



# The Changing Landscape of Commercial Property Lending in the UK

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## 2001-2007

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- Securitisation of mortgage backed assets
- Cheaper money
- Lower margins
- Offloading risk

# Thinking That Got us There

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- *“.....there is ample capital available to meet the need of the various levels of individual and institutional real estate investors, causing industry analysts to forecast still lower cap rates in some sectors, as well as an increase in CDO\* activity.”*

*Jeffrey Baker, Jan 2006*

\* *Collateralised Debt Obligation*

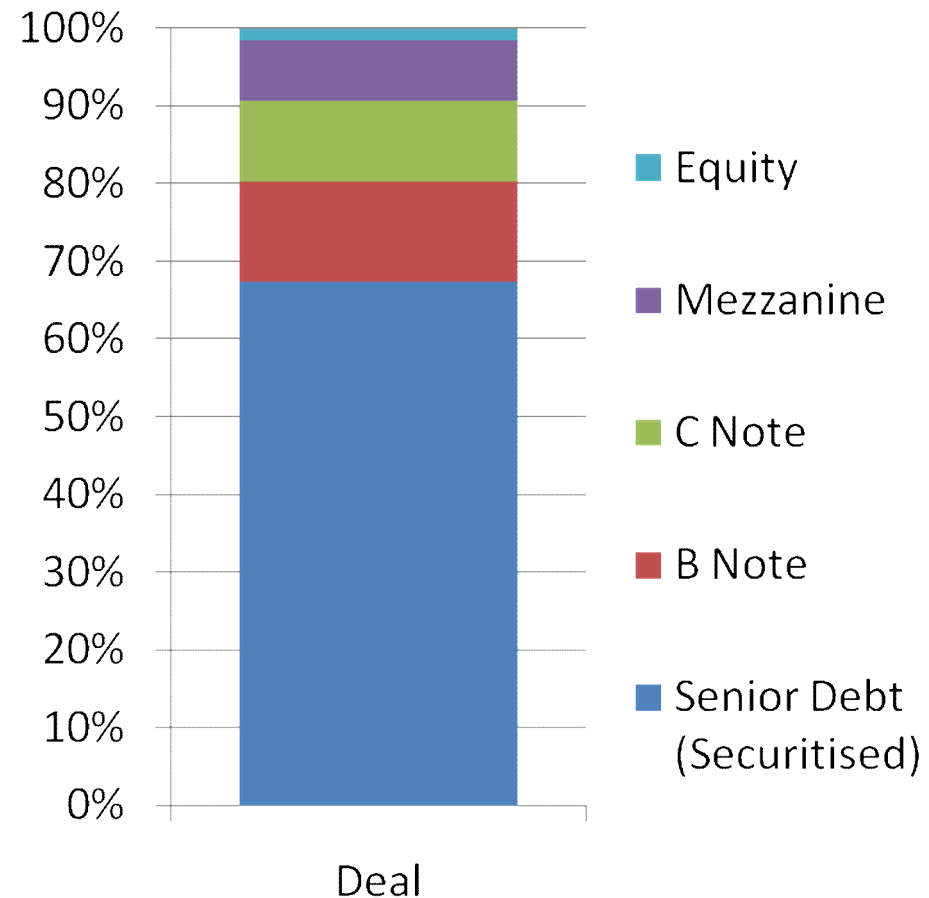
## 2001-2007

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- Risk pricing
- Thinner margins
- Banks profit from more risky lending
- Higher LTVs
- Higher risk
- Mezzanine, quasi equity

# How the Equity Slice Shrank

- Normal senior debt securitised at small margin
- Banks started to lend B and C notes at higher margin
- Then Mezzanine and quasi equity
- Leaving the equity player in some extreme cases paying less than 2% of total price



# How crazy it became



# The Debt Drove the Deal

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- Cheap and plentiful money
- Buyers ignored the property fundamentals
- Because debt was cheap even very poor property deals appeared to give positive returns
- The spread between prime and secondary property became very blurred

# The Experts v The Market

	Investment Property Forum Consensus Forecast Total Return (February)	Investment Property Databank UK All Property Total Return Outcome End December
<b>2004</b>	<b>8.0%</b>	<b>18.3%</b>
<b>2005</b>	<b>10.6%</b>	<b>19.1%</b>
<b>2006</b>	<b>11.2%</b>	<b>18.1%</b>
<b>2007</b>	<b>9.0%</b>	<b>-3.4%</b>
<b>2008</b>	<b>-2.6%</b>	<b>-13.8%</b> <b>(October YTD)</b>
<b>Average</b>	<b>7.21%</b>	<b>6.74%</b>

# But Some People Saw the Problem

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- *“With fierce competition raging on among conduit lenders, the risk of declining credit quality through increased leverage remains quite high, alternatively, the lenders are accepting lower spreads which will ultimately affect their own profitability - that is the challenge that lenders and investors will have to live with for some time to come.”*
- Susan Merrick, Fitch Ratings, Jan 2006

# 2007

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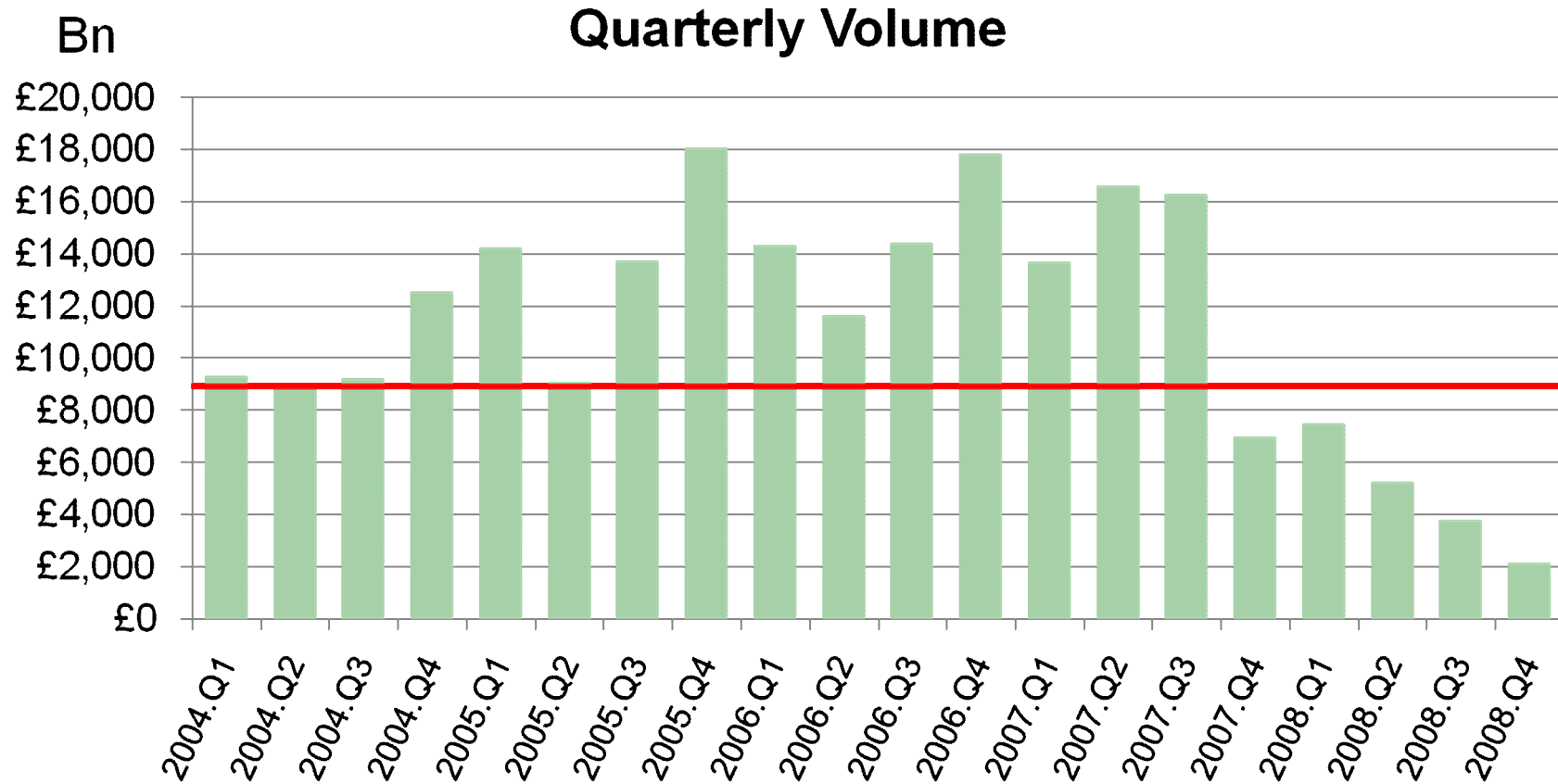
- Sub prime
  - US led but UK not unaffected
- Credit crunch
  - Suddenly every lender started to check what debt they really had
- Balance sheet lending
  - No conduit available so balance sheets soon dried up
- LTV defaults

## 2007-2008

- Bank failure
- Bank bailout
- No credit
- No debt
- No deals
  - Apart from forced selling



# UK Investment Transactions



Source : Property Data 2008

# 2008

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- Back to basics
- Relationship banking
  - Not purely asset driven
- Bigger margins
- Bigger fees
- Lower LTVs
- Strong Interest Cover
- Everything leads to lower risk for lenders

# 2008

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- Governments stepping in to control lending
- Nationalised banking system – Governments own banks and banks will own many companies and assets
- Distance between credit committee and lending teams widening, causing some panic
- Easy borrowing dead - creativity needed to generate lending

# Back to Basics

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- Asset sustainability
  - Is this fundamentally a good property deal?
- Debt sustainability
  - Does the addition of debt add too much risk to the underlying deal
- The general market improvement will not save you
  - Asset management is back
  - Only good asset managers will survive

# 2009

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- LTV covenants
  - Foreclosures
  - Forced sales
- Back to syndicated loans for larger ticket deals (>£30m)
  - Slower and more complicated
  - Securitisation will not be back for a long time
- Lending driving pricing and timing
- Risk being priced again
- Far less liquid market
- Banks will take many equity stakes off their borrowers

## Basel II

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- Senior debt limited to 75% LTV as a maximum
- More likely 50%-65% LTV will be the norm for the near future
- Period of loan getting shorter
- Speculative development will be un-financeable
- Major lending banks will not be in the Mezzanine or Subordinated space
- Higher risk loans become uneconomic for lenders

## 2009-?

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- Back to normal? (whatever that is!)
- A little more liquidity but harsher credit controls
  - Many banks are now effectively government owned
  - UK lenders focussing on residential and SME lending
- Cheaper base rates – 2% and below?
- Higher fees and margins
- Amortisation
- Clear definition between Prime and Secondary

# Potential

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- Institutional and cash buyers will re-enter before debt driven buyers
- Mezzanine funds from long term investors not banks
- Recapitalising over leveraged funds and companies – M&A
- The equity player is king – buy cheap now, restructure debt later
- Banks taking control of market direction
- Banks need to be considered as our co-owners, not just our lenders....

# Conclusions

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- Asset management is the key
- Lenders may get up to 75% LTV for the best deals
- Margins will stay high
- Base rates will stay low for some time
- Good advice on rents and tenant demand
- Good banking contacts essential

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