7 April 2009

Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee Members

Senate Inquiry: Australian Business Investment Partnership Bill 2009

Thank you for an opportunity to provide comments to the inquiry into the Australian Business Investment Partnership Bill 2009 and the Australian Business Investment Partnership (Consequential Amendment) Bill 2009.

The Property Council welcomes the Senate inquiry and strongly supports this legislation to inject stability and confidence into the economy.

The Property Council of Australia is the peak body representing the interests of owners and investors in Australia's $320 billion property investment sector.

Our members include the major Australian real estate investment trusts (A-REITs), developers, property advisors and investors who are significantly impacted by the proposals in the Bill.

Our submission is attached.

Yours faithfully

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Submission to the Senate Standing Committee on Economics

Australian Business Investment Partnership Bill 2009

7 April 2009

> "I think [a fire sale] is probably worth avoiding. So I do not have a problem with there being a plan [ABIP] in the top drawer…"
>
> Glenn Stevens, Governor of the Reserve Bank of Australia, February 2009

The **Voice** of Leadership

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PROPERTY COUNCIL of Australia

Contents

1. Introduction

The Property Council supports the proposed Australian Business Investment Partnership (ABIP).

ABIP is a temporary contingency fund.

It's designed to prevent a needless fire sale of well-performing property assets by bridging gaps in rollover finance that occur when banks, particularly foreign banks, exit the Australian marketplace.

It also encompasses a more general objective to provide financing in other areas of commercial lending if agreed to unanimously by the shareholders. This could allow ABIP to make new loans or support a property company's debt issuance with an ABIP guarantee.

The U.S. and Japanese governments are developing similar vehicles.

Submission Structure

This submission:

- summarises the case for ABIP;
- demonstrates that:
  - the Australian commercial property market is significantly exposed to foreign banking finance;
  - foreign banks are already exiting the Australian commercial property market; and,
  - there is a high risk that foreign banks will continue to withdraw or scale back their exposure to the commercial property sector.
- shows that the withdrawal of foreign finance will directly impact on:
  - jobs;
  - superannuation benefits;
  - small businesses;
  - housing and social investments; and,
  - 'mum and dad' investors.
- identifies and responds to the common criticisms made of ABIP; and,
- demonstrates that other nations are also addressing rollover financing deficiencies within the commercial property sector.

We have also provided appendices that summarise the ABIP legislation and the Property Council of Australia.

2. The Case for ABIP – In Brief

- **The property sector has a huge exposure to foreign financiers** – there is more than $30 billion of foreign credit in the commercial property market and more than 70% of syndicated loans are controlled by foreign banks.

- Several **foreign banks have *already* refused to rollover existing credit lines for commercially viable projects and assets**.

- Foreign banks face increasing **political pressure to re-focus on their domestic markets** – most of them are partially nationalised and are controlled by foreign politicians. In short, the pressure to withdraw from the property sector will increase.

- Where foreign banks refuse to refresh existing credit lines, many **property owners and developers will be forced to unnecessarily liquidate commercially sound assets**.

- The retreat of foreign banks increases the risk of an **artificial fire sale that could engulf all property asset prices**.

- A **meltdown would also harm the general business community**, which relies on property as a security for both operating and investment finance.

- An artificial collapse of commercial property values could also **squeeze the credit available to home buyers**.

- Credit rationing would also needlessly **delay the cyclical recovery of residential and non-residential property investment activity**.

- The bottom line would be **less new investment, slower economic growth and higher job losses**.

- A **contingency fund is needed** to address the exit of foreign funds **caused by factors totally extraneous to the fundamentals of the Australian economy and its property markets**.

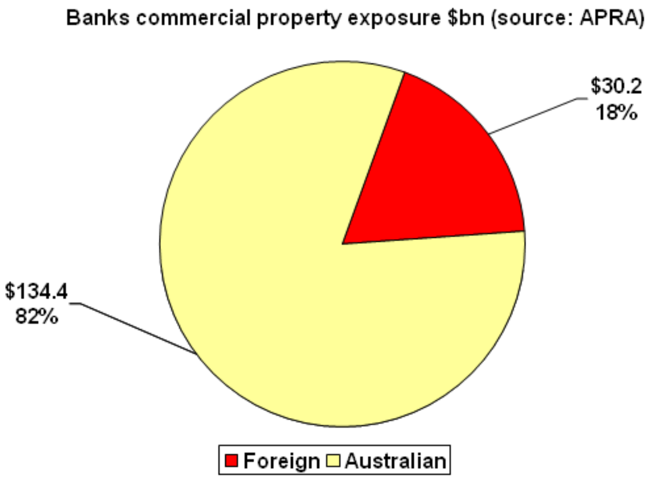
3. Is There A Problem?

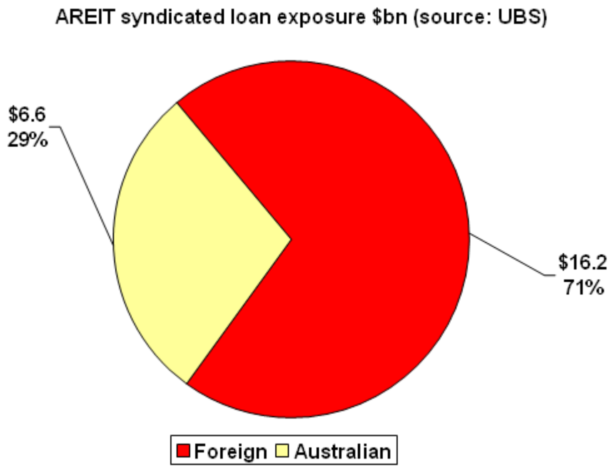
The sector contends ABIP is needed to address two major risks:

- the property sector's significant exposure to foreign banks; and,
- the withdrawal or scaling back of these banks.

The Commercial Property Sector is Exposed to Foreign Bank Finance

The commercial property sector has bank debt totalling $165 billion. **$30 billion (18%) of this total commercial lending is provided by foreign banks** (source: APRA 2009).





Australian real estate investment trusts (AREITS) have syndicated borrowings of $23 billion. **$16 billion (71%) of this is syndicated debt is provided by foreign banks** (source: UBS 2009).

Consequently, the commercial property sector is significantly exposed to the decisions of foreign banks, an increasing number of which are nationalised.

Are the Foreign Banks Really Pulling Out of Australia?

The Property Council has surveyed its members and they report that the following foreign banks:

- have already withdrawn funding; or,
- are at risk of reducing their exposure to Australian commercial property funding -

1. ABN AMRO
2. Bank of America
3. Bank of Nova Scotia
4. Bank of Tokyo–Mitsubishi
5. BayernLB
6. BNP Paribas
7. BOS International
8. Calyon
9. Chinatrust
10. Citi
11. Dexia SA
12. HSBC
13. ING
14. Lehman Brothers
15. Merrill Lynch
16. Mizuho
17. OCBC (Overseas Chinese Banking Corporation)
18. Royal Bank of Scotland
19. Societe Generale
20. Sumitomo
21. Toronto Dominion
22. United Overseas Bank
23. WestLB

Citi, Merrill Lynch and Royal Bank of Scotland have contacted the Property Council to question claims that they are scaling back or withdrawing from the Australian market.

This is symptomatic of the uncertainty that now confronts commercial property borrowers. The Property Council has written to all banks asking them to formally declare their forward lending strategies in relation to the **commercial property sector**.

The Property Council's firm view is that there is **clear evidence of foreign financiers leaving the Australian commercial property market**.

Foreign banks are already refusing to rollover their finance. There is evidence that they are exiting syndicates of well run Australian property businesses and tenanted properties.

The risk is that this trend will accelerate as global economic conditions deteriorate.

Duncan Fairweather, the Executive Director of AFMA (which represents foreign banks) endorsed ABIP "as a precautionary measure". While he argued the case for foreign banks, he also noted "that's not to say there won't be some degree of [foreign bank] withdrawal" (AFR, March 2009).

Domestic banks can't fill the void left by departing foreign financiers, which means owners will be forced to **needlessly liquidate their assets**.

Equity capital is equally scarce.

The major Australian banks say they are over exposed to the commercial property market, and that regulators are leaning on them to reduce their exposure to this sector. Consequently, there is virtually no spare capacity in the Australian debt market.

The CMBS and corporate bond markets are effectively closed to commercial property funding. ABIP is an essential mechanism to inject stability and confidence into commercial property lending.

Will Banks Keep Withdrawing?

The lessons learned from earlier Japanese, Latin American, Asian, Swedish and Russian liquidity crises, underline the validity of a contingency fund that addresses the risk of an economy-infecting fire sale arising from a single economic sector.

There is a high risk that foreign banks will cut back their lending as they refocus on their domestic markets. As already noted, Property Council members believe this process has already commenced.

The global financial crisis is creating 'siege economies' that could lead to an era of financial protectionism.

Last week, the managing director of the International Monetary Fund, Dominique Strauss-Kahn referred to the strings attached to bank bail outs as a "new kind of back-door protectionism".

Mervyn King, the Bank of England Governor, said that to reduce banking leverage without restricting lending to the 'real economy' would require the "netting of exposures" to cross border transactions. In short, international lending would fall to meet domestic economic and political priorities.

The U.K., U.S., Dutch and German governments have already told partly nationalised banks to increase lending at home.

Royal Bank of Scotland and Lloyds were each instructed to increase domestic lending by $32 billion over the next two years. The Dutch Government told the bailed out ING Barings to inject $33.2 billion into the Netherlands market this year alone.

Royal Bank of Scotland is reportedly selling its branches in Vietnam, Romania, Argentina, Pakistan and the Philippines and retrenching staff in 15 countries.

The Obama/Geisthner bail outs have also clearly emphasised the responsibilities of banks to focus on domestic markets, small business and jobs.

Global capital flows are expected to fall to $165 billion this year, from $929 billion in 2007 according to the Institute of International Finance.

It would be foolish to believe that Australia will prove immune to trends to repatriate capital as the global financial crisis deteriorates over the next year.

4. Who and What Will ABIP Protect?

This section outlines the beneficiaries of ABIP and provides some examples of situations where ABIP will operate.

Construction jobs…	☑	15,000 construction jobs have already been lost since August last year. Most of Australia's 448,000 construction firms are small businesses. 90% of these firms employ less than 15 people. ABIP will enable rollover finance for projects under construction – it will deliver a safety net for workers facing a 40% decline in construction spending over the next two years.
Australia's superannuation wealth…	☑	Industry funds create retirement wealth and income for millions of Australians. More than 10% of the industry fund investment pie is allocated to non-residential property. This exposes 10.4 million Australians to an artificial collapse of commercial property values. A needless fire sale will slash property values way beyond supply and demand fundamentals –this would result in lower income and investment returns for retirees and greater pressure on the social welfare safety net.

Small business and employment in general…	☑	When banks lend to small businesses they demand real estate collateral. An artificial hit to property prices will further squeeze lending to the small businesses that generate employment. ABIP would help minimise the risk of collateral damage to small business lending.
Housing and social investment…	☑	Property investors are now major developers of affordable housing communities, retirement villages and aged care facilities. The collapse of rollover finance will halt the continued growth of these emerging social asset classes. ABIP will stimulate the confidence that supports investment in these essential community assets.
Mum and Dad investors…	☑	More than 1.1 million mum and dad retail investors hold units and shares in real estate investment trusts (AREITs). The long-term retirement wealth of these Australians is impacted by the refinancing risk that ABIP addresses. Investors inject the capital that creates jobs. However, they won’t commit to new investment when they can’t rollover finance for their current assets and projects.

The Impact of Foreign Withdrawals - Examples

Example 1 - Brisbane: A leading property development and investment group is constructing a 5 star Green Star, $1 billion 79 level mixed use tower in Brisbane. This project has stalled due to the withdrawal of foreign bank re-financing. 600 construction workers have been laid off or redeployed until re-financing is found. The site has been closed.

Example 2 – Southwest Sydney: A publicly listed property group is building a mixed-use development that includes residential premises targeted at first home owners. The project bankers have cut back on their originally agreed credit facility. The project cannot be re-financed and is likely to stall. Other associated projects have been deferred.

Example 3 - Victoria: A publicly listed property company is developing a residential land subdivision project in Victoria. The project is 50% complete and financially sound. Despite previous agreements, the foreign bank financier has stopped any further payments (and any further Australian property lending). The project and associated jobs are now in jeopardy.

Example 4 – Perth: A publicly listed property group is developing a significant multi-stage residential project in Perth. The banks have reduced their original funding commitment, which means the project will now stop at the completion of the current stage of development. This will inevitably cause substantial job losses for employees and sub-contractors if alternative financing cannot be found.

Example 5 – Australia: A publicly listed property group with property across Australia refinanced a syndicate loan in early 2009. Four foreign banks refused to re-finance the syndicate as their new owners (foreign governments) want the project capital returned to the UK. As a result, the property group is radically reducing the number of projects under development. This will result in major job losses and cancellation of sub contracts.

Example 6 – Indirect Investor: A property securities fund that has investments in over 40 Australian unlisted property vehicles has been told by its foreign bank that a finance facility will not be rolled over despite the fund's modest gearing levels. The fund will be forced to needlessly liquidate assets. This impact will cascade through the underlying property funds which will need to realise assets to fill the liquidity gap.

The Property Council can provide further details on a confidential basis if necessary.

5. Criticisms of ABIP

This section summarises and responds to common criticisms of ABIP, including the proposed governance arrangements.

Q. Won't ABIP simply prop up over-inflated property values?

A. ABIP won't artificially prop up values. It is designed to stop a free-falling *over-correction* of values. The Australian property market is already re-pricing itself. Capital values should find their new level in terms of *market fundamentals*, not a liquidity shock caused by political forces and priorities in other countries.

- ABIP re-financing will only be extended to projects or assets that are *commercially viable*.
- Loans will be made against *new valuations* based on supply and demand fundamentals.
- Commercial rates of interest will be charged. There is no free ride or bail out.
- Plus, all five ABIP partners - the four banks and government – must unanimously agree every ABIP re-financing.

Q. Won't ABIP actually tempt foreign banks to exit Australia?

A. The political economy of burgeoning government bank nationalisation is the decisive factor – a large number of foreign banks will exit commercial property lending or scale back dramatically in order to meet their domestic economic and political priorities. The existence of ABIP is a minor factor in such a calculus.

Q. How will ABIP save jobs?

A. ABIP will safeguard existing construction projects and jobs in both the multi family residential and commercial property sectors by maintaining liquidity. These sectors are already under major stress. The exodus of foreign banks would break the back of the construction industry.

- 15,000 construction jobs have already been lost since August last year.
- More than 90% of these construction workers are employed by small businesses.
- Property companies are shedding around 10% of their staff. The trades and professions, such as architects, are heading for job losses of 20%.
- $109 billion of construction projects were shelved in 2008 – nearly eight times the historical average.
- Development approvals are down 26% for new residential projects and 35% for non-residential projects (compared to February 2008 levels).
- Failing to implement ABIP risks decimating the nation's property and construction skills base, just as occurred in the early 1990s.

- The Construction Forecasting Council's April 2009 report predicts construction sector job losses of 75,000 over the next two years. ABIP won't protect all these jobs, but will help inject the confidence that leads to job-creating new investment.

Property owners and financiers are keen to invest in *new* development activity (and to create jobs). However, they cannot do so unless finance for their *existing projects* and *existing assets* is safeguarded.

Q. Shouldn't ABIP cover residential development?

A. It would. Institutional developers are the fastest growing segment of the quality residential market and of master-planned communities. They also face the greatest exposure to foreign lenders. Consequently, there is a direct link between the availability of ABIP gap-funding and the uninterrupted supply of new homes.

Q. Aren't the commercial and residential property sectors totally separate markets?

A. Not in today's fluid capital markets. The U.S. and U.K markets show that when the value of commercial property plummets, lending for ordinary home buyers and new residential development is squeezed.

Q. Don't other sectors deserve assistance? Shouldn't the government focus on SMEs?

A. Real estate provides the collateral for the Australian economy. The Australian Chamber of Commerce and Industry has said that the withdrawal of foreign bank lending would cause instability and undermine confidence that would spread to small businesses that borrow against their property holdings. An artificial property fire sale would further tighten the screws on lending to SMEs and could tip Australia into a recession as deep as the U.K. and U.S. markets.

Q. Isn't ABIP too narrowly/broadly designed?

A. ABIP can expand in size (up to $30 billion) and cover other sectors, such as infrastructure or other commercial lending activities, subject to strict lending and risk criteria and the unanimous agreement of its shareholders.

Q. Isn't this liquidity problem caused by the property sector's high gearing levels?

A. Average gearing levels in the Australian commercial property sector have always been lower than average gearing in international markets, such as the U.S.

The sector has spent the past 15 months moving gearing from around 35%-45% down to 25%-30% and lower.

Q. How will ABIP ensure taxpayers' money isn't wasted?

A. ABIP is a contingency fund that, if activated, will deliver a commercial return. There is no reason for taxpayers to be 'out of pocket'. ABIP's credit and risk criteria will soon be finalised along with a transparent governance structure.

Q. Is ABIP's Governance Model Adequate?

A. The Bill contains appropriate safeguards to share risk and reward with the private sector and minimise risk to the government and tax payers.

Firstly, ABIP will provide refinancing of loans relating to commercial property assets in Australia where finance is not available from commercial providers other than ABIP, and the assets would otherwise be financially viable.

So, ABIP will only be able to fund viable assets. ABIP is not designed to be a toxic asset fund and not designed to expose the government and tax payers to toxic asset risk.

The Bill and Shareholders Agreement contain appropriate governance arrangements for the exercise of ABIP's powers and functions including:

- the Commonwealth's nominee will be the Chairperson of the Board of ABIP;
- board resolutions, apart from resolutions to commence enforcement processes in relation to property of a borrower, must be unanimous. This provision protects all shareholders by ensuring that commercial property assets are only supported where all directors consider that the asset is financially viable;
- resolutions to commence enforcement processes may be passed by four of the five directors. The director nominated by the Commonwealth (or its alternate) must be one of the directors supporting the resolution;
- the directors of ABIP will be required to give the Minister a copy of ABIP's financial report, directors' report and auditor's report for each financial year;
- the Minister will table the reports in each House of the Parliament;
- ABIP's auditor will be the Auditor General;
- the directors of ABIP will be required to establish and maintain an audit committee with functions that include: assisting ABIP and its directors comply with obligations under the Corporations Act; and

providing a forum for communication between the directors, the senior managers of ABIP and the auditors of ABIP;

- the audit committee must be constituted in accordance with any regulations made for the purposes of subsection 44(2) of the Commonwealth Authorities and Companies Act 1997;

- the shareholders of ABIP will enter into a Shareholders' Agreement which will outline, among other things, the operation, control, management and funding of ABIP;

- to provide greater transparency for ABIP's operational arrangements this agreement, and any amendments to it, will be made public as soon as practicable after it is entered into; and,

- to protect shareholders' interest, any major domestic bank that is an existing participant in a financing arrangements before ABIP, must maintain at least their existing level of financing in percentage terms. This will provide a safeguard to ensure that ABIP only lends on fully commercial terms.

Q. Can the Proposed Governance Arrangements Be Improved?

A. The Bill and Shareholders Agreement do not contain specific information about lending terms.

These would normally be a matter of policy for a lending vehicle or institution.

However, should the government choose to further enhance transparency and address any concerns over lending criteria, it could consider:

- requiring independent property valuations for assets subject to refinancing consideration;
- setting a pricing structure for interest rates for ABIP loans; and,
- setting a loan to value security requirement limit for ABIP loans.

These could be included in measures in regulations to the enabling legislation, or included in a lending policy and made available publicly.

In addition, the bill includes a more general objective which enables ABIP to provide financing in other areas of commercial lending if agreed to unanimously by the shareholders. This suggests a commonsense approach of broadening ABIP's focus from refinancing existing debt to assisting companies to raise new debt to fund viable projects.

It would be desirable to develop criteria by which ABIP would determine whether or not it will exercise its general power to provide funding for viable projects.

This criteria could also be clarified in regulations to the enabling legislation and would be welcomed by the industry.

6. Similar International Action

Overseas governments are acting now to provide stability and confidence in their homeland lending and asset financing markets.

The United States Treasury has recently announced its US$1 trillion Public Private Investment Program (PPIP) as a component of the US Financial Stability Plan.

This is in addition to the previously announced Term Asset Backed Securities Liability Fund (TALF) and Troubled Assets Relief Program (TARP).

The PPIP and TALF schemes were recently extended to cover the commercial property sector.

The PPIP has three basic principles:

- maximise the impact of each taxpayer dollar by co-investing with private funding;
- share risk and rewards between government and private investors; and,
- use private sector price discovery to reduce the likelihood that the government will overpay for these assets.

The United States' stability plans include further safeguards to manage investment and lending risks, including requirements for independent credit rating assessments, lending rates and collateral security ('haircuts').

The Japanese government is increasing its one billion yen refinancing program to three billion and extending it to cover real estate rollover finance.

The Japanese government is also considering a one trillion yen investment fund (similar to the US PPIP) where private and public funding would capitalise a vehicle that would then lend to Japanese Real Estate Investment Trusts (J-REITs).

7. Conclusion

ABIP is designed as a contingency fund.

Ideally, foreign banks could commit to the Australian market place and maintain their commercial property lending.

However, the global financial crisis and the rising risk of a new era of financial protectionism call for a mechanism that will address looming liquidity traps.

Real estate provides collateral that underpins the entire banking system.

Unfortunately, real estate business models are not designed to operate in dysfunctional debt markets.

A needless fire sale of property assets would extract a human cost in jobs across all sectors of the community, worsen the economic downturn and delay the recovery.

ABIP provides a back-up system to Australia's banking finance regime.

Similar to an IT back-up system one would hope it is never needed. Nevertheless, it is prudent to develop and implement back-up programs prior to a crisis occurring.

The Property Council believes ABIP achieves this objective.

Appendices

1. Summary of ABIP
2. Property Council of Australia

Appendix 1. Summary of ABIP

The Bill provides for the incorporation of a company, called the Australian Business Investment Partnership Limited (ABIP), to address the risk of liquidity constraints and a funding gap emerging in the commercial property sector.

ABIP will be established as a temporary, contingency measure to provide liquidity support for viable commercial property assets where financiers have withdrawn from debt financing arrangements as a result of the global financial crisis.

ABIP will be established under the Corporations Act 2001 and will be a public company limited by shares. The members of ABIP will be:

- the Commonwealth of Australia
- Australia and New Zealand Banking Group Ltd
- Commonwealth Bank of Australia
- National Australia Bank Ltd and
- Westpac Banking Corporation.

The Government and the four major domestic banks will provide initial loan funding to ABIP and an amount for working capital.

The Government will provide $2 billion and the major banks will provide $500 million each. Accordingly, on its establishment, ABIP will have access to $4 billion in undrawn loan facilities, less an amount for working capital, expected to be $4 million.

The financing provided by the major banks will not be Government guaranteed.

ABIP will provide loans to commercial property assets that meet ABIP's lending criteria, determined by its shareholders.

ABIP will only provide funding for commercial property where the underlying assets, and the income streams from those assets, are financially sound.

ABIP will only be able to enter into new refinancing arrangements of commercial property assets for two years from the date of its establishment.

If additional financing is required beyond the initial contribution of $4 billion, ABIP will be able to issue up to $26 billion in debt to raise that additional funding, subject to the unanimous agreement of shareholders. This could provide ABIP with up to $30 billion in financing.

Debt issued by ABIP will be Government guaranteed.

Appendix 2. Property Council of Australia

The Property Council represents the public policy interest of the investment property sector in Australia. It also fosters a more informed, connected and professional property marketplace.

The Property Council serves the interests of companies across all four quadrants of property investment activity, as well as property developers and managers. Associate members include Australia's leading professional services and trade providers.

Property Council members own or manage $320 billion of assets in all categories of investment activity, including offices, shopping centres, industrial premises, tourism and leisure facilities, aged care and retirement homes, master planned residential communities and mixed use development.