SPLASH

JUNE 2010 THE NEWSLETTER FROM KINGFISHER PROPERTY FINANCE

Post Credit Crunch

Since the beginning of the Credit Crunch, lenders have refrained from putting borrowers into administration and exercising security. The consistent message, with few exceptions, has been that they wish to work out problem loans with borrowers. But the problem confronting some of them is the scale of losses, not just on commercial property loan books. For instance, RBS is reported to have £280 billion of loans covered by the Asset Protection Scheme of which £39 billion is secured by commercial property. Banks languishing with significant losses will need to shrink loan books to match reduced capital bases.

On the other hand, lenders have remained open for business with several stating that they wish to increase commercial property loan books. Throughout 2009 there was lender frustration that the market was dominated by institutional and ungeared purchasers. Lending for the six months to June amounted to just £7.4 billion of which only £3.4 billion was new business. In the following six months there was a further £11.7 billion of lending on new business. This compares with £52.5 billion for the whole of 2008 and £84 billion in 2007. Contrary to what was reported in the press, there was plenty of appetite to lend but a lack of opportunity.

LTV's were at a maximum of 65% with margins of 2½% p.a. Part of the reason for such high margins was the high cost of attracting funds to lend. One year on, we are beginning to see debt financed purchasers being successful in acquiring quality stock in competition with the institutional and ungeared purchasers. LTV's have improved and for the best opportunities, even 75% might be possible. Margins have been driven down, largely by the German lenders, whose source of funds includes the Pfandbriefe market which has withstood the test of time and remained open. We have seen margins of as low as 1.0%–1.5%p.a. quoted for prime opportunities. That being said, there is not a single German lender amongst the top 13 lenders ranked by size of loan book.

Meanwhile, the loans in breach or default need to be managed. Whilst the DeMontfort mid year survey published at Christmas and based on data collected last Summer reported just £19 billion of commercial property loans in breach out of a total of £224 billion, with £12 billion in default, we have been told by one of the largest lenders that up to 80% of its loan book is in breach. The full year report for 2009 reveals a total of £50 billion in breach or default. Ernst & Young has reported that £10 billion of commercial property loans have been written off since June 2009 and Standard & Poors estimate there is a further £23-£37 billion to be written off. The problems are going to be greatest for secondary property with poor income characteristics. There is little lender appetite for properties with short term income; only tenants of good financial standing are acceptable. Shrinking loan books secured on this type of property will be challenging.

Most lenders have been inundated with offers from the private sector for outright purchases, joint ventures and purchases of loans in default at discounts. These approaches have been largely ignored although some large lenders have set up joint ventures to work out trickier situations. In late January/February we saw the first big lender making its move to get money back in. This lender is now frequently declining to renew loan terms. Properties which can be refinanced by others are being targeted in particular. We expect this approach to spread to others soon. The first Irish lenders have transferred assets into NAMA at heavier discounts than expected and we can expect them to look at their options for generating cash. Business plans have been requested prior to taking action to generate cash.

Our conclusion, looking just from the liability side, is that more properties are beginning to come to the market as a result of the actions of lenders. We would expect purchasers to find better value amongst those which are secondary and more difficult to finance, albeit with more risk.

Return on Equity

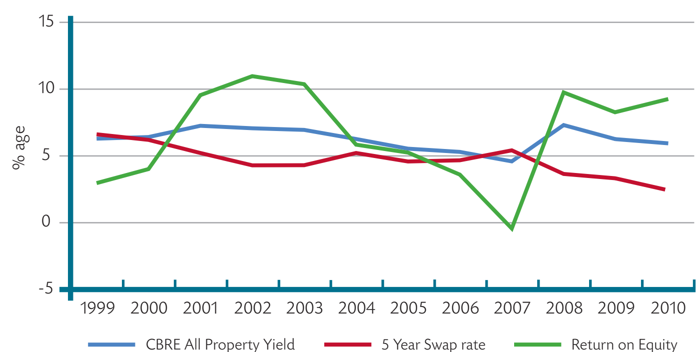
The return on equity to debt financed investors continues at a healthy level above the norm. It peaked between December 2008 and June 2009 at 10% reducing to 8% in December 2009. Since then whilst yields have sharpened the cost of money has fallen to a point where the return has risen to above 9%.

Be sure to check our revamped website www.kingfisherproperty.co.uk. where you can find the graph in the Market Data section. The return is measured by comparing the CBRE All Property Prime Yield with a notional loan based on a 5 year Swap.

A loan amount equal to the average LTV reported to the DeMontfort survey for prime security is assumed at the average margin reported to the survey. Surplus income is then expressed as a percentage return on the implied equity in the transaction. Before 1991, the return on equity was always negative going back to before 1980. Since then it has always been positive with an average of around 5%.

Commercial property investments continue to offer investors a healthy return on equity which is particularly favourable when compared with cash and bonds.

Kingfisher Property Finance Return on Equity Yields and 5 Year Swap Rates 1999 – 2010



RECENT AND CURRENT TRANSACTIONS

Student accommodation joint venture, UK

Kingfisher is helping several clients with finance for student accommodation across the UK with an emphasis on Central London. There is an acute imbalance of demand over supply of suitable stock in certain locations, with many existing operators and universities experiencing financial problems. However there are significant barriers to market entry and we are helping clients to develop business plans focused on exploiting their track record of success in delivering value. Our focus recently has been on raising both senior debt and equity to assist in the conversion of existing accommodation to be let directly to students upon completion.

Planning gain strategic partnership, UK

We have arranged a partnership to promote small and medium sized strategic land sites through the planning framework for subsequent sale to housebuilders. The focus is on filling the gap left in the market by the withdrawal of the strategic land promotion teams of the major house builders adversely affected by the credit crunch. Kingfisher has arranged a new corporate vehicle through which a private investment fund will contribute 90% of the costs of promoting a series of sites in return for a share of profits.

Headquarters Office and 120 bed hotel, Birmingham

We have raised an investment mortgage to assist a private investor client in acquiring the Mitchells and Butler 94,630 sq ft headquarters office building and 120 bed hotel. There was considerable interest from lenders on account of the quality of the income and the length of lease which was 35 years.

Brandon Shopping Centre, Motherwell

A joint venture between Chester Properties Investment Partnership and one of Schroders' funds has acquired this 91 unit, 350,000 sq ft centre anchored by Iceland, Boots, Poundland and Wilkinsons. The price paid was £36 million at a yield of 7.63%. We arranged a loan for the purchase on competitive terms and there was strong competition amongst lenders for this business.

Senior debt restructuring

As the banks have begun to get to grips with breaches of financial covenants across their commercial property loan books, some are taking a tough stance with borrowers needing to renew or refinance existing facilities.

However there is no 'one size fits all' solution and negotiation dynamics vary considerably from one type of loan, asset, borrower and even lender to another. Kingfisher has been busy helping numerous property company, developer and fund clients review their positions, identify their options and prepare robust and coherent business plans going forward. Our excellent relationships with UK lenders has proven invaluable in achieving positive outcomes for clients.

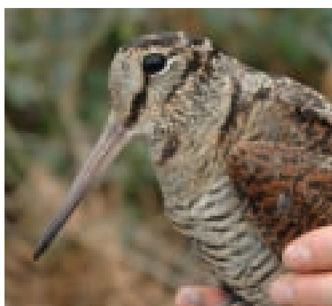
News on Limited Partnerships

Over the last 15 months, Kingfisher Property Partnerships, our FSA regulated company, has promoted 3 new funds and been appointed operator of 7 new Collective Investment Schemes on behalf of a wide spectrum of clients, ranging from Great Portland Estates plc, Land Securities plc and Palmer Capital Partners to private investment "clubs".

The combined funds under management of all 50 funds operated by Kingfisher Property now exceeds £3 billion

Woodcock shoot

A successful Kingfisher Property woodcock shoot was held in January on the Boughton Estate. The party



comprised 8 guns with a mixture of virgins and veterans. Someone had tipped off the woodcock, so there were fewer about than the keeper had promised. Maybe they had gone skiing along with the rest of our clients. Two woodcock virgins made it to veteran status but were spared initiation rites. Whilst there were no right and left opportunities on the woodcock, there were on the pheasants. The party enjoyed a fun day in the snow, which we hope to repeat later in the year.

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