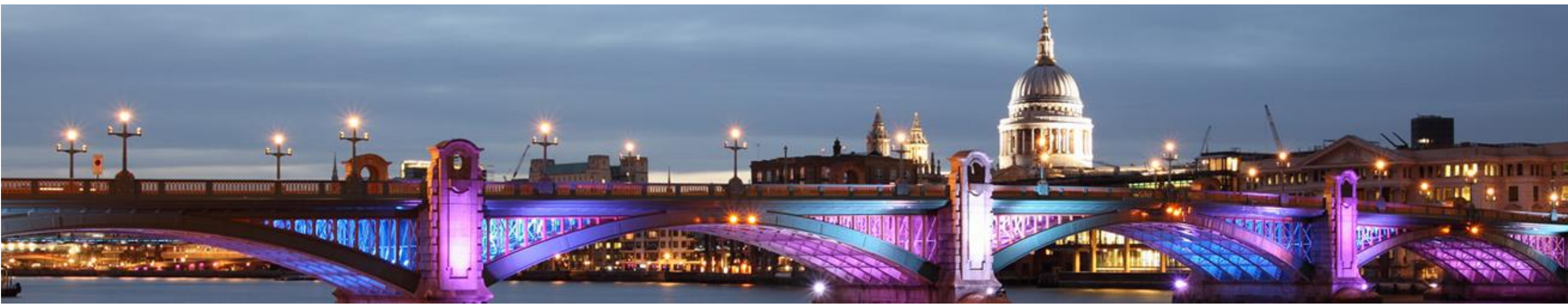


LAXFIELD UK CRE DEBT BAROMETER

Issue 3: Q2-Q3 2014, published November 2014

Laxfield Capital presents the Laxfield UK CRE Debt Barometer, an overview of current finance requirements in the UK commercial real estate market.

The Laxfield barometer gives a unique early indicator of changing patterns in the financing of UK real estate by recording demand for finance at the earliest stage, when sponsors approach debt providers seeking terms.

In its capacity as a real estate debt investment manager, Laxfield collates active requests for real estate finance and compares pools of data quarterly to track changing patterns of demand. This report draws upon a pool of 496 loan requests totalling £46 billion, (of which £13.5 billion has been added in the six months since our last report).

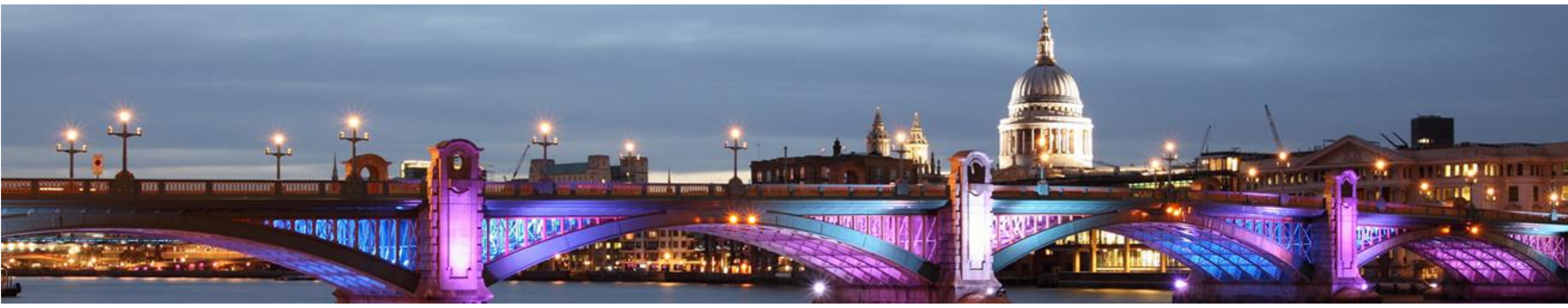
Key findings in the past two quarters

Volumes	High volumes - up 27% on previous six months. Q3 2014 particularly strong with **£7.7bn of finance requests** – 33% higher than the quarterly average data recorded since the end of 2012
Size	Marked increase in average deal size with **51 deals in excess of £100m** in the past six months
LTVs	Average LTVs **down to 55%** (from 58% over Q4 2013 - Q1 2014) as borrowers show restraint against backdrop of high values
Purpose	**Acquisition-related finance is strong and growing**, now covering 51% of deals by volume in the past six months. Sponsors are more confident to seek debt within the acquisition process as the market normalises
Climate	£3.1bn of the requests over the last two quarters (23%) were deals financed in the difficult market after the financial crisis and now **returning for refinance** in expectation of better lending terms
Sectors	Activity across sectors with a strong increase in demand for finance on **mixed portfolios, hotels, student housing and industrial**
Term	Most of the market still revolves around a **five-year cycle, with no increase in long-term finance demand** despite strong appetite from institutional investors to lend fixed rate

The latest findings of our barometer signal a turning point in the market, with volumes at the highest we have seen for seven years and deals weighted towards the large investor. Confidence in finance delivery is back, with debt terms increasingly sought during the acquisition process rather than post-completion. Sponsors, however, remain restrained in their risk appetite and average LTV ratios have declined, showing an enduring caution in attitude towards leverage in the wake of the recession."
Emma Huepfl, Head of Capital Management, Laxfield Capital

LAXFIELD CAPITAL

+44 (0) 20 7493 5026 www.laxfieldcapital.com



LOAN QUANTUM

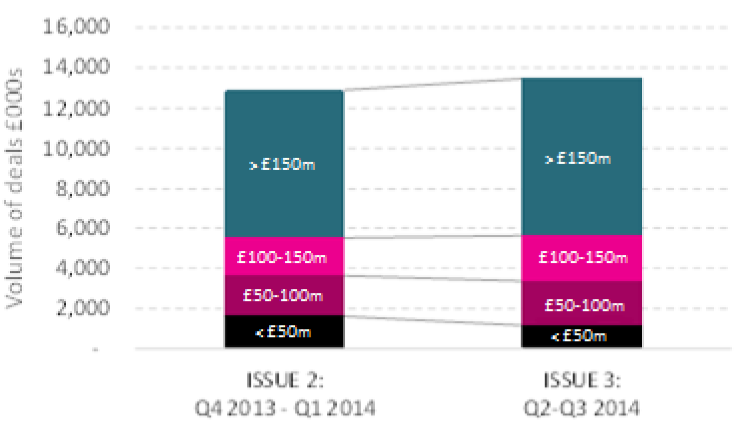
- A significant uptick in the number of large-ticket finance requests received was seen in the last two quarters; by deal count, **51 out of 133 loan requests were for deals in excess of £100m** (compared to 42 in the previous report)
- By volume, 74.9% of loan requests were in this category, and **average deal size has correspondingly risen to £101.2m** (compared to £90.9m in Issue 2)
- The **smaller-ticket loan market declined** by loan count and volume, as overall market activity has been skewed in favour of large investors in the report period

Comment

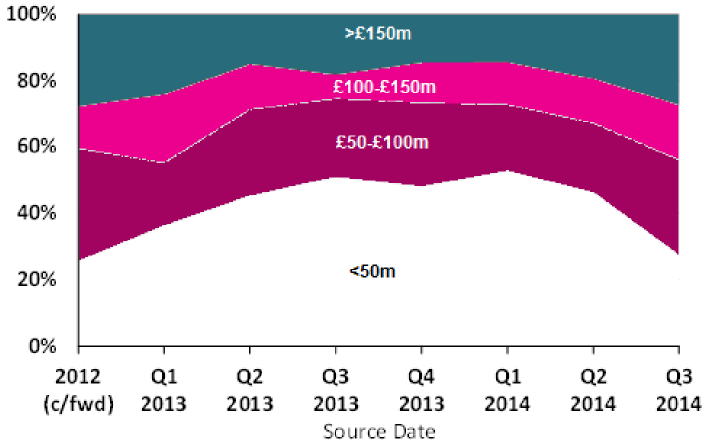
Several factors contribute to larger average deal sizes:

- Big international equity reserves targeting the largest UK real estate assets. Investment agents are also **packaging portfolios** to suit the appetite of large investors
- Exceptionally **strong lender appetite for large-ticket financing**, with large institutions, sovereign funds and banks all competing to deploy capital in real estate debt
- Benign refinancing environment – low interest rates and margin compression producing **highly attractive all-in borrowing cost** and bringing forward large-scale requirements
- Debt being **less available today to smaller investors** without substantial equity

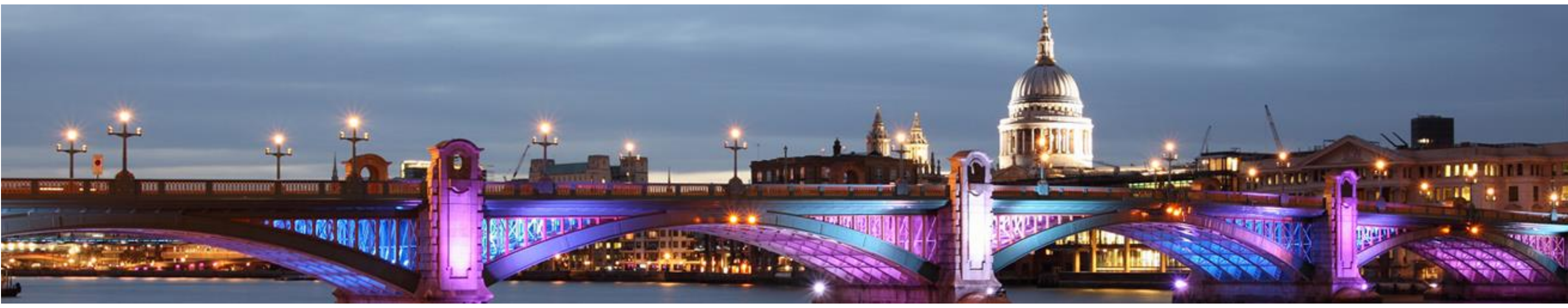
Comparison of average loan size Q4 2013-Q1 2014 vs Q2-Q3 2014



Evolution of average loan size



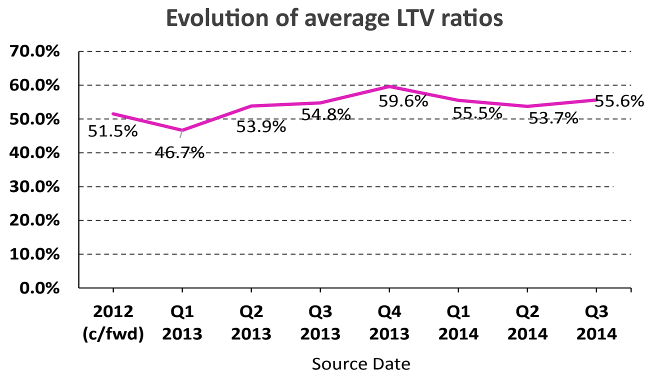
Move towards larger deal size…



LEVERAGE

During the past two quarters…

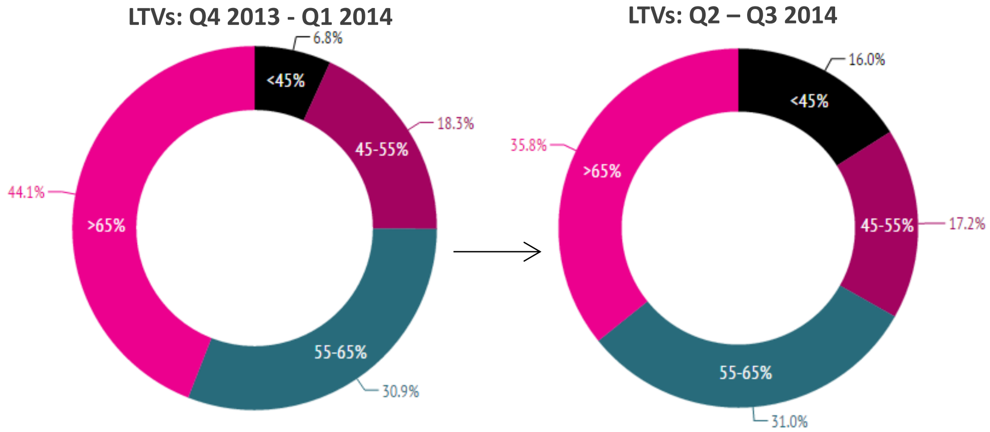
- **Weighted average LTV requirement declined** to 55%, (from 58% over Q4 2013 - Q1 2014), reversing the 2013 trend when LTVs increased every quarter (see graph below)
- Average LTVs were suppressed by more than £2bn of finance requirements from large institutions / corporates seeking to refinance at low LTVs in the current benign environment. **Average loan in the <45% LTV category was very large, at £215m**
- 48 deals were recorded with >65% LTV requirement (35.8% of total loan requests, representing a slight decrease from 44.1% over the last period) and 30 with >70% (22.6% of total loan requests, representing a slight increase from 17.6% over the last period)
- **Isolating the highest LTV band (over 70%), the average request was still less than 75% LTV**. A notable proportion of higher leverage loan requests were to refinance deals that were already highly leveraged and considered 'stressed' loan positions

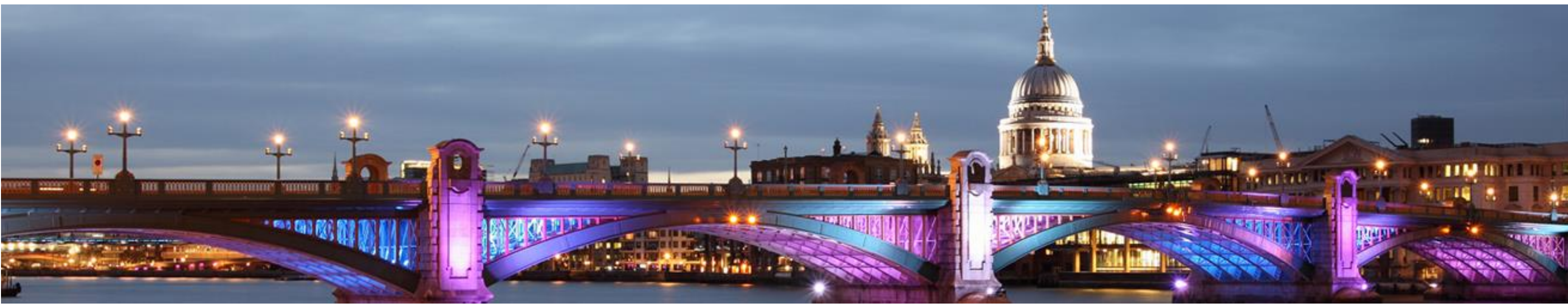


…Muted leverage

Comment

- **Change in attitude to leverage post financial crisis continues**, with investors sensitive to the potential damage of over-leverage, and largely resisting the increased margin cost of additional debt
- The need to underwrite **downside risk of higher interest rates and lower valuations at loan repayment** is incompatible with high leverage against many low yielding assets
- Nominal LTVs are low, but values high. In some cases **60% of today's value may represent 100% of 2010 values** and LTVs need to be considered in this context
- Some evidence has been seen of strong debt tenders fuelling higher acquisition bids, but **equity, not debt, appears to be the main driver of yield compression** in the current environment
- Many real estate sponsors have more capital to deploy than opportunities to invest: **until their equity reserves are utilized, use of debt is limited or postponed**, suppressing average leverage in the market





LOAN PURPOSE

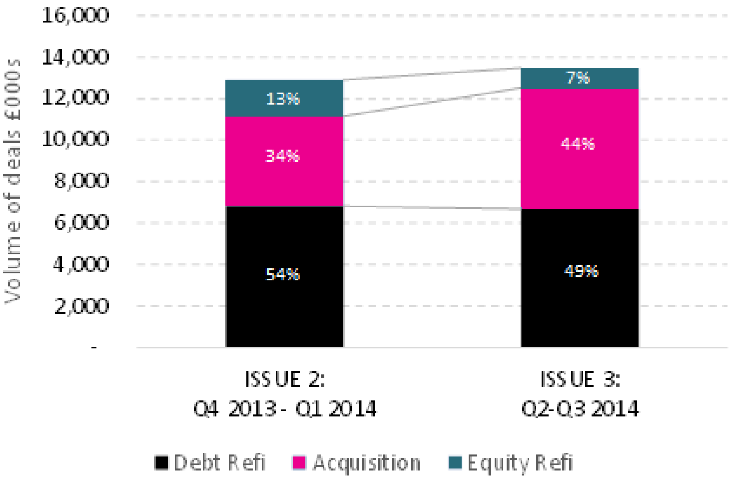
Acquisition Finance vs Refi

- A remarkable recovery in the supply mechanics of debt to real estate has taken place: funding requests at the end of 2012 were dominated by legacy re-financings as a result of the recession (close to 90% of the deal pipeline by volume, compared with 49.5% today). In the past six months, two striking features have emerged:
    - Many current re-financings are returning to the funding markets for the **second time following the recession**, attracting vastly improved terms
    - **Finance at acquisition has returned**. Following the recession, dis-function in lending process meant most deals completed in equity and financed post acquisition, but this has changed, and sponsors now engage with the debt market at the earliest stage, expecting delivery of debt finance at or shortly after completion to avoid a drag on equity returns

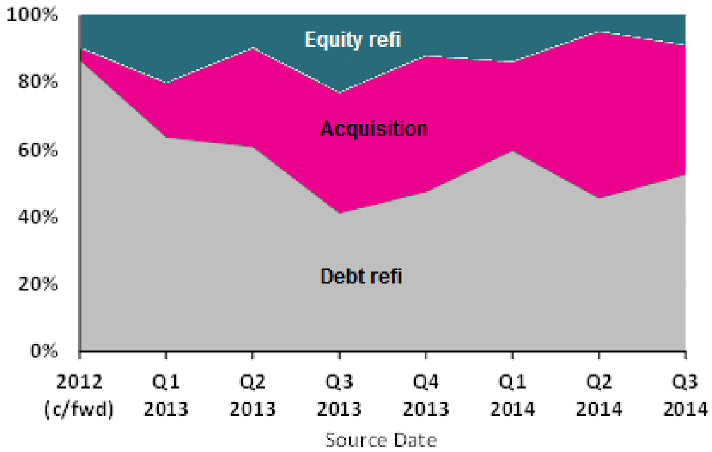
Comment

- **Real estate investors are showing greater confidence** in lender appetite and efficiency of process than at any other time in the past seven years
- **Acquisition-related finance has now pulled ahead of refinancing**, reflecting a market in expansion mode

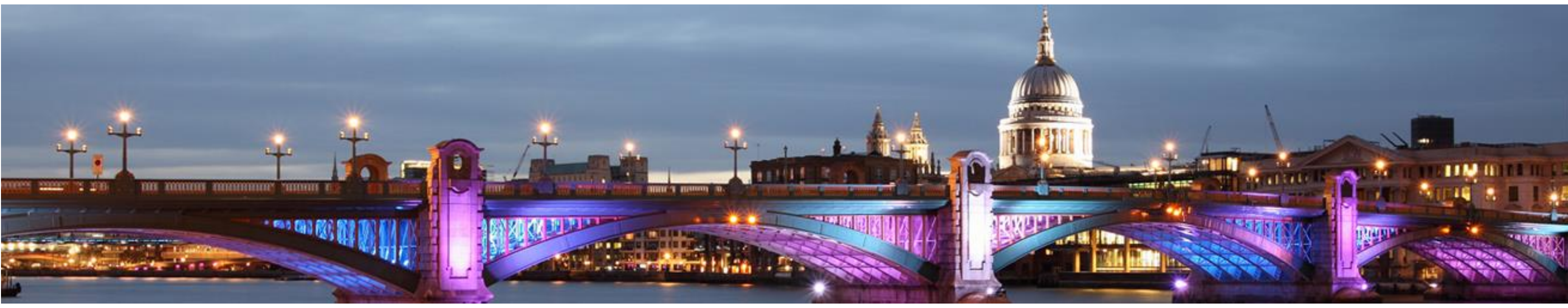
Loan purpose by volume, Q4 2013-Q1 2014 vs Q2-Q3 2014



Changes since end 2012 in percentage of pipeline split between refinancing and acquisition funding



Acquisition-related finance strong…



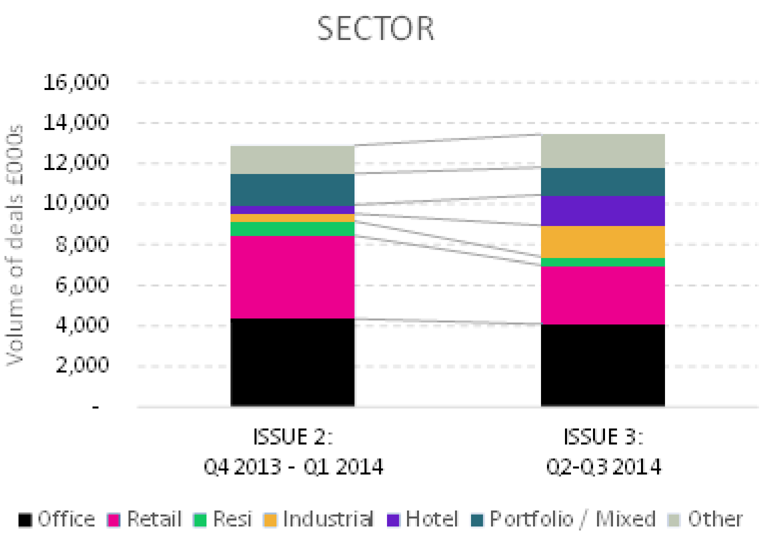
SECTOR

- Diversification has been a strong theme this period. A very **strong increase was seen in demand for finance on mixed portfolios, industrial and operational assets, particularly hotels and student housing**
- The large spike we saw in funding requests on retail assets in Q4 2013 and Q1 2014 settled to more standard levels over the last two quarters, although volumes remain strong in line with investment market activity
- Offices remain the largest sector set, with volumes fairly stable at £4.1bn (vs £4.3bn in the last report), representing over 30% of deal requests
- Overall, where retail and office previously held a market share of over two-thirds, their combined contribution is now around half, as **a continued hunt for yield and competition in core has led to asset diversification** among sponsors with good asset management capability
- **Student housing and hotels** show particularly strong demand for finance in the reference period. There has been a London focus to many of the student housing deals seen during the past six months

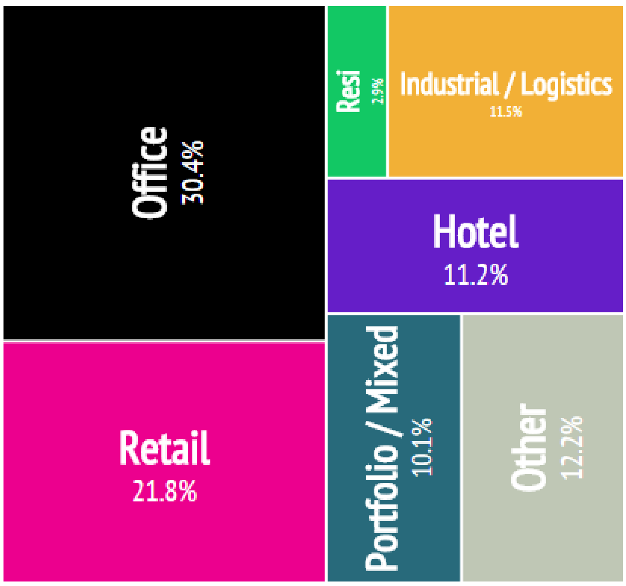
Comment

- Debt-backed investors have faced continued competition from global institutions with huge appetite for core offices and ability to deploy 100% equity. Debt providers have broadened their scope in response to the **reducing the pool of assets to finance in prime office markets**, bringing more liquidity and activity into real estate alternatives

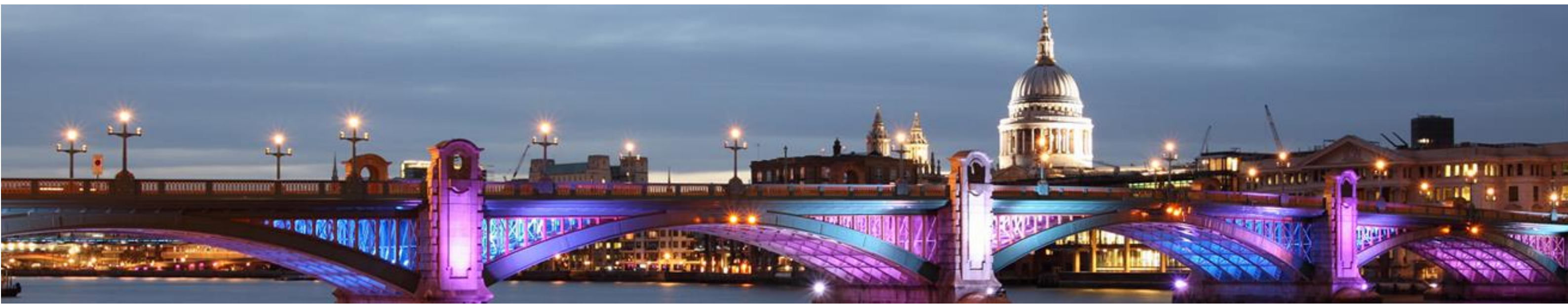
Evolution of Sector Market Share Q4 2013-Q1 2014 vs Q2-Q3 2014



Sector split Q2-Q3 2014



Funding requirements broadening across sectors…

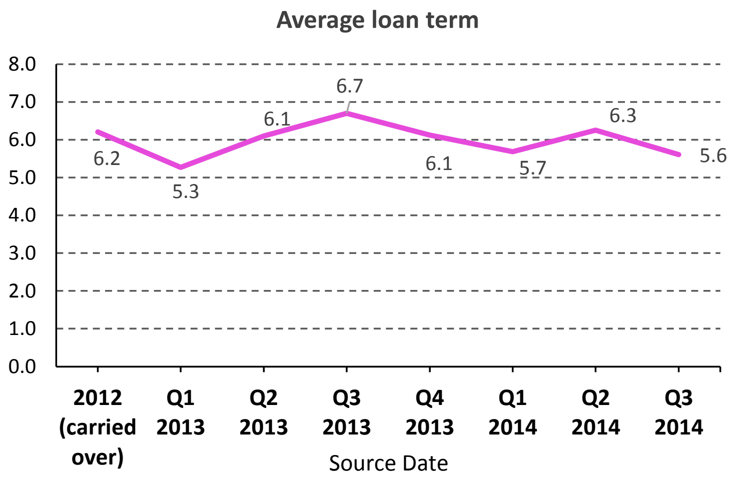


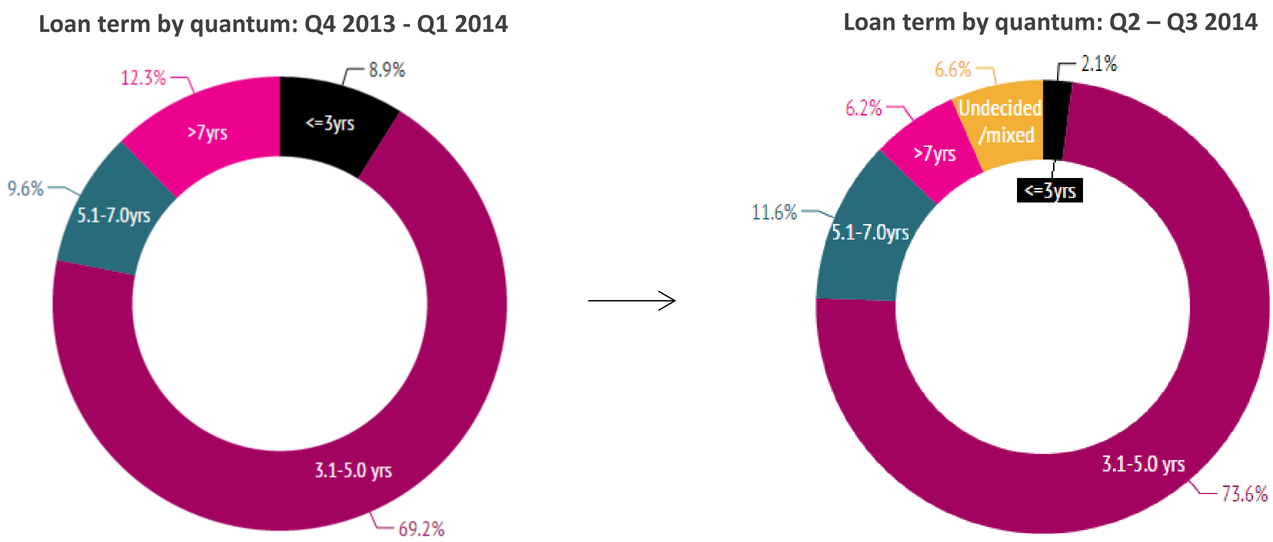
LOAN TERM

- **85% of requests for funding in the past two quarters fall into the 3-7 year range (up from 79%)**
- A small increase in average term requested in Q2 2014 reversed to 5.6 years in Q3, our second lowest term recorded since we began tracking at the end of 2012
- Sponsors broadly seek financing to match the expected term of their equity investment and, for many, this remains a **five-year horizon**

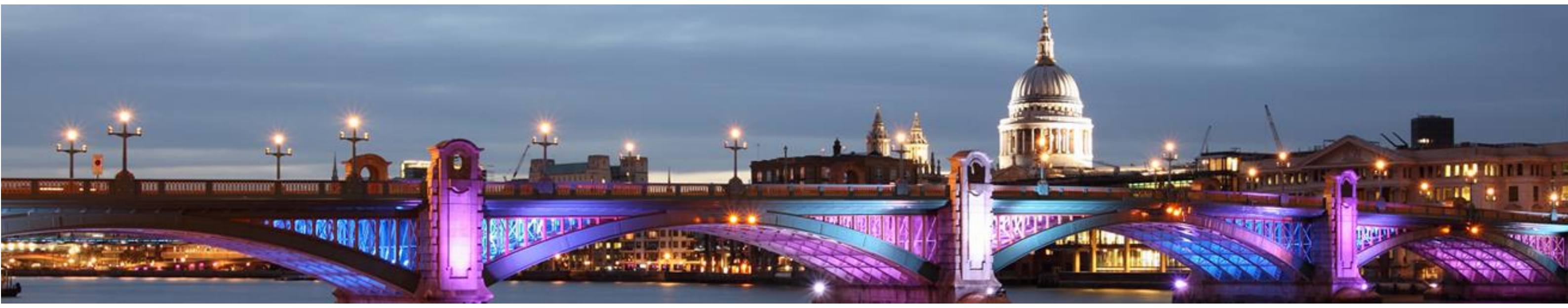
Comment

- Some investors with long-term horizons view this as an excellent time to secure debt at an extremely low all-in cost by historic standards, with current 10y gilts at 2.25% (figure correct as at 6/11/14), but continue to be **wary of the cost of unwinding long-term loan positions**, and potential inflexibility in trading assets in or out of their financing arrangements
- Unlike the US, **the UK market does not routinely transfer financing with assets** (portable loans) and this is holding back widespread appetite for long-term financing among real estate investors
- In spite of significant capital being raised to invest in long-term opportunities, take up continues to be limited





Term not increasing…



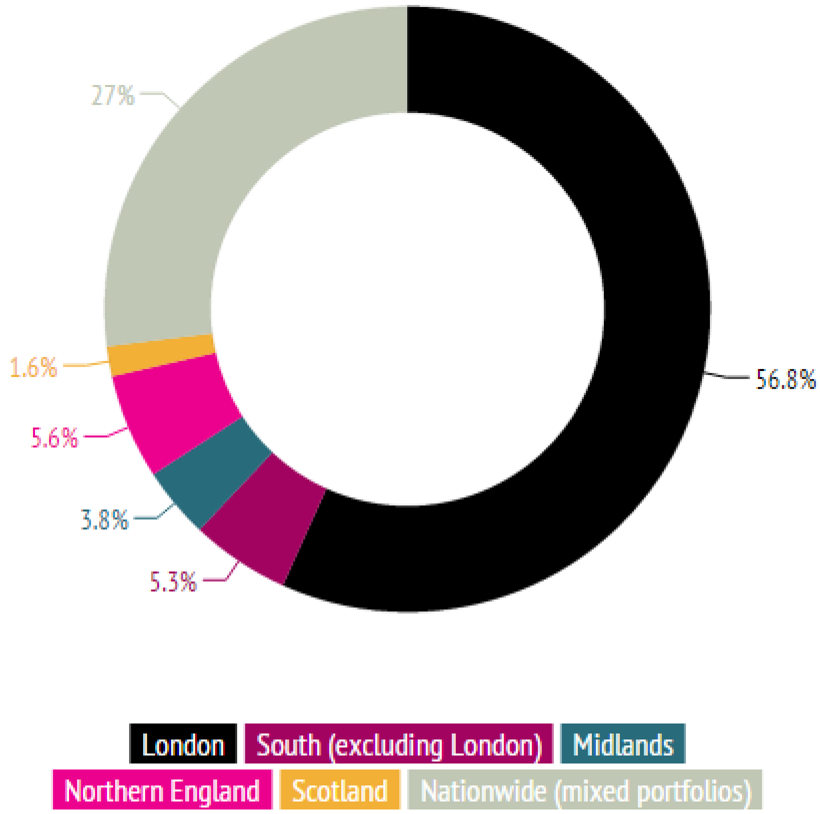
GEOGRAPHY

- Regional deals slightly outnumber London-based transactions (there were 71 regional deals compared to 62 London deals over Q2 - Q3 2014), but measured by value, **London finance requests exceed the regions**, representing 56.8% of the deals and continuing a trend which has been seen over six quarters
- Increasing asset values in London contribute to this dominance, but **average deal size has increased across the pipeline**
- Current averages are:
  - Regional deals: £81.9m (compared to £77.7m for Q4 2013 - Q1 2014)
  - London deals: £123.3m (compared to £105.6m for Q4 2013 - Q1 2014)

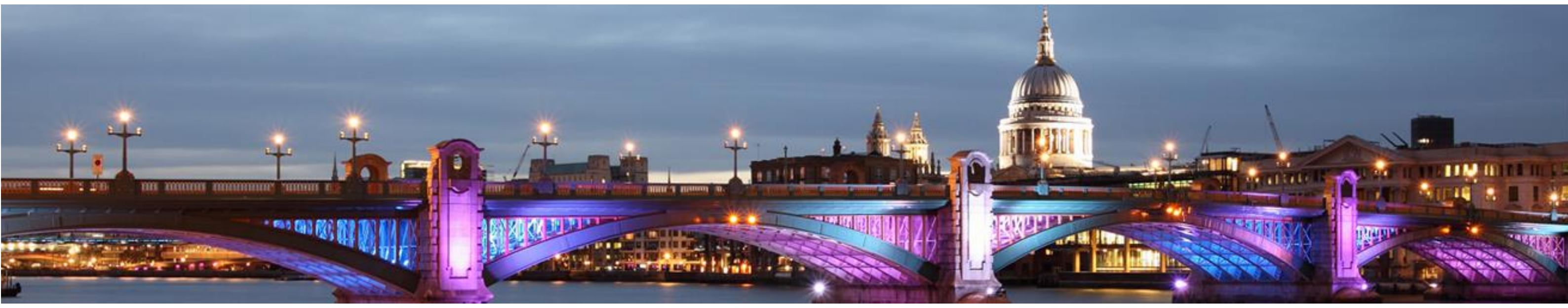
Comment

- Appetite for real estate is strong nationally, and **debt market activity is mirroring strong investment market trading** in both London and on good quality regional real estate
- **Increasing size of debt requests** reflects exceptional market activity in large-portfolio deal trading
- Sponsors appear confident that the debt market will provide large-ticket finance both for London and regional transactions

Deal volume split by region – Q2-Q3 2014



London and South dominant…



Laxfield UK CRE Debt Barometer Methodology

Over Q2 2014 and Q3 2014, Laxfield Capital received 133 loan requests totalling £13.5bn of debt. These requests have been collated and compared with data from Issues One and Two of the Laxfield UK CRE Debt Barometer covering loan requests active from 1 Jan 2013 (including some deals originated prior to 2013, with requirement to fund during the reference period).

The data includes senior and stretch senior loan requirements secured on mainstream income-producing assets in the UK. Loan sizes span £2m - £800m, fixed & floating rate, 2 – 20 year terms and up to 85% LTV.

During the period, Laxfield Capital represented capital providers with appetite for fixed and floating rate loans, senior / stretch senior and junior loans, deal sizes of £5m - £250m, secured on income producing assets in good locations within the UK markets.

About Laxfield Capital

Laxfield Capital is a commercial mortgage origination, investment management and advisory business, which has arranged £2bn of lending since 2008 on behalf of global institutional investors, including life companies, banks and a sovereign wealth fund.

Founded to capitalise on the growing international appetite for UK commercial mortgage investments, Laxfield Capital provides a comprehensive range of services, including origination, investment selection, execution, syndication, investment management and strategic advisory.

Since 1995, the Laxfield Capital principals have originated and managed more than £8.9bn of commercial mortgages in the UK and several European markets and assisted nine international investors in building or expanding their UK commercial mortgage platform.

CONTACTS:

Adam Slater
Managing Director
Adam.Slater@laxfieldcapital.com
Tel: +44 20 7518 1615

Emma Huepfl
Head of Capital Management
Emma.Huepfl@laxfieldcapital.com
Tel: +44 20 7518 1614

LAXFIELD CAPITAL

9 South Street, Mayfair, London W1K 2XA

Tel: +44 (0) 20 7493 5026

www.laxfieldcapital.com