Intelligent Investment

H1 2024 Australia Lender Sentiment Survey

REPORT

CBRE RESEARCH
MAY 2024

Executive Summary

Lending appetite remains strong amidst normalisation in credit scrutiny

CBRE Research's H1 2024 Lender Sentiment Survey received responses from 40 commercial real estate lenders across local banks, international banks and non-banks. We find:

- Appetite for new loans over the next three months has increased for majority of lenders, 58% want to grow commercial real estate exposures with and no surveyed lenders intending to decrease their book.
- Lender investment preference continues to be dominated by the Industrial & Logistics sector, followed by Residential. Nearly 1/4th of Lenders rank student accommodation as a top two preference. Lenders continue to display caution towards the Office sector.
- For new residential-to-sell construction lending, the largest cohort of lenders require 80%-100% of debt funding covered by pre-sales.
- The total cost of debt remains at elevated levels and there is no clear consensus view has yet to be formed amongst institutions and surveyed lenders as to whether rates have peaked, and their expected trajectory over the next 12 months.
- Credit margin expectations normalised following H2 2024's survey, with over 2/3rds of respondents in H1 2024 expecting flattish movement in credit spreads over the next 3-months.
- A moderate decrease in hedging requirements, presumably as interest rate volatility has subsided from levels seen over 2023.
- Preferred LVR requirements have shifted moderately, however majority of respondents continue to have LVR requirements between 40-60%, consistent with prior surveys.
- ICR requirements remained stable over the last six months with more than half (53%) of lenders requiring a 1.5x ratio.

Cost of debt sees stability however future path remains contentious

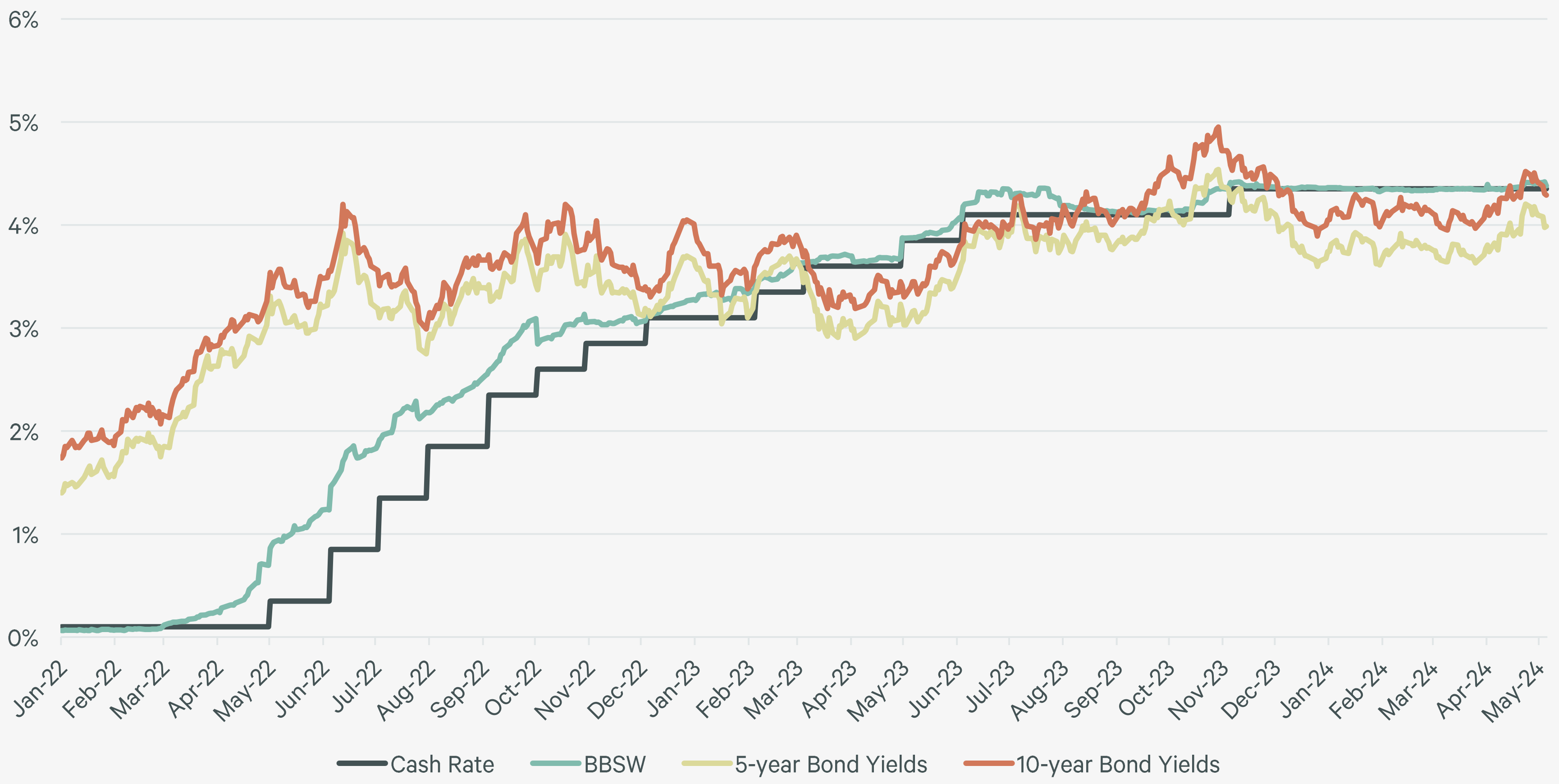
In May 2024, the Reserve Bank of Australia (RBA) held the target cash rate steady at 4.35%. The official cash rate has remained stable since the last 25bps rate hike in November 2023. Inflation remains the key concern noted by the RBA, explicitly noting uncertainty regarding the future path of interest rates needed to tame inflation.

Of surveyed lenders, more than 1/3rd anticipate at least one rate hike to 4.60% or above by December 2024. Half of surveyed lenders expect the cash rate to reach 4.10% by June 2025, representing one rate cut from current levels.

Official cash rate forecasts amongst major Australian banks are mostly shared with all major banks forecasting no further rate hikes[1]. Market participants in the futures market currently hold a more pessimistic view, with implied rates staying higher for longer.

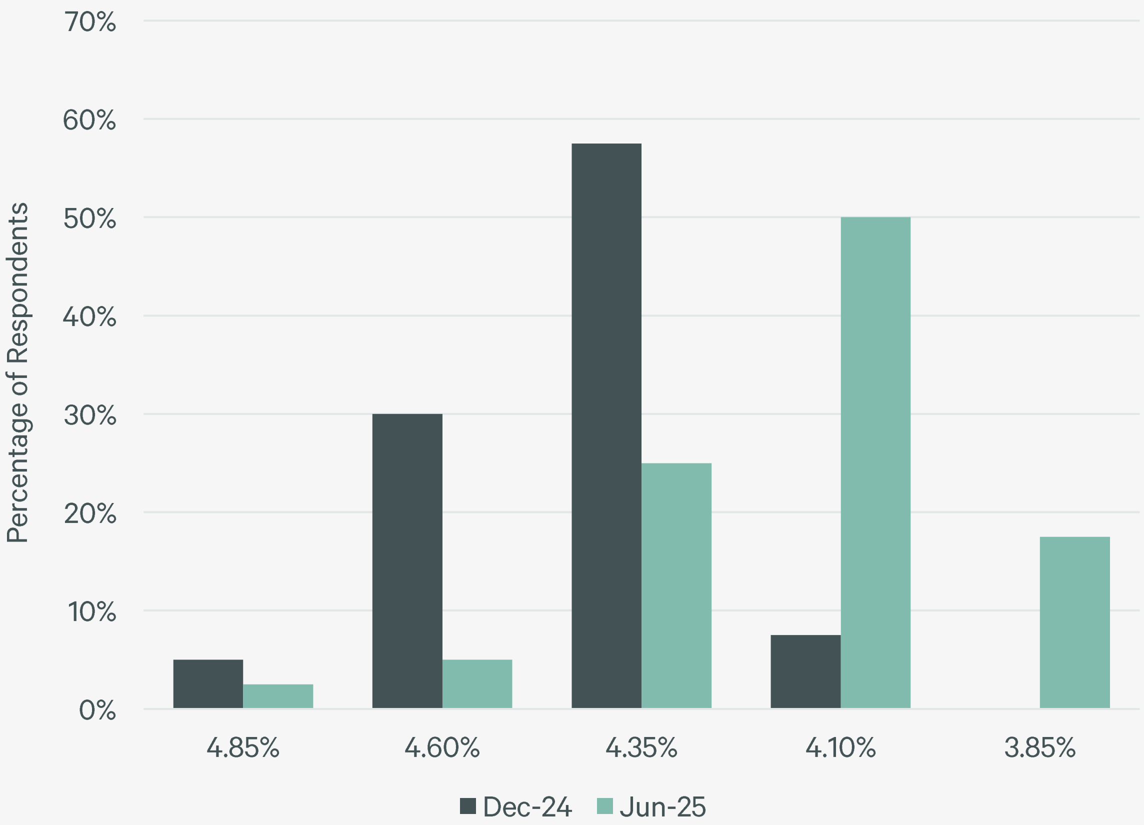
[1] as of the 24th of April 2024.

FIGURE 1: Key Rate Movements (Jan 2022 – May 2024)



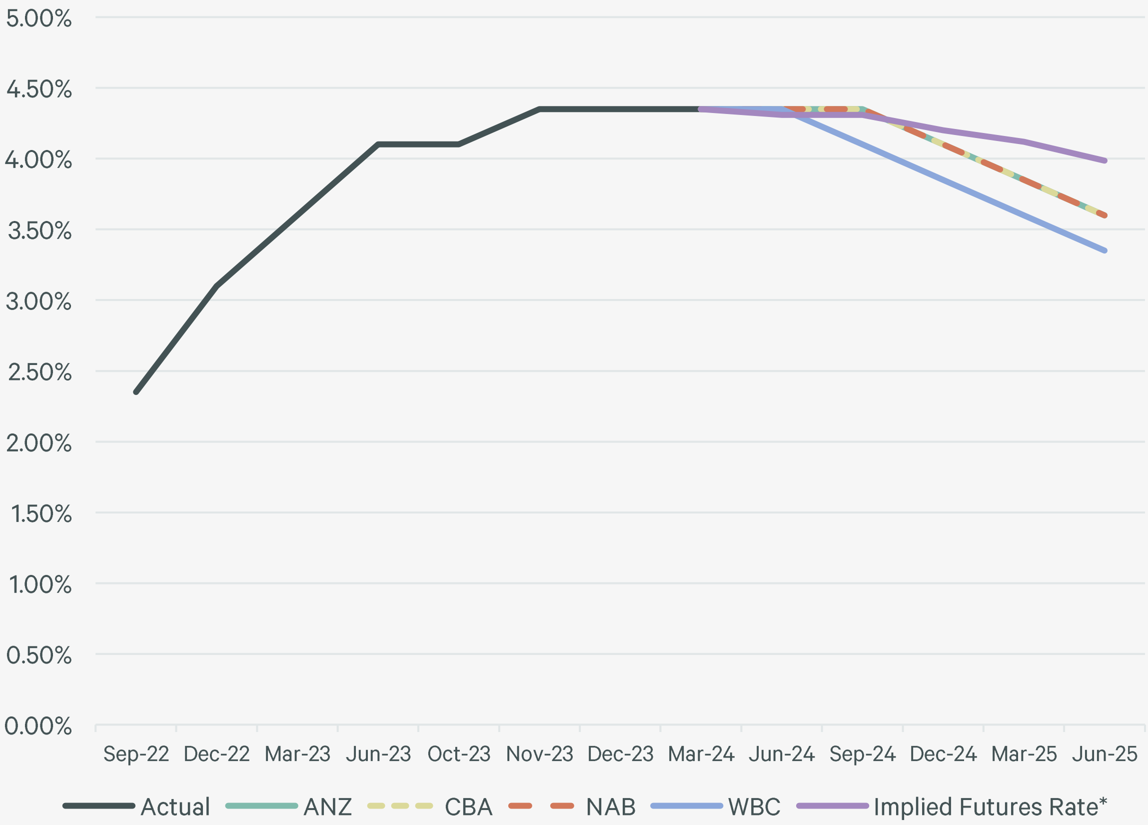
Source: ABS, CBRE Research

FIGURE 2: Lender Expectations for the official RBA cash rate as of:



Source: CBRE Research

FIGURE 3: Official RBA cash rate forecasts.



Source: CBRE Research, Respective institution's Forecast Reporting, ASX.
Note: Implied futures rate data was collected on the 20th of May 2024.

Margins and Hedging requirements

Credit margins are expected to remain mostly stable, with over 2/3rds of lenders expecting flattish movement over the next 3-months. Margin expectations have materially shifted since H2 2023, where the majority view was an upward movement of more than 10bps.

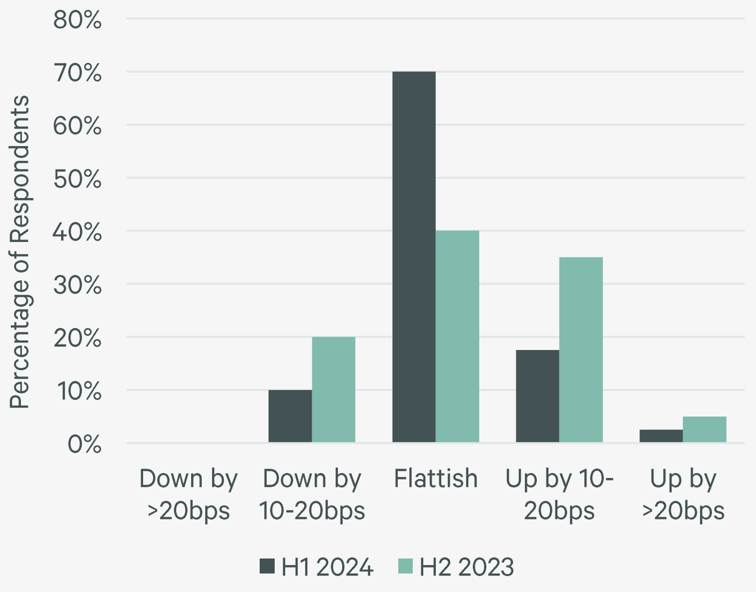
Hedging remains a consideration for lenders amid interest rate volatility. As of H1 2024 55% of lenders require at least 25% of the loan to be hedged, down from 67% in H2 2023.

Lending appetite remains broadly consistent with prior surveys. As of H1 2024, 60% of our surveyed lenders expect increasing new loan appetite over the next 3-months.

Notably, both domestic and non-bank respondents held consensus views of increasing loan appetite (63% and 85% respectively). This is in stark contrast to our international bank respondents, whom only 27% expect an increase in new loan appetite.

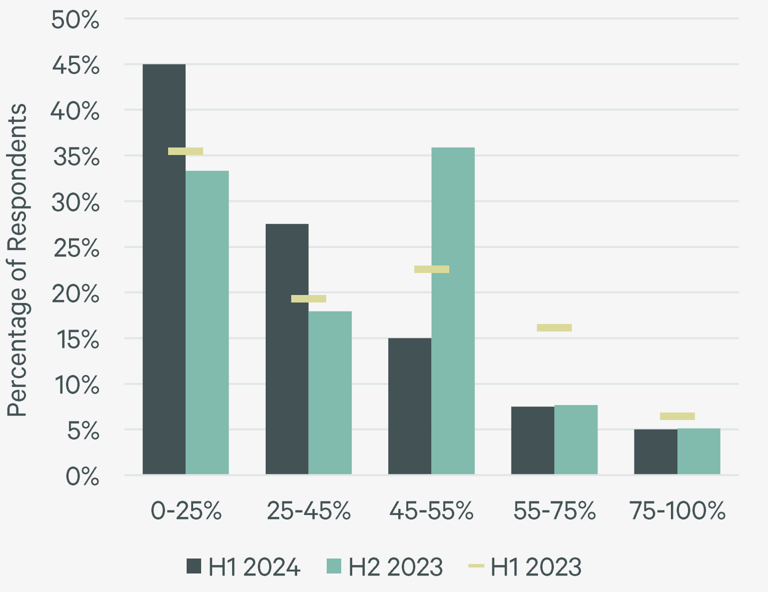
As expectations around macroeconomic conditions become more certain, this should support increased levels of loan appetite locally, in our view.

FIGURE 4: Expectations for credit margin movements over next 3-months on new loans.



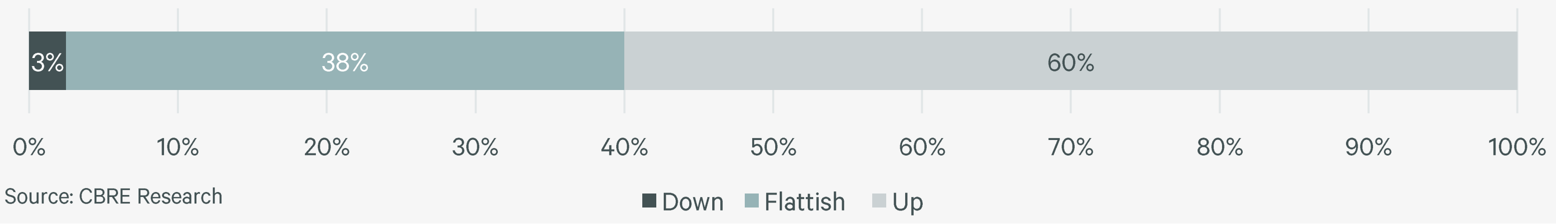
Source: CBRE Research

FIGURE 5: Current lender interest rate hedging requirements by survey period.



Source: CBRE Research

FIGURE 6: New loan appetite expectations over the next 3-months.



Source: CBRE Research

Lending ratio requirements continue to evolve

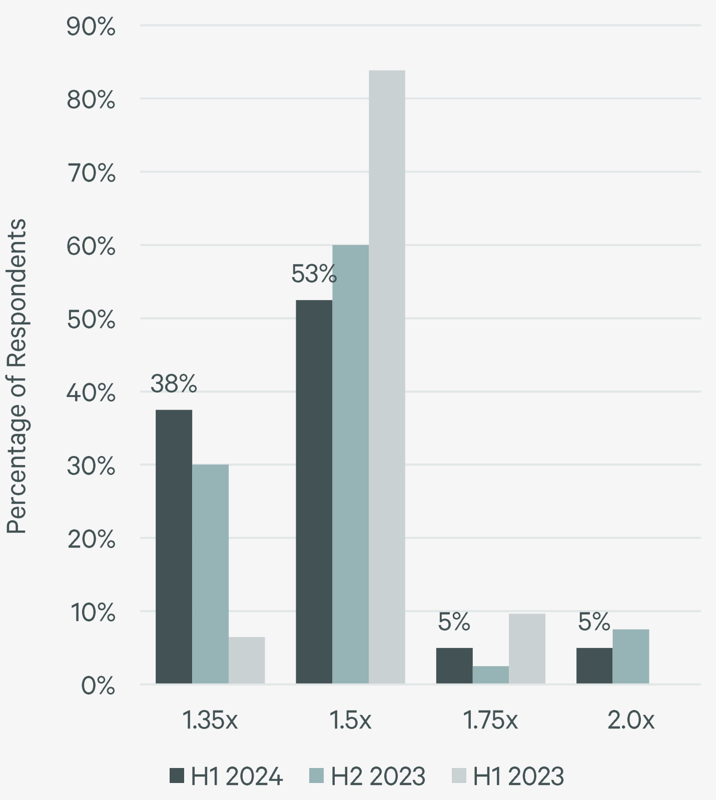
Lender interest coverage ratio (ICR) requirements as of H1 2024 are broadly consistent with views seen in H2 2023. Currently 91% of lenders have an ICR requirement of either 1.35x or 1.5x. This is the same proportion as recorded in H2 2023. Lender ICR requirements have seemingly stabilised following the major shift seen from H1 2023, where close to 85% of lenders had an ICR requirement of 1.5x.

Both domestic and international bank respondents hold majority views for 1.5x ICR requirements, consistent with our H2 2023 survey. On the contrary, 85% non-bank respondents currently have an ICR requirement of 1.35x, up from 64% in H2 2023.

Australian lender loan to value ratio (LVR) requirements have seen a notable shift in the last six months, driven by a large uptick in '60% and above' responses. Whilst most respondents (40%) still hold a preferred LVR requirement between 40-50%, more than 1/3rd now have a LVR requirement of 60% and above.

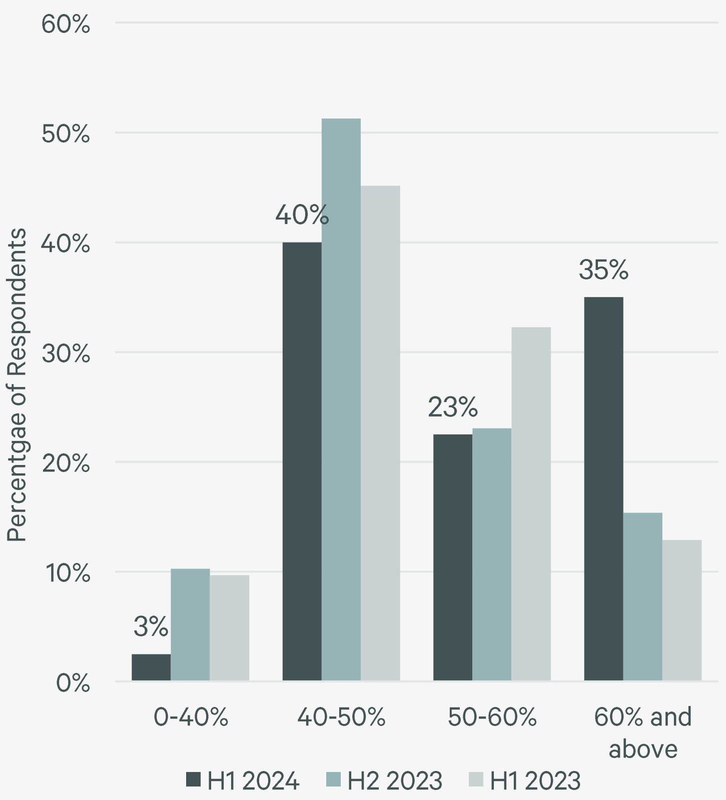
Notably, non-bank respondents comprised majority of the '60% and above' responses, with bank respondents primarily holding requirements within the 40-60% range.

FIGURE 7: Lender ICR requirements for new investment grade lending.



Source: CBRE Research

FIGURE 8: Lender preferred LVR requirement.



Source: CBRE Research

Student accommodation attracts strong investment interest amongst Australian lenders

The Industrial sector has continued to attract the strongest proportion of lender interest driven by its continued record-low vacancy rates and strong rental growth across Australia.

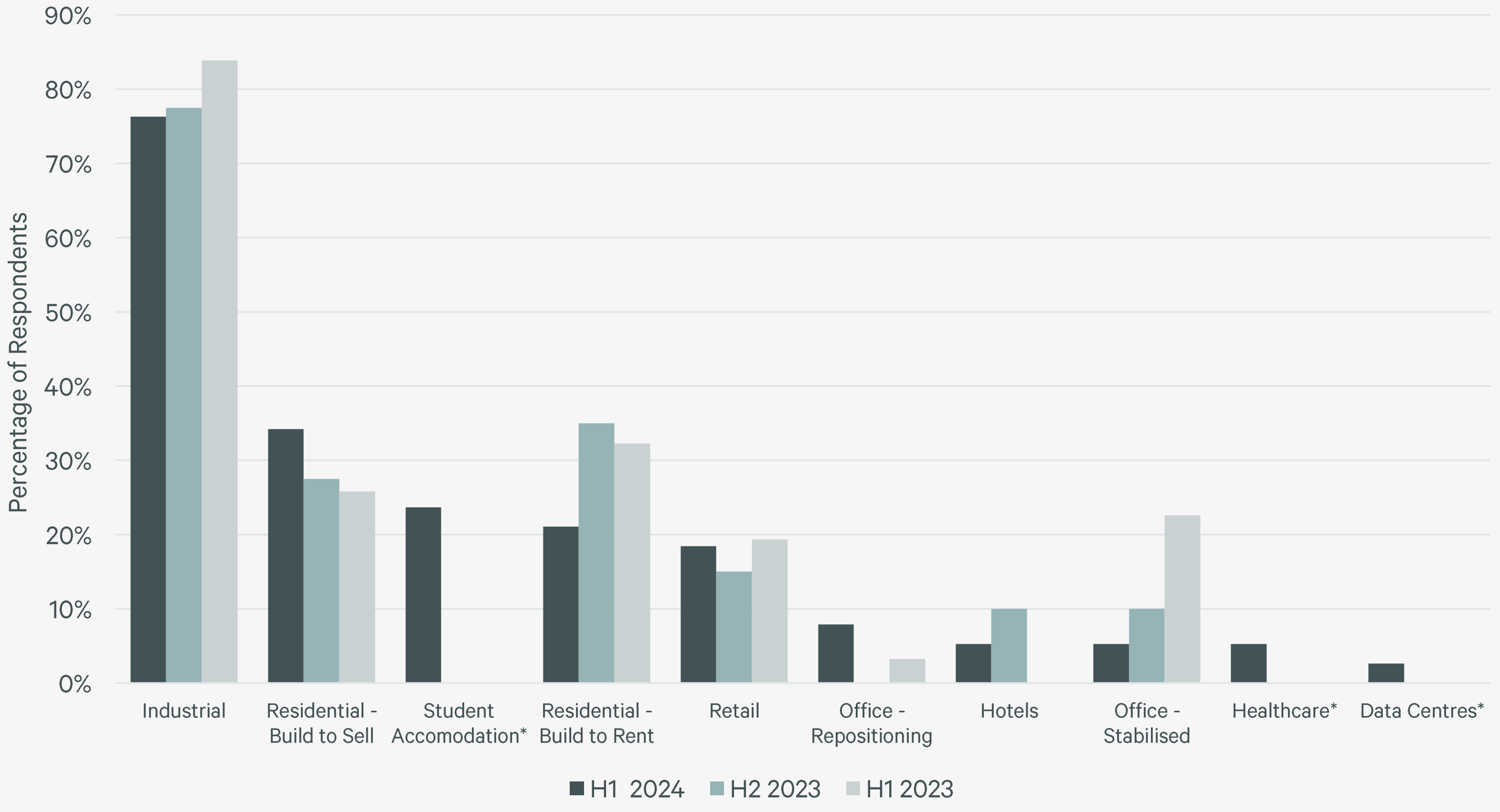
Student accommodation reached the third highest percentage of respondents reaching 24% in H1 2024. The sector offers strong demand fundamentals amidst a relatively undersupplied market relative to our global peers[1].

Lender preference for residential assets continues to remain strong, with the percentage of build-to-sell respondents growing for the second consecutive period.

Lender preference for office assets continues to remain subdued. Despite this, a moderate uptick in 'Office – repositioning' responses was recorded in H1 2024. We attribute this to the attractive value proposition offered by the risk-return offerings of credit investment in office assets. Notably, this is most reflective of non-bank respondents, whose comfort in the asset class has increased since prior surveys.

[1]CBRE research 'Accommodating the growth in students'.

FIGURE 9: Lender preferred asset class for new investment (top two responses).



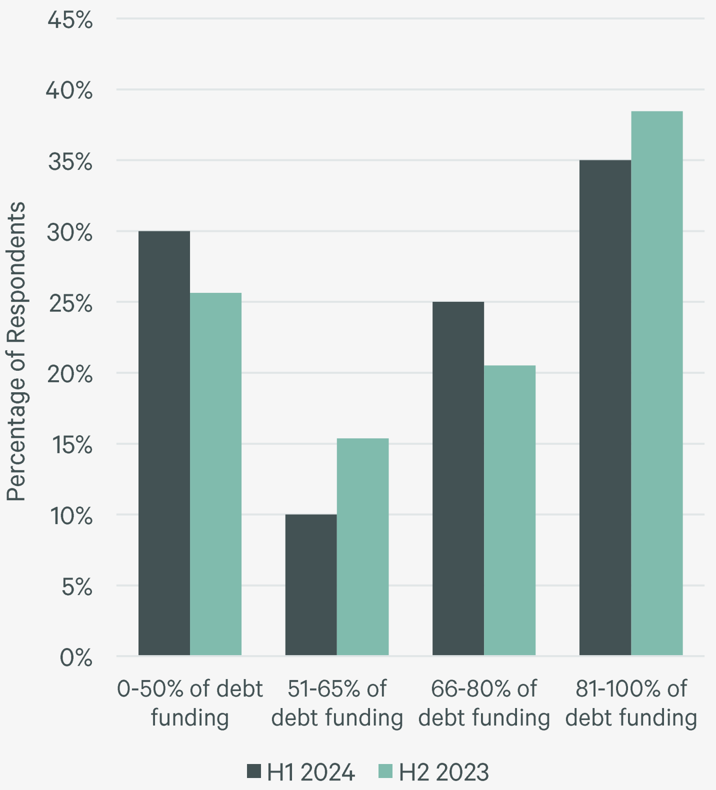
Source: CBRE Research
Note: CBRE Research H1 2024 Lenders Sentiment Survey is the first time Student Accommodation, Data Centres and Healthcare have been available options.

Slight uptick in covenant breaches anticipated over the next six months

Majority of lenders noted no major change in covenant breaches in the past six months (55%) with a slightly higher percentage (58%) expecting no change over H2 2024. Of surveyed lenders, 35% saw an increase in covenant breaches over the last six months, with 43% expecting an increase over the next six months. We expect this increase to be attributed to a rise in LVR breaches caused by continued pressures on asset valuations.

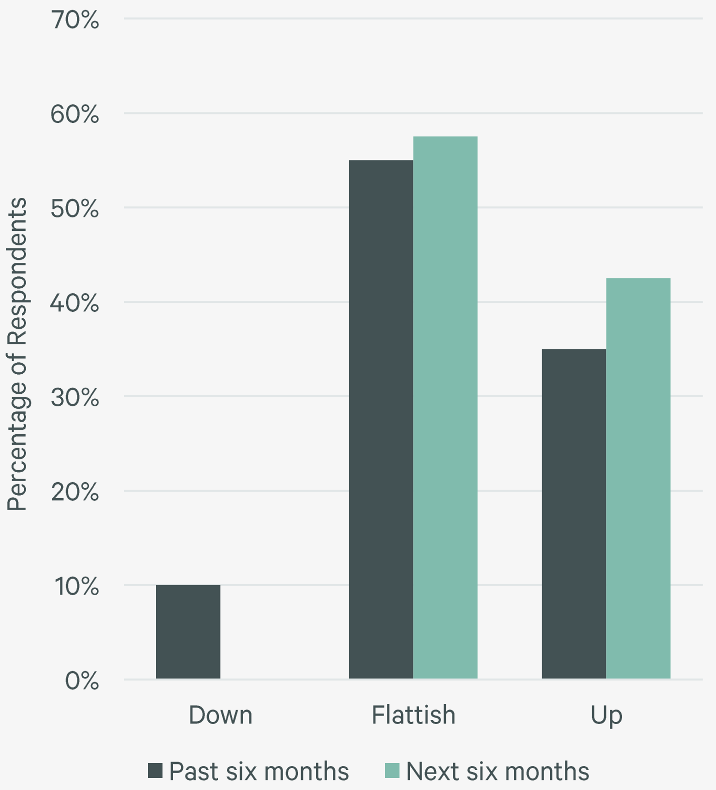
For residential-to-sell construction lending, 60% of respondents require at least 2/3rd of the debt component of construction finance to be covered through pre-sales. This is up slightly from 59% in H2 2023. High pre-sale requirement conditions are likely to continue to dampen future supply in an already supply constrained environment.

FIGURE 12: Pre-sale requirements for residential-to-sell construction lending by survey period.



Source: CBRE Research

FIGURE 13: Lender rate of loan covenant breaches by period.



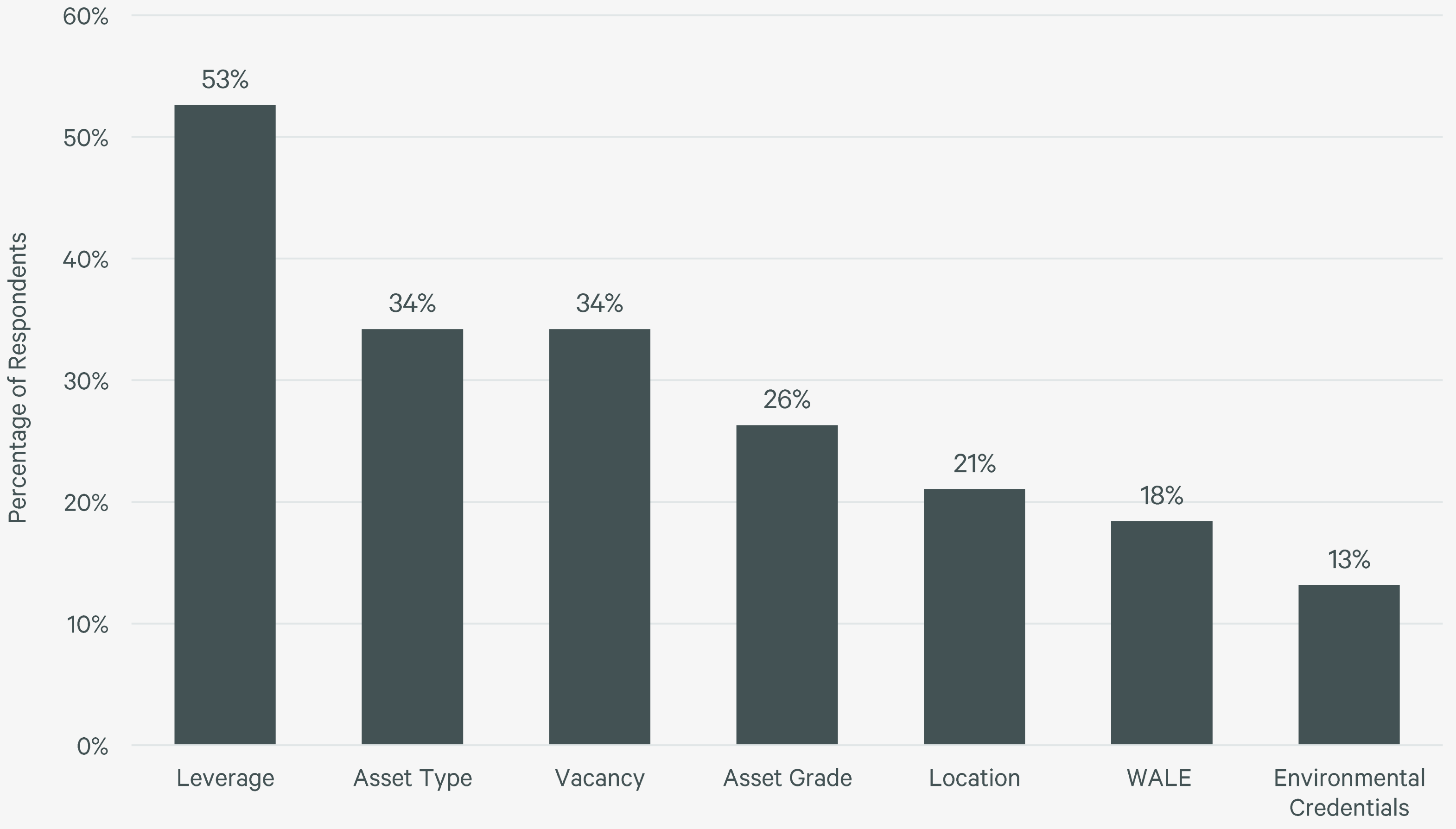
Source: CBRE Research

Leverage is the key concern impacting lender appetite for refinance

More than half (53%) of surveyed lenders noted leverage as one of their top two concerns impacting appetite for refinance. Given the current elevated cost of debt, leverage levels can make a tangible impact on the return and risk profile of a refinance decision.

Lender responses for asset type (34%) and grade (26%) indicate lender acknowledgement of the significant bifurcation happening both between and within key commercial asset classes. Notably, 13% of surveyed lenders identified environmental credentials as a key variable, highlighting the growing importance of ESG in Australia's commercial real estate industry.

FIGURE 14: Key variables impacting lender appetite for refinance (top two responses)

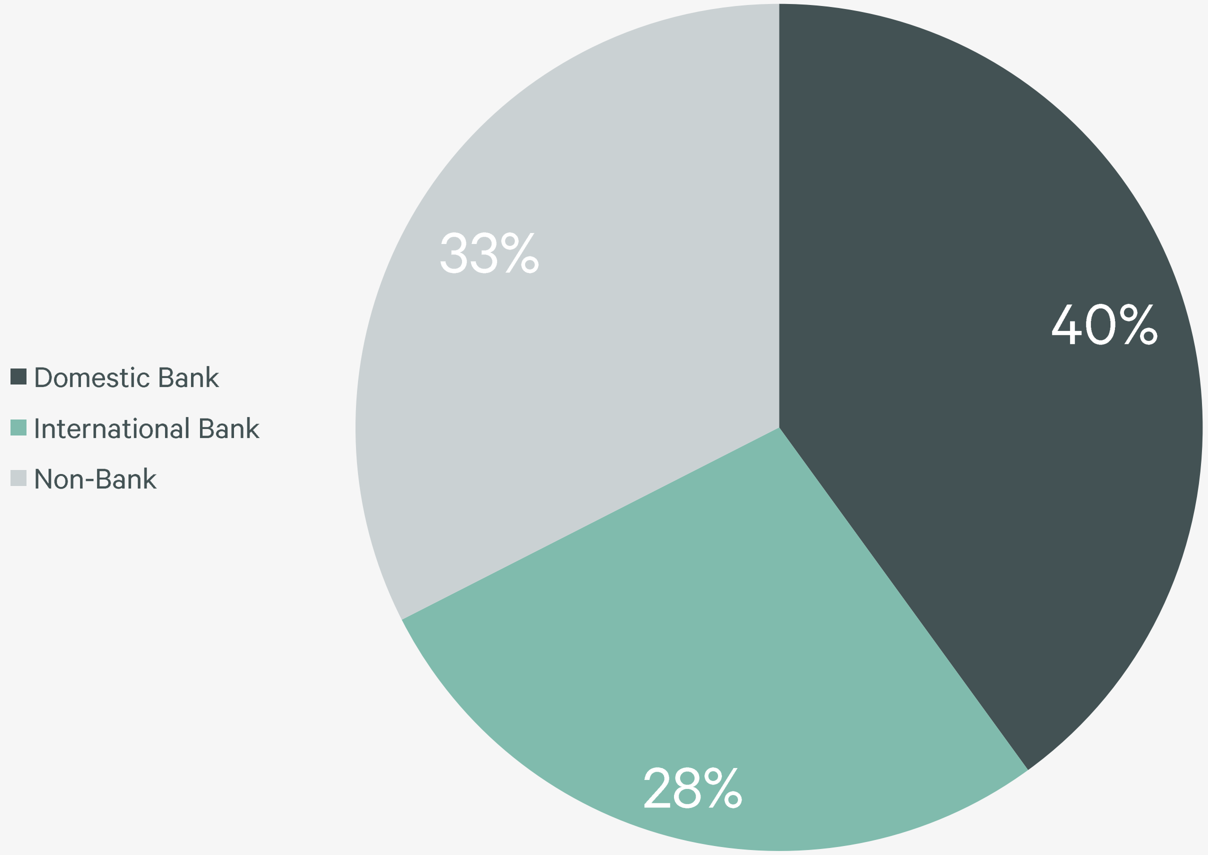


Source: CBRE Research

Survey Profile

The CBRE Research H1 2024 Lenders Sentiment Survey was conducted over May 2024. A total of 40 responses were received following the May 7th, 2024, RBA Cash Rate Decision.

FIGURE 13: H1 2024 Respondent Profile by Type of Respondent Surveyed.



Source: CBRE Research

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