Banks Risk Bigger Loan Writedowns on London Focus: U.K. Credit
By Neil Callanan May 29 (Bloomberg)

U.K. banks including Lloyds Banking Group Plc and Royal Bank of Scotland Group Plc face further writedowns of their commercial property loans unless owners and buyers outside London are provided with more credit.
The lack of loans available for purchases of poor-quality properties in regional locations is prompting investors to shun that part of the commercial-property market, a survey by De Montfort University published on May 17 showed. That's threatening to drive down real estate values, which would increase impairments for loans held by companies led by Lloyds and RBS, according to Deutsche Bank AG.
Investors may fail to refinance 92 billion pounds ($139 billion) of U.K. commercial property loans as real estate values fall, the De Montfort survey estimates. About 45.5 billion pounds of loans are due for repayment this year, the survey showed. That compares with about $1.8 trillion of commercial property debt in the U.S. due to mature from 2012 through 2016, 29 percent of which is estimated to be higher than the value of the buildings backing them, Trepp LLC said in March 2012.

'Not Lending'

"They're not lending on it, which means it's hard for people to buy into the secondary market and it may depress prices," said Colin Lizieri, a real estate professor at Cambridge University. "That's not going to help them unwind their loan books."
Credit availability for commercial real estate was little changed in the first quarter and was predicted to remain so through June, according to a credit conditions survey published by the Bank of England survey in April.
About a quarter of all outstanding U.K. commercial property loans are in "severe distress," according to De Montfort. At the same time, about 70 percent of income-producing properties outside London are still losing value, research firm Investment Property Databank Ltd. estimates. That follows a 7.2 percent decline from September 2011 through March as a double-dip recession caused buyers to avoid all but the safest assets.
Lloyds and RBS may see a further 5 percent loss in their U.K. commercial real estate loan books through 2014, Deutsche Bank analysts Jason Napier and Martin Allen said in the January note to clients. "The U.K. banks aren't at the end of the road to rehabilitation," ratings company Standard & Poor's said in a statement yesterday. "While the good times will doubtless return, the market for bank credit is in our view unlikely to return to where it was when the music stopped in 2007 to 2008."

Lloyds Provision

RBS had 60.5 billion pounds of commercial real estate lending globally through March. Lloyds' Business Support Unit, one of its divisions that handles commercial real estate debt, had taken a 36.7 percent impairment provision on its 15.7 billion pounds of corporate property loans through December, according to the bank's annual report.
RBS and Lloyds declined to comment on the De Montfort survey and the Deutsche Bank estimate.
"The valuation model for real estate has a certain assumption that debt is behind it," Stephen Eighteen, the former global head of non-core real estate at RBS, said at a seminar in London last week. "If, over time, the debt market for certain types of property doesn't return, then actually that valuation model has to come into question," said Eighteen, who left RBS last year.
U.K. banks and building societies held more than half of the 217 billion pounds of outstanding real estate debt at the end of 2012, according to Leicester-based De Montfort's survey, the largest of its kind covering the U.K.

Bad Loans

The lenders include Co-Operative Bank Plc, which in March attributed most of the loss generated by its non-core corporate business, to bad commercial real estate loans. The unit is being wound down. On May 24, the company said it won't lend any more to new business customers.
Susanna Voyle, a Co-Op Bank spokeswoman who works for Tulchan Communications, declined to comment on the De Montfort survey's findings.
With central banks around the world providing cheap cash, lenders are under reduced pressure to realize losses on loans where the value of the property is less than the amount owed. Bank of England Governor

Mervyn King said at a press conference on May 15 that “bank funding costs have fallen and mortgage costs have fallen” because of the Funding for Lending Scheme.
The extra yield investors in Europe demand to hold securities backed by commercial mortgages dropped to 245 basis points over benchmarks yesterday, the lowest since May 2008, from a record 1,000 basis points in 2009.

Wider Margins

Other U.K. banks have also cut their share of new lending as they repair their balance sheets, leaving insurers and U.S. lenders with less competition and allowing them to grant loans with wider margins. British banks and building societies provided 49 percent of new commercial-property loans last year, down from 72 percent in 2008, the De Montfort survey showed. “They got into trouble from over-lending on property that perhaps they shouldn’t have been lending on,” Lizieri said by Banks Risk Bigger Loan Writedowns on London Focus: U.K. Credit phone. “They have to learn from that and I think many of them have.”
Cornerstone Real Estate Advisers LLC, an affiliate of Massachusetts Mutual Life Insurance Co., and other insurers stepped into the void, advancing about 9 percent of the 25.4 billion pounds of new lending compared with little or nothing in 2011. North American banks including Wells Fargo & Co. And Citigroup Inc. doubled their market share in 2012 to 6 percent, the survey said.

Lending Target

They’ve been attracted by lending margins wider than those in their home markets and earnings that look attractive compared with yields of less than 2 percent for 10-year gilts. Most of the new entrants, however, are focused on providing senior debt for income-producing properties in London, which is starting to tighten margins for that debt.
“We’ve got a significant lending target this year, but we face a huge amount of competition,” Gabrielle Berring, head of the London and mid-market real estate team at Lloyds, said on May 13 at a conference organized by the Loan Market Association. “You’re seeing overseas equity coming into London,” she said. “They may then gear up with their domestic banks back home so banks sitting in London aren’t getting a look in.” German banks incur lower funding costs than U.K. lenders, allowing them to remain competitive in London. Germany, together with France and the U.K., are the favored European markets for lenders, broker Cushman & Wakefield Inc. said March 8.

New Money

“This year in the U.K. we will have, clearly, our most profitable year,” Mark Titcomb, head of U.K. real estate lending at DekaBank Deutsche Girozentrale, said at the May 13 conference. “I don’t think we will have as profitable a year again because of the weight of new money coming in and the nature of the buyers who operate in the core markets.” DekaBank, based in Frankfurt, is the fund manager for
Germany’s state-owned savings banks. The company doesn’t report earnings figures for its U.K. units.
The re-emergence of commercial mortgage backed securities Banks Risk Bigger Loan Writedowns on London Focus: U.K. Credit as an alternative to bank financing is also having an impact. “The banks are being compressed on spreads because they can see a recovery in the CMBS market,” Matt Webster, global head of real estate finance at HSBC Bank Plc, said at the LMA conference.

“There’s no yield anywhere in investment markets,” Eighteen said. “If you want 7 percent yield, where can you go today? Actually, you have to go secondary markets in real estate. There’s no other form of investment that I know of where you can get a 7 percent relatively safe income return.” Those yields may help the debt market for prime real estate outside London to recover, according to Nassar Hussain, managing partner at Brookland Partners LLP. “I’d be very surprised if lending on some of the assets doesn’t come in faster than people expect,” he said at the May 22 seminar organized by his company.