Shadow banks surge amid APRA squeeze

Housing There are fears unregulated sector may cause fresh problems.

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The burgeoning shadow finance sector is shaping up as the next battleground for regulators, whose crackdown on banks threatens to spur a surge in potentially risky lending by non-banks to apartment buyers and developers.

While still in its infancy, the unregulated industry is experiencing a leap in growth that is expected to continue as the squeeze on regulated banks intensifies.

"The APRA lever has dramatically altered the marketplace and limited funding to borrowers," said the executive chairman of Australia's largest commercial loan manager Balmain Capital, Michael Holm.

While non-bank lenders account for about 6 per cent of the financial system, the Reserve Bank of Australia signalled earlier this month that it had the sector in view, after announcing a raft of restraints such as limits on interest-only loans to curb the flow of credit to investors that have been blamed for inflaming the nation's property market.

"The tighter post-crisis prudential framework for the regular banking system creates a risk that credit provision will migrate to the less regulated shadow banking sector," RBA officials say in the latest financial stability review. The central bank also noted that securitisation warranted "ongoing attention" and new figures showed non banks have issued $5 billion in residential mortgage-backed securities so far this year.

Former RBA governor Glenn Stevens, who finished his term last year, repeatedly warned while in office that one of the consequences of the introduction of so-called macroprudential tools could result in parts of the finance industry setting up shop outside supervisory ring-fences.

The new wave of lenders operate by intermediating between large pools of local and foreign capital desperate for yield in a world of ultra-low official interest rates with property developers or buyers who have been unable to get loans from regulated banks.

Providers of capital to the non-bank lenders have been lured by returns of as much as 33 per cent for very short-term loans, compared to the official cash rate of just 1.5 per cent, although the standard rates vary between 7 per cent for apartment loans to 20 per cent for development loans.

Sydney-based private lender Development Finance Partners said there was definitely unmet demand.

"Private lenders cannot keep up with the demand from foreign buyer purchases seeking finance to settle their purchase contracts," director Matthew Royal said. "There is a large pool of customers with very limited competition for private lenders lending to foreign buyer purchasers.

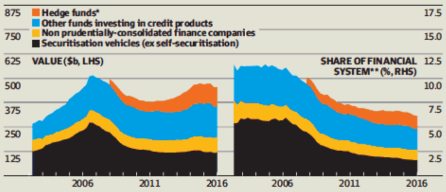
"We have capital lines available, however, we are constantly looking for additional capital sources to help meet unmet demand especially with respect to low doc facilities where the opportunity is the greatest," Mr Royal said.

ASX-listed mortgage broker N1 Holdings, a popular go-to broker for foreign buyers, has been referring on calls for funds. "We are very busy. Every day we get inquiries, inquiries from people who need to settle and developers who can't borrow from banks," chief executive Ren Hor Wong said.

Experts say the sector doesn't yet pose a systemic threat to the economy, as any potential losses would be borne by a relatively small pool of lenders. However, because there is relatively little direct oversight, concerns are growing that problems could emerge that cause wider damage to the economy.

Shadow banking in Australia

Financial assets, by economic function



Non-bank home loan securitisations, year-to-date

Sponsor	Issuance	Amount ($m)
Resimac	Resimac Series 2017-1	1000
Australian Central Credit Union	Light Trust 2017-1	500
RedZed Lending Solutions	RedZed Trust 2017-1	300
Pepper Homeloans	Pepper Trust No. 18	900
Liberty Funding	Liberty Series 2017-1	800
La Trobe Financial	La Trobe 2017-1	300
FirstMac	FirstMac Series 2017-1	1706
		Total 5506

* Data since Jun08 ** Ex RBA

SOURCE: FINANCIAL STABILITY REVIEW, MACQUARIE

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> Michael Holm, Balmain Capital

The Australian Prudential Regulation Authority has no direct responsibility for the sector, and the Australian Securities and Investments Commission only supervises mortgage lenders as part of its mandate to uphold the National Consumer Credit Act. This doesn't cover commercial development or construction finance lenders.

An ASIC spokeswoman said the regulator was working with the Australian Small Business and Family Enterprise Ombudsman to ensure lenders providing business loans of up to $1 million "understand their obligations under the ASIC Act".

Balmain's Mr Holm said the macroprudential crackdown had dramatically spurred activity in the sector. "The space is opened by the withdrawal of the banks and is being slowly closed by private markets."

DFP's Mr Royal said APRA's actions had pushed a lot of borrowers into the non-bank sector. "A lot of borrowers are pushed out. They have got to … refinance in another market."

A spokeswoman for ASX-listed private mortgage lender Pepper said: "The non-conforming lending market was increasing in size, mainly as a result of the growing population of borrowers and tightening of credit criteria by traditional bank and other prime lenders."

Industry sources said demand was strong for two kinds of residential loans – mortgages to foreign and local homebuyers who have been turned away by banks, and development and construction loans to residential developers who are overseas-based and do not have enough experience, or lower-tier developers unable to sell enough apartments prior to securing funding from a bank to start construction.

Funds are being sourced from high net worth investors, foreign banks, local superannuation funds and foreign pensions funds, which has created a new pathway away from the traditional bank warehousing or securitisation by firms such as Pepper and Firstmac.


Wealthy Australian-Chinese migrants are looking to lend to residential projects.

Last Friday, 40 wealthy Australian-Chinese migrants looking to lend about $500,000 each to residential projects attended a property valuation seminar held by Melbourne-based lender Zank & Co. Director Tiger Liu said they were sophisticated investors with global portfolios of assets.

Also in residential projects, superannuation funds Local Government Super and Fire & Emergency Services Superannuation Fund have tapped into the residential lending business through fund manager Centaur Property's real estate debt funds.

Gresham Property, Chifley Securities and Qualitas have rounded up funding from institutional investors, private equity, hedge and superannuation funds. Zank & Co, Chifley Securities, Mortgage Ezy and La Trobe Financial have also joined the stalwarts of the industry such as Pepper and Firstmac.

For commercial residential loans, depending on the type, length and loan-to-value ratio of the loans as well as the quality of the assets, private lenders are charging double digit rates of about 12 to 20 per cent and there have been cases where 33 per cent was charged for very short-term loans.

Mortgage and home loans are cheaper. Pepper and Firstmac's home loan interest rates are about 5 to 6 per cent. DFP and Mortgage Ezy rates reach 8 per cent, but these higher rates apply to foreign buyers, to whom big banks have turned off lending. Pepper and Firstmac lend only to local owner occupiers and some investors.

Developers were another source of finance, raising their own capital to help their buyers, particularly with Chinese buyers who have been hit by China's capital transfer restrictions.

These rates are much higher than compressed direct residential and commercial property gross returns at about 3 to 5 per cent in metro areas.

Whether regulation was needed, Mr Holm said the small size of the sector was unlikely to grow fast enough to fill the gap left by the major banks, responsible for about 95 per cent of loans in Australia. "All the non-bank players recognise the opportunities, but it's a big bucket to fill," he said.

And banks need the "looser" private lending sector to provide a buffer, even if APRA wants to cool the residential market and tighten up lending policies, Mr Royal said. "People need a bit of non-conforming lending," he said. "Banks [and APRA] don't want a collapse in values."

Mr Cannon was concerned some of these players, who were taking advantage of current market opportunities, might end up defeating the cooling APRA wanted.

"But I think APRA is going to succeed in its efforts. This is the first time we have seen APRA pull that third lever, the regulatory lever, and it's going to be very interesting," Mr Holm said.