

SOME REFINANCING CONTINUES, BUT MOST NEW LENDING BUSINESS FROZEN

Closed for business

THE BIG PROPERTY FINANCIERS ARE STILL BATTERED AND BRUISED, LEAVING THE FIELD OPEN TO FITTER – MAINLY GERMAN – PLAYERS

BY JUDI SEEBUS

IN BRIEF

- Big UK and Irish banks have major debt problems
- German Landesbanken most active in Europe
- No recovery seen before 2011

The European property finance landscape resembles a lunar landscape following the fallout from the US subprime crisis which has spread eastward to the UK before moving deeper into Europe. Major players like Royal Bank of Scotland, HBOS and the Irish duo Anglo Irish Bank and Bank of Ireland are still grappling with enormous toxic debts and have virtually frozen business while the US investment banks and Icelandic companies Kaupthing and Landsbanki have disappeared from the radar altogether. Like their UK counterparts, the leading German players Eurohypo, Deutsche Pfandbriefbank (formerly Hypo Real Estate) and Aareal are now being propped up by government funds and have all seen their loan portfolios shrink in the past year. With a few exceptions including ING Real Estate Finance, most of the other major Continental banks have retreated to their home markets. The banking crisis has seen more moves by banks to lend domestically, particularly as some banks are partially or totally under public ownership.

ING Real Estate's parent company also received government support in the aftermath of the Lehman Brothers debacle, but it is the only bank in the top five of PropertyEU's ranking of top financiers to have reported an increase in its real estate lending volume in 2008 from 2007. This partly explains its jump from eighth to fifth position in the ranking (see interview with ING REF on page 65). A notable newcomer in the list is German Helaba, which came in at number nine. In the past year, the Landesbank of the German states of Hessen and Thüringen has emerged as one of the most active real

estate financiers, as many of its potential competitors have fallen away. Helaba is not the only German property financier to benefit from the financial crisis. The larger players may be battered and bruised, but this has opened up the field to smaller players like Berlin Hyp, Deutsche Hyp and Deka Bank. All three saw their lending portfolios expand in the past year.

But with the CMBS market still totally moribund and financing terms far more stringent, the real estate investment market remains in a state of near-paralysis. 'The level of lending activity is a fraction of what it was in the heady days of 2007,' notes William Newsom, head of Savills UK Valuations. 'We have detected some easing and when the right product comes up, there is some competition. But we remain in a credit crunch. Lenders are very selective, whole swathes of the market cannot be financed. And there is virtually no development financing anywhere across Europe.'

GERMAN LENDERS DOMINATE IN UK

Cross-border financing has also virtually dried up and what activity there has been has been led primarily by German financiers and been concentrated in the UK market. The number of German banks active outside their home country is quite extensive. 'Our analysis shows that two-thirds of top lenders for UK property are German banks with the likes of Deka, Deutsche Pfandbriefbank (a recent addition), Deutsche Postbank, DG Hyp, Eurohypo, Helaba, Landesbank Berlin, LBBW, Munich Hyp, Nord LB and Westimmo featuring on our list,' says Nick Harris, head of Savills' European Valua-



tion team. 'Helaba and Westimmo are now particularly active.' According to this year's ranking of top financiers, Helaba boosted its lending portfolio to €29.9 bn in 2008 from €27.2 bn a year earlier. While Westimmo saw its lending portfolio slip slightly in the past year, it extended new loans totalling €3.1 bn up to end-June, 3% more than last year. (See interview with Westimmo on page 63).

CLUB DEALS

Helaba and Westimmo are also active in syndicated deals which has become standard practice for larger financial transactions above €50-100 mln. In June they teamed up with Deutsche Postbank to arrange a club deal loan totalling €140 mln on behalf of MGPA for a mixed office and retail property at Place de Madeleine in the central business district of Paris. Aside from London and Paris, Westimmo has also been spotted in deals in Warsaw and Bucharest in recent months.

The local and cross-border financing by German state banks received a fresh impulse at the beginning of this year when the German Pfandbrief market re-opened, notes Newsom. 'The Pfandbrief market closed in October following the collapse of Hypo Real Estate, but this

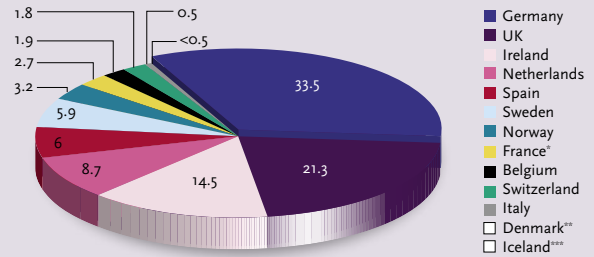
year it has staged a recovery and has helped funding by the German banks.' Newsom stresses that the German banks have been dominant players in the UK market since the early 1990s. 'The actual names have ebbed and flowed and some are now stronger than others. They are now not all necessarily masters of their own destiny,' he adds, pointing to the large government bailout funds some German banks have received since October, headed by Hypo Real Estate. Historically, the German federal states each had a single Landesbank or state bank which benefitted from state guarantees, Newsom continues. 'They were bloated in the past and then the European Commission started tackling them on competition grounds. That resulted in some mergers on a geographic basis, for example NordLB in northern Germany.' Banks like Deka and second- or third-tier Landesbanken did not have so much exposure to the UK market before the credit crunch, adds Robin Hubbard, executive director of CB Richard Ellis' real estate finance business. 'Some are now making moves to boost their market share. There's still some willing equity from retail investors driving players like Deka. But the majority of other foreign lenders have no interest in cross-border busi-

PROPERTYEU'S RANKING OF TOP EUROPEAN PROPERTY FINANCIERS

2008	2007	COUNTRY	BANK	OUTSTANDING VOLUME		PRODUCTION
				END-2008 (€ BN)	END-2007 (€ BN)	
1	1	UK	Royal Bank of Scotland	130.5	146.0	-
2	2	Germany	Eurohypo	83.0	96.2	13.7
3	4	Germany	Deutsche Pfandbriefbank (formerly Hypo Real Estate)**	58.5	60.8	7.8
4	3	Ireland	Anglo Irish Bank	48.8	-	44.6
5	8	Netherlands	ING Real Estate	37.0	32.1	7.0
6	7	Ireland	Bank of Ireland	34.0	35.8	-
7*	-	Ireland	Depfa (now part of Deutsche Pfandbriefbank)	34.0	n.a.	-

TOP FINANCIERS BY COUNTRY

German banks accounted for the lion's share (33.5%) of the outstanding loan volume in Europe at end-2008, followed by the UK at 21.3% and Ireland at 14.5%. The Netherlands ranked fourth (8.7%), reflecting the relatively strong position of ING Real Estate.



*BNP Paribas not disclosed **n.a. Danske Bank ***n.a. Kaupthing and Landsbanki

ness, they are concentrating on their home markets.' Earlier this year, Ahsan Ellahi, head of European Structured Finance at Germany's leading property financier Eurohypo, put the total amount of outstanding commercial real estate debt in Europe at around €1.3 tln. Speaking during a panel at the Mipim property fair in Cannes, Ellahi stressed that this was an estimate as there were no official figures on the level of total outstanding debt. But he said bank lending to property doubled during the recent real estate boom with European banks issuing some €100 bn of real estate loans annually in 2000 and 2001, rising to €200 bn in the boom years of 2006-7. In the UK alone, the level of outstanding loans to commercial property in the UK rose 10% to £243 bn (€279 bn) by end-2008, according to a recent survey by De Montfort University. CBRE estimates the total at about £300 bn including loans into the UK from overseas lending offices, a third of which will mature in the next three years. With investment activity down roughly 50-

60% in most markets across Europe, it is fair to assume that the volume of new lending has plunged by an even higher amount given the more stringent loan-to-value ratios. Conversely, the volume of bad commercial real estate debt is set to swell further as property values continue their downward slide, occupancy levels dwindle and earnings weaken. Although there are signs that the UK property market may be turning the corner, looming problems with short-term debt maturities will cloud the prospects of recovery of the financing market for some time to come. A recent poll by DTZ indicated that banks do not expect to see any signs of recovery until 2011.

DEBT DEFAULTS AND FORECLOSURES

The number of potential foreclosures is substantial, claims Hubbard. 'It will depend on how the weak economy seeps into the business.' In any case, Hubbard expects the number of delinquent loans to start increasing by the end of the year. 'We may see another round of

RANKING OF TOP FINANCIERS continued

2008	2007	COUNTRY	BANK	OUTSTANDING VOLUME		PRODUCTION
				END-2008 (€ BN)	END-2007 (€ BN)	
8 *	-	Germany	Helaba (Landesbank Hessen-Thüringen)	29.9	27.2	10.4
9	30	Sweden	SEB Sweden	27.8	22.5	-
10	24	Germany	Berlin-Hannoversche Hypothekenbank (Berlin Hyp***)	25.6	24.4	2.7
11	13	Norway	DnB Nor Markets	25.4	22.0	-
12	5	UK	Lloyds-HBOS	23.9	24.0	-
13	11	Germany	Deutsche Genossenschafts Hypothekenbank (DG Hyp)	21.8	22.5	3.8
14	14	Spain	La Caixa	21.5	20.2	-
15	9	France	Société Générale	21.4	24.9	-
16	12	Germany	Aareal Bank	19.5	22.3	3.5
17	20	Netherlands	FGH Bank/Rabobank Real Estate Group	16.5	13.5	4.8
18 *	-	UK	Barclays Capital	16.4	14.3	-
19	22	Belgium	KBC Bank	15.2	11.1	-
20	10	Switzerland	Credit Suisse	14.6	12.5	-
21	18	Sweden	Handelsbanken	13.9	13.5	-



AHSAN ELLAHI



LUCA GIANGOLINI



WILLIAM NEWSOM



NICK HARRIS

problems, particularly for secondary and tertiary quality assets. Yields haven't stopped moving out yet for these asset types. We're especially concerned about the occupational side of the equation. It's a tenants' market and rents will continue to fall. I expect corporate earnings will weaken in the second half with the number of debt defaults and foreclosures rising.'

Eurohypo's Ellahi expects the 2006-7 vintage of loans to contain some major problem cases due to weak origination standards among some lenders. Market watchers expect it will take between three to seven years to resolve the European commercial real estate debt burden, with several expecting the brunt of the refinancing crisis to hit the European Continent in 2011-12. While all banks in Europe are involved, UK, Irish and German banks were the most exposed, Ellahi warned. In August, Lloyds Banking Group reported a pre-tax loss of £4 bn (€4.7 bn) as bad debts in the first half rose to £13.4 bn, the bulk of which stemmed from bad commercial real estate loans

at its recently acquired Scottish subsidiary HBOS. Meanwhile RBS saw losses narrow to £1 bn in H1 from £24 bn in 2008. The Scottish banks have major problems, notes Newsom. 'They're not actively lending in the UK at the moment, except maybe for existing clients. Overall, however, there's little new lending and a lot of retrenchment.' Other banks that have gone quiet in recent months include Santander, which is active in the UK through its subsidiary Abbey, and Milan-based Unicredit, which has a strong presence in Central and Eastern Europe. Newsom: 'Unicredit hasn't been active in the UK for the past 18 months or so. What they have been financing on a massive scale is wind farm projects.'

TOUGHER FINANCING TERMS

The tight debt market has inevitably led to tougher financing conditions. 'LTVs are down significantly,' says Luca Giangolini, head of the corporate finance team at Cushman & Wakefield. 'In most cases, LTVs are being

RANKING OF TOP FINANCIERS continued

2008	2007	COUNTRY	BANK	OUTSTANDING VOLUME	OUTSTANDING VOLUME	PRODUCTION
				END-2008 (€ BN)	END-2007 (€ BN)	END-2008 (€ BN)
22	19	Netherlands	SNS Property Finance	13.8	11.6	4.7
23	17	Spain	Santander	13.5	14.2	-
24	21	Germany	Westdeutsche Immobilienbank (WestImmo)	11.2	12.2	5.5
25*	-	Germany	DekaBank	7.4	5.2	3.5
26	23	Germany	Deutsche Hypothekenbank (Deutsche Hypo)	6.6	5.9	1.5
27	16	Sweden	Swedbank Mortgage	6.0	17.5	-
28	26	Germany	CorealCredit Bank	5.7	7.3	1.4
29**	-	Italy	Banco Popolare	3.7	n.a.	-
30	27	Netherlands	NIBC	2.4	3.1	-

* NEW IN THE RANKING FOR 2008

** INCLUDES LANDESBANK BERLIN

*** INCLUDES DEPFA



capped at 65%, although there have been one or two exceptions in the UK of 67.5%.' Bank margins are generally around the 2.25% level, he continues, adding that margins in the UK are falling slightly due to some increased competition on selected deals. 'It's not a trend as yet, but we may see more downward movement if the market stabilises. But we need to see more stability before leverage increases.'

SMALLER LOT SIZES

Lot sizes are also significantly smaller, Giangolini says. 'The Germans are getting together on some transactions, but there is not much appetite for big deals.' One of the key issues in the current financing climate is a flight to quality, adds Giangolini. 'Banks are much fussier nowadays,' he says pointing to a loan which collapsed due to a minor point on the leasing contract. 'There's much more focus on the borrower.' The good news is that capital markets are stabilising somewhat, notes Giangolini. 'We're seeing equity buyers in the UK, and at the prime end we're even seeing some yield compression. There is no longer a feeling of a bottomless pit or a huge fear of where the bottom may be. In the UK, we may even be past it. I expect to see liquidity improve in the next six to 12 months.' A recent report by adviser BNP Paribas Real Estate, formerly AtisReal, indicates many banks are not

calling in loans that have simply breached their loan-to-value ratios and are instead focusing on restructuring, continued investment or equity injection as possible solutions. The report is based on interviews with senior professionals from banks including RBS, Alliance & Leicester, Allied Irish Bank, Bank of Scotland, Hypo Real Estate and Northern Rock on their attitude towards defaults, LTV breaches, and the future of property loans within banks. Some 75% of the respondents looked at LTV breaches on a case-by-case basis, with almost 50% saying that an LTV breach was not reason enough to call in a loan and falls in LTV accounting for less than 15% of loans being called in. A further 17% said that they would waive the breach or take no action, with 15% renegotiating or restructuring the loan terms. 'If possible, banks will try to avoid becoming property owners,' says Hubbard of CBRE. 'But,' he adds, 'there are a number of issues that need to be resolved, for example, regarding government protection. There is equity out there in the form of opportunity and debt mezzanine funds, but the amount of money in relation to the problem is, I think, relatively insignificant, probably no more than between 5-20% of the total.'

NO FLOOD OF FIRE SALES

Giangolini does not expect a flood of fire sales either. 'Banks like RBS, Lloyds/HBOS have received support from the government asset protection scheme. They will try to get out whole, without crystallising losses. They are reluctant to take action where a loan is under water. If they sell them for anything less than the underlying loan value, they will be forced to book a loss.'

Tony Horrell, head of capital markets at Jones Lang LaSalle, agrees. 'Loan-to-value ratios may be down, but if the asset is producing an income, the banks will try to work through it and restructure the debt. Any new lending will be at lower LTV ratios of 60-65% and will remain restricted to the narrow band of prime assets and equity investors.' He adds that banks will likely look differently at assets that do not produce any income like undeveloped land and vacant buildings. 'They will have to deal with such assets and get them off their balance sheet. There is no other way.' ■

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