

Knight Frank Debt Dashboard Q1 2024

Market Outlook



2023 was an interesting year, a year where debt forced its way to the forefront of every property agent's mind. Investors buy real estate for a range of different reasons - but what last year taught us is that ultimately if the numbers don't stack up, the acquisition won't happen. So, what now? Here is a selection of key themes that we are expecting to see play out in the first half of 2024.

Interest Rates are unsurprisingly at the top of the list given the impact they had on the investment market last year. Given the downward inflationary trend, we know that rates will come down this year, the only real question is when. It's always tricky to predict the movement of interest rates, this was highlighted when I looked back at market expectations for rates this time last year, at which time SONIA was expected to peak at 6.40% in April 2024. Thankfully, that prediction didn't materialise. Our view now is that the first rate cut of 25bps will be in the first half of 2024, perhaps in late Springtime and with the market currently forecasting SONIA to drop below 4.00% by the end of 2024, we are already seeing a range of transactions benefiting from reduced hedging costs in the medium term.



It will be interesting to see how the downward trajectory of interest rates plays out with non-bank lenders who have until now, been able to meet their return hurdles due (in part) to higher underlying rates. We expect to see **SONIA floors** built into loan terms for as long as borrowers are accepting of this position. The interplay between bank and non-bank lenders will be interesting to watch, as banks continue to take a conservative view on new funding opportunities this should arguably allow **non-bank lenders to continue to command higher pricing**.

Towards the end of last year, we began to see **debt-driven sales activity**. Lenders who had previously shown forbearance with borrowers, began to take a firmer stance.

The expectation in 2024 is that there will be an increase in the number of refinancings, as the extensions provided by lenders last year, begin to roll off. **Lower swap rates will take the pressure off to some extent**, in particular when examining ICR covenants which have so often been the restricting factor for leverage in recent months.

Lender appetite will be skewed towards defensive sectors, with Living assets garnering the most attention. There was much talk of the office sector in 2023, and whilst appetite to debt finance offices has certainly moderated, terms are still available albeit with a focus on **flight to quality** and with values at rebased levels.

Overall, whilst we believe that 2024 won't necessarily be plain sailing, we have started the year with a degree of optimism. The **market is showing more stability**, inflation data is trending downwards, and rates are set to follow. This should allow for borrowers and lenders to have **greater conviction in underwrites** which should ultimately, lead to increase levels of activity.

Lisa Attenborough

Head of Knight Frank Capital Advisory

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Debt Market Overview



Capital Sources

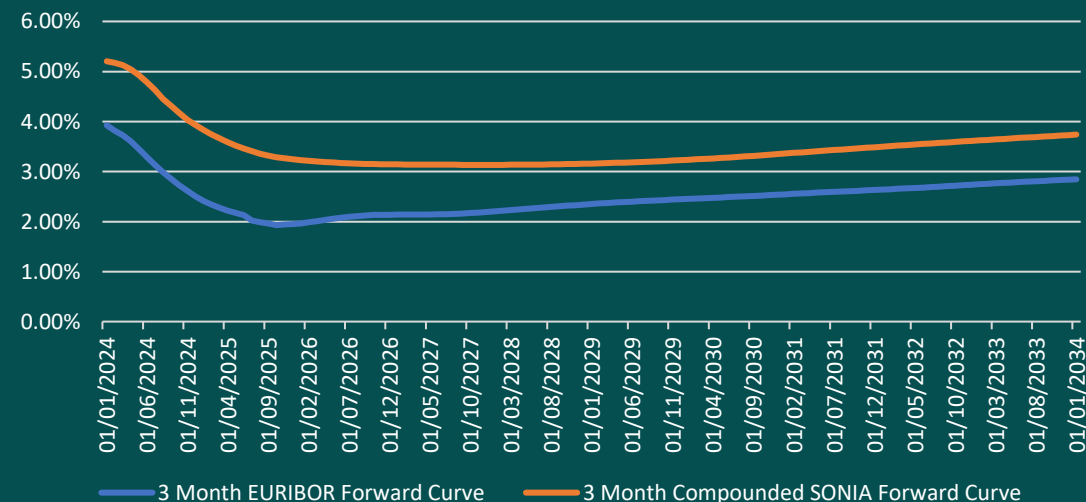
- The influx of **new entrants** into the debt market continues as equity investors continue to seek to diversify down the capital stack into lending, on both a **tactical** and **strategic** basis.
- The lower end of the market (<£100m) is becoming a crowded trade, delivering deep **liquidity** for borrowers, whilst the larger end also remains **well capitalised** with non-bank lenders increasingly able to support **significant underwrites** previously reserved for the banking community.
- There continues to be a **deepening bifurcation** in appetite for every sector with **pricing and leverage accommodating a wide range of scenarios** from best in class to value-add plays.
- Overall, we expect liquidity in the debt market to continue to remain robust and for competition to continue to support competitive **pricing and leverage**.
- **Specialist players** are coming to the fore for new sub-sectors providing increased liquidity to support equity investment into niche sub-sectors.



Credit Conditions & Lender Types

- The **forward curve** has moved meaningfully **downwards** since the last quarter of 2023, with SONIA swap rates now coming in **c.110bps lower** than where they were in October. This, combined with 5yr UK inflation CAGRs still at **3.8%** provides support for **increased equity underwriting conviction**.
- Whilst regulatory cost of capital continues to put **pressure on bank balance sheet capacity**, appetite remains for large underwrites particularly with associated public markets issuances
- Alternative lenders remain comfortable supporting slim even **sub-1.0x coverage metrics** with the requisite structural protections. LTVs have always been a secondary metric for lenders, **debt yields and interest cover ratios** are becoming even more important.
- Non-bank lenders are diversified in their returns requirements providing a **deep bench of borrower options** ranging from **competitive bank-style margins** for those supported by insurance capital, to **higher returns offerings** for those seeing **additional leverage**.

SONIA & EURIBOR Forward Curve
(3-month Compounded SONIA & 3-month EURIBOR)



Source: Chatham Financial (08/01/2024)

SONIA Forward Curve:

- Peak: 5.21% January 2024
Last month: 5.23% December 2023
- Trough: 3.13% November 2027
Last month: 3.54% March 2028

EURIBOR Forward Curve:

- Peak: 3.93% January 2024
Last month: 3.96% December 2023
- Trough: 1.93% October 2025
Last month: 2.24% September 2025

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Indicators



Sector Margins

The table below sets out our current view on margins for investment finance, covering a range of sectors and based on terms obtained during the month prior.

Sector	January 24		December 23	November 23	Q1 23
Residential					
BTR	1.75% - 2.05%	●	1.75% - 2.05%	1.75% - 2.05%	1.75% - 2.05%
PBSA	2.00% - 2.40%	●	2.00% - 2.40%	2.00% - 2.40%	2.20% - 2.60%
Office					
City Office	2.05% - 2.35%	●	2.05% - 2.35%	2.05% - 2.35%	1.80% - 2.10%
West End Office	1.80% - 2.10%	●	1.80% - 2.10%	1.80% - 2.10%	1.70% - 2.00%
Regional Office	2.70% - 3.00%	●	2.70% - 3.00%	2.70% - 3.00%	2.20% - 2.50%
Retail					
Retail Park	3.60% - 3.90%	●	3.60% - 3.90%	3.60% - 3.90%	3.65% - 3.95%
Retail Food Store*	2.25% - 2.55%	●	2.25% - 2.55%	2.25% - 2.55%	2.15% - 2.45%
Retail Shopping Centre	4.65% - 5.05%	●	4.65% - 5.05%	4.65% - 5.05%	4.85% - 5.15%
Other					
Logistics	1.75% - 2.05%	●	1.75% - 2.05%	1.75% - 2.05%	1.80% - 2.10%

Please note the margins provided above are for indicative purposes only, and assume a £50m+ debt ticket at 55% LTV on a 5-year, interest-only basis for a core, stabilised asset in the UK with a strong sponsor and income profile. Pricing also assumes a best-in-class asset with strong ESG credentials. Margin ranges are based upon terms obtained by Knight Frank Capital Advisory during the month prior. * 15 year income assumed

Reference Rates

Swap Rates	Latest		1 Week Ago	3 Months Ago	12 Months Ago
3 Year SONIA (%)	3.90	▲	3.69	4.93	4.13
5 Year SONIA (%)	3.62	▲	3.38	4.66	3.86
3 Year EURIBOR (%)	2.69	▲	2.55	3.55	3.08
5 Year EURIBOR (%)	2.54	▲	2.43	3.40	2.90

UK Gilts	Latest		1 Week Ago	3 Months Ago	12 Months Ago
5 Year Yield	3.55	▲	3.36	4.41	3.49
7 Year Yield	3.61	▲	3.39	4.41	3.47
10 Year Yield	3.83	▲	3.60	4.57	3.54

German Bunds	Latest		1 Week Ago	3 Months Ago	12 Months Ago
5 Year Yield	2.07	▲	1.93	2.77	2.34
7 Year Yield	2.05	▲	1.93	2.80	2.28
10 Year Yield	2.13	▲	2.02	2.89	2.30

US Treasury Bonds	Latest		1 Week Ago	3 Months Ago	12 Months Ago
5 Year Yield	4.02	▲	3.84	4.68	3.90
7 Year Yield	4.04	▲	3.88	4.73	3.82
10 Year Yield	4.05	▲	3.88	4.72	3.71

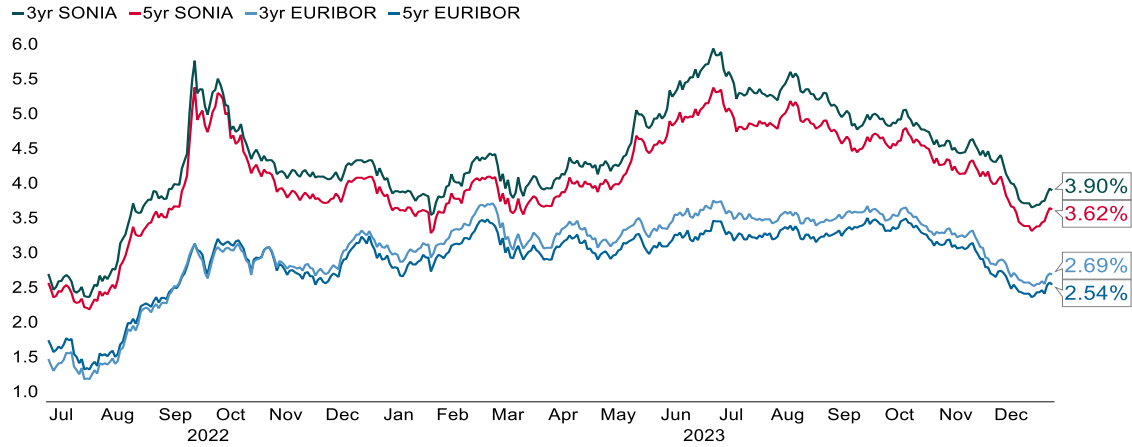
Base Rates	Current		Next Decision	Previous	Date of Change
UK	5.25%	●	01/02/2024	5.25%	14/12/2023
Eurozone	4.50%	●	25/01/2024	4.50%	14/12/2023
US	5.50%	●	31/01/2024	5.50%	13/12/2023

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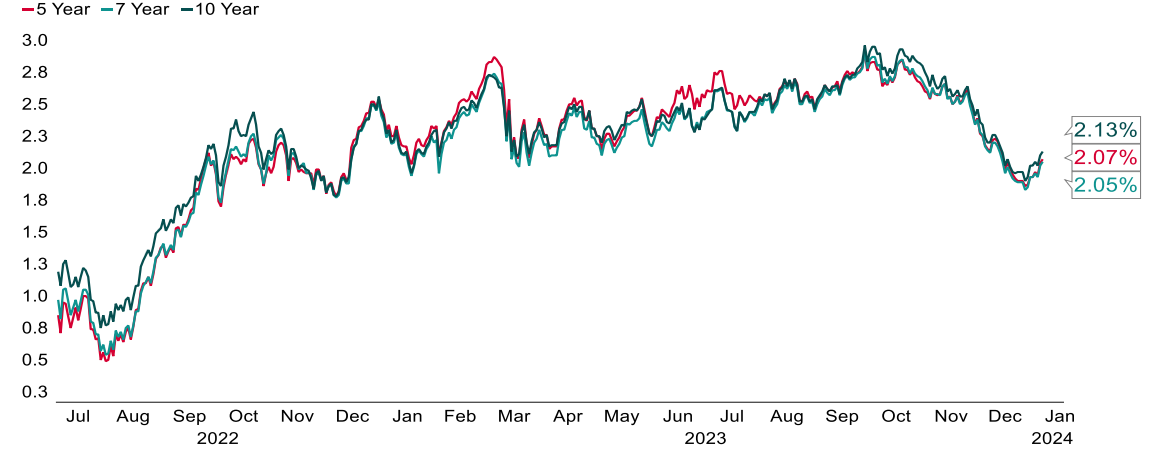
Historic Charts



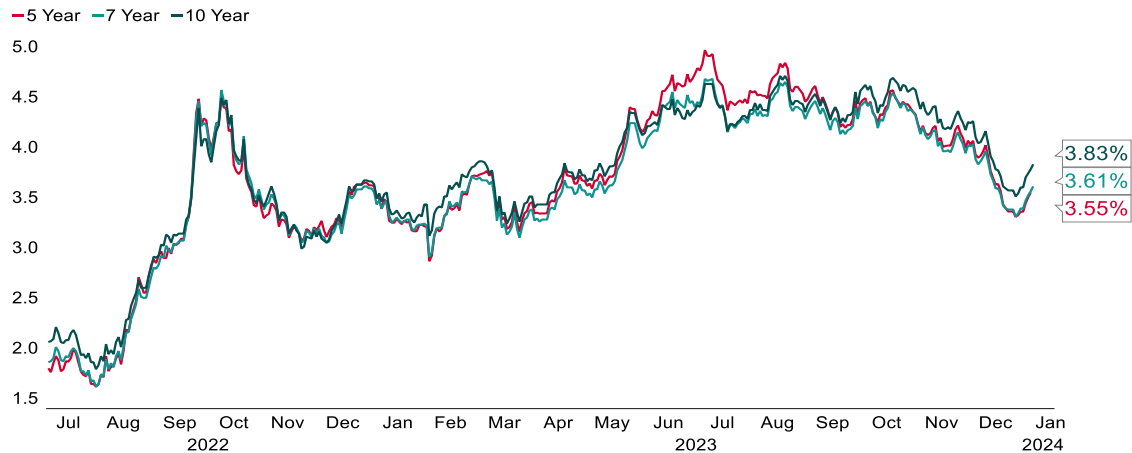
SONIA/EURIBOR Swap Rates (3/5 Year)



German Bund Yields (5/7/10 Year)



UK Gilt Yields (5/7/10 Year)



US Treasury Yields (5/7/10 Year)



Source: Macrobond, ICAP (08/01/2024)



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