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End of the rainbow

23 May 2009

Rained off: Funding is as scarce as gold dust, and banks are cautious - and reticent about what they will lend on. *Stacey Meadwell* goes prospecting

If you are seeking property finance, you may as well look for a pot of gold at the end of the rainbow. There is plenty of talk about banks lending again but, when it comes to putting your hands on cold hard cash, the pot has - in almost all cases -moved just out of reach.

The banks' reticence to lend is not surprising. Many will be licking the wounds from overzealous lending practices for some time yet, as bad debts mount up and falling capital values push more and more borrowers into breaching their covenants.

Earlier this month, Lloyds Banking Group, which is now partially owned by the government, said that it expected to make a loss this year and that corporate impairment fees for writing down bad debt are expected to rise.

Where does this leave Yorkshire's property businesses? Are banks amenable to refinancing deals or even lending for investment and development projects? And, if so, who is actually lending and at what rates?

A recent sentiment survey of Yorkshire's property professionals (see p84) showed that 83% of respondents believed that more developers would breach their bank covenants.

Alex Whiting, senior director of capital markets at CBRichard Ellis in Leeds, says: "Anyone who bought property in the past three years will inevitably be breaching their banking loan-to-value covenant."

It is unsurprising that much of the work being picked up by valuation teams in the region is for developers negotiating refinancing deals with their lenders.

Whiting explains: "Banks aren't lending, so they have to make money in other ways. They say that they will turn a blind eye to breach of covenant, but they want a massive fee and are putting up the margins."

Refinancing generally involves negotiating with a lender with which a relationship has already been established. The message coming back loud and clear is that a good, long-established relationship with a bank is vital if you are to see any money in the short to medium term.

But, even then, it is difficult to get money from some of the bigger names. Much of the banking sector is a closed shop when it comes to property, with any deals taking place kept firmly out of the public eye.

Banks such as Lloyds Banking Group and HSBC remain tight-lipped about any appetite for property lending. Even the Co-operative Bank, which is probably one of only a handful of financial institutions to come through the financial crisis in relatively good shape, while being happy to talk about increased corporate lending, will not comment specifically on property lending.

Yorkshire Bank is also talking openly about increased business lending - indeed, it issued a celebratory press release on the subject last month. However, when pressed about how much of that was for property, a spokeswoman said that it "was not looking to extend exposure at the moment".

Nonetheless, there are two names that crop up regularly as those that are lending and adding substance to the existence of that pot of gold: Nationwide and Abbey.

Nationwide has a commercial lending office in Leeds and issued a statement saying that Yorkshire was a market in which it was interested. It said:"At the moment in Yorkshire, we are considering new deals and opportunities, as we're doing elsewhere in the UK. In short, we're still lending."

Refreshingly, Abbey is happy to talk. James Meigh, head of real estate for Abbey in Leeds, says: "We have got a strong appetite to build a property lending book on proper structured transactions with experienced property companies based on current market prices.

"We are doing both investment [lending] and development [lending], but, in the current climate, development has got to involve an experienced developer on prelet transactions. We don't have an appetite for speculative development finance."

He says that up to 70% gearing would be offered for the strongest transactions, but that 60-65% would be a more comfortable level.

Arrangement fees have risen but "we like to achieve as close to 1% as possible" with costs in the region of 2%. Meigh says that loans of up to £30m are being considered; much above that and it would look at joining with another bank to spread the risk.

So there is a faint glimmer of hope but, as Meigh hints, lending is under the strictest of criteria (see panel). And there is little optimism that the situation will improve anytime soon.

As Tim Edwards, partner at BTG McInnes Corporate Finance, says: "Until there is a sensible funding market, it will be very difficult [for the property market].We won't see that change until the end of the year at the earliest."

Investment vs development funding

Funding for speculative development remains as elusive as the endangered northern hairy nosed wombat - not that anyone has an appetite for speculative development in Yorkshire at present.

Investment remains a safer bet and, thus, the more favoured option for the few banks that remain in the market to lend.

As Matthew Hopkins, industrial and investment partner at Gent Visick, explains: "From a bank's point of view, why not fund investment at 8.5%, when there is less risk, secure rental income and very little downside?

"For development, land values have dropped but development costs haven't, so there is very little opportunity for profit."

He adds that development funding is available only on deals where there is a "secure exit strategy", for example, if the scheme is prelet to an occupier with a gilt-edged covenant, like the public sector, or is presold.

For investment, the banks expect more equity up front. Andrew Wilkinson, director of investments at Sanderson Weatherall, says that banks feel comfortable with a 50:50 equity-to-loan ratio.

And, if you can get a lender, it is going to cost, warns Alex Whiting, senior director capital markets at CB Richard Ellis. "Banks will want a high margin - say 3%-plus - with fees three times what they would have been," he says. "And they often want certain amounts of security or collateral. It's almost like a bond because there is virtually no risk."