STARWOOD
EUROPEAN FINANCE

Starwood European Real Estate Finance Limited

Quarterly Investment Update

June 2016

Share Price / NAV at 30 June 2016

Share price (p)	105.75
NAV (p)	100.92
Premium/ (discount)	4.8%
Issued shares	304,180,000
Market cap	£321.7m

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 & wider European Union's internal market. No more than 50% in any country except the UK where it is unlimited (subject to sector limits below).
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. No more than 30% of NAV in residential for sale. No more than 50% of NAV in any single sector in the UK except office which is limited to 75%.
Counterparty & Property Diversification	No 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 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 Europe.

Investment Portfolio at 30 June 2016

As at 30 June 2016, the Group had 16 investments and commitments of £323.7 million as follows:

Transaction	Sterling equivalent balance [(1)]	Sterling equivalent unfunded commitment [(1)]
Centre Point, London	£45.0m	–
5 Star Hotel, London	£13.0m	–
Center Parcs Bonds, UK	£9.5m	–
Industrial Portfolio, UK	£31.8m	–
Hospitals, UK	£25.0m	–
Hotel, Channel Islands	£27.0m	–
Varde Partners mixed portfolio, UK	£35.1m	–
Mixed use development, South East UK	£6.5m	£8.5m
Total Sterling Loans	**£192.9m**	**£8.5m**
Industrial Portfolio, Netherlands	£21.4m	–
Office, Netherlands	£11.5m	–
W Hotel, Netherlands	£19.3m	£1.3m
Retail & Residential Portfolio, Ireland	£4.6m	–
Residential Portfolio, Cork, Ireland	£5.0m	–
Residential Portfolio, Dublin, Ireland	£6.5m	–
Logistics, Dublin, Ireland	£14.4m	£3.6m
Total Euro Loans	**£82.7m**	**£4.9m**
Industrial Portfolio, Denmark,	£34.8m	–
Total Danish Krona Loans	**£34.8m**	**–**
Total Portfolio	**£310.4m**	**£13.4m**

(1) Euro and Danish Krona balances translated to sterling at 30 June 2016 exchange rates.

Portfolio Activity

The following significant activity occurred since the publication of the last factsheet on 27 April 2016 up to 30 June 2016.

Varde Portfolio: on 16 May 2016, the Group arranged a 3 year £158.1 million floating rate facility for certain affiliated companies of Varde Partners to refinance a portfolio of 141 retail, office and industrial assets located throughout the UK. With 393 tenants the portfolio reflects very strong diversification in terms of tenant, geography and sector. The Group worked closely with a major investment bank which provided the borrower with a £123 million senior loan facility, leaving the Group to advance a £35.1 million mezzanine facility on which it expects to earn an attractive risk-adjusted return in line with its stated investment strategy.

Mixed Use development, South East UK: On 2 June 2016, the Group, together with other Starwood affiliates, committed to a £75 million whole loan in relation to three mixed use development projects in the south east of England. In total the Group will fund a £15 million participation in the whole

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Key Portfolio Statistics at 30 June 2016

Number of investments	16
Percentage of currently invested portfolio in floating rate loans [1]	63.0%
Invested Loan Portfolio annualised total return [2]	8.2%
Weighted average portfolio LTV – to Group first £ [3]	18.4%
Weighted average portfolio LTV – to Group last £ [3]	65.8%
Average loan term (stated maturity at inception)	4.4 years
Average remaining loan term	3.3 years
Net Asset Value	£307.0m
Amount drawn under Revolving Credit Facility (excluding accrued interest)	-£8.0m
Portfolio value (including accrued income)	£315.0m
Cash	£7.9m
Other net assets/ (liabilities) (including hedges)	-£7.9m

(1) Calculated on loans currently drawn 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. Twelve of the loans are floating rate (partially or in whole and some with floors) and returns are based on an assumed profile for future interbank rates but the actual rate received may be higher or lower. Calculated only on amounts funded to date and excluding committed amounts and cash un-invested. 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 W Hotel, Centre Point and the mixed use development, south east UK, the calculation includes the total facility available and is calculated against the market value on completion of the project.

loan with an initial drawdown of £6.5 million. The borrower's aim is to deliver strong mixed use schemes in the centre of high growth commuter locations providing PRS, private residential for sale, retail, office, hotel and serviced apartments. These markets are demonstrating consistent, moderate growth given the long term structural shortages of much needed new real estate supply. A large element of the schemes had already been presold to institutional investors ensuring the Group has a lower exposure on a debt per square foot basis. The floating rate facility has term of 3 years with a single extension option of one year and the Group expects to earn an attractive risk-adjusted return in line with its stated investment strategy.

Logistics, Dublin, Ireland: The Group committed to a €31.2 million five year floating whole loan to support the acquisition of a portfolio of fully let prime logistics assets in Dublin. Much of the portfolio is let on a long term basis to a strong covenant which uses the assets as its national headquarters. The loan had an initial drawdown of €17.6 million in June with a further drawdown of €4.4 million on 8 July 2016. Post-closing the additional loan uses have proved to be unnecessary and the remaining commitment will consequently not be drawn and has been cancelled. In addition, a prepayment of €7 million was received after 30 June 2016, leaving a net position remaining of €15 million.

Dividend

On 25 July 2016 the Directors declared a dividend of 1.625 pence per Ordinary Share (annualised 6.5 pence per Ordinary Share) in relation to the second quarter of 2016.

Repayments, Reinvestment and Capital Raising

As has been discussed previously, the Group experienced substantial loan repayments in the first half of the year. These came to £92.1 million in repayments and amortisation, in addition to £37.7 million received in the last quarter of 2015.

It is worth noting, however, that, notwithstanding a repayment of 42% of the portfolio in such a short period, the Group has managed to remain substantially fully invested throughout and has continued to be able to pay the dividend at target levels. The Group has achieved this through utilising the £60 million revolving credit facility efficiently and being cautious on when to raise additional equity.

Origination in the first half of 2016 has been stronger than the first half of any previous year with total commitments of approximately £100 million being made compared to an average of £35 – £40 million in the prior two years. The impact of this new origination is also reflected in the maturity profile of investments as at 30 June 2016 :

Remaining years to contractual maturity*	Value of loans	% of invested portfolio
0 to 1 years	£19.3m	6.2%
1 to 2 years	£51.0m	16.4%
2 to 3 years	£113.9m	36.7%
3 to 5 years	£101.2m	32.6%
5 to 10 years	£25.0m	8.1%

**excludes any permitted extensions. Note that borrowers may elect to repay loans before contractual maturity.*

The second half of any given year has also historically been stronger for the Group with between 65-100% of origination activity occurring in this period. Considering the maturity profile of the remaining loans, the Group is, therefore, optimistic about the need to raise further equity in the second half of this year.

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Country	% of invested assets
UK – Regional England	37.4
UK – Central London	17.0
Netherlands	16.5
Ireland	10.3
Denmark	9.9
Channel Islands	8.9

Sector	% of invested assets
Light Industrial	29.3
Hospitality	22.5
Residential for sale	13.2
Retail	9.8
Healthcare	8.2
Office	6.5
Residential for rent	5.2
Logistics	5.0
Other	0.3

Loan type	% of invested assets
Whole loans	61.4
Mezzanine	38.6

Loan type	% of invested assets
Sterling	63.2
Euro	26.9
Danish Krona	9.9

Market Commentary

Brexit and the macro implications of Brexit have been thoroughly discussed throughout all media forms and so we will look to avoid repetition here.

The Group continues to monitor the unfolding situation to assess the impacts upon it.

Prior to Brexit, two annual information updates occurred, being the Savills UK "Financing Property" briefing and the publication of the previous year's De Montfort University UK lending study. The tone of both reviews of the UK lending and real estate market was a healthy but not overheated one albeit that they were issued prior to the EU referendum. Savills nicknamed 2015 as the "Goldilocks Period": not too hot nor too cold. Given the impact of oil and China shocks, 2016 was already reflecting slight margin increases and LTVs softening. Key points from the Savills and De Montfort reports were as follows:

- 2007 was another life – 64% of lenders in 2007 thought that 80% LTV was "no risk" and senior bank LTVs were typically 70-80% LTV compared with 2016 where they were more typically 55-65%.
- The all in cost of finance remains at generational lows. Although margins are consistently higher than previous cycles, LIBOR has never been this low. 5 year swap rates were 12.5% in Q4 1989, 5.4% in April 1999 and 1% in May 2016.
- With the UK All Property Equivalent Yield at just under 7%, the spread with the cost of money remains extremely wide.
- 2015 UK lending was £53.7 billion, being a 19% increase from 2014. This is the first time since 2007 net lending was close to positive but still not quite.
- Estimated total outstanding UK real estate finance of £211.6 billion at 2015 year-end held 45% by UK banks/building societies, 16% by international banks, 15% by insurance companies, 11% by German banks, 6% by north American lenders and 7% by alternative lenders.
- In 2015, the average max LTV levels for mezzanine decreased from 84% to 80% - this is still high relatively compared to the Group's own typical advance rates.
- The limitations on UK banks are considerable today. These range from regulatory capital treatment issues to ring fencing which has led to a material reduction in their market share. In 2007, UK banks accounted for perhaps 60%+ of new lending whereas now it is c30%.
- Alternative lenders (of which the Group is one) are seen favourably by borrowers who identify their speed, skills and flexibility as key attributes.
- Key bubble signs not evident – limited speculative development finance, low lending complexity, thoughtful lending policies, strong due diligence and no extravagant broker parties.

Brexit subsequently followed the issuance of the Savills and De Montfort reports and it is simply too early to tell the full impact on the markets in which the Group is active but the above suggests that the credit markets are, on an overall basis, reasonably well placed to face any future volatility and uncertainty.

The media frequently identify the property sector for analysis of some kind following Brexit and seeks to use the data to identify future trends. Property data tends to lag the rest of the business world and it will probably be some months before we can extract meaningful analysis, especially as the summer has definitely descended early on the property world given recent events. With the uncertainty of the future post-Brexit, it is not helpful to add further macroeconomic views but we can imagine there will be a modest recessionary

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environment until further clarity as to how the UK will leave the EU is provided. The UK's short to long term fate will then divide depending on whether the so called soft (single market access) or hard (no single market access) Brexit occurs. In such a short term environment, the Group could foresee investment and leasing softening and a 10-15% value decline has been talked about especially in the office and perhaps retail sectors. Such a value decline has been reflected and magnified (by gearing) in the recent UK listed property stock performance and the very public open ended fund "gating" as a result of an insufficient discount penalty that led to a liquidity run.

It is also worth highlighting a specific aspect of property lending being the Loan to Value ("LTV") covenant clause. LTV clauses exist as early warning devices – to allow the lender(s) to react to a changing situation with sufficient time and value headroom by triggering protections if the property value declines to a specified level. Today there is often a two tier covenant structure in place - namely that a very modest value decline will lead to a loan cash sweep (whereby available cash flow is applied to debt repayment or trapped for a period of time to enhance collateral) and then following a further modest decline an LTV default that allows for the loan to be accelerated for repayment. In the recent market, such covenants have typically been set only 5-10% away from the initial starting point. In post Brexit UK, one could imagine that value declines could well impact the LTV covenants of loans in the market. In itself it is unlikely that this will lead to material market impairments or losses, however what it might engender is greater credit committee oversight and increased new lending caution from mainstream capital providers. This situation also highlights the obvious but nevertheless vital distinction between the probability of default and probability of loss. Good property lending often seeks balanced but nevertheless rapid default in volatile markets. These triggers may well not imply any actual impairment or loss but, rather, provide the lender(s) with stronger levels of control going forwards when the situation arises.

Whilst there is of course good reason for caution, for heightened scrutiny and focus on the existing loan book, there is also reason to be optimistic that the Group can look to again extract outsized returns for moderate risk in the UK market. The rest of Europe may not be immune to heightened volatility given the number of national elections and referendums in the coming months and the ongoing financial market fragility. This argues that enhanced lending vigilance should also be applied across the continent whilst reiterating the optimistic sentiment that good lending opportunities should arise. With the vast majority of near term loan repayments having occurred in recent months the Group is well placed to further grow with a loan maturity profile now well spread out over the coming 5 years.

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