Starwood European Real Estate Finance Limited

Quarterly Investment Update

June 2014

Share Price / NAV at 30 June 2014

Share price (p)	103.00
NAV (p)	98.91
Premium/ (discount)	4.1%
Issued shares	238,100,000
Market cap	£245.2m

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.starwoodeuropeanfinance.com

Investment Restrictions & Guidelines

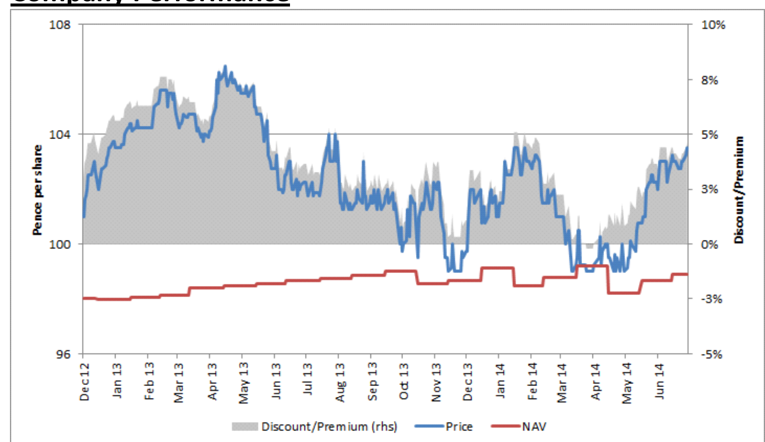
Location	UK & Continental Europe
Loan Term	Between 3 and 7 years
Loan Type	Senior, subordinated and mezzanine loans, bridge loans, selected loan on loan financing and other debt instruments
LTV	Absolute maximum of 85% with a blended portfolio LTV of no more than 75%
Real Estate Sector & Property Type	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.

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.

The Company has targeted a net total return on invested capital of 8-9 per cent. per annum and a dividend of 7.0 pence per Ordinary Share once fully invested.

Company Performance



Commentary

Investment portfolio

As at 30 June 2014 the Group had committed 96 per cent. of net IPO proceeds through the following investments:

	Original Commitment[(1)]	Balance as at 30 June 2014
Maybourne Hotel Group	£19.0 m	£19.0 m
West End Development	£10.0 m	£10.0 m
Lifecare Residences	£14.5 m	£13.0 m
Heron Tower, London	£18.0 m	£16.5 m
Centre Point, London	£40.0 m	£40.0 m
FC200, London	£27.0 m	£21.7 m
Total Sterling Loans	**£128.4 m**	**£120.2 m**
Retail Portfolio – Finland	€45.0 m	€42.1 m
Industrial Portfolio, Netherlands	€55.9 m	€55.9 m
Office, Netherlands	€14.3 m	€14.3 m
Total Euro Loans	**€115.2 m**	**€112.2 m**

(1) Commitments include PIK facilities over the life of two loans for a total of approximately £5m. A subsequent €25m loan commitment was made in early July on the W Hotel, Amsterdam.

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Key Portfolio Statistics at 30 June 2014

Number of borrowers	9
Number of investments	9
Percentage of currently invested portfolio in floating rate loans (1)	47.9%
Invested Loan Portfolio annualised total return (2)	8.6%
Weighted average portfolio LTV – to Group first £ (3)	9.8%
Weighted average portfolio LTV – to Group last £ (3)	60.1%
Average loan term	4.1 years
Percentage of net IPO proceeds uncommitted (4)	4.0%
Percentage of net IPO proceeds committed to senior and whole loans (4)	75.8%
Percentage of net IPO proceeds committed to second lien and mezzanine loans (4)	12.5%
Percentage of net IPO proceeds committed to other debt instruments (4)	7.7%
Percentage currently invested in GBP (1)	56.2%
Percentage currently invested in Euro (1)	43.8%

(1) Calculated on loans currently outstanding (as shown on page 1)

(2) Calculated on amounts currently outstanding and assuming all loans are outstanding for the full term. Five 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 loans closed to date and excluding cash uninvested.

(3) LTV to Group last £ means the percentage which the total loan currently outstanding (when aggregated with any other indebtedness ranking alongside and/or senior to it) bears to the market value determined by the last valuation. LTV to first Group £ means the starting point of the loan to value range of the loan currently outstanding (when aggregated with any other indebtedness ranking senior to it). For ground up development (Lifecare) the calculation includes the total facility available and the market value on completion of the project. Where the loan relates to a redevelopment project with facilities currently undrawn (Centre Point) the calculation includes current debt drawn against the lower of current use market value and vacant possession value. Upon commencement of development, the loan to value will be tested by reference to loans drawn plus available loans against a value assuming completion of the development. This calculation will therefore change as the other facilities are drawn. LTVs are calculated for each loan and weighted by the Group's investment in each loan

(4) Calculated based on the original loan amount including amounts which may have since been repaid as amortisation and including amounts which are committed but currently undrawn. This is expressed as a percentage of net IPO proceeds plus net amounts raised in the subsequent tap issues (£233.8m).

The following transactions were closed between the publication of the factsheet for 31 March 2014 and 30 June 2014:

FC200, London: The Group provided a £27 million financing facility for an office building in Park Royal, West London. £21.7 million of the available facility was drawn in early June. The three year financing is secured against a six-storey, 160,000 square foot building named FC200 located within the First Central mixed-use development site in Park Royal. The financing allowed the sponsors to refinance the all-cash acquisition of the property in late 2011 as well as providing funding for the remaining capex to complete its fit out. The Group expects to earn a solid single digit return in line with its investment criteria.

Industrial Portfolio, Netherlands: On 30 June 2014, the existing €35.3 million whole loan facility was increased by €36.1 million in cooperation with private debt funds associated with Starwood Capital Group. The Group's overall exposure increased to €55.9 million. The additional funds facilitated the acquisition of nine light-industrial and office properties in the Netherlands taking the overall portfolio to 28 assets. This marks the final increase in the facility as MBay, the joint venture between M7 Real Estate and Bayside Capital, completes its current light-industrial Dutch acquisitions strategy.

The following transaction was closed since 30 June 2014:

W Hotel, Amsterdam: The Group has committed to provide €25 million out of a total of €99 million for the refinancing and refurbishment of a new W branded hotel located in the centre of Amsterdam. The sponsor is Liran Wizman, a highly experienced hotel owner and key shareholder in Grand City Hotels, a highly rated pan-European hotel management company. Expected to be completed in the third quarter of 2015, the refurbished hotel is based on Spuistraat, a prime location within the city and providing easy access to transport links and attractions including the Royal Palace and Dam Square, which the hotel adjoins. The first drawdown from the Borrower under this facility of approximately €9.3 million was made on 17 July 2014.

Since 30 June 2014 (to 30 July 2014) the Group also received a €1.3 million prepayment on the Retail Portfolio, Finland and a scheduled amortisation receipt on the Heron loan of £0.8 million.

Once the W Hotel loan is substantially drawn, the Group will be capable of delivering a net portfolio yield of approximately 6.9 per cent. on deals committed to date (after scheduled amortisation but prior to any other prepayments).

Syndication and Pipeline

In the March factsheet, the Company noted that some of the new opportunities in the pipeline would require subsequent syndication to achieve target return levels. Of the new loans originated since the publication of the March factsheet, the Group expects to syndicate approximately £42 million releasing this for reinvestment in order to increase the net portfolio yield up from 6.9 per cent. to in excess of 7 per cent. We are in advanced discussions with credit approved acquirers in respect of these loans and expect to complete the syndications during the second half of the year.

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Managing the timing and occurrence of these syndications with opportunities to re-invest the proceeds will be important to minimising cash drag and maintaining current returns.

A foundation stone of the formation of the Group was the emphasis on relative risk/return. It is incumbent for the Group to continue to focus on this and not simply absolute return. It follows that for any potential investment in Southern Europe, following the change to the Investment Policy, the Group will adhere rigorously to this principle.

Any pipeline for the Group has to flex and adapt to the changing market dynamics. In the market commentary section below it is clear that certain markets have now fully recovered, indeed some may be showing very early signs of overheating. Central London, for example, is one such market. It is not that the Group would not invest further in such markets, merely that it is now applying a higher degree of caution. Starwood Property Trust recently announced the provision of a £101.8 million loan on London residential. Whilst the specifics of the loan itself were attractive, the Investment Adviser, Investment Manager and directors felt the Group now had sufficient London residential exposure to warrant declining any participation.

However the scale of the UK market means that good risk/return is still sourceable especially in regional markets. As is evident in recent transactions, Holland remains a key focus for new business. Whilst an Irish investment has not yet been effected the Group remains positive on this market for deployment of capital. Central Europe has become more interesting as the asset quality review appears to be unlocking a number of potential situations. Following approval to adjust the investment policy guidelines, Italy and Spain are being considered on a cautious, risk adjusted basis.

Overall a pipeline of opportunities continues to exist reflecting the geographical comments above. At this stage it is felt the UK will still account for over 50 per cent. of capital in the medium term. The Group continues to seek strong sector diversity. Whilst the proportion of whole loans is high at 79 per cent. of the current loan book it is expected to fall. The Group's key access to deal flow is through the provision of whole loans but it is now more active in the subsequent syndication of senior positions to enhance returns through the retention of mezzanine, especially in the UK.

It would not be surprising to eventually see a more balanced mix of relative whole loans and end mezzanine as envisaged at IPO.

Dividends

At launch, the Company had targeted a dividend of 7.0 pence per Ordinary Share upon full investment.

On 23 April 2014 the Company declared a dividend for the period from 1 January 2014 to 31 March 2014 of 1.25 pence per Ordinary Share being an annualised 5.00 pence per Ordinary Share.

On 23 July 2014 the Company declared a dividend for the period from 1 April 2014 to 30 June 2014 of 1.35 pence per Ordinary Share, being an increase to 5.40 pence per Ordinary Share on an annualised basis, principally reflecting the reduced impact of historical cash drag.

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As noted above, the Group will be delivering a net portfolio yield of 6.9 per cent once the W hotel loan is substantially drawn. Based on the current syndication plans and deals in the pipeline to re-invest those proceeds the Company remains comfortable that it will be able to pay an annualised 7.0 pence dividend upon completion of the syndication and re-investment, expected to be completed in the second half of 2014.

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.

It is the intention of the Company to seek to implement permitted liquidity facilities up to an amount of £50 million (and in any event limited to 20 per cent. of Net Asset Value) that may be utilised to assist in the rapid securing of additional investment opportunities, as a bridge to the raising of additional equity or repayment of existing loans and for other short term cash management purposes.

Market Commentary

Previous factsheets have highlighted the continued dichotomy of the European Capital Markets. On one side macroeconomic policy, including the ECB's announcements, continue to ensure the market has strong liquidity and a penchant for hunting yield. On the other side the on-going need for deleveraging as well as addressing problem situations by banks has been turbo charged by the Asset Quality Review. Events in Portugal are perhaps merely an example of other situations likely to occur over the coming months which encourage macro risk whilst also creating deal level opportunities.

This dichotomy is therefore still an overriding theme of the real estate capital markets. Certain markets have arguably fully recovered – Central London office and residential as cases in point. Other markets such as Spain seem to see patches of perhaps optimistic exuberance. Hand in hand lenders, notably US investment banks, have re-found an interest in the provision of loan capital. Any investment deal of low to reasonable leverage in core sectors and with good sponsors now attracts excess liquidity which has resulted in substantial pricing decline. However the other side of the dichotomy is throwing off ever greater opportunities including the continued need for structured finance solutions that the Group specialises in.

In summary, the market recovery inevitably requires us to strike a balance between the continuing opportunity and taking an increasingly prudent approach to new business and portfolio management.

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