INSIGHT

LENDING TO GROW IN 2016 BUT HAS PRICING SHIFTED?

European Lending Trends

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Contents

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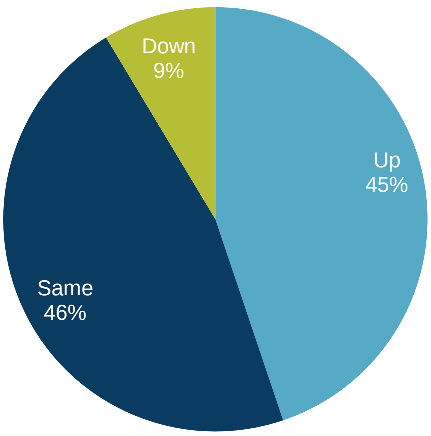
- The lending environment across Europe remains positive with the majority of lenders expecting to maintain or expand their activities in 2016. The environment for refinancing remains stable, the pace of growth for originations, though positive, is set to be lower in H1 2016.
- The UK, France and Germany remain the top tier and key focus, with a marginally higher proportion considering the UK and Germany. Expansion is also observed in Spain and the Nordic markets compared to our previous survey.
- A majority (57%) of lenders engaged in senior loans, however a growing proportion (20%) are now engaged in whole loans. Whole loans are now clearly the second most popular form of finance, though often syndicating either the senior or mezzaEUR246.3bn, the highest level on record, and surpassing the previous peak of EUR230.5bn in 2007.nine position.
- Average all property LTVs are typically 55-65% across Europe, with the highest in Frankfurt and Paris (64%) and London (63%). Debt funds are willing to lend at higher LTVs compared to commercial banks and institutions.
- We see a broader range in margins from ca 130bps in Stockholm and ca 140bps in Frankfurt and Paris, up to over 250bps in Lisbon. Commercial banks are typically offering the lowest margins ahead of institutions and debt funds. Separately we have observed margins in the UK rise 25bps – especially London.
- Attitudes towards lending in both Tier 1 and Tier 2&3 cities shows little change compared with our previous survey. Only lending on speculative development appears more negative, though contrary to other feedback we see in the market.
- Whilst weight of capital remains the primary risk, lenders see a broader range of risks in the market during 2016. Lower for longer interest rates and conservative lending will support CRE investment activity.

Figure 1

Outlook for lending 2016



Source: Cushman & Wakefield Research

Introduction

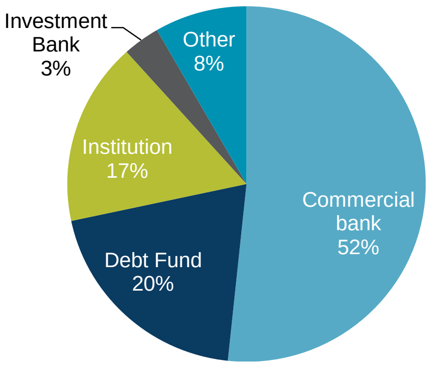
This is our third survey covering trends in lending towards commercial real estate across Europe. The survey is based on responses from over sixty active lenders in Europe, who provided more than EUR80bn of loans in 2015.

The survey was conducted during the first half of December 2015, with just over half of the responses from commercial banks. Debt funds (20%) and Institutions (17%) were the next major respondents (Figure 2) and broadly in line with our previous survey responses.

Questions were consistent with previous surveys, covering both current and recent lending activity as well as trends in the year ahead. However we have expanded the city level coverage on lending terms.

Figure 2

Responses by lender type



Source: Cushman & Wakefield Research

Loan book

UK, France and Germany remain core focus

The majority of lenders remain focussed on the three core markets of UK, France and Germany, which represent close to 50% of lending activity (Figure 3). We have seen an increase in those targeting the UK and Germany at the expense of France, where we have observed a drop.

Spain and CEE growing in focus

The results also show an increased appetite to lend in Spain and also across the Nordic markets. The former underscores the transformation in activity and willingness to move lending up the risk curve. In contrast the appetite to lend in Italy remains weak. Appetite to lend was stable in Benelux and CEE markets.

Pace of growth in originations set to slow

Over the last six months a majority of lenders (81%) stated that originations were either stable or up (Figure 4). Moving forward we see a high proportion of lenders expecting originations to be stable or higher. However those reporting an increase over the next six months shrinks from 56% to 41%, implying that the pace of increase could be slowing.

Refinancing remains stable

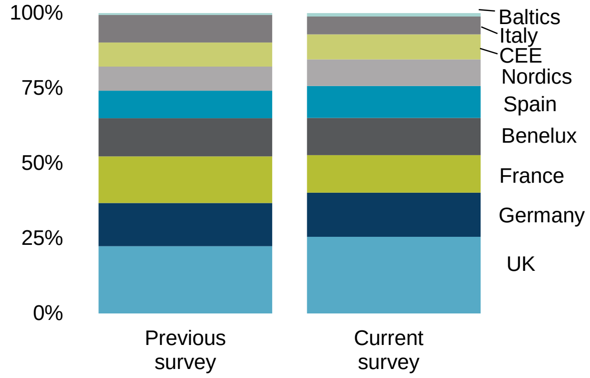
A similar trend is also evident for refinancing, although a far higher proportion of lenders report stable levels of activity and this is set to increase further into 2016.

Loan books set to expand further

On a positive note the outlook for overall loan books is one of expansion, with fewer expecting loan books to decline in the next six months. This implies that the workout of loans and write downs is nearing an end; combined with new lending and refinancing, lenders expect some expansion in loan books. Further, lenders remain positive for 2016 overall (Figure 5), with over 90% expecting lending activity to increase or remain static compared with 2015 levels, with the balance evenly split.

Figure 3

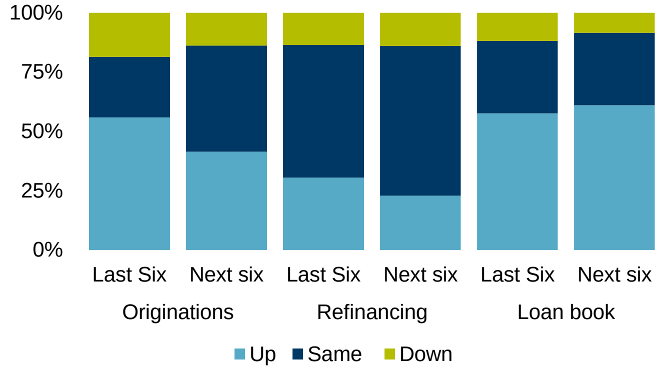
Geographic focus of lending activity



Source: Cushman & Wakefield Research

Figure 4

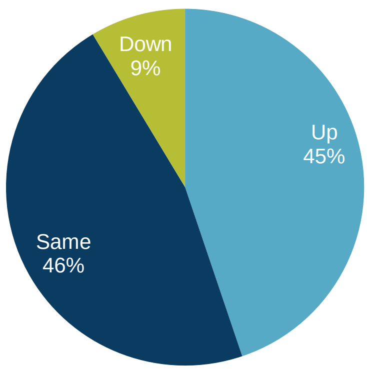
Loan book expectations



Source: Cushman & Wakefield Research

Figure 5

Outlook for lending 2016



Source: Cushman & Wakefield Research

Lending style

Senior dominant, whole loans on the rise

The majority of lenders (57%) remain engaged in senior lending, which is consistent with our previous surveys (Figure 6). In contrast with the past, we now see a higher proportion (20%) of lenders engaged in whole loans. This style is now a clear second preference for lenders, ahead of mezzanine finance and stretch senior. Many lenders will offer a whole loan and then syndicate either the senior or mezzanine position later.

Limited change in lending style

Attitudes towards lending by style in both Tier 1 and Tier 2&3 markets has changed little over the last six months (Figure 7). In line with previous surveys there is a greater willingness to lend on non-prime standing investment in Tier 1 markets. There is also a greater propensity to lend towards pre-let development in Tier 1 markets, although the proportions have changed little.

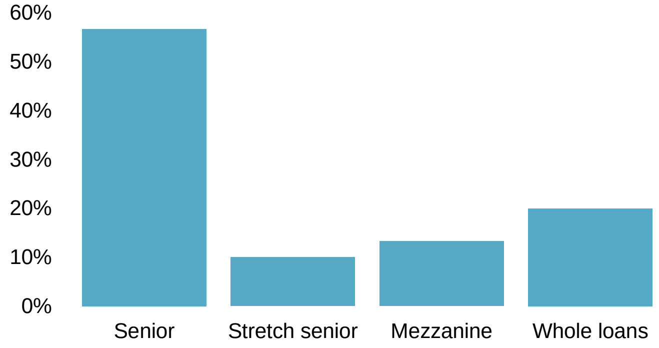
Looking forward the outlook remains broadly stable, with the majority of lenders seeing no change in their level of lending activity. This is a step change in attitude compared with our previous survey where we saw a greater willingness to increase in all markets. This is consistent with attitudes in the previous section, where the pace of lending is expected to slow.

One clear trend is the greater caution towards speculative development, with the balance of lenders (those expecting a rise less those seeing a fall) negative in both Tier 1 and Tier 2&3 markets (Figure 8). In Tier 2&3 markets we do see marginally stronger appetite for pre-let development. This would be consistent with the limited supply pipeline and willingness to develop where risks a lower.

The caution towards speculative development is contrary to evidence we see in the market where lenders, in our opinion, remain warm to the idea.

Figure 6

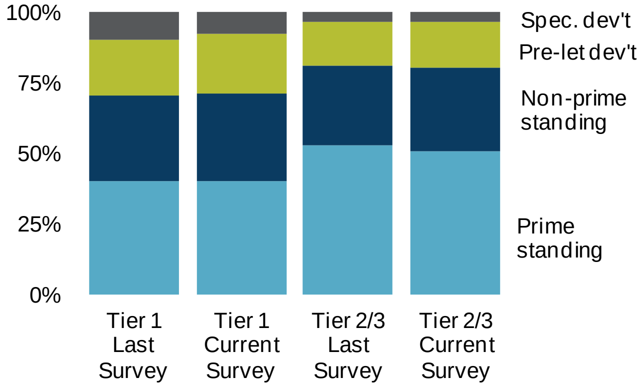
Lending style



Source: Cushman & Wakefield Research

Figure 7

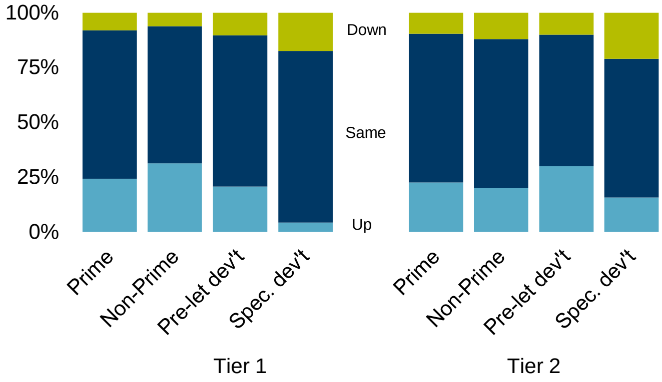
Lending in Tier 1 and Tier 2&3 markets



Source: Cushman & Wakefield Research

Figure 8

Expectations for lending by location and type



Source: Cushman & Wakefield Research

Lending Terms

Overall loan terms remain broadly conservative (Figure 9). In major core cities average LTVs are 55%-65%, with the highest in Paris and Frankfurt at 64% and London marginally lower, at 63%. LTVs are lower in Southern European cities Milan (57%) and Madrid (59%), although Lisbon registers the lowest at 50%.

Average margins show a broader range from 128bps in Stockholm to 268bps in Lisbon. Margins in Paris (138bps) and Frankfurt (139bps) are lower than in London (157bps). In line with lower LTVs average margins are typically higher across Southern Europe.

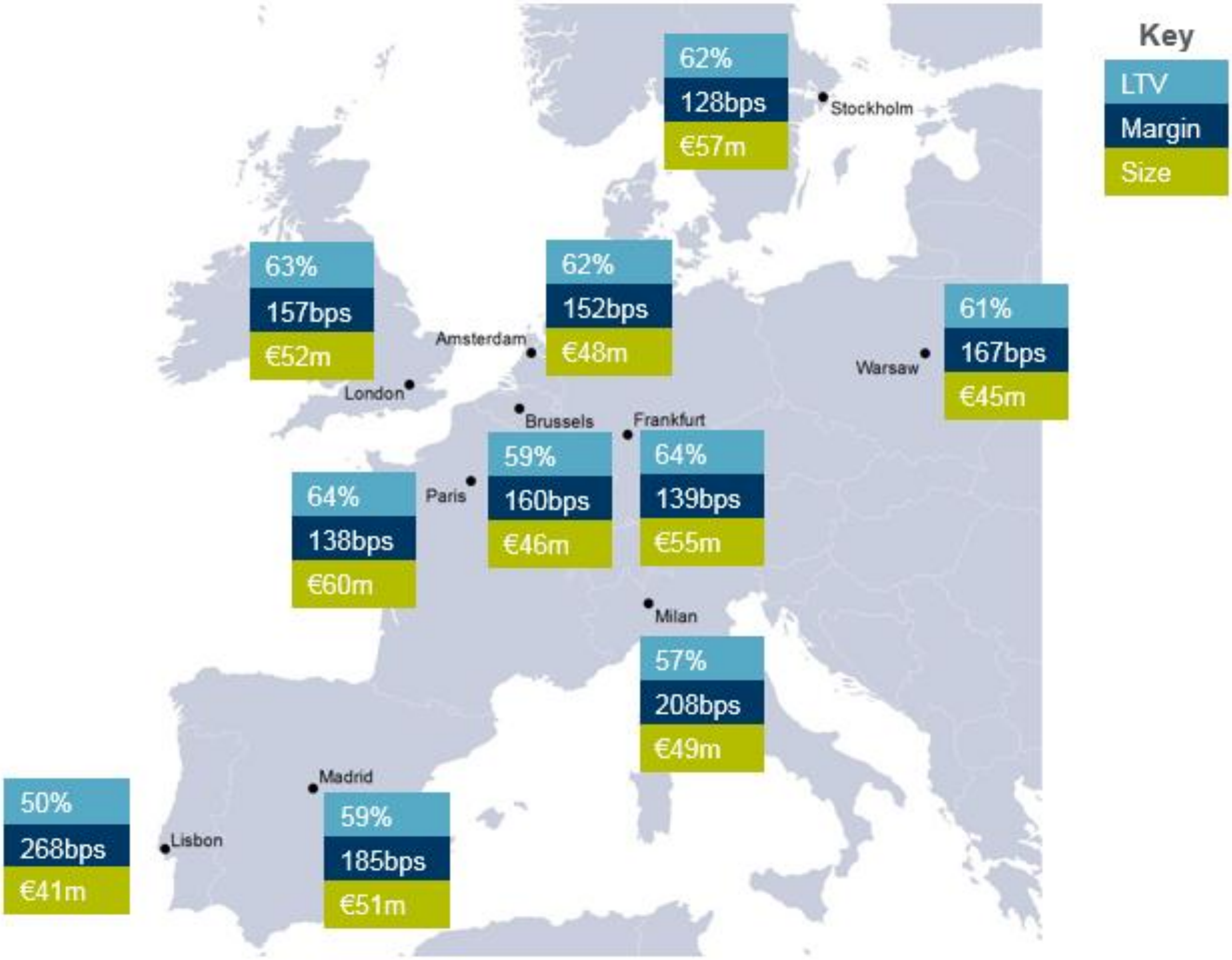
We do observe variations in the terms across different lender types. Typically debt funds will offer higher LTVs in all markets, and be in the upper 60% bracket on average.

Both commercial banks and institutions will target the 55%-65% bracket. The broad expectation is for LTVs to remain flat over the next six months. Only in a few instances do lenders see a reduction, with only 10-20% expecting an increase.

For margins there is a broader consensus. Commercial banks are typically sub 200bps, with institutions in the 300-400bps range and debt funds at 400bps+. Looking forward, a higher share of lenders expect margins to be under further downward pressure, with typically 40-55% of respondents expecting further falls. In both London and Stockholm we see ca. 20% of respondents expecting some upward pressure on margins. In fact during Q4 2015, our own observation was that margins in the UK rose by a modest 25bps, especially in London. It remains to be seen whether this was just a short term blip.

Figure 9

All Property Loan Terms



Source: Cushman & Wakefield Research

Outlook

The findings from the survey continue to highlight confidence in the outlook for the market, with a positive balance expecting lending and aggregate loan books to increase. In line with the previous report, we see lenders increasing their risk profile with a higher share willing to lend in in selected Southern European markets.

Nonetheless the theme in our previous report, that lenders were disciplined on risk, remains. Average LTVs are typically below 65%, and relatively few lenders are looking to expand into speculative development.

Broader range of risks to market

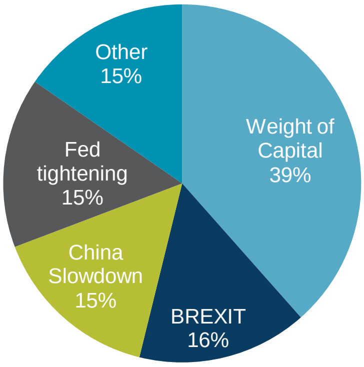
Against a backdrop of increased lending, lenders foresee a broader range of risks (Figure 10). In our previous survey, a majority (58%) of respondents saw weight of capital as the main threat to the lending market. Whilst weight of capital remains the biggest threat, at 39% it is much reduced. The threat of a British exit from Europe (BREXIT) is seen as the second biggest threat at 16%. A Chinese slowdown at 15% is the next biggest threat, this compares with just a 4% weight in our previous survey and reflects the continued volatility in equity markets and lower growth in the Chinese economy. Despite these headwinds commercial real estate investment markets still offer good investment opportunities and demand remains which will support the positive sentiment in this survey.

Accommodative monetary policy across Europe

Cited by 15% of respondents as a risk, Fed tightening is also in the mind of lenders. Indeed the process of raising rates has already begun in the US with the Federal Reserve raising interest rates 25bps back in December 2015. Closer to home, a majority (52%) expected the UK's base rate to rise in the second half of the year. Given recent comments from the Governor of the Bank of England, sentiment may now have shifted in the UK. For Europe increases are expected to come later. Some 40% expect increases to start a year later in H1 2017. Interestingly a further 46% still expect the rise to be later still (Figure 11). In an era of lower for longer interest rates and accommodative monetary policy, we see lending conditions remaining positive and supporting further growth in investment markets.

Figure 10

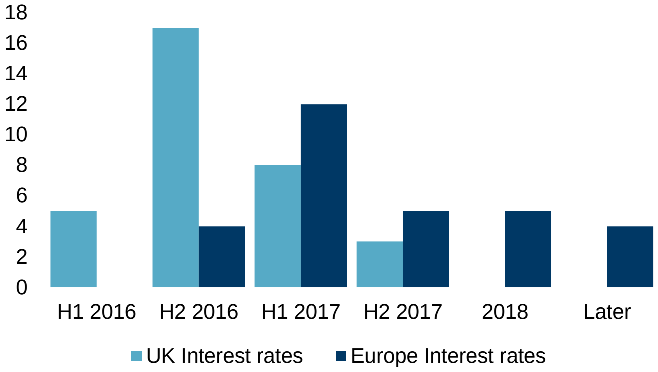
Risks to lending market



Source: Cushman & Wakefield Research

Figure 11

Expectations for interest rate rise



Source: Cushman & Wakefield Research

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