by analysing current loan books against underwriting metrics, default rates and loss provisions against a background of default and loss exposure over time.
- Section 7 provides a commentary on a decade since the Global Financial Crisis (GFC), uses the long time series of Survey data to outline trends and cycles in real estate leverage against the background of values and trading in the underlying market.

For consistency with earlier reports full sets of tables and graphics with more detailed results are provided in Appendix 1. For survey sponsors, survey participants and purchasers of this Report, the full historic and current data sets are also available in an Excel spreadsheet.

1.3. Main classifications and labelling

The main definitions and classifications used in this report can be found in Appendix 3.

2. Lenders loan originations

Market liquidity is an important indicator of financial stability and determines the future returns and performance of the CRE loan market. Lending cycles have been subject to changes in the liquidity in the underlying property transaction and investment market or changes in the banking and credit supply market. 2024 started with a renewed sense of optimism, with news about positive economic growth, lower inflation and interest rates stabilising. However, H1 2024 shows that investment volumes have hit a record low. Investment in UK real estate reached £16.2bn in H1 2024 – 25% below the 10-year average of £21.5bn according to JLL. It is a slight improvement from the £14.2bn in H1 2023. Hence, this is the second year of low transaction market activity, which is also impacting on new lending volumes.

Despite more government stability and initial interest rate cuts by the BoE there is little hope that transaction will return in H2 2024, pushing the market recovery over to 2025.

Table 1. Loan originations by lender group (£millions)

	MY 2024	MY 2023	YE 2023	12-month % change
UK Banks	8,191	8,594	17,264	-4.7%
German Banks	-	1,477	2,084	-100.0%
Other Intern. Banks*	4,120	2,882	5,146	42.9%
Insurers	1,177	2,074	3,029	-43.3%
Debt Funds	3,300	3,584	5,154	-7.9%
All Lenders	**16,787**	**18,611**	**32,677**	**-9.8%**

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report, *includes German Banks

Overall H1 2024 loan origination activity was 9.8% behind H1 2023. With the continues decline of German Bank lending activity, for the first time since 1999 this group was merged into Other International Banks. The UK lending market has been changing post the pandemic in 2020 towards UK local lenders, continuing a trend that potentially had already started with Brexit. Especially the German Banks, which historically played a significant role in the UK lending market reaching their peak during 2004 – 2007, have slowly withdrawn over the last 7 years (from 2017).

Figure 2. Market comment

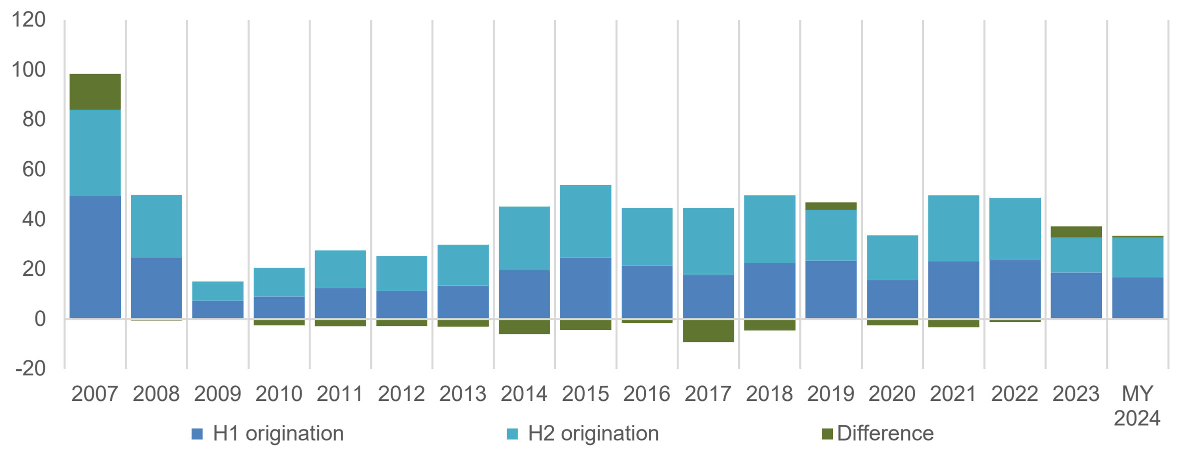
About 17% of German banks' CRE exposure is international. Most of this is in the US, and historically followed by the UK., According to Fitch analysis earlier in 2024, Deutsche Bank held €17bn in foreign CRE loans, Helaba, €11bn ; Aareal Bank €8 billion. The banks mostly financed properties in large cities and metropolitan regions, where they have extensive local market knowledge and established records. The prevailing asset types are offices and residential assets.

Source: Fitch, 2024

H1 2024 was dominated by UK Banks supplying 49% of new loans. International Banks provided 25% of new loans, followed by local UK debt funds with 20%. The insurance sector is only taking a share of 7% in direct lending, but are providing equity into debt funds to diversify.

With few new transactions in the market, the is little product for loan syndication. The syndication market during H1 2024 reached £3.9bn compared to H1 2023 with £5.7bn, and the outlook for the rest of the year remains low. Some syndications and club financings were the result of splitting large debt amounts between several banks, at times when their underwritten loan amounts have been restraint by their credit policy.

Figure 3. Loan originations during half-year periods (£bn)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Note: Insurers were not identified as a separate lender type before 2012.

- Origination volume since 2000 has a range of £15bn to £85bn; it increased continuously from 1999 to 2007 with the rise fairly equally shared across lender types apart from a growing proportion from US and Canadian banks.
- Loan originations have been massively pro-cyclical: For example, the £165bn in new loans for 2006 and 2007, equivalent to 70% of outstanding loans at the end of 2007, came after the market signal of a peak rate in capital growth in 2005.
- The origination cycle has been recovering since 2010 and peaked in 2015 with £53.7bn. Since then, there has been a decline in volumes. 2020 has been the weakest half-year since 2013 and the fourth lowest number in a 10-year cycle as a result of the economic shutdown related to the health pandemic.

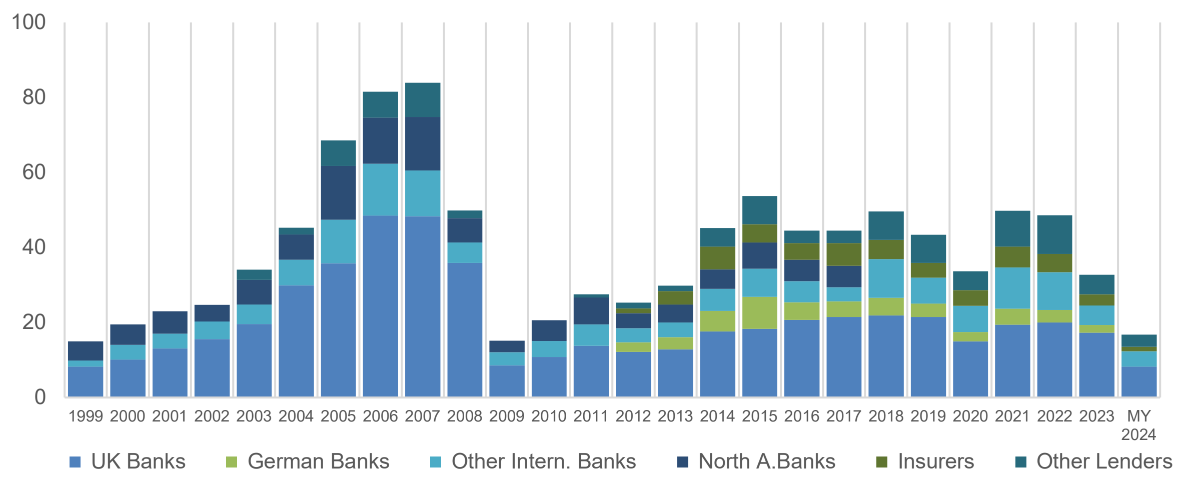
Most recent cycle:

- H1 2024 volumes are still ahead of the weakest half-year in 2020 (£15.5bn) with just £16.7bn, but 9.8% below H1 2023. The reason for the subdued volume of new lending is mostly due to the limited transaction activity, but lenders are looking to finance new repriced assets and good sponsors.
- New acquisition lending was low with 45%, followed with refinancing of own loans accounting for 35% of activity. Lending conditions for these refinancings are less favourable in terms of LTV and pricing.

Historically, the conjoint crisis of lenders and borrowers slashed origination in 2009 to £15bn, a refresh rate at only 6% of outstanding loan books. Nevertheless, from that point onwards there was a continuous annual rise in volume to the new plateau of around £53bn by 2015 in loan originations. From 2015 onwards, a new cycle has become visible with the low point in 2020 caused by multiple business shutdowns due to the pandemic, followed by economic uncertainties and high interest rates in 2022 – 2023. The latest market volatility shows similar pressure on asset values as during the GFC 08/09 but this time the downturn is related to general economic changes weighting down business activity.

- The origination shares of the long-standing bank lenders versus non-banks reached a split of 70% (banks) – versus 30% non-bank lenders, while the split between outstanding loan books is 60% vs 40%, banks vs non-banks.
- For International Banks, combined shares in origination have been more volatile, running from a quarter to a half of the total but settling in a range of 30% to 40% over the last 15 year. Since Brexit, however, the market share of International Banks including German Banks has been declining from 30% to 21%. International Banks typically participate in the UK CRE lending market in prime locations, lending on very prime assets with low credit risk profiles.
- Insurance Companies keep their directly lending book stable, reaching a share of 17% at H1 2024. They also participate in Debt Funds, who have been growing their market share to 21% in H1 2024, hence their risk exposure is larger than visible through their direct lending book.

Figure 4. Loan originations by lender type, £bn and % of total 1999 – H1 2024

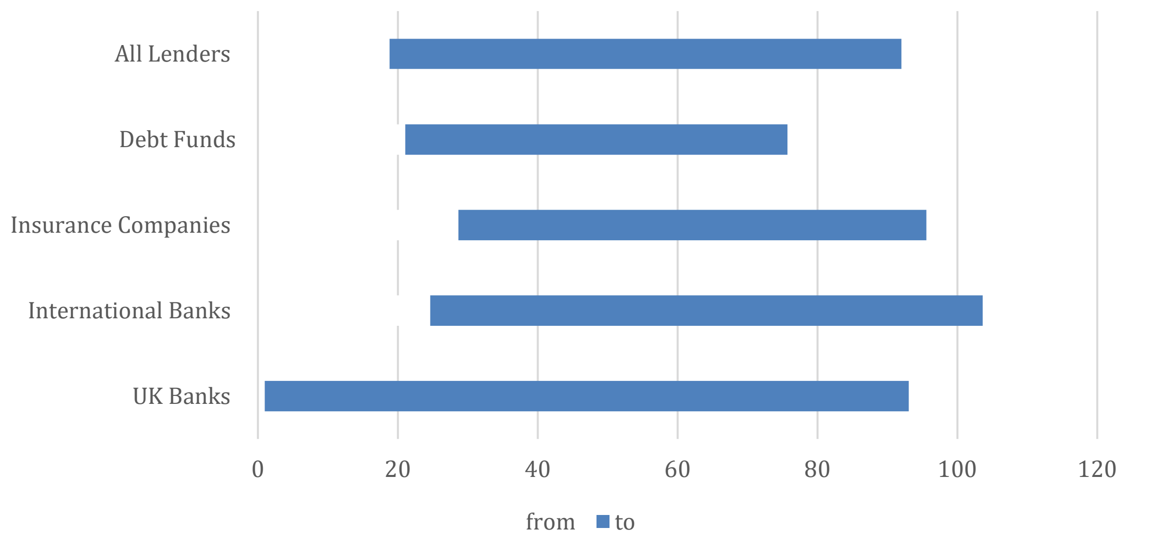


Source: Bayes Business School Commercial Real Estate (CRE) Lending Report.
Note: Insurers were not identified as a separate lender type before 2012. North A. Banks were merged with Other International Banks from 2018.

- A total of 22% of new loans were provided for development finance, with commercial construction projects accounting for 11%. This could be projects for new ground-up office development, logistics, but also data centres, or hotels. Residential financing took a share of 11%.

- International Banks, operating in the UK are focused on originating loans over £100m as a matter of efficiency and prime property asset sizes mostly found in London, but can also go to smaller sizes starting from £25milllion.
- Limited transaction activity meant that large loan exposures were difficult to find, and the overall average loan size was only £46m on average across all lenders. Even Insurance Companies who are seeking loans above £100m, have settled for the average size of £58m.

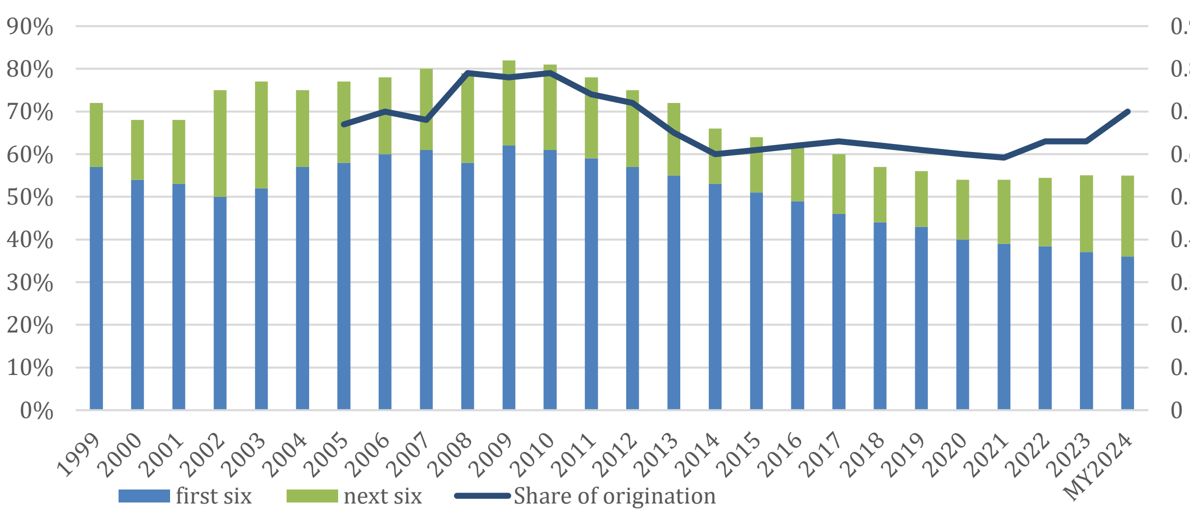
Figure 5. Average loan size, £million



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

In H1 2024, the largest 12 originators by total volume were 4 UK Banks, 5 International Banks, 1 Insurance Company and two Debt Funds. Combined, they were responsible for 59% of total loan origination, showing the strong concentration in the loan market.

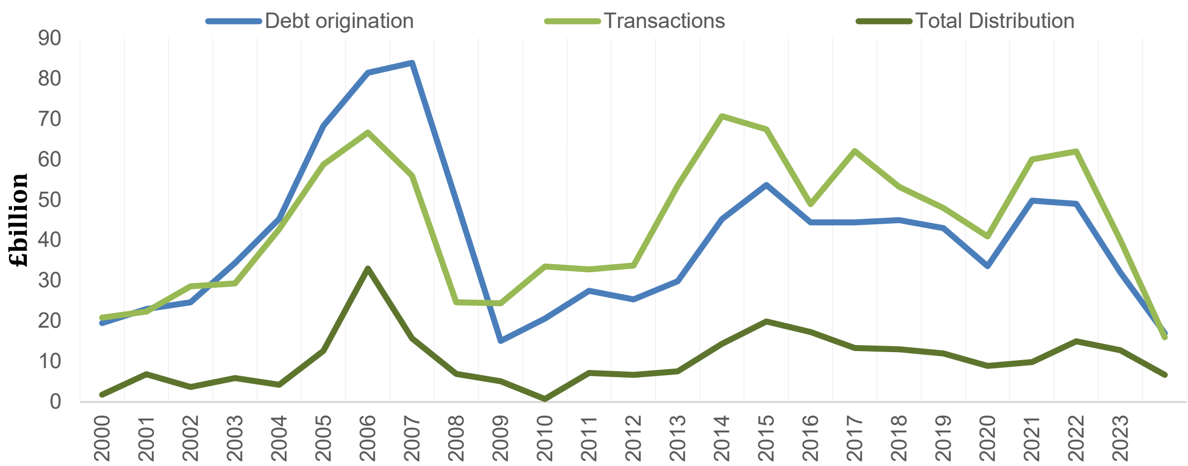
Figure 6. Number of 12 largest originators, H1 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Secondary market activity is another important indicator of the health of the real estate finance market. Over the longer term, 25% - 30% of loans are not held on a balance sheet but distributed into the secondary market. This level of secondary loan distribution is considered a healthy, liquid market. Secondary loan distribution accounts for syndications and securitisation of loans. After the collapse of the securitisation market, the syndication market stabilised over the last five years. Insurance Companies typically syndicate 30 - 40%, International Banks 40 – 50%, and UK Banks 20 - 25%.

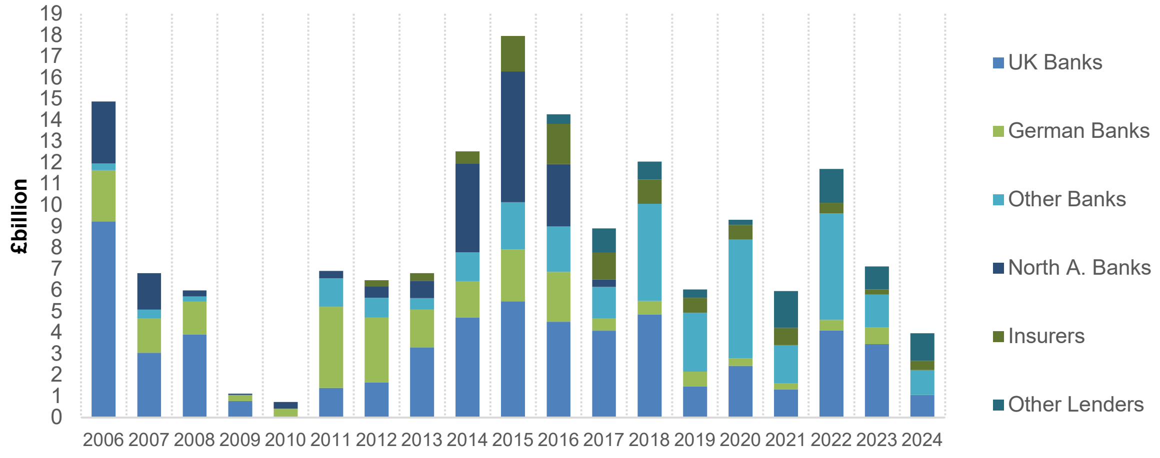
Figure 7. Loan origination & market indicators, 1999 – H1 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report, CoStar

Despite pricing difficulties and changing interest rates, the syndication market generated £3.9bn of activity and was off to a good start in H1 2024. In total 8 lenders were active in syndication (11 in 2023) and 8 lenders (12 in 2023) recorded club deals and participations. For Insurance Companies originated 37% of their new lending via participation or syndication facilities, Debt Funds 38%, and International Banks 28%. Only UK Banks rarely enter into participations, however, they do use some synthetic balance sheet securitisation as a risk trade-offs.

Figure 8. Syndication volume by lender origin, £bn, 2006 – MY 2024



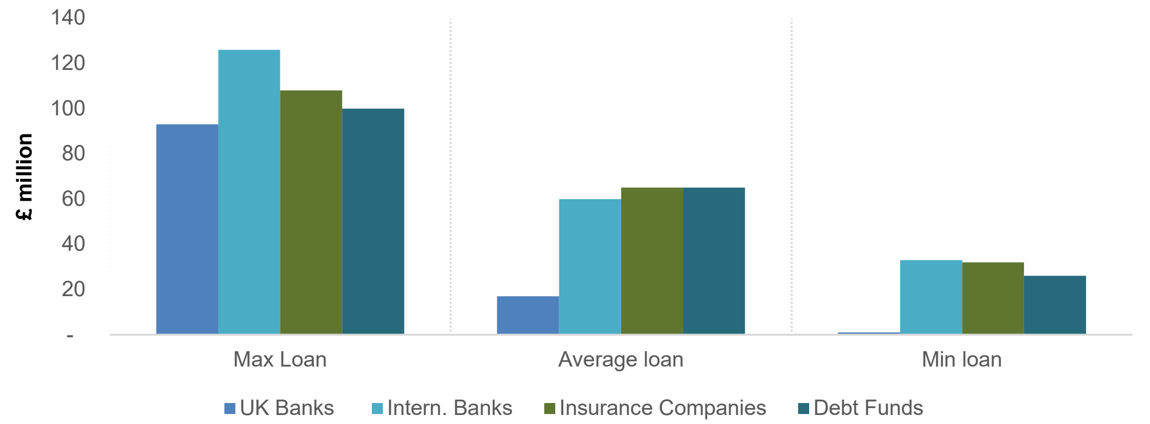
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

2.1. Lenders and loan sizes & lending policies

Typical loan sizes are a feature of loan books, which differentiates strongly between types of lenders. Leading up to the GFC 2008/09, the maximum loan size had reached more than £1bn for a large portfolio financing while during the crisis it was difficult for lenders to write loans larger than £50m.

- Between 2015 and 2020, the average loan size had decreased. In 2015, a total of 27 reportedly lent a single loan larger than £100 while in 2020 only 23 managed to lend above £100m ticket size. In 2021, 26 lenders provided a single loan of more than £100m, three of which were above £500m.
- In 2023, the average maximum loan size was above £100m with £132m, which is still lower than in 2022 with £155m. The overall average loan was around £67m, which is 5.7% lower than 2022.
- In the first half of 2024, the average maximum loan size reduced further to £108m, which was related to low transaction volumes of significant size. The overall average fell to £525m.
- For 10 lenders the typical average loan was above £100m, whereas for 12 lenders was less than £10m. Larger loans have been more often subject to club deals, thereby splitting exposures and risks across several lenders. Most lenders have a hurdle rate of >20m or >30m for their minimum acceptable loan size.
- Figure 7 shows the loan size average originated in H1 2024 for minimum and maximum loans size between different lender groups. Insurance companies are typically the source of large loan origination, since which have a capacity to underwrite large loans without the need for further syndication or participation partners.
- Overall, there is a large amount of liquidity across lenders for loan sizes between £20m to £100m available. Fewer lenders wanted to look at loans from £1 – 20 million. UK Banks are less likely to originate loan sizes above £100m.

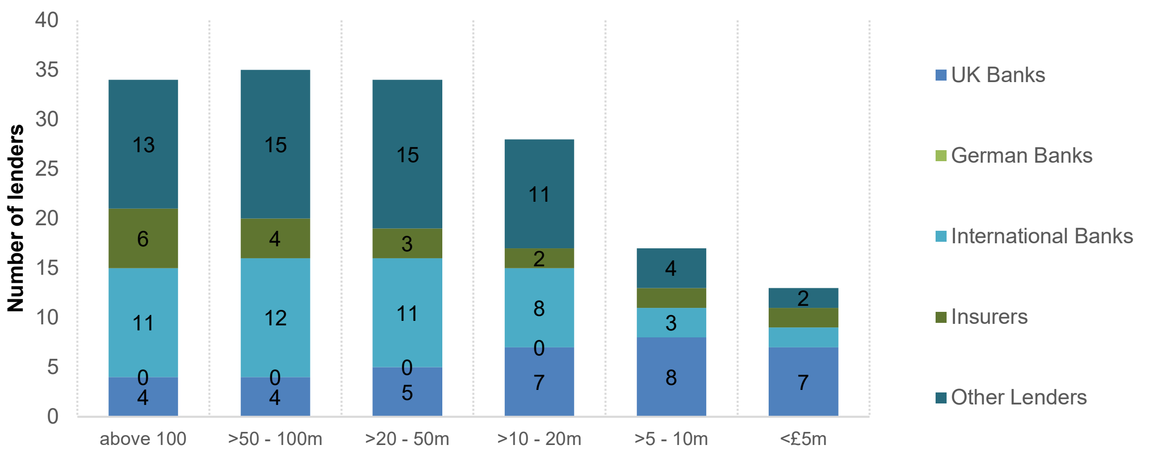
Figure 9. Average loan sizes by type of lender, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

The survey also asked lenders about their latest lending policies for 2024. During 2009, many lenders stopped lending or reduced their loan size significantly. In the H1 2024, 34 lenders are looking to provide investment finance above £100m, decreased by 6 compared to H1 2023. Out of 71 lenders that completed this section of the survey, 50% (35) and 49% (34) would finance investments between £50m-£100m and between £20m-£50m, respectively. The smaller the loan size, the less attractive to lenders and the only 13 lenders are willing to lend on small loans of less than £5m and 17 of less than £10m.

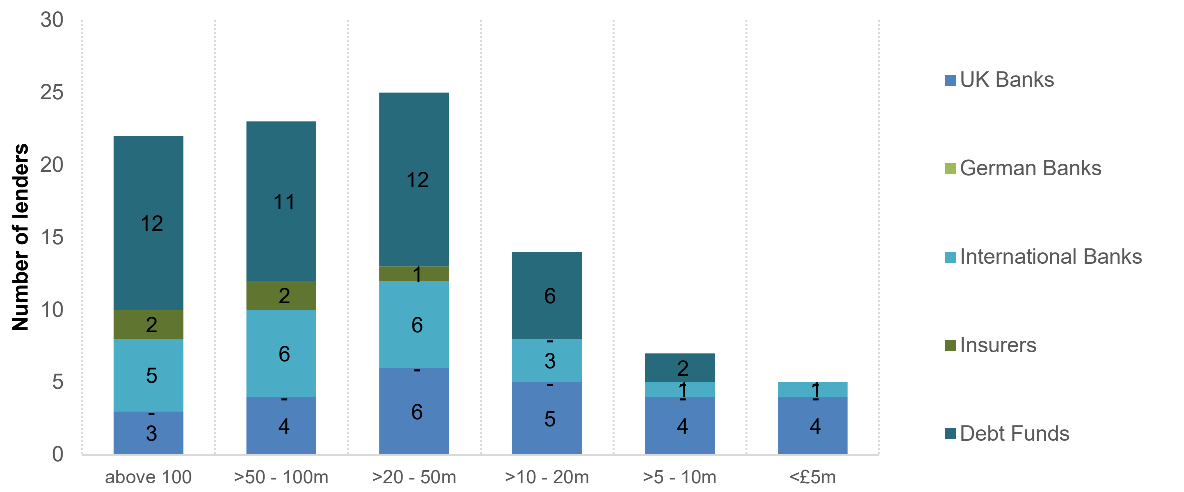
Figure 10. Loan size preferences for investment finance for MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

For development lending, 22 lenders are looking for large development deals with of above £100m, which remained at a stable level and also 23 lender were financing projects between £50 – 100m. Most liquidity exists between £20 – 50m offered by 25 lenders. For small development projects, which are mostly residential up to £5m, there is limited appetite of only 5 lenders offering financing.

Figure 11. Loan size preferences development finance, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

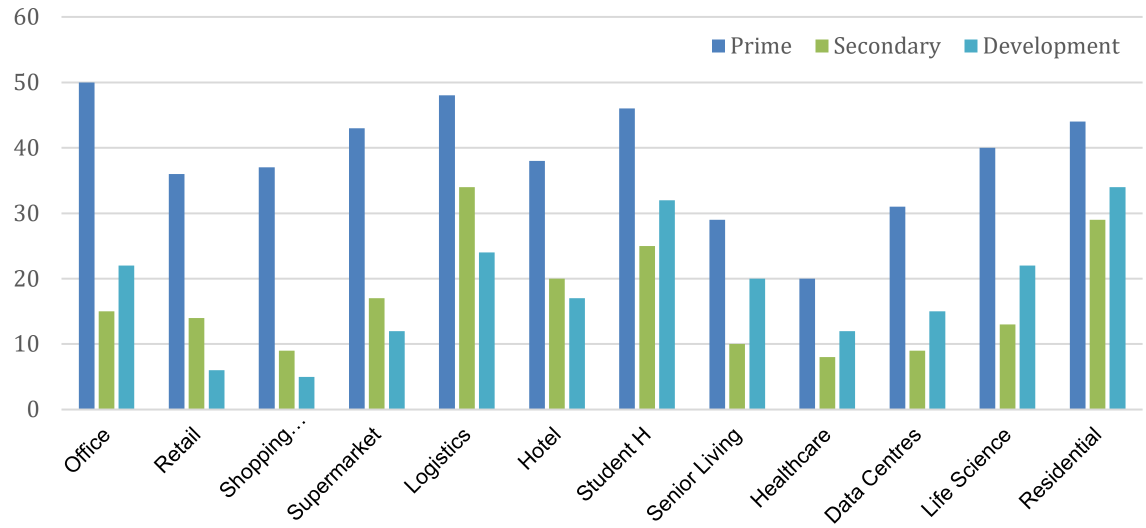
Lenders were also asked about which types of assets and sectors they are still lending to in H1 2024. A total of 56 (80%) responded to these survey questions. Prime office (89%) and industrial/logistics (86%) find the highest numbers of lenders willing to lend. It worth noticing that lenders that are willing to finance prime office properties increased by 4 lenders. More specifically, a total of 50 lenders are offering finance for prime office deals, but this number drops to only 15 (27%) for secondary properties. More than half of the participants (61%) offer financing for secondary industrial/logistics properties. Student housing assets are the third most attractive sector with 82% of the responders to finance this sector, followed by prime residential with 79%. In addition, over half of the lenders, who replied to this section would finance residential development projects (61).

Other sectors, which attract a large amount of lenders are prime supermarkets for which 77% of lenders offer financing, prime life science with 71% and hotels with 68%.

When it comes to secondary assets or locations, financing options drop quickly to less than 20 lenders or 10 -15% of lenders. The only exceptions are secondary logistics assets, which are financed by 49% of lenders, secondary residential by 41% and secondary student housing by 36%.

The number on development asset to be financed by 49% of all lenders are residential projects, followed by student housing with 46%. It is also possible to find financing terms for logistics developments from 34% of lenders.

Figure 12. Number of lenders active, by asset type, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

2.2. Securitisation market H1 2024

In the UK CMBS issuance has been on hold since the interest rate rise by BoE in 2022. Some internal securitisations were noted within UK Banks reaching £1bn. These are held on the balance sheet of the bank as a risk-trade off instrument.

2.3. Summary

- In the first half of 2024, the average maximum loan size has been significantly reduced to £108m and average loan size was £52m across all lenders. This reduction was due to low transaction activity in the real estate market.
- Lenders still favour the financing of residential, logistics and student housing assets (45 – 50 lenders offering terms), but prime offices and repriced retail assts are also seeing more lenders offering competitive loan terms again.
- Development finance is offered by less lenders in general, and most active lender groups are UK Banks and Debt Funds. Most liquidity is found for residential development and student housing developments with more than 30 lenders.
- Smaller financing requests of less than £5m experience low liquidity levels as lenders prefer to write larger loans. Smaller loans require the same amount of underwriting and internal resources as larger loan tickets, hence a small loan is less attractive.

3. Lenders – loan books and segmentation

The following section provides a comprehensive analysis of lenders' outstanding loan books broken down by categories of lender groups, types of assets, types of lending and lender size. Table 2 provides a more complete picture, including undrawn commitments. These are to development loans, which have not been fully drawn yet and could still be withdrawn.

Table 2. Outstanding loans and commitments, £ million

	Outstanding Loans H1 2024	Undrawn Commitments	Total book H1 2024	Total book Dec 2023	% change
UK Banks	59,798	17,174	76,971	76,216	1.0%
German Banks	-	-	-	12,107	-
International Banks	33,410	5,068	38,478	32,933	16.8%
Insurers	31,662	1,163	32,825	33,982	-3.4%
Debt Funds	37,654	2,122	39,776	38,648	2.9%
All Lenders	**162,523**	**25,527**	**188,050**	**193,887**	**-3.01%**

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

When including undrawn commitments, total loan books have reached an overall balance of £188bn, which is 4% below December 2023. Undrawn commitments stood at £25.5bn. Overall, this relatively high amount shows the slow refinancing activity and little movement in overall debt volumes, to indicate lower LTV's on outstanding loans. Unless specified otherwise all analyses in this report apply to the total outstanding loans of £162bn, excluding the undrawn commitments. Lenders have been struggling to keep their lending book volumes stable, heavy repayments and little new origination have led a decline in outstanding loan books across the different lender groups.

Table 3. Outstanding loans, £ million

	Outstanding Loans H1 2024	Origination H1 2024	Outstanding loans 2023	Origination H1 2023	Outstanding loans % change
UK Banks	59,798	8,191	59,158	8,594	1%
German Banks	-	-	11,937	1,477	
International Banks	33,410	4,120	30,092	2,882	11%
Insurers	31,662	1,177	32,683	2,074	-3%
Debt Funds	37,654	3,300	36,690	3,584	3%
All Lenders	**162,523**	**16,787**	**170,559**	**18,611**	**-5%**

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

3.1. The lending market concentration

Over time and especially since the GFC, the UK CRE lending market has seen a rising number and wider range of lenders with new small debt funds launched by asset management firms and less conventional lending channels such as peer-to-peer lending by pension funds and to an as-yet limited extent, crowd-funding platforms for both investment and development loans.

The focus of the CRE Lending Survey remains on mainstream lenders. For instance, those with teams dedicated to the origination and management of loans as secured against commercial assets, excluding those for whom loans are likely to be very short-term (bridging finance) or occasional bespoke arrangements (peer-to-peer lending). Aside from the regional classification of lenders the report also considers lenders categorised by the size of their loan book (Table 4). Lenders have been sorted into four distinct groups by loan book size.

Table 4. Categorisation of lenders by size of loan book

Firm size	Number of firms	Category	Category name
<500m	12	26	Small
500m – 999m	14		
1bn - <2.5bn	28	28	Medium
2.5bn - <5bn	10	10	Big
5bn - <10bn	4		Large
>10bn	3	7	
Total	**71**	**71**	

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

In June 2024, a total of 71 lenders reported to the survey. These have been categorised into four groups. Lenders with total loan books of less than £1bn of assets are considered “small”, these often lack the economies of scale to build up their lending capacity, and reach necessary diversification targets. Most lenders operate loan books of £1 – 2.5bn of assets, which allows them to diversify their loan book and increase their individual loan size. Fewer lenders manage loan books of more than £2.5bn (Table 5 showing total loans and originations for lenders ranked 1-5 in terms of outstanding loans and so on).

Table 5. Lender concentration – June 2024

Size Rank #	Outstanding Loans £m	% Total Outstanding Loans	Loan Origination £m	Origination % Outstanding Loans	% origination of total origination
1 – 5	58.0	36%	8.1	14%	48%
6 – 10	25.1	15%	2.9	12%	18%
11 – 20	28.1	17%	2.7	10%	16%
21 – 30	17.8	11%	1.5	8%	9%
31 – 40	13.5	8%	1.0	7%	5%
41 – 50	10.1	6%	0.4	4%	3%
51 – 60	6.6	4%	0.1	2%	1%
61 – 71	3.3	3%	0	0%	0%
Total	162.5	100%	16.7	10%	100%

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

The largest 10 lenders hold 51% of the outstanding loans and originated 66%. During the first half of the year, lenders renewed turn around 8-10% of their loan book, however the smallest lenders only replace 2-4% of their loan book with new loans.

- The five largest lenders, all long-standing market leaders, still account for 36% of total outstanding loans; they have written £8.1m of new loans representing 14% of their loan book. These numbers are on par with other half years, and the expectation is to see the same activity in the second half.
- The top 20 lenders account for 68% of the total market and originate 82%. This confirms a high concentration in the lending market with a lot of market power in the largest 20 institutions, especially in a difficult market. The rest of 51 lenders combine 32% of loan books and only 18% of new loan origination.
- Smaller lenders achieve an average loan size of £27m, 15 of these lenders fall into the category of Debt Funds.

Table 6. Change of outstanding loan books by lender group

	Small	Medium	Big	Large	Average loan size
UK Banks	5	6	0	4	17m
Intern. Banks	6	10	2	1	60m
Insurance Companies	2	3	5	1	65m
Debt Funds	15	9	3	1	65m
Total	**36**	**28**	**9**	**8**	52m
Average loan size	27m	50m	120m	80m	

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Table 6 shows the loan book distribution by lender group. Most Debt Funds still have loan books below £1bn of total loans, but as private credit funds are growing, there are now four institutions with CRE loan books of more than £2500million. Some of the largest books and loan sizes are found in books on Insurance Companies.

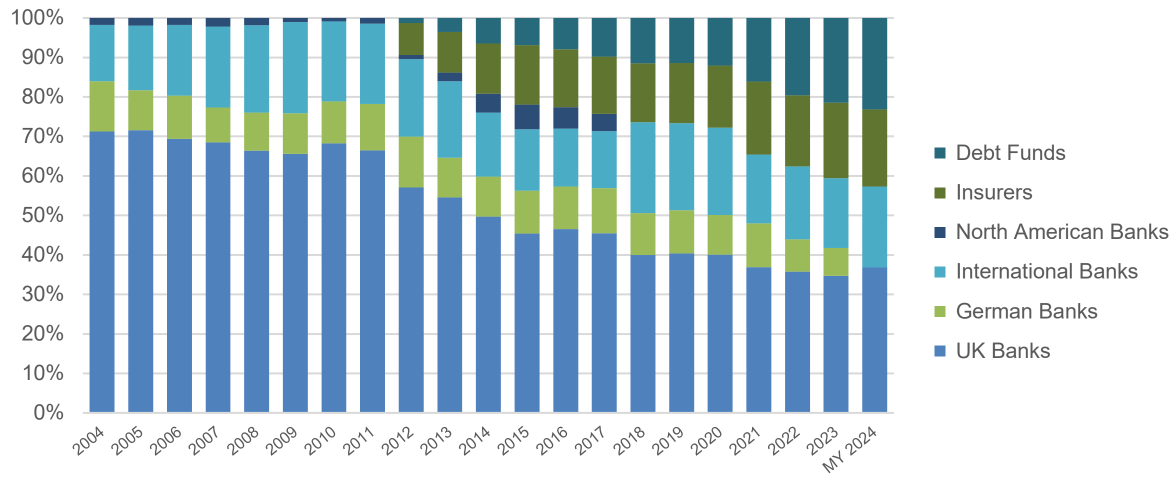
3.2. Outstanding loans

There has been no substantial change to the volume of outstanding loans held across lenders, confirming that lending is not being diverted to other channels.

In addition, £25.5bn of loans were undrawn commitments, resulting in a total loan book value of £188bn. Undrawn commitments are a good indication for construction activity in the market. In H1 2024 overall development exposure remains at elevated levels.

- From 2014 onwards, outstanding loans have run between £160 and £170bn with the current figure of £177bn. In H1 2024 lenders struggled to keep outstanding loan books flat, experiencing more repayments than new lending. As a result total outstanding loans dropped to a low of £162bn
- UK Banks have maintained their market share of 41%, Insurance Companies account for 17%, Debt Funds for 21% and the new combined Other International Banks and German Banks together account for 20% of market share. When excluding undrawn loan facility, the market share of UK Banks drops to 37%, leaving 21% for International Banks, 19% for Insurance Companies and 23% for Debt Funds.
- Historically, the market share of UK Banks has dropped by 14bp since 2012 and the combined share of bank lenders has continued to drop since the introduction of debt funds from 91% in 2012 to 65% in 2021 (72% in 2020).

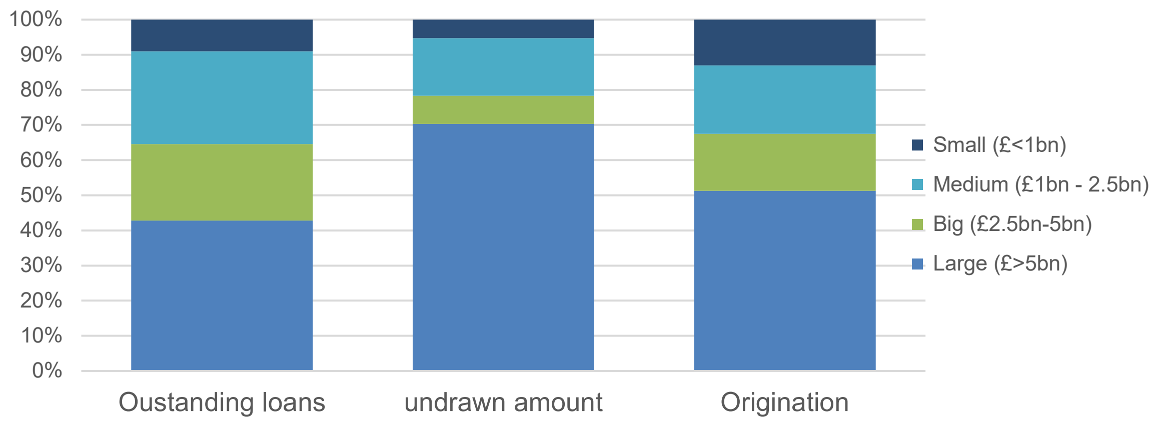
Figure 13. Outstanding loans by lender size, % of total



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 14 shows the market segmentation by loan book size. The largest lenders have approx. 40% of market share in outstanding loan books as well as origination. They also hold the largest amount of undrawn commitments for development.

Figure 14. Share of loans and origination



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

3.3. Summary

The CRE Lending Survey has tracked nine years of continuous growth in loan books up to 2008 (at an average of 20% per year) followed by six years of continuous contraction (at 7% per year) to 2014. Between 2014 - 2020 loan books have shown a slow increase of 3-4% p.a. with a total increase of 16% over 6 years till 2020. In the most recent cycle, 2020 was the top when loan books reached £191bn, which have since then reduced back to £162bn by H1 2024.

- Since various economic uncertainties and threads have had an impact on real estate asset values and interest rates have increased lending rates, loan originations are experiencing another market trough.

- Lenders were keen to continue with new business early in H1 2024, after a slow year in 2023. Many are trying to maintain their balance sheets, which is encountering more repayments than new loans. Also Debt Funds have raised new debt capital to deploy for new lending, which puts them under a slight pressure to find transactions to finance.

- Historic re-cap: Since 2014 total outstanding CRE loans have remained between £160bn and £170bn. Annual loan originations have run in a tight band from £45bn to £55bn: The lending cycle has turned in 2019 with a decline of originations and expanding loan books, continuing this trend in 2020. Finally, 2021 has been a short post pandemic peak in loan origination, which had been held up in 2020

- From 2022 loan originations have dropped, due to economic uncertainties, and rising interest rates.

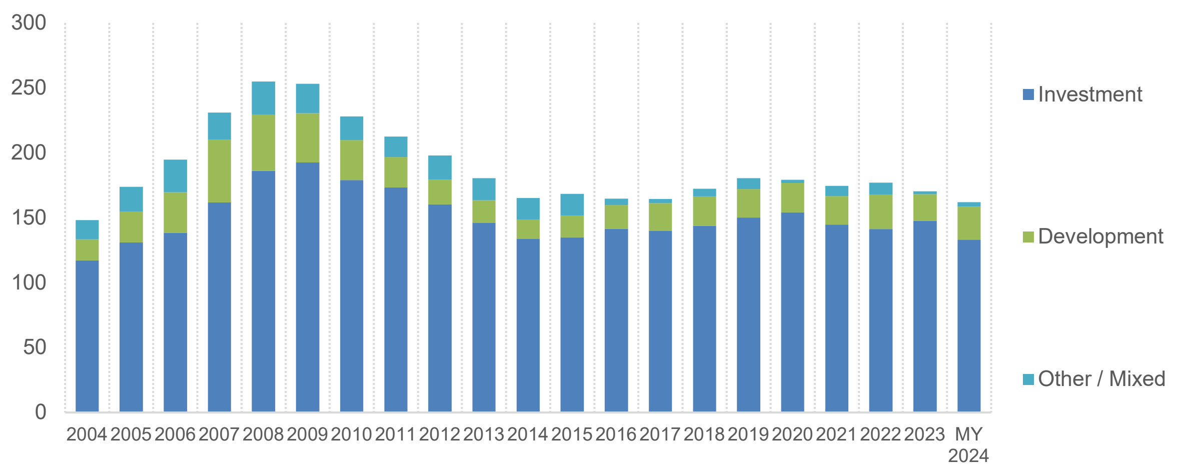
4. Collateral – loan types and market exposures

This section looks at collateral, that is, security for the £177bn of outstanding loans and £18.6bn of new loan origination in H1 2024. It shows a mix between the type of collateral, the form of loan and how these characteristics vary across lender type and size in the market.

4.1. Purpose of loans

The Survey identifies several primary purposes of borrowing. Loans secured against existing investment properties are split between refinancing existing loans, either by the same lender or Debt Funds and new acquisitions. Loans advanced against development are split between 100% pre-let or partly speculative commercial projects and residential development for either sale or rent. Figure 13 shows the broadest split of loan books.

Figure 15. Outstanding loans by type of collateral, £bn 2007–H1 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

The Survey provides unique insights into the assets underlying lenders' loan books and originations, categorised by type of project, loan form and asset location. At the aggregate level, loan books are dominated by senior debt secured by existing investment properties with small fractions in riskier development projects or subordinated loans. However, the split across lender types and sizes shows strong differentiation in business models and risk exposure.

- Loans for investment dominate outstanding books, at an average 80% of the total each year, ranging from a low of 70% to a maximum of 87% that share investment loans have held since 2015.

- At H1 2024 standing investment properties are collateral for 84% of the outstanding loan value; out of which 2% is allocated to other investments. These are investment which could not be classified into the standard asset types of office, retail, logistics, student housing, hotel etc.

- The share of development lending has remained stable at 18%. Development lending splits further into residential development lending £16.8bn and £11.8 commercial development lending. Commercial development lending increased for the first time since 2019 due to increased demands for ESG building upgrades.

- Development exposure is highly concentrated in UK Banks (20% of their total outstanding loans) and Debt Funds (32% of their outstanding loans). Also, International Banks offer development finance, with 9% of their book in development loans. Insurance Companies have a share of development finance is only 3%.

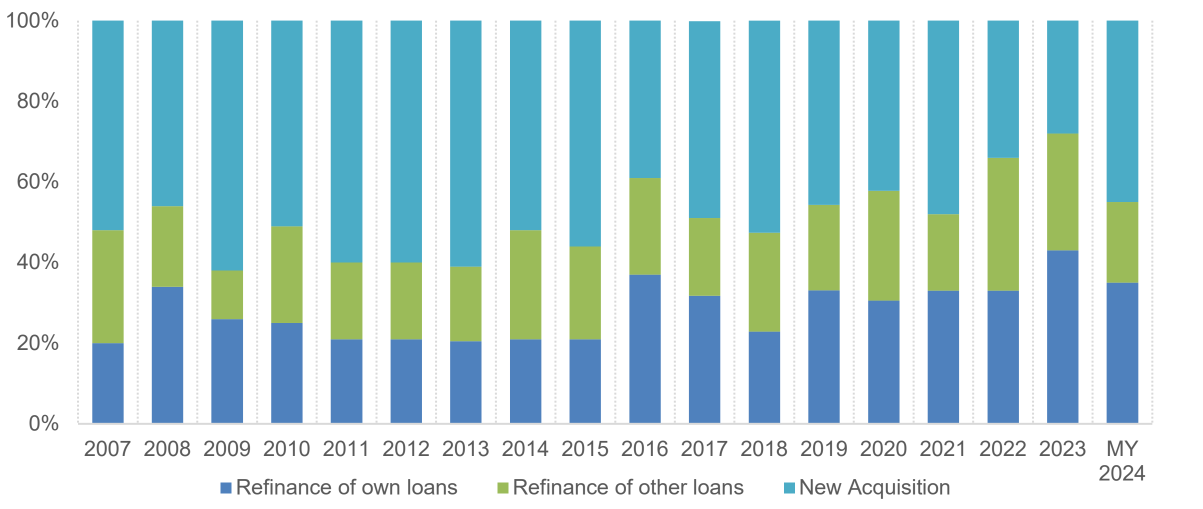
- UK Banks supply 57% of all residential development finance and 30% of all other commercial development finance in the market, however none of it was speculative finance. They have particularly expanded their commercial development lending exposure and development lending in non-standard asset classes, which can include life science centres, data centres, senior living and land finance, which also account for 33%.

- Debt Funds provide 57% of all speculative financing, 35% of residential development funding and also 28% of development finance for alternative asset classes.

- 22% of all origination volume in H1 2024, confirming that the development pipeline remains high and very active.

Figures 14 to 15 show the split origination between refinancing of loans already on the books of the originating lender, refinancing of loans from Debt Funds, or new loans, and the origination of new loans, which would typically occur for borrowers buying new assets. The splits are available in this form only from 2007.

Figure 16. Origination of loans by purpose, £bn 2007–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- Originations split roughly half-and-half into acquisition finance and refinancing averaged over the period shown.

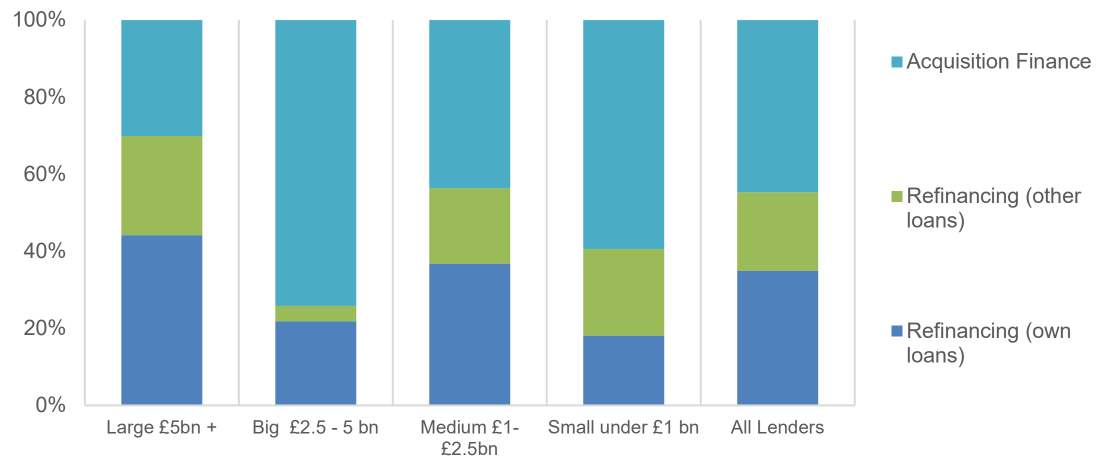
- Despite low transaction volumes, new acquisition lending took the largest share again during H1 2024 with 45% of all loan origination. Refinancing of internal loans has slowed down to 35%, and only few lender refinance loans from Debt Funds (25%).
- For Debt Funds, 69% of their lending was concentrated in acquisition financing, followed by International Banks with 48%. International Banks have been supporting foreign investors buying prime assets in and around London.
- UK Banks were still busy with refinancing their internal loans (51%), but also generated new business accounting for 31%. This is especially important as new loans will generate a higher return with higher quality credit quality, and lower leverage assets underlying the loan. Hence, improving the overall loan book and risk capital position.

Figure 17. Origination of loans by purpose & lender type, % by value

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

There are, however, substantial differences in the mix of origination business across types and sizes of lenders: The market saw a clear segmentation by lender loan book size, lenders with large loan books generated 44% of their lending from refinancing their own loans compared with small lenders which saw most of their origination, 59%, come from acquisition finance. The smaller the loan book of the lender the lower the chances that they will be refinancing a loan for a client.

Figure 18. Origination of loans by purpose & lender size of loan book, % by value, MY 2024



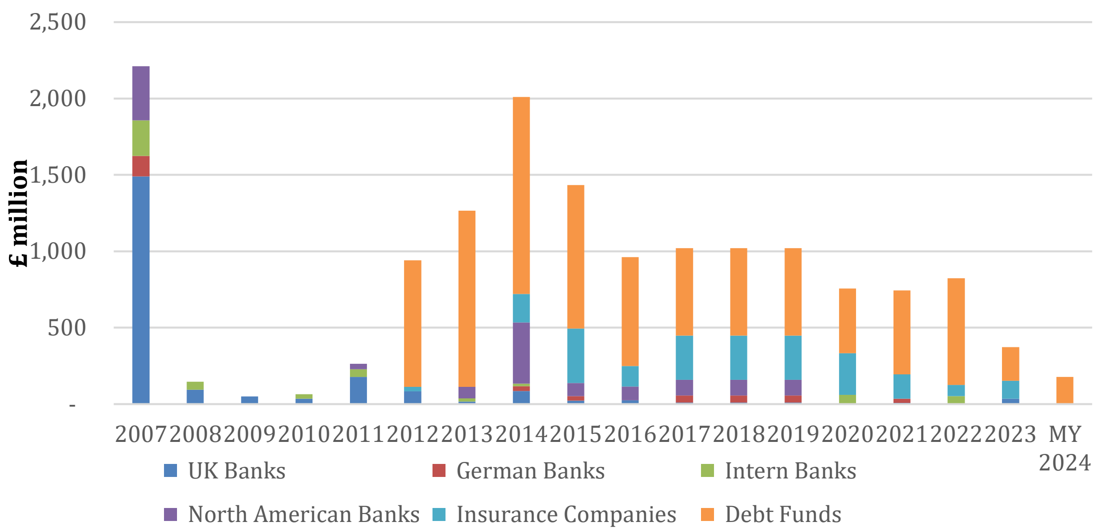
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

4.2. Loans and the capital stack

The survey distinguishes two levels of collateralisation in lending: senior debt, following the standard definition of a first loan secured by a prior claim on the asset and subordinated debt defined as all forms of lending not secured by a first claim. Splits using terms such as stretched senior, junior and mezzanine debt have proved impossible to collect from lenders due to the lack of common definitions.

Over time, subordinated debt has accounted for only 2% to 5% of outstanding loans covered by the Survey with a slightly pro-cyclical variation within that range and currently stands slightly below its long-run average at 1.8% of books or just £2.9bn. Junior debt might also not get captured in the outstanding loan book, because it can be very short term.

Figure 19. Originated subordinated loans by lender type, £m 2005–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

The share of subordinated debt appears, at first sight, surprisingly low but should be considered against the relatively small proportion of the capital stack made up by junior and mezzanine loans. As Figure 18 shows, there has been a significant shift in the mix of lenders providing subordinated loans:

- Senior loans – with first claim on underlying collateral – dominate loan books; subordinated loans have a share of only 1.8% of outstanding debt and 1.1% of origination at H1 2024.
- Subordinated debt is highly concentrated among Debt Funds, who have accounted for 70%-80% of origination since 2014, supplanting the bank lenders who previously dominated this market segment.
- Despite some junior funds being launched, the overall amount of junior or mezzanine debt is at historically low levels within banking institutions and other financial institutions and debt funds largely financed by institutional investors. Some bridging and mezzanine funding might be appearing in the C2C and B2C markets.

4.3. Development lending

Since the increase in interest rates, developers have been struggling to finish some of their development projects. Since 2020, the have also been facing higher costs for materials due to inflation and supply shortages, which have compressed developer's profit margins. There has been a slight relief when the Construction Leadership Council (CLC) has released a statement revealing that the supply of most building materials — such as bricks, blocks, boilers, plaster, and timber — has returned to pre-Covid levels and the BoE is also lowering interest rates step-by-step.

Both equity and debt capital are granted by lenders only for projects that have a chance of generating profits even in today's market situation. For lenders, the decisive factor is the current rent level, not the expectation of a possible rent increase. Projects that disregard sustainability criteria are now no longer financeable.

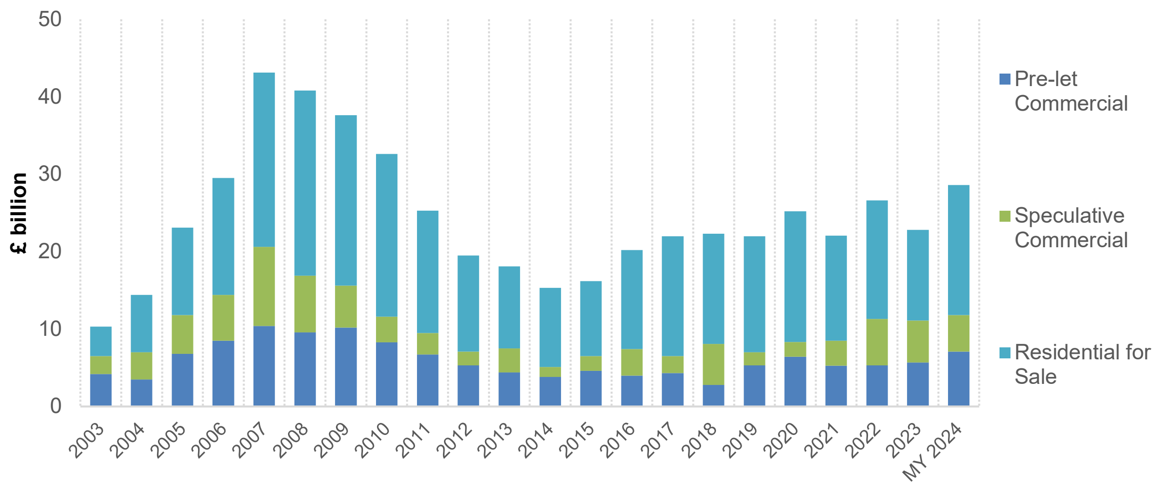
Some developers are still confronted with an equity crunch as well as a credit crunch. If they succeed in raising additional "real" equity, their chances of obtaining debt capital increase considerably. By contrast, "purchased" equity in the form of mezzanine is hardly accepted.

Total outstanding loans secured against development projects (Figure 18) has followed the general cyclical pattern, peaking at close to £40bn in 2007 and increasing since 2014, reaching a new peak in 2022, continuing to a new maximum level in H1 2024 with £28.7bn.

- From 2016 onward, exposure to development has settled at 13%, a shade over its long-run average; residential development (including development for sale or rent) accounted for most recovery in total development loans.
- A total of 17% of existing outstanding loans are development loans, of which 11% are new facilities originated during H1 2024. New development lending had a share of 22% of the total origination volume in H1 2024.

- Residential development stood at £16.8bn in H1 2024, or 10% of outstanding loan books. When accounting for undrawn amounts, there is still a strong financing pipeline to residential projects going forward.
- Commercial development lending stood at £11.8bn (7% of total outstanding loan book), showing in increase in both pre-let development schemes as well as speculative development finance. New commercial development loan facilities surpassed new residential development funding in H1 2024.

Figure 20. Development – outstanding loans, £bn 2003– H1 2024, £bn



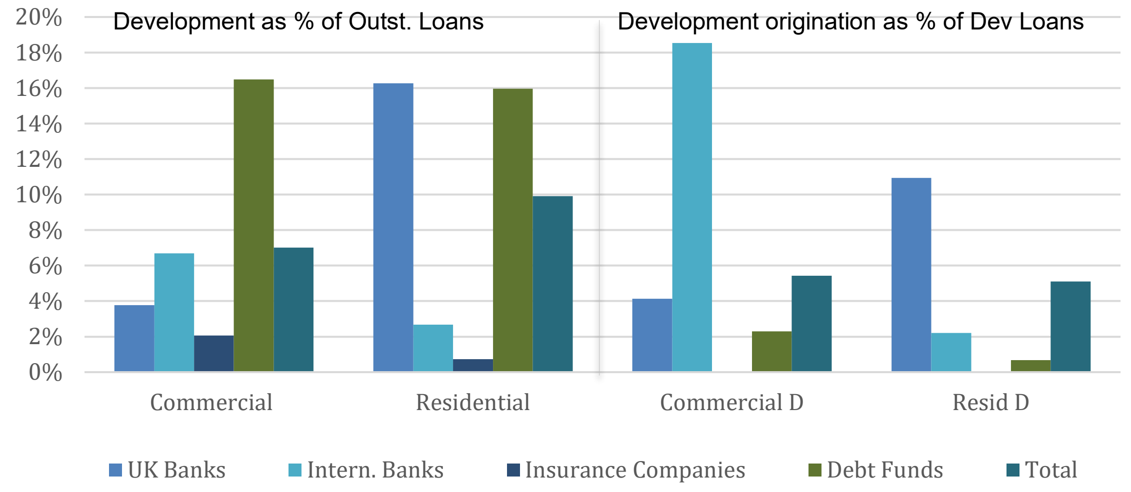
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Lenders vary widely in their appetite for development lending (Figure 20). Commercial development is largely supplied by International Banks, who supplied 55% of new commercial development lending, followed by UK Banks with 31%.

UK Banks are the prime lender for residential development, supplying 88% of new residential funding during H1 2024, while Debt Funds supplied only 5%.

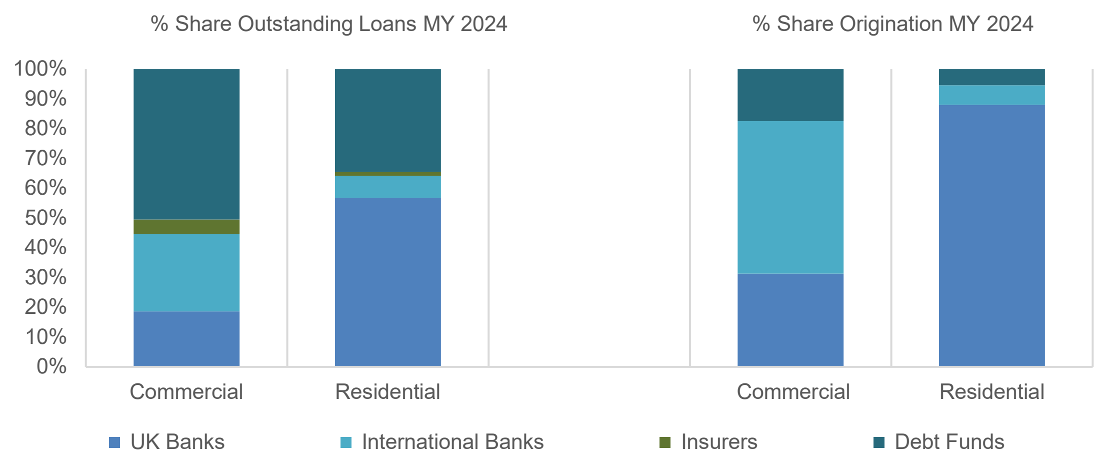
However Debt Fund supplied 17% of new commercial development finance. These can be schemes for offices or logistics, but also student housing and hotels. When it comes to total outstanding development loans, Debt Funds currently hold 60% of total outstanding commercial development finance with pre-let conditions and 57% of speculative development finance on their book. Figure 20 shows the overall contributions to development finance by the different lender groups.

Figure 21. Development exposure and origination rate by lender type, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

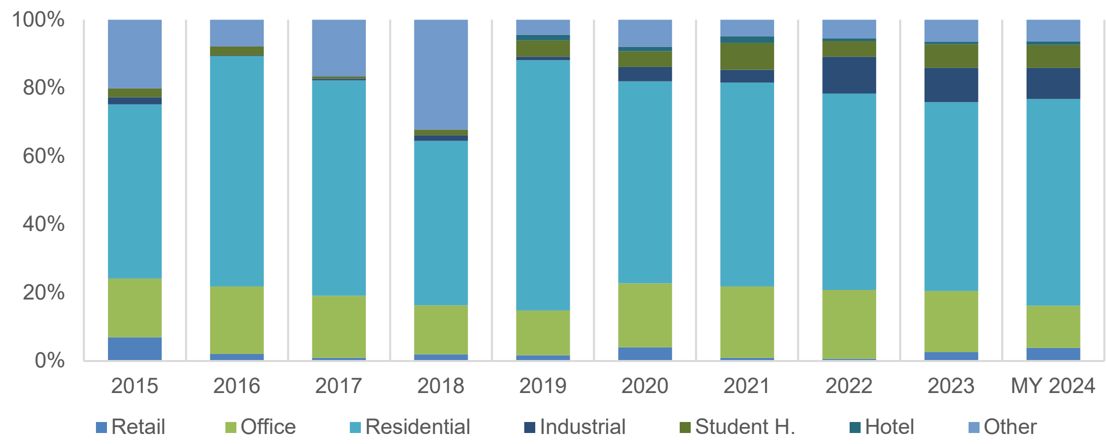
Figure 22. Development exposure and origination rate by lender type, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Respondents also provided a breakdown by property type for £27.7bn of development finance on their loan books. The largest proportion of outstanding development loans is allocated to residential development (60%). In comparison, the second-largest share, £3.4bn, goes to financing office developments (12%), another 9.1% are allocated to logistics development and student housing accounted to for 6.8%. The development of health care, data centre and public sector asset has increased to 6.3%.

Figure 23. Outstanding, drawn development exposure by property type, 2015–MY 2024



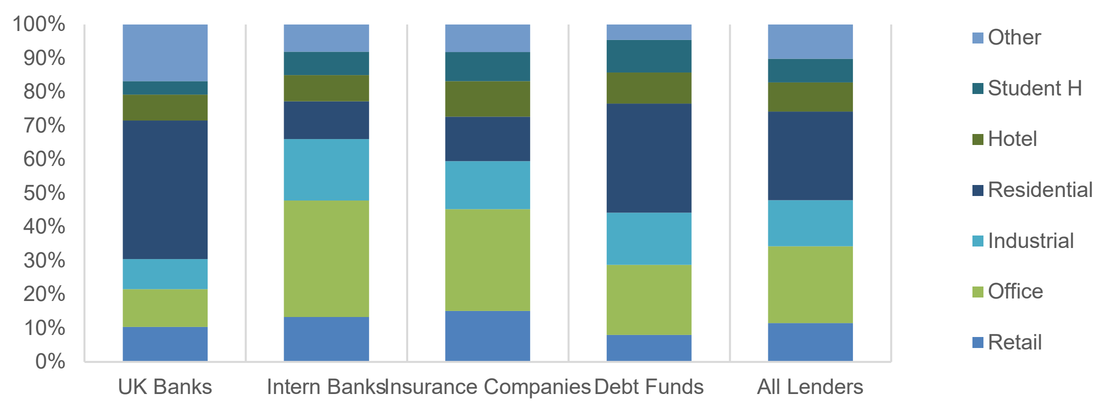
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

4.4. Asset type exposure

This section analyses the outstanding loan books by diversity of loans secured by different property types. The historic overview shows the changes in the types of underlying property secured by loans. The data excludes loans to Social Housing from 2016 onwards.

In H1 2024, lenders continue to specialise in different areas of lending. German and International Banks still concentrate most of their loan exposure in the traditional property types (retail, office, industrial) with 66%. For Insurance Companies this is 59%. On the other hand UK Banks hold 41% of their outstanding loans in residential assets, and another 17% in alternative sectors such as data centres, life sciences, public sector, health care, senior living.

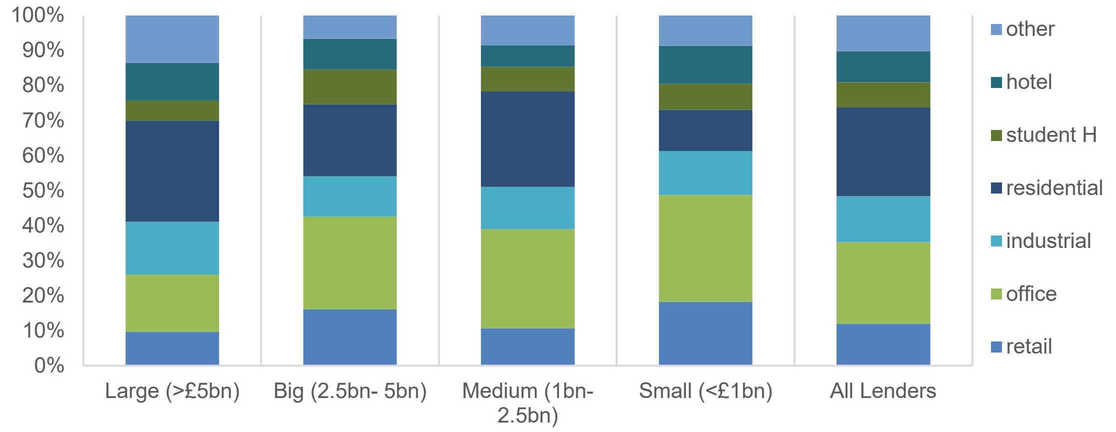
Figure 24. Outstanding loans by lender and asset type, % by value MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

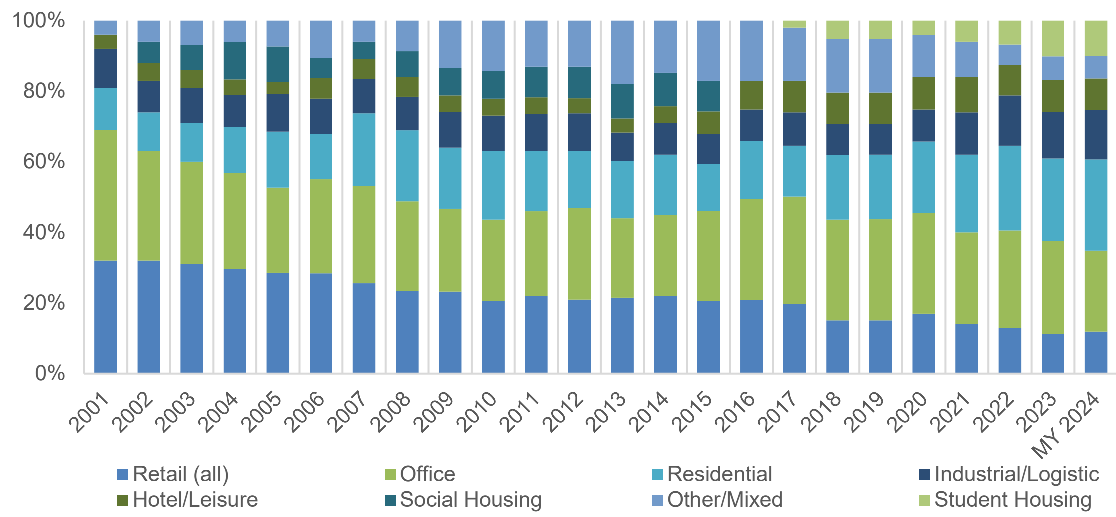
Over time the office sector's exposure has declined in H1 2024 to 23% across outstanding loan books. The outstanding loans to the retail sector have started declining to 12%, logistics exposure has increased to 14%. Loans to residential property have grown to 26% and are now the largest collateral type for real estate loans. In addition another 7% go to student housing assets and 9% hotels.

Figure 25. Outstanding loans by loan size and asset type, % by value MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 26. Outstanding loans by asset type, % of book value 2001–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

A cross-section analysis of different lenders by size of their loan books reveals that the smallest lenders are slightly more exposed to other asset classes but office. However, there is no particular lender group which is exempt from any specific asset type exposures. Overall, the loan exposure to traditional property types, in proportion to outstanding loan books has been declining in favour of alternative property types and residential loans.

4.5. Summary

The Survey provides unique insights into the assets underlying lender loan books and originations, categorised by type of project, form of loan and asset location. At the aggregate level, loan books are dominated by senior debt secured by existing investment properties with small fractions in riskier development project or subordinated loans. However, the split across lender types and sizes shows strong differentiation in business models and risk exposure.

- At H1 2024, standing investment properties are collateral for 83% of outstanding loan value; development loans have edged up from 9% in 2014 to 17% in H1 2024, but stand well below their peak share of 21% in 2007.
- Senior loans – with first claim on underlying collateral – dominate loan books, junior loans account for only 1.8% of outstanding debt and 1.1% of origination.
- Development lending has been a strong driver for UK Bank lending and had a share of 31% of their total new lending during H1 2024. A total of 20% of lending within smaller institutions of less than £1bn of loans is done in residential development finance as well as a notable amount of 9% of speculative financing schemes, resulting in a higher risk profile for these institutions.
- For International Banks commercial development lending accounted for 20% of their new origination.

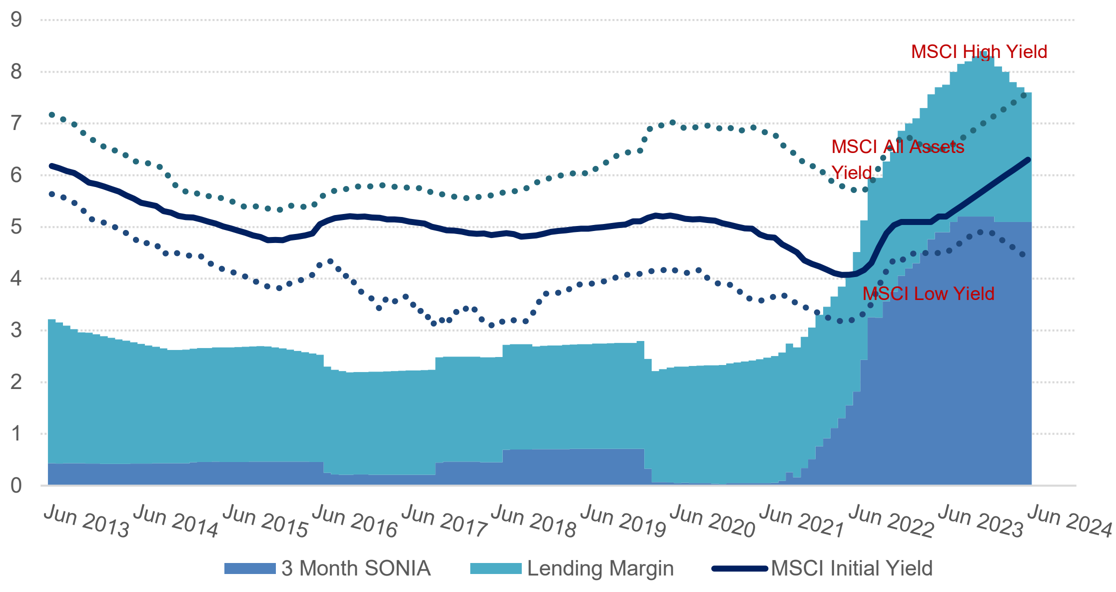
5. Underwriting – interest rates and lending terms

This section sets a framework of general trends in debt pricing followed by a detailed consideration of key lending terms and pricing margins currently sought by lenders. These are split by type of collateral.

5.1. Debt costs and yields

Figure 26 shows borrowing costs (the total of the stacked area) for senior debt, on three months floating rate basis, based on three months SONIA plus margin. The components of that cost are the prevailing overnight rate, the Swap margin, plus the target lending margin for prime offices averaged across the respondents to the Survey at six-month intervals (the intervening months have interpolated values). The cost is set against the average current net operating income yields for investment-grade property from the MSCI Real Estate UK monthly Index. The dotted lines show MSCI yields for highest and lowest quartile-point yields in any market segment. The top yield quartile at 6.5% was in retail and the top of the low yield quartile at 4.5% for industrial properties up by 0.1% compared to YE 2022.

Figure 27. Borrowers' costs and property yields, % June 2013–June 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report; MSCI UK Quarterly Digest, Bloomberg

The reference base for hedged loans has varied over five years with:

- Flat or falling LIBOR rates from 2012 through to mid-2017.
- Since December 2021, the BoE increased the base rate from 0.1% to 3.5% in December 2022.
- In the first half of 2023, Bank of England increased further the interest rate to 5.25%, and finally saw the first reduction by 25bps in July 2024.

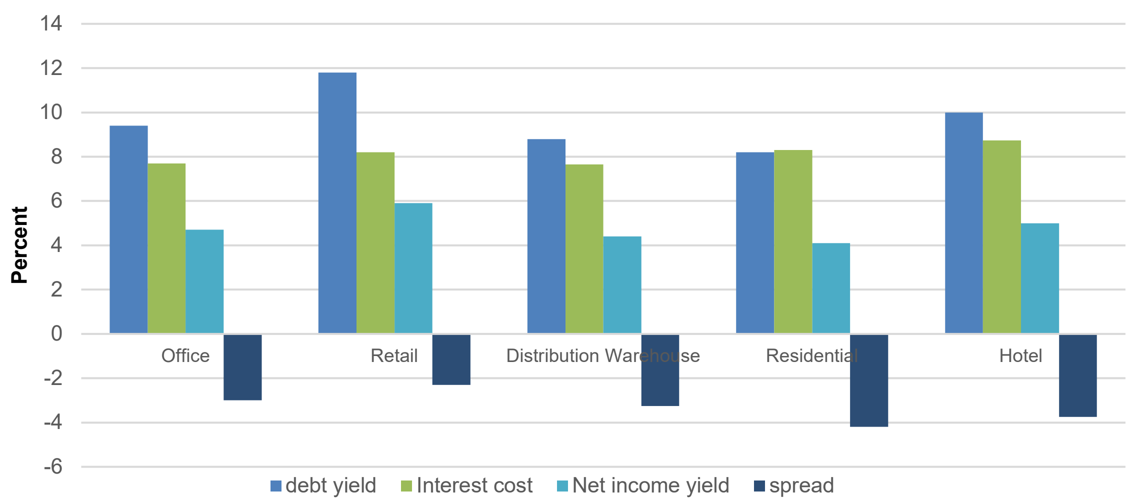
5.2. Debt yield & sustainable LTV

The Debt Yield – defined as property net income divided by the loan advance – provides an alternative to the conventional setting loans relative to capital value and the comparison of borrowing costs against property yield. The Debt Yield stands as an income-based measure of loan underwriting which avoids the potential inflation of debt with artificially low property yields or lending margins. Historically, lower debt yields (4–7%) indicate higher leverage and therefore, higher risk. Conversely, higher debt yields indicate lower leverage and thus, lower risk (8–12%). The debt yield is used to ensure a loan amount is not inflated due to low market cap rates, low interest rates, or high amortisation periods. The debt yield is also used as a common metric to compare risk relative to other loans. Given the low income yields over the past years on properties, debt yields are at overall low levels, leading to levels 40-45% below previous levels. This has also resulted in lower loan amounts of 50 – 55% LTV across all property types.

Figure 26 shows a generic example using real estate income returns represented by the MSCI Initial Yield. The calculation of Debt Yield is derived from:

Debt Yield = MSCI Average Initial Yield / 100 x CRE Loan LTV.

Figure 28. Debt yield by property type at 50% LTV, %



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report, MSCI

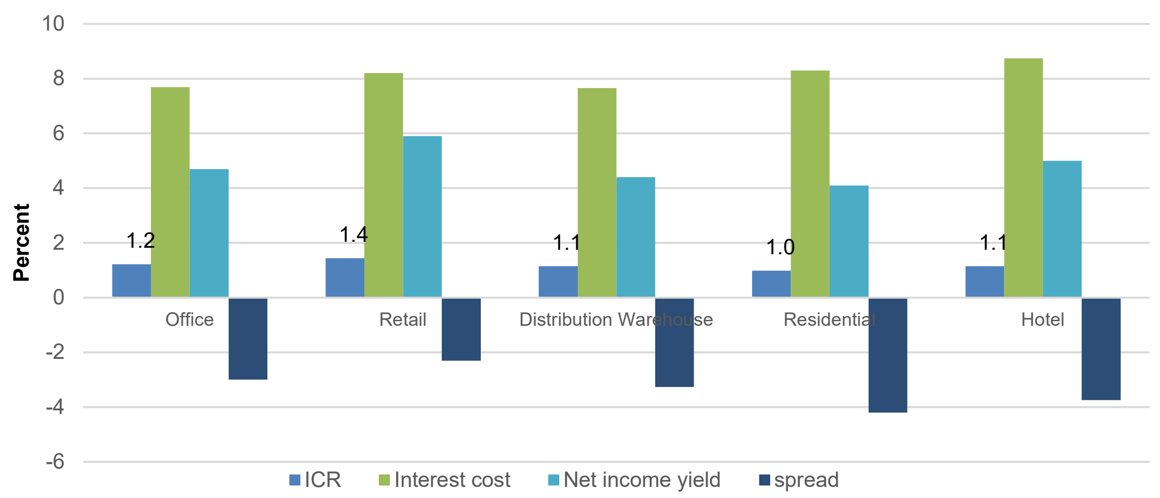
Figure 26 also shows current assumed debt yield for different property types at 50% LTV based on 5-year 5yr Sonia swap + loan margin.

- Across all property types, there is still a negative spread between all-in interest costs (5-year Sonia swap (30 June 2024) at 5.1%+loan margin) versus property yields. Together with low property net income yields, lenders are still lending at low LTV of 50% - 55% against prime property.

- Property yields for non-prime assets and locations have increased and can be up substantially from the prime yield. Secondary properties, such as logistics and office are believed to be at fair value.

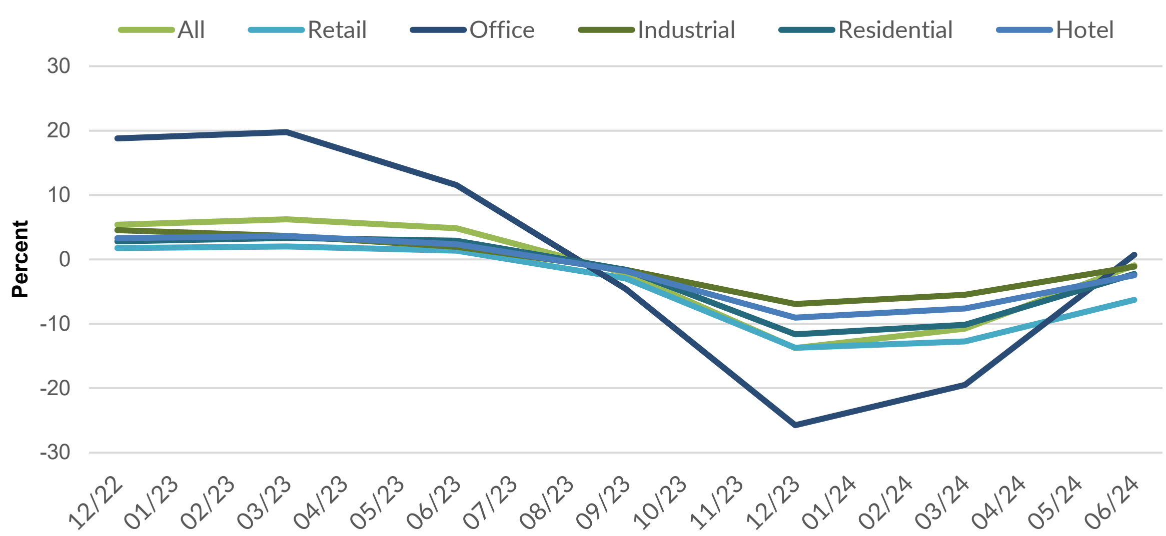
Figure 29 shows the implied ICR for a 50% LTV by property type using MSCI net income yields. At 50% LTV the implied ICR is still at the minimum levels of around 1.1x – 1.4x for prime properties. Hence, it is not surprise that new ICR covenants in loan agreements are set to lower levels, to avoid ICR breaches very early on into the loan term.

Figure 29. Illustrative ICR cover ratios, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report, Bloomberg

Figure 30. MSCI Asset value growth by sector, June 2004 – June 2024



Source: MSCI UK monthly index

- Figure 30 displays the asset value growth for the main five asset classes.

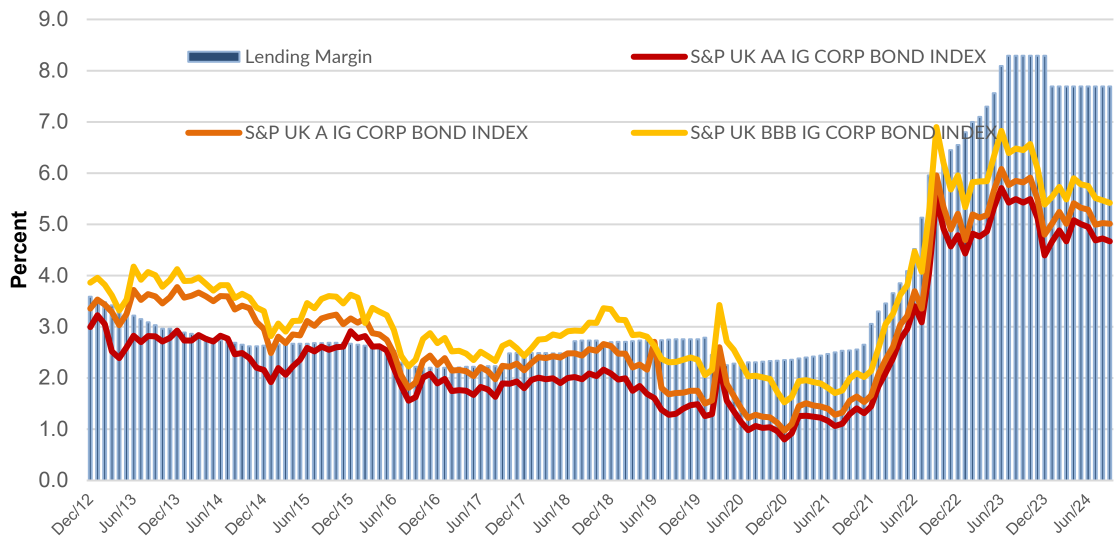
- According to MSCI data, the CRE asset values suffered significant losses in 2020 due to the pandemic. The impact was driven by the sharp decline in Retail assets (-464bps in May 2020 alone), whereas Industrial was the most resilient asset class.
- In 2021, the asset values bounced back with 1.3% average growth and Industrial assets outperformed the other asset class with 2.6% growth.
- However, in 2022 the Ukraine-Russia war and the following inflationary period resulted in a price correction. CRE asset values decline by 108bps across all sectors except from the more resilient residential assets. Industrial assets considered to be overpriced and their value dropped by 1.47%.
- In the first half of 2024, during the first six month so 2024, the capital value growth index is still negative, with only two sectors experiencing capital value growth (retail 0.1%, industrial 0.8%), but offices still loosing 2.8% over six months, hotels 1.1% and also residential 0.4%.
- Overall, in the last five years, CRE asset values experienced significant volatility, resulting in LTV covenant breaches for many borrowers.

The scenario assumes a 5-year loan at 50% LTV based on 5-year Sonia+loan margin. With expectations that the 5-year Sonia swap rate might fall slightly in the next 3 months, this would mean a minimal improvement in loan interest costs. Another option is to choose an even longer-term rate to minimise loan interest.

A last point of comparison for CRE lending rates is lenders' interest income –lending margin + 3month Libor/Sonia– representing the income received by lender against BBB and A non-financial corporate bonds, as shown in Figure 31.

Up until June 2020 real estate loan pricing was below BBB corporate bonds but above AA and A rated bonds, which can be considered very tight given that most REITS only achieve ratings between A – BBB. The relationship changed again by the end of 2020 and throughout 2021 and 2024 loan pricing increased, while corporate bond pricing declined. This had fuelled a new issuance of corporate property bonds especially for well rated property companies. From the start of January 2022 the pricing gap between CRE loans and BBB bonds (spread) has been widening till early 2024, when interest rates started to show a slight decline. Overall there is a now a large spread differential between CRE loans and BBB bonds.

Figure 31. Borrowers' cost and corporate bond yields %, H1 2012– MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report; Bloomberg

5.3. Interest rate policy & hedging

The global economy has moved from a period of long-term low Interest rate cycle to a period of consecutive interest rate increases, staring in January 2021 with the first increases till July 2024. In July 2024, the UK base finally declined by 25bps to 5% from 5.25%. This was less then anticipated but borrower are seeing a little relief.

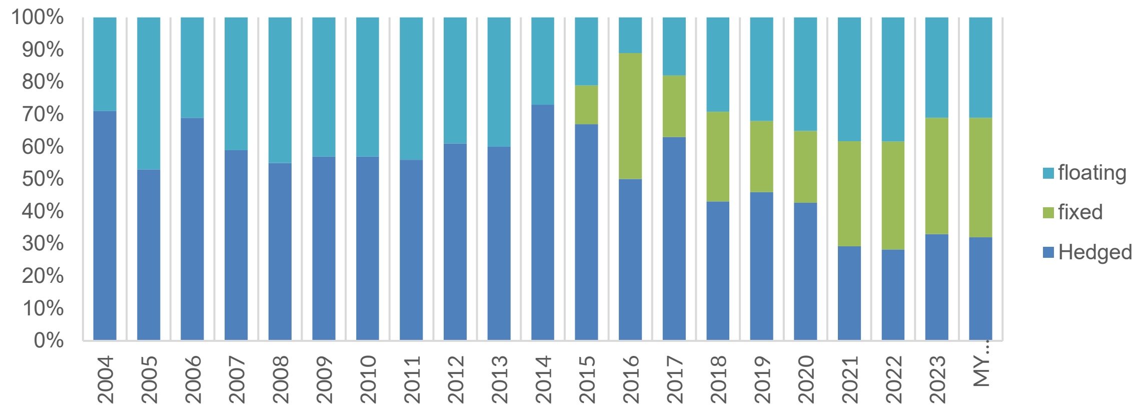
Since the interest rate shocks of the early 1990s which trapped many floating-rate real borrowers between rising debt costs and falling real estate asset values, it has been common for lenders to make interest rate hedging a condition of loans, or less often, to set fixed interest rates on their loans. In the post- GFC economic and interest rate market much of this had been neglected. Previous CRE Lending Surveys have shown that up to 2013 around 60% of outstanding loans were hedged with an interest rate Swap or set at fixed interest to the lender but that proportion has run at a higher 70%-80% from 2014 on with a peak in 2016 (89%). Since 2021 have started providing more fixed term finance, when at the same time, hedging has become less common. Since 2021, this shift to fixed rates loans and the decline of hedged loans using swaps has several reasons:

- Long-term low interest rate environment and market expectations on the Bank of England's monetary policy.
- Banks were being sued for miss-selling interest rate swaps, which means fixed rate loans have a lower reputational risk for them now.

- German Banks and Other International Banks typically mostly use fixed loans in their home markets, and the UK with the use of interest rate swaps was already an exception for them.

At MY 2024, 37% of loans were fixed are loans, another 32% were hedged, while 31% remained floating.

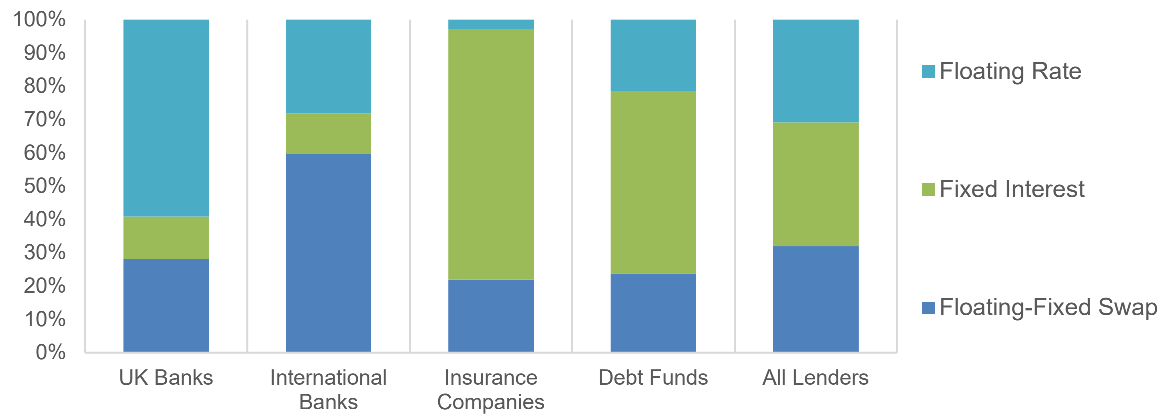
Figure 32. Interest rate basis, % by value of outstanding loans by loan book size, MY 2024



Source: Bayes Business School Commercial Real Estate CRE Lending Survey

Loan pricing since 2020 is based on three months Sonia rate as a reference rate or the corresponding 5-year Sonia swap rate for hedged loans. UK Banks reported a large share of 59% of their lending book to carry a floating rate, however, this is intricately linked to the large amount of development facilities, which are not paying current interest, but interest is rolled-up into the outstanding amount during the development period.

Figure 33. Interest rate basis, % by value of outstanding loans by lender type, MY 2024



Source: Bayes Business School Commercial Real Estate CRE Lending Survey

As shown in Figures 31 and 32 interest rate policies vary widely across lenders of different types and sizes. Figure 31 shows the percentage of loans in the three categories for the period 2004 up until June 2024. Low interest rates encouraged borrowers to use floating rates and not to use any hedging.

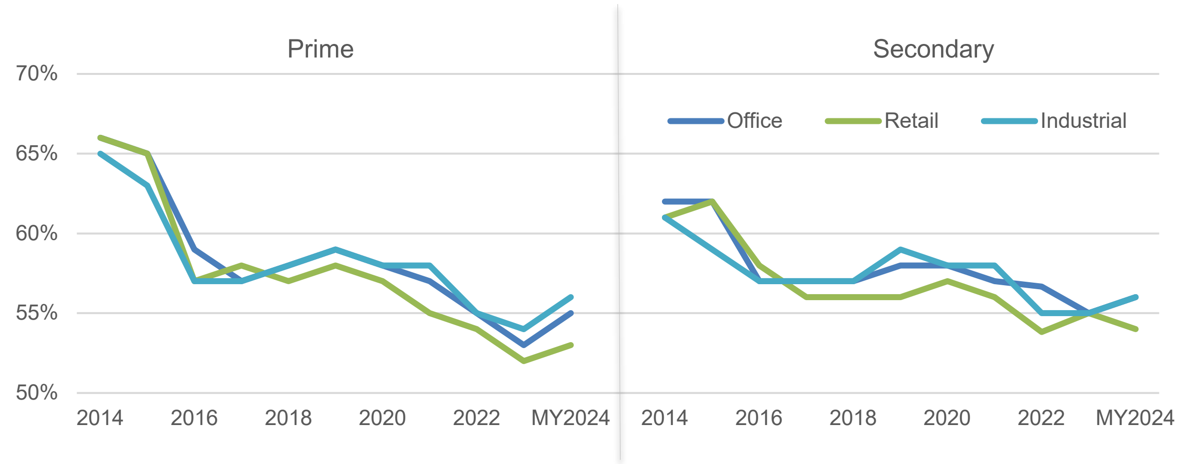
- Bank lenders with an in-house capability to arrange Swaps are most inclined to apply Swap hedging but there has been a shift in bank behaviour. In 2019 still 80% of German Bank loans used swaps when in 2020 it was only 69% . In total 60% of outstanding loans on books of International Banks were using a fixed-floating rate swap.
- Insurance Companies reported to have 75% of their loan book in fixed rate loans. This helps them with liability matching and managing their customer claims.
- Debt Funds by default offer more fixed rate loans, 55%, they require another partner institution to arrange a hedge via a swap, which is a derivative. This adds additional cost for the borrower to their often already slightly higher loan pricing, hence only 24% of loans are using a swap derivative for hedging.

5.4. Target LTV and lending margins

This section details lending terms over time across types of projects, property type and quality. Respondents are asked the maximum Loan-to-Value ratio they currently set on new loans (and Loan-to-Cost for development projects) together with their target lending margins over Libor and fees. From July 2020, the basis of lending margins has also been changed to 3-months Sonia. Quoted margins are provided over Sonia. Not all respondents are prepared to quote pricing terms.

For June 2024, the analysis is based on returns from 47 lenders, who provided terms across a range of the categories requested. As would be expected, more lenders state terms for prime property, while responses on secondary property and development lending come from the smaller numbers who lend in those segments of the market. It should be borne in mind that the terms quoted are general lender targets and not the finally agreed terms, which will vary loan by loan with the borrower and asset-specific circumstances.

Figure 34. Average of maximum senior loan to value ratio by property sector, % 2013–MY 2024

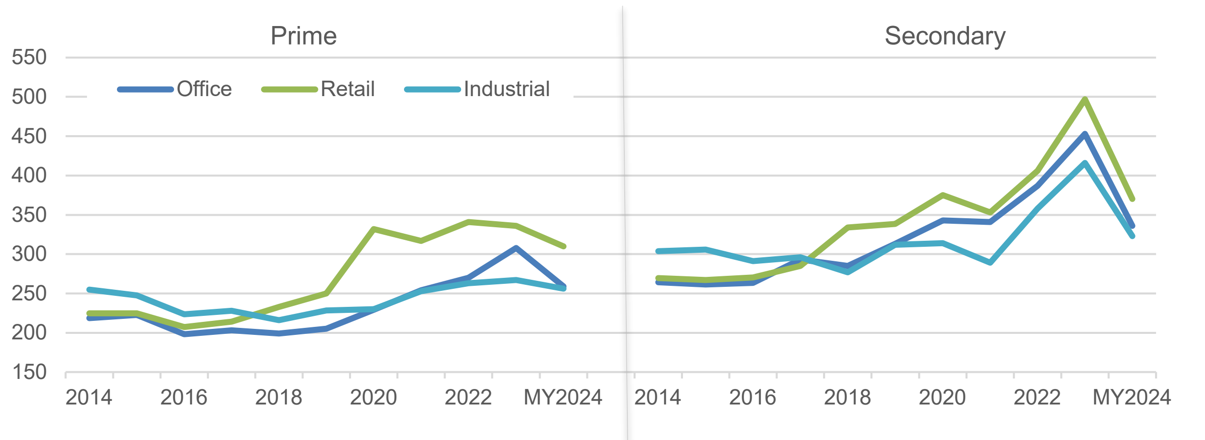


Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Regarding Loan-to-Value, there has been little differentiation between sectors since 2010. The overall cut in prime LTVs post-GFC and convergence across sectors may be the outcome of several factors pushing in the same direction. Foremost is regulatory pressures on bank lenders through international Basel standards and the somewhat more stringent UK Slotting rules, which broadly require higher capital reserves against loans above 60% LTV. Only non-bank lenders in the market are free from this restriction and may more often offer higher LTV's. Figures 33 and 34 plot the headline LTV and margin terms since 2014.

- MY 2024 has been the first time since the pandemic in 2020 that lenders are competing fiercely on loan-to-value range, with LTV ratios pushing upwards, with 25% of lender offering up to 60% LTV across asset classes, and on residential investment property up to 65% LTV
- The senior LTV rate lending against prime asset types had reached a trough in 2016, falling from 65% LTV to below 60% LTV, this decline was driven by regulatory changes. However, from the pandemic in 2020 LTV levels have dropped further, reaching a new trough, falling below 55% LTV, close to 50% in many cases. This change was driven by real estate market changes.
- Whole loans are available for prime office and industrial up to 75% LTV and prime retail and office up to 70%, however due to the overall high interest costs, this is likely not to be economically viable.

Figure 35. Average senior lending margins by property type bps, 2013–MY 2024



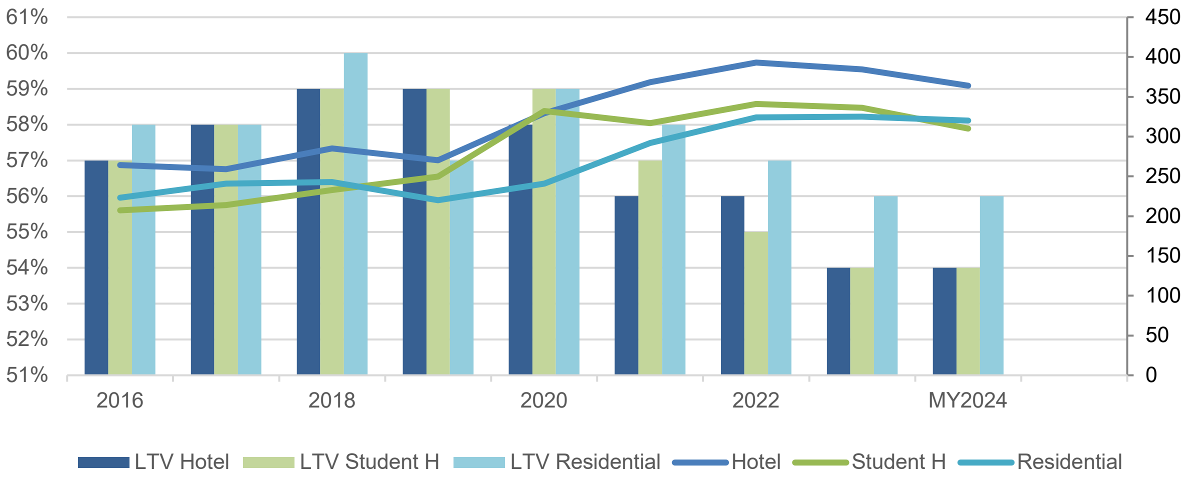
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Loan Margins: When turning to target lending margins there is a principal point of contrast between grades of underlying assets:

- Across property types, the previous cycle peak was reached in 2012 (prime office 324bps). Between 2013–2016 margins declined, reaching a new low in 2016 (prime office 198bps).
- Over the first six months of 2024, lenders have been competing for very few transactions in the market, hence LTV ratios and margins have been very tight, with margins moving down across all property types. Loan terms against prime office assets showing a 15bps compression, prime retail 26bps compression and even prime logistics still showing loan compression by 11bps.

- Also lending against secondary asset types is showing loan margin compression, with secondary office showing loan margin compression of 43bps followed by secondary logistics with 42bps.
- The living sector had reached its peak pricing in 2022/2023. Most competitive loan pricing is still available for residential investment loans, followed closely by student housing.

Figure 36. Alternative assets, average senior lending margins by property type bps, 2013–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Amortisation: despite low LTV levels, depending on the property type amortisation will be included in the financing terms.

- Out of 39 lenders that quote pricing for Senior Prime Office, 11 require amortisation for major prime asset classes and generally for loans above 55% LTV.
- Amortisation ranges from 75bps to 500bps per year. Some lenders require a specific LTV target level to be reached at exit over a 5-year period, while others provide a 25 yr term of amortisation.
- International Banks and debt funds are offering interest-only loans for lower LTV range up to 55%, while most UK Banks require amortisation.

With prime property repricing, slightly lower base rates from BoE and very tight margins, LTV ratios have moved upwards, and lenders are competing fiercely for few market transactions. While most lenders have reduced their loan margins over the last six months, some additional fees might have been added to arrangement fees and exit fees. Another area lenders are competing on are more flexible covenant levels, and ICR covenants can be as low as 1x or 1.1x.

Table 7. Margin quotes received by type of asset.

	Lenders H1 2024	Banks	Debt Funds	Lenders quoting YE 2022
Prime office	41	20	21	40
Prime retail	31	15	16	26
Secondary office	18	11	7	24
Secondary retail	12	9	3	11

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

A total of 41 lenders have quoted margins for prime office and 31 lenders have quoted for prime retail. However, there was further reduced appetite for financing secondary properties. Only 18 lenders that provided quotes in H1 2024 for secondary offices, and 12 lenders provided quotes for secondary retail.

While loan terms on new acquisition loans are extremely competitive with increased LTV levels, low margins and low ICR covenant levels, refinancing terms are less favourable. On existing loans with high LTVs, many lenders require the extra surplus to be taken in a full cash sweep to amortise the outstanding debt down to acceptable LTV levels. In addition, more fees apply for extensions or restructuring of loan facilities.

Table 9 provides additional detail on senior lending terms and Table 10 the same metrics for junior loans. Especially margins for logistics/industrial property continue to be incredibly competitive. 'Last mile' logistics assets have been highly sought after by investors and lenders. Even on secondary logistics assets, lenders are pricing loans very competitively. Lenders, who cannot compete within the main commercial property sectors look for extra returns from more specialist asset types, such as Data Centres, Life Sciences and Hotel and Student Housing.

Table 8. Senior debt – target lending terms by property type, June 2024

Property type	Average LTV %	Average Margin bps	Diff from 10 Year Avg bps	Arrangement fee bps
Prime				
Office	55%	259	31	114
Retail	53%	310	46	111
Industrial	56%	256	13	110
Secondary				
Office	56%	336	28	140
Retail	54%	370	46	155
Industrial	56%	323	13	122
Residential	58%	320	57	107
Hotel	55%	364	19	125
Student Housing	55%	275	47	102

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Generally, lenders are favouring lending against assets in the “living” sector, such as residential, student housing, or hotels.

Junior loan pricing has declined significantly, due to the highly competitive pricing of the senior loans and limited demand for junior loans. Borrowers typically choose to preserve the maximum return for the equity investors by keeping leverage at moderate levels.

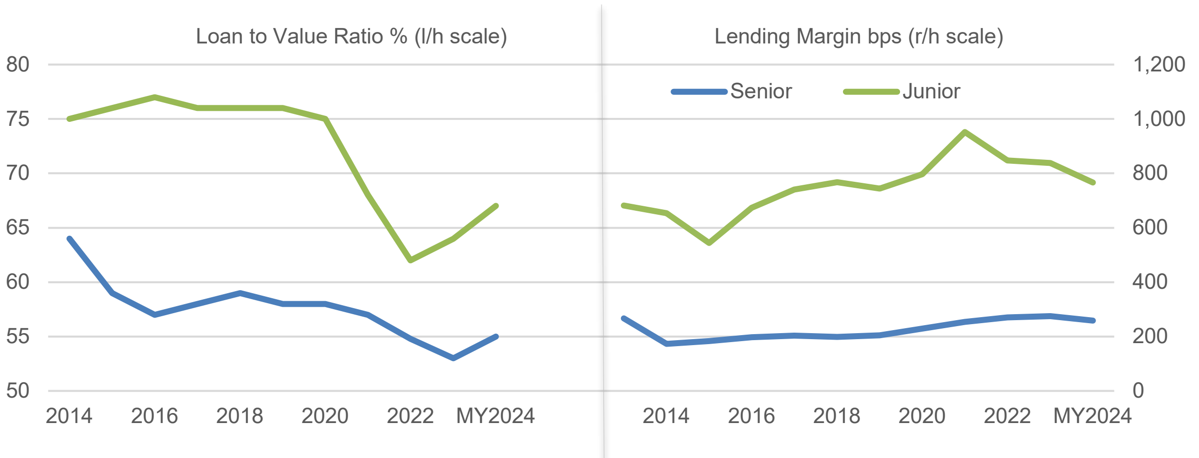
Table 9. Junior debt – target lending terms by property type, June 2024

Property type	Average LTV %	Average Margin bps	Diff from YE 2023	Arrangement fee bps
		Prime		
Office	67%	766	-72	138
Retail	66%	754	-72	141
Industrial	69%	723	-12	131
		Secondary		
Office	66%	839	-373	139
Retail	55%	817	67	133
Industrial	66%	764	-338	129
Residential	66%	716	-137	142
Hotel	64%	843	-3	116
Student Housing	65%	698	-291	116

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- Due to many new market entrants in the alternative lending sector, the range of available junior loan financing has been extended starting from 55% - 80%. This results into an average of 67% LTV for junior prime office loans with a loan margin of 766bps. In addition, lenders may charge arrangement and exit fees. The lower cut-off for senior lending allows lenders to price whole loans and junior loans at high interest rates and also increase the loan portion of the junior loan.
- Junior lending against secondary commercial property types has also declined in pricing and increased in the upper limit of LTV levels. Some income loss due to the lower loan margin offered is recovered via charging slightly higher fees at the beginning and exit of the loan.
- Figures 35 and 36 track prime and secondary, senior, and junior loan terms over the last decade.

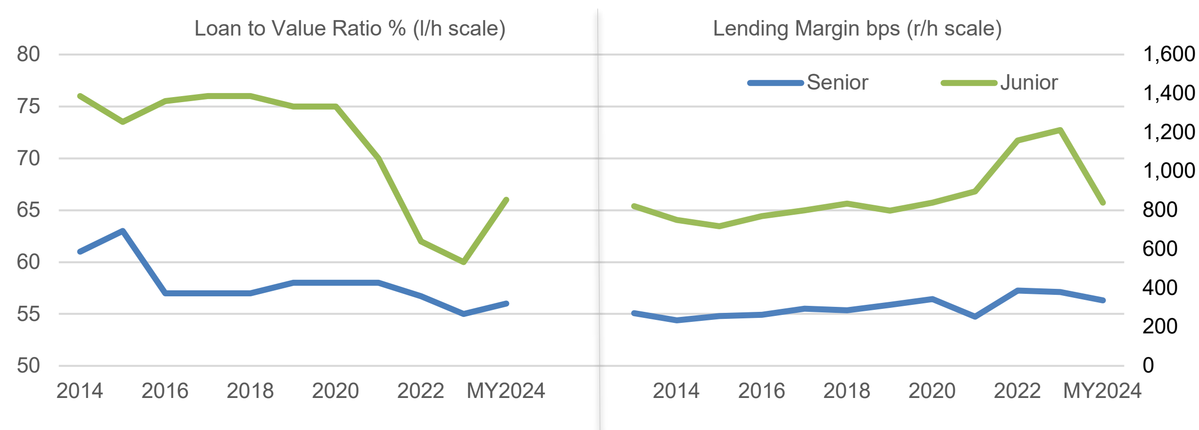
Figure 37. Prime office - target lending terms for senior and junior loans, 2013–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

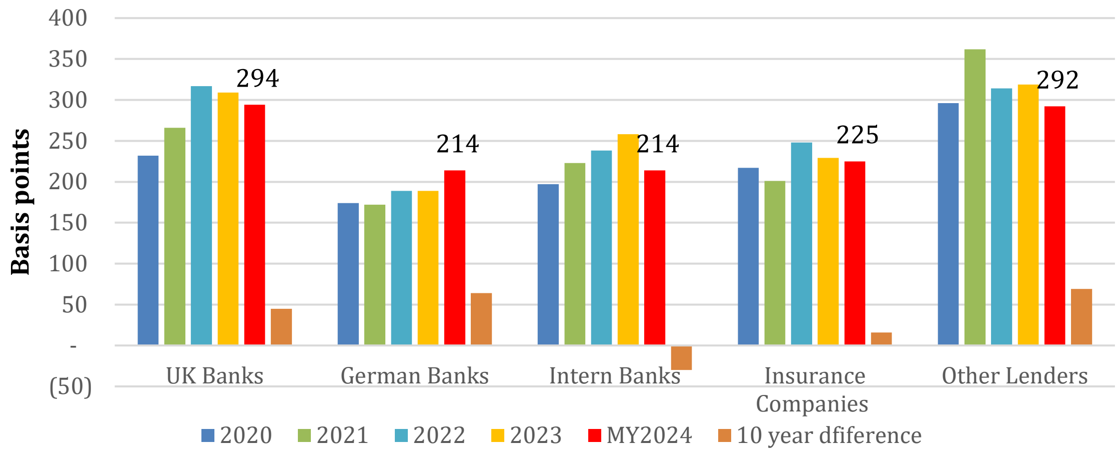
- There is a clear increase in junior LTV levels, pushed upwards by the increasing senior LTV level and more aggressive loan pricing for junior lending.

Figure 38. Secondary office – target lending terms for senior and junior loans, 2011–June 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

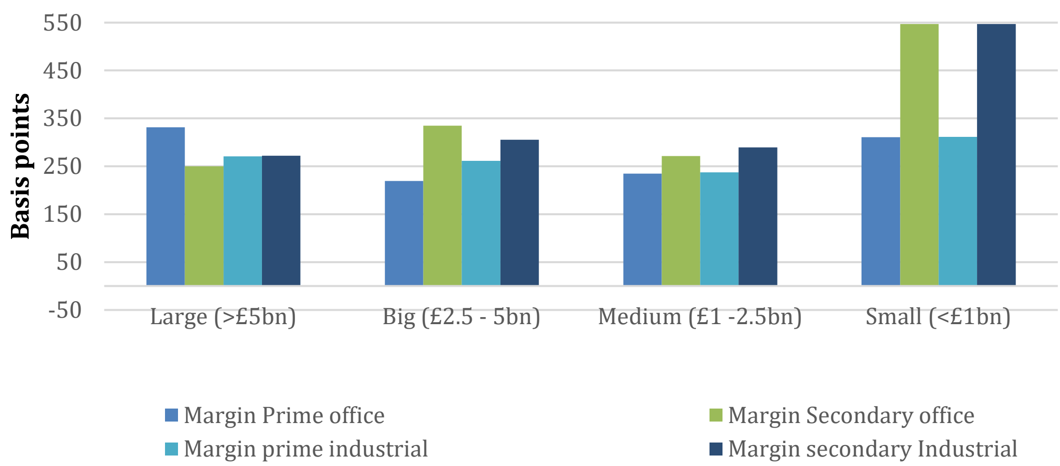
Figure 39. Prime office lending margin by lender (basis points), MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- As displayed in Figure 37, more significant differences have been detected in loan pricing between different lenders depending on the size of their loan books and type of lender origin.
- Over the past six months, all lenders have reduced their loan pricing levels to stay competitive.
- When considering the size of lenders loan books, lenders with loan books >£5bn or >£2.5bn offer margins below or around 280bps. Smaller lenders are more expensive especially with regards to secondary property, but across property types offer slightly higher LTV at day one.

Figure 40. Prime office lending margin by lender loan book size (basis points)



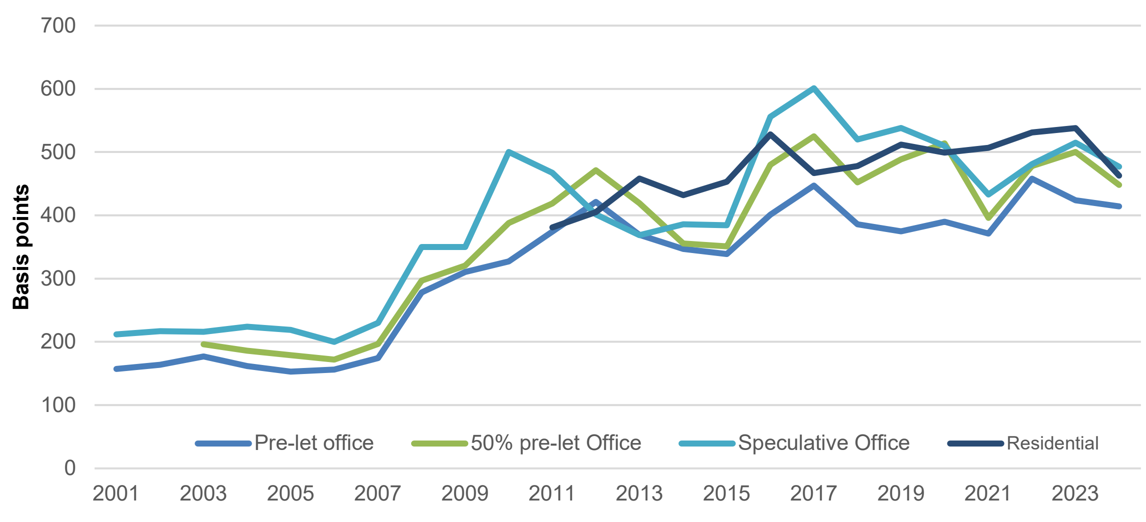
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

5.5. Pricing of development loans

Only a minority of lenders are active in or targeting development lending, even fewer in speculative schemes. Therefore the 2024 quotations on terms in this section are based on 21 lenders providing pricing for commercial developments and 30 lenders providing terms for residential development. Development lending, expressed in terms of lending margins, has followed a different path from the investment lending described in the last section:

- Over the last years, target margins for any type of development finance remain high, not only against the 150-225bps margins prevailing before 2008 but also against the low point reached in 2015/16. At year-end 2022 margins development finance pricing increased further across all sectors. Margins for residential developments and pre-let commercial development are at their 20-year period peak.
- In MY 2024, margins for development lending increased by 41bps and 27bps for speculative and half speculative/half pre-let schemes.
- Average margins for pre-let schemes alone declined, however this is due to the lower LTCs lenders are currently offering. At 45% LTC, pre-let development margins fell by 19bps and for 55% LTC by 26bps.
- Residential development finance has been offered by a changing range of market players. Only 14 of 30 lenders active in 2024 were banks, the rest were insurance companies and non-bank lenders. Residential development margins did not increase in H1 2024, but they are still higher than the 5-year average.

Figure 41. Target senior lending margins for development loans bps, 2002–MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Table 11 gives a broad view of current development lending terms.

- Judged by the number of lenders providing information, there was a slight increase in lender willingness to contemplate residential development finance through the first half of the year. However, fewer lenders have provided quotes for other types of CRE development finance.

- There is more liquidity again in pre-let commercial development lending and even for speculative schemes. A total of 11 lenders were offering speculative development financing terms, compared to 12 in December 2022.
- Overall day-1 LTC loan amounts have been reduced to less than 60% LTC, reflecting a 50% LTV on completion.
- Arrangement fees range from 111bps to 143bps.

Table 10. Average senior lending terms for development loans, June 2024

	Lending margin bps	Arrangement Fee bps	Loan to Cost Ratio %	Lenders quoting MY 2024
Commercial pre-let	414	115	62%	21
Commercial 50% Pre-let	448	137	59%	12
Commercial Speculative	477	141	57%	11
Residential	463	117	62%	30

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Tables 12 and 13 offer additional details about terms for senior and junior lending per each group. The most expensive margins provided by Debt Funds across all types of development sectors, whereas Insurance companies and German banks are more cautious offering low LTVs and pricing.

Table 11. Senior lending terms for development loans, June 2024

	Pre-let dev LTC	Margin bps	50/50spec LTC	Margin bps	Spec LTC	Margin bps	Resi dev LTC	Margin bps
UK Banks	66%	392	45%	350	#DIV/0!	#DIV/0!	68%	489
Intl. Banks	53%	381	55%	413	55%	450	55%	358
Insurance Companies	51%	363	55%	375	48%	385	52%	416
Debt Funds	67%	448	61%	464	60%	506	66%	495
All Lenders	62%	414	59%	448	57%	477	62%	463

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Junior finance can almost only be sourced from debt funds. Banks may occasionally provide higher LTC financing in the form of whole loans and additional drawdowns if the borrower already has a development loan from the same bank.

Loan packages for development schemes, especially those from Debt Funds, are typically more complex and bespoke than for investment properties, making terms difficult to summarise and compare. On junior loans, lenders will use a combination of lending margin, arrangement fees, exit fees and perhaps some form of conditional participation in profit to arrive at target returns. For this reason, terms are also expressed as IRR, where sufficient responses were given. For senior development finance, target IRRs on pre-let commercial schemes stand at 9%-18% and for residential development at 10%-17% and 7%-14%.

Table 12. Junior lending terms for development loans, June 2024

	pre let dev	Margin	50/50spec	Margin	Spec	Margin	Resi dev	Margin
	LTC	bps	LTC	bps	LTC	bps	LTC	bps
Banks	62%	575	60%	750	63%	800	64%	464
Debt Funds	65%	575	63%	825	64%	1000	69%	475
All Lenders	65%	607	63%	825	64%	857	70%	762

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

5.6. Summary

The current terms applied by lenders have adapted to the changes in regulatory frameworks and persistently low interest rates of the last decade. Actual loan margins have started increasing slowly since 2015/16 due to several economic and political effects. Together with other indications, such as low origination and growing loan book levels, margins also suggest a new lending cycle has started.

- Typical lending margins have reached a turning point in December 2016, and they are increasing even since with current margins to be the highest since 2012.
- The upward trend is observed across all asset classes. Across the three main asset classes, retail is the most expensive with margins above 350bps, followed by offices and industrials just below 280bps. For secondary assets, margins vary between 360bps for industrial and 400-420bps for retail and office.
- Margins on development loans have risen sharply in the period 2015-2022.The upward trend continues in 2024 for speculative development finance. Pre-let schemes are priced lower but this due to fewer lenders providing quotes for LTCs above 60%. At 55% LTC margins increased by 26bps. Residential development margins are at the same levels as before at 530bps.
- The upper bound for senior LTV ratios and prime assets has settled at 50%-54%. However, lenders ideally want to lend between 50-55%, despite their lending policy allowing slightly higher LTV's. Slightly higher LTV ratios can be obtained by Debt Funds on a whole-loan basis.
- Across secondary assets, LTVs have settled between 54% and 56%, with offices to experience the greater decline by more than 100bps.

6. Loan book quality

This section reviews the long-term cycle and process of normalisation in loan books and summarises current lenders' risk exposure indicators at MY 2024.

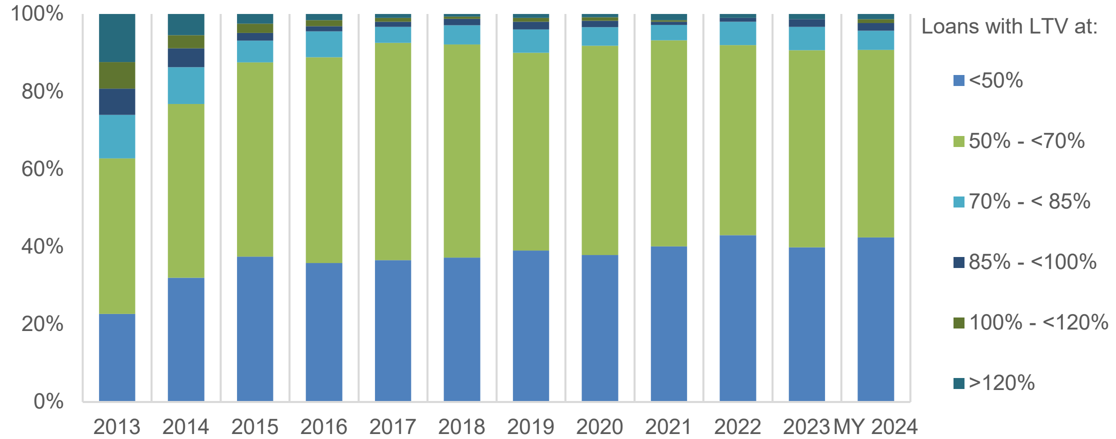
6.1. Loan book risk

On standard underwriting metrics, the status of loan books has improved enormously from the low points of 2010-2012, with LTVs suggesting good coverage against any dip in capital values. However, many covenant breaches have been recorded over the last 6-12 months, but as valuations are being delayed, lenders take no further actions so far.

- Since the previous GFC, banks have been writing senior loans with maximum LTV ratios of 50–60%, so their risk is considerably lower than in 2007/08. However, some financing structures have used higher leverage.
- UK banks strict slotting requirements to determine risk capital held for CRE loans means that 55% of their loan books is below 50% LTV, followed by Insurance Companies which hold 46% of their loan book below 50% LTV.
- In H1 2024, a total of 2% of outstanding loan are in negative equity (>100% LTV) and another 8% are between 70 – 100% LTV. Debt Funds reported 15% of their loans between 70 – 100% LTV and 32% between 60 – 70% LTV. In order to stay competitive many lenders offer senior loans again above 60% LTV at day-one.
- The first sign of a shift in the lending cycle has nevertheless been visible since 2017, in the trend to lower ICR cover ratios of loans on lenders' balance sheets, which coincides with the first rise in the incidence of defaults since 2011. In addition, a slight shift in LTV levels on outstanding loans towards higher LTV loans is becoming visible.

Figures 35 and 36 track the two key indicators of loan quality – current LTV and Interest Rate Cover (net income from asset divided by debt interest due).

Figure 42. Outstanding loans by LTV band, % of book value 2013–MY 2024

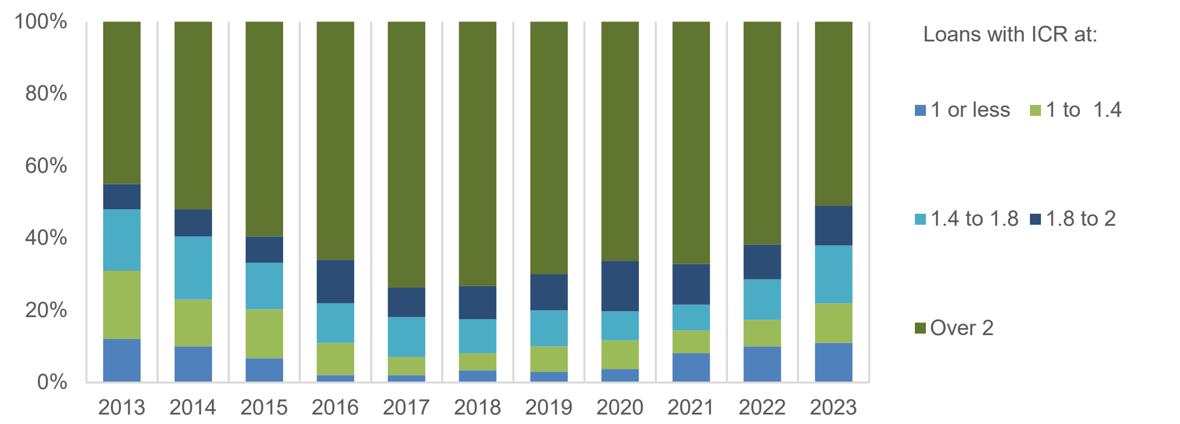


Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- Average loan book LTV was highest in 2013 with 37% of loans showing a higher than 70% LTV. The amount of continuously fallen to 6.7% in 2017. It has been largely stable reaching 9% in MY 2024. This can be due to minor changes in whole loan and junior lending and cannot be attributed to a fundamental change in real estate lending risk.

- Overall ICRs have increased until 2017 when they reached a maximum. Loans with ICR levels below 1.4x increased to 23% from 15% over 12-months. Loans with an ICR of less than 2x account for 52% (from 34%).

Figure 43. Outstanding loan by ICR band, % of book value 2013– MY 2024



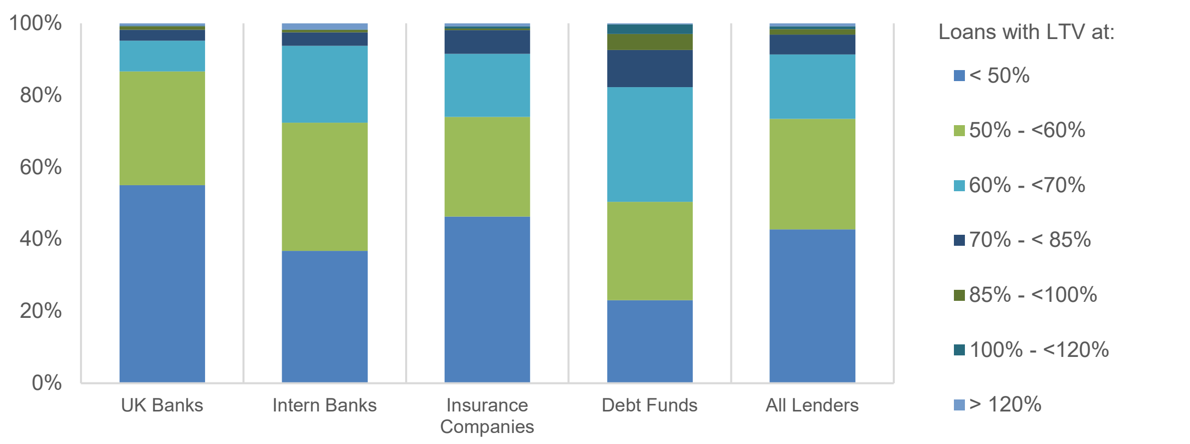
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- Lenders with higher average LTV loans on their loan book also report the lowest ICR coverage levels, hence Debt Funds reported 62% of their loans with ICR levels below 1.4x. This means half of their book could experience an ICR breach with only one tenant leaving or not paying.

- Insurance Companies, which provide a lot of whole loan lending also have 27% of their loans with ICR's lower than 1.4x (previously 14%).

- Lenders with larger shares of loans still above >2x ICR are UK Banks (57%). In the current environment this is often related to long-term hedging in place.

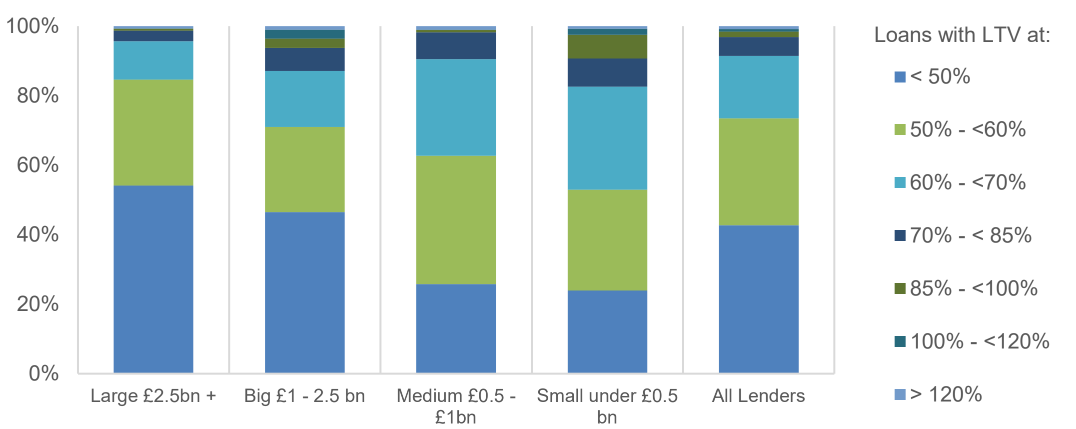
Figure 44. Outstanding loan % of value by loan LTV band and lender type, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- The largest lenders in the market show the lowest risk profiles in terms of LTV ratios of their outstanding loan book. At H1 2024, 54% of their loan book was below 50% LTV and 84% below 60% LTV.
- In comparison smaller lenders hold 47% in H1 2024 of their exposure in loans above 60% LTV. In general, smaller lenders specifically lend more in the LTV range 60 – 70%, which accounts for 30% of their lending.

Figure 45. Outstanding loan % of value by loan LTV band and lender size, MY 2024



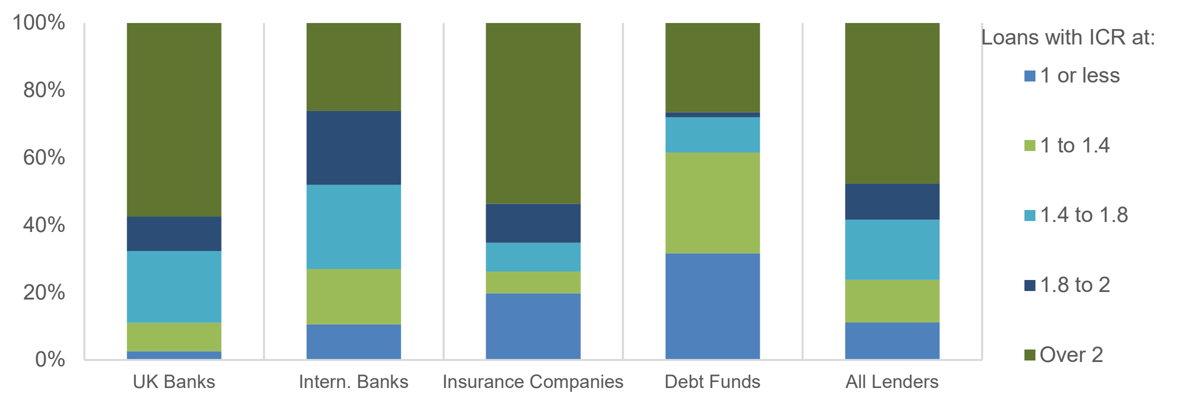
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

These differences in loan book security are, to an extent, matched with current lending policies. Given their freedom from the regulatory constraints applied to banks, and in some cases higher target returns to investors, Debt Funds have a higher tolerance for subordinated and development loans at higher LTV's. Due to their slightly higher return requirements, they can also not compete with banks in the prime senior lending space, hence they gain an advantage by offering slightly higher LTV-loans.

At MY 2024 figures also showed substantial variation in loan book security across lender types and size (Figures 44 and 45). The importance of economies of scale for the lending business has been discussed in various places. Lenders with largest loan books, have access to lend against assets of higher credit quality, hence they report most of the loans with ICRs above 2.0x, while especially for smaller lenders loans with ICR levels of less than 2x now account for 70% of total loans, indicating that lenders have to monitor a large amount of their book very closely. For the largest lenders 54% of loan exposure still sits above ICRs of 2x.

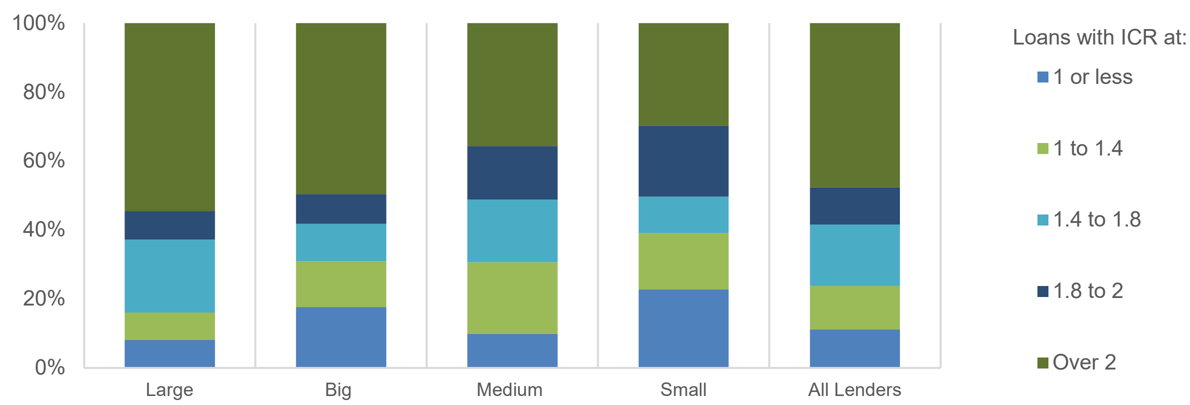
While loan book LTV's are only shifting slowly, because new loans will be added again at lower LTV with new valuations, interest cover ratios are showing more downward movement, with significantly more loans with low ICR's between 1.0 – 1.4x reaching 13% of total loan books and 11% at 1x or below.

Figure 46. Outstanding loan % of value by loan ICR band and lender type, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 47. Outstanding loan % of value by loan ICR band and lender size, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

6.2. Defaults and loss provisions

As noted in Section 2, between 2006 and MY 2024, the Survey identified £263bn of loans which were, at some point, defaulted to the extent of more than 90 days arrears in payments.

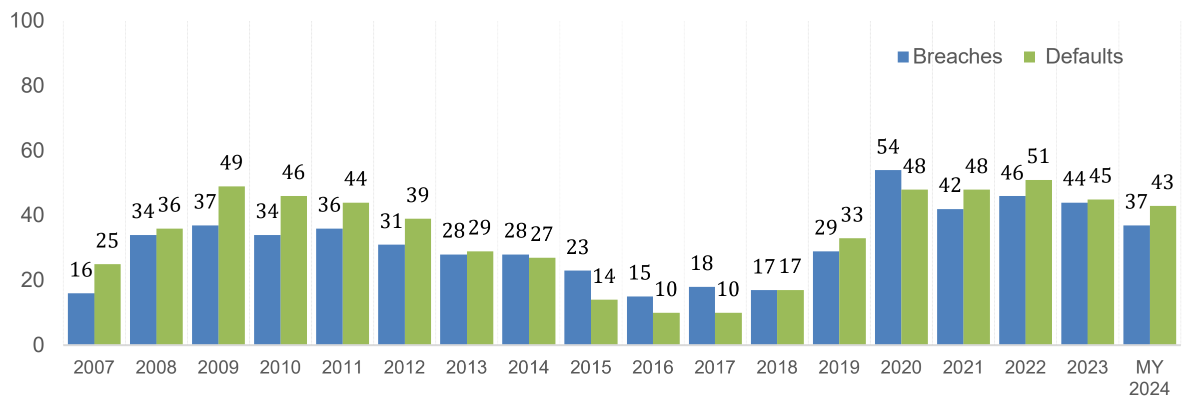
After tracking the lending and real estate markets through the major cycle of the 2000s it is fitting to conclude the history with measures of the impact, on both lenders and borrowers, of the leveraged boom and bust. As of June 2024, 50% of lenders reported loan breaches (42% in December 2023) and 59% defaults and increase of 3% from December 2023.

For loan defaults the Basel definition is used. It includes a delinquency-based component in which the delinquency level is set to 90 days past due. While this indicator understates the totals in breach of covenant, it also overstates the totals for write-downs and realised losses as many cases may cure.

As shown in Figure 45:

- Across all lenders, defaults rose from minimal levels in 2007 to a peak nearing 25% of all loans in 2011 and 2012, five years after a peak in loan originations and three years after the low point in market capital values , before subsiding steadily to around 3% in 2016.
- More detailed analysis of historic default results 2009–2012 suggests that default rates were higher, unsurprisingly, among lenders with a high exposure to development and less predictably with a higher exposure to provincial than London markets.
- The severity and timing of defaults varied widely across lenders, to a degree, as might be expected from their lending policies. German Banks historically experienced a lower default curve post GFC 2010 - 2013 while UK Banks showed the highest cumulative default rate.

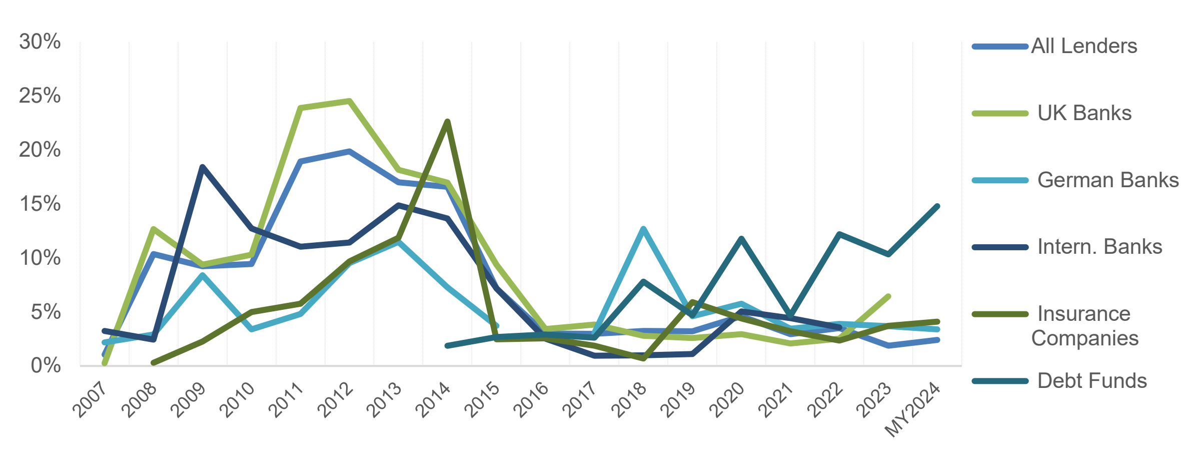
Figure 48. Number of lenders reporting breaches and defaults, MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- By December 2020 defaults have been slowly rising to 4.6% (3.2% in 2019) of outstanding loan book as the current Covid-19 crisis's effects will only become visible in another 6-12 months. As an indication from the beginning of the GFC in 2008, defaults peaked by 2010/11. Overall, £4.6bn of loans where report in default in 2020, but property values recovered quickly in 2021 and loans in default reduced back to £1.7bn.
- At year-end 2022 loan defaults have been slowly rising again to an average default of 3.5% across all lenders. The highest default rate was reported by Debt Funds with 12.2%. In total 9.3% of loans were in breach or default by the end of 2022.
- With the sharp rise in interest rates and decline in property values, resulted in a 4.9% average default rate of loan books by MY 2024 (up from 4% in MY 2023). A total of 9.7% of loans have been reported as under-performing (breach or default).

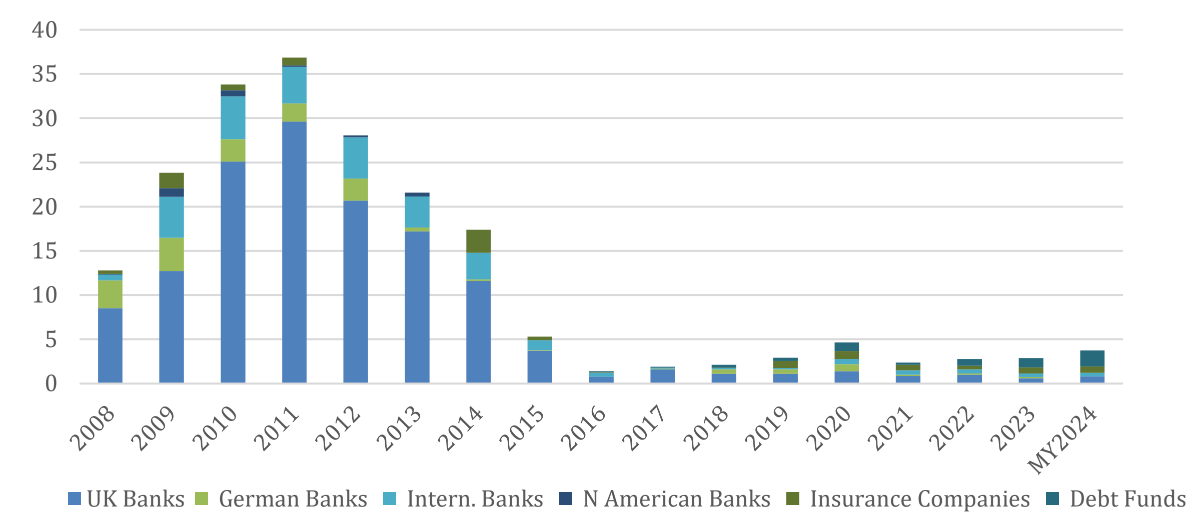
Figure 49. Value of loans in 90-day default as % of outstanding loans 2007-MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

- In absolute amounts defaulted loans reached £3.7bn at the end of H1 2024 with another £3.6bn in breach. Most important reason for loan breaches are set covenants of ICR as well as LTV breaches. The most common reason for loan default is non-payment at maturity, leading to an unwilling extension.
- Bank lenders are reporting the lowest loan defaults ranging from 2.4% - 3.4% of outstanding loan books. Insurance Companies are reporting slightly higher levels with 4.1%. Debt Funds can expect an average of 14.8% of loans defaulting within their live-time.
- The largest balance sheet lenders are reporting the lowest levels of default with 1.9% on average across the loan book, which can be considered exceptionally low for CRE lending. Mid-sized lenders might see default of 4 – 8% on average, but smaller lenders are seeing 10.2% of loans defaulting at some point before maturity, which is causing more intense management for these small teams.

Figure 50. Value of loans (£bn) reported in default by lender type, £bn, 2008–MY 2024



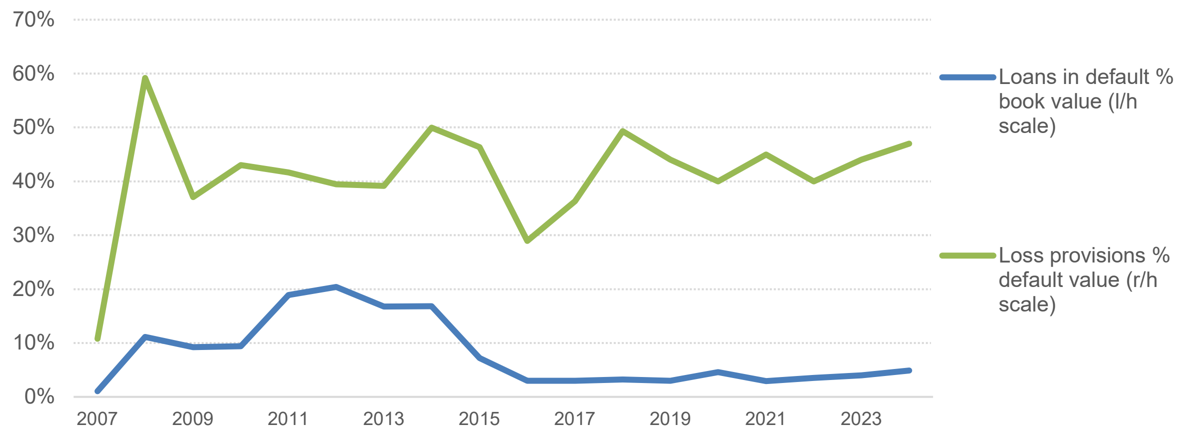
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 48 also reports an alternative, more finely tuned and timely measure of borrower stress: the value of loans reported as in breach of lending terms. What constitutes a breach will vary with the detailed conditions on which loans are advanced. However, the criteria would typically include exceeding a pre-determined LTV threshold or falling below ICR/DSCR multiple. A breach of terms would be expected to trigger a discussion on remedial action between lender and borrower and in most cases would not result in a default in payments.

- As we would expect, reported breaches leapt with the collapse in real estate capital values from 2007 to 2009. By 2009, loans in breach reached 47% of book value among those lenders reporting on this measure.
- Between 2011 to 2016 reported breaches fell steadily from a peak of £37bn to less than £1bn by 2016. However, since 2016 the trend has been increasing with reported breaches of £4bn in December 2020. By June 2024 breaches had declined to £3.3bn.
- In 2020 only, a total of 23 lenders reported having made provisions already. The average provisioning rate was only 9%. By 2021 with closer view to resolve the default provisioning went up to 15%. Finally, first write-offs crystallised in 2021 indicating an average write-off of 8%.
- After the pandemic, YE 2022 shows a new rise of loan defaults due to the increase in interest rates. 17 lenders have reported loan provisions, while 35 report loan defaults of a total of £2.7bn.
- At MY 2024, the average loan loss provisioning rate increased to 9.3%, however, there have been no significant loan write-offs. Provision were only reported by 16 lenders.

Loan breaches are only an early signal of potential defaults and losses and in many cases will result in neither. The extent to which defaulted loans are associated with lenders booking provisions for losses provides some measure of how serious lenders consider a breach. Over the last 3-5 years there has a notable change in lender provisioning behaviour. Out of 29 lenders reporting defaults, only 16 have made provisions for those loans. The average provisioning of these lenders was 47% of the outstanding defaulted loan amount.

Figure 51. Defaults and loss provisions, % of value 2007 – MY 2024



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Loss provisioning has declined from the 40%-50% which prevailed from 2008 to 2015 down to only 29% in 2016. At MY 2024 lenders average provision rate was 47%, but behaviour has varied from 90-100% provision, to more conservative actions of 10-30% provisions. This might also be because this concept only applies to banks and not to debt funds in the sample. However, bank lenders try to avoid setting provisions too high as it impacts banks' reported balance sheet performance and consequently affects shareholder value.

6.3. Summary of findings

On standard underwriting metrics, the status of loan books has improved enormously from the low points of 2010-2012 with senior LTVs suggesting good coverage against any dip in capital values, and remarkably high levels of income cover now the standard due to continued low interest rates.

- H1 2024 loan defaults are still controlled, with a 1 percentage point increase to a weighted average of 4.9%. Most increases were noticed within the Debt fund segment. The real rate of problem or under-performing loans has been report as 9.3%. However, with the survey's cut-off date on 30 June, some loans which might have been on balance sheet, could have been resolved within the period and would not be recorded by the survey.
- The risk metrics also vary across lender types: for banks of all origins, for example 79% of outstanding loans on bank loan books by value are at 60% LTV or lower while that proportion is only 50% for the Debt Funds, who are more inclined to take on subordinated debt and development funding.
- More lenders are focusing on other risk metrics such as quality of income and debt yield, recognising the change in rental income streams from long leases to operational income. Hence, assets in the so-called living sector are favoured by most lenders.

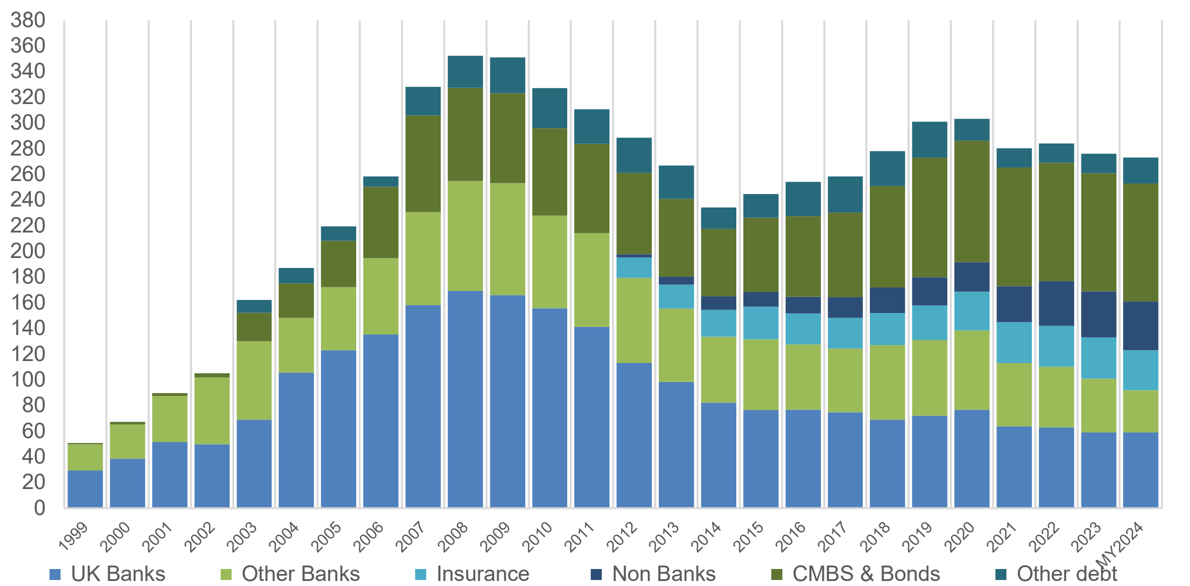
7. Debt and the market cycle

The CRE Lending Survey, now in its 25th year, has tracked lending volumes through a range of market states, most notably, of course, the long boom through the first half of the 2000s which ended with the Global Financial Crisis (GFC). This section reflects on "a decade since Lehman" and takes a brief look at the linkages between lending volumes, real estate values and trading volumes over two lending cycles. In particular, the previous 2008/09 Global Financial Crisis was driven by the shortness of credit supply after a period of large credit expansion and relaxed credit approval procedures. The market changes observed since 2019 were primarily driven by changes in the investment market, economic uncertainty, ongoing structural property market changes and the pandemic.

7.1. Lending volumes

The lending market has entered a new cycle. While the last year's report still focused on the pre-/post GFC era "The CRE Lending Survey has tracked nine years of continuous growth in loan books up to 2008 (at an average of 20% per year) followed by six years of continuous contraction (at 7% per year) to 2014", the pre/post COVID cycle is showing its impact. While there have been five years of stability 2014–2019 political changes and the economic effect of COVID have started a new downward cycle in 2019, which recovered quickly in 2021, but interest rate increases, inflation and economic difficulties are making 2024 a challenging year for property investment and lending.

Figure 52. Lending cycle – 25 years (£bn)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report.
*Note Insurers were not identified as a separate lender type before 2012.

On several counts, 2014 can be taken as the end of the adjustment of the lending market to the crisis of 2007 to 2009. Through that period, trading, origination, and loan books appear to have run at even levels. Origination volumes have run at around 25% of outstanding loans each year which given an average loan term of around four years, is a rate that would be expected to produce modest changes in total loan books, coincidentally, also standing remarkably close to their long-run average value.

The cycle turn can be seen in 2017 when loan books started expanding again, which can be attributed to some extent to international banks but mainly to other financing sources and instruments. With a look towards total market leverage, the situation in 2020 clearly shows that equity investors will bear a large part of any market downside. The lowest leverage was reached in 2017 with 41%. Since then, the Business School (formerly Cass) estimates are that overall market leverage has increased by 6%.

8. Conclusion

Lending activity in H1 2024 has declined -9.8% year on year, with lending to new acquisitions taken a share of 45%.

- The quality of loan books shows a divide between lenders with large loan books and those with smaller loans book. Smaller lenders are writing loans with higher LTV's and are more at risk of upcoming loan defaults due to increased interest payments. In fact, smaller lenders show on average an default rate 3x as high as larger balance sheet lenders.
- The key reason for the slow movements of default rates, overall loan book LTV, interest cover ratios is primarily due to loan hedging arrangements, this will always lead to a time delay to what is observed current refinancing problems. However, the rise in interest rates and declining property values have resulted in visibly high loan defaults and ICR covenant breaches, through lower overall ICR coverage levels. Lenders reported 31% of their loans are exposed to floating rate interest rates.
- Over the last three years it has become more apparent that economies of scale are an important factor for lenders to attract borrow and assets of high credit quality to create a high quality loan book. Scale is also important to achieve loan book diversification and being able to expand your average loan size. The statistics received from the survey show that holding a total loan book of £1bn is a critical size threshold in this regard.
- Despite lenders offering more competitive loan terms in H1 2024, moving LTV levels upwards, margins downwards and lowering ICR covenants, for many borrowers interest payments are still leaving limited access cash flow in existing assets. Better coverage is achieved for repriced high yielding assets.

Appendix 2: Definitions & Classifications

For the purposes of this research, the following section provides definitions and classifications specific to this research.

- Commercial property: lending covers all lending secured on UK commercial property, including residential, held for the purposes of investment income generation, and on the balance sheets of Survey respondents.

- Junior/Mezzanine loan: Junior debt is debt with a lower priority for repayment than other debt claims in the case of default. Junior and mezzanine debt are types of subordinated debt. It can be structurally and legally subordinated. A junior tranche can be structurally subordinated to the senior tranche in a whole loan financing but still secured on the same mortgage security. A mezzanine loan can be legally and structurally subordinated and separate from the whole loan secured financing. It does not form part of the whole loan security; hence it is unsecured.

- Junior loan pricing refers to all subordinated loan pricing stretching to the maximum LTV provided by lenders.

- Loan Default: The Basel definition of default captures a wider range of defaults, including circumstances in which the reporting bank considers that the obligor is unlikely to pay its credit obligations in full. For example, under the Basel definition, defaulted credits would also include debt obligations where (1) the bank puts the credit obligation on non-accrued status, or (2) the bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure.

- Loan margin: risk premium charged over a base rate/reference rate such as 5 year Sonia swap based on a 5 year-average loan term.

- Outstanding Loan books: The net exposure to UK commercial property loans excluding any equity finance, as well as loan amounts sold to Debt Funds or securitised loans, to avoid double counting on the specific cut-off date.

- Senior lending: loans secured by a first claim against the underlying collateral.

- Subordinated lending: all other forms of loans, embracing junior and mezzanine debt.

- Secondary property: Prime and secondary property classification is used to distinguish loan pricing for different property grades and locations. A prime property is in a class A location within the five key UK cities or, for logistics, in key logistics areas. Secondary property is all other properties in class B and C locations in other secondary UK cities.

Lenders are classified by business lines and by country taken as the domicile of the ultimate corporate parent. For brevity in charts and tables, labelling may be in an abbreviated form of the full classification. Note the label UK Banks includes the small number of remaining UK Building Societies active in CRE lending to avoid revealing commercially sensitive data inadvertently.

Labelled	Business & country
UK Banks	Banks and Building Societies with ultimate parent domicile in the UK
German Banks	Banks with ultimate parent domiciled, respectively in Germany
International Banks	All bank lenders domiciled in countries other than the above (from 2024 including German Banks)
Debt Funds/Other Non-bank Lender, NBL	Private debt funds and all lenders outside of Banks, Insurance companies and UK Building Societies, primarily debt funds run by asset management firms.
Insurance Companies	Firms with core business as Insurance Companies irrespective of ultimate country of ownership

Secondary property: Prime and secondary property classification is used to distinguish loan pricing for different property grades and locations. A prime property is in a class A location within the five key UK cities or, for logistics, in key logistics areas. Secondary property is all other properties in class B and C locations in other secondary UK cities.

Appendix 4: Respondents to the mid-year 2024 Survey

Aareal Bank AG
Aberdeen Standard Investments
ARA Venn Capital Partners
Aldermore
Allica Bank
Allianz
Allied Irish Bank (GB)
Alpha Real Capital Limited
Atelier Capital Partners
Atom Bank
Aviva Investors Real Estate Finance
Axa Real Estate
Bank of America Merrill Lynch
Bank of Ireland Group
Barclays Capital
Barings
Bayern LB London Branch
Beaufort Capital
Blackstone Real Estate Debt Strategies
BNP Paribas
Cain International
Cambridge and Counties Bank
Canada Life Ltd
Cheyne Capital Management (UK) LLP
Close Brothers Property Finance
Clydesdale Bank
Corebridge Financial
Coutts and Company
Crédit Agricole Corporate & Investment Bank
DekaBank
Deutsche Bank AG
Direct Line Group
DRC Savills IM
Bentall GreenOak
Helaba Landesbank Hessen-Thüringen
Hermes Investment Management
HSBC Bank plc
ICG
ING Real Estate
Invesco AM Limited
Investec Bank (UK) Ltd
J P Morgan Securities
Jones Lang LaSalle Incorporated (JLL)
Just Insurance Group
Landesbank Baden-Wüerttemberg
Legal & General
Leumi UK
Lloyds Banking Group
M & G Investment Management Ltd
Maslow Capital
Morgan Stanley
Münchener Hypothekenbank
NatWest
Nuveen Real Estate
Octopus Group
Pacific Life
pbb Deutsche Pfandbriefbank
PGIM
PIMCO
Pluto Finance
Principality Building Society
Royal Bank of Canada
Santander Corporate & Commercial Banking
Schroders
Silbury Finance
Société Générale
Starwood Capital Europe Advisers LLP
Sumitomo Mitsui Trust Bank Limited
Wells Fargo Bank International
Yorkshire Building Society
Zorin Finance

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