Urban Exposure PLC: Written Statement

Respondent Number: 2806

Ref: Policy H2 Small sites (M20)

Urban Exposure is a leading development finance provider with expertise in, and a commitment to, funding public land developments including residential, mixed use, student, retirement and build-to-rent/PRS schemes.

We would like to see greater recognition in the Draft New London Plan of how private finance, including non-bank sources of finance, can help fill the significant funding gap which will exist in London if housing targets within the Draft Plan are to be met, particularly for smaller developers.

Bridging the housing finance gap in London

Our research indicates there will be a funding gap of £33bn for developments in London over the next five years, if housing completions of 65,000 per annum are expected to be met.[1]

This has been accentuated by a reduction in lending from high street banks, which have operated in a tighter regulatory regime since the financial crisis. Specific regulations which have affected bank lending include:

- **CET1 capital requirements**. Development finance loans are 150% risk-weighted regardless of the borrower's sophistication, asset quality and de-risking factors such as pre-sales. This has significantly reduced risk appetite for this asset class, relative to other forms of lending.

- **Senior Persons Regime**. This regime imposes severe penalties on the Board of a bank if it does not demonstrate proper management of its loan book, which makes complex lending such as development finance more unattractive to banks without an established record in this asset class.

- **Conduct requirements**. New FCA and PRA conduct requirements call on banks to demonstrate deep and detailed procedures relating to the origination and project monitoring of property development finance loans. Some banks are not set up to manage the monitoring of these loans to the extent required by their regulators.

In spite of a recent uptick in lending, research indicates that debt outstanding and secured by residential development projects for sale has steadily declined by approximately 46% from a peak of £23.9bn (2008) to approx. £13bn (2016).

Impact on smaller developers

Smaller developers have been significantly more exposed than larger developers to the impact of this diminution in bank funding.

[1] De Montfort University, *The UK Commercial Property Lending Market*, Research Findings, 2015

A survey last year found that 54% of SME developers have identified a lack of finance as a barrier to increasing output, with 45% reporting that there are sites they are interested in but unable to develop for financial reasons. This was a significant increase on 2016, where 35% experienced this problem.

This also comes at the end of a long period of market consolidation in recent decades, which has seen the proportion of new homes built across the UK by smaller developers fall to just 12% in 2017 compared to 40% in 1988.

This is a problem for development in London, which has a range of small sites which requires a diverse market of developers of different scales and capabilities to deliver new homes quickly and on time. This has been identified by Policy H2 of the Draft Plan, which calls for boroughs to create new targets for completions on small sites and the introduction of a presumption in favour of certain types of housing development on these sites.

These are commendable policy asks, which Urban Exposure welcomes, but they are unachievable without addressing how the capital for these developments can be procured.

Non-bank finance as a solution

Examples of non-bank providers of finance include debt funds, peer-to-peer lenders and other specialist lending institutions offering a range of specialist financial products. Urban Exposure provides market-leading Senior and Stretch Senior Debt, Mezzanine Finance and Bridge Finance to residential developers.

These forms of investment have been growing since the financial crisis, when traditional sources of finance significantly diluted their exposure to this sector. It is estimated that 16% of all new lending in the UK real estate market in the first half of 2017 came from non-bank lenders.[2]

These non-bank sources of finance can help reduce the finance gap in London's housing market by increasing the availability of funding to smaller developers and offering a wider range of criteria, pricing, product and risk appetites.

Our asks

- The Mayor should work with central Government to develop a **guarantee for private development finance made available to smaller developers** building on sites which meet or exceed the Mayor's target for affordable housing provision. This would help smaller developers unlock additional, lower-cost, private sector finance.

- Following the announcement in the 2017 Autumn Budget of £8bn in new guarantees to support housebuilding, including SME builders, we would like to see the Mayor and the Government **develop a London-specific guarantee** which recognises the particular needs of London's housing market and helps deliver on the Mayor's housing targets.

- We would like to see the Mayor issue guidance stating that, for developments on public land, **the lender supporting the project can step in and complete the project** should delivery targets agreed in advance not be met by the original developer. These 'step-in' rights should be structured contractually such that they can be implemented with minimum time impact.

[2] De Montfort University, *Commercial Lending Report,* HY2017