

Property Finance The Future is Now

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The Past – 2007 and 2008

- > By mid 2007, money (debt) had become one the most abundant – and cheapest – commodities in the world
- > By late 2007, liquidity flows had virtually stopped
- > Re-finance risk became extreme
- > Cost of funds exploded from early 2008
- > Property as an asset class marked down severely by equity markets – witness fall in REIT index relative to asset values
- > Significantly uncertain economic outlook
- > Risk of complete financial meltdown loomed large
- > Western Australia – Price bubble appeared to have burst

The Present – 2009 A Year of Consolidation

- > Banks have re-capitalised
- > Australia's "Big 4" are rated AA-, and are in select company globally
- > Capital markets are showing signs of life
- > Credit spreads are narrowing as a result
- > Australian REIT's have raised circa A\$16b in equity, stabilising their balance sheets and reducing gearing
- > Outlook for property has stabilised – but have rents reached the bottom?
- > Despite Australia's relative strength, levels of regulation in the finance sector are increasing and having a specific impact on property

**What factors will impact on the Property
Finance market in 2010 and beyond?**

Major Bank's Exposures to Commercial Property

- > Australian Commercial Banks typically limit their exposure to commercial property to 10% of gross lending assets.
- > Some Australian Bank's are above that, with recent consolidation in the industry having a particular impact.
- > Focus of some lenders may be on reducing their exposures to commercial property.

Refinancing Challenge

- > Although global debt markets are beginning to recover, the commercial property sector still faces a considerable refinancing challenge over the next two years.
- > Approximately A\$70b of total debt and A\$30b of listed sector debt is due to mature by the end of 2011.
- > Is there enough capital in the system to meet this re-financing requirement?

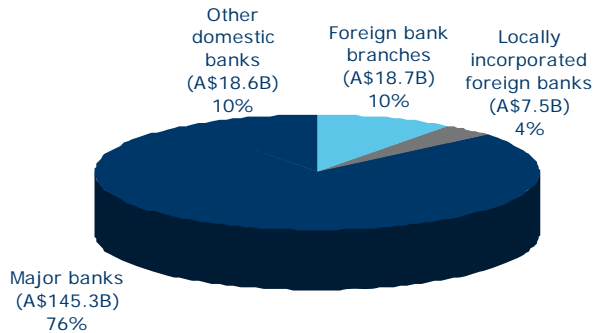
Regulatory Impacts on Commercial Property

- > Under Basel II, Australian commercial banks are required to allocate capital commensurate with risk.
- > Higher risk loans require increased capital provisions.
- > Commercial property loans are regarded by the regulators as being of higher risk.
- > Expect this to impact on both the availability and price of property credit.

Major Bank's Exposure to Commercial Property

Major bank's exposure to commercial property

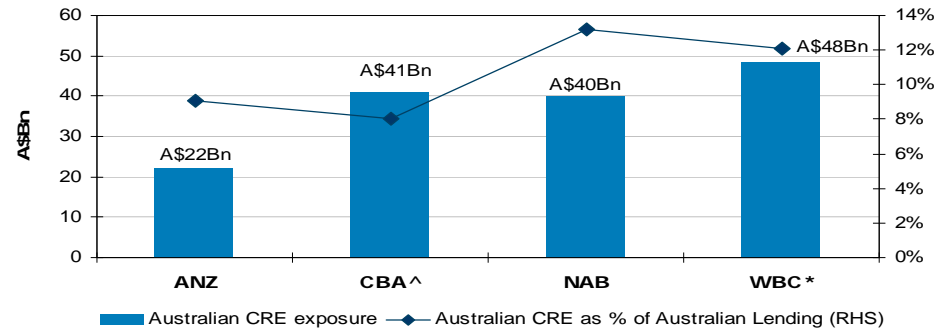
Total commercial property exposures – Dec-08



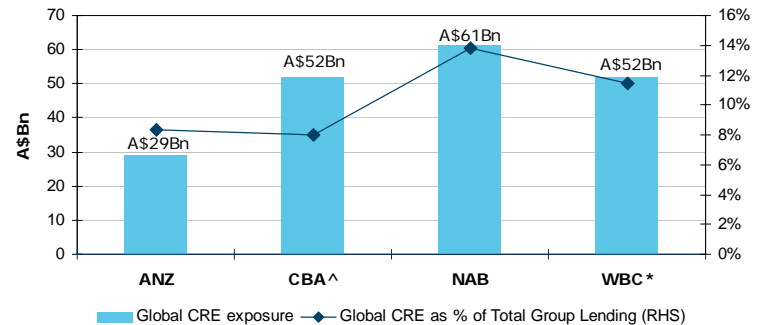
Source: Senate Standing Committee on Economics - "Inquiry into ABIP Bill 2009", Apr-09.

- > Senior commercial property lending market is dominated by the four major Australian banks.
- > Commercial property lending broadly equates to circa 10% of total lending assets for major banks.
- > The merged WBC/SGB entity has the largest exposure to commercial property, controlling circa 32% market share, followed by CBA (27%), NAB (26%), and ANZ (15%).

Commercial property loans as % of Australian lending



Commercial property loans as % of global group lending



Source: APRA, ANZ / NAB / WBC Interim Financial Reports for HYE 31/03/2009, CBA Annual Financial Report for FYE 30/06/2009, ANZ estimates.
 ^ CBA includes BankWest exposures.
 * WBC includes SGB exposures.



Major bank's exposure to commercial property

- > Australian bank exposures to commercial property impacted by recent consolidations in the market (CBA & BankWest / Westpac & St George).
- > NAB has significant levels of "off shore" property assets – especially in the UK.
- > Headroom to cap determined by:
 - Commercial Property Lending
 - Total Bank Lending
- > Economic recovery likely to create additional headroom for commercial property lending as total Bank lending increases.
- > Key question: Can "overweight" property lenders increase their "non property loans" fast enough to satisfy regulators
- > If not, the alternative may be to reduce outstanding property loans.
- > As at Jun-09, ANZ has circa A\$8.7B combined global headroom.



Re-Financing Challenge

Approx. A\$70B of commercial property debt maturing next 2 years

Where are we now?

- > Equity raising/deleveraging continues - over A\$16B raised, avg. leverage ratio of rated sector down ~8% since Jun-08 to ~25%.
- > Race to reduce gearing, repair balance sheets and bolster liquidity.
- > Devaluations well underway – expect property values to bottom out in H1 2010, earnings to remain under pressure throughout 2010.
- > Banks curbing lending, raising refinancing costs, revising covenants.

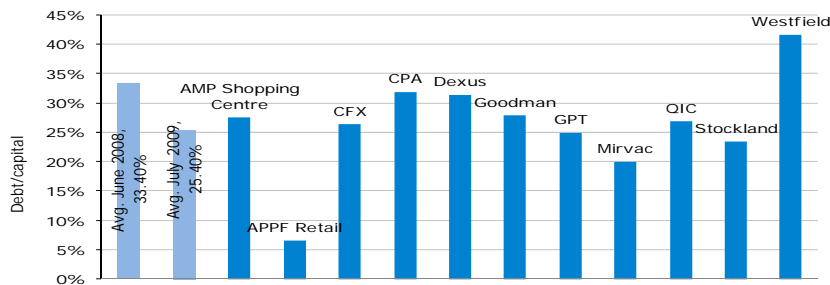
Refinancing challenge remains – genuine lack of available debt

- > ~A\$20B of rated sector debt maturing before 2011.
- > Availability of capital – CMBS, foreign banks, smaller domestic banks.

Rated versus unrated sector (unlisted)

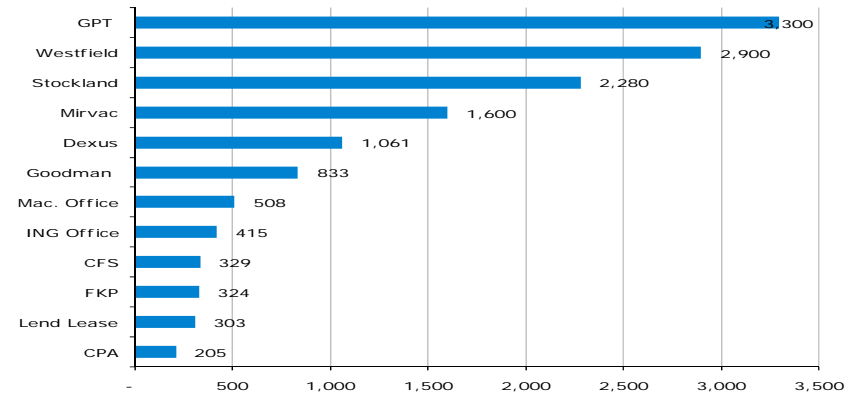
- > Largest and best capitalised players (REITs) – have been able to manage LVR by raising equity to recapitalise. Smaller rated players?
- > Unlisted/unrated property players still heavily reliant on banks – higher risk of breaching covenants as property values decline.

Rated Australian property sector leverage Gearing at Dec-08, Proforma for subsequent capital raisings



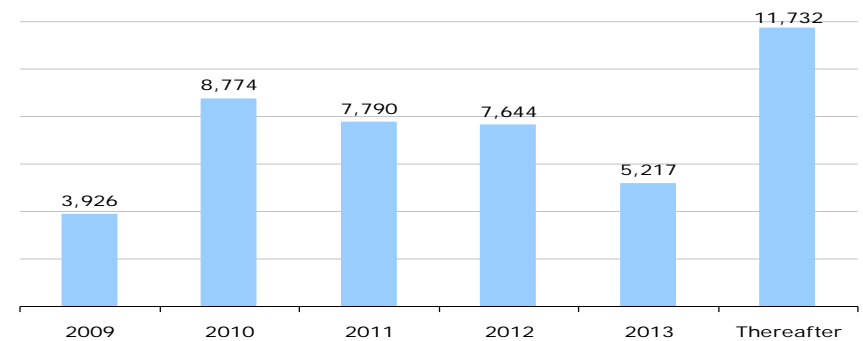
Source: Standard & Poors

Australian property sector – capital raisings (A\$M) Since Sep-08 (As at Jul-09)



Source: ANZ Markets

Debt maturities of rated Australian REITs (A\$M) At Dec-08



Source: Standard & Poors



Capital markets easing, but CMBS still a major concern

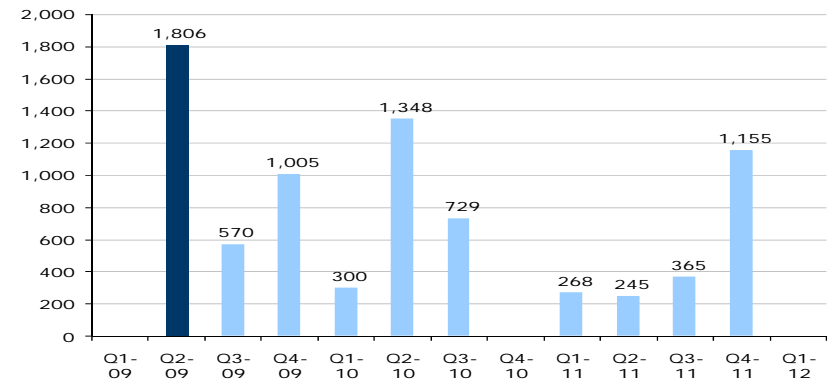
CMBS market still virtually shut despite first trade in 2 years

- > ~A\$6B maturing before end of 2011 – *refinancing risk remains high.*
- > Capacity of domestic banks to fill gap being tested.
- > So far so good in 2009, real test is 2010 (A\$2.4B) “maturity hump” - implications of a default are high and will impact the whole sector.

Timely return of A\$ MTN market/global bond markets

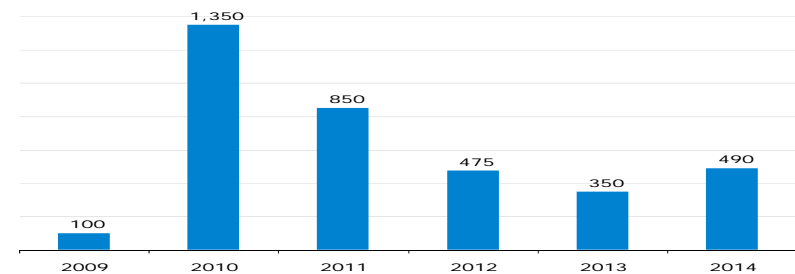
- > Reopened A\$ market providing timely access to capital markets funding for investment grade REITs.
- > Investor confidence back as credit spreads and CDS have rallied.
- > 3 REIT issuers have come to market - CFS Retail Property Trust, Dexu, APPF, all oversubscribed and upsized, reflecting demand.
- > A\$1.35B in REIT bonds maturing 2010 - BBB space now open, tenor up to 5 years - enabling REITs to term out debt maturities.
- > MTN market to provide funding relief going forward.

Rated Australian CMBS maturities (A\$M)



Source: Fitch Ratings

REIT A\$ bond maturities (A\$M)



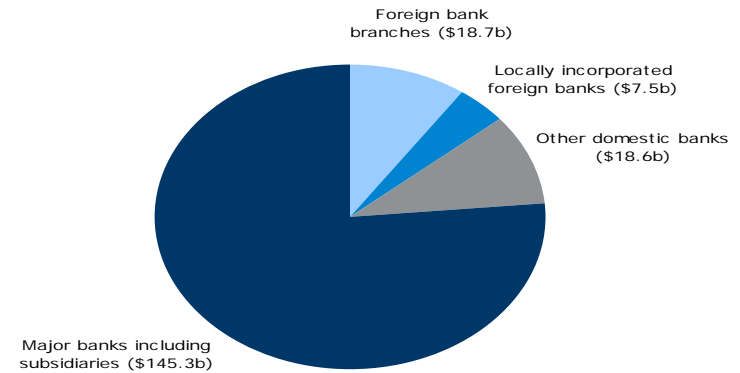
Source: ANZ Markets

Issue of possible foreign bank retreat / exit from Australian market

- > At Dec-08, foreign banks held A\$26B of exposure to commercial property, predominantly through the provision of syndicated loans.
- > A\$50B commercial property syndicated loans maturing next 2 years.
- > No mass exodus of foreign banks - distinction between 'exiting' and reviewing exposure (credit rationing).
- > Limited capacity of well-capitalised domestic banks to increase exposure (even post deleveraging of REIT sector).
- > Existing banks rolling over commitments albeit at higher costs.
- > Extent of foreign bank activity not yet fully known – will see the market tested in 2010 – resilience of Australian economy.
- > Composition of foreign banks changing with Asia increasing activity – potential for institutional investors to increase activity as some foreign banks reduce exposure.

¹ APRA, Senate Standing Committee On Economics April 2009

Total commercial property exposures (A\$B) At Dec-08



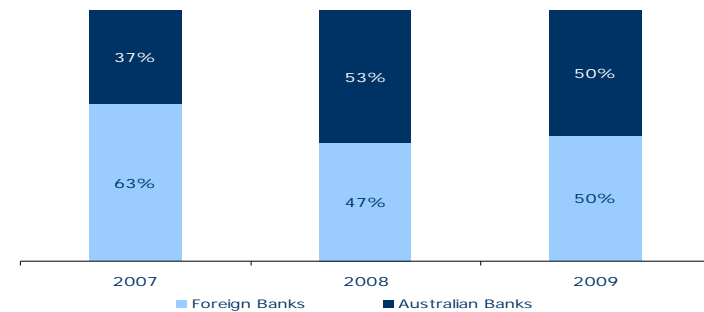
Source: APRA

Origin of foreign bank syndicated loan participation

	2007	2008	2009
Asia	28%	31%	48%
Europe	53%	54%	40%
North America	18%	15%	11%
Middle East	0%	0%	0%
Offshore Institutions	1%	0%	1%
No. of Foreign Investors	112	87	65

Source: ANZ/Loan Connector

Australian syndicated loan market sources of funding



Source: ANZ/Loan Connector



Estimated funding gap of A\$30B in 2010 & 2011 *

> **Funding shortfall of circa A\$30B estimated in 2010 and 2011 due to:**

- Prudent lending and single customer concentration limitations of the major four Australian banks
- Reduced lending by select foreign banks
- Reduced lending by smaller domestic banks e.g. Suncorp, BankWest
- Equity issuance in FY09 to outweigh natural demand, restricting future raisings
- Closed avenues to capital (e.g. CMBS)

> **How will this be made up?**

- New equity – but how much supply can be absorbed given A\$16B already issued since Sep-08
- New debt providers – new foreign banks willing to fill gap left by others (potentially Asian syndicates)
- Other debt products – hybrids/convertibles
- Increased MTN issuance
- ABIP (“Rudd bank”) or revised version of government assistance

* Quadrant Real Estate Advisors

Regulatory Influences

Treatment of Commercial Property under Basel II

Reporting method : Banks now report on RoB2K opposed to RoRWA under Basel I

Basel I : $\text{RoRWA} = \text{NPAT} / \text{Regulatory Capital}$

Basel II : $\text{RoB2K} = \text{NPAT} / \text{Basel II Capital}$

Regulatory Capital or Basel II Capital = Limit
 × Usage in default
 × RWA factor
 × ANZ capital requirement

Change	Description	Implication for Commercial Property
Limit	Unchanged	NONE
Usage in default	Larger assumed usage of certain facilities at time of default	LOW
RWA (Risk Weighted Assets)	Under Basel II the RWA factor is significantly more granular than	HIGH
ANZ capital requirement	Unchanged	NONE
Commencement of Capital Provisioning for unavailable facilities	Under Basel II, capital is allocated to the facilities as soon as a LOO is issued. Under Basel I, capital was allocated when the LOO was accepted.	LOW/MEDIUM

CONCLUSION: Under Basel II, Banks allocate capital commensurate with risk i.e. higher risk loans require increased capital provision.

Changes under Basel II Specifically Affecting Property Finance

Change	Description	Implication for Commercial Property
RWA (advanced corporate vs slotted property)	<ul style="list-style-type: none"> > Basel II requires the use of slotted property RWA factors for income producing real estate (“IPRE”). Slotted property RWA factors are less granular and often higher than advanced corporate RWA factors. > The Advanced Corporate Basel II Asset class is used for lending to a <i>“corporation, partnership, or proprietorship.”</i> > The Slotted Property Basel II Asset class is used for lending to a company whose primary activity is constructing and/or managing <i>“office buildings to let, retail space, multi-family residential buildings, industrial or warehouse space and hotels”</i> and <i>“where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the [above mentioned] asset[s]. The primary source of these cash flows would generally be lease or rental payments...”</i> 	HIGH

CONCLUSION: In most circumstances under Basel II, a higher capital provision is required for a commercial property loan with the same CCR, SI and tenor as a regular corporate/institutional loan.

In Summary

Major Bank's Exposures to Commercial Property

- > At least 2 of the 4 major Australian Commercial Banks hold commercial property exposures of more than 10% of their gross lending assets.
- > ANZ is the lowest of the four major banks at circa 8% of gross lending assets.
- > The withdrawal of liquidity by major domestic Banks will exert pressure on the refinancing task due to limited alternative avenues of funding.

Refinancing Challenge

- > Although global debt markets are beginning to recover, the commercial property sector still faces a considerable refinancing challenge over the next two years with limited access to capital.
- > 2010 looms as a particularly challenging year, with maturing CMBS compounding the refinancing challenge – **refinance risk remains high.**
- > Property market participants should deal with expiring credit early and pro-actively.

Regulatory Impacts on Commercial Property

- > The amount of capital put aside on a loan under Basel II is strongly correlated to the risk grade, security coverage and tenor of the loan.
- > Generally, this results in lower capital provisions under Basel II for “non-property” transactions.
- > Loans to property developers and investors are almost always required to put more capital aside for the exact same facility extended to a regular corporate client.

Outlook for Property Finance and ANZ

Outlook for Property Finance

- > Difficulties seen over past 2 years likely to ease
- > However, conservative lending practices are likely to continue
- > Dilemma for major Australian banks as funding gap emerges – increase exposure to and provide timely liquidity for refinancing or face the consequences of further large declines in commercial property prices as a result of forced sales?
- > Focus will be on a Borrowers capacity to service / interest coverage – rather than straight LVR
- > Market risk unlikely to be a feature of many development loans and recourse likely to be a more common requirement
- > Pricing to reflect increased risk and greater capital allocation
- > Regulatory environment having a specific impact on property – Basel II / APRA

Outlook for ANZ

- > ANZ very much “open for business”
- > The most “underweight” of the “Big 4” in property (relative to the “CAP”) and underweight in WA in particular
- > WA represents a significant growth opportunity for ANZ, an opportunity we intend to take
- > Resources allocated to WA to meet aggressive growth targets
- > ANZ targeting new clients as opposed to “new deals”, with the whole of relationship a key consideration.
- > Debt only opportunities not highly sought after.
- > Seeking to balance the book between development & investment finance and to the various property sectors

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