

*BRITISH BROADCASTING CORPORATION*

*RADIO 4*

*TRANSCRIPT OF "FILE ON 4" "COMMERCIAL PROPERTY MARKET"*

*CURRENT AFFAIRS GROUP*

*TRANSMISSION: Tuesday 9<sup>th</sup> February 2010 2000 - 2040*

*REPEAT: Sunday 14<sup>th</sup> February 2010 1700 - 1740*

*REPORTER: Michael Robinson*

*PRODUCER: Ian Muir-Cochrane*

*EDITOR: David Ross*

*PROGRAMME NUMBER: 09VQ4569LH0*

THE ATTACHED TRANSCRIPT WAS TYPED FROM A RECORDING AND NOT COPIED FROM AN ORIGINAL SCRIPT. BECAUSE OF THE RISK OF MISHEARING AND THE DIFFICULTY IN SOME CASES OF IDENTIFYING INDIVIDUAL SPEAKERS, THE BBC CANNOT VOUCH FOR ITS COMPLETE ACCURACY.

“FILE ON 4”

Transmission: Tuesday 9<sup>th</sup> February 2010

Repeat: Sunday 14<sup>th</sup> February 2010

Producer: Ian Muir-Cochrane

Reporter: Michael Robinson

Editor: David Ross

---

ROBINSON: It's negative equity, but not as we know it. Britain's commercial property market is in deep trouble; after an unprecedented boom, prices have slumped.

When it was £17 million back in 2007, could you have bought it back then?

CONWAY: No, far too expensive for us.

ROBINSON: And what did you pay?

CONWAY: We paid £6.25 million for it.

ROBINSON: Wow, about a third?

CONWAY: Yes.

ROBINSON: That's bad news for the banks. As with residential mortgages, most commercial property loans are now far bigger than the bricks and mortar they're secured on. Shortfall is reckoned at a staggering £50 billion.

NEWSOM: The size of the problem is so gigantic, it's never been seen before to this order of magnitude.

ROBINSON: Tonight we investigate this new potential black hole and the effect it could have on us all, and we ask whether the banks are facing up to the consequences.

## SIGNATURE TUNE

### ACTUALITY AT SILVERBURN SHOPPING CENTRE

ROBINSON: This is the Silverburn Shopping Centre in South East Glasgow, and as shopping centres go, it's a class operation. Along its broad and well-lit snaking covered walkway, there are getting on for a hundred shops, most of them major national retail chains. Silverburn is easily the biggest and it's probably the best shopping centre in Scotland. But even that wasn't enough to shield it from the effects of crashing prices for commercial property. Over ten years in planning and construction and backed by finance from HBOS, Silverburn opened in autumn 2007, just as the boom in commercial property was coming to an end. Ian Fraser, the former Financial Editor of the Glasgow Sunday Herald, joined me in a Silverburn café. He now writes and blogs on banking and commercial property lending in Scotland.

FRASER: The problem was that the original people who built this shopping centre borrowed approximately £300 million from HBOS. Unfortunately their timing was unlucky. When they opened it there was a property market crash, the commercial property market in the UK plummeted and it turned out that the asset was worth less than the loan.

ROBINSON: Negative equity?

FRASER: Yes, it was deemed to be worth less than the £300 million which the builders had borrowed to construct this place.

ROBINSON: So what did HBOS do about that?

FRASER: They put the company into administration and then they organised a sale of this shopping centre. They did extremely well in the end because they almost got their money back, because they had lent approximately £300 million and they sold it for about £297 million.

ROBINSON: That price was far better than first expected, as buyers around the world competed for this prime commercial property asset. So, though the developers of Silverburn lost their investment, the lender got back most of its money. But with commercial property, Ian Fraser says, Silverburn is likely to prove the exception.

FRASER: It's prime property, it's grade A space, it's the crème de la crème, it's very well located, very well built, it's got very good tenants who are locked in for twelve year periods – people like Marks and Spencer, Debenhams, Boots, you name it, they're in here. This is prime retail, it's grade A space. It would be wrong to assume this is typical property.

ROBINSON: Before 2007, across the country, the price of shopping centres soared as money was poured into commercial property.

#### ACTUALITY WITH DATABASE

WILLIAMS: What I've got here is a database which we keep of every shopping centre transaction that's occurred. It goes right back to 1990. Nearly two and a half pages. And that was the boom ....

ROBINSON: Mark Williams, of the consultancy DTZ, charts the buying and selling of shopping centres for BCSC, the shopping centre owners trade association.

WILLIAMS: From this, what you can see is how the boom built up. So here we have 2004, which at a quick reckoning probably thirty transactions ...

ROBINSON: Okay ...

WILLIAMS: And then, as we move on, we hit 2006 which goes on for nearly two and a half pages, and that was the boom, with about ninety-nine shopping centres trading.

ROBINSON: So thirty transactions in 2004, a hundred nearly in 2006.

WILLIAMS: Yes.

ROBINSON: Have you ever seen anything like that before?

WILLIAMS: No, that is the peak as long as we collectively keep records, which is as far back as you can go.

ROBINSON: And when you were keeping those records back in 2006, what did you think when you saw this?

WILLIAMS: We thought it was crazy and many of our clients took that advice to sell.

ROBINSON: Selling while prices were high was smart advice, because after 2007 the boom in commercial property turned to a bust and prices started falling.

#### ACTUALITY IN SHREWSBURY

ROBINSON: It's a Saturday morning, it's a fantastic bright sunny day and I'm here in Shrewsbury, not far from the Welsh border, where it's pretty chilly because the Welsh mountains in the distance are covered in snow. And I've come here because this is a town where the shopping centre has been put on the market. It's a complex, in fact, of three centres that runs from the centre of town up on the hill down the hillside to the banks of the River Severn. It last changed hands at the height of the commercial property boom in May 2006. The price - £118 million. The question is, what is it worth now?

## ACTUALITY OF KEY CUTTING

ROBINSON: Most shopkeepers I met were disappointed that the improvements they'd hoped for from the new buyer didn't materialise. In a recession, trade has been harder to come bar, and coffee bar owner, Munzir Karadaghi, says that makes it even tougher.

KARADAGHI: The last period has been very bad, no lighting, no new decoration, nothing, it's all the same. For example, if you see all the paint for the shopping centre, it hasn't been painted maybe in the last ten years. But look in here, for example.

ROBINSON: This is the corridor, this is where the customers come?

KARADAGHI: Yes, when the customers come, look at the carpet ...

ROBINSON: Yes, it's full of chewing gum.

KARADAGHI: Yes, okay, look at the ceiling ...

ROBINSON: Yes, it's all starting to fall to pieces. It's one of those, the ceiling with sort of slats, it's kind of metal slats and some of them are missing and you can look through and see the wires.

## ACTUALITY IN TEASHOP

ROBINSON: Hello, could I have a tea please?

WOMAN: £1.30 love.

ROBINSON: The teashop here at the bottom of the escalator is doing reasonable business, but all around it the picture is not good. At one side of the escalator there's a large unit now empty. Still up at the window – 25% off everything, but the shop's got nothing in it now. On the other side a completely empty unit, and next door to that, Gamezone, offering new and used computer games, well they've moved on too. And



LAMB: We're on the Vaughan Trading Estate, which is Tipton in the West Midlands, which is a mixed industrial and commercial part of the West Midlands. Traditionally more based on manufacturing with an amount of warehousing as well.

ROBINSON: It's seriously big. I mean, you really need your car to get around.

LAMB: You do. It's a big site, some big buildings varying from some very old style buildings to some more modern buildings, which were built in the last ten years.

ROBINSON: Right. Well, let's find a good place to pull up where we can see things and tell me the story.

LAMB: Okay, we'll just pull up just up here.

#### ACTUALITY OF CAR DOORS CLOSING

ROBINSON: Property consultant Andy Lamb knows the Vaughan Trading Estate well. Back in 1982 it was sold for just £2.5 million but then came the commercial property boom and a new buyer in the shape of a Scottish-based property company, the Kenmore Group, backed with finance from a Scottish-based bank, HBOS.

LAMB: It was bought in 2007 by Kenmore Group. They paid the price of £36 million which obviously, when you think it was sold in 1982 for £2.5 million, represents quite a good increase in value.

ROBINSON: £36 million? Eighteen times as much?

LAMB: Indeed, in 2007.

ROBINSON: What did you think of the price Kenmore paid?

LAMB: Yeah, I thought it was absolutely insane, to be quite frank. I came round with a client and we walked the estate. He phoned me up, would I advise them on what they thought of the estate, and at the time big estates with big numbers were attracting even crazier prices, because it was a bit of a feeding frenzy really. It was quite scary, I didn't really understand it, that's the truth, why people were paying what they were. I looked at this estate, I walked round with a client and I talked myself out of a very big fee by telling them that they must be crazy to buy the site. And consequently they didn't buy it, which obviously I'm rather glad they didn't.

ROBINSON: And you lost your fee.

LAMB: And I lost my fee but, you know, there you go, hopefully they'll trust my judgement in the future.

ROBINSON: A key reason Andy Lamb advised his client against buying the estate was its condition. He says much of it is little changed since it served as a UK headquarters of a giant American chemical company in the 1980s.

LAMB: This building we're now looking at was the headquarters of DuPont.

ROBINSON: Head Office Reception, this says.

LAMB: Yes, this was many moons ago.

ROBINSON: It doesn't look like anyone's been through that door in a while.

LAMB: No, there about 110,000 square feet of vacant space on our left hand side as we drive along here, and as you can see it's very old accommodation, and it's not the kind of accommodation that companies currently want, and I know that this building has been empty for very very many years.

ROBINSON: You've got thirty-nine, forty loading bays. I mean, does anybody want loading bays now?

LAMB: Yes they do, but these aren't proper, modern tailgate loading or unloading facilities and, as you can see, you can get in them anyway because they've put car parking in front of them all.

ROBINSON: The key factor determining the price of any commercial property is the amount of rent it can generate from its tenants. The more attractive and modern an estate, the higher the rents it's likely to produce.

LAMB: When Kenmore bought it, they were promising to undertake refurbishment work, to add value by making it better, and for whatever reason, probably because the market fell off a cliff, they were unable and decided not to spend any more money on the site.

ROBINSON: If you had this now and I came to you and said, 'I've got this, please sell it,' what could you do for me?

LAMB: I'd have to sit down and obviously look at the tenant profile and see which tenants want to stay long term and have a master plan really for the whole estate and really how you're going to turn it around, how you're going to add value, and rents across the Midlands anyway have slipped. A lot of companies know and are educated enough to know that there are some great deals out there, and we try very hard to maintain rents where we can, but some clients are more desperate than others and will do deals accordingly.

ROBINSON: How much have rents fallen since the boom? For a place, for this kind of ...?

LAMB: Pretty much halved.

ROBINSON: And what does that mean for prices?

LAMB: It pretty much halves the price that you can achieve.

ROBINSON: Really? As simple as that – rents down, price down?

LAMB: It's a pretty simple equation. That's why I'm not a brain surgeon.

ROBINSON: A short drive away, near the centre of Birmingham, there's another large Kenmore investment. On the way to see it, property consultant John Griffiths took me past an example of prime Birmingham commercial property.

GRIFFITHS: Creeping into view very shortly is Number 1 Snow Hill, which is a fantastic new building developed by Ballymore. And hopefully if you look over to your left now you can just see it appearing, it's just between the two bricks ones ....

ROBINSON: Oh, the big glass affair?

GRIFFITHS: Absolutely. About quarter of a million square feet of fantastic office accommodation.

ROBINSON: Brand new?

GRIFFITHS: Brand new, yes, completed this year.

ROBINSON: Let?

GRIFFITHS: Nearly fully let. New headquarters for KPMG in the city and Barclays Bank also have a major presence in there.

ROBINSON: Like Silverburn in Glasgow, Number 1 Snow Hill has also recently been sold, at a better price than expected. But Kenmore's investment just across the road, a complex in an old tower block, hotel and abandoned low rise, is a very different story. It was also bought with financial backing from HBOS.

GRIFFITHS: There it is in front of us. We can see part of the site, which was the original development site that was bought, which was known always as The Strip. It's a derelict two-storey classic bit of 1960s architecture, and I'm sure at the sort of peak of the market the aspiration would have been to look at a wholesale redevelopment to create something more fitting for the 21<sup>st</sup> century and more in keeping with what occupiers want.

ROBINSON: Knock it all down and start again?

GRIFFITHS: That sort of thing.

ROBINSON: It may look a pretty sorry sight now, but John Griffiths says at the height of the commercial property boom it wasn't just Kenmore who were after it.

GRIFFITHS: I remember it very well. Plenty of people were chasing it. We may well have been involved with advising some of them ourselves. Clearly Kenmore were very very keen to secure the site and I think that they had been looking for a while for a major development opportunity within Birmingham, and at the end of the day they paid what they felt they had to at the time to secure it.

ROBINSON: What did Kenmore pay for it?

GRIFFITHS: Well, of course there's always a great deal of secrecy over what's paid for these buildings. The general speculation in the marketplace is that the price was in the order of around £21 million.

ROBINSON: £21 million?

GRIFFITHS: That sort of order, yes.

ROBINSON: Okay. And what would it fetch now?

GRIFFITHS: That would depend on what someone is prepared to pay for it. If we were in the position of looking at it on behalf of a potential buyer, we could certainly see the potential there at somewhere north of £10 million but probably not into the teens, not as much as £13 million.

ROBINSON: Half? Less than half?

GRIFFITHS: Yes, that sort of order.

ROBINSON: That's a huge difference in not a very long time. That's three years, half the money gone.

GRIFFITHS: It's a big difference, you know, I think at a point in time development was feasible on there. At a point in time in the future development will be feasible. Whether it will ever be feasible to the extent to justify the original price that was paid, that's a big subject for debate, clearly.

ROBINSON: It's now also a very practical question for Lloyds TSB, which took over HBOS and its loans in autumn 2008, because after the bust, Kenmore's investments were worth far less than the loans secured on them. Last month, Lloyds decided to put Kenmore into administration, along with a small group of other property companies in a similar situation. So what's Lloyds likely to get back on Kenmore's Birmingham investment?

GRIFFITHS: I think they've got a good chance of selling it on the basis that with property you've got underlying value in bricks and mortar. There are assets against the debt. Now the asset value at the moment may not cover the debt, almost certainly doesn't. However that's not to say it's a completely hopeless case and, you know, let's face it, there've been plenty of discussions around recovering 40p in the pound, 50p in the pound, 60p in the pound, whatever, against certain distressed assets.

ROBINSON: But the idea that Lloyds is going to get all the money it's lent on that back, what odds would you put on that?

GRIFFITHS: I'd put zero on that and I'm sure they're fully aware of that themselves.

ROBINSON: Almost half of all the loans which fed the British commercial property boom came from just two aggressive, fiercely competing Edinburgh-based banks – the Royal Bank of Scotland and HBOS, now merged with Lloyds. Under Chief Executive James Crosby and Head of Commercial Lending Peter Cummings, HBOS pioneered a new way of financing the group of property companies it backed, which included Kenmore. Instead of simply making loans to the companies, HBOS started setting up joint ventures, providing them with additional money on top of their loans in the form of equity capital. Before the boom, property companies could normally only borrow just 60-70% of the cost of a project, but at the height of the boom banks were typically lending 80-90%, and HBOS's equity capital investment was on top of that. According to Ian Fraser, this additional money gave a powerful boost to a company's buying power as a quote attributed to Kenmore's founder, John Kennedy, describes.

FRASER: John Kennedy told a newspaper that when Bank of Scotland started forming joint ventures – ie fifty-fifty companies which the bank owned half the equity and John Kennedy's Kenmore owned half the equity – it was suddenly as if he'd discovered the overdrive on a fifteen year old car, by which I think John meant that you're ambling along at 40 miles an hour down a country lane in an ancient old Bentley or something and suddenly you find there's an extra switch on the dashboard, the overdrive. You push that and you're like racing forward at 110 miles an hour. The equity was like the rocket fuel which was propelling the thing to achieve these immense speeds.

ROBINSON: Which way round is it? Is it the property people saying we'll do all this stuff or was it the bank lending the money?

FRASER: Well, it's a combination, you know, it takes two to tango. If somebody, who is a reasonably accomplished property developer, suddenly finds they can borrow vast amounts of money, they probably are inclined to invest in more risky developments than they might otherwise do, but I think the mere existence of this money probably did encourage some of the property entrepreneurs to grow faster than they would

FRASER cont: normally have wished. They probably all wanted to grow and so they probably really liked it at the time, but at the end of the day they tended to grow faster than they could really cope with in terms of controlling their own empires.

ROBINSON: As boom turned to bust, HBOS continued to support the joint ventures it had set up with the property companies it backed, while most other banks were pulling back from the sector. But it wasn't to last. In September 2008, following the collapse of Lehman Brothers, financial markets froze and a crippled HBOS had to be rescued by the merger with Lloyds TSB. In May 2009, Lloyds set out its own assessment of the quality of HBOS's corporate loan book, which included the bank's commercial property lending. Of the £116 billion of loans outstanding, Lloyds said £80 billion – almost 70% were 'outside Lloyds TSB's risk appetite'. In other words, Lloyds wouldn't be prepared to make such loans. Neither Sir James Crosby nor Peter Cummings would be interviewed for this programme, but in a statement Sir James told us:

READER IN STUDIO: The world economy has seen unprecedented turmoil, adversely impacting a great many financial institutions. Throughout my time as Chief Executive at Halifax and HBOS, I believe that I always acted in good faith and with due care.

ROBINSON: Last month, Lloyds put four of HBOS's commercial property clients, including Kenmore, into administration. But these casualties are the tip of an iceberg. Across Britain, many property companies with loans from a wide range of banks are struggling to stay afloat as the value of their investments fell below the amount they owed. Negative equity is now so prevalent that West Midlands based Andy Lamb says it's got its own new jargon.

LAMB: Have you heard of a thing called a Scooby loan?

ROBINSON: Scooby loan? No.

LAMB: There's quite a lot of smaller property companies that have borrowed extensively, they've borrowed to buy an estate. They then have it revalued, gear it up, take the equity out and go and buy another one, so you just keep on rolling the dice doing that. And then suddenly, when the music's stopped, they find themselves with a highly geared estate and ....

ROBINSON: Because they've borrowed more and more?

LAMB: Because they've kept borrowing. But then when the market takes a bit of a turn, all of a sudden you find yourself with a portfolio that's underwater, and that's called a Scooby loan.

ROBINSON: Why a Scooby loan?

LAMB: Actually what it means is a scuba diver – ie, he's under water but he's still breathing – just.

ROBINSON: And he's breathing because he can meet the interest payments.

LAMB: He can meet the interest payments. All other banking criteria shot to pieces.

ROBINSON: So there are more distressed companies out there with more troubled loans. At Savills, the well known property consultancy, the Head of UK Valuation, William Newsom, has been trying to estimate the size of the negative equity problem in British commercial property. He based his calculations on an authoritative survey from De Montford University, showing a fall in prices since the height of the boom of well over 40%.

NEWSOM: I took the values at the time of the relevant period 2003/4/5/6 and 7 and I went to the industry research on this by De Montford University, who stated what the loan to values were, so we know how much money was lent secured against

NEWSOM cont: properties at a given time at each annual date. I then indexed all the numbers back to current value. As a broad measure, certainly at the time when I calculated it, I did simple arithmetic and came to a figure of £38 billion on a loan book of just over £200 billion.

ROBINSON: It sounds a lot.

NEWSOM: It's enormous, but development properties have fallen in value very much more. I've known cases where values have fallen by anything up to 80% or 90%.

ROBINSON: And if you add that 80% to 90% fall on land values to what you've identified on investment property, what do you get then?

NEWSOM: Well there's inadequate data, so I've had to very broadly estimate it, so I've rounded up the £38 billion to £50 billion, but it could be more, significantly more.

ROBINSON: What's the significance of that? I mean, how bad is it?

NEWSOM: Oh, how bad is it? It's never been seen before to this order of magnitude. It's 25% of the entire loan book in round terms.

ROBINSON: Most loans carry conditions – so-called covenants – which allow banks to foreclose when a loan is in negative equity or can't be refinanced. But if banks exercise that right, they'd have to take the losses onto their own balance sheets. Which is why, William Newsom says, banks are doing all they can to keep distressed commercial property borrowers afloat. This tactic also has a jargon – Extend, Amend and Pretend. Or, more simply, 'Delay and Pray.'

NEWSOM: They have been renegotiating loan terms, they have been extending loan periods and hoping that if you extend it another two years, that at the end of the two years everything will be sorted out.

ROBINSON: And it might be?

NEWSOM: It might be, yes.

ROBINSON: But what's your view?

NEWSOM: For prime property I think there's a good chance of that. But prime is only a fraction of the market. There's a whole ramp of secondary and tertiary and worse and there's all the big losses in the developments.

ROBINSON: But do they not have to revalue these things? If I've got security against a loan and suddenly it's half its value or 10% of its value in the case of development land, shouldn't someone say, 'Well, we've got to put that in the books.'?

NEWSOM: There's no obligation on the banks at all other than perhaps pressure from their auditors. What the banks talk about is they don't want to crystallise the losses, meaning if they commission us to provide a formal certificate of value, it's declarable to their auditors and they have to take the write-off. So what they're doing is they're seeking from us informal opinions, market commentaries, that sort of thing.

ROBINSON: But don't put it down on paper?

NEWSOM: That's correct, yes.

ROBINSON: Because if you did?

NEWSOM: There would be pressure to make the write-offs. There are a lot of banks out there who, in my opinion, are burying their heads in the sand and not admitting to the extent of the problems that they have, for obvious reasons.

ROBINSON: Some banks, including Lloyds, have made provisions against potential losses in commercial property – what are called impairments. Lloyds told us that 'Where it's appropriate to do so, we naturally take impairments and these are accounted for as required.' And they add, 'This process is subject to extensive internal

ROBINSON cont: review and challenge by independent risk and finance professionals and is reviewed by external auditors.’ But Conor Downey, a lawyer specialising in banking and commercial property finance at the City firm Paul Hastings, says in practice most banks make impairments only when borrowers are already clearly in trouble, for example, when they fall well behind with interest payments. But even though the banks now face massive potential losses on companies now struggling to keep going with negative equity, he says for the most part no provision for such loans has been made.

DOWNEY: Even though it’s well known, anyone can figure this out from reading any newspaper or listening to the radio that commercial property values have fallen substantially across Europe, the banks have not recognised those losses and are continuing to treat those loans as performing assets worth the same amount that they were on the day that the loan was originally made.

ROBINSON: But how can that make any sense?

DOWNEY: Well the banks are clearly in a more precarious position at the present than they have been in the past and the banks have had to recapitalise themselves. If they recognise these losses, they are going to need even more capital than they already do.

ROBINSON: But the losses are there?

DOWNEY: Absolutely, the losses are there and they are creating a risk for the banks which the whole market is aware of, that they are contributing to uncertainty as to the long term viability of some of the institutions that we deal with every day.

ROBINSON: So how can we tell how healthy a bank is? How can we know what losses they potentially face?

DOWNEY: At the moment we can’t.

ROBINSON: What about auditors here? Don't they have an obligation to say, 'Hang on, that's wrong.'?

DOWNEY: The auditors would say that they are there to make sure that the accounts are prepared in accordance with the rules and it's not for them to say whether the rules are right or wrong.

ROBINSON: In a statement today, the British Bankers' Association, the industry trade body, told us:

READER IN STUDIO: UK banks are subject to one of the most open and robust accounting regimes in the world, and the full extent of their liabilities is open for everyone to see when they publish their accounts.

ROBINSON: Fear of property losses hitting their books gives banks an obvious incentive to go on supporting the companies they lent to in the boom. But Roger Bootle, the founder of Cambridge Economics and one of the few British economists to warn of the consequences of the property bubble, says that support comes at a cost, because when a bank uses resources to support a troubled property company, it has less for other potential borrowers, many also struggling with the effects of the recession.

BOOTLE: Well if you think the banks have got a fixed amount of lending that they can do, and the more they do to commercial property the less they can do for someone else, and that means that in keeping this huge stock of commercial property lending going, then they're effectively squeezing loans for businesses, individuals and so on.

ROBINSON: And is that a real connection? So a business really might not get a loan because it's being diverted to this commercial property?

BOOTLE: Well I think the position is actually more complicated than that, because this makes it sound as though the solution for businesses to get more loans is actually for banks to drop their commercial property lending, to foreclose on existing loans and then thereby releasing resources for ordinary business. I don't think it



DOWNEY: What we've seen is that in practice, when problems arise on these deals, there's less flexibility to deal with those problems than there would be with simpler forms of finance.

ROBINSON: Why? I mean, a bank can extend the term, the bank can roll over, why can't one of these loans, the same thing happen?

DOWNEY: Because when a bank makes a decision to extend and pretend, that's the bank acting for itself, it's taking the risk of rolling over or extending, which in a securitisation, when a problem comes up in a loan and say, for instance, it's necessary to consider extending that loan, the bank has no ongoing involvement, the bank that originally made the loan, the decision is being made by a trustee who is answerable to a group of somewhere between perhaps twenty or a hundred investors on one loan.

ROBINSON: Many securitised commercial loans issued in the boom are now also deeply into negative equity. Conor Downey predicts more forced sales as such loans mature over the next two years.

DOWNEY: It's going to be a big trend in the future. It's estimated that there are about 150 of these transactions across Europe and that about half of those are British transactions.

ROBINSON: Seventy-five?

DOWNEY: Seventy-five.

ROBINSON: And they're big?

DOWNEY: Yes, each one runs to hundreds of millions, in some cases billions.

ROBINSON: That's a lot of property ...

DOWNEY: Yes.

ROBINSON: ... locked in in this inflexible situation.

DOWNEY: That's correct, yes. It is estimated that UK securitisations probably accounted for somewhere between 15% and 25% of all property lending at the peak of market. So yes, all of those transactions will, in one way or another, need to be restructured, refinanced or end up with disposals. Inevitably in some instances there will be fire sales.

ROBINSON: And what's that going to do to the commercial property market?

DOWNEY: I think it has to have a negative effect. It has to decrease value. That volume of property coming to the market in a short period of time in a circumstance where there is limited investor demand and limited financing available has to decrease values.

ROBINSON: If more forced sales from securitised loans are added to the market, prices are likely to be depressed further. From a small amount of commercial property, from the few companies banks have put into administration, it's clear that prices are already well down on where they were.

## ACTUALITY ON LAND

CONWAY: Now our land comes across here, and that's our boundary up there, see where the bridge goes across that takes the railway? We will have a few buildings on the site, there'll be lorries parked here, there'll be loading bays and it'll look very clean and tidy.

ROBINSON: Civil engineer Michael Conway is a beneficiary. He's picked up seven acres of land near Heathrow Airport which he's going to use as a base for his operations inside the M25. It's yet another of the investments Kenmore made at the height of the boom, with backing from HBOS.

CONWAY: Kenmore, they paid about £17 million for it.

ROBINSON: £17 million?

CONWAY: Yes.

ROBINSON: It seems a lot of money for a bit of wasteland, what it looks like now.

CONWAY: Well, it's quite valuable land, I mean ...

ROBINSON: What are you going to do with it?

CONWAY: Well, we're going to use it as another depot. We dig out a lot of roads and footpaths, so we'll bring some of it back here and then we'll reuse the aggregate to make concrete.

ROBINSON: When it was £17 million back in 2007, could you have bought it back then?

CONWAY: No, we would have not even looked at it. Far too expensive for us.

ROBINSON: And what did you pay?

CONWAY: We paid £6.25 million for it.

ROBINSON: Wow, about a third.

CONWAY: Yes.

ROBINSON: Bad news for Kenmore, good news for you.

CONWAY: Yes, that's correct, yes.

ROBINSON: As real buyers like Michael Conway start to establish genuine prices for commercial property, Conor Downey says it's going to be harder for banks to continue extending and pretending that the security on their loans is better than it really is.

DOWNEY: As large volumes of transactions happen in the market and it becomes absolutely beyond doubt where value lies, that increases hugely the pressure on the banks to recognise the true value.

ROBINSON: And what will the effect be of that on the bank and its capacity to lend to business and the household sector?

DOWNEY: Potentially quite dramatic. The banks are required by Government to maintain certain amounts of cash and cash equivalents to protect them against the risk that a very large amount of their investments and their loans go bad. As their loans go bad, the amount of capital that they have available to them will decrease unless they can raise it again in the markets. So it will, in the long term, reduce the ability of banks to make loans at the same levels and in the same volumes as they have historically.

ROBINSON: So this is a sort of time bomb. Maybe that's overstating it, but it's a nasty in the works waiting to come out?

DOWNEY: It is, very much so, yes. I think the markets know that they're there, certainly everybody involved in banking knows that the problems are there, but the effect of these bad loans on the economy in a wider sense is yet to be seen.

ROBINSON: In return for taxpayers' massive support for the banks, across political parties politicians have been calling on them to increase lending to recession-hit businesses and households. But economist Roger Bootle believes the huge legacy of commercial property debt still in the system will continue to be a constraint, whoever wins the coming General Election.

BOOTLE: I suspect that if the Government wants to get the banks to lend more, it's got to do one or perhaps both of two things. First of all it may have to put more capital into the banks.

ROBINSON: More?

BOOTLE: More. And secondly, it's got to tell them what to do. If you just leave the banks alone and say, 'Right, look after your own interests, seek profit, we're just the majority shareholder picking up the tab, but do whatever you want to do and pay yourself a bonus,' then you won't get the result that it's in the public interest. The public interest is in the bank's lending, lending a lot more than they have been doing, but the Government has fought shy of actually telling them and making them lend.

ROBINSON: Even if the Government did tell them what to do, there are not many choices left, are there, here?

BOOTLE: I don't think there's any way that the Government can dig the banking sector out of the difficulties with regard to commercial property, whatever happens. There have been some duff loans, the banks are going to register some pretty nasty losses on commercial property, and that's not really a big surprise because it was massive boom/bubble. Someone's got to pick up the tab.

SIGNATURE TUNE