

NBKI

Commercial Real Estate Finance

Real Estate Finance in a Post Pandemic Climate

A recent timeline of Commercial Real Estate Lending



Legacy of the Pandemic:

- Market activity stalling already due to Brexit
- Reassessment of office occupation
- Leading to a reevaluation of estates
- Feeding into vacancy rates and rental levels
- Market in flux, lending appetite reduced

Market Position:

- A strong recovery seen in 2021
- Transaction levels back to 2017 levels
- Debt origination back to 2015 levels
- Significant drop in in loan defaults
- Increase in lending margins for prime offices

The Outlook:

- Geopolitical instability in 2022
- Turbulence seen in Capital Markets
- Global inflation rising, Central Bankers react
- A change in Monetary Policy to curb this
- ESG and sustainability high on the agenda



Loan Origination – Overview

Market Highlights

- Research from Bayes Business School revealed that lending volume in 2021 reached £49.8bn – 48% up on 2020
- Development lending made up 20% of new origination in 2021, though the residential pipeline has slowed down
- Underperforming / NPL / defaulted loans declined significantly from 4.6% in 2020 to 2.3% in 2021
- Margins for prime office loans rose by another 25 basis points over 12 months
- Researchers believe the big hurdles this year will be increasing interest rates and declining income coverage ratios
- Using data from 76 UK lenders, the Bayes report found that:
 - lenders turned their attention to new loan origination in 2021,
 - lenders are focusing on good quality assets from offices and logistics to residential or student housing, and
 - retail and hotel assets are still often rejected by lenders.

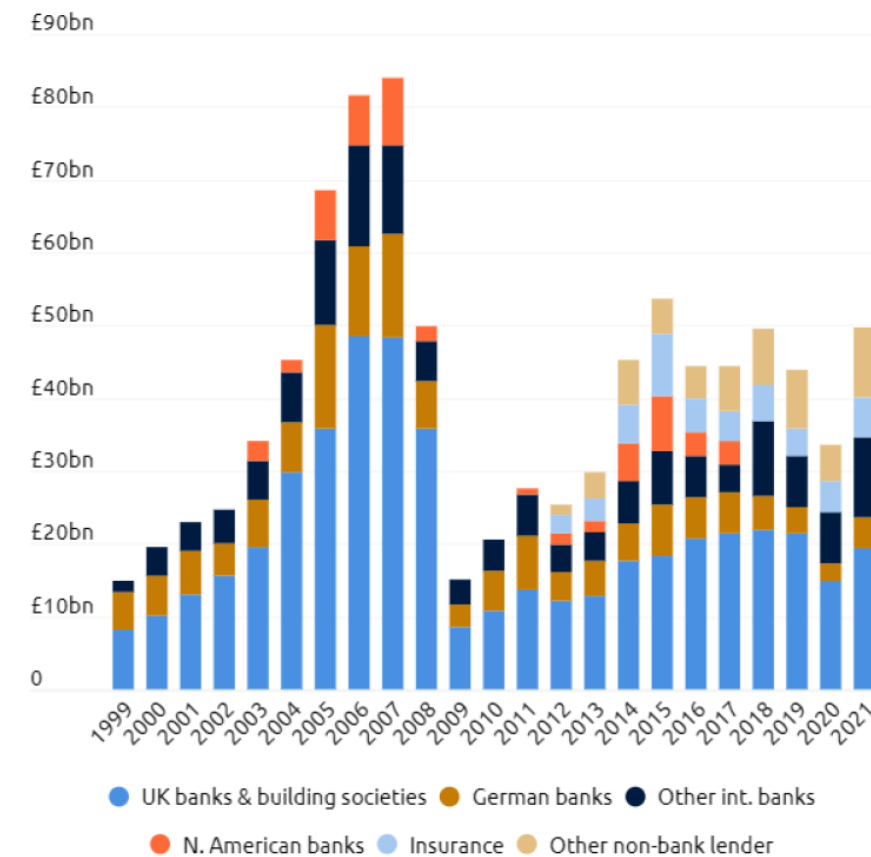
Loan Origination – Market Players

Lender Type	YE 2020 (£m)	YE 2021 (£m)	12-month change (%)
UK Banks	14,944	19,430	30%
German Banks	2,510	4,217	68%
Other Banks	6,968	11,048	59%
Insurers	4,219	5,547	31%
Other Lenders	5,024	9,557	90%
ALL LENDERS	33,665	49,798	48%

Loan Origination – Market Players, Outstanding Loans and Commitments

Lender Type	Outstanding Loans (£m)	Undrawn Facilities (£m)	Total Book Dec 21 (£m)	Total Book Dec 20 (£m)	Change (%)
UK Banks	63,841	18,105	81,945	92,009	-10.9
German Banks	19,203	577	19,781	19,651	0.7
Other Banks	31,404	3,333	34,737	33,517	3.6
Insurers	32,357	872	33,229	30,609	8.6
Other Lenders	27,823	2,976	30,798	24,482	25.8
ALL LENDERS	174,627	25,863	200,490	200,268	0.1

Loan Origination by Lender Type





BANK
LOANS

IN CASE OF
EMERGENCY

CROWD-
FUNDED
LOANS

SCHWADRON

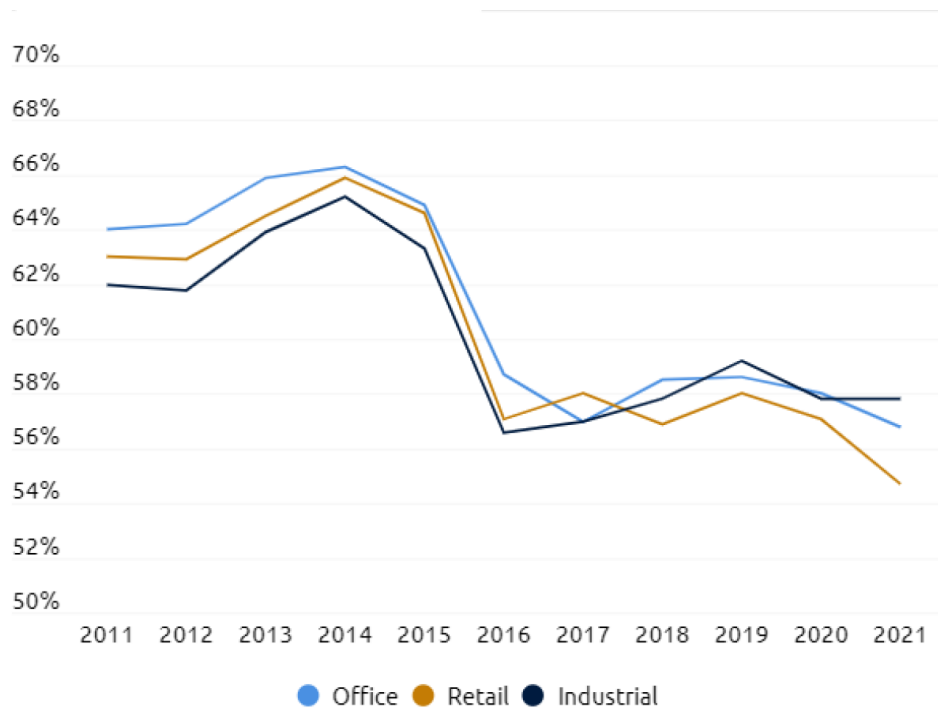
Lending Terms: LTV's, Margins and Fees

Market Summary

- Since 2016, there has been a general convergence of LTV's across property sectors
- The differences in how much lenders are lending as a percentage of property value across sectors are smaller now
- Currently, the average loan-to-value ratio in every sector sits between 55% and 58%
- Typical borrowing costs increased by 35bps from 229bps for prime office in 2020 to 254bps in December 2021
- Residential pricing increased to 292bps by the end of 2021
- For prime retail assets, the margin has reduced slightly by 15bps to 317bps
- Given the compression of industrial property yields, leverage has expanded significantly for logistics properties

Lending Terms: LTV's, Margins and Fees

LTV's by Property Sector and Specification



NB: Graphic above tracks Prime Office, Prime Retail, Prime Industrial only

Lending Terms by Property Sector and Specification

Property type	Average LTV (%)	Average margin (bps)	Difference from 10-year average (bps)	Arrangement fee (bps)
Prime office	57	254	17	97
Prime retail	55	317	54	108
Prime industrial	58	253	-3	99
Secondary office	57	341	33	112
Secondary retail	56	353	33	126
Secondary industrial	58	289	-26	106

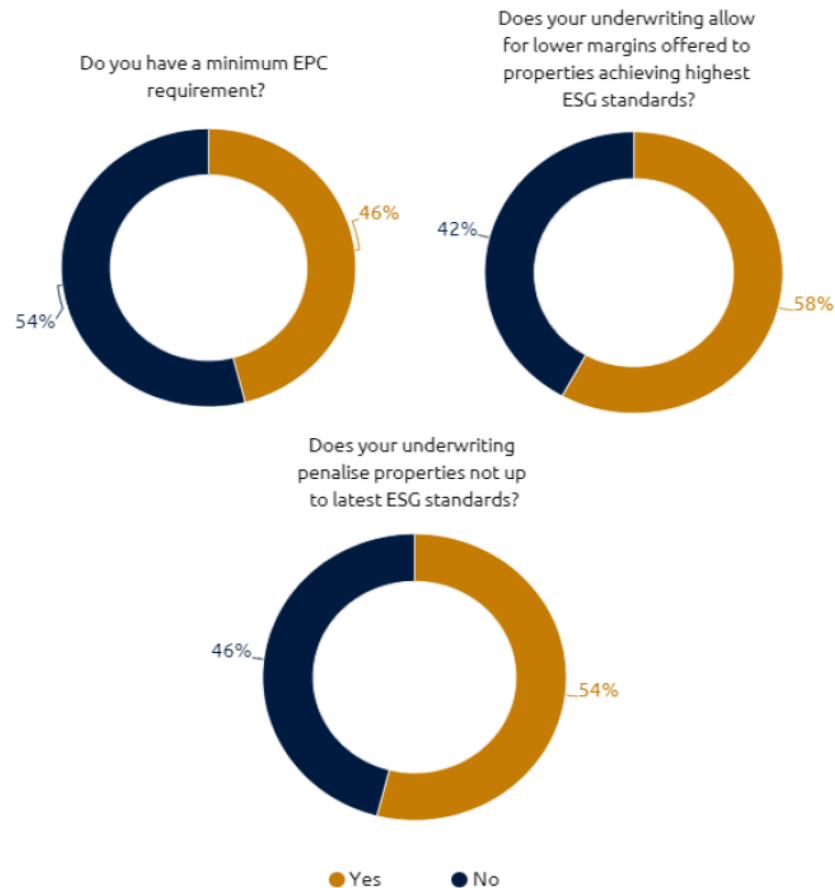
Data above as at December 2021

ESG Agenda Sustainability

ESG Agenda

- EPC targets for landlords over the coming decade
- CAPEX to improve energy performance for valuations
- A lack of investment creates a risk of “stranded assets”
- Increasing regulatory focus on climate footprint
 - Management of hydrocarbons
 - Management of waste
 - Keeping carbon on site where possible
- Reputational concerns for lenders with poor practices
- Diversity and Inclusion – a key area of focus for corporates
- Growing focus on office culture and management structures
- Higher standards of staff empowerment and development

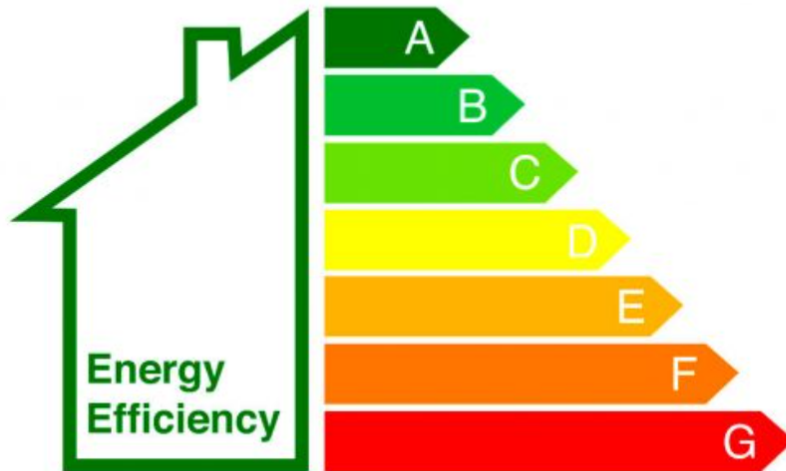
ESG Policies



ESG Agenda Sustainability

Sustainability Check List

- ZERO**
Targeting a net zero carbon operation
- All electric building**
- Sustainable timber curtain walling, CLT floors and green roof**
- Air-source heat pumps**



BREEAM® OUTSTANDING

 <p>Low occupancy costs will attract occupiers and provide a base for rental growth</p>	 <p>Ability to create a future proofed building providing the highest sustainability and wellness accreditations</p>
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Headwinds

Risks on the horizon

Global Economy

Geopolitical Turmoil	<ul style="list-style-type: none"> With COVID-19 in the rear view, there is still pressure on supply chains and the biggest threat to the global economy is the war in Ukraine Spikes in energy prices have already been seen / felt across continental Europe and UK
The end of Quantitative Easing and a changing monetary environment	<ul style="list-style-type: none"> As QE programs end and inflation soars, Central banks (including Fed, BoE, ECB) will increase rates this year slowly but surely, conscious not to deter investment by making the cost of borrowing prohibitively high

Overall Impact

Rising energy costs	<ul style="list-style-type: none"> The cost-of-living crisis in the UK is impacting households as real wages fail to keep up Many landlords are also taking the hit in sectors such as student housing and PRS Some landlords are pushing these costs back onto tenants
Construction Costs	<ul style="list-style-type: none"> BCIS General Building Cost Index showed a 10.2% annual rise from Sept-20 to Sept-21 Costs of construction materials in UK are at a 40-yr high, based on the BCIS Materials Cost Index showing growth of 19.7% from Sept-20 to Sept-21

Commercial Real Estate

Valuation	<ul style="list-style-type: none"> As operating costs increase as well as FM costs, valuers are increasingly bearish and forced to include CAPEX lines in their valuations of assets As rates go up and the cost of borrowing rises, property yields will soften
Lenders Respond	<ul style="list-style-type: none"> Quality asset selection and managing credit exposure are more important than ever With rising interest rates, income coverage ratios will decline and are expected to fall into a range of 1.4x–1.6x on many loans



Headwinds

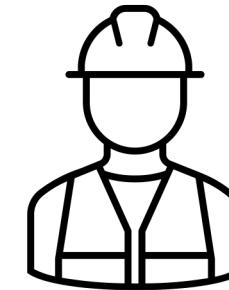
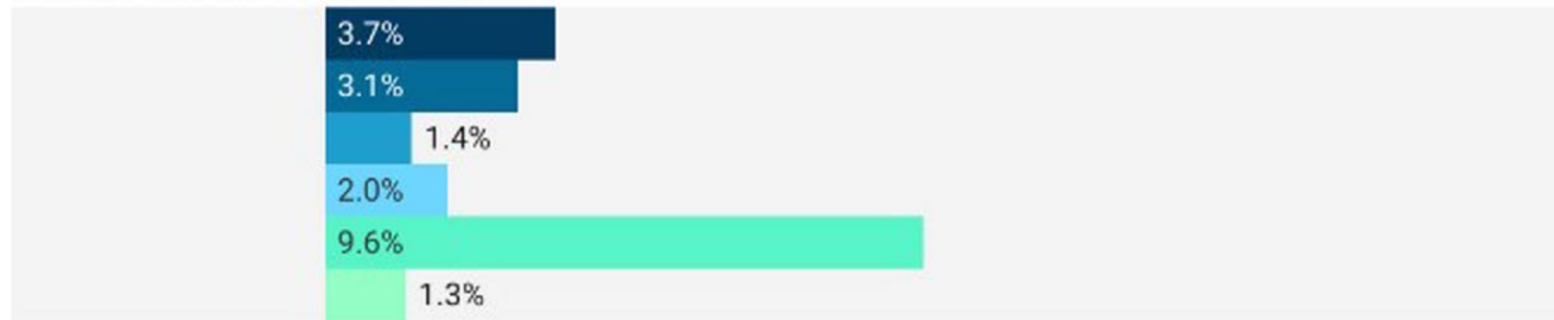
Risks on the horizon

Construction Costs

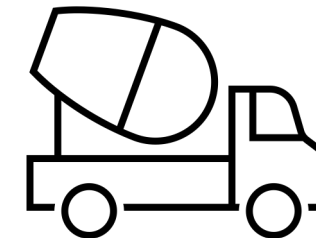
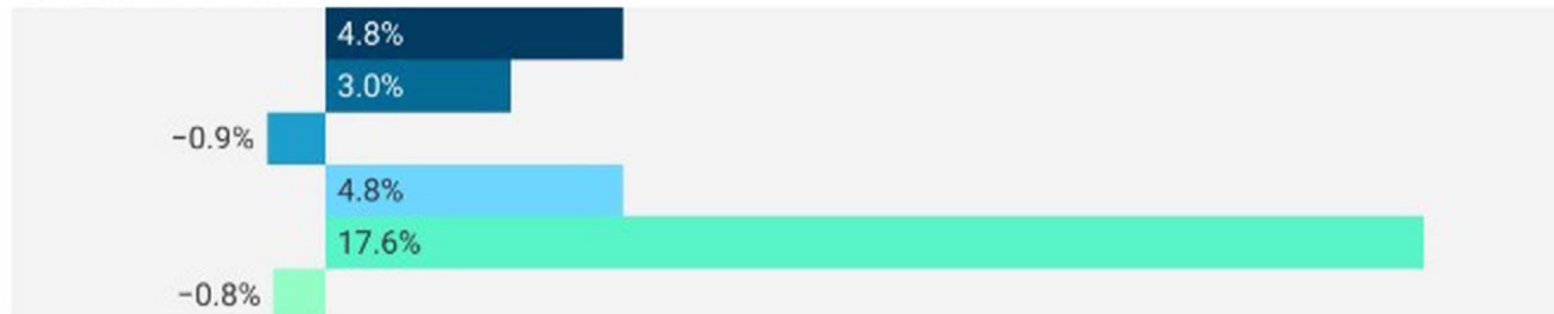
Performance of selected BCIS cost indices, growth rate (year on year) 2018-2023

■ Jan-2018
 ■ Jan-2019
 ■ Jan-2020
 ■ Jan-2021
 ■ Jan-2022(f)
 ■ Jan-2023(f)

BCIS General Building Cost Index



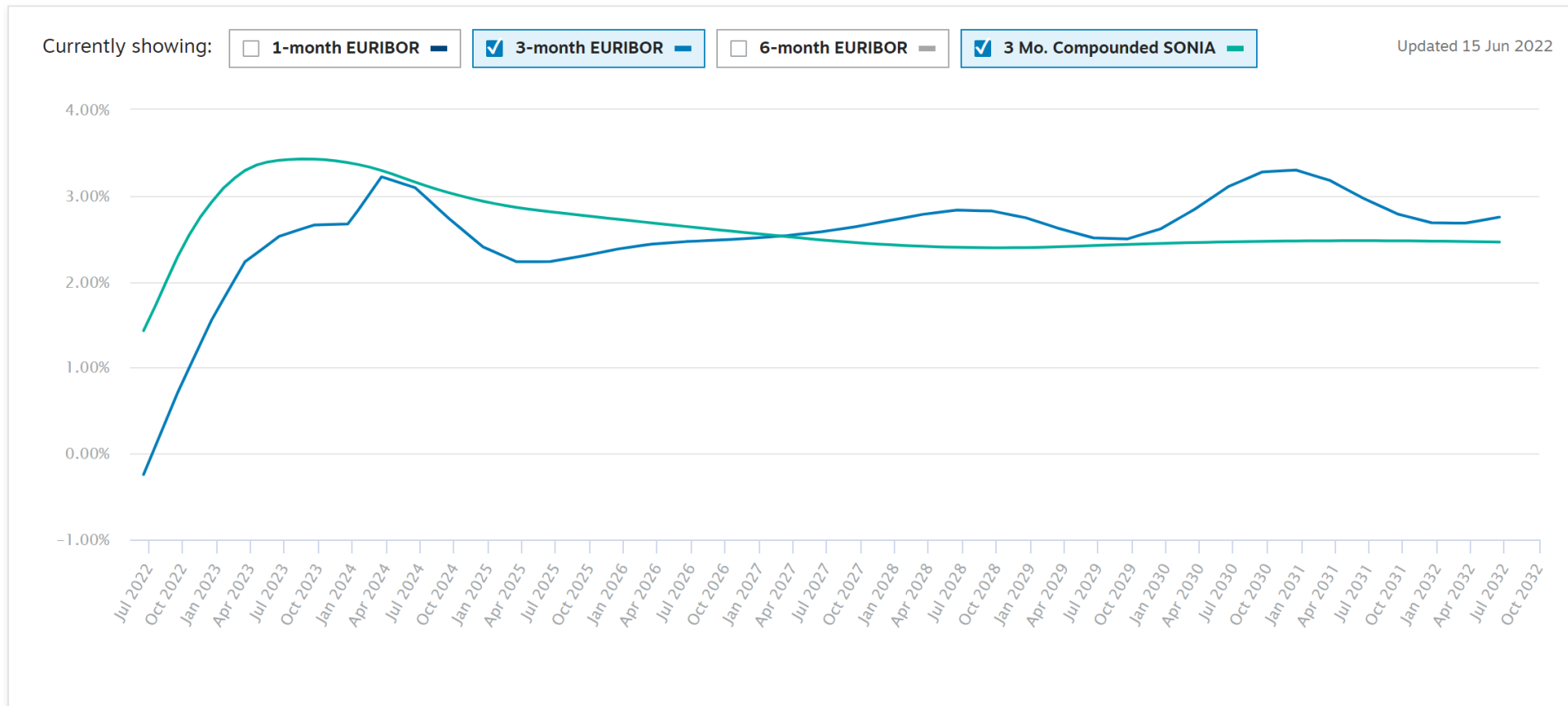
BCIS Materials Cost Index



Headwinds

Risks on the horizon

3-month EURIBOR vs 3-month Compounded SONIA



Sources: RICS, November 2021, ONS and BCIS

Synopsis

Key Takeaways

- UK commercial real estate has officially recovered from COVID-19
- International banks and debt funds have been the frontrunners in growing their loan books
- International banks and insurance companies dominate big ticket lending (over £100m)
- During the second half of 2021, commercial development lending activity picked up significantly
- While pricing still varies from sector to sector, there has been a convergence in LTVs across property sectors
- ESG is an increasing priority, led by regulatory change
- The war in Ukraine is a major threat to the global economy and general sentiment in capital markets
- The main headwinds are a sustained high inflationary environment and, consequently, rising interest rates



Thank You

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