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European CRE lending, 2022

Bayes Business School, City, University of London

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Bayes Business School European Commercial Real Estate (CRE) Lending Report

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1. Introduction

This is the first edition of a European lending survey carried out during December 2022 – February 2023.

For this pilot study, a total of 1100 lenders across Europe have been contacted, including banks, insurance companies and alternative lenders. The results are based on responses received. All responses have been received anonymously.

2. General market situation

Market liquidity is an important indicator of financial stability and determines the future returns and performance of the CRE loan market. Lending cycles have been subject to changes in the liquidity of the underlying property transaction and investment market or changes in the banking and credit supply market.

Loan origination is a combination of refinancing of existing positions and financing of new acquisitions, hence there is a strong link to overall transaction activity of the market. Based on data collection using investment transaction data supplied by agents, debt reported to the different surveys in France, Germany and the UK, the best market estimate assumes a total European CRE debt market of €1.5trillion with an annual new debt origination amount of €310bn. These estimates exclude private debt against the residential property market.

The four European markets Germany, France, Spain and the UK contribute 55% of the total market. In addition, there are €95bn of public real estate bonds.

Table 1. Estimation of EU total CRE debt outstanding (€bn)

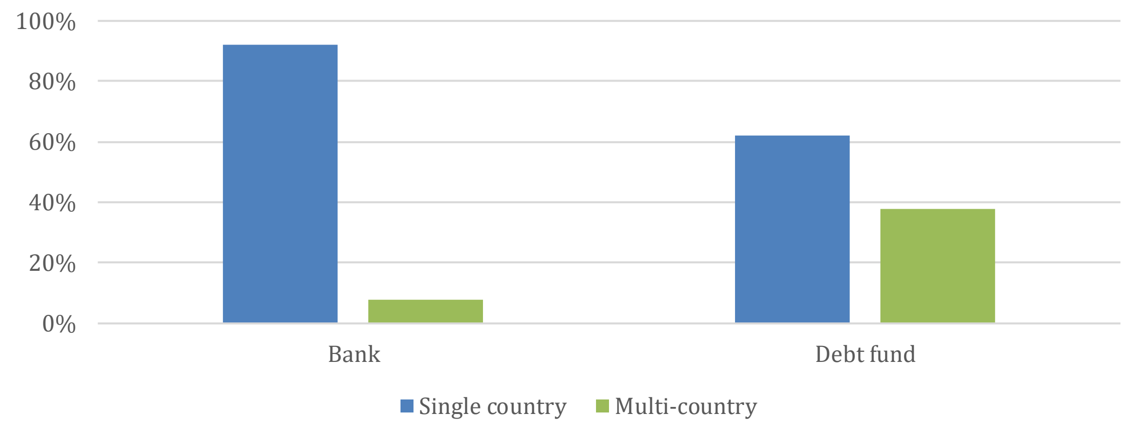
	YE 2022	Annual origination
UK	280	40
Germany	360	90
France	150	30
Spain	75	10
Other	700	140
All Lenders	**1565**	**310**

Source: Bayes Business School estimates

The CRE debt market consists of banks, insurance and pension funds and debt funds. While many debt funds are operating across Europe, banks have shifted their lending business since 2012 largely to their national - home markets. German banks lend approx. €20 - 25bn outside their home market, when it was €60 -70bn in 2007/2006.

Of all contacted lenders, 828 were banks, 281 debt funds and 18 were insurance companies. Unsurprisingly, 92% of banks only lend in their home market, while 38% of debt funds were targeting a multi-country approach.

Figure 1. Lending across Europe



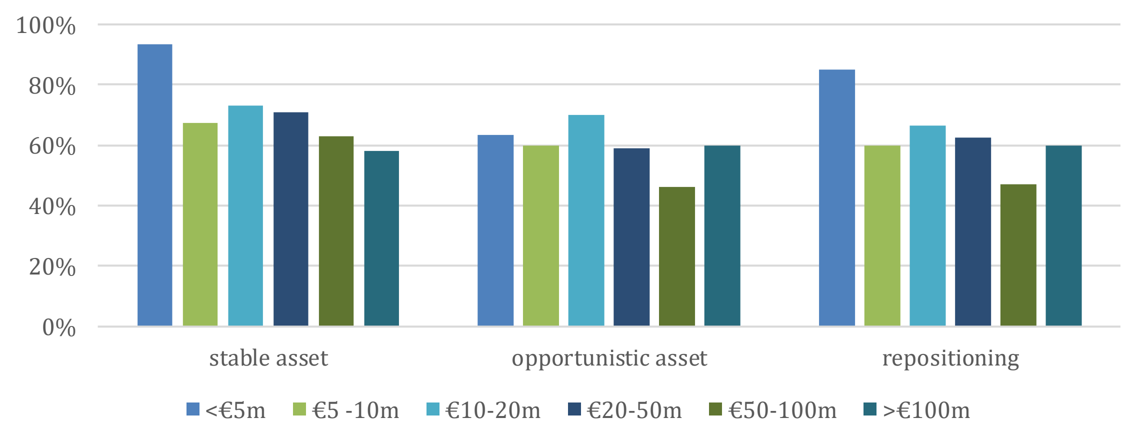
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

2.1. Lenders and loan sizes & lending policies

The typical loan size can differ widely depending on the type of lender.

- On average bank's average preferred loan size ranged between €20 – €50 million. There was also appetite for loans from >€5 million to €100 million.

Figure 2. Average LTV by loan size

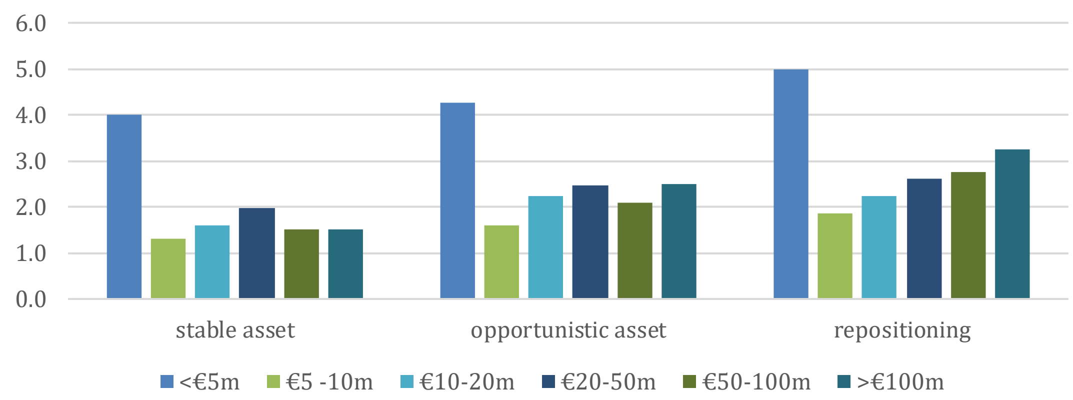


Source: Bayes Business School Commercial Real Estate (CRE)

- Loans below €5 million are typically covered by debt funds unless the borrower has a contact with a local bank and the lending is against a stable asset. Generally, the range of interested lenders declines sharply for loans less than €5 million in size.

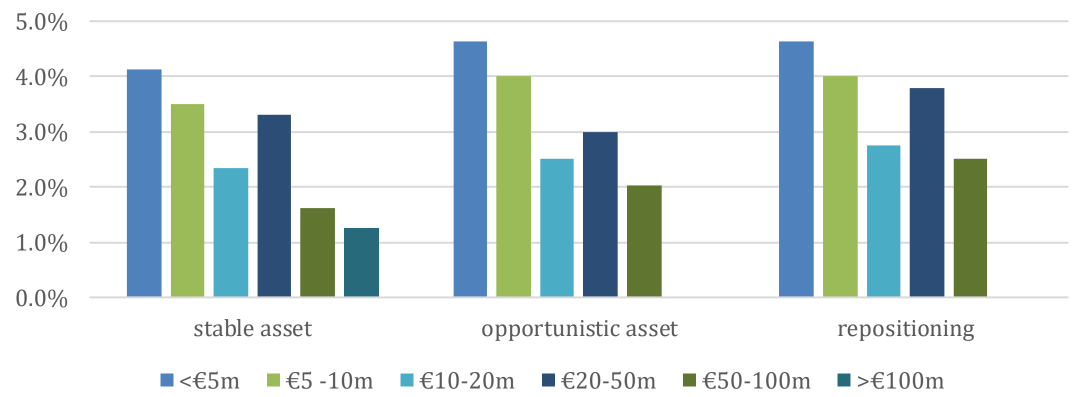
- Because loans <€5 million are a segment mostly served by debt funds, their pricing may be a lot higher than for assets requiring loans larger than >€5 million in size, which is typically the hurdle for bank lending, with many requiring a minimum loan size of €10 million.
- Loan pricing is clearly also a function of asset size/loan size and for stable assets larger assets may be charged at a more favourable, lower price.
- For opportunistic and repositioning assets, the loan price for larger assets typically increases with the complexity of the asset/financing.

Figure 3. Average margin by loan size (variable rate)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 4. Average margin by loan size (fixed rate)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

3. Lenders – key loan terms

The following section provides a comprehensive analysis of lenders' key loan terms provided for different types of assets.

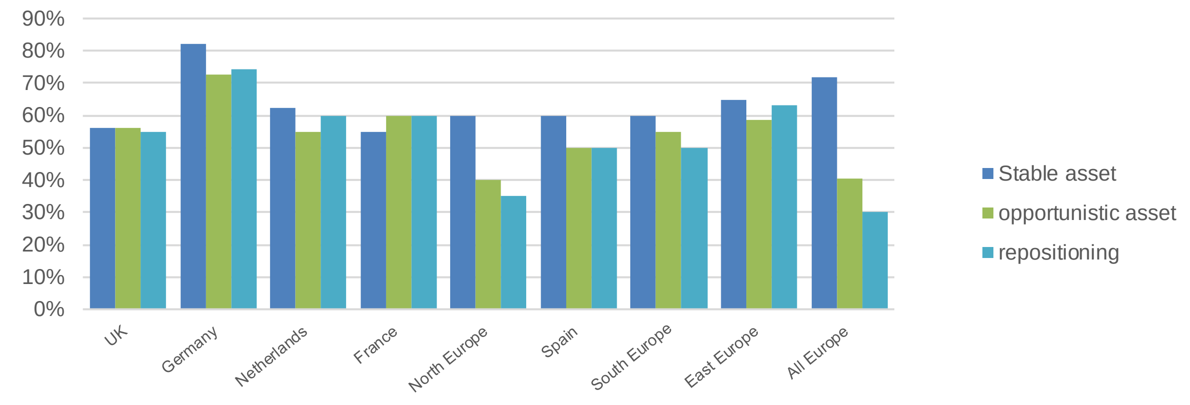
Lenders have been asked to provide loan terms for three different types of assets:

- Investment/stable assets
- Opportunistic asset
- Repositioning asset

They have provided their maximum LTV they would be prepared to lend together with a guide price. Figure 4 shows the maximum LTV for different types of assets

- Generally stable assets may receive higher maximum LTV financing terms, given they generate a stable income flow and are considered relatively low risk.
- Lowest LTV levels may be achieved for repositioning assets, which could be as low as 35% of leverage.
- Germany still shows the highest LTV's available in the European market.

Figure 5. Maximum LTV



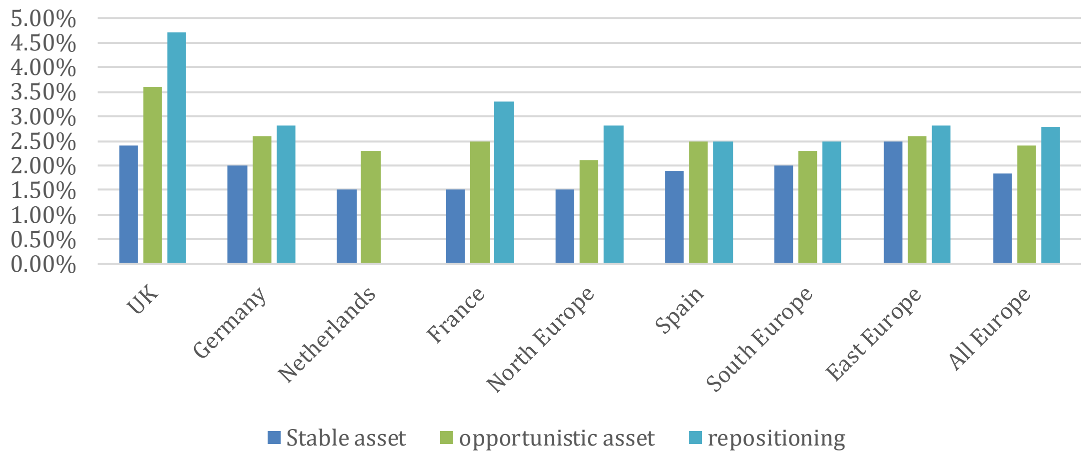
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

3.1. Average loan margins by asset type

Lenders provided average lending margins for three different asset types.

- The German market were the first to react to higher interest rates and the increased credit risk perceived for real estate assets. Banks are also aware that the implementation of the new Basel regulatory capital floors will increase their overall cost of lending.
- At year-end 2022, lowest margins were available for stable assets in the Netherlands and France.
- In all markets loan margins for loans against repositioning and opportunistic assets are priced higher, the price differential can be 100 – 150bps or more

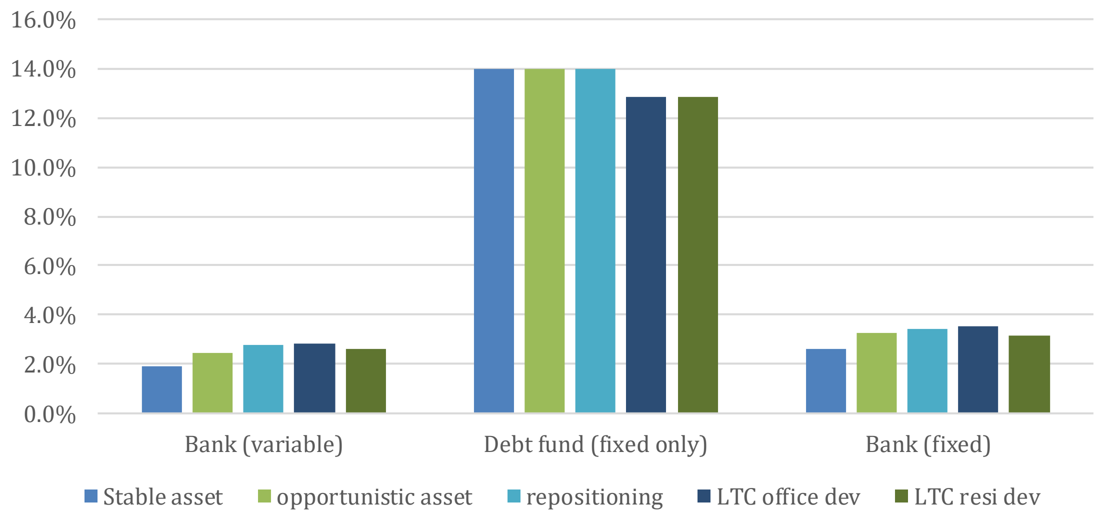
Figure 6. Loan margins (variable rates)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Depending on the type of lender loan terms may differ widely. Lending rates from banks start at 1.9% on average for variable rates (5 yr loan term), with fixed rates being 60 – 80bps wider. Debt funds are often providing debt for a specific purpose, where a bank does not lend, hence their lending rates are within the double digit range with higher LTV ranges (83 – 88%).

Figure 7. Senior/Whole loan margins



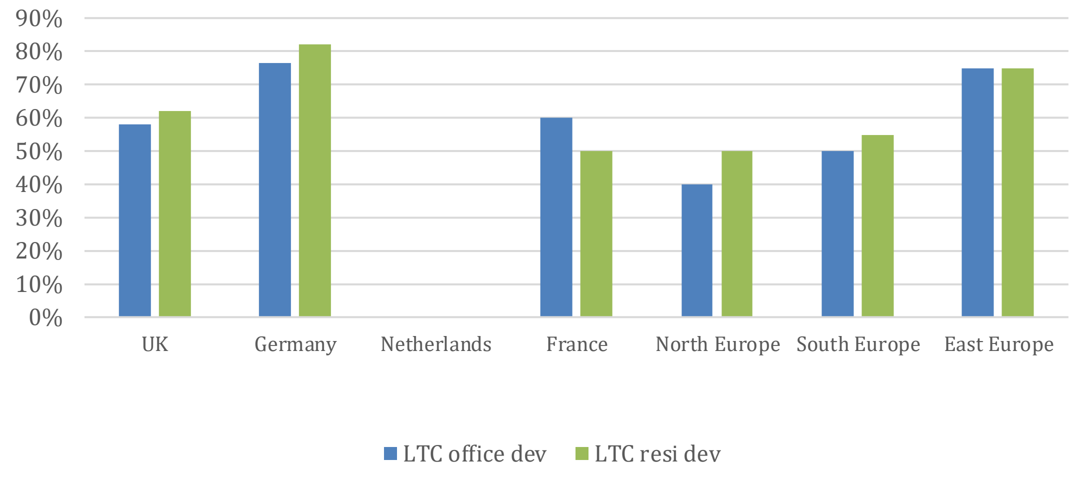
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

4. Development lending

Lenders provided terms for office and residential development lending. Lenders have been asked broadly to distinguish between residential and commercial development lending based on loan-to-cost ratios.

- Germany also holds the place of highest LTC ratios being offered for development finance. In comparison, other countries appear more conservative, such as France, or Southern Europe.

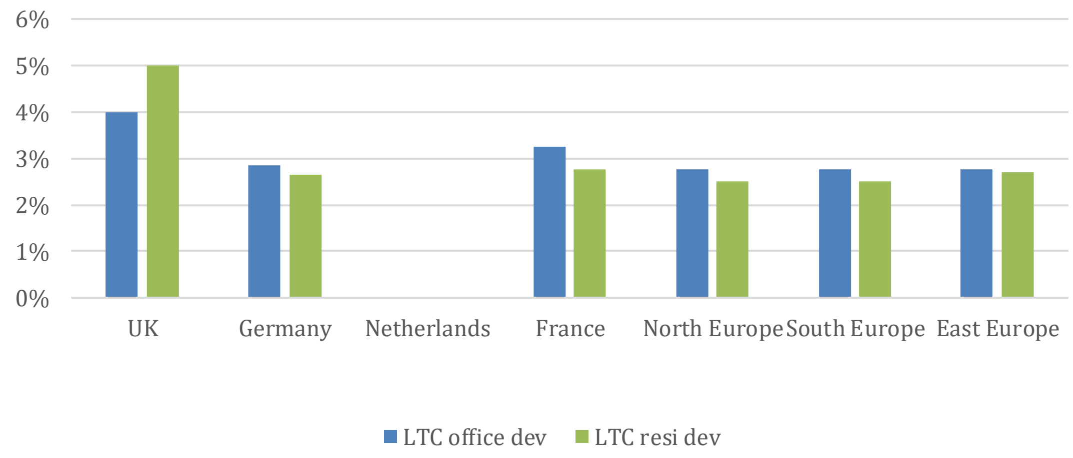
Figure 8. Development – Max LTC



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Generally residential development lending is still cheaper than commercial development finance, however margins for development finance range from 3% - 3.75%.

Figure 9. Development – Average margin

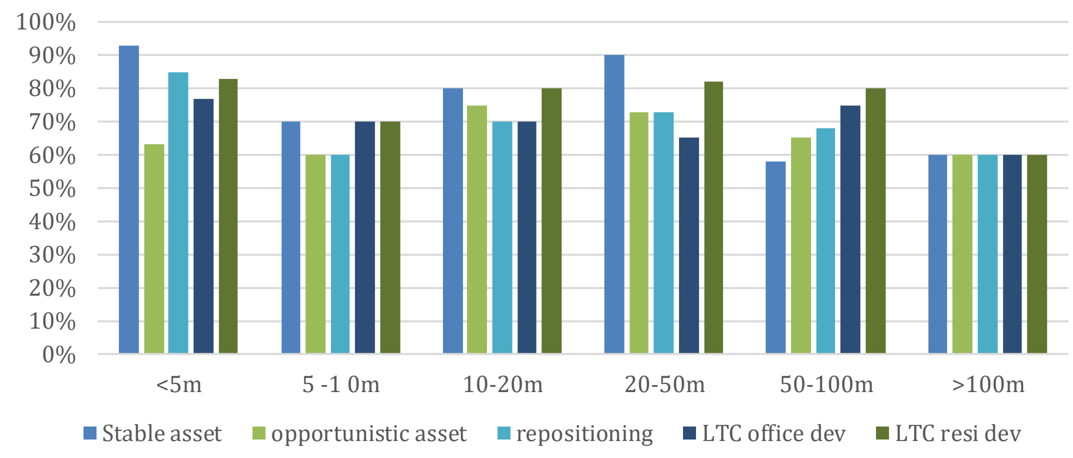


Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

5. German lenders lending in Germany

This specific section provides some insight into lending rates in the German market provided by German banks. Generally, LTV's are often highest for the smaller assets, while LTV's on larger loans are capped at around 60%.

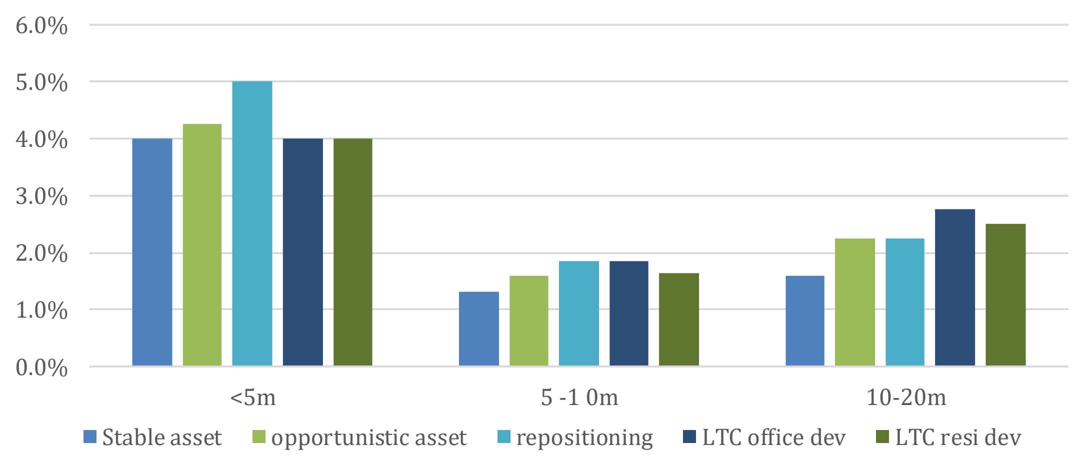
Figure 10. Max LTV by loan size (Germany only)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Loan margins are higher for smaller assets, which are priced around 4% - 5%, while stable large assets can achieve a pricing as low as 1.5 – 1.6%. However, the average LTV was lower for larger assets or large portfolios of assets across all different situations.

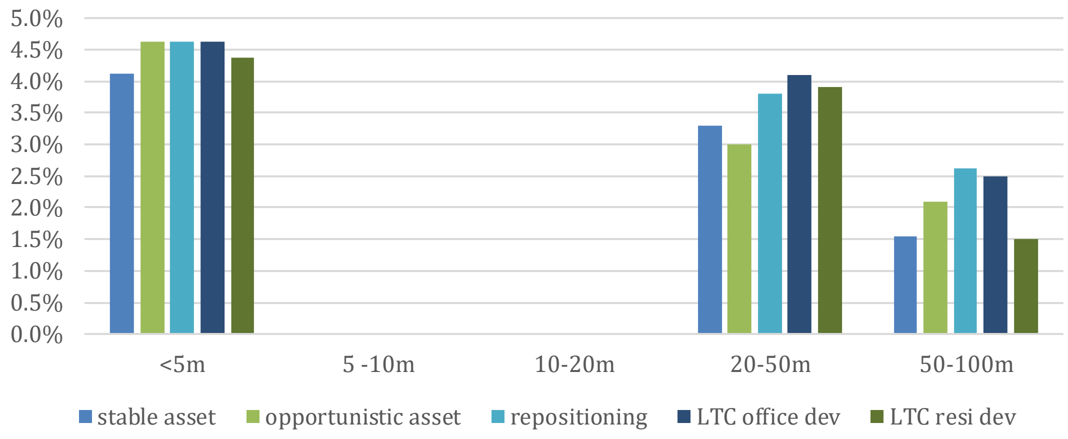
Figure 11. Average loan margin (variable)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Fixed rate margin are slightly above variables rates for a 5-yr loan term.

Figure 12. Average loan margin (fixed)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

6. Interest rates and lending terms

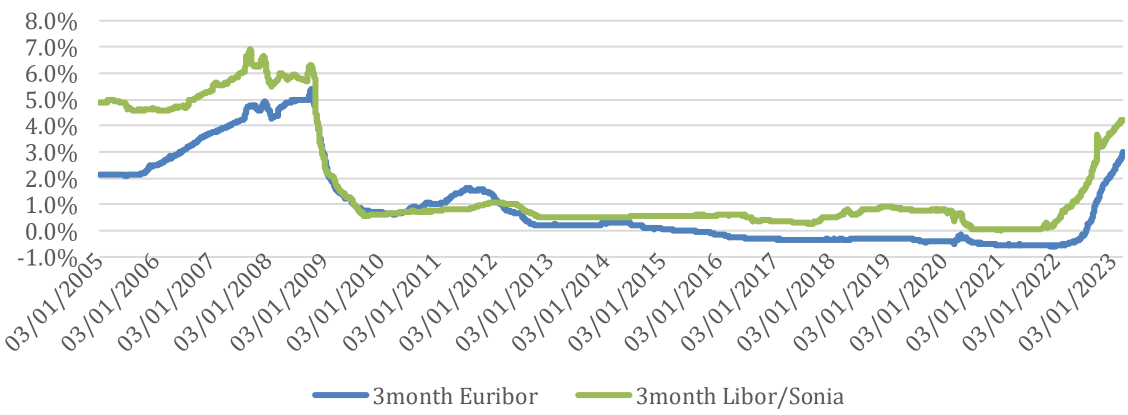
This section sets a framework of general trends in debt pricing followed by a detailed consideration of key lending terms and pricing margins currently sought by lenders. These are split by type of collateral.

6.1. Interest rate policy & hedging

Overall findings show that banks may choose to price loans using a variable rate or fixed rate. The fixed rate reflects the variable pricing + a benchmark rate. Debt funds on the other hand using a fixed loan price model. In the UK approx. 30% of all loans are fixed, while in Germany this is 40%.

Figure 12 shows the long-term low interest rates and the recent changes in Q4 2022 and Q1 2023. Since December 2022 interest rates have slowly increased again in 2023.

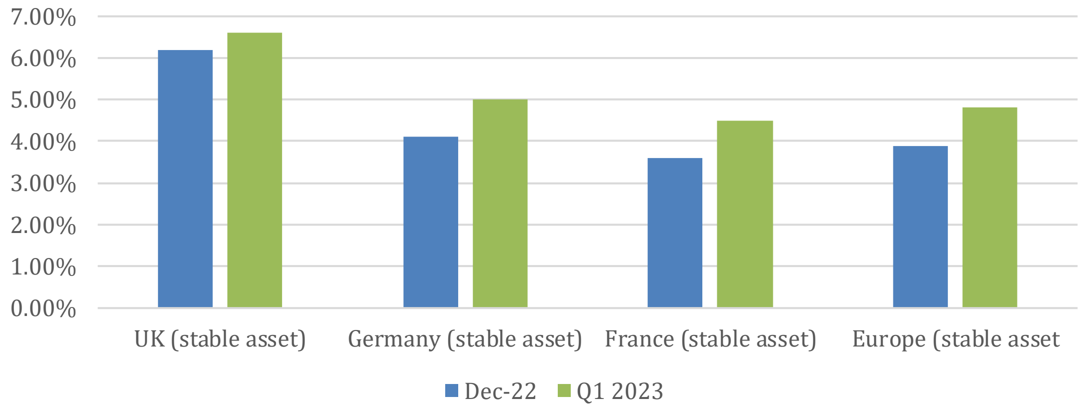
Figure 13. 3month Euribor & Sonia



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Overall, current rates mean variable loan interest rates starting from 4% across Europe and starting from 6% in the UK for prime stable assets, which explains the level of current fixed rates and double digit expectations for junior financing. Especially for the European property market, where property yields for prime offices have been ranging from 2.75% to 3.5% the level of financing rates cannot be sustained and are forcing property values down or leaving assets and borrowers stranded.

Figure 14. Current all in variable loan interest (stable prime assets)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

6.2. Junoir loan terms

This section provides some insight in to junior and mezzanine lending. These rates are provided on a fixed rate basis. Across Europe, stable assets may be financed at a margin below 10%, however, they might not contain all fees.

- For repositioning assets, development assets etc, margins are typically around 15%, fixed, including all fees, with LTV’s ranging from 70% - 92%.

Table 2. Junior– target lending terms by property type, Dec 2022

Property type	Range LTV %	Average Margin %	LTV %	Average Margin %
	Stable asset		Repositioning	
UK	40% - 80%	5.7% - 10%	40% - 80%	6.5% - 18%
Germany	60% – 90%	8% – 15%	70% – 92%	9% - 18%
North Europe	60% - 90%	8% - 15%	70% - 90%	9.7% - 18%
Spain	60% – 75%	8% - 8.5%	70% - 75%	9% - 10%
South Europe	65% – 75%	8% - 8.5%	70% - 75%	9% - 10%
All Europe	40% - 90%	5.7% - 10%	40% - 92%	6.5% - 18%

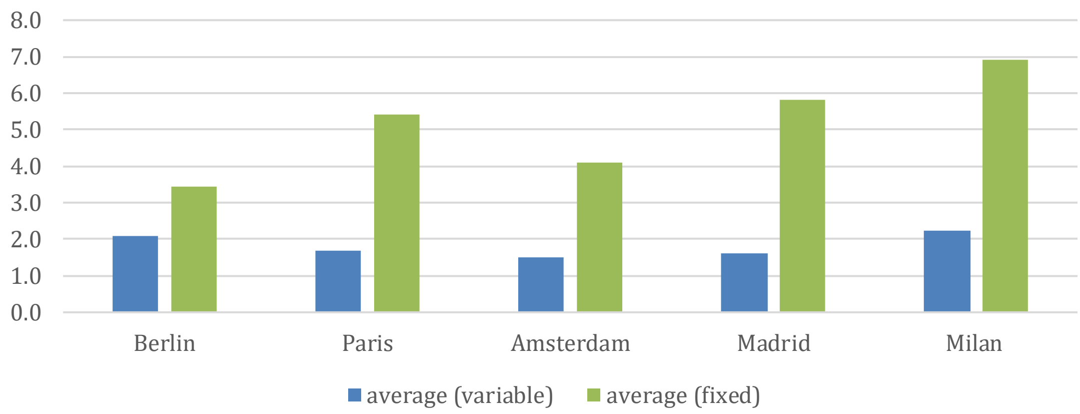
Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

7. Key city loan terms

This section presents the best terms for prime assets in the key cities listed below.

- On a variable basis, best assets in capital cities can still achieve a loan pricing of below 2%, although lending margins in Germany have increased.
- Fixed rate loan pricing in Madrid and Milan is slightly higher than in northern European cities.

Figure 15. Key city – loan terms (fixed vs variable rate)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

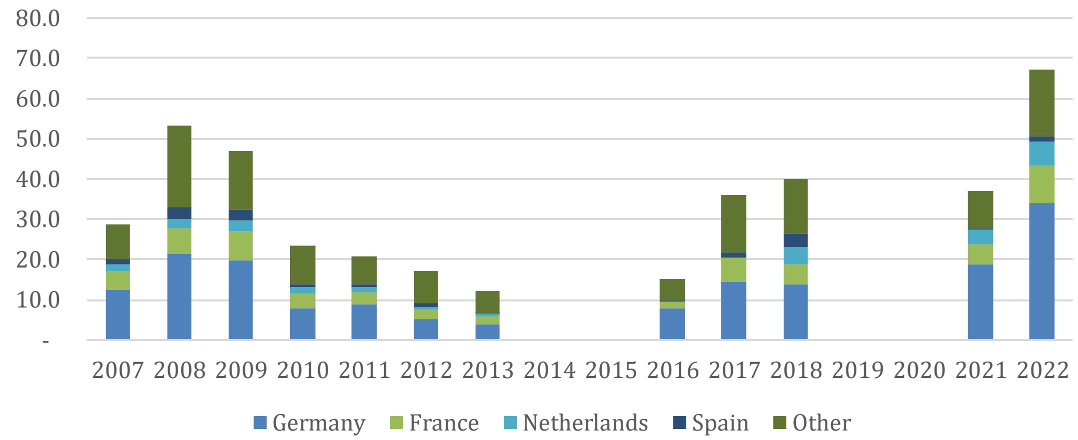
- Overall variable rates provided by banks are more competitive than fixed rate pricing, which may often be provided by alternative lenders.

8. Historic lending covered by cross European lenders (UK CRE survey)

Over the years we have been reporting sporadically about European lending volumes and trend from UK headquartered lenders lending outside the UK. Historically the research included European lending flows until YE 2013. In 2018, 23 lenders have been reporting exposures and origination to the lending survey, during the pandemic years, the data has not been collected and the first full collection has been undertaken for the year-end 2022.

Historically, the European outstanding loan book value reported to the survey peaked in 2008 with £53bn. Between 2008 and 2013, the volume reduced due to deleveraging efforts across all lenders.

Figure 16. Historic lending exposure



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

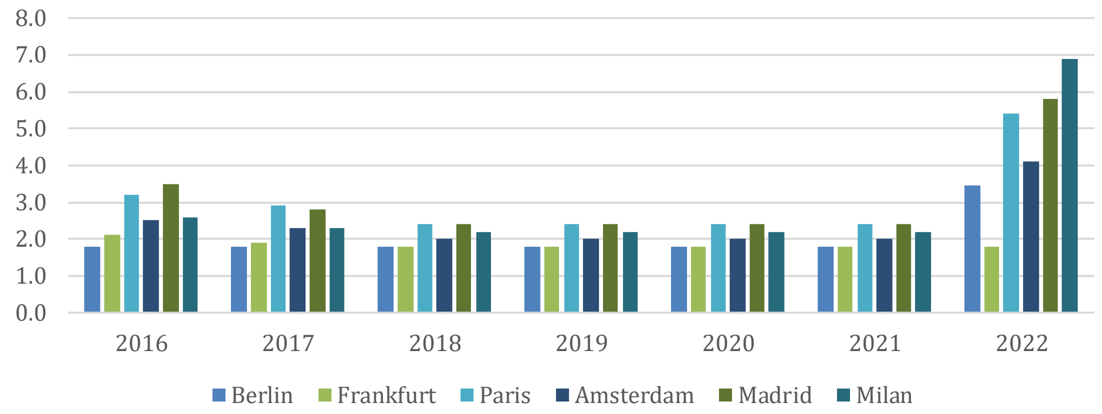
Findings about European debt are based on heavily lending across all jurisdictions in Europe and include €67bn of European CRE debt of which 51% is located in Germany and another 14% is French debt. Another 20% falls into other North and Western European countries.

Secured CRE loan pricing and LTV ratios were provided for prime lending in key cities across Europe by the different lender groups. LTV ratios across Northern European countries are typically slightly higher than in the UK.

After the GFC pricing has increased and has remained at a higher level than 2007 even in key cities. In 2018, the average margin for loans secured by German properties (Frankfurt, Munich) was recorded at 181bps, followed by loans secured by properties in Milan with 218bps. Loans secured by properties in Paris still attract a higher margin of 261bps. Between 2017 and 2018 loan margins across major European cities have decreased by 20 – 25bps on average, however lenders have remained conservative with regards to loan-to-value ratios.

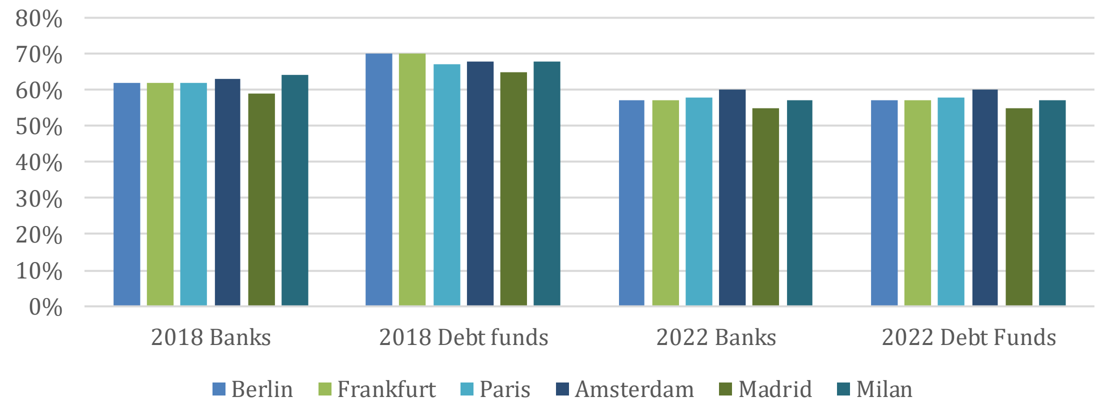
For all European loan pricing, it should be noted that this is from lenders, which are operating outside their home market. In many cases, such as in Germany, France or Spain, local banks will offer real estate loans at lower margins.

Figure 17. Key city – historic loan terms



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Figure 18. Key city – historic loan terms (LTV)



Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

9. Conclusion

This first report focusing on European lending aims to bring together the different lender groups across Europe and provide some insight into the lending behaviour and loan pricing.

- It should be noted that all lenders may provide different loan rates in their home market versus lending outside their home territory. Especially for junior financing loan rates offered may differ widely depending on the type of asset, location and especially type of lender. Rates can be specifically high if there is little appetite from lenders to lend on an asset class, leading to very limited supply/debt liquidity.

- Smaller loans might be priced higher because there is less lender appetite, as well as very large loans, which might require more than one underwriting lender.

- There is a clear pricing distinction between stable assets and those which require some repositioning across all European jurisdictions.

- German lenders still offer some of the highest LTV's for investment assets and LTCs for development lending, while Southern European lenders have been more conservative.

Appendix 1: Data tables

Table 3. Variable interest rate margins across Europe

Max	Stable asset	Opportunistic asset	Repositioning asset	LTC office dev	LTC resi dev
			Max		
UK	5.0	8.0	8.0	8.0	6.5
Germany	4.0	4.3	5.0	4.0	4.0
Netherlands	1.5	2.3	-	-	-
France	1.5	2.5	3.3	3.3	2.8
North Europe	1.6	2.2	3.0	3.0	2.6
Spain	2.0	3.0	3.0	-	-
South Europe	2.0	2.3	2.5	2.8	2.5
East Europe	3.8	3.8	3.8	3.8	3.8
			Min		
UK	1.5	1.9	2.7	2.0	2.0
Germany	1.2	1.5	1.5	1.9	1.7
Netherlands	1.5	2.3	-	-	-
France	1.5	2.5	3.3	3.3	2.8
North Europe	1.4	2.0	2.5	2.5	2.4
Spain	1.8	2.0	2.0	0.0	0.0
South Europe	2.0	2.3	2.5	2.8	2.5
East Europe	1.3	1.5	1.8	1.8	1.7
			Average		
UK	2.4	3.6	4.7	4.0	5.0
Germany	2.0	2.6	2.8	2.8	2.7
Netherlands	1.5	-	-	-	-
France	1.5	2.5	3.3	3.3	2.8
North Europe	1.5	2.1	2.8	2.8	2.5
Spain	1.9	2.5	2.5	-	-
South Europe	2.0	2.3	2.5	2.8	2.5
East Europe	2.5	2.6	2.8	2.8	2.7

Source: Bayes Business School Commercial Real Estate (CRE) Lending Report

Appendix 2: Definitions & Classifications

For the purposes of this research, the following section provides definitions and classifications specific to this research.

- **Commercial property:** lending covers all lending secured on European commercial property, including residential, held for the purposes of investment income generation, and on the balance sheets of Survey respondents.
- **Senior lending:** loans secured by a first claim against the underlying collateral.
- **Junior/Mezzanine loan:** Junior debt is debt with a lower priority for repayment than other debt claims in the case of default. Junior and mezzanine debt are considered to be types of subordinated debt. It can be structurally and legally subordinated. A junior tranche can be structurally subordinated to the senior tranche in a whole loan financing but still secured on the same mortgage security. A mezzanine loan can be legally and structurally subordinated and separate from the whole loan secured financing. It does not form part of the whole loan security; hence it is unsecured.

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