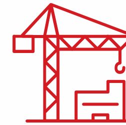
Real Estate Debt Capital Markets Survey 2024

Driving forward

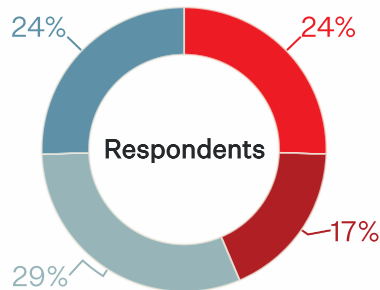
About the research

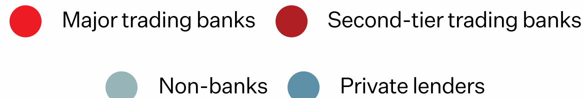
Online survey conducted in April 2024

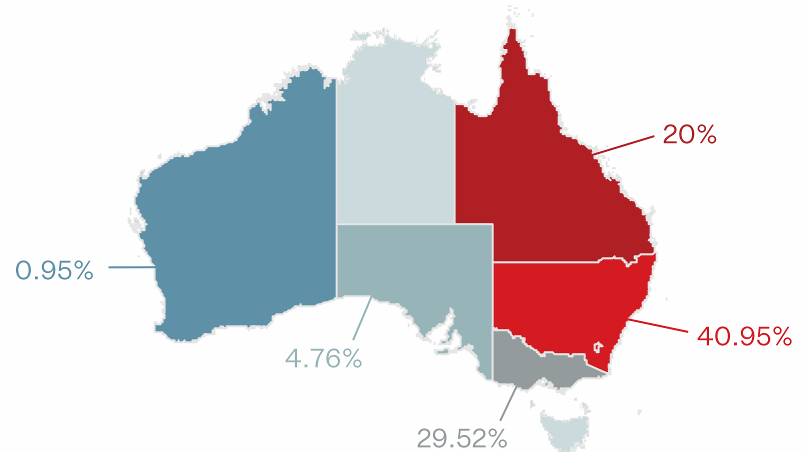
Over **100** respondents



83% are construction lenders (up from 75% LY)







Foreign lender/investor - 3.82%

Liquidity has returned to Australia's debt capital markets – but there are still a few hurdles to overcome.

After a challenging 2023, the road ahead is looking clearer. So who will be accelerating and who will be hitting the brakes?

Successive cash rate rises meant a rough ride for many in 2023. And while relief may have once been on the horizon, the less-than-ideal inflation print for the March quarter 2024 has caused further uncertainty as to when rate relief will come. While the year started off optimistic, when we surveyed respondents in April, most (67%) expected interest rates to drop by the end of the year – but not by much. But as of publication, economists are now open to the chance of at least another rate rise come August.

This year, the effect of cash rate stabilisation, along with continuing migration-fuelled demand for housing and ongoing supply shortages, has led many lenders to take their foot off the brake – particularly non-bank lenders. An overwhelming 90% of respondents say they plan to increase their loan book this year – and almost half by more than 15%.

The shift towards non-bank lending continues. Two-thirds (66%) expect non-banks to increase construction lending and 64% expect non-banks to increase investment lending. In comparison, only 33% expect major banks to increase construction lending and 42% expect major banks to increase investment lending. This expectation is demonstrated by our own experience at Stamford Capital – in 2023, 78% of our loans were with non-banks, and the value of our non-bank loan book has multiplied eight-fold since 2019.

We're now in a state of cautious optimism. There's plenty of capital available, but there are also some acute challenges to be aware of.

- Peter O'Connor
Managing Director, Stamford Capital

But not everyone is moving forward freely. Builder insolvencies, high material costs and labour shortages continue to impact construction feasibility, making it challenging for private developers to respond to the current housing crisis. Construction lenders are scrutinising builders more closely during due diligence – and that's blowing out deal timelines. At Stamford we're seeing construction loans take around 50% longer to finalise, compared with two years ago.

In NSW, iCirt ratings are a new due diligence step. Of our NSW survey respondents, only a third (33%) report they take iCirt ratings into consideration when assessing construction deals, however, another 19% report they plan to start this year. Out of the respondents that do consider the Building Commissioner's star-rating system, 43% have turned down a loan application with a poor iCirt rating.

A return to fundamentals in 2024

In April 2024, we surveyed more than 100 major banks, non-banks, second-tier banks and foreign financial institutions for their insights into the current market. The results help us understand how Australia's debt capital markets have been impacted by the events of the last 12 months, and give us some insights into how this will affect the future.

The responses revealed five significant trends:

1. The appetite to lend has returned
2. Lenders are more robust with due diligence...
3. ...but a little more relaxed about presales
4. ICRs and margin expectations are more realistic
5. Construction costs are holding developers back.

Key findings

1 The appetite to lend has returned

While capital was tight last year, this year we're seeing the return of the appetite to lend – particularly among non-banks.

Ninety per cent of lenders told us they plan to increase their loan book this year – and almost half predict growth in excess of 15%.

And while they were less inclined to lend for construction in 2023, it's a different story one year on. Two-thirds of respondents expect non-banks to increase construction lending – double the proportion who see major banks stepping up in this space.

The appetite for investment lending has also returned, with 64% of our respondents expecting non-banks to increase investment lending and 42% expecting major banks to do so.

So what's fuelling an expected surge among the non-banks? With rates stabilising and capital searching for yield, the private market has more funds available, and they need to put that capital to work.

At the same time, banks have been more cautious with successive interest rates rises and covenant pressures, providing space for non-banks to step in.

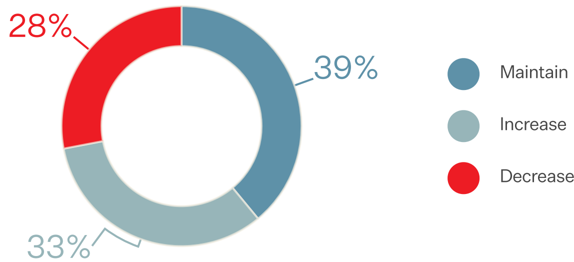
However, with rates now somewhat stabilised, major banks have started to and are likely to continue to return to compete in the debt capital markets.

In 2023, some non-banks were really struggling for backing, whereas now there's an insatiable thirst in the private market for credit. This means non-banks now have a lot of funds they want – and need – to put to use.

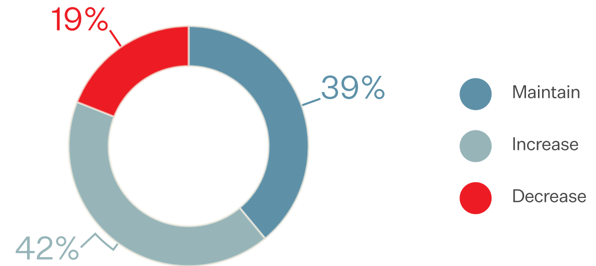
- Peter O'Connor
Managing Director, Stamford Capital

According to respondents:

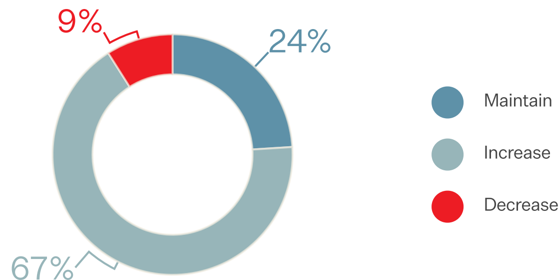
Major banks are likely to increase or maintain construction lending activity in 2024.



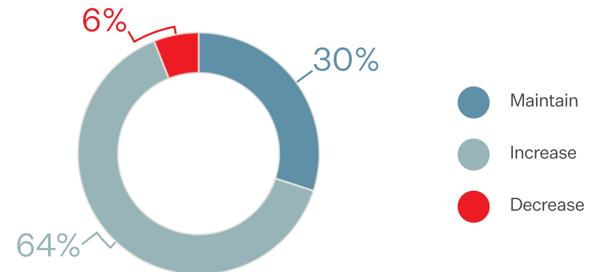
Major banks are more likely to increase or maintain investment lending in 2024.



Non-bank lenders are expected to increase construction lending in 2024.



Non-bank lenders expect to increase investment lending in 2024.



2 Lenders are being more robust with due diligence

While lenders have their foot on the accelerator when it comes to chasing deals, they've also added a few speed bumps when it comes to due diligence – especially for construction lending.

Recent ASIC insolvency data shows 2,142 companies in the construction industry went out of business between July 2023 and March 2024. This, alongside rising construction costs, means lenders are taking a more rigorous approach to due diligence on construction projects. Of those who responded to our survey, 82% have increased their due diligence as a result of elevated numbers of builder insolvencies. This also means deals are taking much longer to approve. And lenders are increasingly turning down deals if builder financials don't stand up to scrutiny – especially in NSW where the recently introduced iCirt ratings provide greater transparency of builder and developer capabilities, integrity and reputation.

Of the NSW construction lenders who responded to our survey, a third report they now take iCirt ratings into consideration, and almost 43% of those have turned down a loan application based on a poor iCirt rating in the last year.

Our respondents told us their heightened due diligence process includes more thorough analysis, scrutiny and stress testing of builder financials. It also involves engaging third-party construction specialists, insolvency practitioners, accounting firms and business analytics specialists to provide additional insights on builders and their financials.

With the additional focus on due diligence from banks and non-bank lenders, we're seeing construction deals taking over 50% more time from inception to settlement.

- Peter O'Connor
Managing Director, Stamford Capital

3 Lenders are more relaxed about presales

In 2023, cautious construction lenders told us they were planning to maintain or increase residential presale requirements. However, this year, high migration and lack of housing supply coupled with the desire to deploy capital, and lenders are less worried about off-the-plan sales as an indicator of demand.

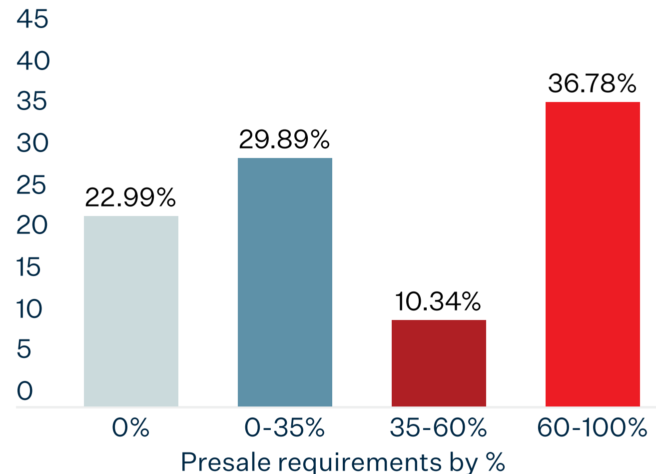
With record migration levels and the housing shortage, lenders are open to reducing risks through different avenues.

- Peter O'Connor
Managing Director, Stamford Capital

Nine per cent are planning to decrease presale requirements this year. Almost a quarter require no presales at all – up from 18% in 2023 – and just over half report they'll fund projects with zero to 35% presales.

As lenders spend more time undergoing due diligence, scrutinising builders and balance sheets, presale requirements are no longer the key factor for risk mitigation.

Off-the-plan residential sales are also increasingly challenging, particularly for luxury developments. Rising borrowing costs have deterred buyers from purchasing off the plan, despite a narrowing housing supply. If lenders want to deploy their capital and grow their loan book, they are having to compromise on presales – or miss out on the deal.



4 ICRs and margin expectations are more realistic

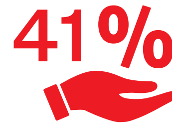
Last year, Interest Coverage Ratios (ICRs) were in the spotlight due to concerns about rising interest rates. In 2023, almost three-quarters of our respondents said they had minimum ICR requirements of between 1x and 2x, and many were concerned about a potential increase in covenant breaches. However, these did not eventuate.

This year, we're seeing a more relaxed approach with 28% of our respondents saying they have no ICR requirement – an increase from 17% last year. Of the lenders that do have a minimum ICR, 15% expect to decrease it in 2024.

The majority of survey respondents expect interest rates to drop later this year, which alleviates the pressure to provide cover against future rate rises. Those lenders who are prepared to be more flexible with ICRs will also find it easier to get deals across the line – and meet their growing appetite to lend.

This surge in lending appetite is creating robust competition in the market, putting pressure on lenders to reduce margins.

Sixty-three per cent told us they expect to maintain loan margins this year, whereas last year more than half expected to increase them. And it's increasingly likely that foreign banks will add to that competitive pressure, with 46% of respondents saying they expect foreign financial institutions to play a growing role in Australian property lending.



predict interest rates will drop to between 4%–4.25% by December 31 2024.

> Last year, we didn't see as many banks acting on ICR covenant breaches as expected, and many lenders feel they can continue to be more flexible with ICRs going forward.
>
> - Peter O'Connor
> Managing Director, Stamford Capital

5 Construction costs are holding developers back

While housing supply and affordability are in the spotlight, it's very difficult for private developers to find a solution on their own. With high construction and land costs, project viability is skewed to higher-priced luxury developments targeting downsizers rather than affordable developments for first home buyers.

Construction costs are making projects unviable, impacting site values and making it difficult to meet approval processes.

- Survey Respondent (private lender, NSW)

According to our survey respondents, high builder and materials costs is the number one barrier to affordable housing. This is not likely to improve soon, with 39% of our survey respondents expecting construction costs to increase further in the next 12 months.

With current construction costs, affordable housing isn't stacking up from a feasibility point of view.

- Peter O'Connor
Managing Director, Stamford Capital

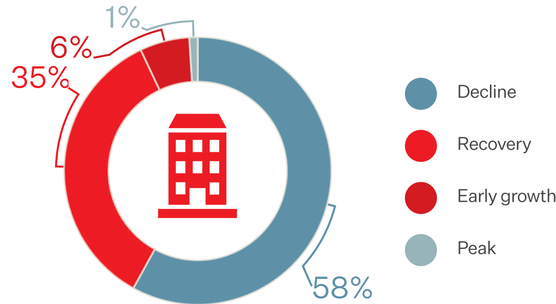
What is the number one barrier to more affordable housing entering the market?

- Elevated cost of construction – 49%
- Land use regulation and planning – 30%
- Cost of capital – 9%
- Access to funding – 8%

Sectors at a glance

Here's the sector outlook for 2024, according to our survey respondents:

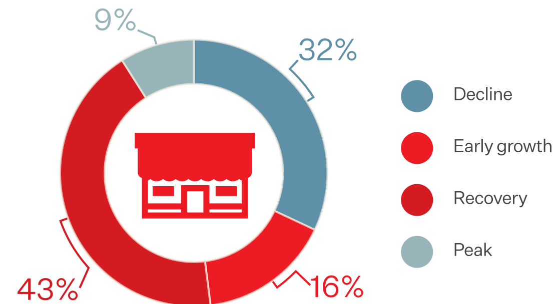
Commercial office is inching into recovery



> The B-Grade and C-Grade office market is a concern given the oversupply of new builds and changing tenant requirements.
>
> - Survey respondent
> (major trading bank, VIC)

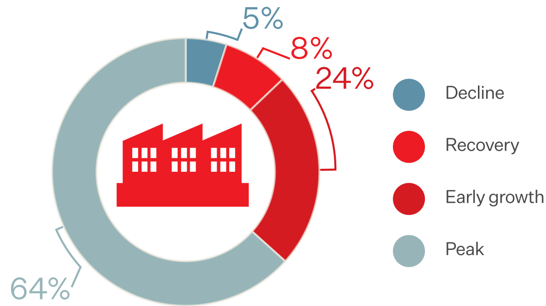
> For tenanted retail investments, the principal factor is what the tenant looks like. If there is a strong covenant, there is stiff lender competition.
>
> - Peter O'Connor
> Managing Director, Stamford Capital

Retail has some positive signals



Sectors at a glance

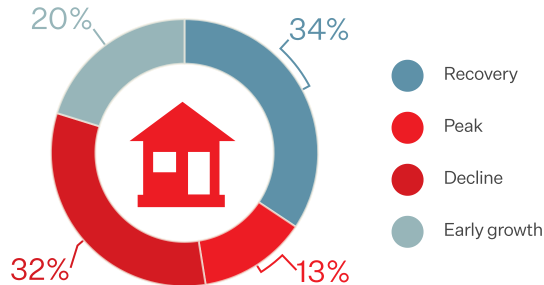
Industrial could be reaching its peak



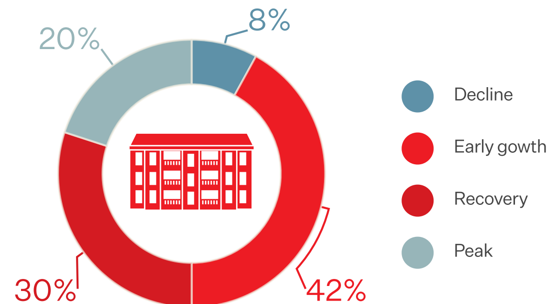
Residential unit development is a concern. Increased building costs and compliance make feasibility tight. We need density relaxed to improve supply.

- Survey respondent (major trading bank, NSW)

Residential development is mixed and market-dependent



Residential apartment/housing still has room to grow



The local view

New South Wales

Bill Moskovich – Executive Director

The construction industry is still trying to recover from the COVID hangover which saw construction costs increase 30%+. Residential construction, in particular, remains the hardest hit with a record number of builders going into administration each week. Developers continue to face challenges in finding the right builder at the right price and making projects stack. With strong levels of demand and an undersupply of stock in the market, we expect to see strong growth in residential values especially at price points at the lower end of the market.

The commercial market has had a tough run the past few years, with softening cap rates across the board causing a deterioration in values. We have seen values of properties fall 20-30% as cap rates went from 4% during peak-COVID to 5.5-6% in today's market. Sentiment towards commercial has improved in 2024, with the stabilisation of interest rates expected to be a driving factor.

The retail sector has improved over the last two years, with vacancies declining in most sectors.

But with some retailers going into administration, lenders are paying close attention. The longer interest rates remain high, the more we expect households to hold back on expenditure – and pressure in the retail sector will continue.

We're seeing a lot of new industrial space coming into the market this year, indicating supply is peaking. Rental growth in this sector is spectacular, but it is easing and vacancies are expected to increase.

Victoria

Barn Wilson – Director

Victoria's residential apartment market is well positioned for a period of price growth on the back of relatively subdued rates per sq m for comparable product compared with other markets, however the timing of that growth spurt remains unclear. When it does eventuate, it should lead to a jump in construction as projects become more feasible.

Commercial assets are still the most challenging sector, with working from home headwinds continuing. Lender appetite to fund uncommitted office space remains low, creating a challenge for developers.

In the retail sector, vacancy rates continue to tighten. Sentiment towards retail as an asset class is gradually improving, and as more workers return to the office, CBD retail should continue to benefit. Lack of supply of quality sites continues to support prices in the industrial sector, while demand continues unabated for sites capable of housing warehouses and logistics centres.

Queensland

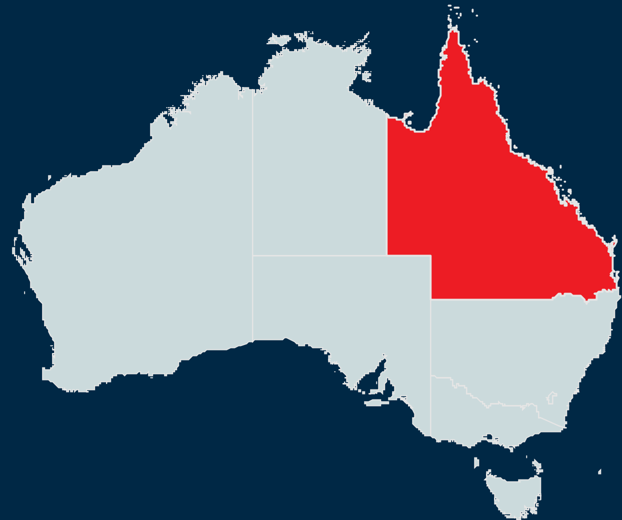
Grant Rex – Director

Southeast Queensland's property market is generally healthy, driven by strong population growth and economic stability. Continued population growth is pushing residential rents up and fuelling demand for larger-scale residential construction projects closer to the CBD. However, planning restrictions continue to impede higher density projects in many suburbs. Cost escalation, limited trade availability and a shortage of tier-one builders also pose a challenge for Southeast Queensland developers.

Retail and commercial office sectors continue to struggle, with demand for both deteriorating over the last few years. More specialised sectors such as quick-service retail, self-storage, boutique healthcare and childcare assets continue to attract a wide variety of investors looking for stable returns.

In the industrial sector, strategically located property continues to outperform. Infill industrial sites are difficult to find, pushing developers towards the growth corridors between Brisbane's south and the Gold Coast, and Brisbane's southwest and Ipswich.

Industrial rents in Southeast Queensland have increased by around 40% in the last four years, highlighting the undersupply in the market.



South Australia

Adam Miller – Director

We've seen strong recent performance in the South Australian economy, and the outlook is positive. Adelaide's residential market is expected to continue experiencing strong growth into 2025, with recent interest rate rises offset by demand buoyed by population and GDP growth. Downsizer demand for medium and higher density residential projects is also growing.

The office sector is more cautious, which is not likely to abate significantly through 2025. In retail, growth and activity are expected to continue in the Adelaide large format retail segment as it maintains one of the lowest vacancy rates of the retail sub-sectors.

Industrial will remain strong over the next 12 months with tight vacancy rates and limited supply of developable land. We expect rental growth, particularly for new buildings, and an increase in gentrification and redevelopment of older buildings.

Navigate the road ahead with an experienced capital partner by your side

The defining sentiment of 2024 appears to be cautious optimism. While there is capital ready to fund quality deals, there are still hurdles – especially for construction lending.

Lenders will be looking closely at builder financials, reputation and capabilities, and there is little relief in sight for development costs. However, with interest rates stabilising, pressure may start to ease.

Experienced brokers will play an increasingly important role during the pre-due diligence stage, ensuring feasibility studies stack up and financial records are in order. Having a trusted partner throughout the journey can help borrowers see their deals through with more confidence – knowing demand for property remains strong.

The market is very competitive at the moment for good deals. Margins are tight, and with this level of liquidity, Stamford Capital can find most deals a home.

- Peter O'Connor
Managing Director, Stamford Capital

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