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Australian Business Investment Partnership Bill 2009

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Australian Business Investment Partnership Bill 2009

Date introduced: 12 March 2009

House: House of Representatives

Portfolio: The Treasury

Commencement: The day after the Act receives the Royal Assent

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

To provide for the establishment of the Australian Business Investment Partnership Limited (ABIP), a company under the *Corporations Act 2001*, to address the potential risk of the funding gap in the commercial property sector due to an anticipated reduction of foreign banks' level of financing.

Background

The Australian Commercial Property Market[1]

As at December 2006, the estimated size of the Australian investment market was A$6.1 trillion of which the Australian commercial property component represents A$288 billion (approximately 5 per cent). The private equity and debt market for property comprises approximately 49 per cent, being nearly equally distributed with the publicly traded market (Real Estate Investment Trusts) representing the largest component at 47 per cent. In separating the equity, property and securitised debt components, the size of the Australian investment market for these assets can be compared to the global equivalent e.g. the proportions of the Australian market are similar to those of other markets.

The total value of the global investment market is A$152 trillion, and is apportioned equities (39 per cent) debt securities (55 per cent) and commercial property (6 per cent). The comparable Australian market share is A$2.5 trillion and represents just below 2 per

1. David M. Higgins, Placing commercial property in the Australian capital market, RICS Research paper series, Volume 7 Number 12 September 2007, University of Technology Sydney, Australia.

cent of the global investment market. The percentage ranges across the different investment sub-markets with the commercial property sector accounting for 2.4 per cent of the global property market. This is relatively high and is due to the significant proportion of Australian investment grade property owned by institutions.

The Australian commercial property sector has bank debt totalling $165 billion, according to the Australian Prudential Regulatory Authority (APRA) figures, of which $30 billion is provided by foreign banks.[2]

Investment bank UBS reported that foreign banks financed 71 per cent of the $23 billion syndicated debt of listed property trusts.[3]

In one of its first indications of the slowing market, an article in the March 2008 issue of ASX Investor newsletter, Daryl Wilson, CFO and Director of Cromwell Group hinted that:[4]

> …certainly the recent climate, and the accompanying major fall in A-REIT stocks [previously known as listed property stocks], is not in line with historical behaviour at this point in the economic cycle. In the past, the A-REIT sector has been a defensive haven in volatile times. This time around, along with the broader financial services sector, it has been one of the hardest hit with the S&P/ASX 300 A-REIT index down 23% in the 12 months to 31 January 2008.
>
> …the current crop of A-REITS are a very diversified bunch indeed. Some characteristics which have been introduced into the sector, or grown in nature in the past 10 years, are:
>
> **Higher gearing** - the disquiet surrounding the A-REIT sector started back in December 2007, when the market became concerned about some A-REITs being caught with high gearing at a time when it became much more difficult to obtain debt funding, particularly in the US. While there are some extreme examples, in recent years, it has become relatively common for gearing levels of some A-REITs to be 50% or higher. With the sub-prime crisis unfolding in the US in the later half of 2007, and having a flow-on global effect, those A-REITs with higher gearing levels have suffered.

Certainly since September 2008, after the collapse of the large US investment Bank-Lehman Brothers, and the resulting crisis in the global financial markets, there has been a lingering uncertainty in the highly leveraged commercial property sector in Australia.

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2. ibid.

3. Florence Chong and Sara Rich, Property firms hail kick-start to lending, *The Australian*, January 26, 2009

4. Daryl Wilson, State of the property sector, *ASX Investor*, March 2008

On 5 November 2008, another indication of the market slide appeared in the Brisbane Business News. According to its dispatch, the market was poised to slow down with dramatic impact. It observed:[5]

> Queensland's property industry faces its biggest year of change in 16 years, CB Richard Ellis has warned Brisbane industry heads.
>
> Speaking at CBRE's annual Market Outlook breakfast in Brisbane, executive director of research and consulting Kevin Stanley says while Queensland will remain near the top of growth rankings in the year ahead, it remains 'very exposed'.
>
> Expect reduced investment activity.
>
> Until issues with strong credit availability are resolved, this will be the overall trend.

In a dispatch from Western Australia on 9 December 2008, the ABC reported that the credit squeeze was stalling the growth of the commercial property market:[6]

> The credit squeeze is being blamed for an increasing number of construction projects in Perth being abandoned. (ABC: Graeme Powell)
>
> Western Australia's commercial property sector is feeling the brunt of a credit squeeze with companies putting off multi-million dollar projects.

Of late, the investment market in commercial property stocks has shown a surge in volatility. In a news item on 5 March 2009, *The Australian* reported:[7]

> THE listed property sector was hit by a fresh wave of selling yesterday, pushing the unit prices of key stocks Stockland, Goodman Group and GPT to all-time lows and wiping about $2.6billion from the sector.
>
> Market watchers thought the GDP figures or a potential lift of the short-selling ban could partly explain why the benchmark ASX/S&P A-REITs 200 Index dropped by 6.1 per cent, but the general equities index dropped just 1.6 per cent.
>
> The sector has fallen by $127billion since the peak in February 2007. Stockland fell 20c, or 7.25 per cent, to close at $2.56 -- the lowest in over 17 years; while GPT was down 8.5c, or 24 per cent, to close at 27c and Goodman Group dived 19 per cent (4.5c) to 19c. Market leader Westfield Group lost 58c, finishing the day at $9.92c a unit. Even the two strong Australian-focused trusts, Colonial First State Retail Property Trust and Commonwealth Property Office Fund, fell more than 9c.

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5. Brisbane Business News, Commercial property sector should batten down the hatches warns CB Richard Ellis, 5 November 2008

6. ABC, Credit squeeze blamed for commercial property slump, 9 December 2008

7. Florence Chong, 'Listed property sector suffers price freefall', *The Australian*, 5 March 2009.

> Stockland is the second-largest shareholder in GPT with more than 11 per cent stake, acquired from Perennial Investment for $544 million in November.

> An offshore portfolio manager for A-REITs said investors were concerned about liquidity and capital management of trusts, like Goodman. Combined with poor global sentiment, these concerns of refinancing and funding weighed heavily over the sector, the manager said.

Basis of Policy Commitment

On 24 January 2009, the Prime Minister announced that:[8]

> Commercial property projects that could be supported by this initiative include shopping centres, office towers and factories under construction, as well as existing properties of that nature. Without action, a combination of weak demand and tight credit conditions could see up to 50,000 people in this sector lose their jobs, according to Treasury, with flow-on effects to jobs in other parts of the economy.
>
> Small and medium size businesses which service the commercial property sector could also be devastated by weak demand and tight credit conditions in the sector.
>
> The Government will not sit idly by and watch these jobs and small and medium size businesses be wiped out by fluctuations in global credit markets.
>
> The commercial property sector employs about 150,000 people in Australia. Many of the 150,000 workers employed in the commercial property sector are tradespeople, such as plumbers, electricians and carpenters. Without action, a combination of weak demand and tight credit conditions could see up to 50,000 people in this sector lose their jobs, according to Treasury, with flow-on effects to jobs in other parts of the economy.
>
> Small and medium size businesses which service the commercial property sector could also be devastated by weak demand and tight credit conditions in the sector.
>
> The Partnership will be structured to minimise the exposure risk to Australian taxpayers. It will not allow the major banks to pass on any underperforming assets to the Australian Government. Safeguards will ensure the banks continue to finance the projects to be supported, and that projects will only be considered where a member of a syndicate has actually decided to exit.

Given the backdrop of such development, the Rudd Government's intervention in the market is seen as an attempt to mitigate any fallout from the withdrawal of foreign banks from the market.

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8. The Hon K Rudd, Prime Minister, Media Release, 24 January 2009.

The Australian Business Investment Partnership Limited (ABIP): Structure and Functions

ABIP will be established under the *Corporations Act 2001* and will be a public company limited by shares. The members (shareholders) of ABIP will be the Commonwealth of Australia (Commonwealth) and Australia's major domestic banks: Australia and New Zealand Banking Group Ltd (ANZ), Commonwealth Bank of Australia, National Australia Bank Ltd and Westpac Banking Corporation. [9]

The Government and the major banks will provide initial loan funding to ABIP and an amount for working capital. The Government will provide $2 billion and the major banks will provide $500 million each. Accordingly, on its establishment, ABIP will have access to $4 billion in un-drawn loan facilities, less an amount for working capital, expected to be $4 million.[10]

The financing provided by the major banks will not be guaranteed by the Government.

ABIP will only be able to enter into new refinancing arrangements of commercial property assets for two years from the date of its establishment.

If additional financing is required beyond this initial $4 billion, ABIP will be able to issue up to $26 billion of government guaranteed debt to create up to $30 billion of loanable capital.[11]

The Partnership will provide financing on fully commercial terms for commercial property that meet ABIP's lending criteria, determined by its shareholders, and where the underlying assets, and the income streams from those assets, are financially viable.

The Partnership will be limited to the re-financing of existing Australian commercial property syndicated loans on commercial terms when the withdrawal of funding by a participant of the syndicate threatens the refinancing of the loan.

The Partnership will focus on completed commercial property investments and partly completed development projects with secured pre-commitments (for example, retail shopping centres, commercial office and industrial property). It will be structured to allow sufficient flexibility to provide financing in other areas of commercial lending, should the need arise and the Government and four major banks jointly agree.

Completed commercial property projects would be included in this partnership to ensure that systemic instability in the commercial property sector does not undermine investor confidence.

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9. Australian Business Investment Partnership Bill 2009, Explanatory Memorandum, p. 3

10. ibid.

11. ibid, p. 4

On 20 February 2009, the Government announced that Ahmed Fahour, then Executive Director of the National Australia Bank, would take up the position of interim CEO of ABIP.[12]

Committee consideration

At the time of writing, the Bill had not been referred to any committee. The Senate Selection of Bills Committee is due to met on 17 March 2009, but is unknown whether the Committee will consider the Bill at that meeting.

Position of significant interest groups/press commentary

In a press release following the introduction of the Bill, Property Council of Australia Chief Executive, Peter Verwer, said that the 'Ruddbank' was an essential mechanism to inject stability and confidence into the economy. The Council noted that: [13]

> Australia has a significant exposure to foreign lenders.
>
> The commercial property sector has bank debt totalling $165 billion. $30 billion (18%) of this total commercial lending is provided by foreign banks (source: APRA).
>
> Australian real estate investment trusts have syndicated borrowings of $23 billion. $16 billion (71%) of this is syndicated debt provided by foreign banks (source: UBS).
>
> "There is clear and present risk of foreign lender withdrawal from Australia. Foreign banks have been told to focus on homeland markets by their new owners - foreign governments."
>
> "The Property Council has this week surveyed its members and they report that over 20 foreign banks from Europe (43%), USA (26%), and Asia (31%) have signalled plans to reduce their exposure to Australian commercial property funding, or have already withdrawn funding."
>
> Domestic banks can't fill the void, which means owners will be forced to needlessly liquidate their assets. There is virtually no capacity in the Australian debt market. The commercial mortgage-backed securities (CMBS)[14] and corporate bond markets are effectively closed to commercial property funding.

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12. The Hon Wayne Swan, 'ABIP interim CEO announced' Media Release 20 February 2009.

13. Property Council of Australia, Bi-partisan support urged for ABIP**,** Media Release, 13 March 2009

14. CMBS is actually a type of mortgage-backed security that is secured by the loan on a commercial property. A CMBS can provide liquidity to real estate investors and to commercial lenders. As with other types of mortgaged backed securities (MBS), the increased use of CMBS can be attributable to the rapid rise in real estate prices over the

On 29 January 2009, in welcoming the Government's 24 January announcement, the *Sydney Morning Herald* reported that:[15]

> Without an alternative source of funding our local banks would need to take up the slack and pump more credit into a sector to which they are already overexposed or take the risk that many property companies will suffer a funding crisis. This would result in commercial property prices falling and the sector moving further into trouble.
>
> Australian banks have already had to wear big losses in the commercial property sector, and without some kind of assistance the losses would be greater.
>
> The retreat of foreign banks from lending to Australian companies is not confined to property; they are systematically pulling out of lending in all sectors but property is one of the more highly geared industries where lenders are simply unwilling to increase their exposure.
>
> The potential collapse in commercial property is something the Government is clearly wanting to avoid even if it requires using taxpayers' money to achieve it.
>
> The Government has cited employment concerns as its primary motive. However, the damage that a collapse in the commercial property market would have on the financial system is probably more evident.
>
> Kevin Rudd has already demonstrated this desire to ensure retail and commercial credit lines remain open by guaranteeing bank deposits and wholesale bank lending. Propping up commercial property is just the latest move in the list of piecemeal proposals designed to keep the good ship Australia afloat.

The *Australian Financial Review* on 13 March 2009 in an article report titled 'Ruddbank's scope widens', stated that the scope of the ABIP as contained in the Bill introduced in the Parliament on 12 March 2009 goes beyond the Government's initial announcement on 24 January 2009. The AFR observed that:[16]

> The government … introduced legislation yesterday that would enable the investment partnership to replace local lenders in banking syndicates, going beyond its initial mission of filling the gaps left by foreign banks that scale down their lending in Australia …

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years. Because they are not standardized, there are a lot of details associated CMBS that make them difficult to value. However, when compared to a residential mortgage-backed security (RMBS), a CMBS provides a lower degree of prepayment risk because commercial mortgages are most often set for a fixed term.

15. Elizabeth Knight, Finance concerns behind Government's commercial property fund, *Sydney Morning Herald*, 29 January 2009

16. David Crowe and Paddy Manning, 'Ruddbank's Scope Widens', *Australian Financial Review*, 13 March 2009

> But the government yesterday tabled legislation and a 40-page shareholders' agreement setting out objectives that go beyond that initial plan.
>
> The first objective is to refinance loans for commercial property when finance is not available from other lenders and the assets would otherwise be financially viable. The second objective in the legislation and shareholders agreement is to 'provide finance in other areas of commercial lending through financing arrangements of a kind unanimously agreed by the shareholders'.

Coalition /Greens/Family First/Independent policy position/commitments

The Leader of the Opposition, The Hon Mr Malcolm Turnbull MP, said that the extended scope would exceed the Government's initial commitment and create an easy source of finance that would distort the finance sector and make it easier for foreign banks and other lenders to leave the market.[17]

The Greens said on 12 March 2009 that they had concerns about the legislation but had yet to decide their position. Independent Senator Nick Xenophon and Family First's Steve Fielding have yet to declare their positions.[18]

Financial implications

Standing appropriations[19]

The Bill will require an appropriation totalling $2 billion, consisting of a loan facility to ABIP ($1.998 billion) and an equity contribution to meet the Commonwealth's share of ABIP's operating costs ($2 million).[20] It will also require an appropriation for claims covered by the Government guarantee on any debt that ABIP issues up to a maximum of $26 billion, plus any interest that may be payable in relation to the principal debt issues.

The loan facility and equity contribution themselves will have no impact on the underlying cash balance. However, interest received on the loan facility and dividends on the equity contribution will improve the underlying cash balance, and these will be offset by interest costs paid on financing the loan and equity contributions. Non-repayment of loan (or equity) can impact on the underlying cash balance and fiscal balance depending on the circumstances under which it occurs.

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17. The Hon Malcolm Turnbull MP, JOBS FOR AUSTRALIA. FORUM, TAX CUTS, RUDD BANK, 30th January 2009
18. David Crowe and Paddy Manning, 'Ruddbank's Scope Widens', AFR, 13 March 2009
19. Explanatory Memorandum, pp.4–5
20. Explanatory Memorandum, pp.4–5

A contingent liability may arise out of the Government's debt guarantee of $26 billion. If the guarantee is called upon at any time, there will be implications to the underlying cash balance. Conversely, the guarantee fee will improve the cash balance.

Compliance cost impact

Applicants for financing from ABIP will not incur additional compliance costs over and above those they would have incurred had they applied for refinancing from another commercial lender. The impact is low.

Key issues

The growth of Australia's economy is inexorably dependent on the growth of the services sector which dominates the economy with an overwhelming share of about 77 per cent. Not surprisingly, the importance of the property and business services sector (about 14 per cent share in the economy in 2008) is an integral part of this growth momentum. The property and business services sector registered about 4.6 per cent average annual growth since 1991 compared to 3.6 per cent growth of the economy during the same period.[21]

So the stakes for ignoring the importance of the property and business sector are definitely high.

Main provisions

Clause 5 requires the Commonwealth to register ABIP as a company under the *Corporations Act 2001.*

The Bill does not actually spell out who, besides the Commonwealth, would be members (that is, shareholders) of the ABIP. However, this detail is spelt out in the Shareholders' Agreement, which is the subject of **clause 6,** and a draft of which was released when the Bill was introduced. Clause 6 does not *require* such an agreement, but provides an indicative list of issues that the members may agree upon, including the operation of ABIP's business; the control, management and funding of ABIP: and the rights and obligations of its members. Any shareholders agreement, including any subsequently amended version, must be published, either on the internet or otherwise.

Clause 7 sets out the two objects of ABIP. These are:

- To provide refinancing for loans relating to commercial property assets in Australia in situations where both (a) finance relating to the assets is not available from

21. Australian Bureau of Statistics, National Accounts, December quarter 2008

commercial providers other than ABIP Limited and (b) the assets would otherwise be financially viable, and[22]

- to provide financing in other areas of commercial lending through financing arrangements of a kind agreed to by the members of ABIP Limited in accordance with **proposed paragraph 8(3)(b).**

Clause 8 supplements clause 7 by setting out limitations on the situations where ABIP may provide finance.[23] Financing arrangements can only be entered into if they are for an object mentioned in clause 7. In relation to the second object mentioned above, paragraph 8(3)(b) does not provide any real detail of the limitation, other than allowing the ABIP to agree to other kinds of specified financing agreements, as long as this is unanimous and agreed in writing. In such cases, the ABIP may subsequently enter into a financing arrangement that is of the specified kind. Any arrangements must be entered into within two years of the Act commencing, and run for no more than either three years, or any longer period specified in the regulations.

Finally, due to limitations on the Commonwealth's constitutional power, **subclause 8(2)** provides that the financing arrangement must involve at least one of the below:

- at least one other party to the arrangement must be a constitutional corporation,
- the arrangement constitutes, or is for the purpose connected with, interstate or overseas trade or commerce, or trade within or by a Territory,
- the arrangement is entered into in a Territory, and /or
- the arrangement is for a purpose connected with the supply of goods or services to the Commonwealth, or a Commonwealth authority or instrumentality

ABIP may borrow money for the purpose of entering into, or meeting obligations under, financial arrangements permitted under clause 8, but only up to a limit of $26 billion, and where all members have agreed: **subclause 9(1).** Any funds lent separately to ABIP in accordance with any ABIP shareholders' agreement(s) does not count towards the subclause 9(1) limit: **subclause 9(2).**

Clause 10 requires ABIP to have a constitution that contains certain matters. Notably these include:

- ABIP must have five directors

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22. The terms 'commercial property assets' and 'financially viable' are not defined in the Bill, but paragraph 9(1)(a) requires that ABIP, in refinancing a loan, must be satisfied of the financially viability of both the commercial property asset and its income stream.

23. It does not apply to any borrowings by ABIP: paragraph 8(6).

- the director that represents the Commonwealth on the ABIP board, or the Commonwealth appointed alternate director, shall be ABIP's chairperson
- actions requiring Board resolutions must be passed unanimously, except in the case of 'enforcement' resolutions – in the later case, a 80 per cent vote is required, including that of the Commonwealth director
- an audit committee with specific functions including assisting ABIP and its directors comply with obligations under the Corporations Act, and providing a forum for communication between the directors, the senior managers of ABIP and the auditors of ABIP, and[24]
- directors are required to have ABIP's financial statements audited by the Auditor-General, and that the Auditor-General's report and the financial statements must be given to the Treasurer (as the responsible minister).[25]

The Treasurer must table in both Houses of Parliament copies of ABIP's financial report, directors' report and auditor's report as soon as practical after receiving them: **clause 12**.

Clause 13 appropriates $2 billion from the Consolidated Revenue Fund (CRF) for the dual purposes of subscribing for shares in ABIP and providing a loan to it. It also provides for a *standing* appropriation for both (a) paying claims on funds borrowed by the ABIP under a Commonwealth Deed for Guarantee under clause 9, and (b) repaying, and paying interest, on any money borrowed by the Commonwealth under **clause 15** for the purpose of paying claims on money borrowed by the ABIP under clause 9.[26]

Part IV of the *Trade Practices Act 1974* (TPA) deals with restrictive trade practices as such anti-competitive behaviour, price fixing, misuse of market power etc. Section 51(1) of the TPA specifies a range of matters that 'must be disregarded' in determining whether a person has contravened Part IVA. Subparagraph 51(1)(a)(i) includes in this range of matters anything specifically authorised by a Commonwealth Act. **Clause 16** of the Bill effectively brings activities undertaken by ABIP, its shareholders, Directors, officers, agents and employees within the scope of the subparagraph 51(1)(a)(i) of the TPA and hence *not subject* to the various prohibitions of restrictive trade practices under Part IVA of the TPA.

Clause 17 is a standard power to make regulations prescribing matters under the Act.

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24. Regulations may also stipulate how the membership of the committee is to be made up
25. Clause 11 also deals with auditing matters by the Auditor-General.
26. Borrowings under clause 15 cannot be for a term of more than 24 months: subclause 15(2). Paragraph 1.11 (page 8) of the Explanatory Memorandum comments that 'borrowing includes raising money or obtaining credit, whether by dealing in securities or otherwise'.