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Property Finance – Construction funding in the current market

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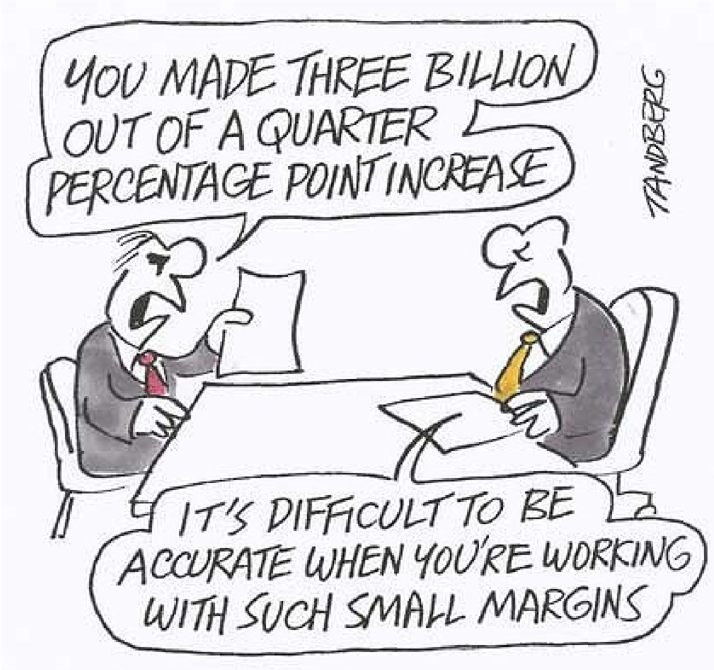
nabproperty

In the media

Billions gouged by big banks

Rate hikes exceed costs: RBA

Ref: Age 13/3/2010



Savings take a hit as big four slash returns

Banks lose your interest

Ref: Herald Sun Tuesday 16/3/2010

Level of discontent with banks rising

Ref: AFR Tuesday 16/3/2010

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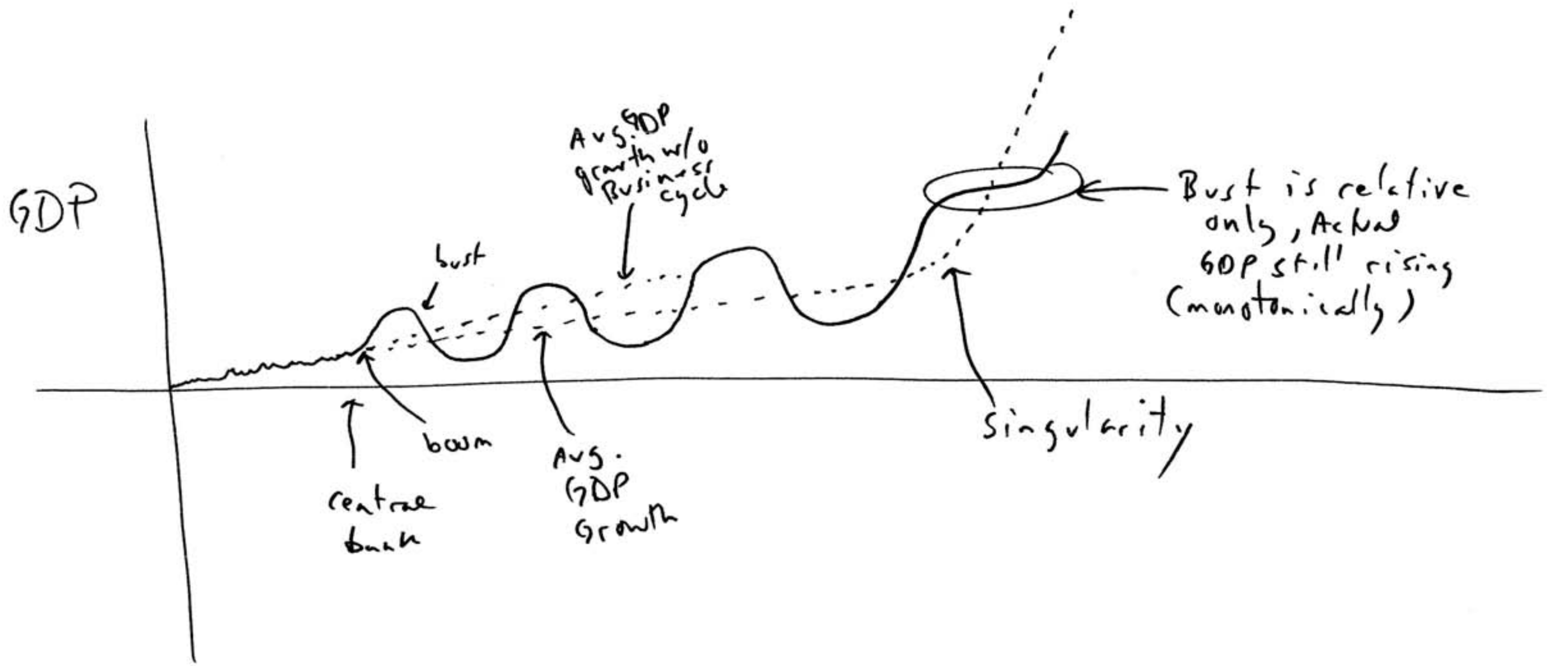
Bank Position – thru the cycle….



Introducing nabproperty

- Part of the strategy to develop industry specialisation capabilities;
- Nation-wide mid market property specialised business unit;
- Offers a national industry view and specialisation;
- QA centre for excellence, consistent business drivers, mindset and culture; improved market intelligence and enhanced risk-return dynamics;
- Segmentation lending.

Property Finance in a Changing Market

- nab
  - open for business
  - first of the big-4 capital raising
  - look after existing customers
  - opportunity to create new quality business

- climate change
  - capital rationing
  - lack competition international and local banks
  - supply & demand equation
  - bank view on interest rates (cash and yield curve)

nab view – the boiling frog

What Happened?

- Internationally, and to varying degrees, finance system broke…

- The chickens eventually came home to roost with……

- Steadily increasing risk
  - Increased gearing = increased risk
  - Specialised assets = increased risk
  - Distributions exceeded cash earnings = increased risk
  - Complex business models = increased risk
  - Offshore Expansion = increased risk
  - Differential Valuation gap too small = increased risk

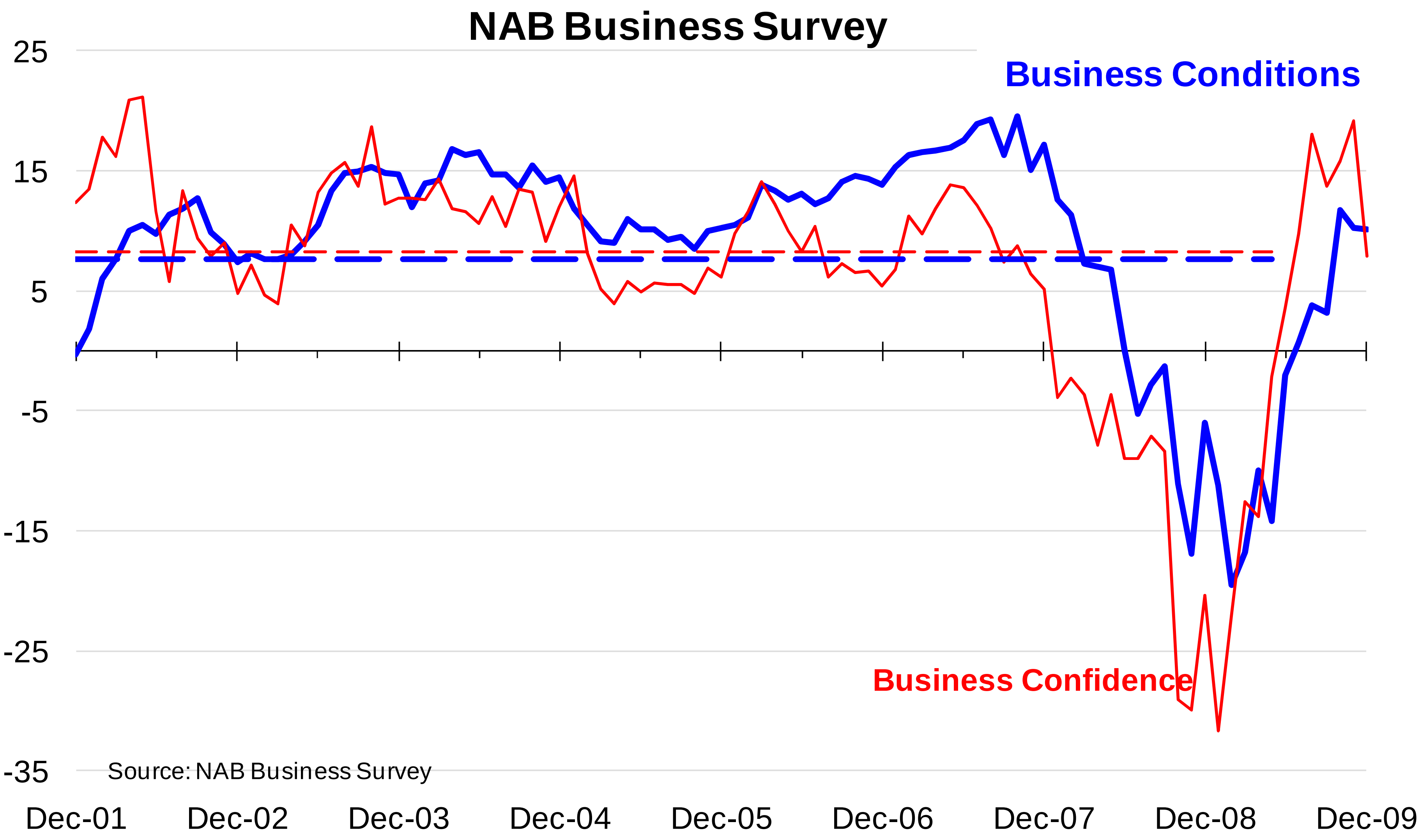
- The boiling frog – if you pay too much, you borrow too much.

- Hostage to weak economy

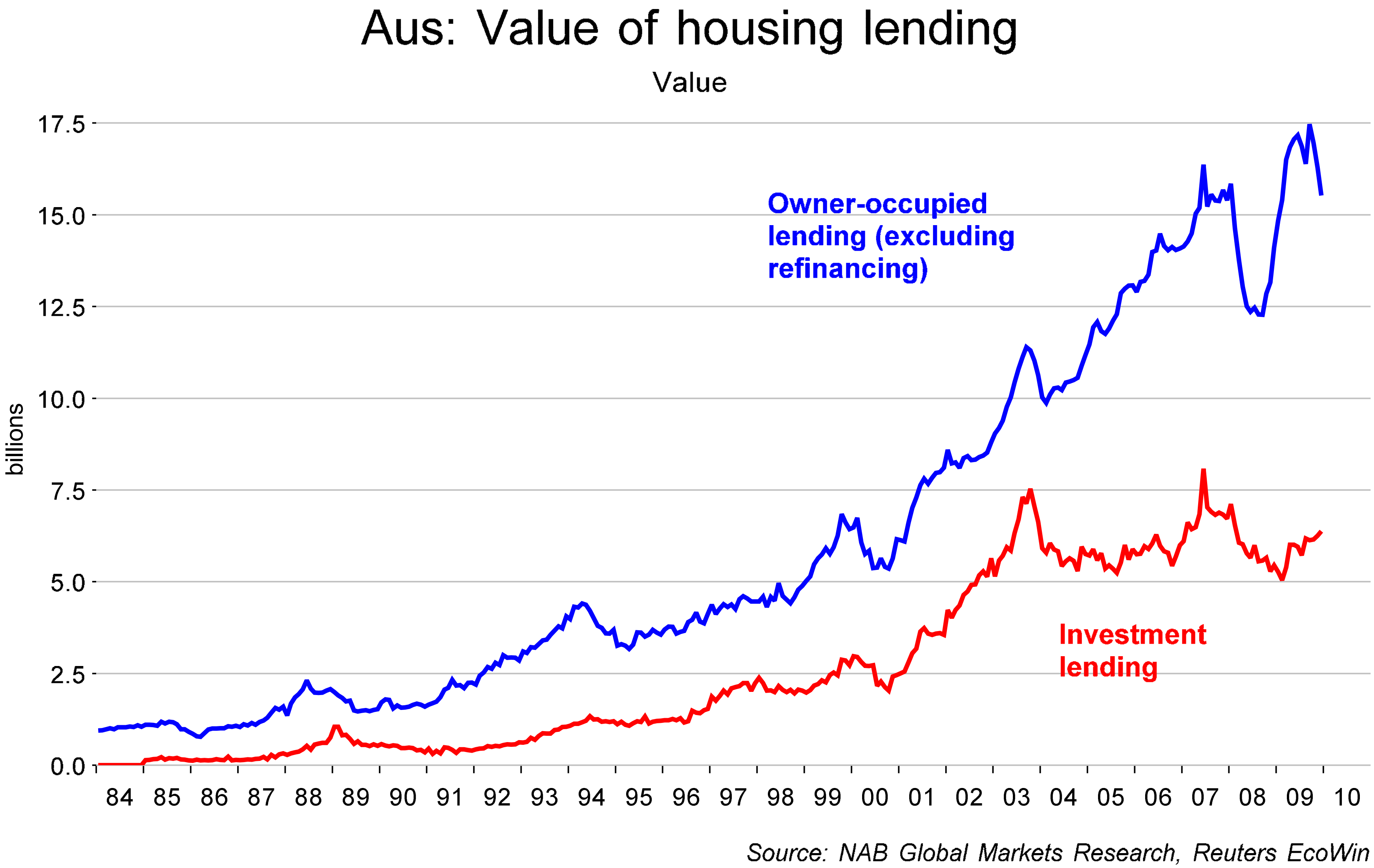
General market outlook – the nab view

- Understanding the factors underpinning Australia's recent success
- Outlook is for accretive recovery ahead
- RBA pause but rates need to be higher before long
- Term borrowing costs have improved recently
- AUD – parity is still on the agenda

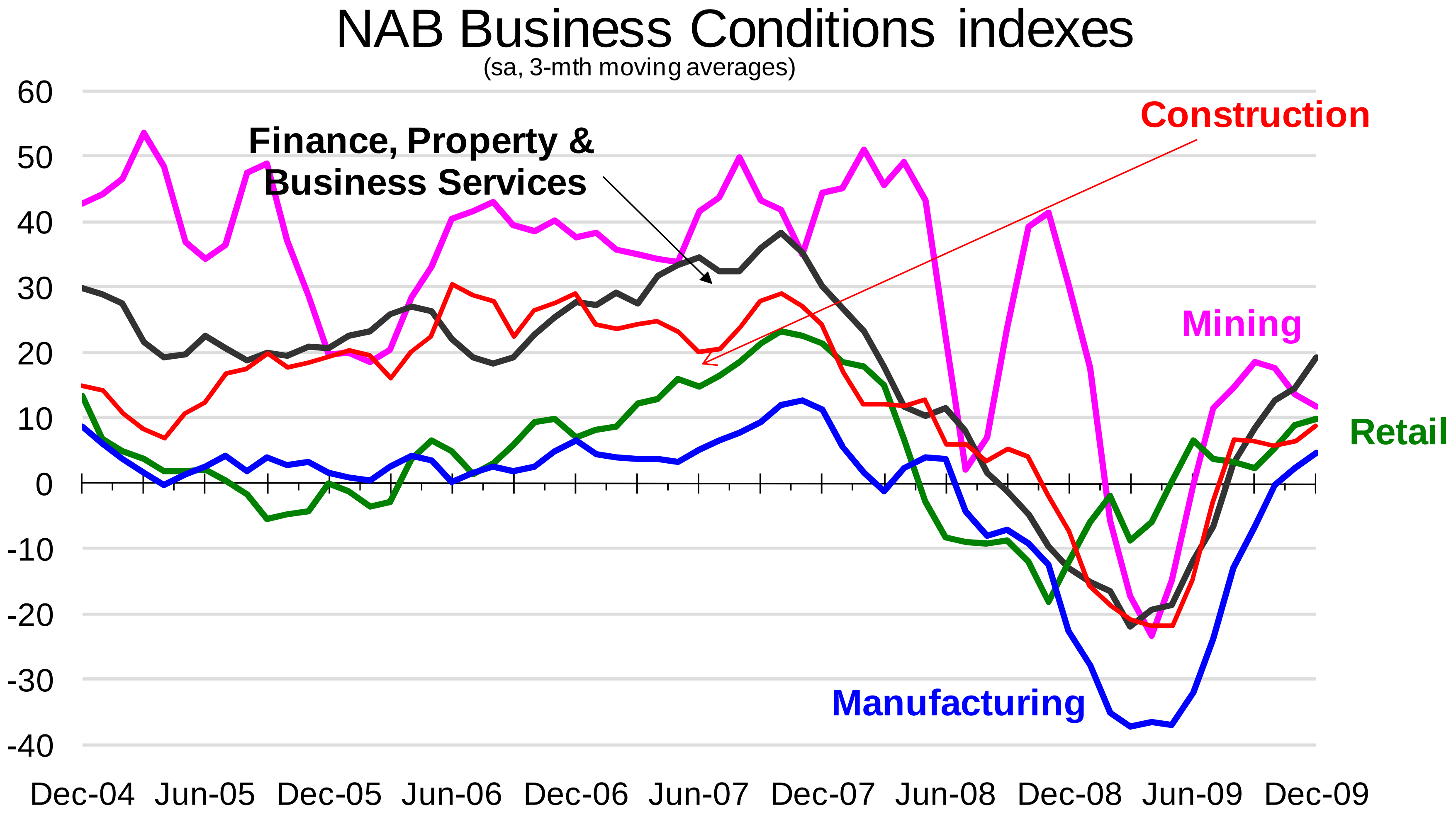
Business Confidence corrects; Conditions show solid growth



Housing lending solid but off the boil

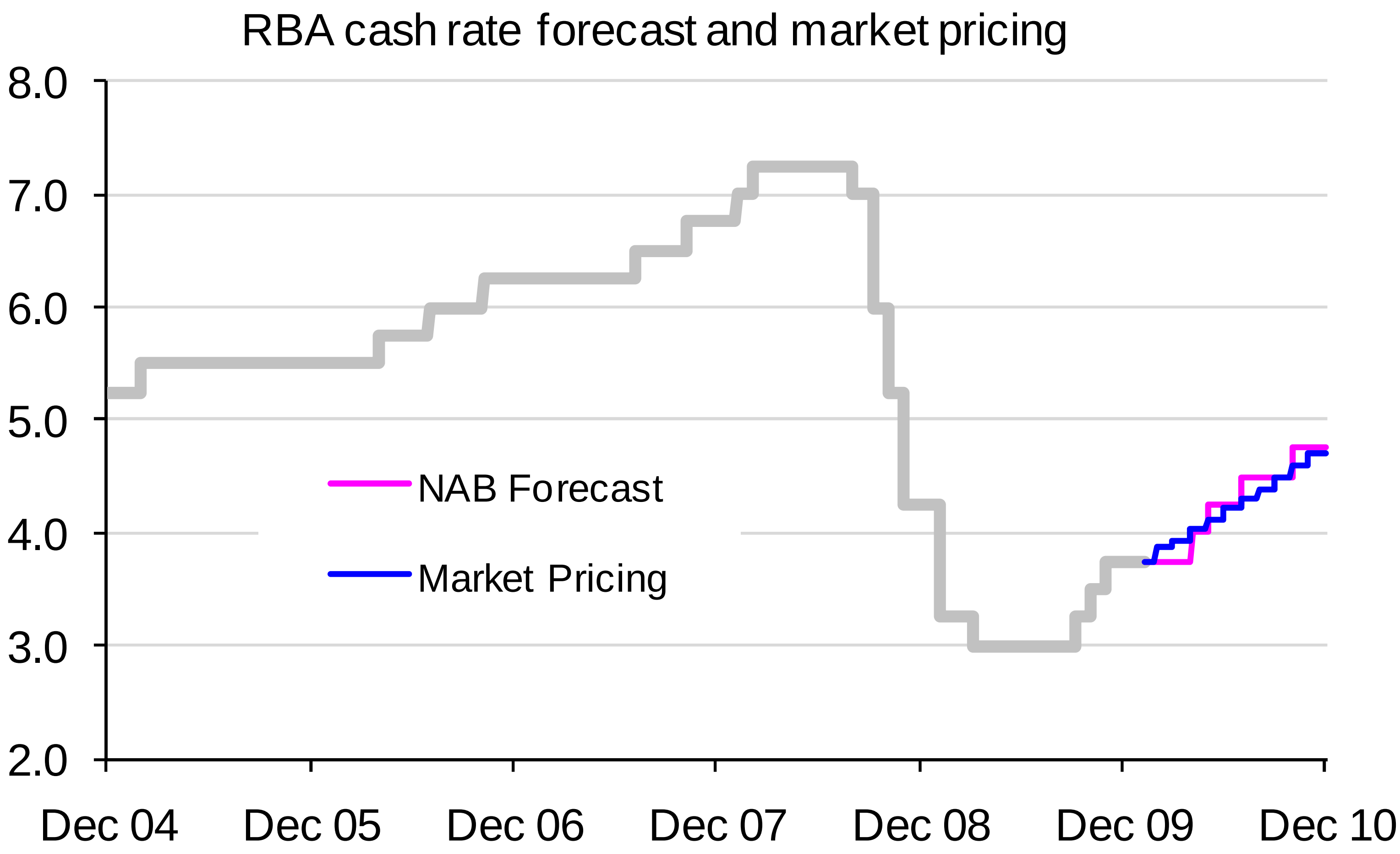


Business Conditions – Broad-based recovery; retail flattening



Source: NAB Business Survey

Market pricing in line with NAB forecasts after jobs data



Property Finance in a Changing Market

- **shifting sands**

  - preference for vanilla deals
  - emphasis on quality of property & sponsor
  - examination of local markets/outlook/geographic concentration
  - benchmarks changed by ~10%
    - loan to cost ratio
    - pre-sales hurdles & interest coverage
  - builder
  - lending limits, syndication and clubbing
  - areas of potential
  - areas of concern
  - granular concentration

The Bank funding cost debate – permanently higher

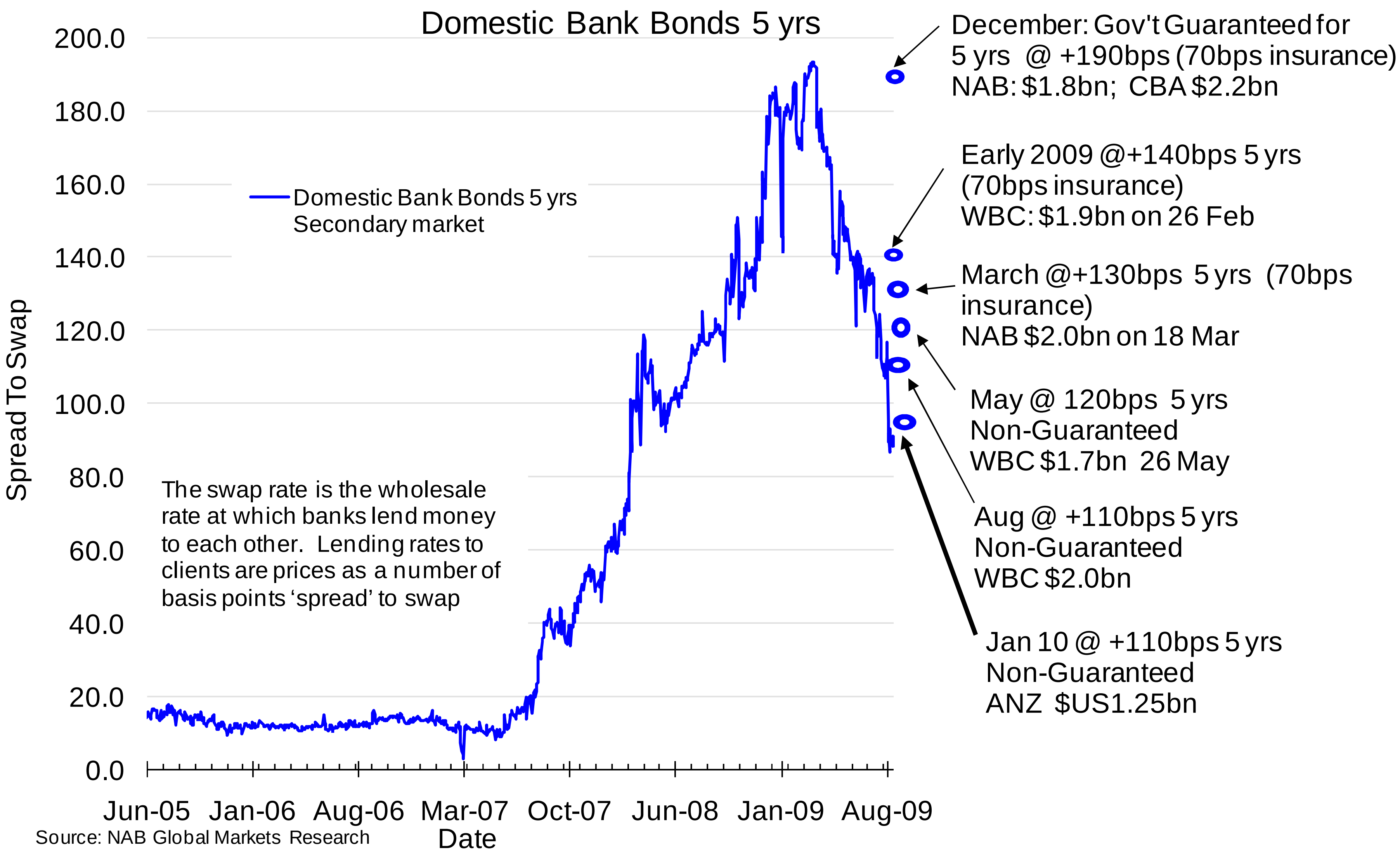
- Tighter regulatory and prudential standards
  - Banks require more stable funding mix
  - Rush for sticky retail deposits, yet deposits are only 54% of total assets so having to compete with other asset classes
  - Banks terming out debt – more 5+ year bond issues more common
  - BBSW no longer Banks costs of funds
  - Banks required to hold more capital
- The macro- cycle
  - Reduced competition
  - Banks cautious
  - Investors cautious

Pricing – a simple formula…

$$\Delta \text{ PRICE} = \text{COF} + \text{S/D} + \text{HL}$$

Not just price but also access to funding.

Term Wholesale Funding - The average cost of funds keep rising for banks – lending rates up



Source: NAB Global Markets Research

current construction funding – guidelines <u>only</u>

New development - residential

- financial capacity of builder essential (Property Construction Manager to confirm technical expertise/capacity);
- only top quality proposals with minimum 80% pre-sales cover;
- maximum LCR 80% for proposals with 100% pre-sales cover (and exit analysis);
- maximum LCR 70% for proposals with < 100% pre-sales cover (with exit analyses);
- emphasis on quality and spread of pre-sales;
- must have sponsor recourse (and capacity) for over-runs.

New development - office & industrial

- financial capacity of builder essential (Property Construction Manager to confirm technical expertise/capacity);
- minimum 1x ICR pre-commitment from strong tenants with minimum projected WALT of five years;
- maximum LCR 70% <u>and</u> projected on-completion LVR of maximum 60%;
- must have sponsor recourse (and capacity) for over-runs.

New development - retail

- financial capacity of builder essential (Property Construction Manager to confirm technical expertise/capacity);
- suitable level and quality of anchor pre-commitments, supporting minimum 1.4 times ICR cover when fully let;
- level of specialty pre-commitments must satisfactorily address Agreement to Lease conditions for Anchors to pay full base rents;
- maximum LCR 70% <u>and</u> projected on-completion LVR of maximum 60%;
- must have sponsor recourse (and capacity) for over-runs.

current construction funding – guidelines <u>only</u>

Land bank (dirty word!)

- maximum LVR 55%, including at least 12 months interest cap;
- the specific property is to have the necessary attributes to reasonably expect the DA / Rezoning shall be successful;
- sponsors to demonstrate the expertise & financial capacity to achieve the required DA / Rezoning;
- must also have sponsor recourse (and capacity) for at least a further 12 months' servicing.

projects funded – residential 2009

- Location
  - Brisbane suburbs, Sunshine Coast
- Scale
  - Stages up to max 100 units
  - Investment stock
  - $30m - $60m debt
- Conditions
  - Pre sales 90% - 100% (net debt)
  - LCR 70% - 75%
  - 15 – 18 months
  - Builder

Future Construction Funding (2 – 3 years)

- Lending has to increase
- Greater emphasis on track record
- More support for owner-builders
- Some softening of the basic lending parameters (LCR and pre-sales)
- Greater risk appetite (property type & structure)
- Equity still very important
- Increase in mezzanine lending / equity sources
- Land banks more favourable (but servicing key)

What Next........

- Further interest increases (inevitable)
- Easing in construction financing
- Potential further fall out in asset values
- Significant opportunities
- Continued pricing pressure on debt (post gfc – overpricing for risk?)
- Further debt to equity conversions
- Large re-finance task during 2010/2011 – no clear home now…

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