CommonwealthBank

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Submission to the Senate Inquiry into the Australian Business Investment Partnership

Purpose

The purpose of this submission is to outline the Commonwealth Bank's views on the Australian Business Investment Partnership (ABIP) with consideration of our role as a shareholder and debt provider.

Background

In late 2008 the Commonwealth Bank (The Bank) was invited by the Government to join discussions aimed at finding a solution to the potential for a looming funding problem in the Australian commercial property industry ("the industry"). The Bank joins with the Government in seeing a risk that this funding problem could have an undesired impact on the Australian economy. As a result of discussions among the Government and major banks, the Australian Business Investment Partnership (ABIP) proposal was developed.

The underlying rationale for the development of ABIP was the view that there is a risk that some traditional sources of finance for commercial property, such as debt capital markets (Commercial Mortgage Backed Securities, or CMBS, and medium term notes, or MTNs) and foreign bank lending, may become less available in the future. Additionally, some financiers that operated in this sector have failed or are no longer providing finance.

As an example: The CMBS market is effectively closed to both new issuance and rollover of maturing facilities, with borrowers forced to turn to bank loans and new equity capital to refinance. Our research indicates CMBS maturities during the two year life of ABIP are:

May 2009 - December 2009 :	$2452m
All of 2010 :	$2377m
January 2011- May 2011 :	$512m

Having already filled some of the funding gaps that have arisen since the global financial crisis began, the capacity of the domestic banks and the foreign banks that remain active in commercial property to continue to fill these funding gaps has diminished.

The last major economic slowdown in Australia occurred in the early 1990s and the property industry was heavily affected. However, the dynamics of the industry were different then. There was a lot more construction underway. The industry had an oversupply problem looming. In the current cycle, supply remains limited, due in large part to the prudent development lending requirements of the major banks based on the lessons learned in the last cycle. Also, occupancy rates of existing buildings remain at acceptable levels and rental incomes from the properties continue, in the main, to be reliable. This limited supply, coupled with stable rental income streams and a low interest rate environment provides the foundations for the system to get through this slowdown with less economic pain than last time around, provided the funding liquidity problem can be resolved.

State of the Commercial Property Industry

While valuations in the industry have fallen on average between 15% and 25% from their peaks, there has been little turnover of property and there remains an overhang of stock. There are buyers interested in making purchases, thereby adding new equity to the market. However, buyers need to be comfortable that valuations have stabilised, or are close to doing so, and they need to be able to obtain finance.

Owners of commercial property are generally comfortable in maintaining their ownership, as rental income remains solid. In general those that are selling are doing so because they need to reduce gearing.

The market is well aware of the above-mentioned CMBS maturities – the amounts maturing are relatively large and capacity of financiers may not extend to cover those large amounts. If they are not refinanced, a process is triggered whereby underlying assets will eventually be put up for sale, thereby increasing the overhang of commercial property on the market, putting further downward pressure on values.

ABIP will potentially be able to provide refinance for commercial property. Whether ABIP does or does not eventually refinance Australian commercial properties is less material than the fact that ABIP exists specifically to forestall a funding crisis, should it develop. In turn, the hope is that this will give the market a boost in confidence and limit the development of a fire sale mentality for both vendors and purchasers.

Commonwealth Bank's Capacity To Assist

The prudential framework under which Australian banks operate requires concentration limits to be maintained on exposure to industry sectors and to single clients. This is prudent banking and is not new. CBA is approaching the maximum level of commercial property industry concentration that we deem to be appropriate. Demand from clients in the industry may become greater than our capacity to assist through normal lending processes. We see the ABIP structure as a way to create confidence in the near-term future of commercial property and, as necessary, use the limited additional funding we can make available to the industry in a way that will satisfy a far greater proportion of the potential liquidity needs of the industry. That is, the additional lending capacity we and the other major Australian banks provide, when joined with funds provided by the Government, are harnessed through the ABIP vehicle to make an effective contribution to liquidity problems that might develop in commercial property.

Management of Risk

The lending criteria that govern ABIP's potential loans to the industry are prudent, driven by a desire from the banks not to expose their shareholders' funds to excessive risk, and the Government's desire not to expose taxpayers' funds to excessive risk. The need for unanimous support from the nominees of each of the major banks and Treasury provides us with comfort that ABIP funds will be used prudently. The extension of this need for unanimity to most decisions helps reinforce ABIP's robust governance structure.

CBA takes comfort that ABIP will operate for a relatively short two year period from its commencement date, with a further period of up to 3 years to allow its loan book to be run down. It is our view that a two year period will be sufficient for the industry to stabilise, hence letting ABIP sunset itself. With only modest new supply of commercial property entering the market in most parts of the country, a recovering economy should see net absorption of space, and vacancy rates coming down from their peaks.

We note, and agree with, the policy that ABIP will not refinance a loan from any of the four major banks. Where ABIP joins a lending syndicate, the major banks will maintain their prior committed participation in that syndicate, alongside ABIP.

Conclusion

The Bank recognises ABIP as a "liquidity backstop" for the commercial property industry that should provide a boost to confidence and assist stabilisation of the industry by reducing refinance risk to the extent that it is used, whilst risk exposure of both taxpayer and shareholder interests will be prudently managed.