September 2014

Share Price / NAV at 30 September 2014

Share price (p)	104.50
NAV (p)	99.28
Premium/ (discount)	5.3%
Issued shares	238,100,000
Market cap	£248.8m

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.

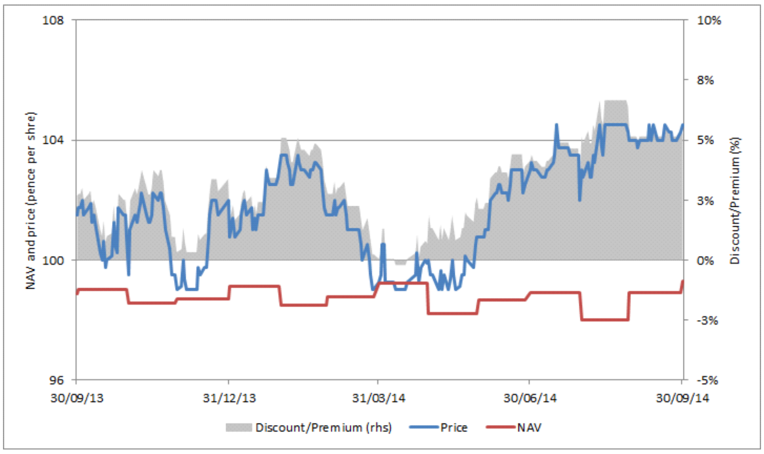
Starwood European Real Estate Finance Limited

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 30 September 2014 the Group had investments and commitments of £201 million (sterling equivalent) as follows:

	Balance as at 30 September 2014	Unfunded Commitments
Maybourne Hotel Group, London	£19.0 m	-
West End Development, London	£10.0 m	-
Lifecare Residences, London	£13.2 m	£1.3 m
Heron Tower, London	£15.7 m	-
Centre Point, London	£40.0 m	-
FC200, London	£ 8.6 m	£4.9 m
Total Sterling Loans	**£106.5 m**	**£6.2 m**
Retail Portfolio, Finland	€40.8 m	-
Industrial Portfolio, Netherlands	€55.9 m	-
Office, Netherlands	€14.2 m	-
W Hotel, Netherlands	€ 9.9 m	€15.1 m
Total Euro Loans	**€120.8 m**	**€15.1 m**

September 2014

Key Portfolio Statistics at 30 September 2014

Number of borrowers	10
Number of investments	10
Percentage of currently invested portfolio in floating rate loans (1)	48.9%
Invested Loan Portfolio annualised total return (2)	8.8%
Weighted average portfolio LTV – to Group first £ (3)	11.3%
Weighted average portfolio LTV – to Group last £ (3)	59.9%
Average loan term	4.1 years
Percentage of NAV in cash	12.4%
Percentage of NAV invested in senior and whole loans (1)	65.3%
Percentage of NAV invested in second lien and mezzanine loans (1)	15.5%
Percentage of NAV invested in other debt instruments (1)	6.6%
Percentage currently invested in GBP (1)	51.5%
Percentage currently invested in Euro (1)	48.5%

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

Syndication

In the June factsheet, the Company noted that £42 million of the loans closed to date would require syndication to enhance the returns on those loans and following the subsequent reinvestment to achieve net returns in excess of 7 per cent.

On 15th September, the Group completed the syndication of a £13.5 million senior note on FC200 to a UK clearer.

The Group is in documentation with a credit approved acquirer for the syndication of a further €35.9 million in respect of the Industrial Portfolio, Netherlands and expects to complete the syndication of the senior note before the end of 2014.

Following this syndication the Group is expected to have approximately £37 million cash available for investment after approximately £18 million of unfunded commitments on Lifecare, FC200 and W Hotel (as detailed on Page 1).

The key priority of the Group is to ensure that cash drag is minimised and that a stable current return is delivered to shareholders. The subsequent swift reinvestment of these syndication proceeds therefore is a key business focus for the Group.

Pipeline

A foundation stone of the formation of the Group was the emphasis on relative risk/return. It is incumbent on the Group to continue to focus on this and not simply absolute return.

The Company and Investment Manager are conscious of the desire of investors to receive guidance on timing of surplus cash deployment. The Group's pipeline remains active and constantly evolves. Indications on the timing of closing transactions has always been difficult and rather than provide precise guidance, the Company and the Investment Manager wish to reiterate their constant focus on the balance of deployment of surplus cash whilst maintaining a desired level of portfolio risk and diversification.

The pipeline flexes and adapts to the changing market dynamics. We have previously highlighted a sense that "proactive" origination should focus on continental European markets where banking market dislocation remains more prevalent (and is, arguably, increasing again) balanced with the reasons that dislocation exists in the first place. The UK offers a scale for "reactive" origination where requests for finance are made to the Group given its market position but balanced with the reality that a recovered market by definition starts to offer more limited risk cushions in certain lending scenarios.

The Investment Adviser has continued to build out its presence in Holland due to the lack of a thriving domestic banking sector for real estate finance. There is a sense that bank deleveraging is offering up more CEE lending opportunities as banks look to restructure or exit atypical deals. The Nordics continue to throw up one-off opportunities to examine – the banking sector is extremely healthy but still shies away from transactions with more volatile income or where speed and/or scale are important. Finland also is less well banked than the other Scandinavian countries. Spain is exciting with positive economic indicators and a hunger for capital

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– recent reforms are also a big positive, certainly relative to Italy which has to date lacked the evident Spanish focus on fundamental banking reform, legal and insolvency framework reform, labour and market competitiveness reform and a resulting ability for the bid/ask to be met. Starwood Capital Group's equity business has recently purchased approximately €800 million of real estate related non-performing loans ("NPLs") in Spain and the investment has brought great insight into where a performing lending business is required namely not just in new or current projects but also assisting in the second stage of such NPL loan pool purchases – the Investment Adviser can envisage for example assisting borrowers to recapitalise investments being bought out from loan pool purchasers at a discount. Indeed the Investment Adviser sees a solid source of business opportunity coming from Starwood's normal competitors in the NPL space by this approach. Ireland has to some extent disappointed those seeking to exploit a dislocated lending market, due to the unbelievably rapid revitalisation of that market, evident, for example, by capital raised by listed REITs. That said we continue to work on several Irish transaction leads. All in all the Investment Adviser has observed a marginal encroachment in the UK of its structured finance patch by more traditional lenders but sees that the original risk/return argument can be still employed by slight geographical refocusing.

Whilst the proportion of whole loans is high at 75 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 see a more balanced mix of whole loans and end mezzanine emerge, as envisaged at IPO.

Dividends

The Company declared a dividend of 1.25 pence per Ordinary Share for the first quarter of the year and 1.35 pence per Ordinary Share for the second quarter, a total of 2.6 pence per Ordinary Share for the first half of the year.

On 24 October 2014 the Company declared a dividend for the period from 1 July 2014 to 30 September 2014 of 1.5 pence per Ordinary Share, being an increase to 6.0 pence per Ordinary Share on an annualised basis.

Based on the current syndication plans and subsequent re-investment of those proceeds the Company remains comfortable that it will be able to pay an annualised 7.0 pence dividend upon completion of such syndication and reinvestment programme.

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 at some point 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

The Group is currently adopting a more cautious stance given recent market uncertainty and our market theme remains a fundamental real estate dichotomy.

On the positive to “warm” side was that the on-going low interest and regulatory environment has unquestionably triggered yet another tiresome hunt for yield. This actually includes the banking sector – an interesting statistic the Group recently noted was that UK SME lending from the banking sector was approximately £80 billion (down from £120 billion at the peak) whilst commercial real estate lending remained at approximately £220 billion (down from £250-260 billion at the peak). The relative scale and lack of CRE loan deleveraging observed is not only testament to the issues noted below but also that SME lending is very capital intensive and that it remains much easier to deploy multi-million loans in a single transaction on property. Investment deals of low to reasonable leverage in core sectors and with good sponsors now attract excess liquidity which has resulted in substantial pricing decline. It should be noted however that most “take and hold” banks remain very risk focussed and competition is much more about pricing – lessons seem to be learnt. Special mention is made of the UK Clearing banks which are subject to standardised capital treatment (the so-called “Slotting” approach) which does put them at a regulatory disadvantage to other banks permitted to utilise advanced capital treatment methodologies that allow them to allocate their own capital per loan. That said most of the UK banks are Globally Systematically Important Banks (“G-SIBs”) and the combination of this regulatory regime and their own internal credit discipline does appear to be having a positive effect of steering them to do solid well thought through business. Where there are potential dangers in the market are those lenders focussed on a more fuller distribution model – the Financial Crisis firmly taught us that the incentivisation structures within such lenders need to discourage looser lending (e.g. minimum retention requirements).

This however does not imply that in totality markets have fully recovered. Indeed over the year as the reality of the on-going Asset Quality Review started to seep through, the markets were reminded that the “cool” side of the equation remained prevalent. The continuing requirement for European banks to further face the implications of both non-performing and simply non-core loans is still one of the largest issues of the global economy. In a recent report Cushman & Wakefield estimate there remains nearly €600 billion of non-core real estate loans on banks’ balance sheets, with a sizeable element impaired and arguably not fully written down to appropriate levels. The strong acceleration of loan divestment observed over 2014 is evidence of both the scale of the issue and the ever greater need to address. The accession of the European Central Bank as Eurozone bank regulator in November 2014 is welcomed as a positive step towards a firm and robust reality check on the banks’ true positions.

Recent market turbulence is perhaps in fact welcomed. The sense that markets were ahead of themselves was prevalent and, indeed, repetition of mid 2000’s anecdotes of “ever harder to find value” were a reminder that all things are a cycle. Removing a degree of exuberance is no bad thing and may well create tempered opportunity.

The Asset Quality Review / Stress Test results, perhaps unsurprisingly, were a careful balancing act. Out of 130 banks, 25 technically failed as at the cutoff date but most subsequently passed as a result of the €56 billion of capital raised between January and September. Thirteen still failed as at today, four of which were Italian. Of €136 billion of newly uncovered NPL's, €55 billion were from definitional harmonisation. More interestingly, there is some scepticism the approach was really rigorous rather than just rigorous, for example in shipping finance, an area important for German banks, or indeed the cornerstone assumption that sovereign defaults cannot occur. Also fully loaded implementation of Basel III would have led to substantial failures including four German banks. Overall harmonisation of rules and supervision is a good thing but the process reflects the fact the banking system still has a long way to go not least dealing with their still high absolute leverage levels. The ECB in any case could not afford a material failure which is why there appears to be an almost perverse collective sigh of relief from an already volatile market. Italy has been hit and indeed this may further encourage speedier resolutions such as bank mergers or bad bank creation. It also supports the Group's cautious wait and see on this market and the on-going prohibition of Italian investing.

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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