'The realist's view from the armchair' - September 2013

Dear Reader,

As the summer appears behind us and the memories of our holidays fast disappearing, we reconnect with the reality of business and the usual anticipation of what the last quarter has in store!

For the first time since pre credit crisis/ recession we read multiple financial reports that show positive signs for UK economic growth. This rhetoric is encouraging if not to eclipse the nervous sentiment that has been prevalent in our market for so long. In the same way however that we in the Prime Central London property market become restless of hearing continued reports of strong growth, a market perceived as over heated and the potential for a negative counter-effect, similarly the process of reporting the signs of recovery from such a deep and far reaching recession needs careful attention. The chancellor must be very mindful of a seemingly over generous housing market stimulus that serves to create no positive effect and simply allows a repeat of history!

There is absolutely no room for complacency if we are to have a successful recovery.

Since the appointment of the new governor for the Bank of England there has been an audible sigh of relief in the economy. Previous governors have not been so forthright with their early economic statements, offering sustained low interest rates purporting to be until at least the end of 2016. This is of course tempered by an unemployment rate falling to at least 7% and a spike in inflation above 3.5% before any adjustment is considered. Even though many economists maintain we will breach these targets sooner than the expected dates and the financial markets appear to have discounted the governors views as we see Swap rates nudging upwards. There is certainly mixed views as to when short term rates are to be impacted. It is prudent to consider a medium term fixed rate or some form of interest rate hedge, clearly of course understanding any potential pitfalls.

Unfortunately the institutional credit markets appear not to share the same positive sentiment, as the regulatory reforms post crisis take effect and in preparation for the implementation of Basel lll (the voluntary regulatory standard on bank capital adequacy, stress testing and market liquidity risk). Beyond the Third Basel Accord there is further regulatory concentration to strengthen capital levels in the banking sector. This has indeed become a very hot topic with comments that banking has become a world of higher capital requirements and lower returns.

In short the common held view that some banks continue to remain undercapitalised manifests itself in to a distinct opposition to risk unless balanced. This reduces of course the availability of credit in key sectors, namely development finance that is recognised to have a greater underlying risk and hence requiring greater capital reserves to offset this perceived risk.

When presenting a real estate proposition for credit approval, very careful analysis must be undertaken to pre-empt the credit process, clearly highlighting the risk mitigates to optimise success. There has been a seismic shift in the length of time to complete transactions, where a high level of perseverance, tenacity and understanding of the credit process needs to be employed. The requirements of the borrower coupled with the nuances of each lending institution vary greatly and a guiding hand is needed throughout the process.

Recently we have experienced a number of clients who as a direct consequence of the credit crisis moved to alternative lending institutions as their original lenders become redundant or imposed restrictions that were untenable. The switch in lender although costly was at the time a necessary process to provide some degree of certainty to initiate a new lending and private banking relationship that offered the opportunity of being progressive in a market environment that had changed unrecognisably. However a year or so later the realisation of ambiguously worded terms and conditions or indeed an annual review that in fact was found to be tantamount to an annual renewal, shone a different light on circumstances and forced clients to seek professional guidance.

In our effective capacity as a steering committee we wade through these finite terms and conditions and guide our clients with the benefit of a broad market knowledge. We identify the right institution, negotiate the actual terms and present a proposal that is not simply based upon an attractive margin with hidden pitfalls. The bottom line is that the remedies of a year or so ago are no longer viable.

Meanwhile within the development sector speculators still arrive at our doorstep expecting that we can provide a defined matrix of lending but if only that were the case. We are all for a one-cap-fits-all environment but in Prime Central London (PCL) this is certainly not the case. Location, track record, financial substance and in some cases identifying to the lender that there is the prospect of a wider business proposition, still remain the absolute precursor to begin the process of unlocking credit.

To ensure expectations are not ill served, it is important to acknowledge that it remains a lender's market in certain sectors.

In finishing on a positive note and highlighting the continued interest from investors focusing on real assets, one of our high profile clients, a Prime Central London residential investor, sold part of his portfolio after 8 years and witnessed a return on capital of 230%. Their loan(s) engineered the returns which were compounded by the surplus rental income.

Where else is there a market that has provided this level of consistency? Emerging markets?

Best Regards,

Wayne Coleman