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Pre-sale criteria continues to constrict development: Stamford Capital

Australia's banking sector is in recover mode after being hit by the perfect storm of influences, according to a new industry survey from Stamford Capital.

Due to the effects of APRA restraints, the Royal Commission and resulting Hayne Report, pre-sale criteria continues to constrict residential development, according to Stamford Capital's Real Estate Debt Capital Markets Survey 2019.

The survey found lenders are looking to size up loan books and scramble to develop new products for the changing market and many anticipate an interest rate decrease.

More than 100 active lenders participated in the national survey from major trading banks and non-bank lenders to super funds, foreign banks, private financiers and second-tier trading banks.

Stamford said the survey aims to be a barometer of lending sentiment and an early identifier of market trends.

Overwhelmingly, the sentiment is that the residential apartment and housing market is in decline, according to the survey.

85% of respondents believe the residential markets are in decline, up from just 50% in 2018.

"The pre-sales hurdle is now a barricade in the market and this is where we are witnessing one of the biggest divides between bank and non- bank lenders. It is no surprise that non-bank lenders are continuing to gain momentum in this market," said Stamford Capital Executive Director Michael Hynes (pictured above).

The Stamford Capital Survey reveals that while 84% of major and second-tier banks require pre-sales of between 60 to 100%, 34% of non-bank lenders have no pre-sale commitment requirement.

Survey respondents also forecast an interest rate decline in 2019 which could prop up the residential sector - with 29% believing rates would drop, up significantly from just 3% in 2018.

Interest Cover Ratio (ICR) has replaced Loan Value Ratio (LVR) as the preferred metric for bank credit assessments and 60% of term-debt lenders see an ICR of 1.5 times for investment lending with banks seeking at least two times ICR.

“Lenders are definitely looking to find their feet in this rapidly changing landscape and typically the non-bank lenders are nimbler at this as they are not governed by APRA,” said Hynes.

A third of respondents revealed concerns are limited to specific locations and market sectors with the top three identified for risk:

1. Inner-city residential apartment oversupply in inner-urban areas of Sydney, Melbourne and Brisbane;
2. Pre-sales settlement defaults in new residential projects; and
3. Under-performing retail assets

Despite weakening market sentiment and rigid lending criteria for banks, the survey revealed that 73% of respondents are looking to increase the size of their loan book, down from 92% last year.

A whopping 90% of non-bank lenders expect to increase or maintain their loan book size with 62% indicating they expect increasing by 15%.

“Non-bank lenders are growing in terms of volume and appetite in this market, while the banks have pared back - adding further fuel to the fire in an already dynamic commercial finance sector this year,” said Executive Director of Stamford Capital, Domenic Lo Surdo.

However, the non-bank sector may soon face greater restrictions on lending criteria reducing their competitive edge – with 65% of Stamford Capital Survey respondents saying they expect APRA to increase oversight.

But while lenders remain cautious about market risks, Stamford Capital’s survey revealed many are developing innovative ways to cater to investor demand with 41% of respondents looking to introduce new products in 2019-2020.

Build-to-rent is a firm favourite new product with more than half of respondents looking to introduce loan facilities catering to this market, with 36% focusing on investment loan products and 34% on stretched senior debt investment products.

Crowdfunding is unlikely to make an impact in Australia with only 9% of respondents viewing it as a credible commercial lending option.

The outlook is not entirely bleak with increasing flexibility for investors who conform to criteria.

“All lenders are competing for quality investment applications to replace their construction loan books so investors are tipped to come out on top and those who tick the boxes will get competitive finance deals,” said Lo Surdo.

Non-banks however will have an increased appetite for investment and construction lending, transacting construction deals that don’t meet the banks criteria.

75% of survey respondents anticipate non-bank investment loan appetite will increase with 36% predicting investment margins will also increase.

Further, 67% of respondents anticipate non-bank appetite for construction loans will increase with 48% forecasting an increase in construction margins.