EUROPEAN LENDING TRENDS

SPRING 2017

CUSHMAN & WAKEFIELD

Loan book expansion

LOAN ORIGINATION GROWTH CONTINUES AHEAD OF 2016 ACROSS EUROPE

LTVs and margins rise

LTVs REVERSE THEIR RECENT DOWNWARD TREND BUT MARGINS RISE

Prime over secondary

LENDERS REMAIN FOCUSSED ON PRIME ASSETS AND STRONG LOCATIONS

OVERVIEW

Cushman & Wakefield has conducted its fifth survey on commercial real estate lending activities across Europe in the first quarter of 2017. This survey captures the latest dynamics across Europe's real estate lending markets. In line with previous surveys, a majority (close to half) of all respondents are from commercial banks, with institutions (19%) and debt funds (15%) representing most of the remaining responses.

LOAN BOOK

Lenders remain focused on the Big 3, core markets: UK, Germany and France. Lending towards the UK has diminished post the EU Referendum vote, reflecting a slowdown in demand for credit and lower turnover of the investment market as geopolitical risk slowed decision making.

Lending towards the Benelux and Nordics has increased since our previous survey, reflecting strong underlying fundamentals. Southern European and Central and Eastern European markets appear to be losing share. Changes to VAT legislation in Poland could be a factor being caution in CEE. However, our own evidence does not point to any specific reduction in lender appetite across these markets.

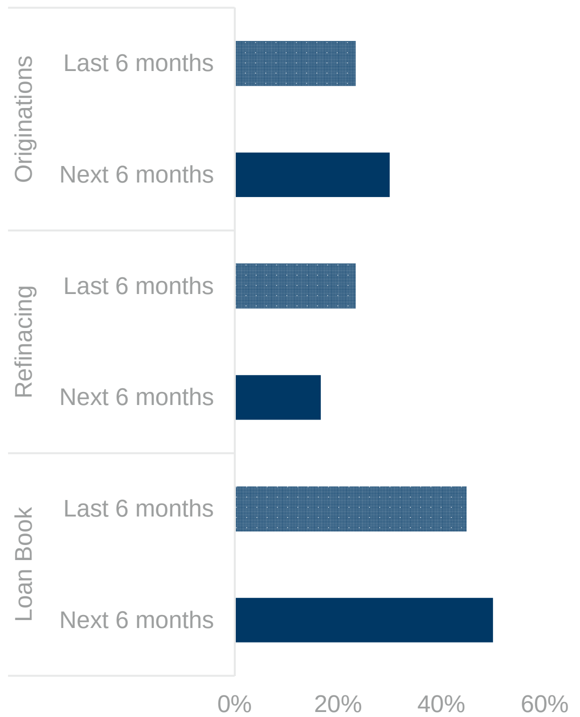
"Lenders anticipate increased loan book exposure to commercial real estate driven by new originations"

A positive balance of lenders reported growth in originations across Europe in the second half of 2016 in line with expectations from our previous survey. Moving forward a net 30% expect originations to grow. This is ahead of trends in the last six months but lower than surveys in 2016, implying lenders are more cautious in their outlook.

Refinancing continues to expand, although the outlook for the next six months is marginally weaker. Overall, lenders expect further expansion of their loan books.

"Lending volumes rise in Germany, the Benelux and Nordics"

Loan book expectations (net balance)



Source: Cushman & Wakefield Research

CAPITAL STRUCTURE

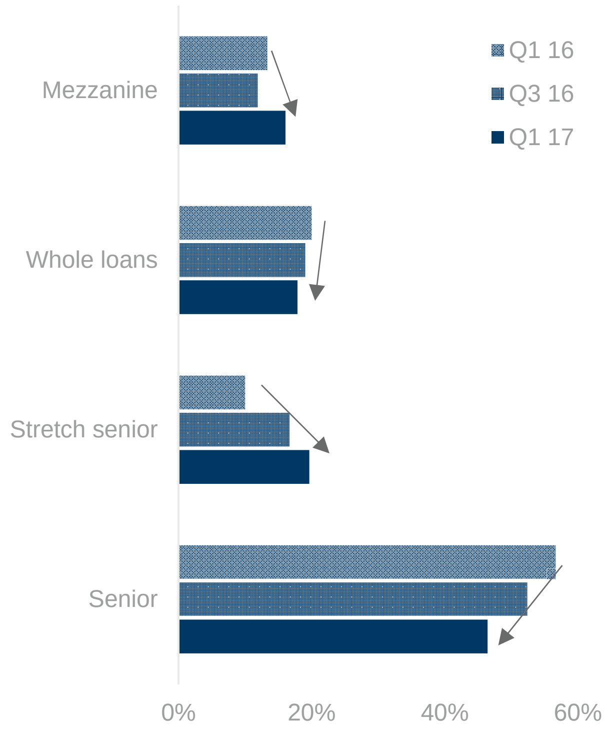
Senior debt remains the preferred loan structure for the majority of lenders, although its share has diminished over the past twelve months.

The shift away from senior debt has been in favour of stretched senior and mezzanine finance. Stretch senior is preferred by 20% of respondents, up from 10% a year ago. Stretch senior is now the second most favoured choice ahead of whole loans which remains equally popular, despite a declining share. The drop in whole loans is surprising as we have not observed any drop in lenders willing to offer whole loans.

> ***“Increasing appetite for stretched senior debt amongst investors”***

The trend away from pure senior debt reflects the desire of borrowers to increase their loan to value ratio (LTV) but with a preference through one single source. Mezzanine finance is also increasing in popularity with more lenders offering this facility, though often at a cost for borrowers, and it remains to be seen if there is sufficient demand.

Capital Structure

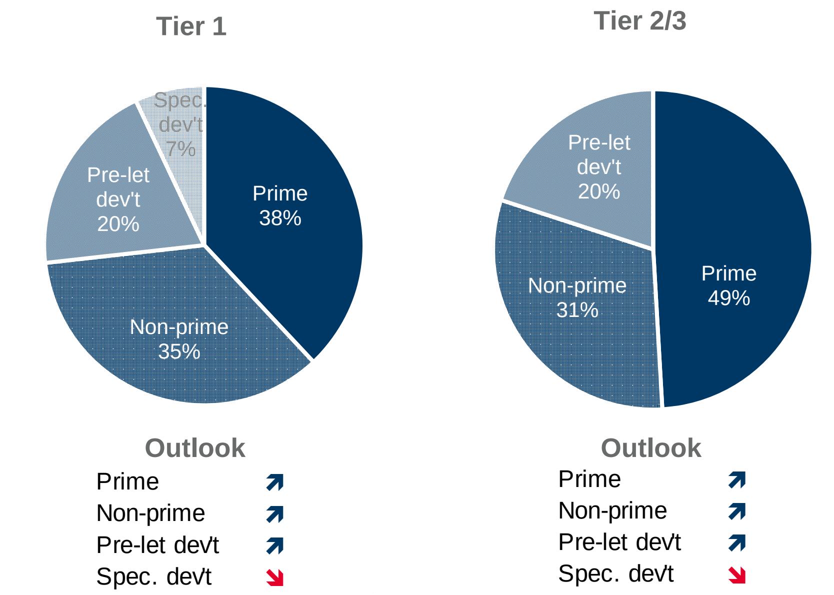


Source: Cushman & Wakefield Research

TARGET LENDING TYPE

Lending in both first and second tier markets remains concentrated on standing investments. The appetite for providing development finance remains limited and mainly geared towards pre-let development.

Target Lending Type



"Lending remains focused on prime assets or locations"

"few lenders offering finance on speculative development"

Source: Cushman & Wakefield Research

We continue to see distinct patterns in lending across market tiers. Investors struggling to source prime assets in tier one markets are seeking secondary or development opportunities in 'build to core' strategies supporting demand for more lending on these assets. This is evident in our survey where the share of lenders targeting non-prime and pre-let development in tier one markets has risen in the past six months. Lenders report an expected continuation of this trend over the next six months.

In second tier markets, prime standing investments remain the primary target. Compared to our previous survey we see more interest in non-prime standing investments, which could partly reflect the ability to access prime assets. Moving forward, in second tier markets, we do see signs of caution with a greater balance of lenders showing growth in lending towards prime standing investments rather than non-prime standing assets or pre-let developments.

Few lenders will offer speculative finance, with none now on offer in second tier markets based on this survey.

LENDING TERMS

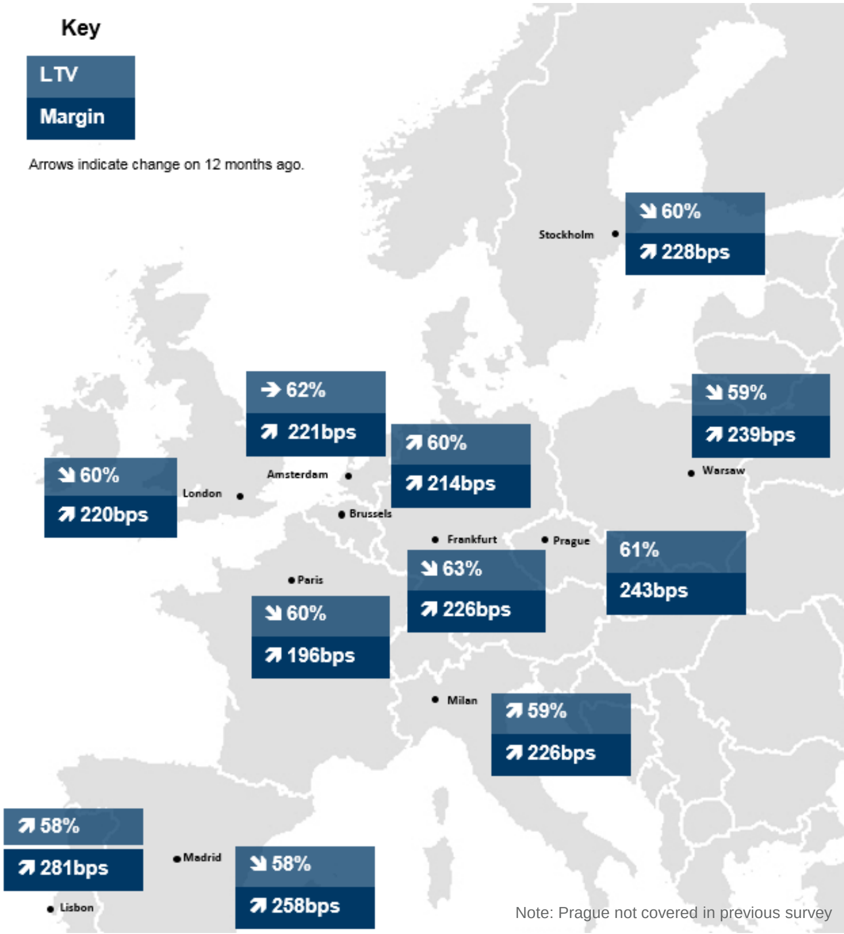
At an all property level, average LTVs have risen in the majority of markets and are edging back towards levels seen a year ago. Margins have, on average, risen across all markets.

In most markets LTVs are typically one to two percentage points below where they were a year ago but still remain low by historical standards - typically around c. 60% in the major cities.

A year ago, all property margins were sub 200bps. However, today margins are above 220bps in the majority of locations. Paris is the only region where we see ‘all property lending’ margins of sub 200bps.

“All property lending margins have risen across all markets over the past year”

All property lending terms and change on 12 months ago



Source: Cushman & Wakefield Research

Sector Trends

- ***Industrial -*** We see higher LTVs across the sector in all the markets surveyed – rising on average from 54% to 61% in the last six months ago. Margins have reduced in the region of 25-50bps over this same period.
- ***Offices and retail -*** The adjustment in LTVs has been more modest. In London, average LTVs for office and retail have not moved. Loan to value ratios in other core cities such as Frankfurt, Milan and Madrid are up three to four percentage points. The adjustment in margins is more varied over the past six months, but with a clear upward adjustment on a year ago.

OBSERVATIONS AND OUTLOOK

- Strong competition amongst lenders for prime assets and high margin return business
- Lenders more selective on secondary…. with margins remaining largely static
- Lenders generally seeking higher levels of amortisation
- Majority of lending between 55 – 60% LTV for senior with amortisation above this
- Lender appetite for development finance, (especially speculative) remains weak and at a cost

Our own market observations show strong competition from lenders towards prime assets which is maintaining downward pressure on margins (c. 10-15bps) since the start of the year in major markets. We have not seen any evidence of any tightening outside of prime.

For secondary assets, lenders remain selective. LTVs are typically no more than 60% for senior debt on secondary assets with lenders more selective on what they will finance and heavily focused to amortisation and exit value. Finance for development is selectively available, but at margins typically prohibitive for ordinary borrowers, even though general vacancy rates for grade A space remain low. Overall borrowers are increasingly focussed on pushing cash-on-cash returns by maximising LTVs to a point without the need for amortisation.

Despite political and economic headwinds, lenders considered upcoming elections to be broadly neutral, though views varied, especially in relation to the UK's exit from Europe. In the lower for longer interest rate environment, the current cycle is likely to be extended, though with the tightening regulatory environment, lenders remain cautious and wish to retain their current sensible lending standards.

CONTACT DETAILS

AUTHORS

Nigel Almond

Head of EMEA Capital Markets Research

+44 (0) 20 3296 2328

nigel.almond@cushwake.com

James Spencer-Jones

Head of EMEA Structured Finance

+44 (0) 20 7152 5524

james.spencer-jones@cushwake.com