What just happened to Private Commercial Finance?

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Introduction

I'M JUST WONDERING HOW MANY COVID-19 TYPE EMAILS HAVE YOU RECEIVED IN THE PAST COUPLE OF WEEKS? I KNOW I'VE RECEIVED HUNDREDS.

THE TERM WHICH STANDS OUT IN ALMOST EVERY EMAIL FOR ME IS "UNPRECEDENTED TIMES".

It was 40 years ago when I first wore a suit and tie and started business life as a cadet accountant. So for me when I relate to Unprecedented Times, it's something that I've never experienced in 40 years.

Sure I saw Wall Street's Black Monday in 1987, and then I saw home loan interest rates climb to 18% when Keating gave us the Recession we had to have in 1990. Finally and quite a while later securitisation blew up into the GFC in 2007.

I understand how these issues affect the market and how the market gets out of a hole, what I don't understand is how to react to a constant and never ending uncertainty as is the case with this global virus.

I have read that this time is different because instead of supply (of money) drying up like the above 3 examples, the demand to spend money has virtually stopped except for staples of course; and retail is closing it's stores one chain at a time.

However, demand has not really dried up at all and I still can't get toilet paper (I wish I had listened to my wife and installed a bidet!). Companies who make sanitiser have all been making super normal profits lately – and many new companies are adapting their manufacturing lines to make sanitiser, masks etc etc.

Therefore the issue is to look at where the demand is in the property sector because it doesn't matter what happens with the virus, there will all be less uncertainty where there is more demand.

The last 2 weeks

With more and more business closing their commercial offices and working from home, the reality of how severe the Virus is for Australia finally set in. At the same time, mass business closures for an indefinite time brought about employment uncertainty and long Centrelink queues.

For a moment in time it looked like the perfect catastrophe was unfolding before our eyes. And the finance market panicked.

It looked like the government was reducing demand for a whole segment of the economy. But what they take with one hand, they give with the other – and stimulus packages were brought about to provide confidence in the market that demand was still going to be there.

So how did this relate to Private Finance?

Some went back to equities to take advantage of huge recent write-downs in stocks, whilst others could have had large margin calls – I will never know. Most just pulled out to wait and see what happens next to the market.

International funds have had a similar experience and again there is a wait and see approach and contributory funds are all but closed.

However this is not everybody. I am still settling private transactions as I write this article. There is less funding than there was 3 weeks ago – but that doesn't mean there is no funding.

The main change is where there was an over-supply of private lenders in the market say 3-4 weeks ago and prices reflected an abundance of money verses transactions.

Some of you may have heard me talk about a "race to the bottom" or an unequitable balance between price and risk. At this time the price of private money was cheap.

In the past 2 weeks that has been reversed. With an exodus of investor funds as well as many lenders pause business activities until market/ consumer sentiment improves, there is less money available than there are transactions. This is having the effect of increasing the price of money.

What is important to be aware of here is that whilst I believe that price now more accurately reflects risk - but brokers need to look out for price gouging.

So where does the demand exist?

To answer this question each sub-segment of the property sector needs to be analysed.

Remember what I said earlier; look for where the demand is and most of your uncertainly arising form this virus is eliminated.

Residential – Development

- This is still a strong area with no real signs for a permanent fall. The process by which property is being sold will need to change but with a constant demand of some 371,000 people to house each year in Australia, there is constant underlying demand.
- With or without the virus, demand for housing will always exist
- The unemployed make up a material part of the demand for this segment. At the moment there is government support and empathic programs from the banks to support this segment.
- The problem with development funding is that lenders will no longer allow their developer borrowers to rely on China as a single major source of the materials supply chain but look at spreading the risk with significant portion of parts, materials, equipment and appliances sourced elsewhere, ideally locally.
- Access to finance to acquire property may be difficult unless the government relaxes lending rules to stimulate demand for housing as it did with interest rates.
- Finance for DA land banks is also strong.
- For the moment funders will “cherry pick” transactions so make sure underlying precepts are strong when presenting transactions

Industrial

- Majority of industrial property remains strong
- Food related business using commercial premises will be adversely affected but all other areas are still strong.

Retail

- Demand for physical retailing of goods is almost nil at present
- The recovery of this segment is directly linked to the control of the virus and who knows when that will happen
- This area will take quite a long time to recover
- No excess demand in this category

Commercial Offices

- This area is expected to be stagnant.
- Prior to the virus there was large demand for commercial space. People are now learning to work differently and it is too early to see what medium term impact this will have.
- As much I don't like saying it – we will have to wait and see what happens in this property class

Hotels

- Difficult asset category as Travel industry has now stopped.
- Long time to recover
- Likelihood of many hotels going into receivership

The Recovery for Brokers?

In the foregoing paragraphs I've steered you towards where the demand is and will be where to look in the short term for finance opportunities.

Once demand is seen to exist and be available on a consistent basis – more finance will come back to the private sector.

Expect to pay a little more than what was being quoted some 4 weeks ago whilst being aware of opportunistic funding.

The underlying benefits arising from low interest rates still exist to support the end user in the development construction finance cycle.

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