

RICS Global Distressed Property Monitor

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North American agents report sharpest rise in distressed properties

- **Over 75% of all 27 countries surveyed see rise in distressed properties compared to three months earlier**
- **Investor interest grows in distressed properties globally with biggest pick up in Italy and UK**
- **Speed of bank foreclosures remains moderate with less than 2 in 10 respondents on average reporting a pick up**

Two years into the credit crunch, RICS have carried out a global survey of agents on the emergence of distressed properties in the commercial property marketplace.

RICS members and other real estate executives were asked to comment on the volume of distressed* commercial properties which have come to the market over the last three months compared to three months earlier.

Respondents were also asked to comment on the speed at which they thought banks are foreclosing and the general level of interest which specialist funds are showing in purchasing foreclosed commercial property assets.

Such foreclosures may arise when loan agreements have gone sour; either through breach of loan covenants or failure to meet interest payments on the part of landlords.

Landlord income streams may come under pressure as a result of rising tenant defaults on rents following corporate bankruptcies and falling income streams once rent reviews are carried out.

Of the 27 countries surveyed, more than 75% of respondents reported a rise in the number of commercial properties which are coming to market under distressed conditions in the second quarter of 2009 compared to three months earlier.

For Q2 2009, the biggest pick up in distressed properties coming to market has been reported in South Africa, closely followed by the US. New Zealand, Malaysia and Hungary were next in line, with The Caribbean, Ireland, Spain, Russia and Ukraine making up the top ten.

At the bottom end of the scale China and Brazil reported a decline in the number of distressed properties coming to market compared to three months earlier. Germany, Czech Republic, Hong Kong, Japan, Italy and Switzerland all reported little change in distressed properties coming to market from three months earlier.

- *A distressed property is defined as a property that is under a foreclosure order or is advertised for sale by its mortgagee. Distressed property usually fetches a price that is below its market value.*



The UK offers an example of where the linkages between banking health and distress in the property market can be analysed. Bank of England data to June 2009 shows that lending outstanding on commercial property has more than doubled to £253 billion in the 4 years to June 2009 and now makes up approximately 12% of all lending in the UK, which represents a 20 year high.

A recent report from De Montfort University* shows that the number of loans in default in the UK have risen sharply to 3200 in 2008 from 400 in 2007. However, the report also suggests that lenders are currently prepared to renegotiate and extend terms as to avoid exacerbating the current pricing downturn.

Indeed, by refraining from foreclosing on properties, a lower number of distressed sales coming to market should add some support to property pricing at the macro level

At a time when many global banks are so heavily exposed to commercial property loans, they may not want to bring additional properties onto their books and sell into a depressed market, crystallising losses at a time when sales prices are down over 50% from their peak in some sectors.

Encouragingly, respondents suggest that as yet, banks are not being overly hasty on foreclosing on properties in breach of loan agreements with less than 2 in 10 surveyors on average reporting an increase in the speed of foreclosure globally compared to three months ago.

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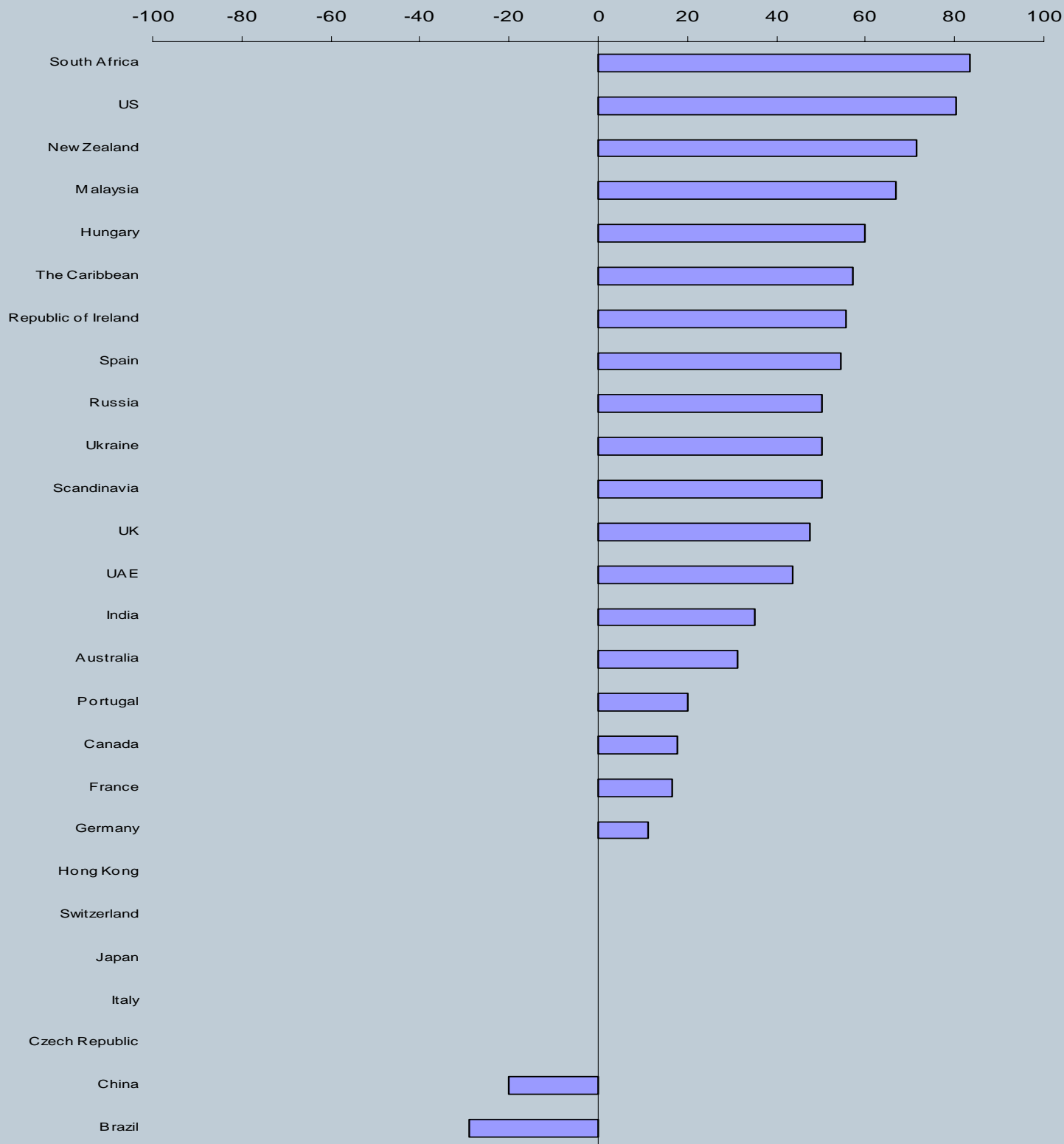
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Country statistics - for Q2 2009

Agents reporting a rise in distressed properties in Q2 ranked by net balance scores



How banks deal with problem property loans will be pivotal....

Whilst lenders in the UK may be currently prepared to work with existing borrowers on extension where loan to values may be breached, a recent IPF paper* concludes that defaults are being called on loans with income issues in the UK.

Problems in meeting income cover tests are likely to rise globally into 2010 as rental declines continue across most markets. Indeed, the latest Global Commercial property survey from RICS reports that rents are expected to decline in over 90% of countries surveyed in Q3.

The situation may also be less sanguine in markets where cross border banks dominated property market lending in recent years. In such markets the motivations of lenders to foreclose may be greater.

Here, currency and political risks could materially impact the ability of a bank to realise the original value advanced. In such cases motives to foreclose on properties early and bring them back onto a bank's books may be more pressing in order to head off future losses.

Real Capital Analytics reports that the sharpest rise in distressed properties during the first half of 2009 has been in Eastern Europe. This region has seen a more than nine fold increase since the turn of the year. Significantly, this was also a region where lending in the economy was dominated by non domestic banks in recent years. With these issues in mind, the speed at which lenders are starting to foreclose should act as a lead indicator on the level of distressed properties hitting the market in the coming months.

As such, RICS surveyed member firms and agents to comment on the speed at which they thought banks are foreclosing on commercial property deals compared to three months earlier. Interestingly, around 50% of respondents are reporting that the speed at which banks are foreclosing has either stayed the same or fallen over the last three months.

Furthermore, even in the countries where the net balance was positive the median net balance of this indicator remains mild at +17, indicating that for every 10 professionals responding, less than 2 have reported a rise in distressed sales compared to three months earlier. This suggests that as yet, agents feel that lenders have not been overly hasty to foreclose on commercial properties, offering some support to the conclusions of the De Montfort study at the turn of the year.

With RICS members working on both sides to any distressed property transaction, a further question was asked on the level of interest from specialist funds in distressed properties and whether this had increased in the last three months.

Unsurprisingly, the majority of agents are reporting a rise in specialist funds expressing interest in distressed commercial properties. Those markets at the forefront include Italy and the UK, with Germany, US, Hungary, Spain and Ireland closely behind.

One obvious reason for current interest must undoubtedly be the scale of property price declines which have occurred in some of these markets since the onset of the credit crunch drawing bargain hunters in.

Furthermore property yields compared to other asset classes are starting to offer value in some markets when compared to historical averages which may start to attract the interest of long term equity players such as life and pension funds.

Other factors enticing investment interest could also include currency plays and the renewed inflows from retail investors into global property funds in recent quarters.

Whilst it is clear that distressed properties are expected to increase in the coming years, it will be the banks which will dictate the speed and scale of future developments. The extent at which increasing distress weighs down on all commercial property values will have further implications at a macro level for the asset base of local banking systems.

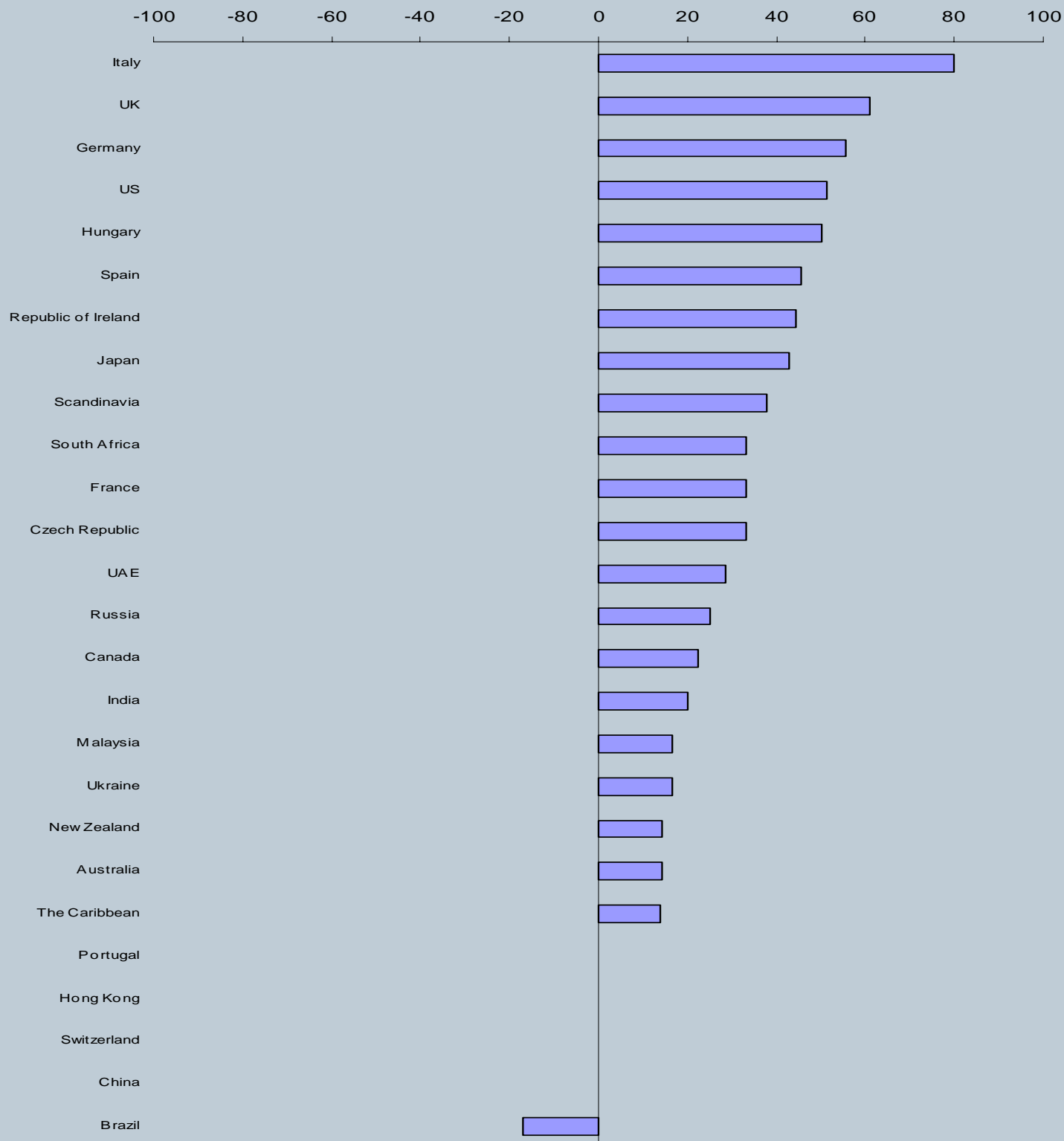
* De Montfort University—*UK Commercial property lending Report year end 2008 (May 2009)*

* IPF short paper series— *UK real estate debt: A problem for the borrowers and the Banks (July 2009)*

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Country statistics - for Q2 2009

Level of interest from specialist funds in Q2 ranked by net balance scores



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Survey Methodology

RICS Global Commercial Property Survey

RICS' Global Commercial Property Survey is a quarterly guide to the developing trends in the commercial property investment and occupier market. This edition details market conditions for the second quarter of 2009 based on information collected from leading international real estate organisations and local firms.

Methodology

Survey questionnaires were sent to real estate organisations in June 2009, with responses received up until the 20th of July 2009. Respondents were asked to compare conditions over the latest three months with the previous three months. A total of 419 responses were received.

Responses have been amalgamated across the three real estate sub-sectors of offices, retail and industrial property at a city level, to form diffusion indices for the commercial market as a whole. The eight world regional groupings have been derived through the weighting of city level diffusion data using city population and country gross domestic product statistics.

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Taking part in the RICS Global Property Survey

If you wish to participate in the quarterly survey, please email jguilfoyle@rics.org to register your details. Please provide your name, company details and the location(s) you wish to cover within the email or register online at www.rics.org/globalproperty

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RICS Global Commercial Property Survey

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The Quarterly Global Commercial Property Survey is available from the RICS web site - www.rics.org, along with other quarterly surveys covering the housing market, residential lettings, commercial property, construction activity, the farmland market and arts and antiques.

This publication has been produced by RICS Economics. For economic and statistical enquiries regarding this publication, please contact.

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www.rics.org/GPScomments2009q2

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