

Non-bank lending to become more influential in property – but navigating deals a challenge

Non-bank lending growth in Australia's \$300 billion commercial property lending sector should be considered a permanent change, but there are challenges for the property industry in navigating the vast non-bank lending universe, according to Tony Moussa, Director Corporate Finance at KPMG, which acts as an independent adviser to a growing number of property owners and developers seeking finance.

He said a common misconception is that non-bank lending for commercial and development real estate only applied to mezzanine finance or those with bad credit. "Non-bank lending has evolved in Australia to become increasingly more competitive, and we are seeing many blue chip deals and lenders emerge."

He said local property owners and developers are accessing big deals via non-bank lenders, with \$250 million - \$500 million arrangements not uncommon. "Offshore lenders are bypassing banks and going direct to borrowers, which allows them to be more flexible on some terms.

"For example, banks can usually only offer 3-5 year tenors, however a non-bank lender may offer 7-10 year tenors with the ability to lend larger amounts at attractive interest rates, depending on credit metrics.

"For borrowers it can be simpler and provide more flexibility as they may only have to negotiate with one lender."

But he said the vast amount of lenders available meant borrowers need guidance. "Non-bank lending is more bespoke and customised by nature.

"Local borrowers have a lot to navigate as every lender has a slightly different approach, different terms, and some of the lenders may have limited resources on the ground locally. Borrowers can benefit from seeking assistance from an independent advisor who is in the market every day who can structure, arrange and negotiate the best deals."

He said growth in non-bank commercial and development real estate lending in Australia accelerated post-GFC where banks imposed tougher limits on lending criteria, which meant more borrowers found it harder to get funding and, whilst this subsequently eased post-GFC, has re-emerged as a challenge given regulatory pressures on banks.

"It's part of a bigger shift and Australia lags regions such as North America and Europe when it comes to non-bank lending market share, but there is a significant trend towards non-bank lending being a more meaningful part of the financing landscape."

This opportunity will see credible non-bank lenders such as super funds, sovereign wealth, insurance and pension funds progressively accessing commercial and development debt positions, whether directly or via managed debt funds operating in Australia.

“We continue to see bigger pools of capital from offshore, coming from big institutions and funds, who are moving from buying equity in real estate to participating in real estate debt”, Mr Moussa said.

David O’Connor, Investment Director at non-bank lender, MaxCap Group, which was founded in 2007 and has originated and managed more than \$6.6 billion of Australian CRE debt, says alternative lenders will play an increasingly important role in Australia’s property construction as the major banks continue to pull back on lending.

He said Australia’s commercial lending market is undergoing a period of adjustment after being out of kilter with global debt capital markets. “Australia’s alternative lending market is relatively immature. Globally the share among alternative lenders is approximately 37%. In the North American market it is approximately 48%.

“Yet in Australia alternative lending currently only accounts for approximately 10% of lending.”

Mr O’Connor said ongoing change was expected due to an increasing weight of capital chasing strong risk adjusted returns in Australia. “This is happening while our local lending environment has become more cautious post Royal banking commission.”

He said local banks have been forced to moderate on the higher yielding portion of their Books. “The initial and most significant segment impacted was residential construction. This has created a significant demand for alternative lending.”

He said alternative Lenders are now prevalent in construction finance and subordinated finance, increasingly prevalent in valued add and core plus, and will ultimately move more heavily into investment finance.

“We are now seeing demand for mixed use and commercial construction, and value add/transitional lending – this might include mixed use developments combining residential, hospitality and commercial, or existing commercial assets which require CAPEX and incentive to re-lease or reposition the asset.”

Tony Moussa, Director Corporate Finance at KPMG, and David O’Connor, Investment Director at MaxCap Group, were guest speakers at PFA’s 2019 Conference in Hobart.