Research reveals new record year of loan origination for lenders across the UK

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Lending activity has bounced back to pre-pandemic levels, according to findings from the latest *UK Commercial Real Estate Lending report*, authored by Dr. Nicole Lux, Senior Research Fellow at Bayes Business

School (formerly Cass).

The report, using data collected from 76 major UK lenders, indicates a peak of new loan origination volume with 2021 yielding the strongest overall year in the market since 2015.

New lending volume in 2021 reached £49.8 billion—more than in 2019 and 48 percent higher, year-on-year, than 2020. During the first half of 2021, the backlog of transactions stuck in the pipeline from 2020 was being resolved while the second half focused on more new acquisition financing for existing and new customers.

Key highlights from the report, which covers data up to December 2021, also show:

- Development lending made up 20 percent of new origination in 2021, but the residential development pipeline has slowed down.
- Underperforming and defaulted loans reduced from 4.6 percent to 2.3 percent during 2021, representing a significant decline.
- Margins for prime office loans rose by another 25 basis points (bps) over 12 months, but pricing has narrowed for other asset classes, such as prime retail, for which pricing was already very high.

Overall debt issuance was strong across all markets. In the UK, Commercial Real Estate (CRE) bond issuance went from £6 billion to £10 billion between 2020 and 2021 according to the Bayes Bond Monitor. The CRE bond market, including commercial mortgage-backed securities (CMBS) represents between five and eight percent of total secured CRE market debt.

While the first half of 2021 showed a rapid recovery of market activity, borrowers were looking to finalize, restructure and refinance loans that had been on hold during 2020. For the whole year, this accounted for 52 percent of lending while the other 48 percent was new acquisition financing.

British banks have been dominating their own market, providing 39 percent of new financing, followed by international banks (excluding German banks) which held a share of 22 percent. Overall the largest 12 originators were responsible for 57 percent of new loans, of which six were UK Banks.

Development funding pipeline declined from 2020 to 2021, accounting for just 20 percent of total origination. This was mostly due to lower residential funding.

Smaller lenders concentrated 15 percent of their lending in residential development finance, as a lender group 'Other Lenders (debt funds)' supplied 32 percent of new residential development loans, and UK Banks supplied 47 percent. For the first time since the start of the pandemic, there was a noticeable amount of speculative office schemes being funded mainly in Central London.

Prime office margins have edged up to 2.54 percent (this was 2.29 percent at year-end 2020) due to the changing universe of lenders offering loans. On a 60 percent loan-to-value (LTV) basis, margins increased from 2.18 percent in 2020 to 2.42 percent in 2021. Loan pricing on prime industrial assets have also increased by 23bps. However, for other property sectors such as prime retail, and secondary properties, which priced very wide from prime, the pricing gap has narrowed by between 15 and 25bps.

A large pricing gap also remains between the largest balance sheet lenders and smaller lenders, resulting in a price differential of 1.17 percent bps for prime office. For example, prime office loan margins for the largest lender stand at an average of 1.88 percent while borrowers can expect to pay an average loan margin of 3.05 percent with borrowings from smaller lenders. With recent interest rate increases of the 5-year Sonia swap to 1.86 percent, this leads to an overall interest rate of 4.4 percent for some properties close to prime office yields—leaving little income coverage with interest coverage ratios (ICRs) expected to range from 1.4x–1.8x. This compares to the weighted average coupon for Sterling bonds issued by property companies specializing in offices between three and five percent for companies rated "A" or better.

When asked generally about lending appetite for 2022, 56 percent of lenders said they were willing to look at prime retail loans, compared to 8 percent who were willing to look at retail development. Prime industrial and residential investments are also two sectors that most lenders are willing to finance (92 percent and 80 percent respectively).

For the first time, the survey asked about alternative sectors of lending. 31 lenders expressed an interest in financing assets in life sciences, with 23 favorable towards finance data centers, requiring specific teams and knowledge. Just 23 lenders stated they lend in this of senior living.

Dr. Lux says that "It is very encouraging to see how quickly lenders have dealt with problem loans, showing efficient workout and borrower communication. The next hurdle for 2022 will be the increasing interest rates and declining income coverage ratios, which are expected to decline to 1.4x–1.6x on a number of loans."

More information: Report: www.bayes.city.ac.uk/__data/as … survey-june-2021.pdf

Provided by City University London

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