

AUGUST 2008 NEWSLETTER

Hi John,

Uncomfortably Numb

*“When I was a child I caught a fleeting glimpse,
Out of the corner of my eye.
I turned to look but it was gone.
I cannot put my finger on it now.
The child is grown, the dream is gone.
I have become comfortably numb.”*

So say Pink Floyd in Comfortably Numb - one of their most famous songs. To see the Live 8 version video [click here](#) (Although Van Morrison’s version is my favourite, to see that video [click here](#)).

Well these lyrics pretty well describes the finance markets at the moment - although maybe uncomfortably numb might be a better description.

As I said in the last Global Update, from the time the credit crunch first surfaced a year ago, most financiers and investors have been sitting on their hands, waiting to see what’s going to happen.

So why is that? What’s making everyone uncomfortably numb? And how long will it last?

Well in my view – and to those of us who have seen it all before – there are three stages to corrections in the economy like the current credit crunch.

The first is shock. When there’s a downturn in the economy it happens much quicker and much deeper than expected. For example who would have ever expected the demise of so many of the finance companies, the flight of investors from not only the finance companies exposed to the riskier mezzanine finance in the property sector, but finance companies in general, and the more recent flight from long established funds and mortgage trusts like the New Zealand Guardian Trust? To see a list of these checkout the recent Herald article [here](#)

The second stage – the uncomfortably numb stage – is realisation and rationalisation. Realisation is that it’s hard to raise money out there, and if you can, the criteria are much tougher. Examples include;

- far more stringent disclosure requirements – forget the simple declarations of the lo-doc residential loans of the past,
- higher interest rate cover on commercial loans,
- the importance of geographical locations,
- the size of the loans (although this is largely a result of the shortage of lenders),
- lenders limiting their exposure to one borrower,
- and of course the cost of finance (a mixture of a shortage of lenders and higher cost of funds to the banks).

Rationalisation we're already seeing in the form of strong finance companies buying out the weaker ones. I'd also include in this process the sensible steps strong funds and institutions are taking to avoid any problems resulting from irrational investor panic. AMP's decision to freeze withdrawals from a property fund is an example. This fund's portfolio includes some of the best located and tenanted properties in the country. [See Herald article](#)

Also during this rationalisation periods it's good to see banks and financiers taking a realistic view on good projects that are having temporary financial problems. A good project, business or property, will always be a good one. So there's no point in financiers joining the panic they're seeing from their investors and withdrawing funds when they should be supporting the client.

The third stage is the road to recovery when all is revealed and - as I said in the last Global Update - financiers and investors start saying "we can't all sit on our hands forever".

So where are we now and how long will it last?

Well I think we're starting to see an emergence from the second stage to the third. And I'll give you a few examples of why I feel that way.

- The U.S. Fed's rescue of Bear Sterns last month and more recently Freddie Mac and Fannie Mae - to see NBR article [click here](#) - have told us all they're not going to let the U.S. and world economies slip into the depression of the 1930's. The Fed has recently confirmed it will extend its emergency loan programmes to Wall Street firms through January. To see the article from Bloomberg [click here](#)
- Closer to home, the fact that Hanover Finance finally put up it's hand and said they've got problems - a fact the financial community's been aware of for months now - has cleared the uncertainty surrounding one of the largest finance companies we have in this country. It's the same old story. Good news is good news and bad news is bad. But the worst news is no news at all. Now at least the position is known and investors can vote on the rescue plan accordingly. To see Fran O'Sullivan's view [click here](#)
- The fact that the New Zealand Reserve Bank - against most expectations - reduced the Official Cash Rate a couple of weeks ago from 8.25% to 8.0% shows recognition that the economy is slowing rapidly. More importantly they say further reductions could be on the cards. To see the release [click here](#) Banks reduced their 2 year fixed rates in response to this, despite their cost of funds from offshore having risen over the last few months.
- There's anecdotal evidence of an increase in enquires for residential and commercial real estate. Buyers have been waiting in the wings for absolute bargains which have not been forthcoming as owners hold. Now it looks like a combination of factors like the perceived end of petrol and interest rate rises, and with Spring and an election in sight, have seen a closing of the expectations of buyers and sellers.
- The National party has come out and said it will undertake multiple tax cuts and a comprehensive Infrastructure plan. Of particular interest to those involved in property, the commitment to simplifying and streamlining the Resource Management Act is extremely welcome. To see Nick Smith's speech [click here](#)

As to how long the uncomfortably numb period will last, this will depend on a number of factors including the housing market in the U.S. and how well the All Blacks do in the Tri-nations and the Bledisloe Cup.

That's because in the end it all comes down to confidence. And at the moment there are still a few uncertainties - including job security - as the uncomfortably numb period draws to a close.

But in the meantime there are financiers out there with money to lend. And while the criteria for traditional debt finance may be tougher, there is an opportunity to bring selected parties together and get sound ventures off the ground. Some examples:

- Joint ventures using bare land as collateral to assist business owners seeking finance.

- Adjacent tenanted properties qualify for more intense development.
- Joint venture arrangements with developers with consented projects ready to go.
- Business ventures now up and running seeking funds to expand.

If you're interested in discussing any of the above respond to this email or give me a call.

Cheers

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