

JULY 2008 NEWSLETTER

Hi John,

Positively Finance Street

*“You’ve got a lot of nerve to say you are my friend.
When I was down you just stood there grinning.
You’ve got a lot of nerve to say you’ve got a helping hand to lend.
You just want to be on the side that’s winning.”*

So says Bob Dylan in his classic song Positively 4th Street.

Some borrowers could be excused for thinking of the poet’s words when they’re in discussions with their existing financiers.

The credit crunch is really hitting home here now. And with the withdrawal of more finance companies from the lending market, and tightening credit conditions from the banks, funds - for property development and subdivisions in particular - are hard to get.

So how bad is it? Are there any lenders out there? If so what are they lending on? And what’s going to happen with the interest rates they’re charging?

How bad is it? First let’s get some of the issues involving the finance companies into perspective. In an article in his latest Weekly Overview, BNZ economist Tony Alexander notes the problems they are facing are negative for the economy “but nowhere near as important as other factors like high interest rates, rising raw material costs, and hikes in food and petrol prices”.

He refers to the Reserve Bank’s May 2008 Financial Stability report which states lending by finance companies at the end of 2007 stood at \$18 billion compared to total bank lending of \$275 billion. And lending by finance companies in the business sector was \$8.3 billion versus \$71 billion for banks.

He also notes that the finance companies experiencing problems are mainly those taking deposits from the public as opposed to those who get funding from parent companies or offshore. These “deposit taking” finance companies stood at almost \$10 billion at the end of 2007 with \$5.8 billion being lent to the business sector. Of this \$5.8 billion some two thirds is to the property sector – or about \$4 billion. There’s much more in this excellent article about the property sector. To read it [click here](#) and go to page 6.

And if you’re worried the banks might be in trouble, you’ll get some comfort from an article in the Australia Business Spectator which reports on a speech by Australia’s financial services regulator in which he says Australian banks (which own the majority of banks here) are in a prime position to ride-out the global economic downturn. To see [click here](#)

Or for a real in depth report on the New Zealand finance markets check out the New Zealand Reserve Banks Financial Stability Report (all 51 pages of it) [here](#)

Are there any lenders out there? Well yes there are but far less than before. The fact is that many of the finance companies that have collapsed – or are now in some form of moratorium – have not been lending for about a year.

And in the last few months, with all the uncertainty around, those lenders that are left have been taking a very cautious approach and holding cash reserves and/or raising capital to strengthen their balance sheets. They’ve been seeking funds from different sources like making bond offers. It is comforting to see

that those who are perceived to be in a strong position have had these bond issues well supported and in many cases oversubscribed. But much of this inflow of funds has been kept as a war chest and is not yet available for new lending.

As I indicated in my May Global View, there's been a trend back to more traditional methods of lending in most areas. For example, where a group of investors participate collectively to provide a mortgage over a specific property.

It's really been a bit of a stop start thing with financiers telling us they're back in the market again one week and saying they're not the next. Uncertainty is rife.

Banks are lending but their lending criteria is tougher. We've seen a tendency to support existing clients rather than seek new business, but in some cases the bank feels over exposed and sends the client home with Bob Dylan's words in their minds.

So what are financiers lending on? The economy has been enjoying a boom in the primary sector – which remains the backbone of New Zealand's prosperity. Last year it earned \$35 billion in exports. Dairy was the largest earner at \$7.5 billion. Accordingly this part of the economy is not experiencing the difficulties in raising finance others are. Some financiers are expanding their lending in this area.

But whatever the industry in which you're looking to borrow, cash flow is king. So for business, proof of earnings is a key issue, and for property developers, even if you have an exit strategy, most lenders are looking for proof of serviceability in the event that doesn't eventuate. And for longer term finance like commercial property, the quality of tenants is being examined more closely, and interest rate cover requirements have increased.

What we are seeing is a closing of the gap between the requirements of the banks and other financiers. While the latter may be more expensive they are competing successfully with the banks for a number of reasons – not the least of which being borrowers limiting their exposure to any one bank, either by choice or by the bank saying no more.

We're also starting to see cashed up investors opening their cheque books. There are a few good buying and joint venture opportunities out there and as they come across my desk I'm showing them to a remarkably large number of clients who have expressed interest in looking at reasonable offers.

As to the future of interest rates, the rapid slowdown in the economy is making economists think the Reserve Bank will reduce the Official Cash Rate sooner than previously expected. Most are now talking September. But without getting into that discussion, would a reduction in the OCR give borrowers some relief? Well there are a number of reasons it may not.

Let's start with the fact that most banks here raise up to 40% of their funds offshore. (According to the Reserve Bank's Financial Stability Report referred to above.) Well just about everywhere overseas we're seeing inflation expectations leading to central banks not reducing interest rates any further - and actually talking of increasing them. Note the U.S. Fed kept its rate at 2% last week and the European Central Bank president is talking of a rise in rates this year. It's starting to look like the interest rate reductions in response to the credit crunch are now over.

In the simplest sense this will make borrowing more expensive.

The continuing problems in the global credit markets are also having an effect on offshore borrowing. This means overseas investors remain risk averse, the availability of their funds is less than normal, and when they do lend they demand higher spreads. So not only do the banks have less access to this money, they pay more for it.

The next reason money's going to cost more is simply one of supply and demand. If you're a lender with money, and you've got the choice of where you can lend it, you can afford to charge higher rates and fees. At Global Pacific we're already seeing this.

In summary, if you're looking to borrow money for property or business:

- Know where to go. Some lenders are out of the market one week but are lending the next. New lenders are appearing - often set up by the prior management of financiers who have

disappeared. Previously popular methods of lending are reappearing in a slightly different form.

- Money's in short supply, so if you need it, and the offer you get isn't what you'd have expected previously, you're probably better off taking it and re-financing in better times.
- Do not expect an immediate fall in interest rates if the Reserve Bank cuts the OCR.
- A proper in depth presentation to the prospective lenders is essential. Know what they're looking for and what they're not.

Unlike the subject of Bob Dylan's song, many financiers are realising the forced sale of certain types of assets in this market is extremely difficult.

On a number of occasions we've negotiated arrangements where the financier does lend a helping hand, which hopefully ends up with both the borrower and the lender winning.

Cheers

JP



John Paine
Global Pacific Corporation Limited
112 Gladstone Road, Parnell,
P O Box 3229, Auckland, New Zealand
Phone +64 9 303 3700, Fax +64 9 303 3031
Mobile +64 21 902 004
Email john.paine@globalpacific.co.nz
Web site www.globalpacific.co.nz

Global View: is an email newsletter reporting on the New Zealand Economy with a bias towards how it affects the property and business finance markets. It is a regular commentary delivered to you by email every month.

Disclaimer: Please note that all opinions and statements expressed in this email are indicative of our opinion only. Both the author and Global Pacific Corporation Limited issue no invitation to rely on the information contained in this email and intend by this statement to exclude liability for any such opinion and statement.

Privacy Policy: We will never rent, share, give, or sell your name or contact information to anyone. Your complete confidentiality is guaranteed. Should you wish to receive no further GLOBAL VIEW newsletters from me please click here [Unsubscribe me from this mailing list](#)