Eureka Funds Management Limited
ABN 47 107 346 841
Level 9, NAB House
255 George Street
Sydney NSW 2000
GPO Box 4201, Sydney 2001
P: 02 9255 0200
F: 02 9255 0299
www.eurekafm.com.au

7 April 2009

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir

RE Submission to the Senate Inquiry on the Australian Business Investment Partnership (ABIP) Bill 2009

1 Purpose

This submission to the Senate inquiry into the proposed ABIP legislation seeks to address the serious liquidity and capital management issues arising from the de-leveraging by the major domestic banks in respect of investments by Australian Superannuation Funds (**Super Funds**) in the Australian commercial real estate markets.

This paper proposes how the planned Australian Business Investment Partnership (**ABIP**) Bill 2009 could be improved for the benefit and protection of returns to the many millions of Australian Superannuation Fund members (rather than for the benefit of exiting foreign banks), improve the governance structure of the legislation and at the same time continue to provide job security for the many direct and indirect employees of the property fund industry.

Attached to this submission is a discussion paper which outlines in some detail many of the serious lending issues which currently face the unlisted wholesale property fund (**WPF**) market. An alternative suggestion or structure to ABIP is also explored being the establishment of a Super Fund Property Investment Partnership (**SPIP**). This is proposed to address the immediate certainty of funding that the Super Fund industry needs in the event that the establishment of ABIP is not achieved in the short term.

2 Background

Super Funds are major investors in Australian real estate on a medium to long term basis with typically, real estate allocations being between 5% to 15% of each Super Fund's total assets. WPFs investments in real estate currently represent approximately 25% of the total commercial property market in Australia.

The unlisted WPF industry has grown significantly over the last 15 years to become the principal conduit for Super Funds investment into Australian real estate. Australian real estate investment trusts (**AREITs**), which are listed on the ASX, have been more suited to retail investors than to Super Funds. Many Super Funds see listed property as having the same characteristics of an equity investment rather than the defensive investment characteristics of unlisted property.

The top 50 Super Fund investors have total investments of $32 billion in WPF real estate investments[i]. These same Super Funds represent in total some 11.5 million superannuation members

	Asset Values	Debt / Gearing	No of funds
AREITs[ii]	$205 billion	$72 billion / 40%	28
Unlisted Funds [iii]			
▪ **wholesale**	$75 billion	*$40 billion / 50%	187
▪ **retail / syndicates**	$30 billion	*$20 billion / 66%	106
Total	**$310 billion**	**$132 billion / 49%**	

* guesstimate

The majority of the WPF real estate exposure is in income producing investment property rather than speculative development property. The nature of underlying investment property leases has traditionally provided an appropriate long term inflation hedge for the Super Fund industry. Accordingly Super Fund investors have been long term property investors rather than short term speculators.

3 Issues / Consequences

The GFC has brought about a number of issues for the WPF sector that are now adversely impacting on Super Funds' current and forecast investment returns from the Australian commercial real estate markets.

These issues have not to date been fully addressed through Government GFC initiatives such as the proposed **ABIP** or the recent budget stimuli. Unless the 4 main Australian banks (**Major Banks**) can be encouraged into changing their property lending practices as part of their "social contract" in return for the Government deposit / inter-bank guarantee support and / or the ABIP legislation is amended, the serious lending issues are expected to continue in the medium term with significant negative consequences for Super Fund investments in real estate.

4 Issues Summary:

The serious refinancing issues facing the WPFs are outlined in detail in the attached report and are summarised below.

Super Fund sponsored borrowers in the real estate markets:

- have been adversely impacted by the GFC through changes to domestic bank lending practices and de-leveraging of the capital structures for real estate investment;

- are incurring ever increasing challenges in refinancing existing facilities, due to bank concentration, credit rationing and a general reluctance to refinance other banks' facilities;
- are facing further refinancing challenges in competition with exiting foreign banks, CMBS maturities, APRA deleveraging requirements of the Major Banks and Suncorp's withdrawal from commercial property lending;
- can no longer appropriately fund their real estate investments on a medium to long term basis that matches their investment horizons;
- have no capacity to make new investments in the real estate sector or energy efficiency improvements of existing stock due to constraints on the debt side of the capital management structure; and
- are facing regulated constraints through changes in APRA polices on aggregation that do not reflect segregation of fund assets normally applied by wholesale fund managers.

All of these issues ultimately have an impact on the retirement savings and returns of millions of members in Super Funds.

5 ABIP Bill recommended enhancements:

The following amendments to the ABIP legislation are recommended in order to quarantine an amount of the ABIP funding for use in refinancing by WPFs and thereby protect the interests of the Super Funds and their members and improve some of the governance structures.

a) Allocations Policies

- Priority needs to be given towards the refinancing of domestic banks looking to reduce their commercial real estate exposures in addressing APRA concerns of being over exposed to commercial property. This can be achieved by way of the domestic banks receiving an allocation of say 70% of the total funding that will be provided by ABIP Limited (based upon their current share of Australian real estate debt).
- Priority should be given towards refinancing involving wholesale property funds. This can be achieved by way of the wholesale property funds receiving an allocation of say 25% of the total funding that will be provided by ABIP Limited (based upon WPF's current share of Australian real estate debt).
- No single borrower (or related group) to access more than say 5% of the total funding that will be provided by ABIP Limited.
- Compulsory minimum funding percentage that a domestic or foreign bank must maintain to receive ABIP funding (e.g. domestic banks only permitted to refinance 50% with ABIP of their current exposure).

b) Term

- Extend the maximum term to 5 years to meet the medium to long term funding requirements of the real estate industry (which match the long term investment horizons of the Super Funds and their members).

c) Governance

- Have a governance structure such as a Supervisory Board to which the ABIP Limited board reports so that stakeholders other than the Commonwealth and the Major Banks can provide their property expertise and also put in place independent checks and balances to address any concerns of ABIP becoming "bank centric".

- Limit the ability of the Major Banks to veto a transaction. The Banks or ABIP management only have to make sure that the proposed loans are in compliance with lending guidelines / criteria set by the Supervisory Board.

d) Definitions

- Have a broad enough definition of commercial property to cover investments and loans in respect of trading operations such as hotels and car parks. (Such investments come under Super Funds property allocations but are sometimes deemed as business loans by banks).

e) Other

- Properly address ABIP restrictions that the commercial property assets being funded are only located in Australia and that there are no portfolio refinancings involving commercial property assets partially located outside Australia or financing of a head company that has invested partially in commercial property assets located outside Australia.

- Allocation for the refinancing of CMBS or situations where the Major Banks were warehousing portfolio loans in expectation of a CMBS refinancing.

- Provide a financial disincentive for those looking to refinance through ABIP (in order to discourage excessive use of ABIP).

- Have urgency in its establishment that recognises that the funding problems of the WPF are a "now" matter and something that cannot wait beyond the middle of 2009.

These recommended amendments are simple changes that will provide enormous benefits to Australian Super Funds and their members and address the medium to long term funding of the wholesale property funds industry which is facing serious liquidity and capital management stresses arising from the de-leveraging by the Major Banks.

Yours faithfully

Niall McCarthy
Director

Michael J. Cowan
Group Treasurer

---

i Rainmaker Information, December 2008

ii JP Morgan - January 2009

iii Property Investment research Feb 2009