HOW TO:

ARRANGE COMMERCIAL PROPERTY LOANS POST GFC AND ACHIEVE THE BEST OUTCOMES.

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HOW TO

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COMPLETE LOAN MANAGEMENT

About Balmain

Balmain is the region's leading non-bank commercial loan manager. With over 30 years of experience and $2b in assets under management, Balmain has a proven track record that encompasses all aspects of the commercial loan lifecycle including loan origination, credit underwriting, mortgage fund management and asset recovery.

Balmain's volume of transactions and credit cycle experience is unmatched in the non-bank sector. With over 140 staff in 8 offices throughout Australia and New Zealand Balmain has the experience and capacity to develop and manage a wide variety of commercial loan portfolios.

About AMAL

For over 16 years AMAL has focused on providing the most efficient and cost-effective loan servicing solutions to its clients in Australia and New Zealand. And with over $A6 billion of assets under administration on behalf of over 30 clients, AMAL is the leading commercial loan and receivables servicer in the region.

AMAL's specialist team, customisable systems platforms and rigorous focus on quality, risk-management and compliance have resulted in a service offering trusted by some of the region's and the world's largest financial institutions.

Balmain is a founding and significant shareholder in AMAL Asset Management Ltd.

HOW TO ARRANGE COMMERCIAL PROPERTY LOANS POST GFC AND ACHIEVE THE BEST OUTCOMES.

Pre GFC

For the five years to the end of 2007 Australian property investors were spoilt by the simplicity and availability of property finance. The four major banks (the four pillars) dominated the financial landscape and the three second tier banks (St George, Bankwest, Suncorp) each had aspirations for growth and property lending featured prominently in their strategy. These seven banks, a variety of third tier bank lenders both on and offshore, a $30 billion mortgage trust sector plus private and niche lenders combined to provide a plethora of lending balance sheets with diverse approaches to risk and lending terms. Many of these lenders were chasing volume growth and were often willing to soften credit criteria to win transactions. Pricing was also used to attract transactions with what seemed like a never ending downward spiral to thinner margins and an acceptance of increased risk as expressed by loan to value ratios.

With cheaper and easier credit being made available, borrowers were prepared to pay ever higher prices for properties, forcing yields down to irrational levels as low as 5% and so fuelling a commercial property bubble. The apparent rise in property values gave lenders comfort and continued to support still cheaper and easier credit. Not only was the initial credit approval easier, so too the loan conditions and post-settlement monitoring with property valuations accepted at face value, scant draw down controls and often a willingness to waive initial approval criteria. Lending grew by about 12% per year in those five years – far outstripping the growth of bank deposits – and with it Australian banks' growing dependence on wholesale funding.
These conditions would not last.

The GFC

Along came the GFC came and the music stopped.

- The Collateralised Debt Obligations (CDO) market collapse in mid 2007 put the first tremors through financial markets and indicated a heightened risk of interbank lending.
- Bear Stearns (an iconic US investment bank) faltered which resulted in a hurried sale to JP Morgan in early 2008 at less than 10% of its year market value.
- Lehman Bros (another iconic US investment bank burdened with toxic CDO asset exposures) faltered in late 2008 and was allowed to fail. This triggered a near breakdown of the global financial system that was only averted by the rapid and concerted monetary policy efforts of the major developed countries (slashing cash rates) and the provision of sovereign guarantees for their respective banks.

The GFC led to a breakdown in interbank lending and a halting of wholesale funding (bank bond issuance). Economic optimism quickly changed to pessimism for lenders worldwide, including Australia, as they struggled to fund existing loan portfolios, let alone credit growth. The lack of funding availability had an immediate impact with demand for property assets declining. This resulted in a 15-30% drop in commercial property values (witnessed by the rapid expansion of commercial property yields to 8-9%) and an even sharper decline in the values of vacant land. Banks immediately tightened conditions on existing loans, called for new valuations, insisted on fresh equity contributions to remedy gearing breaches and reviewed loan pricing dramatically upward. New credit applications were mercilessly cut off, even in many cases to banks' existing clients.
Property investors and developers had no certainty of obtaining loan funds so were unable to transact.

- Starved of wholesale funding, St George, Suncorp and Bankwest suffered in particular and ultimately were acquired and / or rapidly withdrew from commercial property lending.
- Foreign banks ceased lending in Australia and repatriated capital to their domicile (in some cases this was a requirement of their respective sovereign support).
- RBA in an effort to stimulate the faltering economy slashed the official cash rate by 4.25% from 7.25% to 3.00% in just 5 months by Feb 2009. It is worth noting that this was in part to absorb the shock to borrowers of the 1-2% increased cost of bank funds that was passed to borrowers in the form of higher loan margins.
- The Government gave very clear and unlimited support to the Australian banks and approved deposit institutions which allowed them to emerge strong, dominant and in the case of the banks globally well regarded. It also contributed to the issues faced by mortgage trust lenders, who were not included in the guarantee.
- These non-bank lenders suffered by not being covered by the government support offered to ADI lenders. As a consequence they were forced to stop lending activity, build liquidity from loans as they were repaid and in the case of mortgage trusts enter into a planned redemption program to investors.

Post GFC

From a borrowers perspective, the most dramatic consequence of the GFC is the deeper concentration of power within the Australian banking sector. The four majors now control about 90% of property funding (residential and commercial) and are clearly in a position to dictate terms. The banks are again lending but their pricing and their conservative credit terms are generally aligned.

Mortgage trusts, non-bank institutions and private lenders still account for approximately $20 billion in property loans but have been very quiet for the last two years. There are clear signs now that they are re-emerging and ready for business albeit on a modest scale.

In this environment, demand for debt outstrips supply and lenders are very particular about what they will consider. Assessment criteria typically covers the borrower group in great detail, asset marketability, strength of servicing, lease quality and tenor and the possibility of additional fee revenue from the borrower. On top of all this, the bank approval process is torturously slow and unreliable.

Conclusions and Actions

1. Lenders are being very selective on loan applications that they will support. It is essential that applications are well structured, have risks clearly articulated and mitigated, and that the application is tailored to meet each lenders format and positioned patiently and carefully. On this basis, there is a steady and reliable volume of commercial property loans being approved. However, even on high quality transactions, the focus for borrowers is predominantly on the loan amount and conditions of use, rather than on pricing.
2. Many borrowers have experienced trauma with single lender relationships and now value lender diversity. Part of the expert advice required by borrowers is (1) source lenders with appetite for that particular loan profile and (2) source the best channel within each specific lender.
3. Bank line managers have been marginalised by the bank credit areas such that they have no or limited authority and are frustrated at their inability to offer customers acceptable service.
   They are being given application criteria (by Head Office) that are often unrealistic and, as always, are working for the lender, not the borrower.
4. The key to success is maintaining a thorough understanding of preset market dynamics and accessibility
   of all lender channels. Unfortunately, the complexity of this knowledge, the diverse nature of lenders and their continuous changing is generally beyond capabilities of all but the largest borrowers and even then it is a challenge.
5. It is always worth speaking to a specialist about your funding needs. Balmain is Australia's largest non-bank originator of commercial mortgages settling $2-$4 billion of property loans each year accessing lenders from banks, mortgage trusts, non-bank institutions, managed funds and private lenders. It has the widest and deepest knowledge on funding sources and funding structures. Balmain's network of originators work for the borrower to deliver on their funding objectives in a timely, reliable and responsive manner.
   Best of all it costs nothing to find out if Balmain can help. Call us today on 1800 629 900 to arrange a meeting with an experience originator.

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