



Bi-Annual Economic Review

**THE UPDATE ON NON BANK PROPERTY LENDING
BY CHIFLEY SECURITIES**

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Non Bank Lending Growth

ACCORDING TO THE FINANCIAL STABILITY BOARD AUSTRALIA HAS A RELATIVELY LOW PROPORTION OF TOTAL FINANCE PROVIDED THROUGH THE NON-ADI SECTOR.

The non-ADI sector is moving closer to achieving pre-GFC market share for commercial property finance. It is expected that a 70/30 split between ADI and non-ADI sectors will be achieved over the next three years. The ReserveBank of Australia has identified that the movement in these ratios is the most important in explaining growth in capital exposures of the non-ADI sector. Over the next two years, non-ADI's could reach commercial property exposures of \$81 billion which will be greater than any year since 2006. Non- ADI exposures relating to commercial residential property are expected to be between \$17 billion and \$20 billion by 2021.



ABOUT CHIFLEY SECURITIES

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“ *Economic conditions remain conducive to further growth in commercial property finance lending in Australia. The Non- Bank Lending Sector (NBLS) will continue to take an increasing share of this market over the short to medium term.* ”



Rates

HISTORICALLY LOW INTEREST RATES, ALONG WITH EXPECTATIONS OF DOWNWARD PRESSURE IN THE MEDIUM TERM, HAS SEEN BORROWERS MORE WILLING TO SEEK NON-BANK FUNDING. THE PROPERTY MARKET IS AT THE BOTTOM OF THE CYCLE AND BORROWERS FEEL THEY HAVE WEATHERED THE MARKET DOWNTURN.

To capitalise on emerging opportunities in a pick-up, borrowers are supplementing existing banking facilities with non-bank finance. Some commentators believe this is temporary. We don't agree – unless there are some extreme global market shocks. By diversifying borrowings, property developers can better manage single point lender risk. On the other side of the equation, a low interest rate environment will see investors seeking higher relative returns which should increase the amount of capital available to the NBLs. There will be more funds flowing from non-banks to fill the financing gap now and in the future. Non-banks will sharpen the face value of their offerings and diversify their products to meet the market.



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The remarkable trend from this downturn has been the reduction in loan impairments. Typically, as markets fall loan impairments rise. APRA estimates loan impairments in Australia to be at record lows of 0.16%. This could be due to numerous factors. It is most likely that, historically low interest rates have allowed borrowers to weather the market downturn. As interest rates remain low so too will impairments. Prudent lenders in the non-ADI sector that appropriately align risk and return will experience similarly low rates of loan impairments to the traditional banks.



Tighter Regulations for Property Lending

Basel III regulations will be adopted in Australia in 2019. These regulations will put further restrictions on the composition of commercial property lending for Approved Deposit Taking Institutions (ADI's) in Australia. Basel III unfavourably reweights ADI's commercial property exposures, land acquisitions and development exposures. This may lead to capital restructuring by ADI's as they reevaluate risks and see a flight to nonbank capital by the commercial property sector. The Australian Prudential Regulation Authority (APRA) is also imposing light regulations on the non-ADIs. These regulations include regular disclosure. It is unlikely that these regulations will materially impact on the availability of capital to the non-ADI's. New regulatory settings provide a distinct competitive advantage for non-bank

lenders as they have more control of their loan books to meet market demands. Tightening requirements on banks simply institutionalises a shift in funding supply. The only issue is that the ADI sector is yet to exhaust its loan allocations across all property asset classes but in a market upswing that could turn around rather quickly.

While it is the view that the property market has bottomed, there will be volatility as it picks up. Issues with structural defects in (some) buildings in Sydney will see buyer demand dampened in the very short term. Government stimulus (in terms of deposit support) will be provided for first time house and land purchasers which and should lead to a pickup in sales in Sydney and Melbourne markets in the new year. An examination of the Sydney market, shows

“ *The commercial residential property market will experience volatility until it returns to full swing in late 2021. Nonbank lending will continue to increase market share throughout this time and play an important role in the recovery.* ”



segments of the market moving back into an excess demand environment (from oversupply over the past year). Population growth remains strong in major markets and completions have fallen considerably. Exposure limits for ADI's are falling for land subdivisions and other residential so it is likely that non-ADI's will pick up the slack in the shorter term. In terms of other commercial property, ADI's have lending capacity for office, retail and industrial.

This would mean that non-ADI growth in these asset classes should remain stable least amongst asset managers. The pipeline for apartment projects has severely diminished as projects rushed to complete at the back end of the last cycle. The NSW planning system is one of the most inert in the world, so it will be the brake on a market recovery. It is not expected that the pickup will be in full swing until the end of 2021.

Banks Versus Non-Banks In Residential Property

Apartments comprise the overwhelming majority of completions in major residential property markets. With buyer concerns about build quality and major structural defects, off the plan purchasers have deserted the market for the very short term. Non ADI's will

be an important provider of finance to developers. There are some good products available in the market at the moment. Chifley has some of the most competitive low doc products available for developers with interest rates starting from 6.5% (excluding establishment and line fees).

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