



December 2014

Share Price / NAV at 31 December 2014

Share price (p)	106.25
NAV (p)	100.08
Premium/ (discount)	6.2%
Issued shares	238,100,000
Market cap	£253.0m

Fund Information

Fund Type	Closed-ended investment company
Domicile	Guernsey
Inception Date	17 December 2012
Listing	LSE (Main Market)
LSE Identifier	SWEF
ISIN Code	GG00B79WC100
NAV Frequency	Monthly
Dividend Frequency	Quarterly
Origination Fee	0.75%
Management Fee	0.75%
Website	www.starwoodeuropefinance.com

Investment Restrictions & Guidelines

Location	UK & Continental Europe
Loan Term	Between 3 and 7 years
Loan Type	Senior, subordinated and mezzanine loans, bridge loans, selected loan on loan financing and other debt instruments
LTV	Absolute maximum of 85% with a blended portfolio LTV of no more than 75%
Real Estate Sector & Property Type	Commercial real estate sectors including office, retail, logistics, light industrial, hospitality, student accommodation, residential for sale and multi-family rented residential. Not more than 30% of NAV in residential for sale.
Counterparty & Property Diversification	Not more than 20% of NAV exposed to one Borrower legal entity and no single investment exceeding 20% of NAV at time of investment.

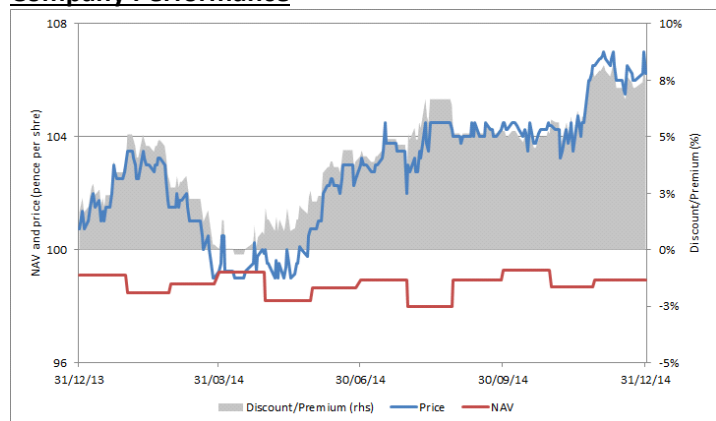
Starwood European Real Estate Finance Limited

Quarterly Investment Update

Summary

The investment objective of Starwood European Real Estate Finance Limited (the "Company") together with its subsidiaries Starfin Lux S.à.r.l, Starfin Public LP and Starfin Public GP (collectively the "Group"), is to provide shareholders with regular dividends and an attractive total return while limiting downside risk, through the origination, execution, acquisition and servicing of a diversified portfolio of real estate debt investments (including debt instruments) in the UK and Continental European markets.

Company Performance



Commentary

Investment portfolio

As at 31 December 2014 the Group had investments and commitments of £246.6 million (sterling equivalent at year end exchange rates) as follows:

	Balance as at 31 December 2014	Unfunded Commitments
Maybourne Hotel Group, London	£19.0 m	-
West End Development, London	£10.0 m	-
Lifecare Residences, London	£13.3 m	£1.2 m
Heron Tower, London	£14.9 m	-
Centre Point, London	£40.0 m	£5.0 m
FC200, London	£9.2 m	£4.3 m
5 Star Hotel, London	£6.9 m	-
Aldgate Tower, London	£37.8 m	£7.2 m
Total Sterling Loans	£151.1 m	£17.6 m
Retail Portfolio, Finland	€40.4 m	-
Industrial Portfolio, Netherlands	€20.0 m	-
Office, Netherlands	€14.2 m	-
W Hotel, Netherlands	€11.7 m	€13.3 m
Total Euro Loans	€86.2 m	€13.3 m

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Key Portfolio Statistics at 31 December 2014

Number of borrowers	12
Number of investments	12
Percentage of currently invested portfolio in floating rate loans ⁽¹⁾	42.1%
Invested Loan Portfolio annualised total return ⁽²⁾	9.6%
Weighted average portfolio LTV – to Group first £ ⁽³⁾	15.3%
Weighted average portfolio LTV – to Group last £ ⁽³⁾	62.5%
Average loan term	3.7 years
Percentage of NAV in cash	6.2%
Percentage of NAV invested in senior and whole loans ⁽¹⁾	61.8%
Percentage of NAV invested in second lien and mezzanine loans ⁽¹⁾	25.7%
Percentage of NAV invested in other debt instruments ⁽¹⁾	6.3%
Percentage currently invested in GBP ⁽¹⁾	67.7%
Percentage currently invested in Euro ⁽¹⁾	32.3%

(1) Calculated on loans currently drawn (as shown on page 1) using the exchange rates applicable when the loans were funded.

(2) Calculated on amounts currently outstanding, excluding undrawn commitments, and assuming all currently drawn loans are outstanding for the full contractual term. Six of the loans are floating rate (some with floors) and returns are based on an assumed profile for future LIBOR or EURIBOR but the actual rate received may be higher or lower. Calculated only on amounts funded to date and excluding committed amounts and cash uninvested. The calculation excludes the origination fee payable to the Investment Manager.

(3) LTV to Group last £ means the percentage which the total loan commitment less any amortisation received to date (when aggregated with any other indebtedness ranking alongside and/or senior to it) bears to the market value determined by the last formal lender valuation received by the date of publication of this factsheet. LTV to first Group £ means the starting point of the loan to value range of the loan commitments (when aggregated with any other indebtedness ranking senior to it). For Lifecare, W Hotel and Centre Point the calculation includes the total facility available and is calculated against the market value on completion of the project. For Aldgate, the calculation includes the current total facility drawn against the latest value in use.

Capital Management

The last quarter of 2014 saw the Company effectively mature through the implementation of a number of highly orchestrated actions.

Three actions were undertaken so that the Company could commit to two new loans amounting to £51.9 million and commit a further £5 million to the Centre Point financing, whilst also ensuring coverage of future commitments and minimising current and future potential cash drag.

Firstly the €35.9 million syndication of the Industrial Portfolio in the Netherlands was achieved in early December at slightly better terms than originally underwritten. The timing was deliberately set to match the likely new investment needs that occurred a few weeks later.

Secondly the directors carefully set portfolio diversification and loan exposure levels on larger new investments working closely with Starwood Property Trust (NYSE: STWD).

Thirdly the board felt it was now appropriate to introduce a liquidity facility given all available liquidity was broadly committed, with additional investment needs now crystallising. A facility was signed in December giving the Company enhanced flexibility. Further detail is set out below, but in summary the facility provides immediate coverage to existing unfunded commitments and, being multi-currency, helps mitigate FX risks on new non-sterling commitments (where a syndication is envisaged) and allows cash drag to be mitigated through the short term warehousing of new investments prior to refinancing with loan repayment receipts or additional equity.

As 2015 starts the Company is well positioned, with a diversified high quality loan portfolio where the last £ LTV averages 62.5 per cent, nearly 62 per cent of the loan book is in senior or whole loan positions and the invested annualised gross total return is 9.6 per cent. The primary focus is to continue to minimise cash drag risk whilst not looking to deviate from the current prudent approach to credit risk. The last two years have demonstrated the Company's careful approach to investing and this is expected to continue.

The board feels that some of the Company's investment policy should now be marginally revised as some of the initial constraints may be no longer appropriate, and occasionally over-restrictive, e.g. the cap on investments in the UK. Consequently the board is proposing an amendment of the Company's investment policy in order to allow the Company the flexibility to make investments in any state that is a member of the European Economic Area and to remove the limitation of 75 per cent on investments in the United Kingdom. The geographical change in no way suggests a change to the Company's core focus; it merely provides the flexibility for the Company to react to quality risk adjusted one-off opportunities. Prudence will apply, for example, it is almost inconceivable any investment would be made in Greece in the short to medium term if ever.

The Company intends to hold an EGM shortly to consider this proposal. The Company will also seek approval for an equity placement programme as a matter of good housekeeping to avoid the need for a further EGM. In line with strategy any equity raising



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will be highly focussed on mitigating cash drag risk and ideally matching deal pipeline.

New Investments

In the last quarter the Company financed two new investments and one top up of an existing position:

Centre Point, London: On 4 December 2014, the Company, along with other Starwood affiliated vehicles, reached an agreement to supplement its existing loan to Almacantar, a property investment and development company specialising in large-scale complex investments in London, for the comprehensive refurbishment of Centre Point, the iconic 34-story tower located at 103 New Oxford Street in Central London. The overall facility will increase by £45 million to £265 million, with the Company funding £5 million of the increase. This is expected to be drawn in early 2015.

5 Star Hotel, London: On 17 December 2014, the Company provided £6.9 million of a £14 million junior loan to refinance a 5 star hotel in central London. The loan's interest rate floats over LIBOR and has a term of 5 years. The Company expects to earn a return consistent with its target for junior loans.

Aldgate Tower, London: On 22 December 2014, the Company provided a £45 million participation in a £200 million facility for the refinancing of Aldgate Tower, a new Grade A office building located in the City of London. The facility will support the acquisition and stabilisation through the leasing of the property. The loan's interest rate is part fixed with part floating over 3 month LIBOR. The Company expects to earn an attractive risk adjusted return commensurate with its stated investment strategy.

Liquidity Facility

In December 2014, the Company entered into a £50,000,000 revolving credit facility (the "Facility") with a major UK clearing bank.

The Facility is intended for short-term liquidity and, under its investment policy, the Company is limited to borrowing an amount equivalent to a maximum of 20 per cent of its NAV, at the time of drawdown. In calculating the Company's borrowings for this purpose, any liabilities incurred under the Company's foreign exchange hedging arrangements shall be disregarded.

The interest rate payable will depend on how long a particular loan is outstanding: LIBOR plus 2.50 per cent per annum at initial draw down and increasing for loans outstanding for more than six months.

It is anticipated that amounts drawn under the Facility will be repaid using the proceeds of one or more issues of ordinary shares or by means of liquidity arising in the portfolio (including the proceeds of syndication of loans and the receipt of loan repayments and amortisation).

The undertakings and events of default are customary for a transaction of this nature.



Dividend and Future Policy

The Company declared a dividend of 1.25 pence per Ordinary Share for the first quarter of 2014, a dividend of 1.35 pence per Ordinary Share for the second quarter and a dividend of 1.5 pence per Ordinary Share for the third quarter, a total of 4.1 pence per Ordinary Share for the first nine months of 2014.

Reflecting the Company's desire for strong distribution of free cash, on 27 January 2015 it declared a dividend for the period from 1 October 2014 to 31 December 2014 of 1.7 pence per Ordinary Share (annualised 6.8 pence), representing a total dividend for 2014 of 5.8 pence per Ordinary Share.

The directors place primary importance now on maintaining a consistent dividend and ensuring, as much as possible, that cash drag does not materially impact this aim. Any future plans to raise additional equity will be considered against this objective and, as previously mentioned, it is intended that the liquidity facility will assist with this.

Given the Company's investment position and continued pipeline of investment opportunities, it is likely that the board will give consideration to the raising of additional equity in 2015. The investment environment for the Company has changed somewhat over the last two years and the Company has to date sourced attractive business consistent with risk/return metrics set out at IPO. Going forward, should any material equity issuance be envisaged, the Company will look to take account of shareholders' current views on the relative balance between risk, returns and scalability.

Market Commentary

All of the Company's previous factsheets have sought to highlight the market dichotomy between the return of tempered banking liquidity for real estate finance and the seemingly endless requirement for banks to adapt to meet new regulatory requirements and exit from distressed or non-core loans.

This very much continues with several new observations to be made. 2015 will unquestionably be yet another transitional and transformational year. The November 2014 AQR process may well have been somewhat massaged, but ECB oversight has encouraged further impaired loan pools to be marketed for sale with the Dutch, German, Portuguese and CEE markets adding to the current flow in the UK, Ireland, Spain and, recently, Italy. Further hits to banks' P&L will probably occur in a number of sale situations. At the same time there is increasing focus on the need to be Basel III compliant – the phasing in of the higher capital requirements starts this year, and recently greater focus has been given to the Liquidity Ratio which is mandatory by 2018. The Liquidity Ratio is a simple tool to track how leveraged a bank is. Normally a bank focusses perhaps more on Risk Weighted Assets (RWAs) rather than the face amounts of its assets. For perceived low risk assets RWAs are lower than face and vice versa. The impact of banks holding AAA rated sub-prime mortgage bonds in the crash was that expected low risk, low RWA assets were shown to be actually very high risk. To learn from this lesson, a new regulatory ratio was devised which is tier 1 capital divided by face value of assets – a very simplistic measure of bank leverage. Basel III imposes a 3 per cent minimum, the Fed has indicated this will be

6 per cent for globally systematic important banks (GSIBs) and the ECB and Bank of England are likely to follow suit. Such a target will be yet another headache for the banking community, especially in France and with a number of German institutions. The net impact remains likely to be at best continued anaemic lending growth if not outright decline. The impacts of the ECB's potential QE programme will be examined in the future but even the mooted €60 billion monthly QE for the next year and a half would only take the ECB's balance sheet back to 2012 levels. This and the ECB focus on sovereign debt purchasing is unlikely to act as a material catalyst to the European bond markets.

There are other reasons that the Investment Adviser has detected a slight softening to the current lending market, hopefully enlarging the opportunity set. There are suggestions that the syndication market is smaller than perhaps anticipated. This has dampened underwriting appetite, which is added to general caution with regards to the impact of the Greek and forthcoming Spanish elections. The Investment Adviser will balance the continued avenue for new business with the macro concerns in the market, not least Greece.

Most of the Eurozone countries are now running current account surpluses, with a major exception being France. The biggest change is the peripheral countries. One might think this is a good thing, but arguably it reflects those countries also not spending, a key growth driver. Without exchange rate tools, the Eurozone's peripheral countries have to deflate more than the core to improve competitiveness and inevitably this increases the real cost of debt. Negative scenarios do not simply impact the lending market but also the asset value side. One could foresee further value strengthening in London, being a perceived "safe haven", and value decline on the Continent. The Investment Adviser will be monitoring this all carefully.

A final area of risk focus is oil. Oil prices are down by over 50 per cent over the last six months, with Brent now under \$50 a barrel. It appears that OPEC members (in particular Saudi) are betting that US shale producers will reduce capital expenditure as a result. Given that US shale is on a quite short (12-18 month) capex/production cycle this is not a wild assumption. So it appears that US shale may in future take the role of the marginal producer from Saudi Arabia. This reorganization of the oil producers, coupled by constantly changing outlook for world economic growth (and therefore demand for oil) will lead to significant price movements in the short term. There should be follow on impacts to the European real estate market. Lower oil prices will boost GDP growth and create more consumption, which should boost retail spending and hence strength of and opportunity in the retail real estate sector. Deflation is the obvious fear and comparisons are made to Japan's lost decades. Note that Japan's GDP still grew in this period whereas such growth eludes the Eurozone today. One other impact is that oil rich Sovereign Wealth Funds are often large-scale buyers of real estate using surplus funds generated from oil revenues. Without such large surpluses (Saudi is running a deficit at the moment) their capacity for further acquisition may be tempered over the short to medium term. On a geographical note Aberdeen and maybe the rest of Scotland will be hit.



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