The UK Commercial Property Lending Market Research Findings 2009 Year End
AN EXTRACT FROM

The UK Commercial Property Lending Market: Year-End 2009 Research Findings

Bill Maxted
Trudi Porter

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Department of Corporate Development
Faculty of Business and Law
De Montfort University
Hugh Aston Building
Leicester
LE1 9BH
**CONTENTS**

<table>
<thead>
<tr>
<th>ACKNOWLEDGEMENTS</th>
<th>viii</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>ix</td>
</tr>
<tr>
<td>INTRODUCTION</td>
<td>xii</td>
</tr>
<tr>
<td>MARKET ACTIVITY 2009</td>
<td>1</td>
</tr>
<tr>
<td>1. Loan book size and gross lending recorded by the research in 2009</td>
<td>1</td>
</tr>
<tr>
<td>1.1 Value of outstanding loan books</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Estimation of market size year-end 2009</td>
<td>3</td>
</tr>
<tr>
<td>1.3 Value of loan originations completed in 2009</td>
<td>4</td>
</tr>
<tr>
<td>MAIN FINDINGS</td>
<td>6</td>
</tr>
<tr>
<td>2. UK commercial property lending 1999 to 2009</td>
<td>6</td>
</tr>
<tr>
<td>2.1 Aggregated value of outstanding debt recorded in loan books</td>
<td>6</td>
</tr>
<tr>
<td>2.2 Repayment</td>
<td>10</td>
</tr>
<tr>
<td>2.3 Prepayments of loans held on balance sheet</td>
<td>12</td>
</tr>
<tr>
<td>2.4 Mezzanine finance</td>
<td>12</td>
</tr>
<tr>
<td>2.5 Annual volume of loan originations</td>
<td>13</td>
</tr>
<tr>
<td>2.6 Market share of loan originations</td>
<td>14</td>
</tr>
<tr>
<td>2.7 New loans and refinancing</td>
<td>16</td>
</tr>
<tr>
<td>2.8 Typical Loan Lengths 2009</td>
<td>17</td>
</tr>
<tr>
<td>2.9 Lending limits</td>
<td>18</td>
</tr>
<tr>
<td>2.10 CMBS</td>
<td>19</td>
</tr>
<tr>
<td>2.11 Syndications</td>
<td>20</td>
</tr>
<tr>
<td>3 Loan terms</td>
<td>22</td>
</tr>
<tr>
<td>3.1 Average interest rate margins</td>
<td>22</td>
</tr>
<tr>
<td>3.2 Average loan-to-value ratios</td>
<td>24</td>
</tr>
<tr>
<td>3.3 Average arrangement fees</td>
<td>25</td>
</tr>
<tr>
<td>3.4 Average income to interest cover</td>
<td>26</td>
</tr>
<tr>
<td>3.5 Extended and Restructured loans</td>
<td>27</td>
</tr>
<tr>
<td>3.6 Junior debt and mezzanine on investment loans to commercial property</td>
<td>27</td>
</tr>
<tr>
<td>3.7 Residual debt</td>
<td>31</td>
</tr>
<tr>
<td>3.8 Hedging strategy</td>
<td>32</td>
</tr>
<tr>
<td>3.9 Loans in breach of financial covenant and defaulted loans</td>
<td>33</td>
</tr>
<tr>
<td>4 Structure of outstanding loan books</td>
<td>37</td>
</tr>
<tr>
<td>4.1 Allocation of outstanding loan book by type of project</td>
<td>37</td>
</tr>
<tr>
<td>4.2 Lending preferences by type of property</td>
<td>39</td>
</tr>
<tr>
<td>4.3 Regional allocation of lending</td>
<td>42</td>
</tr>
<tr>
<td>5. International lending</td>
<td>44</td>
</tr>
<tr>
<td>6. Lending intentions</td>
<td>45</td>
</tr>
<tr>
<td>7 Conclusion</td>
<td>47</td>
</tr>
</tbody>
</table>

*FOR FULL CONTENT LIST OF TABLES, FIGURES AND APPENDICES – PLEASE SEE END OF THIS EXTRACT*
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Bayern LB
Berlin-Hannoversche Hypothekenbank AG / Landesbank Berlin AG
Bristol & West Property Finance
Britannia Building Society
Canada Life Ltd
Coutts & Co
Credit Suisse
DEKA Bank
Deutsche Bank AG
Deutsche Hypothekenbank AG
Deutsche Pfandbriefbank
Deutsche Postbank AG
DG Hyp AG
Dunbar Bank plc
Dunfermline Building Society
Erste Group Bank AG
Eurohypo (UK) Ltd
Europe Arab Bank plc
GE Real Estate
Helaba Landesbank Hessen-Thüringen
HSBC Bank plc

HSH Nordbank
ING Real Estate
Investec Bank (UK) Ltd
Israel Discount Bank
J P Morgan Securities
Kaupthing Singer and Friedlander (In Administration)
KBC Bank NV
Landesbank Baden-Württemberg
Leeds Building Society
Lehman Brothers International Holdings Inc
Lloyds Banking Group
Metropolitan Life Insurance Company
Mitre Capital Partners
Morgan Stanley & Co International Limited
Munchener Hypo Bank EG
N M Rothschild and Sons
National Australia Group Europe Limited
Nationwide Building Society
Newcastle Building Society
Nord/LB (Norddeutsche Landesbank Girozentrale)
Northern Rock plc
Principality Building Society
Prudential M & G
Santander Corporate Banking
Société Générale
The Cooperative Bank plc
The Royal Bank of Scotland
West Bromwich Building Society
Westdeutsche Immobilien Bank
EXECUTIVE SUMMARY

Market Size

The research covers total property lending (commercial property and lending secured by social housing) of £247.7bn held by 59 lending organisations as at 30 December 2009. A total of 68 responses from individual lending teams were received which represents a 100% response rate. (see page 1)

The aggregated value of outstanding debt secured by UK commercial property only, rose from £225.5bn (2008) to £228.3bn (2009 year-end), an increase of 1.2%. (see pages 6 and 7)

On the assumption that this research captures between 90% and 95% of the specialist commercial property lending market, and using the £228.3bn reported above, it can be estimated that the market size is in the region of £240bn to £254bn without social housing at year-end 2009. (see page 3)

In addition, a further £42.5bn of loans were committed but not drawn at year-end 2009. (see pages 1 and 2)

Fitch Ratings provided data on the balance of outstanding CMBS issuances that they had rated and that included loans secured by UK commercial property. At year-end 2009 this amounted to £42bn. Fitch Ratings estimates that the total outstanding balance of UK CMBS at year-end 2009 was approximately £50bn. (see page 4)

UK organisations (UK Lenders and UK Building Societies) held 64% of outstanding debt retained on balance sheet, Other International Lenders 23%, German lenders 11% and North American Lenders 2%. (see pages 1, 2 and 8 and Appendix A)

OTHER HEADINGS INCLUDED IN THE EXECUTIVE SUMMARY OF THE FULL REPORT ARE:

Loan Maturities
Loan Originations and Loan Extensions
Future lending Intentions
Problem Loans
Structure of Loan Book
Loan terms
1. INTRODUCTION

This report analyses the lending patterns of the major commercial property lenders operating within the UK for the year-ended 31 December 2009.

This is the twelfth such report to be published by De Montfort University and is the most recent addition to a series of annual and half yearly reports that commenced in 1997.

The continuing difficult circumstances in the financial markets both nationally and internationally continue to impact on this research and the organisations that contribute to it. Since the report for year-end 2008, two major UK Lenders have completed their merger and will now be recorded in this data as a single organisation. Another two UK lenders have merged and have become part of a major overseas lender. In this and subsequent reports these organisations will also now be recorded as a single organisation and their data reported in the category of Other International Lenders. Organisations that have received support from their respective Governments have undergone a substantial internal restructuring during 2009. In some instances this has resulted in the reclassification and description of current and historic data provided to this research. These revisions have been incorporated into the evidence presented in this report. It has also been well documented elsewhere that a small number of organisations from across the categories adopted in this research have merged and/or have completely withdrawn from commercial property lending. These organisations, however, continue to report their value of outstanding debt to this research.

In December 2009, questionnaires were sent to 59 lending organisations that had contributed to this research in previous years. A response rate of 100% was received from the 59 organisations (68 lending teams).

The rate and detail of response to individual questions varies between organisations due to reasons of confidentiality and availability of data. Thus, 100% response rate may refer to a different total from one question to another.

Throughout the research complete anonymity is maintained. No lending organisations are named anywhere in this report other than in the list of Acknowledgements.

Presentation and methodology

This report is divided into 2 parts followed by 10 appendices.

The first part gives a brief summary of market activity during 2009. This gives the aggregated value of debt outstanding at 31st December 2009, together with data on the value of new loans that were originated during the year.

The Main Findings of the research for 2009 are presented in the second part, together with data from previous years so that market trends can be identified. Data for both mid-year and year-end 2009 will be presented where this has an impact on trends previously identified.

The following 10 appendices provide detailed information on the topics included in the Main Findings. Each appendix has its own index for easy reference to any particular item of information. The final appendix, J, records the comments made by lending organisations in respect of current issues and concerns within the UK commercial property lending market.
The findings of this research are presented mainly in graphical form supported by brief summaries that highlight the pattern and the features most relevant to the analysis. The summaries are largely descriptive making no attempt at this stage to explain the research findings in detail.

To accompany this report, there is a Technical Supplement available in pdf format by request from cplr@dmu.ac.uk, that sets out the detailed lending terms that would be offered for senior debt by the different categories of lenders used throughout this research. No lending organisations are named.

Definitions and classification of lenders

Definitions

Throughout this research, “commercial property lending” is taken to mean all lending secured on UK commercial property including residential investment and development but excluding owner occupier residential mortgages.

Where reference is made to the commercial property loan books of lending organisations, this is taken as the net exposure to UK commercial property excluding equity finance (i.e. net of any loan amounts sold down to other lenders and net of any securitised loans unless otherwise stated).

Classification of lenders

In order to show the variety of lending patterns and the differences between lending organisations a categorisation of lenders has been devised which is applied throughout the analysis. With effect from this report, data from Building Societies and UK Lenders have been combined. This is to guard against identification of individual active Building Societies within the shrinking numbers within this category.

The NEW categories are as follows:

**All**: refers to all lending organisations that have responded to a particular question.

**UK Lenders and Building Societies**: comprises those lending organisations where the head office is located in the UK and includes Building Societies in the UK. During 2009 two organisations that previously were included in UK Lenders have merged with and have become part of an Other International Lender. Consequently in this and subsequent reports these lending organisations will be reported under Other International Lenders

**German Lenders**: comprises all lending organisations, the head office of which is located in Germany.

**North American Lenders**: refers to all lending organisations, the head office of which is located in North America. These organisations are recorded as a separate category since 2003. Prior to this, they were included with Other International Lenders.

**Other International Lenders**: refers to all lending organisations, the head office of which is not located in the UK, Germany or North America. It includes lending organisations whose head office is located in Eire.
MARKET ACTIVITY 2009

1. Loan book size and gross lending recorded by the research in 2009

This introductory section provides details of the value of outstanding loan books at 31st December 2009 and the value of loan originations undertaken during 2009.

1.1 Value of outstanding loan books

A total value of £247.7bn of outstanding debt, including mezzanine finance and loans of approximately £19.4bn secured by social housing was recorded by the survey as at 31st December 2009. In addition, a further £42.5bn of loans were committed but not drawn at this date.

Table 1 presents the categories of lending organisations adopted throughout this report and the amounts of outstanding debt, mezzanine finance, undrawn amounts and equity reported to the survey.

Table 1: Category of lender and type of finance

<table>
<thead>
<tr>
<th>Categories of Lender</th>
<th>Reported UK outstanding loans including social housing</th>
<th>Mezzanine</th>
<th>Equity</th>
<th>Reported UK outstanding loans including social housing, mezzanine and equity</th>
<th>Reported amount of committed funds not yet drawn</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Lenders and Building Societies</td>
<td>£158,905</td>
<td>£394</td>
<td>£548</td>
<td>£159,847</td>
<td>£32,567</td>
</tr>
<tr>
<td>German Lenders</td>
<td>£ 25,972</td>
<td>£183</td>
<td>£ 0</td>
<td>£ 26,155</td>
<td>£ 8,249</td>
</tr>
<tr>
<td>Other Int Lenders</td>
<td>£ 57,454</td>
<td>£261</td>
<td>£ 25</td>
<td>£ 57,741</td>
<td>£ 1,562</td>
</tr>
<tr>
<td>North American Lenders</td>
<td>£ 4,556</td>
<td>£ 22</td>
<td>£ 40</td>
<td>£ 4,618</td>
<td>£ 135</td>
</tr>
<tr>
<td>All Lenders</td>
<td>£246,887</td>
<td>£860</td>
<td>£613</td>
<td>£248,360</td>
<td>£42,514</td>
</tr>
</tbody>
</table>

The data from Table 1 is shown proportionately in Figure 1.
1.2 Estimation of market size year-end 2009

When estimating the total size of the specialist commercial property lending market, the following factors are considered:

1. This research has always targeted those organisations that have specialist commercial property lending teams. Consequently, lending to commercial property on a smaller scale undertaken at branch or regional level by UK Clearing Banks is not necessarily captured in its entirety by this research;

2. It is recognised that some lending into the UK commercial property market is by organisations neither located nor domiciled in the UK and thus is not captured by the research.

Detailed returns continue to be received from the largest organisations despite the recent market dislocation. It is contended that the data collected for this research represents a high proportion of lending undertaken by these specialist property lending teams in the UK. On the assumption that this research captures between 90% and 95% of the specialist commercial property lending market, and using the £228.3bn reported above, it can be estimated that the market size is in the region of £240bn to £254bn without social housing at year-end 2009.

Figure 3 plots the range in estimated market size of outstanding commercial property debt retained on the balance sheet of organisations that have responded to this research between 1999 and 2009 year-end. It can be seen that the value of outstanding debt has remained broadly unchanged between 2008 and 2009.

Figure 3: Estimated range of market size of specialist commercial property lending market 1999 to 2009

It should be noted that the Bank of England data is not exactly comparable to that collected by this research. The Bank of England data include some lending to both social housing and lending secured by overseas property.

Figure 3 does not include any assumption as to the size of the market not captured by this research as detailed in points 1 and 2 above nor the value of undrawn funding of £42.5bn reported to this research at year-end 2009.

A feature of the data is the amount of outstanding undrawn finance of £42.5bn. This has declined from £51.8bn at year-end 2008. Approximately 57% of these undrawn amounts are held by just two organisations. Importantly, significant proportions of the value of these commitments are ‘historic’. These commitments were mainly put into place between 2006 and 2008 and in conditions when both the commercial property market and lending market were far more buoyant. These loan commitments would have been for development (commercial and residential) and commercial investment projects. Thus, for example, the amounts outstanding were committed in order to complete developments and/or to undertake developments where the start dates has been delayed awaiting an improvement in the current property market. Commitments are also made to investors.
MAIN FINDINGS

2. UK commercial property lending 1999 to 2009

This part summarises the main findings of the research for year-end 2009. This is presented together with data collected from previous years to identify trends in the market.

The organisations reporting to the annual research in later years will be slightly different from those reporting in earlier years. This is due to new organisations entering the market, others dropping out, and takeover and merger activity.

When organisations participate in this research for the first time, their historic data on volume of lending and loan book size is also requested. Consequently the historic trends presented in this report will differ slightly from those published in earlier reports.

2.1 Aggregated value of outstanding debt recorded in loan books (and excluding the value of loans securitised into the CMBS market)

Figure 5: Aggregated value of outstanding debt

Figure 5 presents the net aggregated value of outstanding debt recorded in loan books and secured by commercial property and social housing that has been reported to this research since 1999. By year-end 2009 this stood at a total of £247.7bn. In comparison with year-end 2008, the comparable value was £243.3bn and thus the total value of outstanding debt had increased by 1.18% during the year.

At the end of 2009, organisations that held 74% of this outstanding debt, estimated that this lending represented 15% of their total lending in the UK. Table 3 below shows the corresponding proportions reported at previous year-ends since this data was first collected in 2004.

Table 3 demonstrates that the proportions have declined since 26% was recorded in 2006. It should be noted that this research captures data from a wide spectrum of organisations, including overseas lenders whose only business activity in the UK is secured lending to commercial property.
2.2 Repayment

Figure 9 shows the proportion of outstanding debt due for repayment in each of the next five years individually from 2010 to 2014, from 2015 to 2019 and finally after 2019.

**Figure 9: Proportion of debt due for repayment: All Lenders**

During the next five years between 2010 and 2014 inclusive, 71% of all outstanding debt is due for repayment. At 71%, this proportion is higher than that recorded by previous years-end surveys. For example, at year-ends 2006 and 2007, the proportion of debt due to mature within the following five years was 61% and 60% respectively. Also, the volume of lending maturing in each year was distributed fairly evenly across the five year period. This trend was interrupted in 2008 when 69% of debt was due to mature within the following five years. It is suggested that the reason for this change in maturity profile is that in many instances loans that were due to mature in 2008 and 2009 have been extended because of the borrowers' inability to refinance their loans.

This trend is identified in Table 5 which compares the expected loan maturities for years 2010 to 2012 inclusive recorded at year-end 2008 with those recorded at year-end 2009. It shows at year-end 2009 that an additional £30.4bn of debt was recorded as maturing compared to the value recorded at year-end 2008. Thus, it appears that potentially up to £30bn of debt from £43.8bn that should have matured in 2009 has been extended with particular concentrations in 2010 and 2012.
3 Loan terms

3.1 Average interest rate margins

Figure 15 shows the average senior debt interest rate margin for investment loans secured by the different property sectors from 1999 to 2009 year-end. Data for secondary industrial property has only been collected by this research since 2002 and that for residential investment since 2005.

**Figure 15: Average interest rate margins for different sectors: 1999 to 2009**

Average interest rate margins for loans secured by all commercial property sectors generally increased between 1999 and 2002/2003 but declined thereafter until year-end 2006. Increases were recorded during 2007 that continued throughout 2008 and to mid-year 2009. Average margins at mid-year 2009 are the highest recorded by this research for each property sector. The second half of 2009 saw a decrease in levels of average margins from those recorded at mid-year but the year-end 2009 average margins are higher than those recorded at year-end 2008. This is demonstrated explicitly in Figure 15 where, for example, the average margin on loans secured by prime office property increased from 213.5 bps at year-end 2008 to 245.2 bps at mid-year 2009 and then declined to 219.7 bps at year-end 2009. Similarly for secondary offices, average margins increased from 233.4 bps at year-end 2008 to 277.9 bps at mid-year 2009, and then, declined to 254.0 bps by year-end 2009.
Appendix B

Allocation of annual loan originations by organisation

Figure 36 below presents the allocation of new loan originations, of £15.1bn (excluding extensions to maturing loans) completed in 2009 by individual organisations compared with that presented at year-end 2008. The segments coloured red represent the twelve largest organisation measured by the value £bn of their outstanding commercial property loan books.

Figure 36: Lending in calendar year 2009 allocated by organisation

As previously mentioned in this research, direct comparison with year-end 2008 is not possible because of the unknown value of extensions to loans contained within the 2008 data. However, the figure indicates that, in 2009, approximately 67% of the value of ‘new’ loan originations was undertaken by eight of the ‘top twelve’ organisations. This compares with approximately 58% of gross lending being undertaken by seven of the ‘top twelve’ during 2008. Six organisations are represented in these groups in both years. The three organisations that completed the largest amounts of lending accounted for 38% of the value of loans in 2009. This is lower than the 44% recorded at the end of 2008 but greater than recorded in previous surveys when the ‘top’ three loan originators accounted for between 30% and 35% of annual lending.
Respondents’ comments

Comments were invited of a general nature on how the continuing financial crisis had impacted on lending organisations’ commercial property lending policies and activities. Comments were also invited on current issues facing the UK commercial property lending market.

These comments are presented below. It should be noted that these will relate to the market at the time when the questionnaire was being completed which was during the first four months of 2010.

Attitude to lending/lending policy

- We are largely engaged in legacy book management and are unlikely to re-enter the market before late 2010. If and when we do re-enter it will be strictly for capital markets type transactions.
- As of December 2007, the bank would not provide residential development or investment finance, the bank would not provide junior/mezzanine development finance and the bank would not provide 100% speculative development finance.
- We continue to reduce our loan book, however, there is now increasing eagerness to retain sound loans or restructured facilities with good economics, which provide income going forwards. The UK book should be to steady state by Q3 2010 and we expect limited further reserves being required over and above those taken in the 2010 planning. Stabilisation of the European book remains behind the curve and is unlikely before mid 2011.
- Generally, we are very conservative; the UK is still seen as a relatively high risk country.
- Still mainly working on our existing book and reducing overall exposure where possible. Limited appetite for new deals but should have some capital availability.
- Stakeholder pressure to reduce concentration risk in particular has and will continue to drive down our appetite for larger deals and large exposures and to be very cautious generally but especially in respect of speculative deals and unproven counterparties.
- Inability to syndicate debt has meant we are prepared to take no underwriting risk.
- Only do vanilla lending now with clients that we know.
- The only lending we are doing at the moment is to developers to complete development that we are financing.

IN THE REPORT FOR YEAR-END 2009, 16 PAGES OF COMMENTS WERE PRESENTED IN RELATION TO THE FOLLOWING ISSUES:

- DISTRESSED LOANS
- LOAN TERMS
- LENDING MARKET
- PROPERTY MARKET
- ECONOMIC ISSUES
- CURRENT ISSUES AND GENERAL COMMENTS
LIST OF TABLES
Table 1: Category of lender and type of finance ................................................................. 1
Table 2: Value and allocation of loan originations in 2009 .................................................. 4
Table 3: Proportion of commercial property lending as a proportion of organisations’ total lending.................................................................................................................. 7
Table 4: Year-on-year increases in the value of outstanding debt recorded in loan books .......... 7
Table 5: Maturity profile years 2009 to 2012 of loans in loan book........................................ 11
Table 6: Maturity profile years 2010 to 2011 of CMBS issuance ........................................... 11
Table 7: Year on year changes in the value of loan originations ........................................... 14
Table 8: Market share of loan originations ............................................................................ 14
Table 9: New loans and refinancing 2001, 2004 to 2009 ....................................................... 16
Table 10: Lending Limits ........................................................................................................ 18
Table 11: Annual amount (£m) of completed CMBS issuances 2000 to 2009 ...................... 19
Table 12: Amount that lenders wished to securitise but could not during 2008 and 2009 .. 20
Table 13: Annual amount (£m) of completed syndications: year-end 2008, mid year 2009 and year-end 2009................................................................. 20
Table 14: Amount that lenders wished to syndicate debt but could not during 2008 and 2009.... 21
Table 15: Rate of Amortisation ............................................................................................. 31
Table 16: Proportion of lenders with interest hedging strategy in place. ................................. 32
Table 17: Number and value of loans in breach of financial covenant ................................. 33
Table 18 All Lenders: Defaulted loans 2006 year-end to 2009 year-end ......................... 35
Table 19: Number of UK based property teams lending outside UK and value of outstanding loans secured on commercial property ......................................................... 44
Table 20: Allocation of lending as proportion by country ..................................................... 44
Table 21: Future lending intentions ......................................................................................... 45
Table 22: Value of lending undertaken by proportion of organisations that intend to increase, maintain or decrease loan originations ......................................................... 45
Table 23: Responses to specific questions relating to the financial crisis ............................. 46
LIST OF FIGURES

Figure 1: Allocation of drawn and undrawn funding, reported to this research by category of lender .................................................. 2

Figure 2: Allocation of drawn funding secured by commercial property .................................................. 2

Figure 3: Estimated range of market size of specialist commercial property lending market 1999 to 2009 .................................................. 3

Figure 4: Allocation of loan originations in 2009 ........................................................................ 5

Figure 5: Aggregated value of outstanding debt ........................................................................ 6

Figure 6: Allocation of outstanding debt secured by commercial property by category of lender .................................................. 8

Figure 7: Proportion of outstanding debt secured by commercial property held by the largest six and the next largest six organisations from 1999 to 2009 .................................................. 9

Figure 8: Composition of largest twelve lenders by book size 2009 .................................................. 9

Figure 9: Proportion of debt due for repayment: All Lenders .................................................. 10

Figure 10: Maturity profile ........................................................................................................ 11

Figure 11: Amount of mezzanine reported to survey and proportion of mezzanine to outstanding senior debt ........................................................................ 12

Figure 12: Value (£m) of gross annual lending 1999 to 2009 – All Lenders .................................................. 13

Figure 13: Market share of loan originations 1999 to 2008 ........................................................................ 15

Figure 14: Annual amount (£bn) of completed CMBS issuances 2000 to 2009 .................................................. 19

Figure 15: Average interest rate margins for different sectors: 1999 to 2009 .................................................. 22

Figure 16: Average interest rate margins for different projects: 1999 to 2009 .................................................. 23

Figure 17: Average maximum loan-to-value ratios for different sectors: 1999 to 2009 .................................................. 24

Figure 18: Average arrangement fees: 1999 to 2009 ........................................................................ 25

Figure 19: Average income to interest cover: 1999 to 2009 ........................................................................ 26

Figure 20: Comparison of Senior debt, Junior debt and mezzanine terms on loans secured by prime investment property ........................................................................ 29

Figure 21: Comparison of Senior debt, Junior debt and mezzanine terms on loans secured by secondary investment property ........................................................................ 30

Figure 22: Primary reason cited as the cause of breach at year-ends 2008 and 2009 .................................................. 34

Figure 23: Proportion of total value of lending by type of project 2009 .................................................. 37

Figure 24: Allocation of aggregated loan books, by proportion, secured by different types of projects – All Lenders ........................................................................ 37

Figure 25: Allocation of development finance: All Lenders ........................................................................ 38
Figure 26: Allocation of development finance between fully pre-let and speculative commercial development 2000 – 2009 ................................................................. 38

Figure 27: Allocation of outstanding debt to investment and owner occupied property ................. 39

Figure 28: Allocation of outstanding debt to development property................................................. 40

Figure 29: Allocation of loan books, by proportion, to the different property sectors...................... 41

Figure 30: Regional distribution of lending at year-end 2009 ............................................................. 42

Figure 31: Regional distribution of lending 2001 to 2009 ................................................................. 43
Appendix A Structure of loan books

Contents

Appendix A
Change in loan book size 1
Range of outstanding loan book sizes 2
Loan maturity and prepayment 5
Lending reported to the Bank of England 5
Mezzanine and equity finance 7
Lending against single assets and portfolios 8
The Asset Protection Scheme (APS) and National Asset Management Agency (NAMA) 9

List of Figures

Appendix A
Figure 32: Annual change in aggregated value of outstanding loan book value by category of lender 1
Figure 33: Total loan book split by lender 3
Figure 34: Composition of largest twelve lenders by book size: 1999 to 2009 4
Figure 35: Loans reported to the Bank of England 6

Appendix B Annual lending

Contents

Appendix B
Allocation of annual loan originations by organisation 1
Value of biggest individual loans completed 3
Typical loan size achieved 3
Length of loan 6
Mezzanine placed 9

List of Tables

Appendix B
Table 31: Value of the biggest individual loans completed 3
Table 32: Typical loan size achieved 4
Table 33: Typical loan size achieved 1999 to 2009 5
Table 34: Length of loan and proportion by value of lending for investment projects 6
Table 35: Typical loan length data for investment projects: 2008 and 2009 7
Table 36: Expectation of length of loan for investment projects before being repaid or refinanced 8
Table 37: Length of loan and proportion by value of lending for development projects 8
Table 38: Amount (£m) of mezzanine originated by category of lender: 2002 to 2009 9
Table 39: Amount (£m) of mezzanine for residential projects originated by category of lender 2005 and 2009 10

List of Figures

Appendix B
Figure 36: Lending in calendar year 2009 allocated by organisation 1
Figure 37: Value of annual loan originations undertaken by the six and twelve most active lending organisations 2
Figure 38: Composition of the most active 12 lenders 1999 to 2009 2
Figure 39: Proportion of lending originated in 2009 6
Figure 40: Number of lenders with mezzanine in loan books by category of lender 10
Appendix C  Securitisation and syndication

List of Tables

Appendix C
Table 40: Proportions of lenders that have completed at least one CMBS issuance since 2000 1
Table 41: Proportions of lenders intending to securitise 2
Table 42: Proportions of lenders intending to syndicate loans 2
Table 43: Allocation of loan books by category of lender 4

List of Figures

Appendix C
Figure 41: CMBS issuance 2005 to 2009 1
Figure 42: Allocation of outstanding loans books between bilateral loans and syndicated loans 3

Appendix D  Loan terms

Contents

Appendix D
Typical senior debt interest rate margins on prime office property 1
Typical senior debt interest rate margins on prime industrial property 8
Typical senior debt interest rate margins on secondary retail property 9
Typical senior debt interest rate margins on secondary industrial property 10
Maximum loan-to-value ratios on prime office property 11
Maximum loan-to-value ratios on secondary office property 13
Maximum loan-to-value ratios on prime industrial property 16
Maximum loan-to-value ratios on secondary retail property 17
Maximum loan-to-value ratios on secondary industrial property 18
Loan-to-value ratios in a default situation 19
Summary of average lending terms 20
Debt service cover ratios 21
Development finance 22
Average interest rate margins by type of office project 27
Junior debt and mezzanine finance on investment property 28
Mezzanine finance for commercial development projects 28
Residual debt 30
Terms for residential investment and development projects 36
Residential investment project terms 36
Mezzanine finance for residential investment projects 40
Residential development for sale project terms 41
Mezzanine finance for residential development projects 41

List of Tables

Appendix D
Table 44: Terms applied to investment property 20
Table 45: Debt service cover ratios: Prime Office 21
Table 46: Intentions and achieved development finance 22
Table 47: Interest rate margins (bps) on loans secured by commercial development projects 23
Table 48: Loan-to-value and loan-to-cost ratios on commercial development projects 24
Table 49: Terms for 50% pre-let:50% speculative commercial development projects 26
Table 50: Loan-to-value ratios and loan-to-cost ratios on mezzanine finance 29
Table 51: Interest rate margins on mezzanine finance 29
Table 52: Sole criterion approach to residual debt 30
Table 53: Combination approach to residual debt 30
Table 54: Maximum residual exposure on a 5 year loan 31
Table 55: Residual debt exposures as at year-end 2008and 2009 32
Table 56: Exit Yield for a 5 year loan 32
Table 57: Maximum residual exposure on a 10 year loan 33
Table 58: Exit Yield for a 10 year loan 34
Table 59: Assumptions included in determination of value at maturity 35
Table 60: Proportion of organisations prepared to fund residential investment projects 36
Table 61: Summary of other terms applied to loans secured by residential investment project 40
Table 62: Level of Loan-to-Value and Loan-to-Cost at which mezzanine for residential investment projects is provided 40
Table 63: Interest rate margin charges for provision of mezzanine for residential investment projects 40
Table 64: Lending terms for residential development projects 41
Table 65: Level of Loan-to-Value and Loan-to-Cost at which mezzanine for residential development projects is provided 42
Table 66: Interest rate margin charges for provision of mezzanine for residential development projects 42

List of Figures
Figure 42: Pricing of loans secured by prime office property by category of lender: Average typical margins 1999 to 2009 1
Figure 41: Pricing of loans secured by prime office property: Typical margins 2009 and 2008 2
Figure 44: Pricing of loans secured by secondary office property by category of lender: Average typical margins 1999 to 2009 4
Figure 43: Pricing of loans secured by secondary office property: Typical margins 2009 and 2008 5
Figure 45: Pricing of loans secured by prime retail property: Typical margins 2009 and 2008 7
Figure 46: Pricing of loans secured by prime industrial property: Typical margins 2009 and 2008 8
Figure 47: Pricing of loans secured by secondary retail property: Typical margins 2009 and 2008 9
Figure 48: Pricing of loans secured by secondary industrial property: Typical margins 2009 and 2008 10
Figure 49: Maximum loan-to-value ratios on prime office investment: 2009 and 2008 11
Figure 50: Average maximum loan-to-value ratios secured against prime office property: 1999 to 2009: 12
Figure 51: Maximum loan-to-value ratios on secondary office investment property: 2009 and 2008 13
Figure 52: Average maximum loan-to-value ratios secured against secondary office property: 1999 to 2009 14
Figure 53: Maximum loan-to-value ratios on prime retail property 2009 and 2008 15
Figure 54: Maximum loan-to-value ratios on prime industrial property: 2009 and 2008 16
Figure 55: Maximum loan-to-value ratios on secondary retail property: 2009 and 2008 17
Figure 56: Maximum loan-to-value ratios on secondary industrial property: 2009 and 2008 18
Figure 57: Levels of LTV where organisations expect to have no risk of loss: Prime office in Central London 19
Figure 58: Average interest rate margins of loans secured against different categories of office project 27
Figure 60: Proportion of senior debt, junior debt and mezzanine 28
Figure 61: Pricing of loans secured by residential investment projects: Typical margins 2009 and 2008 32
Figure 62: Maximum loan-to-value ratios on residential investment projects 2009 and 2008 32
Figure 63: Maximum loan-to-value ratios on residential investment projects 2009 and 2008 37

Appendix E ALLOCATION BY PROJECT TYPE
Contents  Appendix E
Appendix F  ALLOCATION BY PROPERTY SECTOR

List of Tables
Table 67: Allocation of loan books £m by property type 2000 to 2009 1
Table 68: Lending preference by type of property and type of project by category of lender 2008 and 2009 3

List of Figures
Figure 65: Allocation of loan books, by value, to different property sectors: 1999 to 2009 2

Appendix G  REGIONAL DISTRIBUTION OF LENDING

List of Tables
Table 69: Regional distribution of lending 2

List of Figures
Figure 66: Regional distribution of lending by category of lender 1

Appendix H  Loan terms

List of Tables
Table 70: Future lending intentions 1
Table 71: Future lending intentions: loan book size 2
Table 72: Intentions v Achievements to increase loan book size 2

APPENDIX I  OVERSEAS LENDING

List of Tables
Table 73: Allocation of lending as proportion by country 1

APPENDIX J  RESPONDENTS'COMMENTS