THE AUSTRALIAN

Squeeze on lending a property headache

By **BEN WILMOT**, COMMERCIAL PROPERTY REPORTER

The chief executive of non-bank finance group and property lender Chifley Securities, Dominic Lambrinos, says the "rationalisation" of private lenders is the most striking aspect of the current coronavirus-led downturn.

"The departure of lenders over the last few weeks means there is less money available than there are transactions, with a flight to quality in deals and an increase in the price of money, despite the recent move of the Reserve Bank to lower the cash rate," he said.

The Reserve Bank has called out commercial property as an area of risk as the coronavirus strikes financing, saying highly leveraged owners could struggle if tenants are unable to pay rent, particularly in retail property where the sector faces a grim time.

The central bank's latest Financial Stability Review, released last week, warned that conditions in commercial property markets were deteriorating, noting that even before the pandemic hit, malls were facing challenging conditions due to weak consumer spending and rising competition.

Mr Lambrinos said that after a period in which too many players had chased property deals, current rates more accurately reflected risk. Chifley reported that industrial and residential property remained active, while the retail sector had fallen hard and would take a long time to recover.

Mr Lambrinos was pessimistic on office towers, saying they would be stagnant for months and warning of long-term pain as companies became used to working remotely instead of in high rental city buildings.

"Government restrictions have also seen the sudden and sharp demise of the hospitality segment, with hotels, food and drinks venues hit particularly hard," he said. This area would bounce back once restrictions were lifted, but Mr Lambrinos said the residential sector would be the most

resilient. “The underlying benefits arising from low interest rates still exist to support the end user in the development construction finance cycle,” he said.

The RBA’s review warned that with many tenants shutting down and some threatening not to pay rents during the crisis, declines in rents and increases in vacancy rates were “now likely”.

It also sounded an early warning about once vibrant office markets, saying these were also expected to deteriorate, partly as they must absorb a wave of new office towers being completed in Sydney and Melbourne this year, with demand “unlikely” to keep pace with the additional space.

Most building sales that were in train before the crisis have also been shelved and the central bank expects declines in both sales volumes and valuations, reflecting weakness in rental markets and institutions repricing assets. These pressures have left listed property groups racing to put new financing in place to see them through the turmoil.

Jefferies analysts Sholto Maconochie and Andrew Dodds said major listed property trusts had learned lessons from the global financial crisis and, unlike that time, COVID-19 was a cashflow and solvency issue rather than liquidity problem. The analysts stress-tested the balance sheets of A-REITs and found they could withstand significant pressure on income and fundamentals without the need for heavily dilutive equity raisings.

However, the RBA review warned that geared investors could breach loan covenants, drawing in their lenders, and incomplete projects were also a problem. “For developers with projects still under construction but with currently unsold properties, it could be difficult to finalise sales at a profitable price. Developers will then be left holding inventory — and debt — on their balance sheets with little or no revenue. This is a key risk for lenders,” the bank said.

The analysis said banks had incurred substantial losses from construction loans in past downturns and, while this was only a small share of business lending, it had grown rapidly. Commercial property is just 6 per cent of overall bank lending, but non-bank lenders were “particularly active” in construction lending, including for building units.

Real estate investment manager Qualitas has not seen any distress or sharp falls in valuations appear since the outbreak of the pandemic. Managing director Andrew Schwartz said it was crucial to differentiate between high-quality prime commercial and secondary style assets.

"This new COVID market will differentiate between quality of income as much as quality of the physical real estate; there will be prime income and prime property and they may not come together," he said. Mr Schwartz said assets generating prime income may be more valuable than traditional prime property, particularly where the underlying tenant and its use of the asset was a critical or essential business in the new economy.

BEN WILMOT, COMMERCIAL PROPERTY REPORTER
Ben Wilmot has been The Australian's commercial property editor since 2013. He was previously a property journalist with the Australian Financial Review.