Senate Submission to the Standing committee on Economics regarding Australian Business Investment Partnership Bill 2009

Summary

This submission is in support of the Federal Governments ABIP Legislation as a solution to the liquidity problems that are confronting the Property Development Industry.

The Global Financial Crisis is exacting an enormous toll on the Property Developer who has been caught in a space where capital markets have disappeared and the lending rules have changed. These changes, which have been implemented by the Banks without consultation with the Industry, are unworkable and projects are being shelved, jobs cut and Developers going into voluntary administration as a direct result.

It is proposed within this submission that the Senate Standing Committee consider the impacts that have flowed on to the Property Development Industry in regards to rule changes on lending criteria driven by a lack of debt funding. In considering this impact I would look to the Committee to make appropriate demands of ABIP around its lending criteria to ensure that it will promote recovery to the industry through viable and sustainable lending practices.

Submission

With the Global Financial Crisis has come a resurgence of conservatism from the Banks that is driven primarily by a liquidity shortage and a concern over bad debts and refinancing risks. To overcome this, the Banks have instigated there own market correction by hoarding cash to provision for doubtful debts and refinance exposure. This refinance exposure has extended to the risk of foreign Banks withdrawing from commitments in Australia.

The net result of hoarding cash to cut exposure is that the rules of lending in the sector have made property development unworkable.

The following is a summary of the rules that have changed;

1. Capital shortage means that the **size of the loan tranches available have reduced** dramatically from $100m to $30m

2. **Loan to Value ratios have been reduced** from 65-75% on project funding to 55% and on land acquisition from 55% to 20%. (Several smaller Banks will no longer lend to Developers for land purchase)

3. **Margins have been increased** from 80 basis points to 250-300, which effectively means that the Banks have kept the margin from Reserve Bank rate cuts. This in effect has meant that the pressure is off the Banks to increase new lending to meet shareholder returns

4. **Banks are lending to existing Clients only** - this cuts options and flexibility particularly with less banks now doing Property lending and some Banks telling one story of being open for business when in truth they are not.

5. **Increased presales required on projects** – presales have been typically 30% of projects revenue that normally equates to 50% cover for the loan amount. The new regime is a no risk approach of 100% debt cover. Presales are achieved typically by discounting the price to get the security required by the Bank. At 100% there is no Developer margin left which means the project will not proceed.

6. **Equity required has increased** - The mezzanine market has disappeared and with the Government Guarantee capital has retreated to the Banks rather than the mezzanine lenders. The end result is equity for a project has risen from around 20% of project costs to 45%, this means that returns and risk have now been skewed back to the developer to an extent that makes projects unviable.

Commentary

As an industry participant I can understand the need to tighten the belt and change the rules in an economic downturn, but to artificially skew the market with the assistance of the Federal Government is surely not the intention if it leads to the decimation of a viable and productive sector.

The risk that is run in this sector is that no intervention now takes place and the industry shrinks as a result of lending practices. The flow on effect is that a boom market will be created once lending is relaxed and pent up demand is released. Under this irresponsible approach we will go back to the very boom and bust economies that economic policy is trying to smooth out. Shortages in land and availability of housing will create inflationary pressure that could be avoided by a sensible transitionary approach.

There is no doubt that some restraint is required to lending practices in a downturn environment, however we are at the other extreme in which we threaten the viability of the Industry.

How can ABIP help?

ABIP is the only opportunity that the Property Industry has to work with the Government and the Banks to free up liquidity and set some sensible lending practices to help stabilise this important industry for the economy.

What the industry needs from ABIP is to raise urgently needed liquidity that can help with returning the Property lending market back to some stability by supporting robust and commercially sound projects that would have been underway by now had the lack of funds not changed the immediate landscape.