Intelligent Investment

# Lenders Sentiment Survey H1 2023

LOCAL RESPONSE
AUSTRALIA

Credit available at higher costs

CBRE RESEARCH
MAY 2023

# Key Messages

## Willing to lend ...

CBRE Research's H1 2023 survey of Australian Commercial Real Estate lenders had 31 participants from local banks, international banks and non-banks.

Feedback from lenders is:

- A moderate decrease in lending appetite but 32% still want to grow their book. This reduction in appetite is most prominent amongst non-banks.
- Industrial remains a favoured asset class with more than 4/5 expressing a preference to lend into that sector.
  - Domestic Banks show a strong preference for Industrial and Office – stabilised.
  - Non-Banks are eager to grow their Residential-to-rent (BTR), Residential-to-sell & Industrial portfolios.
- Lenders are divided amongst pre-commitment requirements. By segment, we find appetite among non-banks for <40% pre-lease., whereas domestic banks favour >60% pre-lease.

## .. but at higher costs

Cost of debt is expected to continue increasing.

- Credit margins could continue to see upward pressure of approx. 20 bps, with over 40% of lenders indicating such a move over the next three months.
- ICR requirement of 1.5x for new investment grade lending preferred by over 80% of institutions. ICR is also the main focus for new underwriting..
- LVR has been stable around 40-60% but this may come under pressure  as assets are revalued during the coming two quarters. Hence, we also find slight uptick in hedging requirements since October 2022.
- Lenders indicated higher average credit spreads, LTV and ICR requirements for prime office assets compared to their industrial counterparts.
- There is consensus around 4% BBSW for Dec 2023, a large increase from lender expectations in October 2022, where most respondents expected 250-299bps.

# Credit costs continue to rise in the first half of 2023, but at a slowing pace.

## CBRE observations

In May, contrary to market expectations, the Reserve Bank of Australia increased the cash rate by another 25 bps to 3.85%.

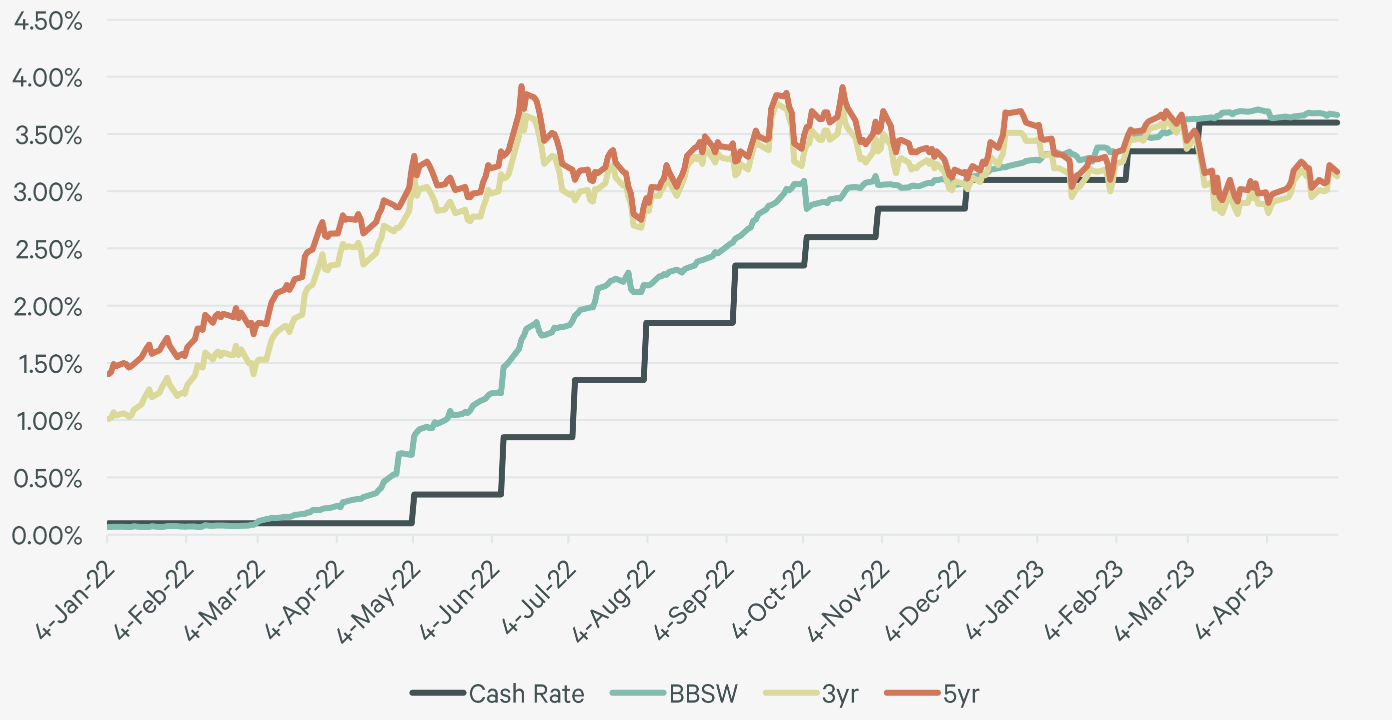
There is continued pressure on credit margins as lenders continue to grapple with the cost of capital and an uncertain economic environment.

The current level of fixed rates has increased the attractiveness of interest rate caps as a hedging mechanism.

Domestic and offshore banks have lowered ICR covenants and we are seeing support at a 1.5x threshold. Lenders are showing a willingness to support new business, with short-term inability to meet ICR requirements.

Transaction volumes have reduced significantly in the first half of 2023, as investors seek further economic and financial certainty. Nonetheless, we see continued appetite from domestic banks and alternative lenders for quality sponsors with track record, sound assets and a clear asset management strategy.

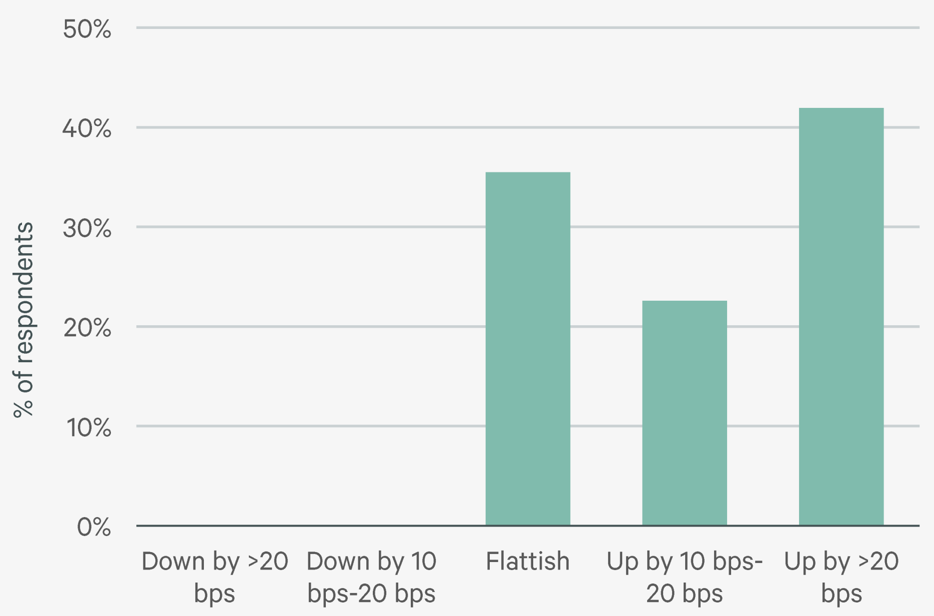
**Interest rate movements since 2022**




Source: Reserve Bank of Australia

# Over 60% of lenders expect credit margins to increase. Dec-23 BBSW expectations increase significantly from Q4 2022, with a greater concentration among consensus view around 4% BBSW. Collectively, this will put more pressure on serviceability/ICR.

**In the next three months, credit margins on new loans are likely to move:**



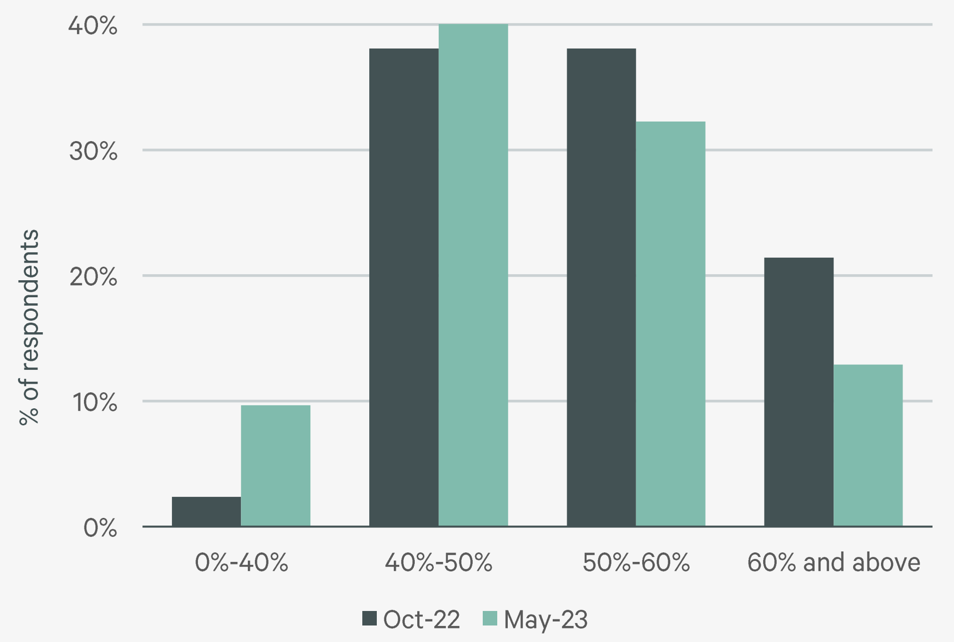

Source: CBRE Research

**My expectation for BBSW at Dec 2023 is:**


Source: CBRE Research

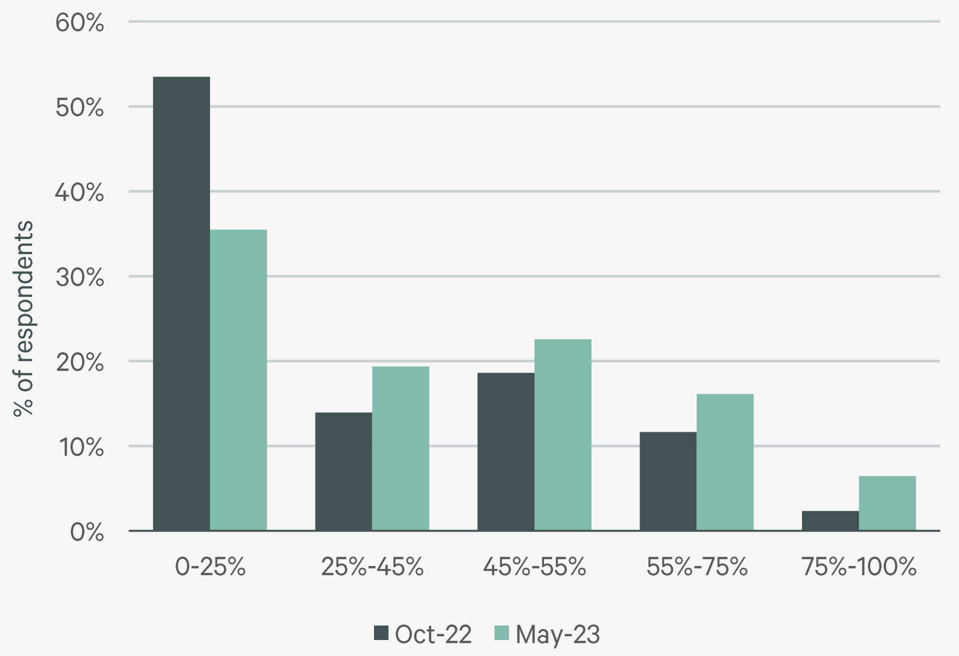
# LVR requirements remain concentrated around 40-60%. Lenders increase hedging requirements as economic uncertainty mounts. As yet there has been nominal downward movements on valuations given a lack of evidence in the market to support a softening. It is expected as sales commence for 2023 the valuation cycles for June and September will place LVR's under pressure.

**Preferred LVR requirement:**




Source: CBRE Research

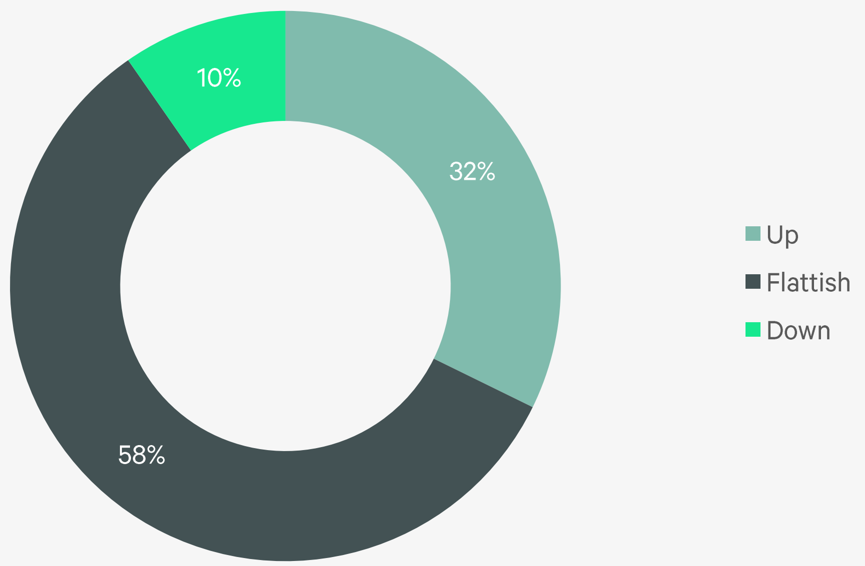
**Current interest rate hedging requirement (choose one)**




Source: CBRE Research

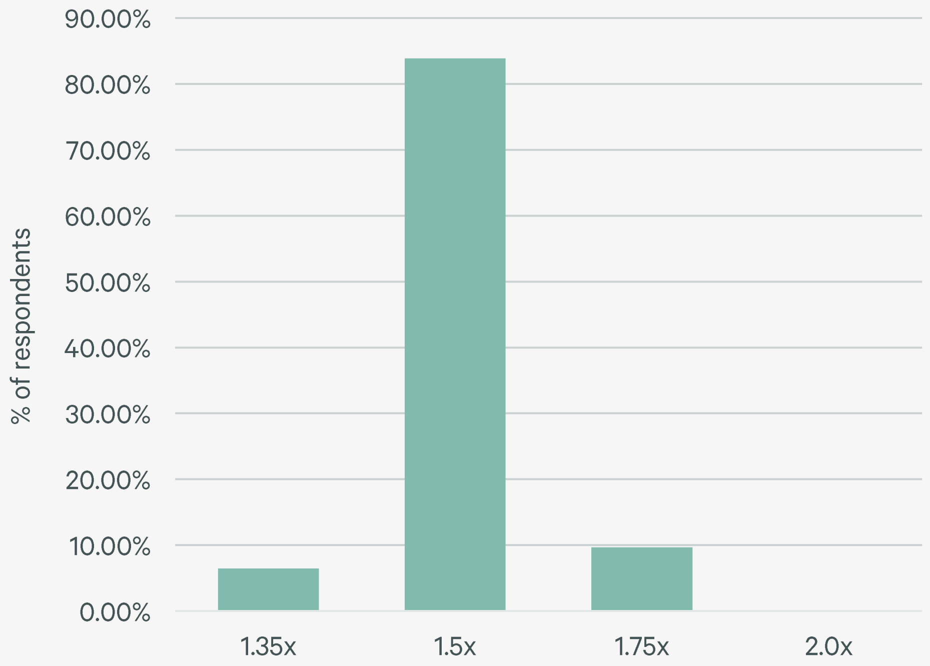
# Lending appetite decreases moderately, with 32% of respondents expressing a desire to grow the book, compared to 44% in Oct-22. This reduction in appetite is most prominent amongst non-banks. Lenders express consensus among ICR requirements at 1.5x.

**In the next three months, our appetite for new loans is likely to move**




Source: CBRE Research

**ICR requirement for new investment grade lending**




Source: CBRE Research

# Lenders continue to favour Industrial in the post-covid economic environment, with more than 4/5th expressing interest.

Industrial remains the most preferred sector for new lending. Residential-to-rent (BTR) has seen a moderate 16% increase from our previous survey, with interest in office-repositioning declining by a slightly larger amount.

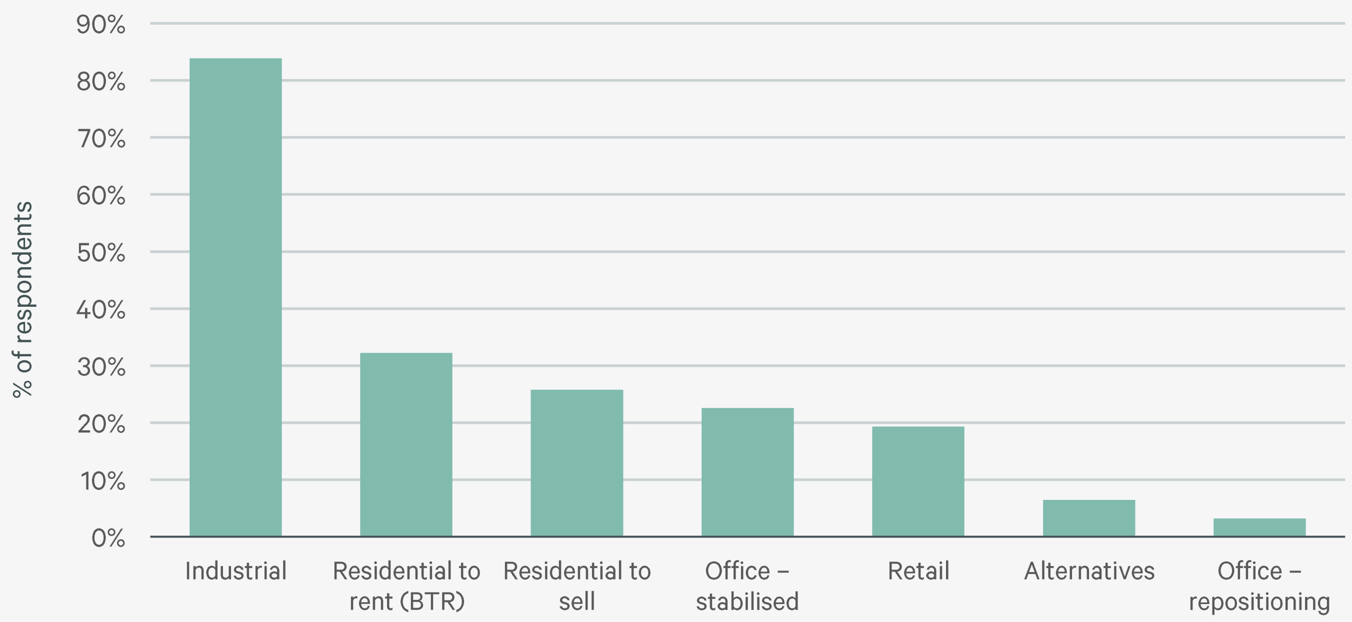
Domestic Banks show the strongest preference towards both Industrial and Office-stabilised assets, with 95% and 37% of respondents choosing the respective asset classes.

Retail was also popular amongst domestic banks with 32% electing it, however the total percentage of respondents preferring the asset class has decreased from 21% in our October survey to 19% now.

International Banks indicate the largest proportion of interest in BTR projects with more than 60% of international bank respondents expressing interest in the asset class.

Non-banks express the most interest in growing their book in the residential sector, with 2/3rd of respondents expressing interest in either BTR or residential to sell assets.

**Preferred asset class for new investment (choose top two)**



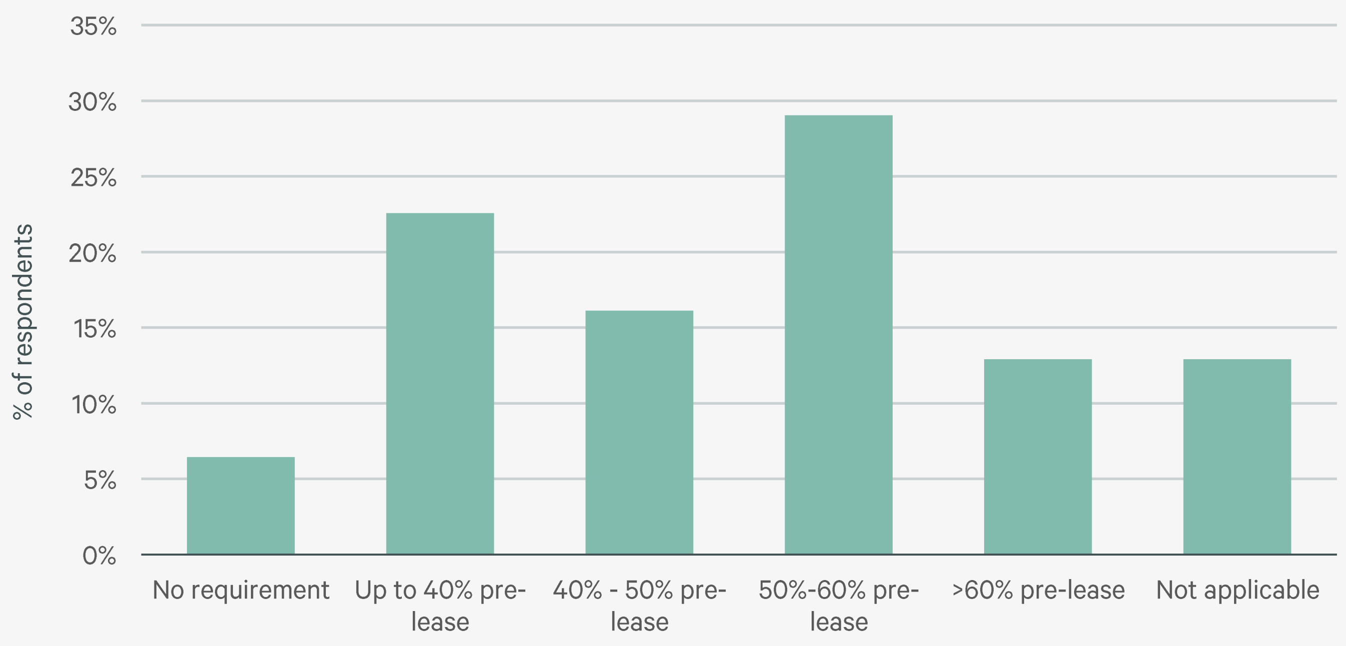

Source: CBRE Research

# Pre-commitment requirements for new developments become split amongst lenders.

Our data continues to suggest non-bank lenders are likely to opt for pre-lease requirements up to 40%.

Domestic banks favour pre-lease requirements above 50%, with 46% of domestic banks requiring 50-60% , and 23% requiring greater than 60%

**For commercial construction lending, our pre-lease requirement is:**




Source: CBRE Research

# Majority of lenders expect change in serviceability requirements in 2023.

In the current economic environment, characterised by economic uncertainty amidst rising interest rates, borrower financial stability is at the forefront of most lenders minds.

Broadly, lenders express the possibility of changes to financial metrics far outweighs those that are fundamentally driven, such as occupancy/vacancy and exit strategy assumptions.

**If you are expecting changes to your underwriting requirements for lending, which areas will see changes in your pro forma underwiring assumptions in 2023?**


Source: CBRE Research

# Higher average credit spreads for prime office assets compared to industrial.

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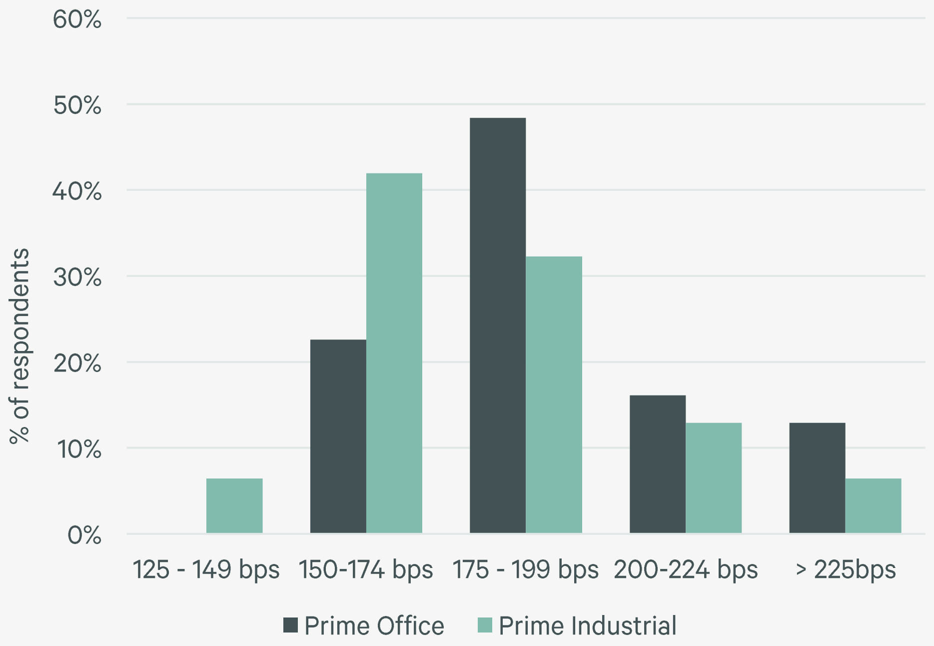
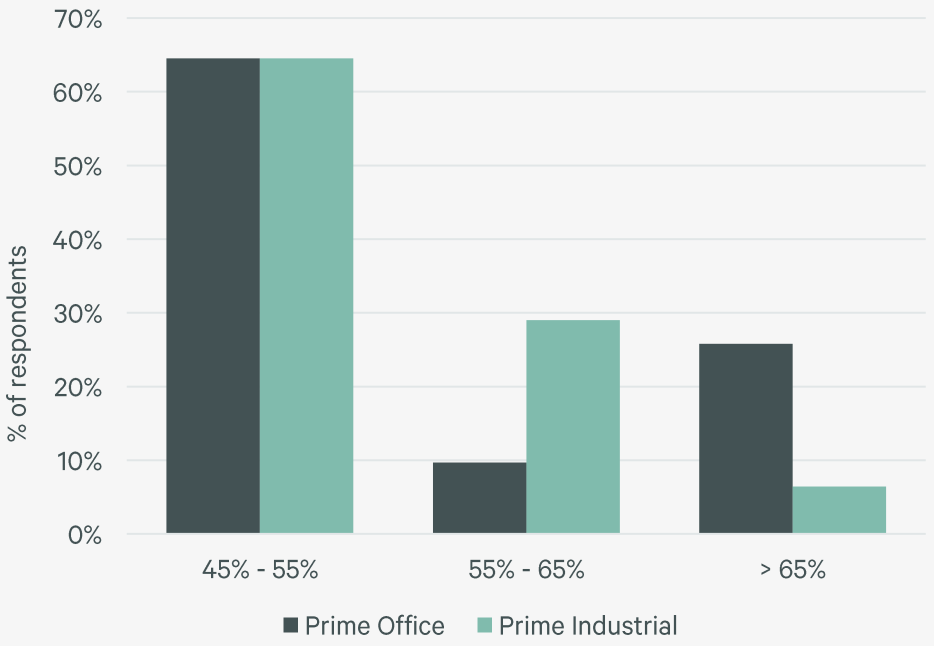
**Our credit spread/margin preference for new lending to ______ assets is:**




Source: CBRE Research

**Our LTV preference for new lending to ______ assets is:**




Source: CBRE Research

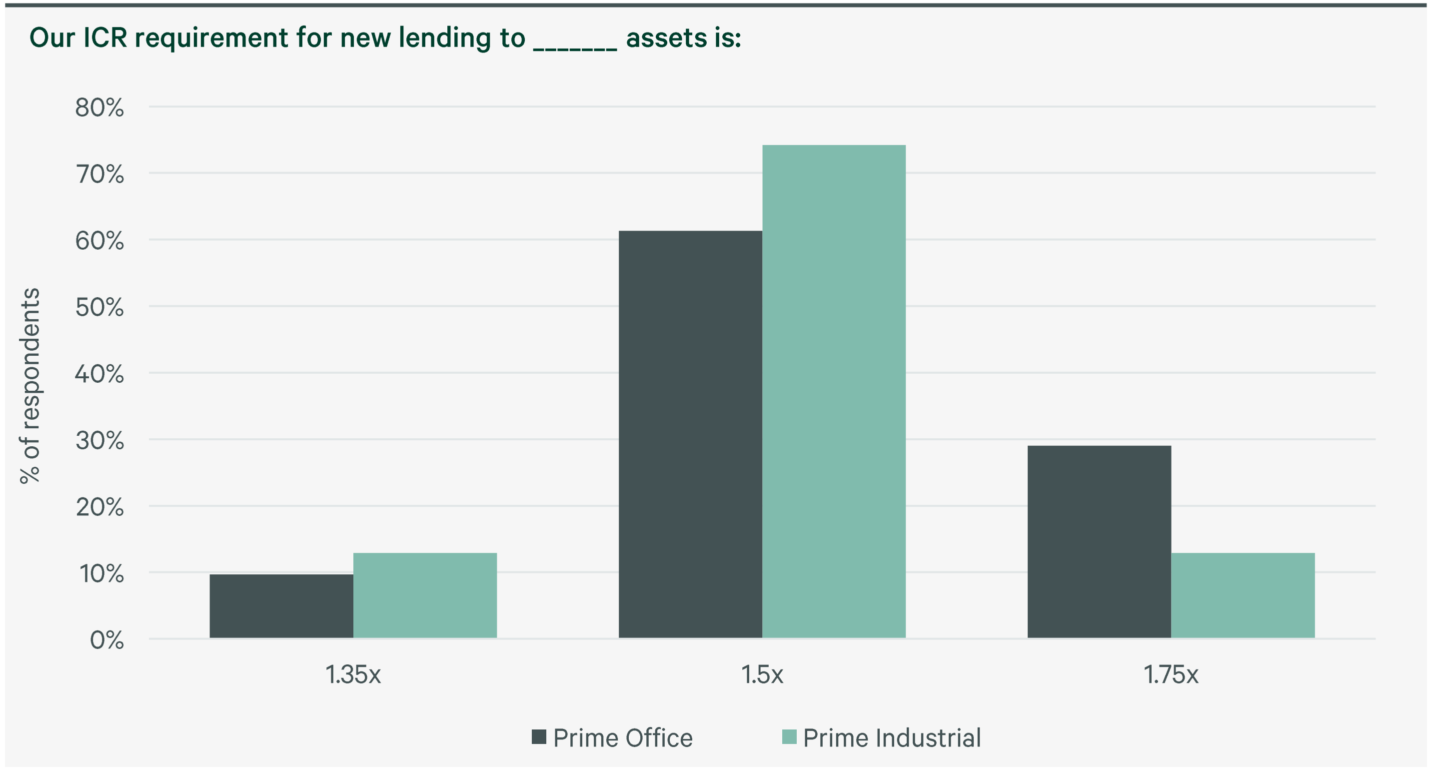
# Lenders express consensus of 1.5x ICR requirement for both office and industrial assets.

Whilst some lenders exhibit similar preferences among asset classes, there is a clear divide amongst prime office and prime industrial assets.

Credit spreads across both asset classes are concentrated among the 150-199 bps range. However, on average, lenders clearly show higher spreads for office lending compared to industrial assets.

LTV preferences tell a similar story, however a greater proportion of lenders agree with the 45%-55% LTV range. A quarter of respondents prefer office lending with a LTV of > 65%. Industrial lending places a higher weighting on the 55%-65% range, with 29% of respondents preferring that band.

ICR requirements are coalesced amongst 1.5x for both asset classes.




Source: CBRE Research

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