

LAXFIELD UK CRE DEBT BAROMETER

Issue 5:Q2-Q3 2015, published November 2015

Laxfield Capital presents the 5th issue of the **Laxfield UK CRE Debt Barometer**, an overview of current financing requirements in the UK commercial real estate market. The report examines key trends in the previous six month period, measuring current statistics against the pool of data collated since the inception of the Barometer in January 2013. This report sees the addition of two new sections: small ticket loans (<£5m) and development deals, reflecting increased activity in both areas. The combined data pool analysed by Laxfield Capital now exceeds £75bn across 904 deals.

"This has been a buoyant period, with substantially more finance demand attributed to new investment. A large contributor came from finance requests for regional investments, and in smaller loan size categories. An end of year slowdown is not yet in evidence at the end of Q3. Borrower appetite for high leverage debt tailed off slightly in this period, which could indicate a developing caution, but also reflects less activity by short term investors who have already traded the best yield compression opportunities. Nevertheless, with almost half of loan requests at 65% LTV or more off high values, leverage should not be ignored as a risk factor."



Emma Huepfl,
Co-Principal Laxfield Capital

"The Property Finance Forum is pleased to sponsor this report for the second time. This forward looking study signposts market direction and helps investors understand how finance demand interacts with wider real estate trading activity. We are interested to note very strong demand for acquisition related finance, which may signal large loan volume increases for the year, and point to overall debt once again increasing in the UK real estate sector after many years of decline. We also note a shift to the regions indicating the search for higher returns". **Rob Short**



KEY FINDINGS FROM THE PAST HALF YEAR:

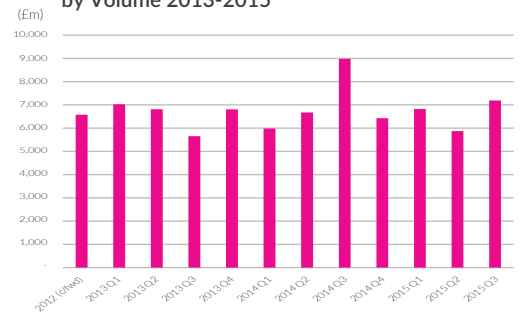
- 1 Acquisition related financing, increased very substantially, and for the first time since the financial crisis, exceeded 60% of the pool of finance requests received during the six month period.
- 2 Almost half of all loan requests exceed 65% LTV – against values which have risen c.35% since the low point in the cycle, but there is more caution above 70%
- 3 Strong activity continues in the smaller loan market.
- 4 Regions producing more loan volume and loan count than London for the first time in recent years.
- 5 Alternatives account for 40% of pipeline – a fall from the last report, but remain strong on a historic basis.

VOLUMES

This was an active period, with total finance requests totaling >£11bn across 154 deals. A noticeable pick-up in activity occurred after the election in May, with lower volumes in Q2 outweighed by second highest volumes recorded in Q3. The bulk of this activity occurred around acquisitions, whilst many re-financings happened away from the open market (see loan purpose section below). On this basis, we expect total origination volumes from lenders to hit a new post GFC high when fully reported 2015 results are available.

In addition to the deals reported above in the mainstream market, section two of this report adds data from 48 small ticket loan requests (<£5m) and 29 development funding requests, totaling £111m and £1.229bn respectively.

Laxfield Capital Quarterly Finance Requests by Volume 2013-2015

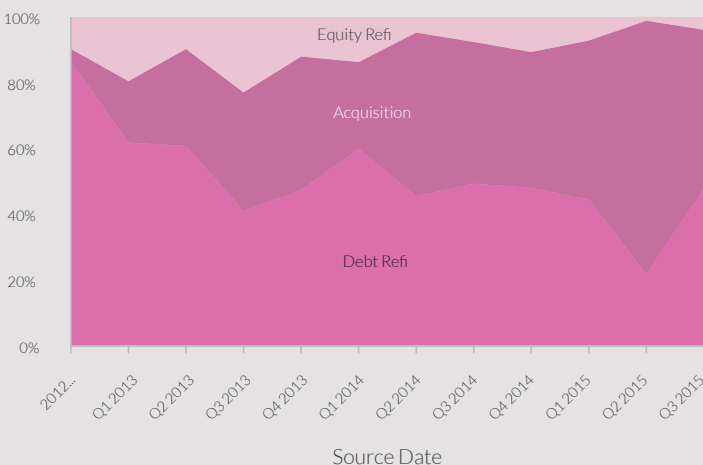


LOAN PURPOSE



- Acquisition related financing increased very substantially, rising to 60.3% of requests by volume over Q2-Q3 2015, compared to 45.1% in the previous six month period.
- This is a remarkable change in market conditions from the end of 2012 when acquisition related finance was just 12% of the total pipeline in a market lacking confidence in finance delivery.

Loan Purpose (by loan size)

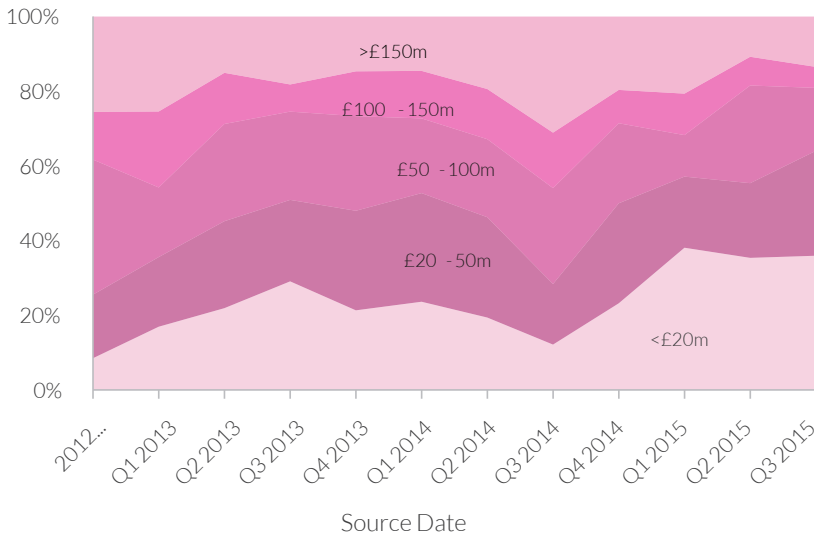


- The lower figures attributed to refinancing also reflects how hard lenders are working to retain borrowers. Rather than risk losing business to a competitive refinancing process, some lenders are prepared quietly to trade down margins for loan extensions. These deals are not presented to the open market, but will contribute to overall volumes at year end. We expect end of year statistics to show that this has been a very active phase in the debt market.

LOAN QUANTUM

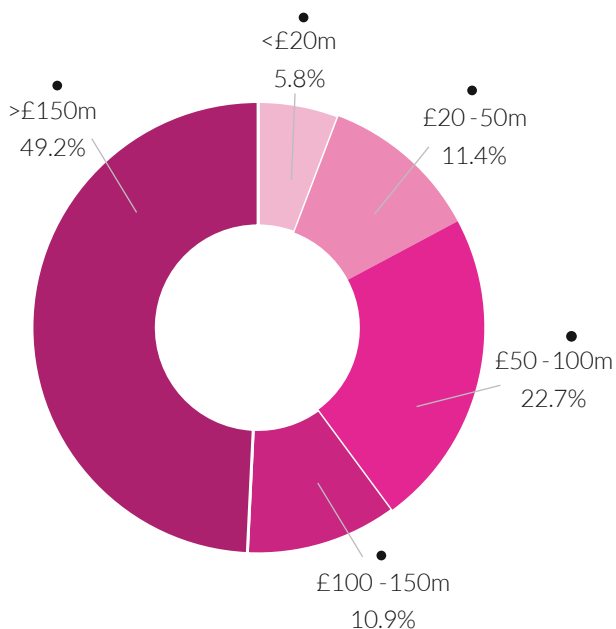
- Large ticket loan requests naturally dominate the pipeline by volume with 60.1% of loan requests being within deals of £100m and above.
- Nevertheless, for the first time, requests for deals below £50m have surpassed 60% by loan count, as activity in the smaller loans market continues to rise. These figures do not include analysis of the new sub £5m band of loan requests. To maintain like for like comparisons in our main data, small ticket requests have been kept separate and provided as Appendix 2 of this report.
- The margin premium noted for smaller ticket deals averaged between 110-150 bps at different leverage points.

Loan Quantum (by loan count)



.....increasingly strong activity in market for loans below £50m

Loan Quantum (by loan volume) - Issue 5

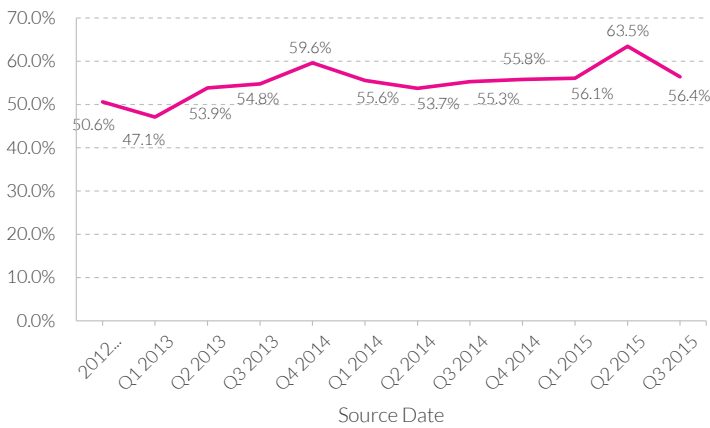


.....By volume, however, jumbo loans still dominate the market with 60% of demand being for loans of £100m or more

LEVERAGE

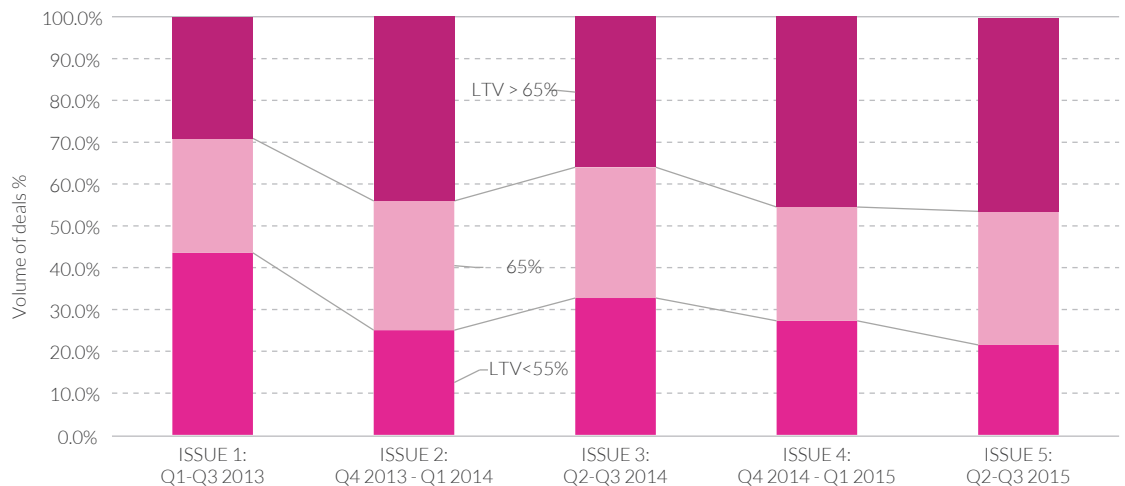
- The long term average line remains remarkably consistent across the pool of funding requests, although a spike of 63.5% was seen in Q2 2015.
- The fairly constant headline figure continues to paint a conservative picture, but LTVs are now measured against valuations c38% higher than the lowest point in 2008 (based on RICS / IPD all properties data). Measuring loan risk against the previous property cycle, a future downturn on a comparable scale to 2008 would see a significant number of loans in excess of 100% LTV.
- Funding requests were heavily clustered between 55 and 70% LTV, with fewer deals in the very high and very low leverage categories – the most homogenized pool of data we have seen.
- The proportion of deals in excess of 70% and 75% LTV, indicates a slightly more conservative approach among leveraged investors during this period, compared to the previous period.
- Institutional investors were also less active in seeking finance during this period, with a substantial reduction in the <45% LTV category

Evolution of WA LTV



...LTVs in line with long-term trends. Overall outlook appears conservative, but true risk must weigh this against underlying asset values which have risen substantially in the same period

Finance Requests Divided by Leverage Band 2013-2015



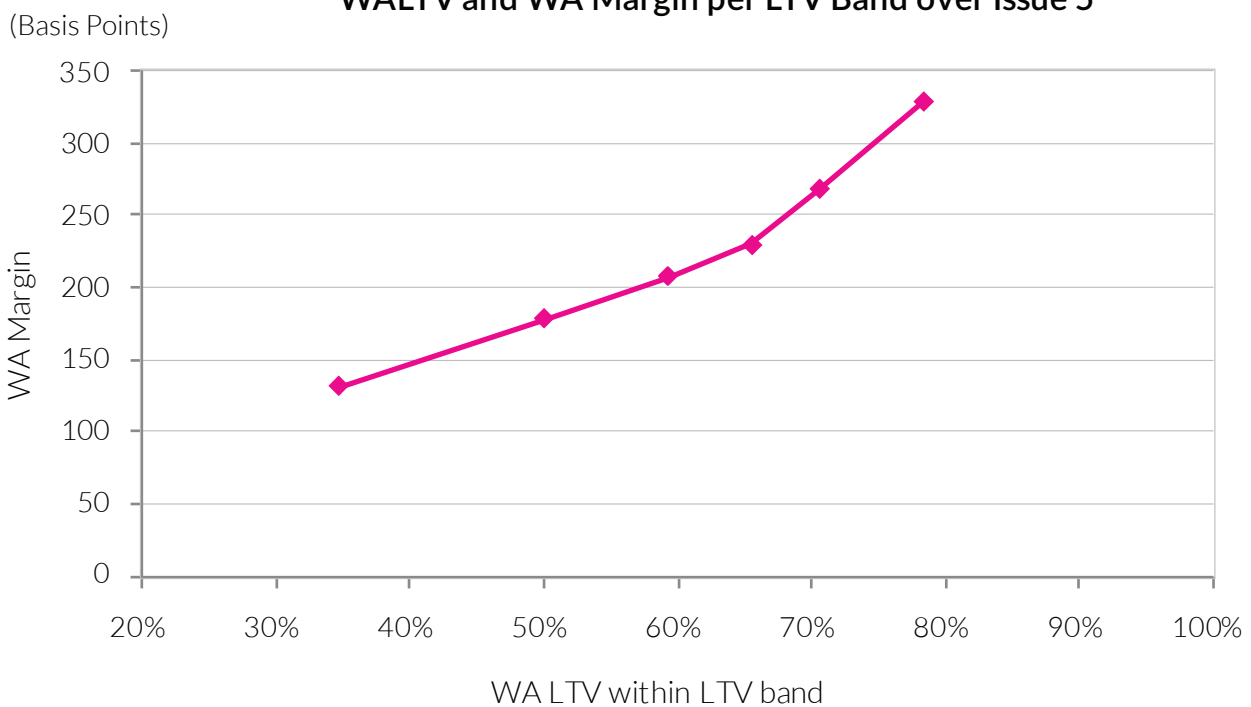
...nearly half of borrowers seek >65% LTV

PRICING

Expected pricing is logged at the time the loan request is received, and reported across the aggregated pool of loan requests seen in the six month period for deals of £5m - £150m+. Loans vary by underlying sector and risk point and differ from period to period

- Against the previous issue, the pricing curve is smoother with less of a marked hike in pricing above 70%.
- Expected pricing increased slightly in the most conservative category. This ties in with wider reports that margin floors for some lenders are higher than six months ago.
- This was offset at the upper end where expected pricing of higher leverage debt was marginally lower, but there was less trading activity
- Across the senior debt band (shown here from 35% LTV – 65% LTV) a range of c.100bps exists between from the lower to the upper end
- Between 65% and the highest LTV requirements seen (78% this issue) a further premium of c. 105bps was observed.

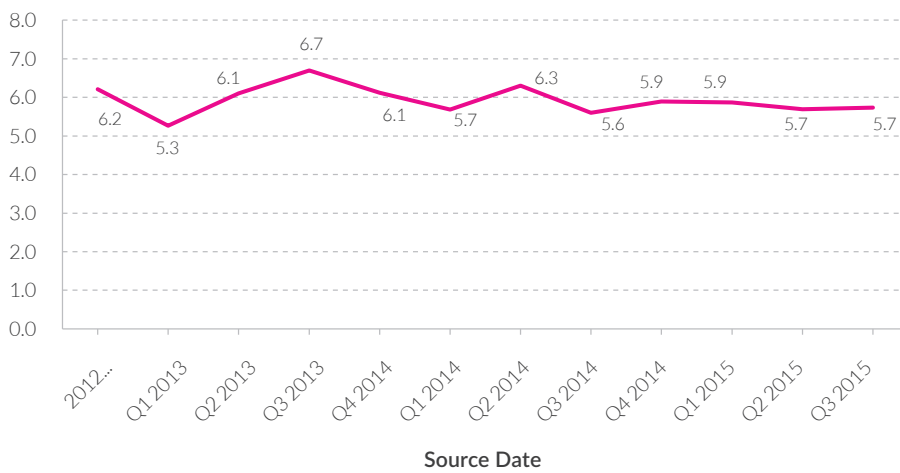
WALTV and WA Margin per LTV Band over Issue 5



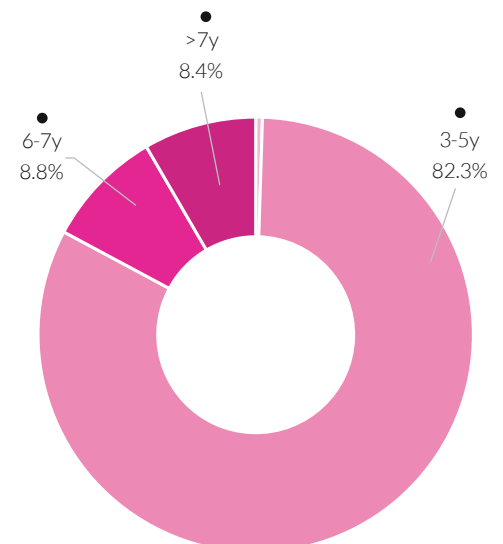
LOAN TERM

- The long term loan market remains a minority activity. More than 82% of the pipeline still expects to trade in the 5 year loan market, and only 8.4% of requirement was seen at the longer (7 year plus) end of the range.
- Competition remains among institutional lenders to deploy capital in the long term market remains high, with expected pricing correspondingly low, despite recent signs that comparable loan assets in the US are currently generating more yield.
- In the UK, un-deployed capital still outweighs demand, and even if appetite softens from US institutions for UK loan pricing, European QE is likely to supplement available capital for long term loans in the UK next year. Our view is that this remains a competitive arena for lenders.

Evolution of weighted average term (years)



Loan Term (by loan size) - Issue 5

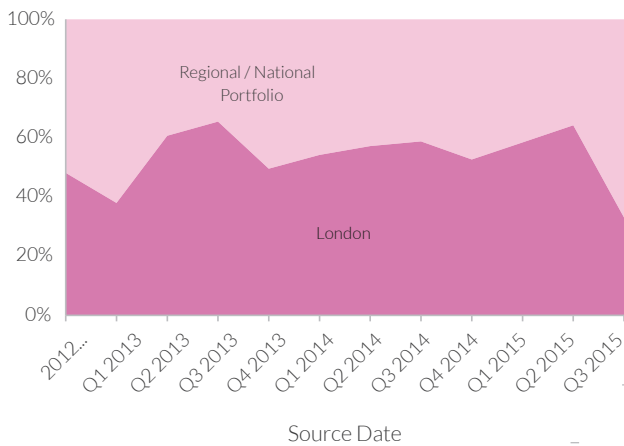


GEOGRAPHY

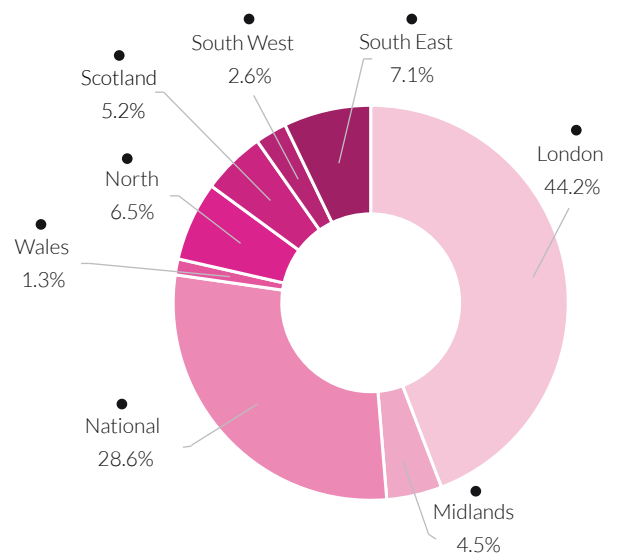


- Very strong activity nationally has seen the regions outstrip London in demand for finance this period by loan count and volume, with a marked post- election hike in Q3. 56% by loan count were for “national” rather than London deals.
- Comparing this to the last time that regional deals were greater than London based transactions, the characteristics of the pipeline have changed substantially. In 2012, the large regional element to the pipeline reflected legacy loans, many of which were in breach of LTV covenants under old financing structures.
- Today, strong demand for regional finance is tied to acquisition activity. 60% of regional loan requests by volume were acquisition related

Geography (by loan size)



Region (by loan count) - Issue 5

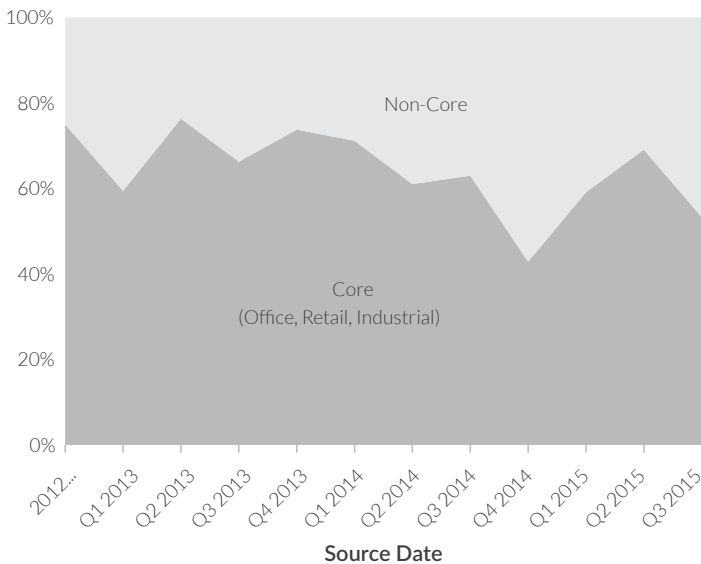


SECTOR

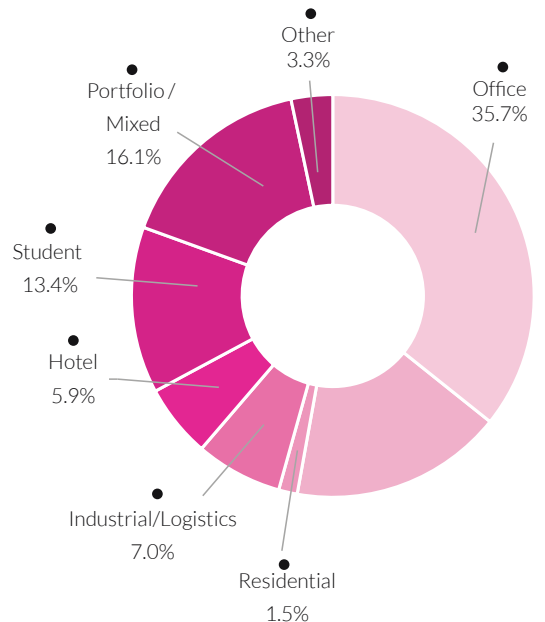


- The large spike in demand for finance for alternative sectors softened slightly in this period, but 40% of requests by volume are outside the three core asset classes, which remains a substantial figure.
- Student accommodation, hotels and residential together formed 21% of the pipeline against 29.6% last issue.
- We saw some increase in expected pricing against operational assets in this period, with lenders expecting better compensation for additional risk carried in this area.

Sector (by loan size)



Sector (by loan size) - Issue 5



SUPPLEMENT A: SMALL LOANS REPORT / SIZE OF POOL

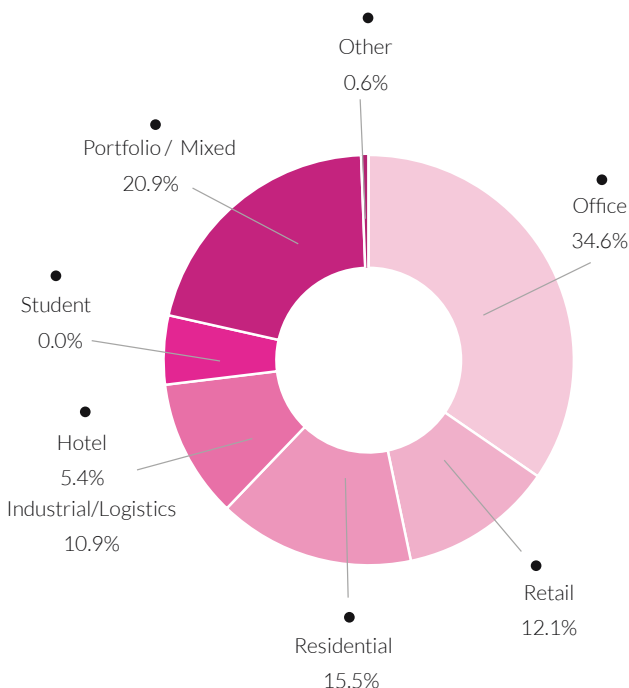


Growing demand for sub £5m loans has provided sufficient data to add a supplemental commentary on this market area, which we expect to expand over time. The data and analysis is kept separate from our main report to maintain like for like comparison. Data for small loans has been collected since Q4 2014, and the total sample is now £121m across 51 deals. Over Q2-Q3 2015, Laxfield Capital received 48 small loan requests with a combined volume of £111m.

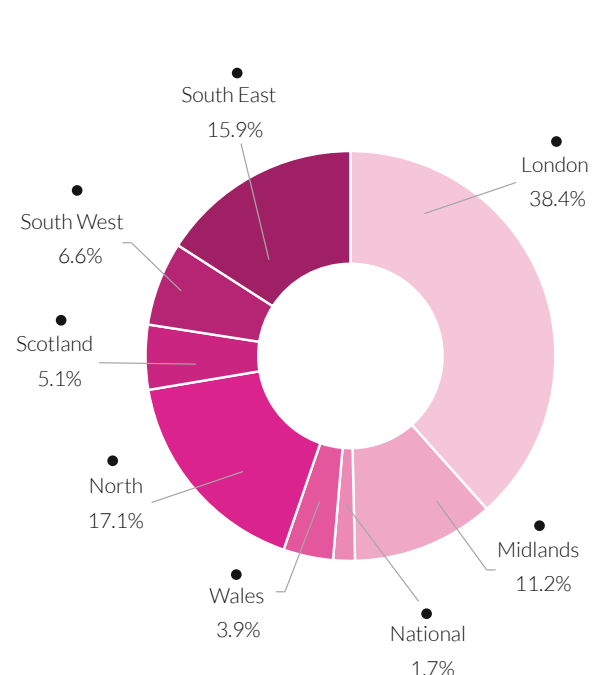
Key observations

- Average LTV was conservative at 54-58% over three quarterly periods
- Pricing expectations are considerably higher than in the larger ticket market, with a premium of c150-200bps at all leverage points
- Stronger bias to acquisition related c.60% of pipeline
- More activity outside London – 62% with good spread throughout the UK, and across a very wide range of sectors

Sector (by loan size) - Issue 5



Region (by loan volume) - Issue 5



SUPPLEMENT B: DEVELOPMENT FINANCING



Development funding requests have been analysed during 2014-15 with a pool now large enough to warrant analysis and observe trends. Included here are loans of any size secured on assets undergoing development in the UK, and may include some rental-income portion for part of the loan term. Leverage is typically quoted for development deals by loan quantum compared to “Gross Development Value” (expected value at completion with defined letting assumptions).

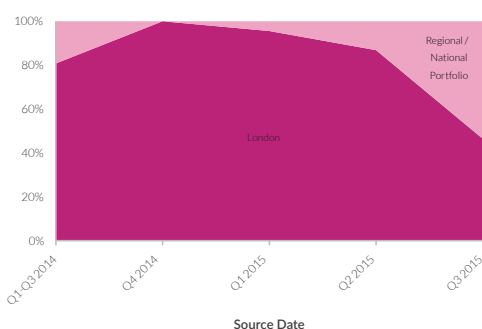
Size of pool

Total sample of £5.2bn development loan requests across 75 deals received and analysed by Laxfield Capital. Over the past 2 quarters Q2-Q3 2015, Laxfield Capital received 30 loan requests totaling £1.3bn of debt.

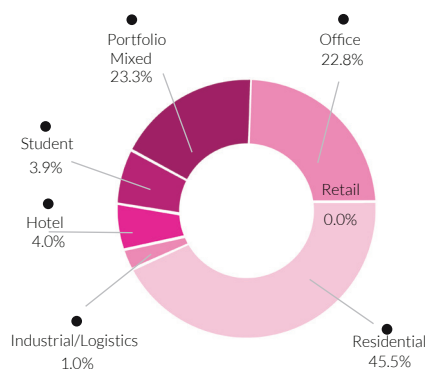
Key comparisons with mainstream loans:

- Demand spread through sector, with strong residential component reflecting large individual loans on jumbo schemes in this sector
- Pricing premium – typically 400-600bps depending on leverage
- London dominance has started to change in the past quarter
- Demand is fairly barbell – a few very large scale deals (dominating the pipeline by volume) supplemented by many deals below £20m
- Typically much shorter in term – almost half are less than three years

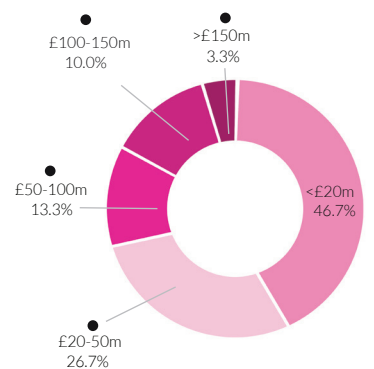
Geography (by loan size)



Sector (by loan size)
- Issue 5



Loan Quantum (by loan count)
- Issue 5



BACKGROUND

METHODOLOGY (figures are for the main Barometer, supplementary sections listed separately):

Added Loan Data: Over the past 2 quarters Q2-Q3 2015, Laxfield Capital received 154 loan requests totaling £11.0bn of debt.

Period: Loan requests active between 1 Jan 2013 – 30 September 2015 (includes some deals originated prior to 2013, with requirement to fund during the reference period).

Loan Parameters: Senior and stretch senior loan requirements secured on mainstream income-producing assets in the UK. Loan sizes span £5m-705m, fixed & floating rate, 2 – 20 year terms and up to 85% LTV.

Capital Representation: during the subject period Laxfield Capital represented capital providers with appetite for fixed and floating rate loans, senior / stretch senior and junior loans, deal sizes of £5m - £705m, secured on income producing assets in good locations within the UK markets.

ABOUT THE LAXFIELD GROUP

The Laxfield Group is a specialist real estate debt business, with five complementary business streams.

Laxfield Capital originates loans for global institutional investors, including life company, bank and sovereign wealth fund clients. Laxfield National, backed by institutional mandates, provides loans of £1m-£25m with a focus on fast and reliable execution.

Laxfield Debt Advisory is retained by borrowers to source the optimum financing structure for their real estate investments. Laxfield Asset Management manages real estate loans on behalf of lender and borrower clients. Laxfield Analytics collects data on finance demand, lender and deal activity and produces the Laxfield CRE Debt Market Barometer on a six monthly basis.

Since 1995 the Laxfield principals have originated, advised or managed loans with a value of more than £10bn, and worked with ten international lenders to build their UK commercial mortgage platforms.

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