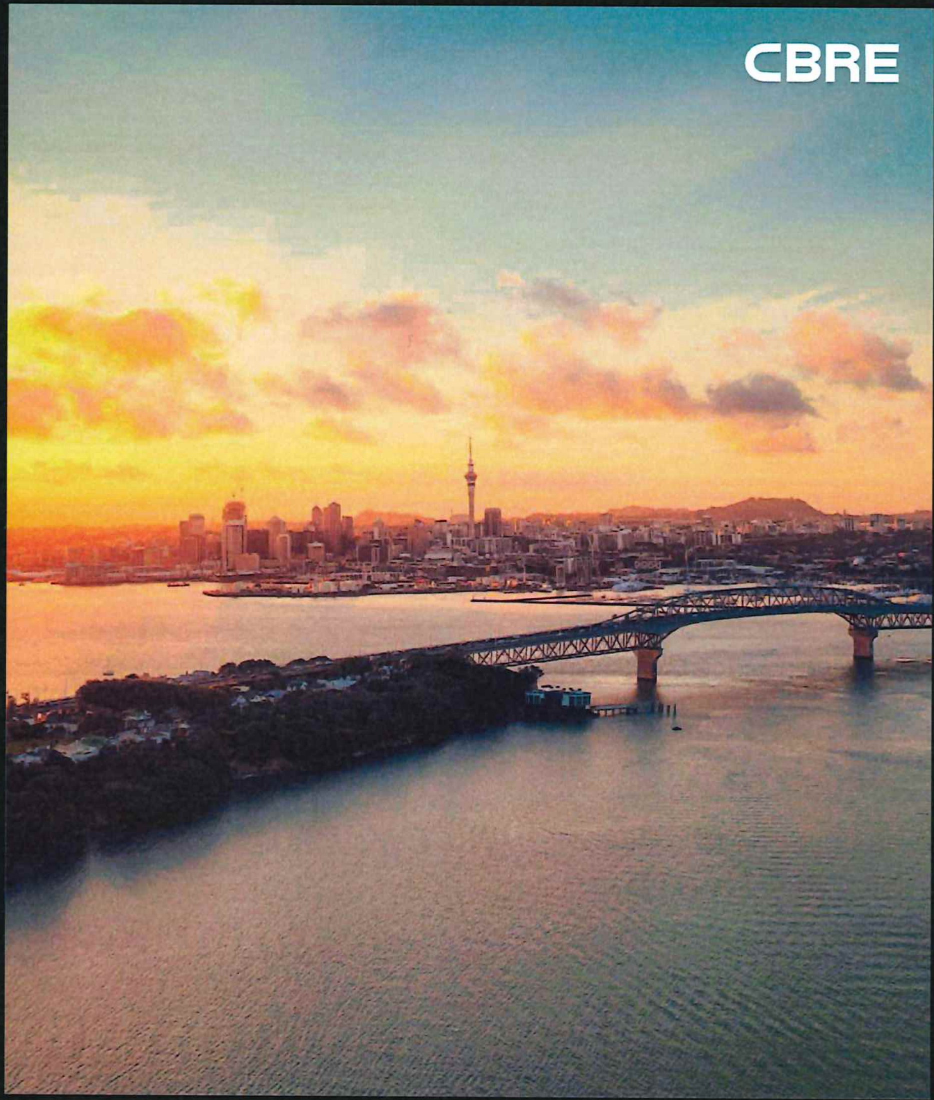
Intelligent Investment

New Zealand Lender Sentiment Survey Q2 2023

LOCAL RESPONSE
NEW ZEALAND

CBRE RESEARCH
JULY 2023



Lenders remain open to business... but at a higher cost and with more prudent LVR, ICR, and presales

- All-in interest rates are likely to continue increasing via lenders' margins. However, these increases are expected to occur at a slower rate than in 2022 as substantial pricing premiums are already built in by most lenders.
- Appetite to lend shows a small improvement compared to last year. This improvement is mainly for investment rather than development loans.
- Appetite for development lending is towards terrace/townhouse dwelling types. Compared to last year's survey, there is a significant uplift in required presales as proof of concept and to help reduce concerns around settlement risk.
- LVR continues to be the bridesmaid to ICR requirements. Non-banks make up the higher end of LVR capacity, driven by comfort with lower ICRs. Bank lenders are seeking a minimum of 1.50x -1.75x ICR cover. For some existing clients they are falling below this level but require a pathway back to 1.50x. Non-bank lenders are less concerned with LVR and ICR, as long as an achievable exit is available, whether via refinance, amortisation, development or divestment.
- Given the current constrained nature of servicing for many stabilised assets, hedging is being highlighted by all banks and an element of hedging as a condition to funding is highly likely.

20 lenders participated in the survey (up from 16 in the previous edition) including seven international lenders and 13 domestic lenders. Of the seven offshore lenders, three were banks and four were non-bank lenders. Of the 13 domestic lenders, three were banks and ten were non-banks. Given the weighting towards non-bank lenders, it is reasonable to assume the results fall towards the higher end of the risk appetite spectrum.

Credit margin pressure has moderated

Credit margin pressure has moderated compared to last year.

For investment loans there is a 50/50 split between those that expect it to increase vs those that think it will remain stable. In last year's survey, nearly 80% of respondents expected margins to increase.

There is greater margin pressure on construction loans with 57% expecting it to increase although this is down from nearly 90% in last year's survey.

For both investment and construction lending, whilst it seems that base rate increases have slowed or plateaued, all-in interest rates are likely to continue increasing via lenders' margins. However, these increases are expected to occur at a slower rate than in 2022 as substantial pricing premiums are already built in by most lenders.

FIGURE 1: In the next three months, credit margins on new **non-construction** loans are likely to move

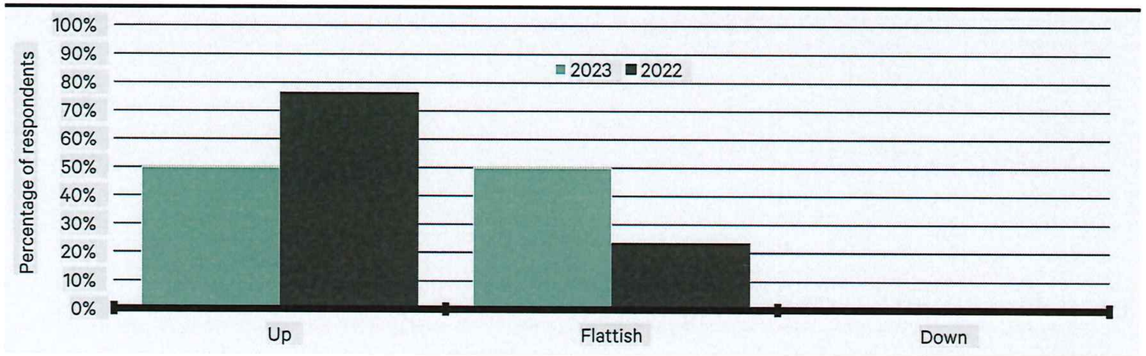
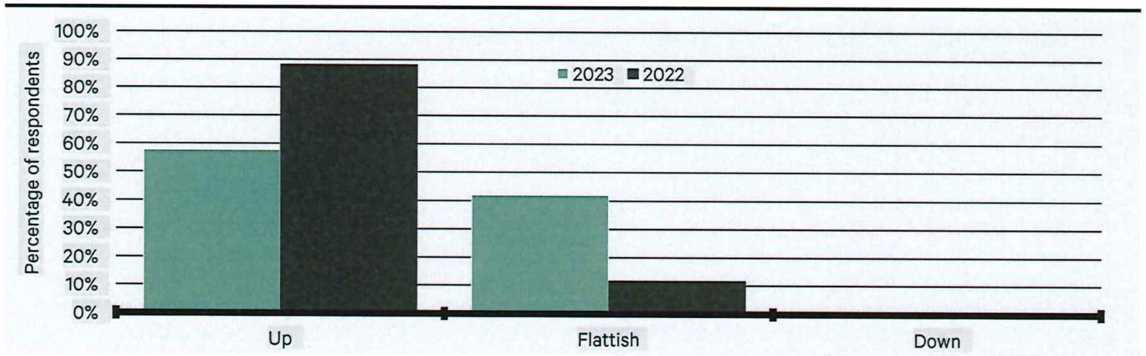


FIGURE 2: In the next three months, credit margins on **new construction** loans are likely to move



Lending appetite is improving

Appetite to lend shows a small improvement compared to last year. This improvement is mainly for investment loans with a net improvement of 45% (those expecting appetite to be up minus those that expect appetite to be down). For construction loans, the net improvement is 21%, up from 12% in 2022.

Whilst banks have advised they have a greater appetite for lending, anecdotally, they remain conservative when considering new transactions and are primarily focused on servicing existing clients.

Opportunistic non-banks will increase lending, albeit cautiously and with expectations of higher returns.

For construction lending, a flight to quality will continue. Until presales levels and construction costs normalise, construction lending will diminish. We also note that the decreased appetite in construction lending as compared with last year is, to some degree, demand driven, i.e. Less projects have commenced in 2023 as compared to 2022 due to challenging market conditions.

FIGURE 3: In the next three months, our appetite for new **non-construction** loans is likely to move

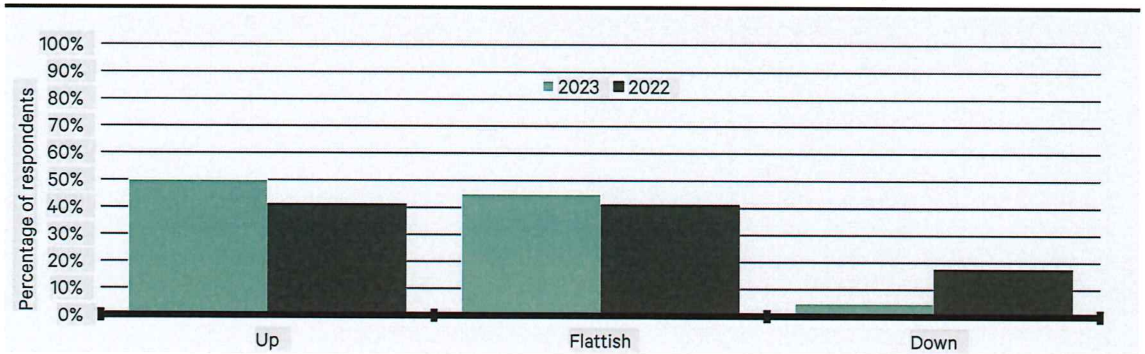
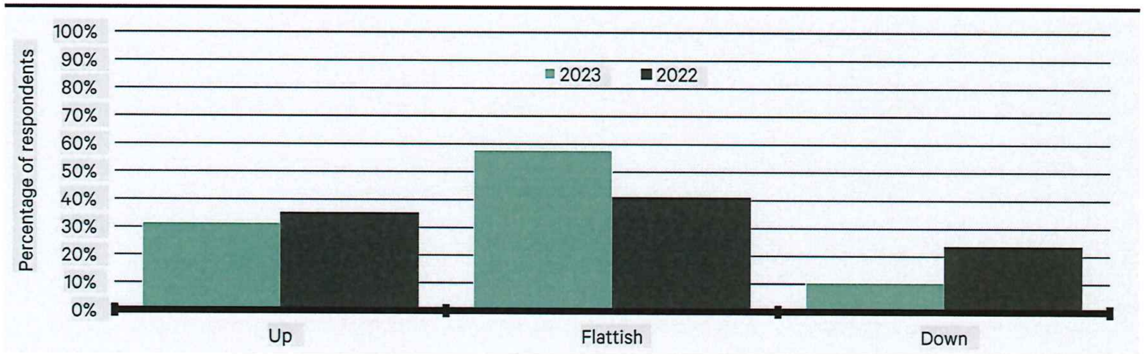


FIGURE 4: In the next three months, our appetite for **new construction** loans is likely to move



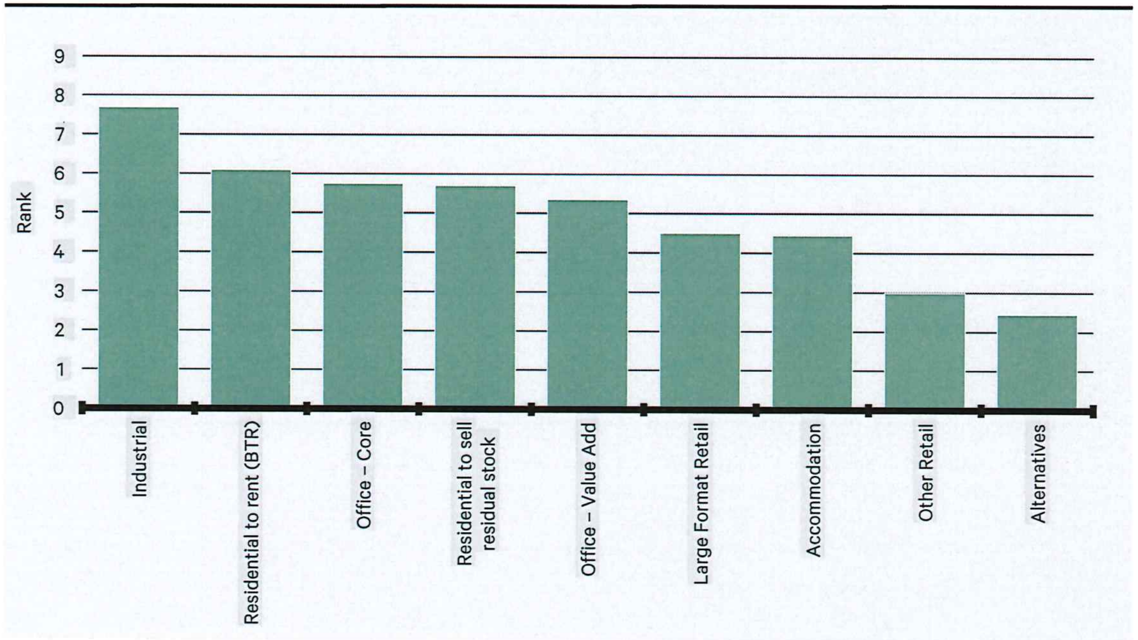
Industrial continues to lead lenders' sector preference for investment lending

For investment lending industrial is the most preferred asset class. Good, core, quality office continues to be supported by lenders with many ranking it as their second or third most preferred choice although, from our latest market observation, a number of lenders started raising concerns around office asset lending. This is influenced by adverse market conditions in offshore markets, especially in the US. Consistently with last year's survey, retail (except large format), and alternatives, continue to be viewed less favourably by lenders, although in CBRE's experience, buyers remain able to access debt in these market sectors.

Lender appetite for the residential sector is more polarised. Built to rent is not the top preference for any lender, but nearly three-quarters ranked it as the second to fourth most preferred (of the nine categories).

Residential to sell for residual stock (dwellings remaining unsold upon physical completion of a new development) is ranked as the most preferred asset by seven of our survey participants, but was also ranked as least preferred by four participants. This polarisation reflects the profile of survey participants and the large number of domestic non-bank lenders who tend to prefer residential development lending with residual stock being a natural extension/exit.

FIGURE 5: Preferred asset class for new non-construction lending (ranked from 1 to 9)



Non-banks make up the higher end of LVR capacity, driven by comfort with lower ICRs

Nearly half of lenders have capacity to lend at a LVR of 60% or more. This is especially true for international non-bank lenders (all of whom in our survey indicated maximum LVR capacity of 60% and above) and to a lesser extent domestic non-bank lenders. Bank lenders tend to be more conservative. LVR continues to be the bridesmaid to ICR requirements. Non-banks make up the higher end of LVR capacity, driven by comfort with lower ICRs. Bank lenders are seeking a minimum of 1.50x -1.75x ICR cover. For some existing clients they are falling below this level but require a pathway back to 1.50x.

Non-bank lenders are less concerned with LVR and ICR, as long as an achievable exit is available, whether via refinance, amortisation, development or divestment.

FIGURE 6: Current maximum LVR capacity

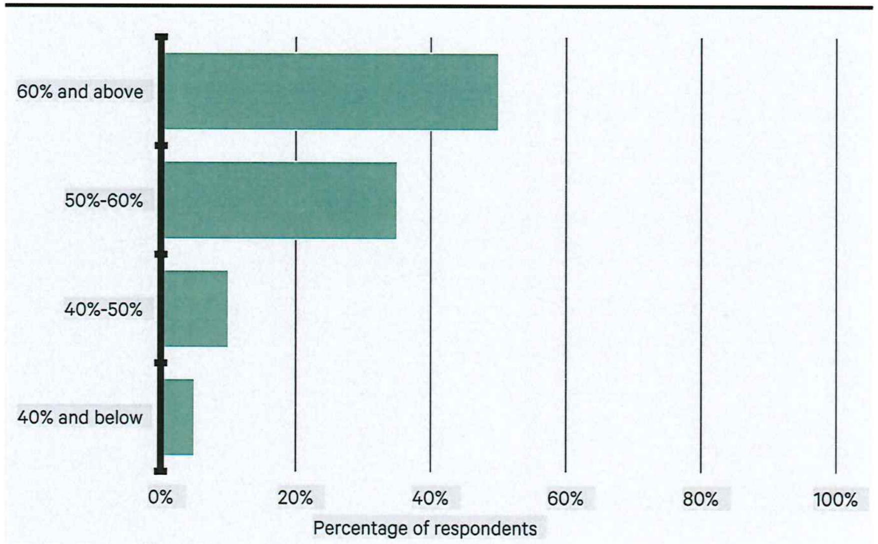
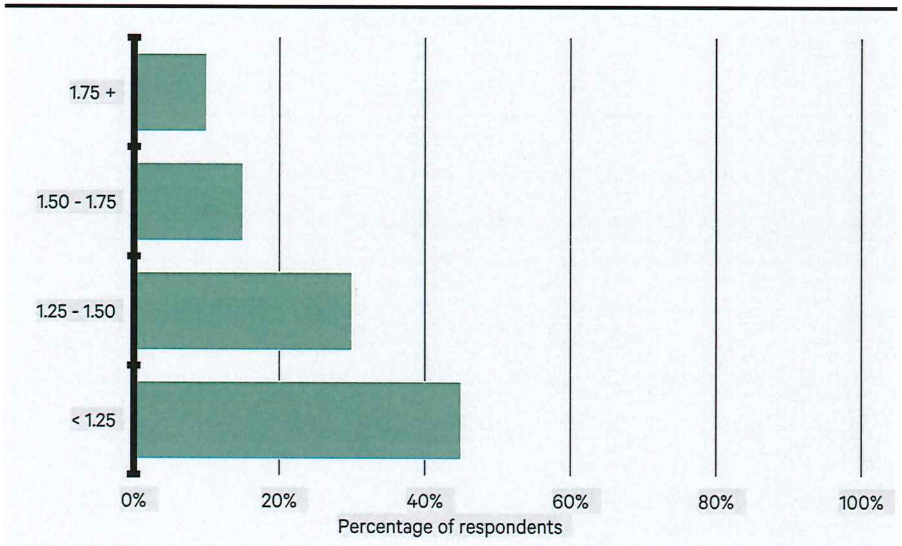


FIGURE 7: ICR requirement for new investment-grade lending



International banks have the highest hedging requirements in general but individual financiers vary widely in their hedging requirements across the lender types

Hedging is generally required for banks and the more conservative of the non-banks. Given the current constrained nature of servicing for many stabilised assets, an element of hedging as a condition to funding is highly likely.

There is more consistency for loan tenor with all domestic non-bank lenders preferring less than 24-month loans (reflecting their focus on construction lending). Half of the lenders outside of the domestic non-bank category prefer loans of three years or more. Lenders are currently reluctant to provide term beyond three to five years unless the debt facility is 100% hedged, and for the full term of the loan.

FIGURE 8: Current interest rate hedging requirement

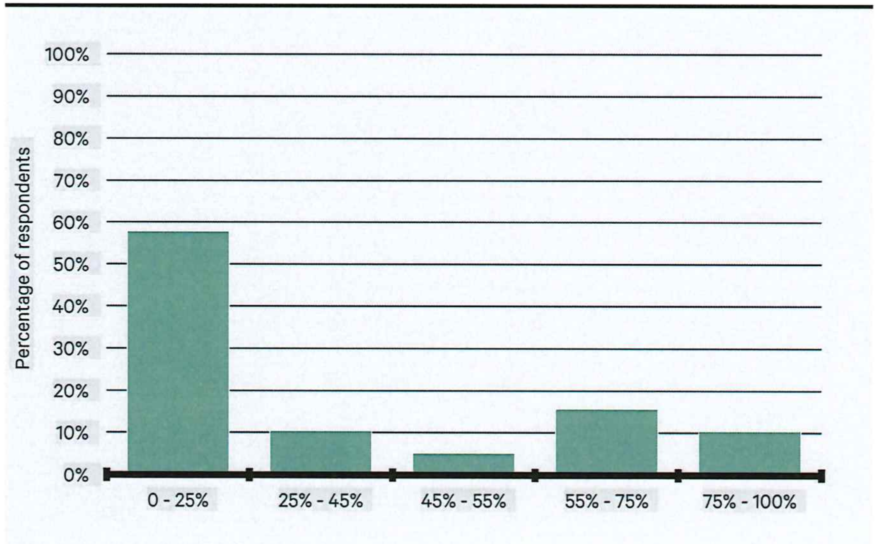
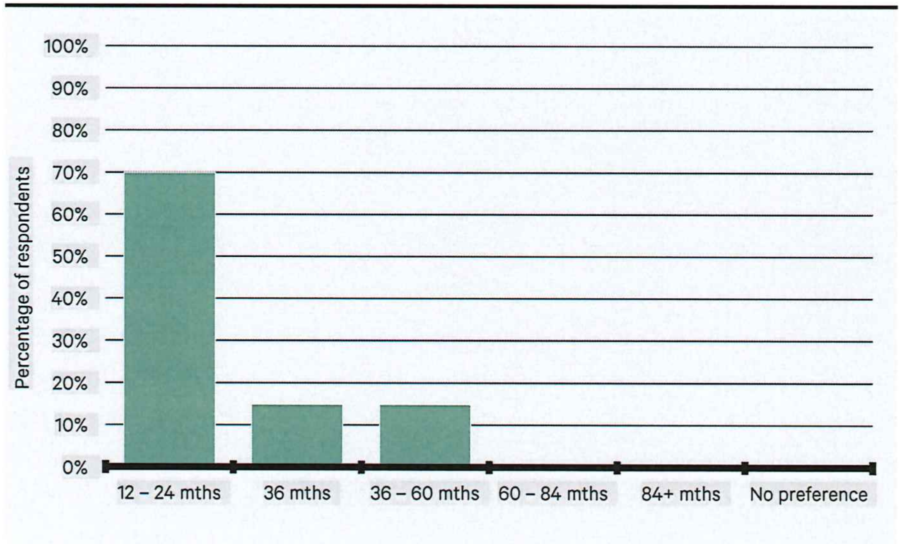


FIGURE 9: Preferred tenor of loan



Appetite for development lending is towards terrace/townhouse dwelling types

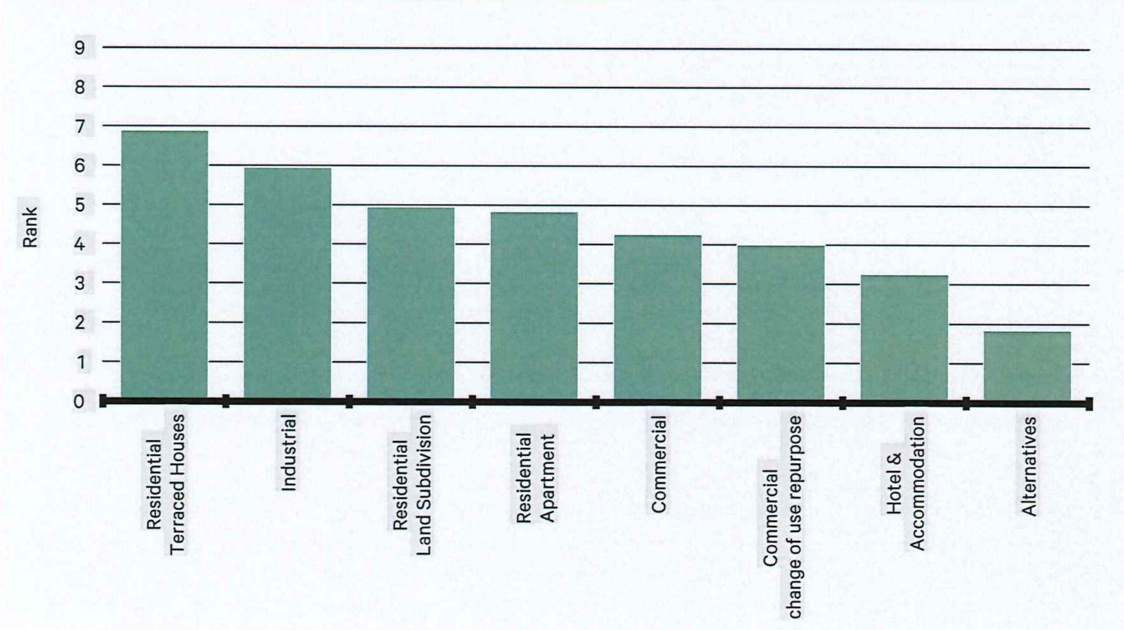
Lending appetite for terrace development remains favourable with seven of the ten domestic non-bank lenders indicating that this is their most preferred exposure for construction lending.

This compares to only one who indicated that apartment development lending is the most preferred exposure. However, there is appetite for apartment lending with half of the 20 lenders placing it as their second to fourth most preferred exposure (of the eight asset classes).

Lending for land subdivision is more polarised with three lenders having this as most preferred (one each of international non-bank, domestic non-bank and international bank) but also seven lenders ranking it sixth or lower.

There is generally lower appetite for less mainstream areas such as hotels and alternatives, although there are exceptions with three lenders ranking hotels and accommodation as their second most preferred asset class for development lending.

FIGURE 10: Preferred asset class for new development/construction lending (ranked from 1 to 8)



Development/Construction Metrics

Banks continue to require presale cover on 100% of their debt. Anecdotally however, we understand some banks have been willing to consider sub-100% cover for existing clients with lowly geared projects.

The interesting change has been the significant uplift in presales required from non-banks. All lenders are now seeking a current and reasonable level of presales as proof of concept and to help reduce concerns around settlement risk.

LVR & LTC continue to be paired back. The primary driver is to ensure there is plenty of equity in the transaction from the sponsor. We are seeing low equity being roadblock to deals, second only to presales.

FIGURE 11: For residential construction lending, the minimum presales to debt cover prior/upon finance close

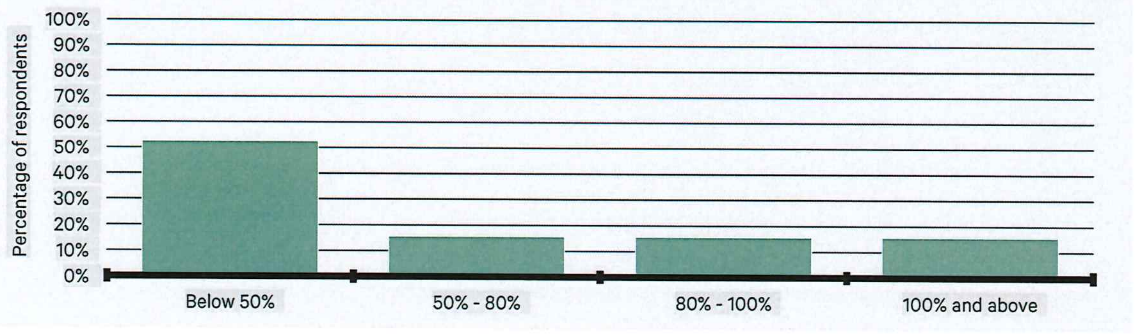
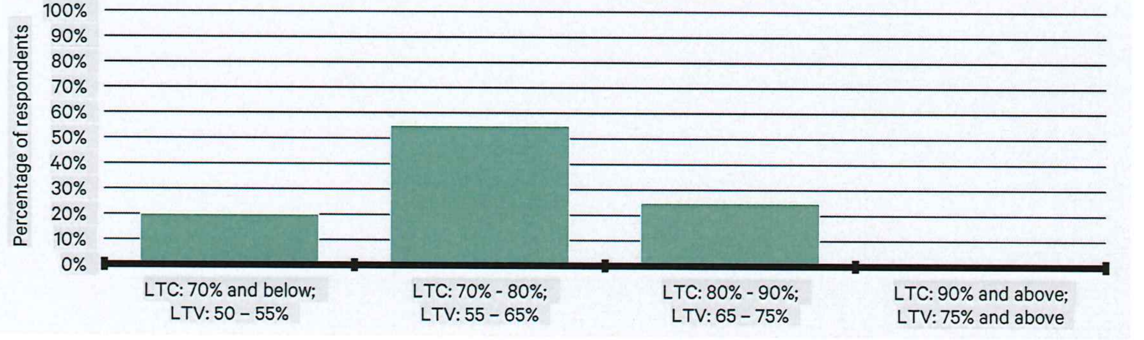


FIGURE 12: Current Maximum LTC and LTV Requirements for Construction Lending



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