Bricks & Mortar - Capital for Growth

February 2016

UK real estate is hot, there's no doubt about it. Since the days of the crash, there has been a resurgence to such a degree it is fair to say the market has reached near pre-recession levels, and many say there is still room to grow.

And alongside this general growth, the combination of market-specific factors and macro-economic trends is ensuring real estate companies and sponsors are accessing debt markets on increasingly beneficial terms. In fact, for the past two years, the strength of the market, plus a widening universe of willing lenders and ongoing benign interest rates, have provided a truly welcoming environment for acquisitions and refinancings of investment properties and portfolios.

But development financing has taken longer to re-emerge. Undeniably, the largest UK real estate companies with the strongest credit profiles have continued to be able to use corporate revolving credit facilities to fund development and, in some cases, the retail bond market has obliged for others. Yet development debt financing has been in short supply for a large proportion of private companies, smaller sponsors and investors.

But the past six months have seen a shift. The development financing market is returning for sponsors of all sizes, not just in London, but across the whole UK, providing an alternative to the institutional forward sale model and enabling growth and investment. Earlier in the year, the Investment Property Forum (IPF) estimated that volumes in the development financing market would increase by 34% in 2015, and material growth is certainly evident. We've seen a marked and growing uptick in appetite from developers in debt funding, alongside a timely increase in the amount of liquidity available from lenders.

Of course, supply of debt is in a healthy position. UK clearing banks continue to remain hungry for real estate assets and non-UK banks are widening their geographical focus outside of the capital – the latter only set to continue with increased regional devolution and a strong London market. Depending on the scheme, business plan and location, senior financing of 60-65% loan-to-cost (with margins starting with a three) is available to more and more sponsors undertaking a range of development projects, from commercial, retail and industrial assets through to healthcare, hotels and student accommodation.

A number of the debt funds that have become a more prevalent option for borrowers post-crisis are shifting their focus towards development assets to write tickets that meet their desired returns. These funds allow borrowers to pursue leverage at a level higher than commonly available in the senior debt market, and can be more flexible around how they take their return. Funds also provide sponsors with an option to move quickly on the acquisition and development of sites. This speed, capacity and flexibility comes at a price, of course.

There is also welcome development at the smaller end of the market: peer-to-peer lending platforms are evolving to provide a solution for single-digit-million deals, which have limited appeal for larger lenders. At KPMG, we've seen peer-to-peer lending facilitating high-end residential development, particularly in London; an appetite from peer-to-peer platforms to fund office-to-residential conversions; and even peer-to-peer funding into more unusual leisure assets.

The IPF anticipated that the peer-to-peer market would reach £87m in volume by the end of 2015, and we can only expect that to grow in line with the wider trend towards connecting individuals with investment opportunities across platforms. With over £1bn raised by peer-to-peer loan funds and listed investment trusts over the last 12 months, plus the increased number of real estate-specific platforms, growth should follow.

So what's the moral of this story? Well, it's pretty simple – for those developers that have been waiting for the right conditions, the time is now. And for the wider sector, expect the heat in the market to continue – it is unlikely we are reaching a ceiling yet.

Simon Mower
Debt Advisory, KPMG
E: simon.mower@kpmg.co.uk
T: +44 (0)20 7311 8967

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