The Renaissance of Commercial Lending

Are we heading for a New Credit Bubble?

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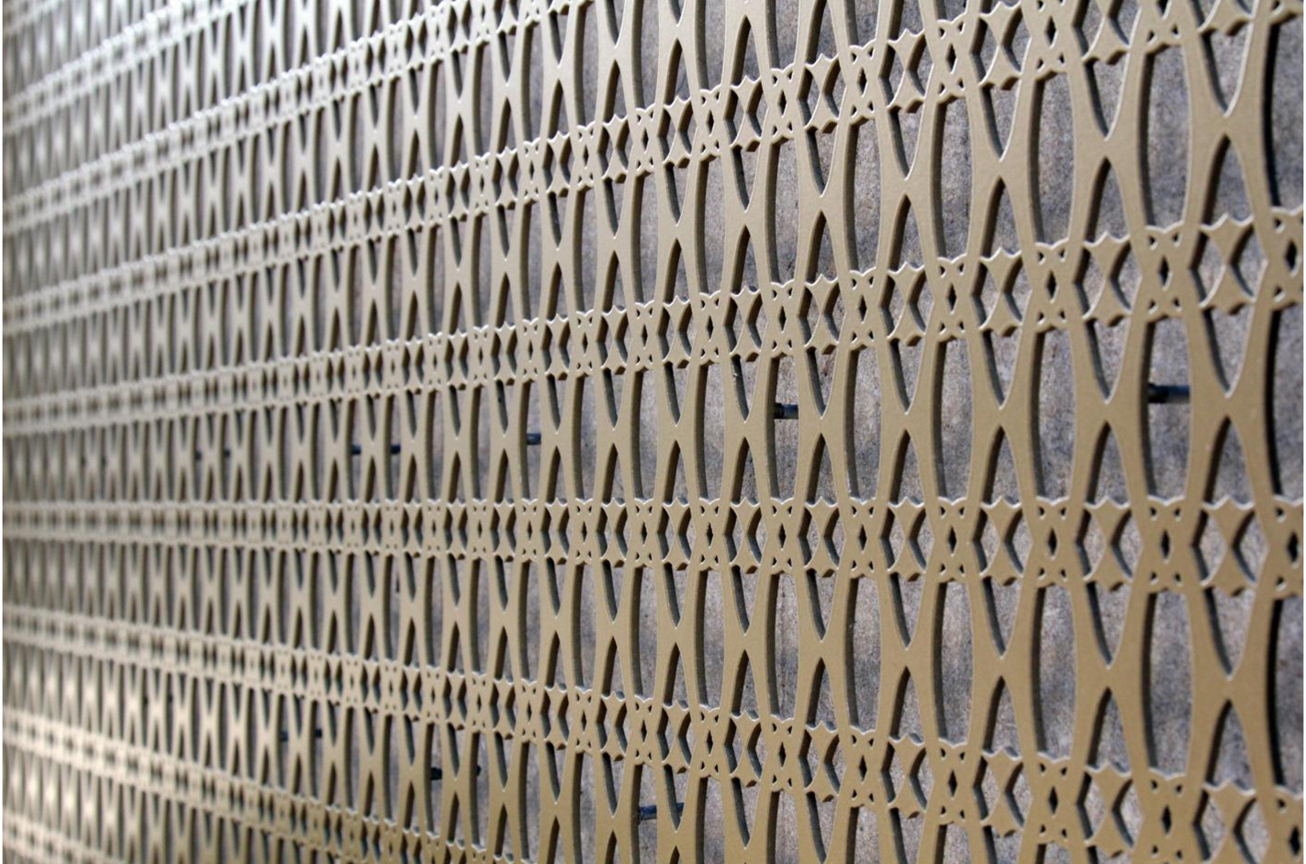


The Renaissance of Commercial Lending

Are we heading for a New Credit Bubble?

As Investment volumes hit seven year highs and yields hit record lows, many commentators have raised concerns of a new credit bubble in the UK property market. However, the latest annual De Montfort report into the UK property lending environment has shown that this time around these trends aren't a result of too much credit and that the current recovery appears to be more than sustainable going forward.

More than 70 lenders contribute to De Montfort University's annual survey on UK commercial property lending. The report is highly regarded in the property and finance industries and referenced by the Bank of England.

The report showed that banks continued to reduce their exposure to distressed loan books, with the total value of outstanding debt held against commercial property falling by 9.1 per cent in 2013, from £197.9bn to £179.8bn (£270bn in 2008).

More importantly, the report highlighted a significant shift in the underlying quality of loan books, with lenders reporting that 50 per cent of their loans are now secured on prime property, up from 42 per cent from last year. In addition, the loan-to-value (LTV) of legacy debt secured against investment assets improved.

Of the outstanding debt, 63 per cent had a LTV ratio of 70 per cent or less, a significant increase on 53 per cent in 2012. The volume of debt with a LTV ratio of more than 100 per cent dropped from £40bn to £31bn.

Chris Holmes, head of UK debt at advisers JLL Corporate Finance, said that the lenders' balance sheets had now been "materially cleansed" of the debt hangover from the financial crisis and the overall credit risk had been lowered.

With banks finally freeing themselves from the legacy of the boom and the economy improving, the lending market has seen a significant change over the last 18 months. Banks have started to relax credit terms as they try to compete with a growing number of alternative lenders and are now in a position to free up money and satisfy the increasing requirement for debt by investors.

2013 saw £29.9bn of new loans, up 17% from 2012. In 2007, however, more than £80bn was lent to the sector. Therefore, whilst the overall market is buoyant and values are rising, this isn't necessarily a sign of a new credit bubble.

The study also revealed growing confidence among lenders and borrowers, a greater availability of finance and increasing diversification among lending

institutions, with the role played by 'non-bank' lenders such as insurance companies and debt funds becoming more pronounced.

Alternative lenders have rapidly expanded their activity across debt markets. According to De Montfort British banks made just 43 per cent of the commercial property sector's £30bn new loan originations in 2013, down from 72 per cent of the market in 2008.

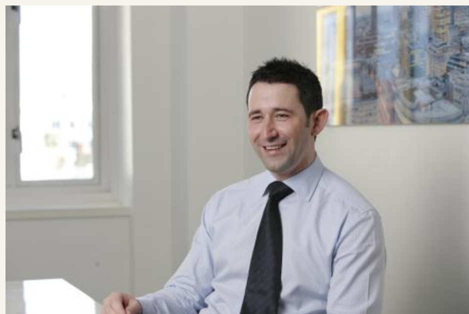
A second influential report, *Savills financing survey (2014),* stated that the number of new entrants over the past 12 months averaged one a week - a continuation of last year's trend. There are now 200 names on the list of groups with ambitions to lend - a record number for the survey. This further highlighted the increase in number and the broadening of type of lenders in the UK market.

In the years following the market crash, legacy bad debt and a lack of access to new funding were two of the biggest hindrances to the UK property market. However, recent data and reports indicate a very different outlook going forward.

2013 appears to be the turning point with banks patching up their balance sheets, a greater availability of finance and increasing diversification among lending institutions. Further, with new lending being undertaken at reasonable levels we are a long way off from creating a new credit bubble and thus in a much better place to withstand the next downturn.

Internal Perspectives

Dominic Wright, Chief Executive



"One of the biggest dilemmas for property investors at the moment will be whether or not it is the right time to invest. Based on the number of bidders chasing prime stock (particularly overseas investors) there is a discussion to be had over the

possibility that London (prime) could be overheating, but as mentioned earlier, we believe that this is very different to 2007 when the extension of credit was out of control.

“We came across a piece of interesting research carried out by Economic Indicator services (MoneyWeek, issue 694), which showed that a business cycle is 18 years long and is primarily driven by real-estate speculation. On this basis, it can be said that we are 6 years into the cycle and that there are another 11 years to go before the market starts to peak. Our own research has also shown that we are further behind in the rental growth story, which will help drive capital growth going forward.

“Whilst we wouldn’t want to put an exact number on how many years the property cycle has to run, with the UK continuing to attract huge amounts of overseas money, interest rates remaining low and the economy rallying, we do believe that the cycle still has a long way to go.

“Property investors should take a medium to long-term stance. We believe that through the continued use of extensive due diligence we are in a position to identify sound investment opportunities across the UK that are not yet overpriced.”

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