Press Release

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SAVILLS: UK FINANCE MARKET MAY HAVE PEAKED BUT NO CRASH FORECAST

Savills addressed the fundamental question of whether the real estate markets are “in danger of repeating past mistakes”, as it opened its 28th annual financing property presentations on early June 2016, in the City of London. The international real estate advisor presented a case for a finance market that may have peaked, but noted that the factors present in 2007 before the GFC are currently absent from today’s market. Referring to presentations from the last 20 years, past mistakes are largely not being repeated, Savills says, although there are some potential risks if an unexpected interest rate rise triggers an increase in the cost of borrowing.

Regulatory reform has been a positive force, Savills says, leading to 180 new lenders from a range of backgrounds having entered the market since 2013, contributing to a increasingly diverse, balanced lending market. By the end of 2015, insurance companies and alternative lenders had grown their respective shares of the market to 16% and 9% respectively. Savills forecasts that these will increase to 18% and 13% by the end of 2016, while the German banks, North American banks and other international banks will retain a 13% share each.

The market share of the UK clearing banks is forecast to decrease from 34% in 2015 to 30% by the end of the year, compared to 70% at their 2008 peak. This is due to the banks’ increased regulatory responsibilities, which has increased the cost of capital while slowing the decision making process, but fundamentally has had a positive effect on the market, Savills says. Indeed, proportionally UK banks are still the most active in the market, with RBS being the biggest lender of 2015 according to research by De Montfort University (DMU).

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Savills Vietnam is the largest and most experienced real estate practice with offices in Hanoi and Ho Chi Minh City. The company provides comprehensive property services such as: Residential Sales, Commercial Leasing, Residential Leasing, Research & Consultancy, Valuation & Feasibility Study, Banking & Corporate Services, Investment Brokerage & Advisory, Retail Consultancy & Leasing, Property & Asset Management, Tenant Advisory & Representation, Industrial Consultancy & Leasing, Marketing & Creative services. Savills Vietnam has won the Asia Pacific Property Awards 2016 - 2017 for “**Best Real Estate Agency in Vietnam**”, and “**Best Property Consultancy in Vietnam**”. With over 20 years of operations and growth in Vietnam, Savills is proud to be the most established real estate consultancy firm, providing the most comprehensive data and insights of the local property market development. Currently, Savills Vietnam consists of over 800 experienced and professional staff nationwide and keep expanding further.

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William Newsom, senior director of valuations at Savills, comments: "Looking back at many years of presentations, it is extraordinary to recall that in 2007 64% of all the lenders DMU spoke to thought a 80% LTV was 'no risk'; something that, happily, we can't even conceive of today. Regulatory reform has had the desired effect, diversifying the market and allowing new entrants including the alternative financiers, who Savills believes are set to lend approximately £7.5 billion by the end of the year, which is some 50% higher than reported by DMU. Overall such lenders are not financing speculative development and therefore are not bringing extra risk into the market. There are now property owners who have a strong preference to borrow from alternative lenders due to a perception that they are faster, skilled and offer greater certainty of delivery. Borrowers are prepared to pay a higher interest cost for these advantages."

With the cost of money at a record low, and the yield spread high, property continues to be very financeable. Gross lending volumes in 2015 reached £53.7 billion, similar to the level seen in 2004/5 and up 19% on 2014, but net lending after repayments has only just returned to positive territory. Furthermore, lending to property comprises only 8% of banks' total lending – the same level as seen in 2002.

Savills observes that loan terms have softened over the past 12 months with interest rate margins on senior debt increasing by between 20 and 50 bps since Q4 2015. Meanwhile, loan to value ratios (LTVs) have also come down due to macro-economic conditions, the current stage of the cycle and lenders' increased costs.

Newsom continues: "LTVs have decreased since 2015, although if mezzanine finance is included, this is capable of pushing total ratios to above 80%. This is of potential concern, but with the cost of money at a record low it can be comfortably achieved in today's market. The issue comes once the cost of money rises. Once it goes up it's a whole new paradigm, but some businesses are being built around the premise that today's low cost environment will continue indefinitely which, frankly, it won't."

With regards to the commercial property markets, Savills observes that while many have suggested that the EU referendum has impacted on activity, investment levels reached £13.8 billion in Q1 2016, well above the long term average of £9.5 billion. Further to Savills 2015 predictions, there has been continued investment in the UK's regional commercial property markets, which are projected to account for almost 62% of total volumes in 2016, with a record high of £10.9 billion invested in alternatives. This reflects the high price of core assets, although opportunities remain in specific sub-sectors such as sheds and central London offices.

Looking ahead, Savills projects that total property returns on all commercial property will fall from 12.9% in 2015 to 4.1% in 2017, before climbing to 7.9% in 2020, with rental growth remaining steady.

Mat Oakley, head of UK commercial research at Savills, says: "Some sectors of the investment market may be softening, implying that it may now have peaked. However, the conditions of 2016 are very different to those of 2007: we're not overbuilding, nor are we pricing secondary assets as prime, and investors and lenders alike have a heightened awareness of the risks in the market. With continued strong leasing activity across all the main sectors, we're going to see a gentle drift back to income rather than capital growth, which bodes well for the future of the market."

In terms of the residential markets, Savills notes that as a result of increased regulation, LTVs remain below the peak seen in 2007, with volumes of 90%+ LTVs forming only 2% of gross mortgage lending in Q3 2015, compared to 14 % in Q3 2007. Average loan to income ratios (LTIs) have risen, however, as buyers have stretched themselves to make purchases, particularly in London.

Lucian Cook, head of UK residential research, says: "LTVs remain low, although in London the creeping increase in LTIs is a concern, leaving the market vulnerable to an unexpected interest rate rise. Overall, mortgage regulation has served its purpose: the key factors that preceded the 2007 crash are not present today, although we now face a different set of challenges including increasing housing delivery and a squeeze in rental supply."

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