

# EUROPEAN REAL ESTATE LENDING SURVEY



MARCH 2012

A Cushman & Wakefield Publication



## KEY HIGHLIGHTS

### Deleveraging continues as new sources of liquidity arrive

- The European lending landscape continues to evolve in response to the ongoing need to deleverage as well as volatile economic conditions and impending regulation
- The number of lenders willing to offer new business lending is down 33% since Q1 2011
- Only five lenders are willing to underwrite over €100m
- Deleveraging by continental European banks has been slower than by UK banks, although it is picking up pace
- New finance providers such as non-bank financial institutions are emerging slowly and this should improve going forward
- The emergence of senior debt funds will be a feature of 2012
- Lending terms have worsened, with LTVs down and increased margins
- The securitisation and syndication markets are still relatively lacklustre
- Germany, France and the UK remain the top targets in Western Europe for new business lending, while Poland and the Czech Republic are still key targets in Central and Eastern Europe (CEE)

**INTRODUCTION**

The European real estate lending market continues to transform rapidly, against a backdrop of economic uncertainty and impending regulatory changes. Finance has become more restricted, with many senior debt lenders unwilling to provide leverage, except to experienced management teams and secured against premium assets let to strong tenants.

Regulators are also closely monitoring the finance industry’s risk weightings and loan provisioning on real estate, given that European banks’ loan books remain heavily exposed to real estate. In many countries, deleveraging has progressed slowly - partly reflecting banks’ greater tolerance on real estate loans – but the pace is expected to pick up markedly in 2012.

A new financing landscape is beginning to emerge however, incorporating a greater diversity of lenders such as non-bank financial institutions (pension funds, insurance companies) - which are likely to adopt a more conservative approach to lending - and specialist managed debt funds targeting higher returns by encompassing both senior and stretch senior lending.

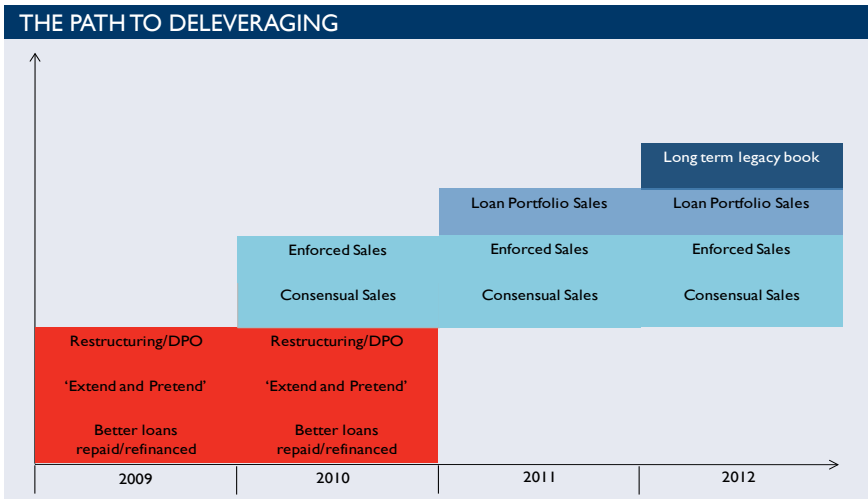
The securitisation market remains relatively dormant in Europe except for prime single asset or strong single tenant credit deals. Whilst the securitisation market was, until recently, seen as potentially providing a much needed source of liquidity for the surfeit of loan and CMBS maturities in 2012-2013, weak property fundamentals and investor scepticism towards the product are not conducive to any significant near term bounce back in activity.

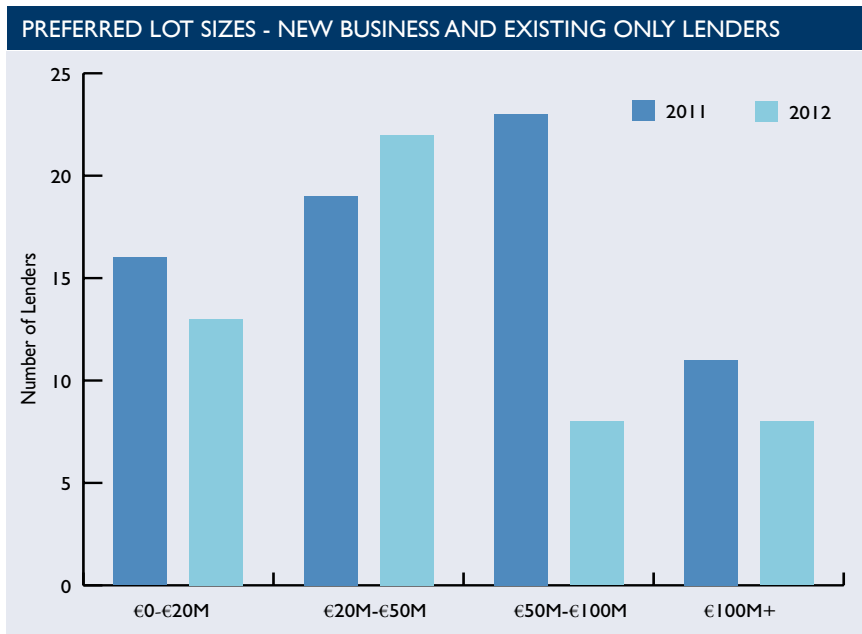
**ACTIVE LENDERS**

Of the 78 lenders surveyed – which included providers of senior, stretch senior and /or mezzanine debt - 36 stated that they would be willing to lend to new customers with which they have no previous relationship, while a further nine would lend to existing customers only. This represents a 33% fall in active lenders since our last survey in Q1 2011. Of the 36 willing to lend to new customers, a significant majority have highly restrictive lending criteria, with some only willing to lend in Central London for example.



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There are 32 senior debt lenders active in the European market, mostly targeting loan sizes of €20m-€50m, although five lenders did signal their capacity to underwrite over €100m. Nevertheless, this is down from 10 lenders last year. Lenders continue to target prime assets, with much of their business in the short term expected to come from re-financing rather than new acquisitions.

### TYPE OF LENDER

Notwithstanding the increased pressure banks are under to meet European Banking Authority and Basel III requirements, the lending market continues to be dominated by balance sheet lenders. The number of lenders in this category has declined from last year however, as some European banks retreated from international property lending, with impending regulation highlighted as a key constraint.

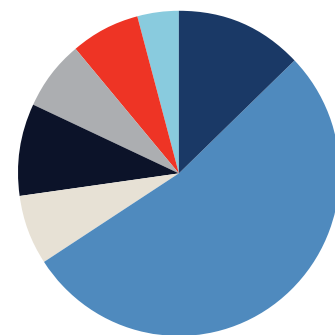
Investment banks, despite having the ability to underwrite big ticket deals, have not been particularly active as the securitisation market remains largely dormant, while syndication markets are still unpredictable.

With the syndication market remaining subdued, there is a preference amongst lenders on larger transactions to form “club deals”, whereby a number of lenders jointly underwrite prior to any deal closing as opposed to syndicating post-closing. This has helped improve liquidity for larger portfolio transactions, providing a much needed boost to this segment of the marketplace.

### ESTIMATED LTV'S & PRICING

Finance providers are continuing to review lending policy on an ongoing basis, which is having a notable effect on maximum loan-to-value criteria and margins.

### MARKET PARTICIPANTS



- Commercial Bank
- Investment Bank
- Insurer
- Building Society
- Private Equity
- Debt Fund
- Prop Co

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Maximum LTV's for senior debt in the UK and other core Western European markets were 65% in 2011, although this has fallen back to 60% in 2012. For exceptionally well-located properties, which are let to investment grade covenants on long leases, higher LTV's are possible although most lenders appear unwilling to exceed 65%. The increased risks associated with providing financing to CEE markets means that senior debt is typically offered at maximum LTV's of 50-55% in this region.

With senior debt provision limited to lower LTV's, the requirement to fill the capital gap between senior debt and equity has led to a proliferation of mezzanine finance providers. Of the 78 lenders surveyed, there are now 16 such providers in the marketplace, while a further five lenders offer a "one stop" solution in providing both senior and junior debt, which reduces execution risk for borrowers. Mezzanine funds are now finding it easier to raise capital from institutional investors, who are more willing to transfer capital to new asset sub-classes such as debt.

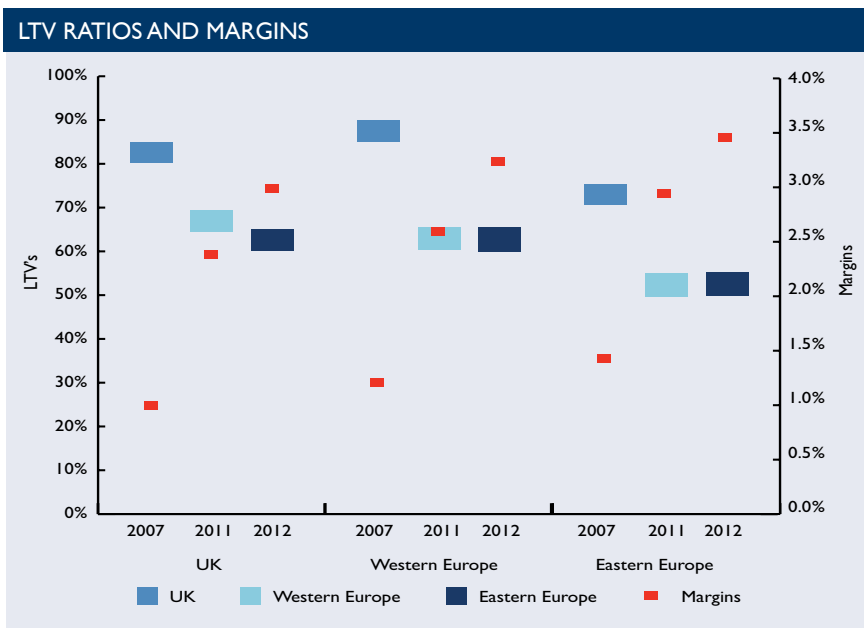
Against a backdrop of falling inflation and a weaker economic outlook, interest rate expectations have remained dovish across Europe and swap rates have fallen accordingly. The overall cost of new loans has not declined however, with margins increasing and liquidity constrained by European sovereign debt woes and increased regulation, as highlighted earlier. In the UK for instance, based on a 60% LTV ratio, the typical "all in" cost of funds stands at 4.5-5.5% for a five year term.

"We have seen further mezzanine funds being raised in the last two years, and while some of this capital has been successfully deployed, one of the challenges for 2012 may be in sourcing the senior debt element of the capital stack to enable further transactions to take place"

Ed Daubeney  
Partner, Corporate Finance

GEOGRAPHY

The core markets of Western Europe, specifically the UK, France and Germany, remain the top targets for new business lending. However, the number of lenders active in these markets has fallen significantly from Q1 2011. The majority of lenders who are committing funds to existing clients are also focused on these markets, limiting their exposure to any new credit facilities as the majority of these loans will be honouring pre-agreed credit lines to existing borrowers.



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The top targets for new business lending in CEE are Poland and the Czech Republic and appetite for lending in these markets has held up relatively well, compared with other European markets.

NEW LENDING SOURCES

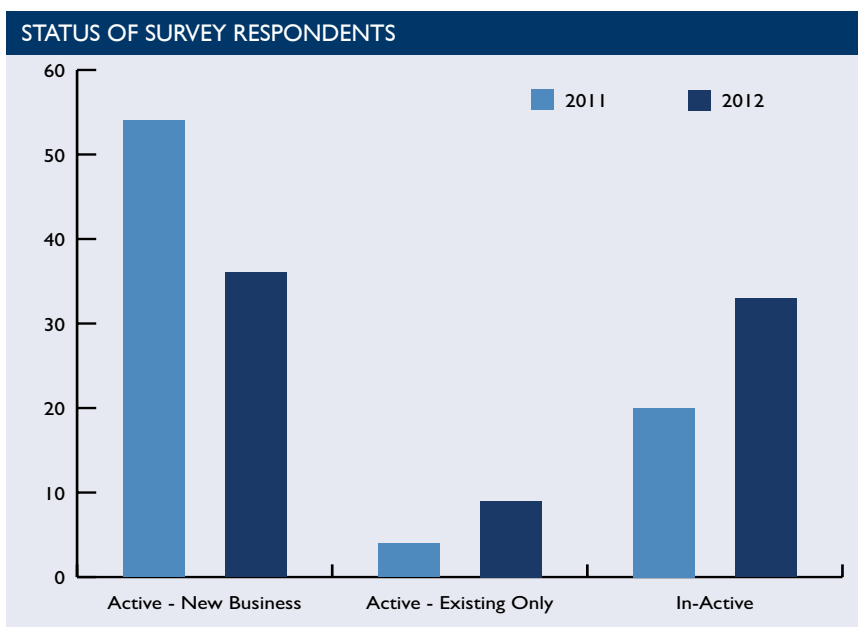
The emergence of alternative finance providers such as non-bank financial institutions and specialist managed debt funds is slow but improving, as real estate debt investment opportunities in Europe lure investors from across the globe. These finance providers are pursuing very different investment strategies, with managed debt funds to date seeking higher returns by focusing on mezzanine or stretch senior debt. This year is expected to see some newly launched funds targeting senior debt only and senior plus stretch senior debt, who will consider both newly originated debt as well as the acquisition of performing and sub-performing loans.

Insurers have also become keener on the debt sector, given the attractive pricing in historic terms and the potentially advantageous capital treatment under Solvency II. Insurers are typically seeking lower risk debt positions and are willing to underwrite loans or buy debt on the secondary and syndication markets.

Pension funds are also becoming increasingly interested in the property debt market, attracted by its higher relative returns when compared with traditional fixed income investment opportunities.

“The findings of our lender survey show the severity of bank withdrawal from the European commercial real estate debt market over the past year. Looking ahead, the bright star is the increased lending activity and intentions of non-bank financial institutions and the potential arrival of senior debt funds this year, which will provide some welcome new sources of liquidity.”

Michael Lindsay  
Head of EMEA Corporate Finance



## TRENDS FOR 2012

- Emergence of senior debt funds
- Mezzanine and preferred equity funders may struggle to deploy their capital and/or achieve their target returns, given low senior debt demand for higher risk assets
- Alternative finance providers will become more established and active. Crucially however, they are still not expected to adequately fill the debt funding gap, at least in 2012
- Banks will speed up the disposal of non-core, sub-performing and non-performing loans
- Banks will find it increasingly difficult to secure opportunities to meet their restricted lending criteria, especially given that other lenders and equity investors are all targeting the same limited asset pool
- In the face of such intense competition, some banks may shift their attention to refinancing, while others may provide key clients with pre-approved revolving credit facilities
- Regulators, concerned that banks have not been making adequate provisions against commercial property loans, will increase the pressure on banks to improve the way their internal models measure risk. There may be a greater focus on using standardised calculations or a process called "slotting" to categorise commercial real estate loan book risk, which could increase the cost of holding these loans significantly
- Appetite for securitisation will remain subdued, especially against a backdrop of economic uncertainty and weak property fundamentals, but there will continue to be demand for properly structured and well-underwritten CMBS secured on prime assets, typified by Chiswick Park in 2011

# About the Report

The data was researched by Cushman & Wakefield's Corporate Finance team, which interviewed senior finance professionals from 78 leading global real estate finance providers to assess the level of appetite for lending and to identify what trends will shape the European finance market in 2012. This research exercise has been undertaken annually since 2007 and supports our strong relationships with lenders in the European market.

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