Interest in alternative lenders

With banks rationalising their commercial real estate loan books, non-bank lenders are plugging a funding gap in the property development market.

While development entity hunger is returning for commercial projects, there's less appetite from banks to fund them as the risk profiles don't mesh with their more conservative prescribed thresholds and policies.

Banks are heavily regulated which restricts them going outside of policy to fund the majority of development projects, according to Nick Bullick who is chief investment officer for commercial real estate financier and investment manager, MaxCap New Zealand.

"Banks rely heavily on presales/off-plan sales to mitigate their market risk however, presales are very hard to achieve in the current environment.

"This means banks are not replacing development loans that are repaying, leaving a funding gap that the non-bank market is happy to fill.

"Although the rates from banks might be a bit cheaper than non-banks, it is very difficult and time-consuming to get a commercial or development loan across the line.

"What non-banks offer are bespoke and flexible lending structures and capital certainty for property investors and developers allowing them to start projects earlier and in most cases, with higher leverage than what a bank can offer."

At best estimate, Bullick says the non-banks have around seven-percent market share of New Zealand's commercial/development lending. Compare this with Australia

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CHIEF INVESTMENT OFFICER, MAXCAP NEW ZEALAND

where non-banks have 20-percent market share and growing, and globally where these lenders have a market share of 50 percent of the commercial real estate lending market, and it's clear that New Zealand lags significantly.

"Historically, this is largely due to the previous strength of the major banks and the relatively small size of the New Zealand non-bank market.

"This niche market in New Zealand has typically comprised of lots of small operators or private families providing bridging-type loan facilities, but we're starting to see some of the major institutional private credit investors set up offices in New Zealand.

"Once we see these institutional investors demonstrably deploy debt capital into New Zealand, the non-bank market share will grow rapidly to become mainstream and in line with the rest of the world."

Bullick says all property markets around the world have been adjusting since central banks increased interest rates.

"The best comparison for New Zealand is Australia where we are seeing most asset classes hold up quite well compared to global markets.

"Similar to Australia, New Zealand is forecast to have a housing shortage in two to three years off the back of high immigration and low building consent issues. Astute developers realise this and are activating projects now with non-bank funding knowing they will be delivering their product into a much more buoyant market once completed.

"Housing pipeline and consent statistics are alarmingly low at the moment and we could be in a scenario shortly where house prices begin to rise rapidly – which will solely be driven by lack of supply.

"If the new coalition government can cut through some of the red tape with councils and allow developers to increase supply, and in turn affordability, then everyone will be a winner."

In terms of the projects MaxCap will fund, every loan is assessed on its merits, no two properties or transactions are ever the same, and while construction loans are what they specialise in, they also provide funding for all asset classes including land banks, residual stock and value-add opportunities.

"We will fund any commercial property or development that makes sense and we are able to buy into the strategy of the investor or developer," says Bullick.

"Whether your project is small or large, banks generally require 100 percent of their loan covered by presales, whereas non-banks require between zero-percent to 50-percent debt coverage and that is a huge difference in the current climate."

Bullick says non-bank lenders draw on capital from a broad base with MaxCap's investors ranging from some of the largest pension funds globally, to high-net-worth individuals and family offices.

"The superfund and Kiwisaver groups will have a big role to play in this lending space as we see more retirees seek regular income with strong capital preservation characteristics."

NON-BANK LIQUIDITY

Operating in non-bank loans for smaller to mid-sized projects, typically for deals up to $30 million, Vega is active in the market funding multi-unit residential developments, commercial projects and land subdivisions.

Commercial finance specialist with Vega, Kevin Miles says despite hearing noises in the market at the start of the year that several main banks were poised to lend and could soften terms such as over-100-percent presale cover of debt for development projects, this hasn't transpired in practice.

"This may well be because the market has been relatively quiet, as shown by the dramatic reduction in the number of consents being processed and the lower volume of housing sales," he acknowledges.

> "The role of the broker is to understand the deal and the client, then match them to the most appropriate lender(s).
>
> **KEVIN MILES**
> COMMERCIAL FINANCE SPECIALIST, VEGA

"The non-bank market, however, remains active and over the last six months has been very liquid, as evidenced by the number of emails we get from various non-bank lenders advising they have funds to place and are looking for deals.

"We believe this is due to funds that have been caught in a relatively slow housing market finally being released, but with a limited and quiet market to re-lend into."

Miles says there has been very little done on the investment debt side of the coin in the last couple of years – not surprising given that for the first time in 30-odd years, interest rates are above yields.

"The market was initially constrained by banks wanting two-times interest cover, which was logical when commercial rates fell to around three percent, but made no sense at an interest rate of eight percent.

"The killer has been the inversion of interest and yield – why borrow at eight to nine percent to buy an asset that yields six percent? There are a number of syndications in a world of pain at the moment with investors not having any hope of a distribution for some time."

In terms of development funding, Miles says non-bank lenders are better positioned than banks as there's not the onerous presale requirement to get deals done.

"The non-bank market seems willing to fund smaller-to-mid infill development at up to 65 percent loan-to-value without presales, whereas the banks simply won't go there.

"From what we are seeing, apartments would still require a significant number of presales and in the current market would be challenged as a development project.

"Subdivision would also be challenging to get across the funding line without at least some presales, while larger-scale development would be stress-tested on a case-by-case basis."

Continued growth in appetite for exposure to the New Zealand market from overseas funders is being noted by Miles, with particular interest from Australian-managed funds.

"The role of the broker is to understand the deal and the client, then match them to the most appropriate lender(s).

"The NZ Super Fund operates at the very big end of town, and we haven't seen them much, while family offices are definitely taking an increasing role – not only in debt, but also equity positions.

"We work with banks and maintain a list of around 118 non-bank funders, ranging from lenders who will only do a $50k second mortgage to those you don't phone unless it's a $50m deal."

Seeing any practical moves by the government to improve consenting processes and other signalled growth-forward policies as positive, Miles' view is that New Zealand's biggest handbrake remains high interest rates and the fact that the cost of debt is so far above asset yields.

"This can only be solved by moving one – or more – of price, rental rates or interest rates. As the economy turns south, I suspect there is little scope for increases in rents so we are looking to values or interest rates to fall to restore the historic norms."

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>
> **GERALD RUNDLE**
> DIRECTOR CORPORATE PROJECTS AND DEVELOPMENT LAND SALES, BAYLEYS

APPEAL OF THE REGIONS

At the property transactional coal face, Bayleys director of corporate projects and development land sales, Gerald Rundle says while banks haven't completely backed out of development lending, in his experience their books are pretty full and they're not necessarily pursuing that segment of the lending market.

"That's where non-bank lenders are stepping up to the plate to get projects moving forward, demonstrating entrepreneurial spirit as they're less constrained by prescribed boundaries when putting these bigger deals together."

Rundle coordinates a team of land sales and development-focused agents around the country and says the Waikato and Bay of Plenty regions are proving to be active hunting grounds and there are good opportunities available.

"These regions are now far more connected with Auckland and can leverage the advantages that the economic golden triangle offers businesses.

"There's the push factor as it's quite difficult to do large-scale development in Auckland right now given the scarcity of favourably zoned land, and council policy barriers to development such as uncertainty about future urban-zoned land and infrastructure challenges.

"A few developers have been caught up in this web and are realising the limitations of having all their eggs in one basket."

But equally, says Rundle, the Waikato and Bay of Plenty have their own pull mechanisms such as cost advantages, population growth, locational benefits and lifestyle opportunities.

"Hamilton is currently outperforming other markets and is the country's fastest-growing metro however, like Auckland, is also finding it increasingly challenging to fund infrastructure to service growth."

While a little sluggish, Rundle says the Auckland development pipeline is still moving with the likes of Simplicity Living – owned by KiwiSaver provider, Simplicity – strategically acquiring pivotally located super sites to provide housing supply under a build-to-rent (BTR) model.

"Simplicity recently acquired 1.4ha of land adjacent to Ellerslie Racecourse in Remuera, close to Greenlane train station, a supermarket, shops and offices, and the medical hub around the Mercy Ascot hospital, in a Bayleys-led sales campaign and has plans for 330 BTR homes.

"After the successful land acquisition, Simplicity said the development was part of its wider building programme, which gave KiwiSaver investors the chance to invest in New Zealand's housing infrastructure. It acknowledged the purchase was a counter-cyclical investment timing-wise, but deemed it a good time to acquire land and get large-scale projects underway."

Rundle says the true BTR sector – which provides long-term rental housing options based on proven overseas models – has been steadily gaining traction in New Zealand, as the advantages that these projects can bring to housing supply and the long-term rental market are recognised.

"Realistically, offshore investment will likely be needed to optimally progress this sector and the Government's intentions to amend the Overseas Investment Act could speed things up and make it easier for new development to happen.

"There would seem to be demand for BTR development well beyond Auckland with other major centres crying out for innovative housing options that provide security and can leverage transport and amenities within established and well-located neighbourhoods."