more than money

National Australia Bank

2017 YEAR IN REVIEW

Corporate Finance

This document was published on 11 December 2017.

WHAT'S *inside*

A LOOK BACK OVER THE *year*

2017 was marked by a return to stability following the volatility of recent times and the rise of innovative new products, especially in the green and social sectors.

For the past five years Australian capital markets have been characterised by themes of volatility but also innovation. Volatility has seen markets close at various times due to many factors, often global in nature. Innovation has been driven by issuers seeking to deal with this volatility and also by changing investor preferences.

The last year mixed this up. Since the resolution of the Brexit vote, apart from a two-week period around the United States presidential election, markets have been open and quite stable. Capital markets have taken a range of geopolitical issues in their stride, from the Middle East, South China Sea, Russia and North Korea, as well as concerns over Australian Sovereign ratings. It will be interesting to see how long this will continue.

Key themes

There are three key themes we are seeing in the Australian domestic market. First, the continued rise in the importance of Asian investors. And secondly, the growth of self-managed superannuation funds in conjunction with the growth of non-institutional investors in the domestic bond market. Both of these also impact on our third theme, increased innovation.

We're seeing increased capital flows both into and out of Australia across debt, equity and private markets. As part of the global hunt for assets, we're seeing more Asian investors and banks setting up shop here as well as greater interest for Australian money to move overseas, whether that's investing in infrastructure or other opportunities, and we've been supporting that interest.

The other big theme is the power of self-managed superannuation and the growth of non- institutional investors in the domestic bond market. Traditionally, we saw this demand in the hybrid and convertible market but increasingly these investors are providing liquidity in senior debt of all types. 2016 was the year when this went from a consistent, albeit small, bid for new issues, into being a more significant part of most book builds.

A number of infrastructure related issuers saw strong bids in 10 year FRNs from this sector and I think this will be a continuing theme as more self-managed superannuation funds increase their exposure to fixed income, a seriously underweight asset class.

The banking industry is facing constant disruption, and we're seeing disruption across all parts of our business. As a result, NAB continues to challenge the market with new and innovative products. This was the year that broader green and social investing gained a lot more attention in the markets and enjoyed growing appetite from investors looking for new options to invest with impact. NAB met this demand with more than A$2.2 billion in green or social bonds issued or arranged during the year.

Earlier this year, NAB printed the first offshore green bond from an Australian issuer. Another first followed quickly with the world's first Gender Equality Social Bond by NAB. The deals reflect this growing investor appetite for assets that are socially responsible. The market will continue to grow as investors have the desire for investments that are attractive in their own right and equally have purpose. I'm really proud of NAB's Shared Value approach to help customers, community partners and governments, and am keen to see this evolve over the year ahead.

WHAT THE FUTURE *holds*

As we look towards 2018, I see the socially responsible investing theme increasing and as you read through this magazine, you'll see hear more about this. Infrastructure and energy demands, while not slowing down, bring a lot of opportunity to proactively influence what communities and societies evolve into. The articles highlighted in this magazine bring true insights into some of the issues facing our customers and community, but they also show the opportunity we have to make a difference. It's this optimism that guides my thinking as I look to the future.

Thank you for allowing us to work with you throughout the year. We look forward to working with you in 2018.

Regards,

Steve Lambert
EGM Corporate Finance

THE AUSTRALIAN CREDIT *market*

2017 has been the best year for both issuers and investors since 2006.

Mark Abrahams

The Australian credit market traditionally has followed and reflected other core markets. We reflect, with a small delay, what happens in the core credit and equity markets of the United States, Europe and to a lesser extent, Asia.

When the offshore markets move tighter, due to our smaller and more tightly held market, we may wait a few days to see if offshore shifts are validated. Australian names tend to follow suit soon after.

Another directional marker for the Australian credit market is global stability or volatility. If equities march higher, economies start to brighten up, commodities are stable, and the geopolitical news isn't disruptive, then Australian credit tends to build momentum. Spreads then tighten. This feeds into our economy with more expansive bank lending and bond market borrowing.

Finally, bonds tend to take direction from the expected direction of official interest rates. If the cash rate is heading higher due to well-telegraphed intentions from the Reserve Bank, this could assist credit spreads to come in as investors will see this as a positive sign. Core markets in 2017 shrugged off the insularity, escalating rhetoric and tribalism in global politics and stopped reacting to these events. An ICBM can be shot from North Korea across northern Japan and land in the Pacific Ocean - and yet equity markets in our region on the day barely dipped. Twenty years ago there would have been major volatility on such an event. The SPX Volatility Index - better known as the 'VIX' - is at all-time lows and yet some pundits still think it is too high.

Global growth in the core economies is starting to swing up. The USA in 2017 gained some momentum to justify the pre-emptive Federal Reserve rate hikes of the last 12 months. Another US rate increase is expected in December. Europe, including the UK, is starting to re-activate. Quantitative easing is being slowly withdrawn. These events are positive for credit markets.

So what happened in the Australian credit markets in 2017? It was - in our opinion - the best year since 2006. As a market intermediary, we don't judge 'best' by percentage returns. Anyway with such a low rate structure, it would be hard for A$ credit investors to match the returns of even just a few years ago where investors could 'ride' sharp rallies.

Our focus instead is on accessibility. This year was special because it supplied issuers and investors a high degree of certainty and stability. It provided a steady rally without any significant bouts of volatility. The market did not have any sharp pullbacks. Conditions were perfect for issuance as borrowers didn't feel exposed. Some investors would argue they had to chase deals and were cut back on allocations. However, it should be noted that in 2017 investors have had more product and name choice, more sectorial supply and were also exposed to new product in the burgeoning green and social bond market. This is the first year since 2006 when we have not seen the A$ credit market closed due to an 'event'. In the years after the GFC, larger events locked issuers out of accessing the market. When the A$ credit market takes stock or reverses in price this eventually feeds into corporate, business and retail loans, and general sentiment.

We have now moved to an interesting place. As global equities marched higher, commodity prices steadied, cash credit spreads in Australia had moved back to the post-GFC lows. In the final weeks of this year it feels like we may push through the 2013 and 2014 lows and track towards levels last seen in 2006.

Rewind to 2006 and an Australian bank could issue a 3yr bond around 3mBBSW/ASW+9 and a 5yr around +15. The 5yr AUD swap in November 2006 averaged a healthy 6.30%. With the current level on that 5yr swap at 2.40%, fund managers would 'tune-out' quickly if they were buying at 2.55%. With the 3m BBSW rate set currently at 1.70%, the argument is even more extreme for floating rate notes. In 2006 the rate set averaged 6.37%.

In Australia 5yr new issue credit spreads for a major bank have rallied over 30bps. CBA and Westpac successfully opened the year with benchmark 5yr deals at 3mBBSW/ASW +111. In early November, National Australia Bank printed a 5.25yr deal at +80. Curve adjusted to a 5yr this is about +78.

We are back at the price lows recorded in 2013 and 2014. Coincidently in those years, we printed 3m BBSW/ASW+78 5yr deals for NAB that were also the post GFC lows. The thinly traded AUD iTraxx has performed even better and has sailed back to 2007 lows.

What could upset the current benign status is still not clear. Global interest rates remain very low. Maybe the central banks misread inflation, growth or employment and don't adjust monetary policy fast enough? Maybe the Brexit debacle causes more angst? Maybe the threats from the Korean peninsula go beyond rhetoric? Nothing obvious stands out. This lack of a possible 'trigger' worries people the most. In most fund manager commentary the tone is that of caution.

Finally the sheer diversity of product in the A$ debt capital markets has been staggering. A steady stream of financial and non-financial corporate names have taken advantage of these robust conditions. Securitised product is breaking post-GFC volume records. Capital products both wholesale and retail have successfully been printed. Non-rated wholesale investor targeted bonds are priced next to A$1bn+ corporate deals. Short dated placements have been efficiently executed. Climate bonds, gender bonds, sustainability bonds are becoming more common.

With all of this energy, is the Australian credit market going to have its own momentum rather than following the directional shifts from offshore? This is slowly happening as the pool of superannuation money directed to fixed income increases in Australia. Another factor is the substantial rise of the sub-institutional bid for fixed income in recent years. The sustained Asian bid for A$ assets has also been a familiar feature.

Ten years on from the GFC, the Australian market has truly matured to the point where we do have our own rhythm and where we can offer a diverse fixed income offering to the different layers of investors. This year provided insight into what is truly possible. We welcome what the next 10 years will bring.

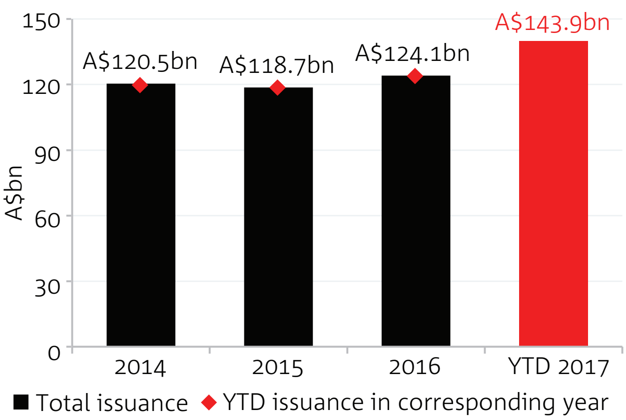
DOMESTIC BANK AND KANGAROO *financials*

Growing pools of liquidity lead to the largest issuance year in the Australian market.

Josh Sife and Lewis Karanicolas

2017 has been a standout year for Australian primary markets with a supportive backdrop providing highly constructive issuance conditions throughout most of the year. Whilst we have experienced brief moments of pause, the market has remained robust resulting in what has been a record breaking year for Australian primary market supply. We finish the year with aggregated supply of A$143.9 billion*, which surpasses the 2016 level of A$124.1 billion and 2015 supply of A$118.7 billion. This is the largest issuance year the Australian market has ever seen and testament to the growing pools of liquidity looking for AUD assets.

Australian debt issuance – annual historical



Source: Bloomberg

Drilling down into these aggregate levels of supply, the Financial Institution Group ("FIG") issuer set has seen a fairly consistent level of issuance relative to previous years with total volumes reaching A$60.5 billion*, compared with A$62.9 billion in 2016 and A$55.7 billion in 2015.

The year started very strongly buoyed by the positive sentiment around Trump's pro-business/pro-inflation rhetoric. As we moved into Q2 however we saw geopolitics drive the headlines with uncertainty generated by the French elections and the snap election in the United Kingdom causing some nerves to creep into credit markets. Issuance volumes reflected these contrasting sentiments with Q1 volume of A$17.9 billion of FIG supply declining to A$11.2 billion in Q2.

However, with market-steadying outcomes in each, supply resumed through Q3 and at A$20.9 billion in total became the largest issuance quarter for the year. The spikes in volatility we did see were primarily driven by rising geopolitical tensions between the United States and North Korea and whilst causing momentary halts to issuance, did not have lasting effects. With the heavy amount of supply, Chinese Golden Week at the start of October came as a welcome reprieve and the month produced the second lowest volume amount for the year (A$3.39 billion). This gave investors a chance to rebase their outlook on credit and build up cash levels.

NAB's 5.25yr transaction which priced at 3mBBSW/S/Q ASW + 80bps was one of the tightest major bank prints we have seen since the GFC and raised A$2.25 billion. As we reached November, cash levels were high, the majors were out of blackout, and the deluge of supply continued amid what were probably the best conditions we have seen in the market for a number of years. NAB achieved the tightest 5yr senior trade since the GFC at +77bps. These conditions resulted in a Q4 issuance total of A$10.4 billion and rounded out what was a historic year for the Australian market.

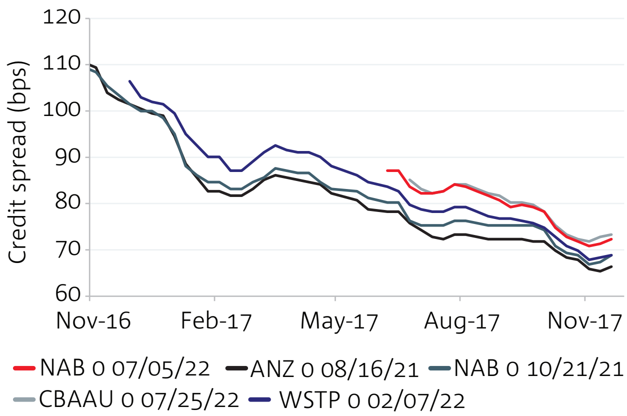
Credit spreads: performance and compression

2017 was a year categorised by a supportive backdrop both globally and domestically. Central bankers changed their rhetoric given improving growth numbers and the wall of money is increasingly becoming the narrative as investors chase new supply. This environment coupled with the absence of material exogenous shocks meant we saw one-way traffic in credit spread performance over the course of the year.

* As at 23 November 2017

Looking at major bank spreads, we have seen secondary market performance in the context of 30-40bps since January. In terms of new issue pricing, the first 5yr major bank trade this year came from CBA who printed at +111bps on 9 January. Fast forward to the end of the year and NAB just printed a new 5.25yr at +80bps so in excess of 30bps of spread performance over the year. This puts major bank new issue levels at their tightest levels since the GFC (noting NAB's +78bps print back in May 2013).

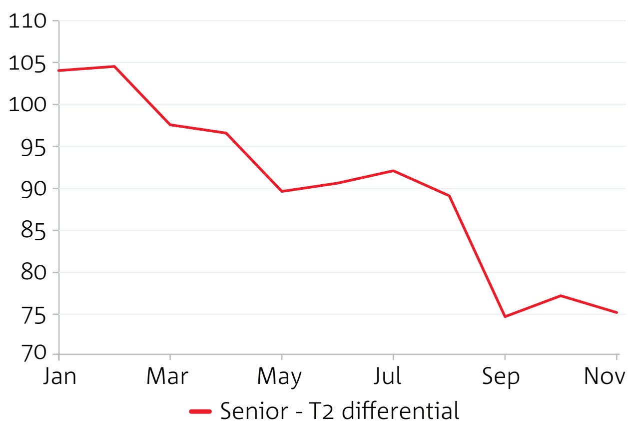
Major bank spreads



Source: Yieldbroker

The other key point to note around spreads is the compression we have seen as we move down the capital structure; namely the compression between senior debt and Tier 2 debt. Driving this compression has been a number of factors: the low rate environment, benign credit conditions, and general lack of supply to name a few. The compression has seen the senior to T2 differential compress from over 100bps to now around mid-70s.

Senior Tier 2 differential YTD



Source: NAB, Yieldbroker

New issuers and products

The Australian market continues to evolve and provide greater flexibility and optionality to domestic and offshore issuers. This year we had a host of inaugural issuers access the market as well as new asset classes and formats offered to the AUD investor base. Shinhan Bank, Banco Santander, Bank of Nova Scotia (Sydney Branch), Bank of Montreal, and HSBC Holdings all gave investors some offshore diversity and were well digested.

On the product front, this year brought the first senior non-preferred trade to the market with BNPP, Credit Agricole, and Banco Santander all issuing the bail-in debt off their respective EMTN programs. In November we also had the long-awaited first callable TLAC trade come to market. A structure that provides for a more efficient form of bail-in funding for the issuer was priced by HSBC Holdings in the form of 6.25NC5.25 and was very well received by the market.

TLAC/MREL supply

The AUD market continued to provide a strong alternative for global issuers looking to diversify their sources of TLAC/MREL funding. As mentioned, investors are now quite comfortable with multiple formats (SEC Registered, EMTN and Kangaroo) as well as bonds being governed under foreign law.

TLAC/MREL-eligible issuance achieved record levels this year with volumes totalling A$6.8 billion, up from A$3.9 billion in 2016.

This year's increase has been driven by additional jurisdictions complementing the US supply we saw in 2016. France was represented through senior non-preferred (SNP) transactions from BNP and Credit Agricole, Spain through Banco Santander's SNP transaction, the UK through both Lloyds and HSBC executing HoldCo transactions, and Japan through SMFG's two separate HoldCo trades.

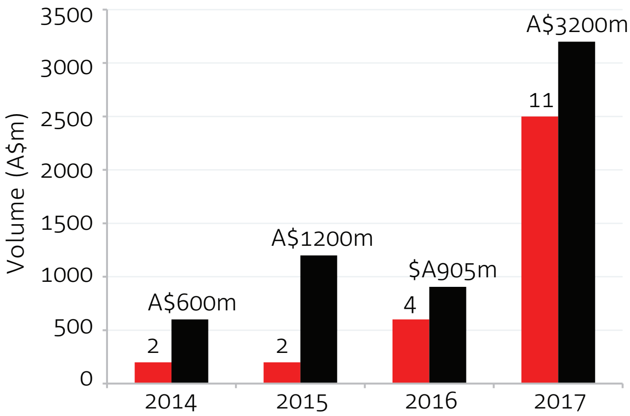
As the AUD investor base gets more and more comfortable with the asset class and global regulators finalise respective requirements, expect A$ supply in this space to keep on growing.

Green/SRI supply

This year has been another record year for green, social, and sustainable bond issuance both globally and domestically. Total issuance is on track to reach US$135 billion with increasing diversity of structures across senior unsecured and subordinated, project bonds, equity linked notes, covered bonds, loans, securitisation, ETFs and Sukuk. In terms of demand side dynamics, we are seeing continued growth in pools of liquidity driven by strong inflows into SRI capital. This is supporting the increasing levels of supply.

Domestically, Australian primary markets too have seen a leap in issuance through 2017 with a total of 11 deals closing and raising A$3.2 billion. A number of firsts within this subset as NAB lead Australia's first social bond, sustainability bond, offshore bank green bond, corporate green bond, and insurance company green bond. Looking ahead, 2018 is shaping up to be even more active as the green and SRI space continues to evolve.

A$ Green Social and Sustainable Bond issuance



Source: NAB, Bloomberg

THE AUSTRALIAN LOAN *market*

Reliable funding and bespoke solutions at competitive pricing.

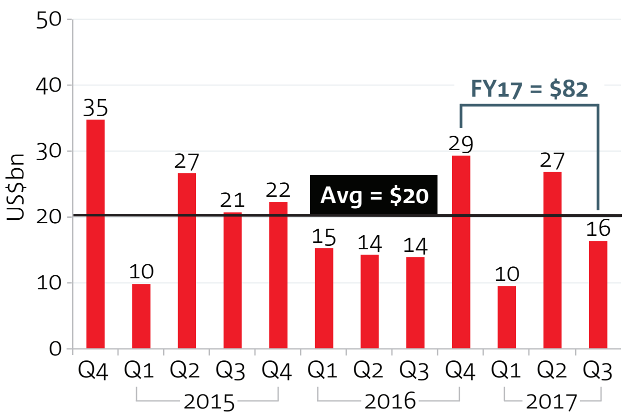
Melissa Gribble, Matt Clendenny and Stephen Boyd

Trends and themes: recent activity

Australia's syndicated loan market remains a deep and flexible source of credit capital for borrowers in virtually every sector and across the credit spectrum. While investment-grade and non-investment grade issuers continue to increasingly access longer-dated funding in the domestic and international bond markets, the clients of National Australia Bank Limited ('NAB') understand that the 70+ participants currently active in Australia's loan market can provide reliable funding and bespoke structures at competitive pricing.

In past years, active lenders in Australia have processed more than US$100 billion (equivalent) of aggregate volume across 200+ multi-bank transactions per annum. 2017, however, marks another year where the supply of new loan deals has not kept pace with the demand we have seen from lenders historically. In terms of dollar volume, NAB estimates that supply has been running 20%+ below proven market capacity.

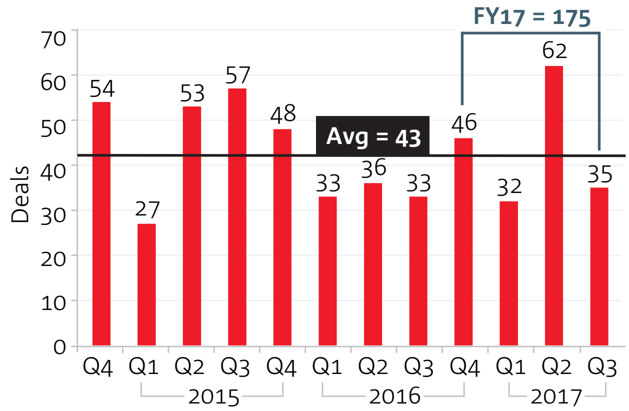
Australian multi-bank loan market: dollar volume



Source: ThomsonReuters LPC, NAB

In past years, most (75%+) Australian loan facilities (or tranches in multi-currency transactions) have been denominated in A$, so the relative weakening of the local currency versus the USD measures used by most data aggregators explains some of that decline in volume. For reference, AUD/USD was above 1.00 as recently as early 2013, but has since fallen below 0.80 where it currently resides. Notwithstanding the vicissitudes of the global foreign exchange markets, however, the number of loan deals is also demonstrably below historical Australian market capacity, as shown in the chart below.

Australian multi-bank loan market: deal volume



Source: ThomsonReuters LPC, NAB

While the number of transactions in any given quarter can be somewhat "lumpy" – Q4 of many calendar years have been the busiest in Australia and Q1 is typically quiet – the trend over the last 2-3 years has been generally lower than what we have seen in the past. In terms of the number of deals that lenders can evaluate, approve and commit to, NAB estimates that supply has similarly been running 10%+ below proven market capacity.

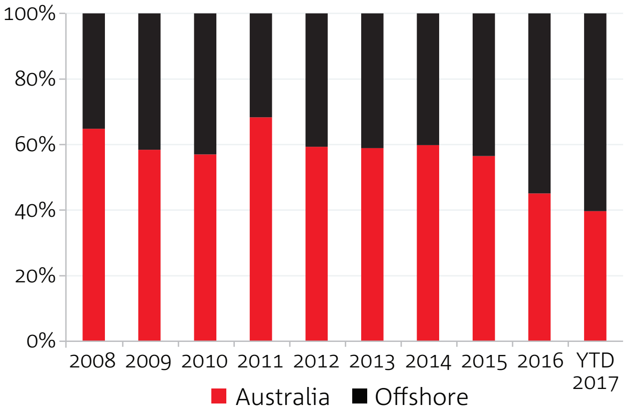
The relative dearth of loan market activity in Australia mirrors what has been happening in the broader Asia Pacific region. Capital expenditure remains subdued for corporate Australia generally, and some of the other drivers of the need for credit capital – mergers & acquisition along with new equity capital – have been more limited than what we have seen in previous years.

Market participants

With hundreds of transactions each year and 70+ active lenders, precise monitoring of relative positioning based on allocated final holds can prove challenging given that the Australian loan market is largely private, with most transactions governed by confidentiality restrictions. In NAB's experience, however, league table aggregators collect and collate information that serves as a useful proxy for lender activity.

In the wake of the global financial crisis, the "Aussie Majors" (NAB, ANZ, CBA and Westpac) largely defended their collective share in the range of 55-65% of the overall multi-bank market. In recent years, however, dominance by the Aussie Majors has been declining and is now approximately 40%.

Market share by lender's primary region (mandated arranger basis)



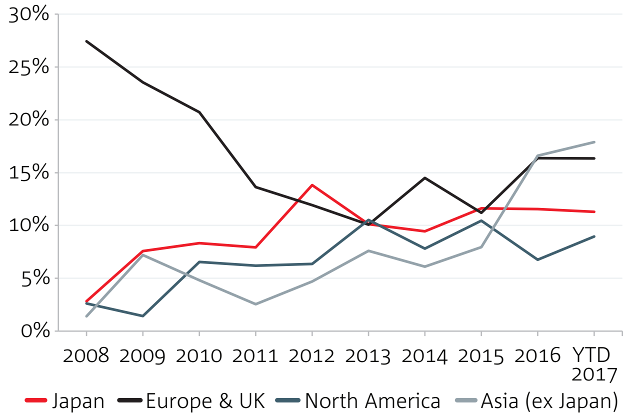
Source: ThomsonReuters LPC, NAB

In NAB's view, there are several factors that explain the changing shape of the Australian market:

- increased capital requirements by Australian regulators (for both corporate & institutional exposures as well as residential mortgages) reducing credit growth
- continued tactical expansion by lenders headquartered in the broader Asian region (the big Japanese banks and, more recently, the major Chinese lenders) beyond supporting home country borrowers in order to offer full-service relationship banking to Australia-based clients
- the weakening of the A$, which facilitates non-Australian lenders making "top-line" commitments on par with the Aussie Majors
- greater titular dilution as non-Australian banks position for "bookrunner" and "mandated lead arranger" with those larger commitments

With respect to which lenders the Aussie Majors are relinquishing share, the chart below depicts relative positioning in recent years.

Offshore market share by lender's primary region (mandated arranger basis)



Source: ThomsonReuters LPC, NAB

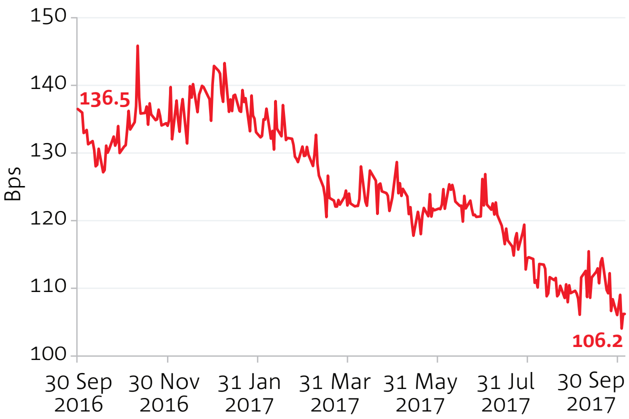
In 2017, China Construction Bank, Agricultural Bank of China and Bank of Communications have continued to make strides in the Australian loan market alongside Bank of China and ICBC, both of which have been growing their local businesses for several years now. The European banks, many of which are strong in project finance, have been growing exposures via infrastructure-related transactions in the wake of the resources boom. For their part, the North American banks continue to support clients with meaningful cross-sell opportunities in investment banking and/or markets generally. Lenders headquartered in Taiwan and some regional banks across Asia continue to provide incremental liquidity for Australia-based borrowers willing to conduct a roadshow in the region.

One noteworthy development is the growing relevance of non-bank lenders in Australia. Government-linked entities (e.g., development agencies), superannuation funds and institutional credit funds have been finding and filling niches in relation to risk and return, or supporting key equity sponsors expanding investment in Australia. And while there has been some debate with respect to liquidity available in the form of institutional term loans, NAB believes that credit funds and infrastructure investors will play an increasingly important role in satisfying borrowers' needs for tenors longer than those available in the more traditional syndicated loan structures.

Pricing

Global credit markets are increasingly interlinked, and the Australian loan market is no exception. Borrowers can generally raise debt in the bond markets at longer tenors than those on offer in the loan market. For their part, lenders source funds in the wholesale bond markets to complement shorter-dated deposits and more permanent capital (equity). During 2017, spreads and margins generally contracted across currencies. In Australia's cash bond market, NAB saw secondary spreads tighten at least 20bps across most investment-grade issues, and issuers took advantage of those moves by printing some record deals in the primary market.

Bloomberg A$ investment grade corporate bond index (option-adjusted spread)



Source: Bloomberg

With respect to Australia's synthetic credit market, the iTraxx measure saw similar contractions in spreads (20+bps) as the bond market.

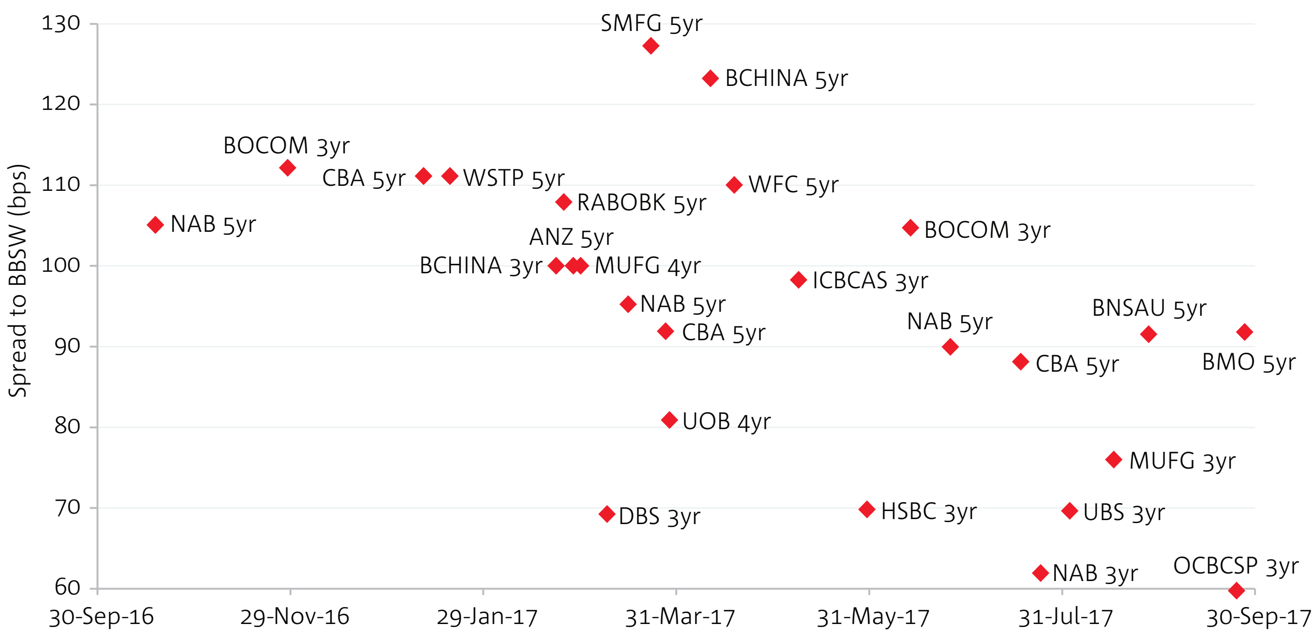
iTraxx Australia (Series 28)

Source: Bloomberg

Lenders' cost of funds

For clients issuing bonds in the global markets, investor appetite was strong in 2017, and the same held true for the Australian medium-term note (A$MTN) market. While NAB recognises that lenders do not match-fund their assets, we have observed that Australian loan market participants' cost of funds (both shorter-term deposits and longer-term wholesale borrowing) are influenced by broader trends on the liability side of their balance sheets.

Select senior unsecured A$MTN issuance



Source: Bloomberg

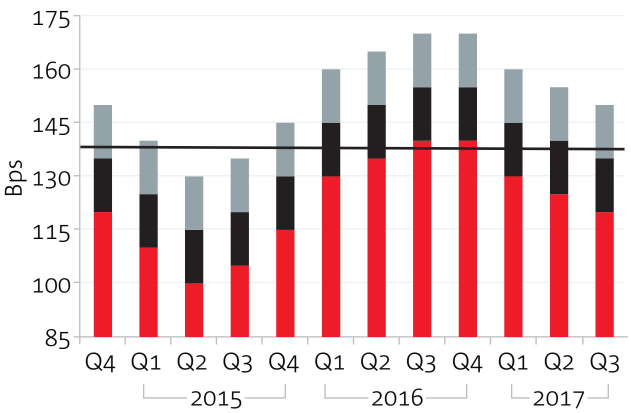
The multi-bank loan market in Australian has been reliably offering borrowers 3-5 year tenors for quite some time since the financial crisis. We summarise above where some select active lenders in the Australian market have issued in the primary A$MTN market for a rough guide to where those same lenders could then be prepared to lend at similar tenors.

Australian loan market pricing backdrop

The movements in the broader credit markets – both with respect to where borrowers can source longer-dated bonds and where lenders are raising their own funds to support their clients – is ultimately reflected in loan margins and fees. After bottoming out in mid-2015, Australian loan margins subsequently increased approximately 20-30bps on the back of some renewed global volatility.

However, that trend of rising pricing ceased in early 2017, and Australian margins (and fees) have resumed declining in line with the broader credit markets. We depict below where we have seen illustrative margins for 4-year tenor – or the mid-point of the 3-5 year market standards at the moment – for investment grade (BBB-band) borrowers over the last twelve quarters.

Illustrative 4-year margins for BBB-rated borrowers



The line on the chart denotes trailing twelve quarter BBB (flat) average.
Source: NAB

NAB SECURITISATION, THE 'GO TO' HOUSE *for Australian* RMBS AND ABS

NAB's Securitisation team goes from strength to strength, being the clear house of choice for customers and thought leader in the market.

Sarah Samson

Markets have been open and stable throughout 2017, supporting record YTD issuance volumes since the GFC. For NAB Securitisation, this year has been the strongest to date, with the team involved in the bulk of transactions to market and undertaking the JLM role for 89% of these, excluding self-led issues. Private side activity has also been buoyant during the year as new lenders enter into finance arrangements for assets which will find their way to public term transactions in the future. New Zealand and United Kingdom have also had a busy year, contributing to the team's overall activity. The 2017 Peter Lee Debt Securities customer advocacy survey ranks NAB highest across seven key measures, affirming the team's capabilities and customer service orientation. We are also proud to be acknowledged and respected by our customers for the 6th consecutive year as Securitisation House of the Year (KangaNews), among several awards.

These awards are determined by votes submitted by debt-markets participants, and as such represent the views of our clients and peers.

Key measures

- Participation rate of 89% (NAB has acted as a JLM on 23 out of 25 deals to market[1])
- Arranger Rate of 68% (NAB has Arranged 17 of those 23 deals[1])
- No. 1 on KangaNews Securitisation League Tables

2017 Australian Securitisation league table (including AUD and foreign currency tranches)*

Bookrunner	Including self lead			Excluding self lead		
	A$m	No. of deals	Rank	A$m	No. of deals	Rank
National Australia Bank	**8,256**	**37**	**1**	**8,256**	**37**	**1**
Westpac	7,573	31	2	5,832	30	2
CBA	6,649	16	3	2,601	14	6
Deutsche Bank	3,609	16	4	3,609	14	3
ANZ	3,384	14	5	3,384	14	4
Citi	3,078	7	6	1,087	5	7
Macquarie Bank	3,050	16	7	2,730	14	5
BAML	553	2	8	533	2	8
MUFG	449	2	9	449	2	9
JP Morgan	436	2	10	436	2	10

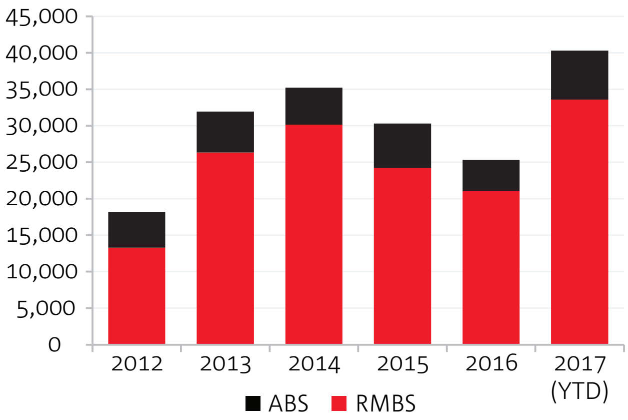
* As at 23 November 2017
Source: KangaNews, 2017 AU Securitisation League Table 23 November 2017

[1] Excluding Self-Led & Private Placements

Reflecting strong market conditions, securitisation issuance volumes are up year on year and will close the calendar year out higher than any other year post the GFC.

Books have been well bid with oversubscription across note classes. This has allowed for price testing and ultimately tighter pricing to be achieved by issuers. This holds true across issuer sectors and product (prime, nonconforming, ABS).

Total Australian RMBS and ABS issuance (A$m)

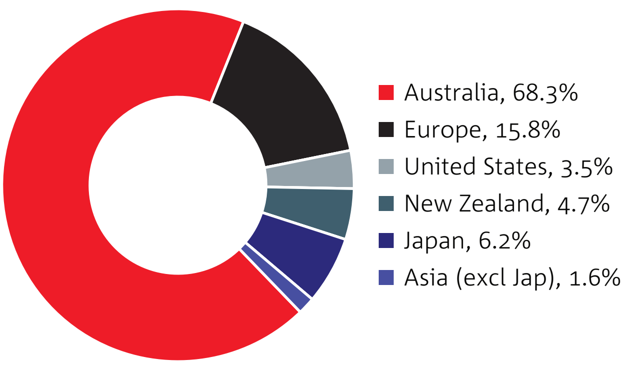


Source: NAB, 23 November 2017

Throughout the year, issuers have been well supported by domestic and offshore fixed income investors with the balance sheet bid continuing to be represented albeit to a lesser extent that for 2016.

Offshore investor participation has grown for Australian securitised product with the continued entry of new investors across regions. RMBS investor location is shown below, representing ~32%.

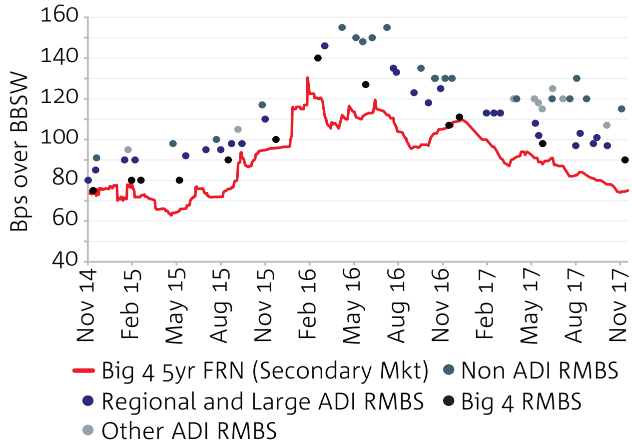
RMBS investor location, 2017



Source: NAB, 23 November 2017

Similar to senior unsecured spreads, RMBS/ABS spreads have contracted throughout the year.

Spread relativity: prime RMBS to 3 and 5 year bank senior unsecured

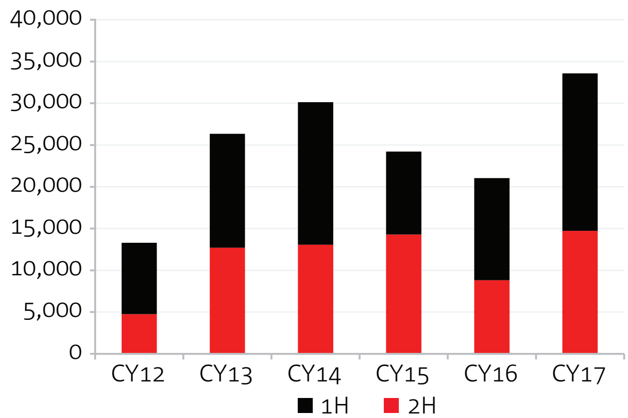


Source: NAB, Yieldbroker

RMBS

RMBS continues to represent the bulk of the Australian securitisation market at 83%, with approximately A$33.6 billion (equivalent) in public issuance across a total of 43 deals as at 23 November 2017. With a number of transactions still to price in 2017, RMBS volume has exceeded 2014 volume of A$30.1 billion, making 2017 the strongest year in RMBS since 2007. We anticipate a strong pipeline moving into 2018.

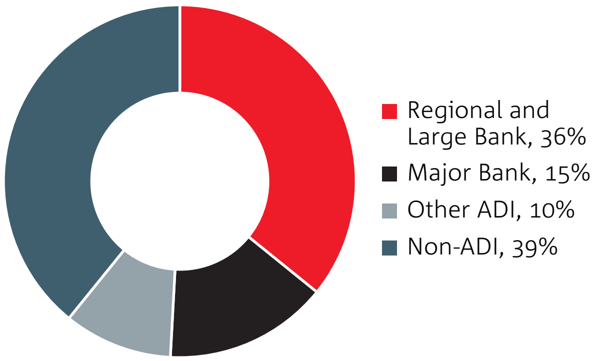
RMBS issuance (A$m)



Source: NAB, 23 November 2017

All RMBS issuer classifications were active during the course of the year. The chart above illustrates that 2017 first half issuance volumes were significantly up on 2016, probably reflecting lower issuer volumes in 2016. Given market conditions are expected to remain constructive for the remainder of the calendar year and a decent pipeline of deals still to come, it is highly probable that second half issuance will exceed A$19 billion, eclipsing that of H2 2014.

YTD2017 RMBS issuance volume by issuer type

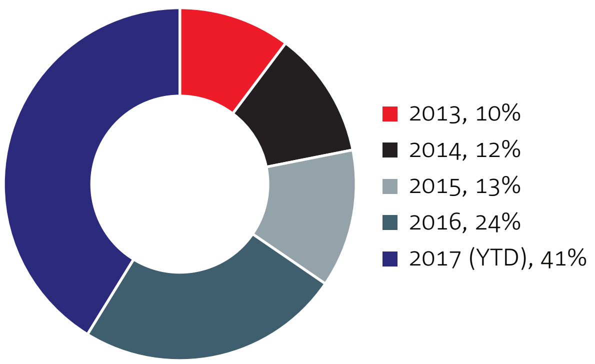


Source: NAB, 23 November 2017

The proportion of nonconforming RMBS public issuance as at 23 November grew throughout 2017 in absolute terms to over A$7.7 billion, up from A$4.5 billion in the prior full year.

Consistent with prior years, non-ADI names continue to tap the US market via USD 144A format providing for greater diversification across markets and their investor base. We expect a small group of issuers including Pepper and RESIMAC will continue to invest in diversification with opportunistic transactions during the course of 2018. We have also seen non-ADIs such as Liberty Financial access specific EUR demand and subject to policy easing in UK/EUR, anticipate this demand will still be accessible.

Public non-conforming issuance



Source: NAB, 23 November 2017

ABS

Total year to date issuance for Australian ABS has increased year-on-year, standing at just over A$6.7 billion, the highest volume certainly since the GFC. Latitude Financial entered the capital markets this year with their inaugural credit card and sales finance master trust issue and followed up with a subsequent tap. In mid-November Latitude also priced a new personal loan issue.

ABS transactions priced for 2017 as at 23 November totals 9 deals, and with the year still not over we are anticipating another couple of issues. Other well-known issuers who have come to market in 2017 include: Macquarie-SMART; Westpac-Crusade; Eclipx Group, Volkswagen-Driver; and CNH Capital. Consumer finance lender Flexigroup-Certegy also revisited the market and followed up with another inclusion of their innovative 'green' tranche, which was well bid by SRI investors.

ABS issues are typically well supported by investors given the diversification value and their shorter tenor to most RMBS issues and 2017 has been no different. Innovation and thought leadership

Innovation and thought leadership

At NAB we pride ourselves on innovation and thought leadership. This year NAB has been involved in a variety of leading issues: Latitude's master trust issuance, FlexiGroup's Certegy ABS issue which for the second time included a 'green' tranche, the only Australian securitisation issuer to do so, and Bank of Queensland's inaugural and very successful €500 million Conditional Pass-Through Covered Bond. NAB also sponsored a 'green' themed panel at the recent Australian Securitisation conference drawing a range of participants and was a key promotor and participant in the ASF's twilight series on the emerging application of green securitisations.

We view securitisation as a transparent funding tool for green assets and believe the Australian market will evolve over time to include more transactions carrying the 'green' label, which will ensure that the securitisation product is accessible to investors who are increasingly focussing on SRI.

Regulatory impacts

In November 2016, APRA released its final draft of APS120. Unsurprisingly to the industry, there was little movement on some of the core changes made in the November 2015 discussion paper. The primary impacts relate to increased risk weights for financial intermediaries providing warehousing and/or investing to customers. There are not expected to be any challenges leading into the effective date of 1 January 2018, although there continues to be a fair amount of warehouse restructuring as issuers have sought to introduce third party mezzanine financing to warehouse structures to manage risk weighted assets.

Overall it is good for the market that APS120 uncertainties have been put to bed and for the first time in quite a while APS120 is not a key topic of discussion with investors.

Another area of regulation that has been of topical discussion is Treasurer Scott Morrison's proposed legislation on the extension of APRA's powers to make rules relating to lending by non-ADIs. This has now been introduced to the House of Representatives. The rationale for the introduction of the proposed legislation is that there was a gap in APRA's ability to manage material financial stability risks that might arise from the lending activities of entities that are not ADIs (for example, non-ADI lenders).

The Bill's Explanatory Memorandum explains that this 'gap' will be closed by providing APRA a reserve power to make rules in respect of the lending activities of non-ADI lenders, should these activities be materially contributing to risks of instability in the Australian financial system. The main point to note here is the use of the word 'material'. It is not expected that the powers will result in any new rules being applied to non-ADI lenders in the immediate future given this test. Rather, non-ADI lenders will need to register with, and provide data, to APRA. Through collection and analysis of data, APRA will have a better understanding of this part of the financial sector and will be able to make rules should the materiality threshold ever be in risk of breach. The intention to provide appropriate tools for APRA to deploy should the size of the sector change, or lending practices within the sector become a cause for concern when viewed through the lens of risk to the stability of the Australian financial system.

Also of note to stakeholders is that the Bill includes legislative changes to:

- remove restrictions on ADIs on the use of the term 'bank', with the Explanatory Memorandum noting that the Bill will promote a reduction of barriers to new entrants to the banking sector and provide a more level playing field amongst ADIs. Further noting that the changes will align community expectations in respect of the use of the term 'bank' with the fact that ADIs are prudentially supervised by APRA and deposits are covered by the Financial Claims Scheme guarantee
- amend the Credit Act to introduce a number of reforms to improve consumer outcomes under credit card contracts. The purpose of the amendments is to reduce the likelihood of consumers being granted excessive credit limits, align the way interest is charged with consumers' reasonable expectations and make it easier for consumers to terminate a credit card or reduce a credit limit.

AGENCY AND TRUSTEE *services*

Leveraging our capabilities to meet market demand.

Theo Gavrilos and Melisha Hughes

This year has been a year of continued growth in the Agency business both in the number and nature of transactions and accelerating activity for our Corporate Trust business. This momentum has been driven by recognition of the capabilities of our people as well as a concerted effort to expand service levels to meet market demand for diversified funding, new product/investment opportunities and high quality end to end service, whilst reducing operational risks for our clients.

On the Agency front, there has been a steady flow of transactions in the renewable energy segment generated by both local and international investment in greenfield Australian solar or wind assets. Where syndicated debt facilities have been put in place to fund such acquisitions, construction or development of projects, NAB has commonly performed Facility Agent and Security Trustee roles but there has been an increasing amount of smaller (e.g. bilateral) facilities led by ultimately foreign sponsors that only require standalone Account Bank services. A number of these projects continue to be funded by foreign lenders as well as government related entities with our expertise via our 'Agency for Hire' service proving invaluable.

Project finance transactions continue to evolve

During the year we closed project finance transactions where our role commenced pre financial close, involving advice on maximising operational efficiency of transactional documents. Our capacity ranged from agent, to security trustee and account bank, to management of equity moneys, and to construction drawdowns (including relationships with expert third parties), and finally all the way through to completion and issuance of capital markets take-outs. Sometimes these transactions also included providing operational cash management solutions post completion.

Our scope of transactions ranged from corporates, project finance, landmark privatisations, as well as the funds segment, including subscription financing, infrastructure and real estate funds. Property activity at the larger end of the spectrum of developers and funds has been steady with continued support for refinancings and new financings in the commercial space. Whilst a number of apartment construction transactions were completed earlier in the year, syndicated transactions in this space have slowed, reflecting changes in credit appetite for this type of lending.

Foreign lenders make an impact

Whilst Australian lenders continue to dominate the Australian 'brand' names, we continue to see evolution on the investor front with a number of foreign lenders establishing branches or representative offices in Australia during 2017, or simply participating from offshore. We are also seeing institutional investors including superannuation and investment funds increasingly looking at participations in syndicated loan transactions at primary syndication.

Of the secondary trades that have taken place across the Agency portfolio year to date, 45% have been conducted with or between non-bank participants, mainly because of trading in distressed transactions such as Arrium. Institutional investors such as superannuation funds continue to be seen in increasing numbers in performing transactions across our book. We expect this to continue into 2018 and note that efforts are underway to standardise syndicated loan documentation custodian language given the representation of superannuation funds across many transactions.

On the capital markets front, in particular USPP, continued appetite for Australian credit has seen more issuers looking to outsource the operational risks of financial close settlements and ongoing management of their inaugural issuances, including payment and note registry services. Our Agency capabilities are easily leveraged to perform such roles with a number of new clients taking up this offering in the last quarter.

Expectations for the future

In terms of ongoing Corporate Trust business, we have continued to see an increase in the number of reinsurance trust transactions as Australian insurers enter into new reinsurance arrangements with offshore reinsurers for combined property and catastrophe aggregate programs. We are also seeing demand for fund administration services from offshore NAB clients acquiring assets in the local market, as well as cashbox/escrow structures to collateralise M&A contractual obligations or mitigate merchant risks for online transactions. Lastly, the business has also been involved in the capacity of trustee for SPV funding structures, and also trustee for innovative unitised alternative investment structures on behalf of a range of institutional investors seeking yield, liquidity and asset quality.

FINANCIAL AND EQUITY *advisory*

NAB now offers an expanded investment banking service for our clients.

Calvin Liu and David Curtis

2017 has been a transformational year for the Financial and Equity Advisory team at NAB. We are pleased to offer an expanded service offering to our valued clients, in what is typically considered the domain of global investment banking firms.

The Financial and Equity Advisory team provides specialist financial advisory, Equity Capital Markets ('ECM') and credit ratings advisory services in an independent and bespoke manner, further enhancing the trusted relationships which we have developed with our valued clients over the years. We specialise in core sectors, including real estate, infrastructure, clean energy, agriculture, resources, financial institutions, Government, healthcare and education. The team also provides tailored services, typically focussed on succession planning, to diversified corporate clients across all sectors.

The most exciting change in 2017 has been the expansion of our ECM capabilities, where we offer the ability for clients to utilise our experience to structure and manage equity capital raisings as Lead Manager across both listed and unlisted markets.

Building on the strong ECM track record in real estate, we have now expanded our ECM mandate in 2017 to other sectors, where we can bring market leading retail and sub-institutional equity distribution capacity to equity capital raisings we undertake on behalf of our clients.

Building upon NAB's A$18 billion Clean Energy Climate Change Commitments has been a key focus of the team, with continued success in the fields of solar, wind and waste throughout the last 12 months. We are also seeing growing interest in the listed space for clean energy as Initial Public Offerings (IPO's) emerge in response to investor demand for Socially Responsible Investing and green initiatives.

The market in Australia remains hot, with 2017 alone resulting in over $4 billion of clean energy projects under construction with a further $4 billion under financial commitment to start construction through the year. The momentum behind clean energy will continue to grow, but recent uncertainty over clean energy policy has clouded investor sentiment. Clarity on the National Energy Guarantee will be the centrepiece of 2018.

SPOTLIGHT ON *North America*

The US Debt Capital Markets provided options for issuers.

Geoff Johnson and Maeve McLaughlin

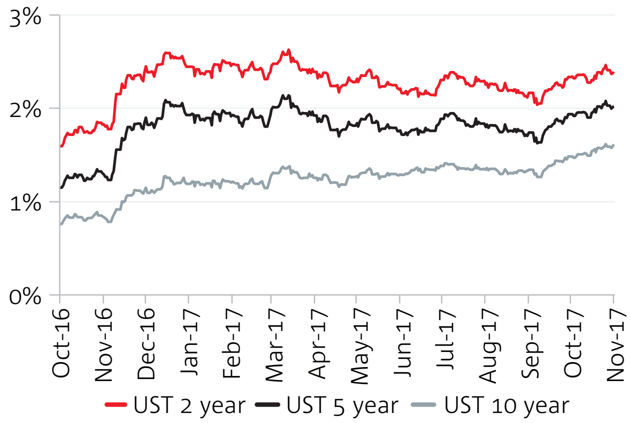
The North American Markets were on fire in 2017, with our two key DCM focus markets, the US Public market and the US Private Placement market, exhibiting vigorous levels of activity. Supply was consistent and demand was exceptionally strong for bond product in these markets, with NAB leading the way on a number of key transactions and importantly in overall market position. NAB was proud to retain its mantle as KangaNews Australian Issuer Offshore Debt House of the Year 2017 for the second year, the only domestic-domiciled bank ever to win this award, which until recently was dominated by international investment banks.

Add to this rapidly improving economic data and a soaring stock market and we had a recipe for a brilliant outcome. Unemployment ended our fiscal year at 4.2%, a level that was last seen in 2001. Similarly, the University of Michigan consumer confidence index ended the fiscal year at 95.1, which puts it in the top quartile of the previous decade.

US Treasury yields and corporate credit spreads

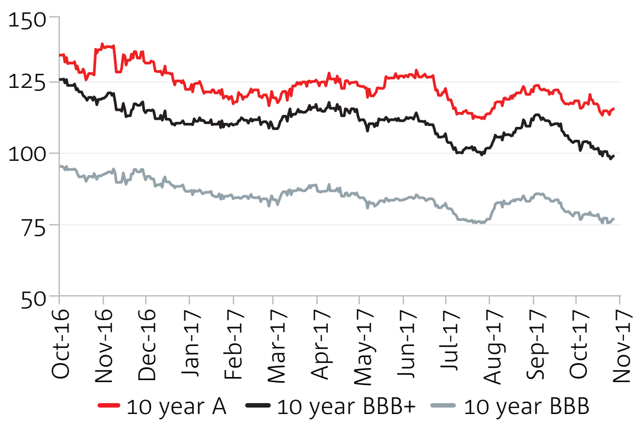
Over the last 12 months, US Treasury yields continued to widen based on optimism in the US economy. No longer was there a flight to quality, as in years past. Instead, we saw a broad acceptance of more risk as investors sold government bonds in favor of corporate bonds. The 10yr US Treasury yield started our fiscal year at 1.62% and ended at 2.34%. This in turn had a whipsaw effect on corporate credit spreads, which tightened from +127 to +106bps over the same period of time. Year to date average new issue pricing concessions is 1.1bps. Last year over the same period of time, the concession was 4.3bps. The average order-book was 3.1 times oversubscribed (vs 3.4 times). The small drop in order-book size is a result of the low absolute level of credit spreads, in conjunction with the thin new issue pricing concession, both of which resulted in levels that are out of reach for some relative value investors.

US Treasury yield



Source: Bloomberg

US industrial credit spreads



Source: Bloomberg

US investment grade market

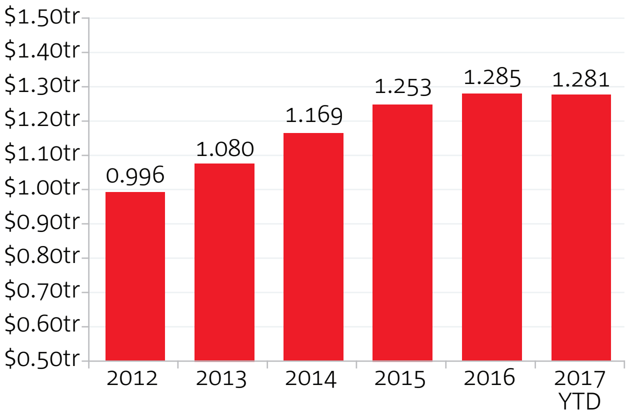
The US investment grade market is on pace to have the best ever issuance year. As of 24 November, year to date volume sits at US$1.28 trillion, up 4% from the same period last year. The final 2017 volume only needs to exceed US$1.29 trillion for it to break the record, and set a new issuance record for a seventh consecutive year.

The mix of issuance this year is relatively similar to previous years with circa 45% financial supply and circa 55% corporate supply.

This continued market strength can be attributed to a number of different factors. Chief among these are the increasing capital needs of companies in the growing economies around the world, the absence of a significant market event such as Brexit derailing the primary flow, and a general view that a businessperson at the helm of the US government will drive a better outcome for issuers. Notably, the potentially destabilizing events which have occurred up during the year, such as the North Korean tensions, have been entirely brushed off by the market and had no impact on overall volumes or spreads.

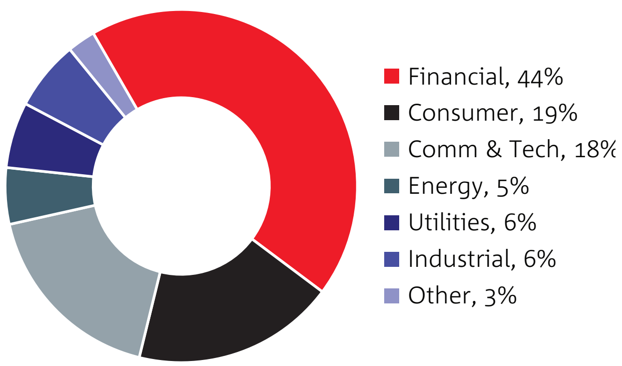
The message from the NAB team to issuers this year has been to access the public market while spreads and yields are low, and investors are pouring their cash into new primary trades.

Investment grade volume



Source: Bloomberg

2017 YTD sector breakdown



Source: Bloomberg

US Private Placements

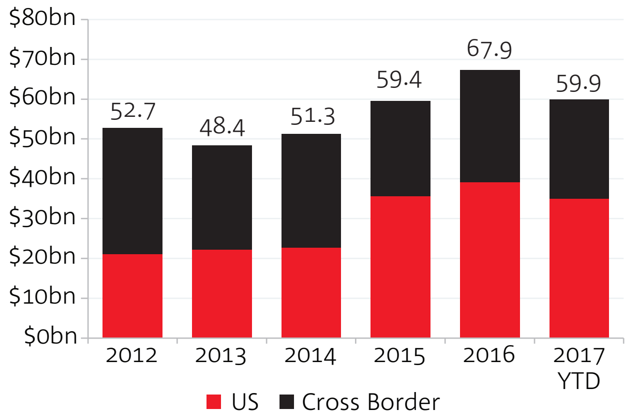
The US Private Placement market is on pace to deliver the best volume year on record. Transaction flow is coming from the usual three regions, Australia, the United Kingdom and the United States with Australia and the United Kingdom in second and third place at 13.2% and 11.9%, respectively.

The investor mix is changing, with more "public style" investors entering the mix to capture additional volume and squelch the thirst for product the US public bond market can't quench. Foreign currency, long delays and mega-bids were quite common in the US Private Placement market this year.

New sectors and regions were less prevalent in 2017, but the market did double down on favorites such as Education, Property, Utilities and Infrastructure. More importantly, the market saw a new record offering for Ausgrid (NAB JLM), which handily took the title of largest cross border US Private Placement transaction of all time with its US$1.9 billion (equivalent) multi-tranche offering.

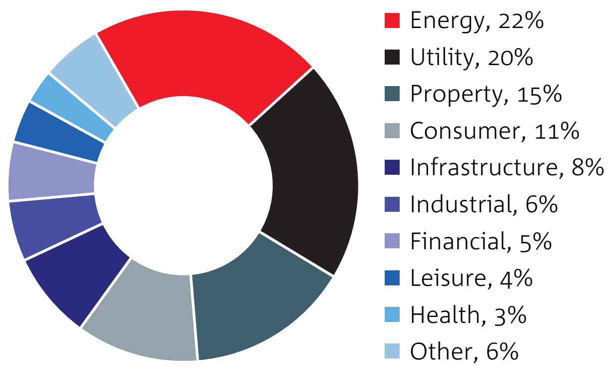
Also this year, we saw a larger than normal number of tenders. NAB completed the largest, a US$335 million tender and new issue for Star Entertainment. As we close out the year we note the mix has been far more heavily weighted towards Utility and Energy when compared to years past, which means the other big sectors Property and Infrastructure are poised for a strong start to 2018.

US Private Placement volume



Source: Private Placement Monitor, November 2017

2017 YTD sector breakdown



Source: Private Placement Monitor, November 2017

Overall we are pleased with volume driven through the market and volume led by NAB. Given the economic stimulus that is on the horizon: enhanced infrastructure spend, corporate tax overhaul and a new, right leaning Chairman of the Federal Reserve Board, it's entirely possible that market performance in 2018 will look at least as good as the year that has just passed.

SPOTLIGHT ON THE *UK and Europe*

Strong investor demand, continued quantitative easing, positive economic numbers – can it get any better?

Andrew Santone

In a year dominated by geopolitical events, potential swings to the right in European politics and continued and ongoing drama with the Brexit negotiations European markets had every opportunity to be impacted and not be able to back up from the strong performance witnessed last year. However, nothing could be further from the truth as the market has used last year's performance as a bedrock to build upon. This year we have continued to see credit spreads grinding tighter, driven by the ECB's buying programme, very strong investor flows into corporate credit funds and economic numbers for the Eurozone that have surprised economic commentators to the positive.

The ECB's corporate sector Purchase Programme ('CSPP') has built further upon the foundation set up last year adding a total of €87 billion to the programme through the past year bringing the total programme to €118 billion as at the time of writing. This buying has been in a steady stream through the year at a little over €7 billion per month. As noted above the bid provided by the ECB has resulted in spreads moving tighter throughout the year for all issuers not only those eligible for the programme but also those which aren't as relative values have adjusted as a result of these moves. Expectations are that the ECB will announce a refinement/reduction to the programme sometime through the tail end of 2017. The likely result is a reduction in the buying amount per month rather than a wholesale cancellation of the programme. This is to ensure that the growth platform that the ECB currently has successfully put in place through the lower borrowing rates will not be hindered.

In addition to the corporate bond buying programme, the better than expected economic growth numbers being witnessed in the Euro zone are resulting in investor confidence returning with more funds being allotted to credit. European Investment Grade credit funds have seen a total of €40.3 billion added to fund managers' portfolios this year with positive inflows being recorded for 39 of the past 41 weeks.

These inflows are also adding a real impetus to spread improvement as investors are chasing transactions whilst, competing with the ECB bid highlighted above.

Brexit continues to impact

The United Kingdom continues to grapple with the "Brexit" election result and through this year an increasingly difficult political environment as the incumbent Tory party continues to come to terms with a disastrous general election result which saw the left leaning Labour party led by Mr. Corbyn almost snatch victory. With Tory party infighting continuing to dominate headlines and the Bank of England Governor Mr. Carney publicly putting interest rate rises on the table whilst scrapping the corporate bond purchase programme, the UK can easily be said to be not following in lock step with European market developments this year. This has resulted in the Sterling credit market demonstrating some weakness through the year with windows of opportunity closing as quickly as they opened.

Total volumes issued for the year (1 October through 30 September) in the Euro market were €1.06 trillion with 1341 transactions being priced. This is up 6% on last year's €1 trillion with a significant increase in the number of transactions from 1246 last year. For the Sterling market volumes are essentially unchanged year on year with 2017 volumes at £116 billion compared to £112 billion. The real story is the number of transactions which increased to 274 from last year's 196. The driver of the increase in the number of transactions is as noted above with the window opening and closing throughout the year a number of issuers particularly supra sovereign agencies have been very active in the market for small taps throughout the year.

Issuance across the corporate sectors has been very evenly split in the market as shown in the charts over the page.

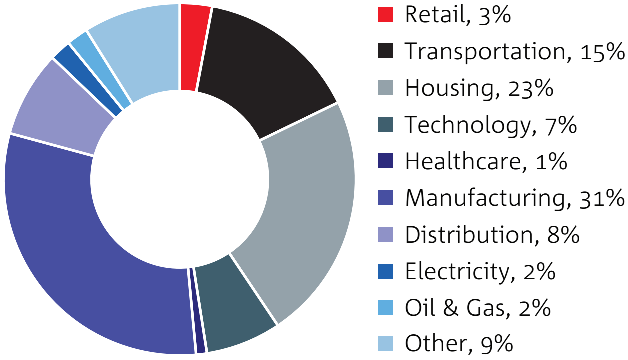
As in previous years we continued to assist our customers in navigating the market with antipodean issuers continuing to enjoy a very positive reception with the European and Sterling investor base. With these issuers not being eligible for the ECB nor BoE corporate bond purchasing programmes the trades generally come at a wider spread to equivalent European and Sterling domestic names albeit, very attractive levels on a swapped back AUD/NZD basis. Also, enticing the investors is their increased likelihood of a strong allocation as the issues do not suffer from the “crowding out” of deal books by central bank buying that they are suffering from when participating in CSPP eligible issues.

In respect to financial issuance all of the major banks from Australia/New Zealand took advantage of the constructive market to issue several transactions. The banks issued across the capital structure from covered through to Tier 2. All issues were very well received demonstrating the positive view that issuers have of the Australian region and the Australian banking sector.

This demand from investors is driven by the same elements that we touched on above:

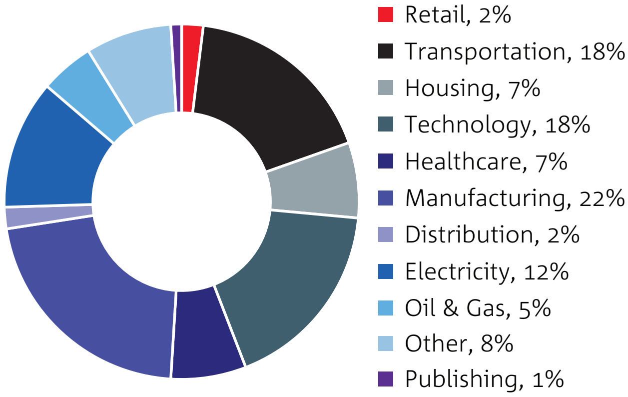
- increased spread available on non-central bank eligible bonds
- ability to receive a meaningful allocation i.e. not be crowded out by central bank buying
- the diversification that issues from the Australasian region bring to their portfolio

Euro markets



Source: InformaGM

Sterling markets



Source: InformaGM

Key transactions from Australian and New Zealand issuers for the year in the Euro and Sterling markets

Issuer	Amount	Coupon	Benchmark	Spread	Maturity
Brambles Finance	€500m	1.500%	Mid Swaps	+70 bps	4 Oct 2027
Goodman Australia	€500m	1.375%	Mid Swaps	+78 bps	27 Sep 2025
Transurban Finance	€500m	1.750%	Mid Swaps	+95 bps	29 Mar 2028
Bank of Queensland	€500m	0.500%	Mid Swaps	+25 bps	10 July 2022
Westfield	£300m	2.125%	Gilts	+133 bps	30 Mar 2025
Westfield	£500m	2.625%	Gilts	+142 bps	30 Mar 2029
Auckland Council	€500m	1.000%	Mid Swaps	+33 bps	19 Jan 2027
Fonterra	€350m	0.750%	Mid Swaps	+55 bps	08 Nov 2024
Chorus Limited	€500m	1.125%	Mid Swaps	+110 bps	18 Oct 2023

Source: InformaGM

The aspect that is most pleasing with the issuance this year has been the low new issue concessions paid by Australasian issuers, which is markedly better than what we saw last year. On average we have seen this as mid-single digits this year contra high single digits last year. In addition to this and highlighting the demand for issuers from the region is the after-market performance for the issuers this year. We have seen outperformance against the domestic European comparable set by 5 to 10 bps; this is driven by the higher spread on offer and at present the relentless demand for issues with such characteristics.

NAB was proud to retain its mantle as KangaNews Australian Issuer Offshore Debt House of the Year 2017 for the second year, the only domestic-domiciled bank ever to win this award, which until recently was dominated by international investment banks.

In market developments the Institutional Term Loan market and the developing European Private Placement Market continues to offer up alternative and more bespoke funding alternatives to clients with the infrastructure entities typically using this market and to great effect. This market is particularly useful for those entities that are subject to regulatory reset WACC charges as the customisation of cashflows, delayed drawdowns and other features allows the issuer to achieve the most effective spread for this portion of their debt.

The key themes that we see as worthy of issuer and investor attention as we move through 2018 are:

- adjustments to the ECB Quantitative Easing programme in place coupled with any move higher in official interest rates. Currently at negative 0.40%
- the Brexit negotiations
- potential consolidation in the European banking sector

SPOTLIGHT ON *Asia*

Another record-breaking year for Asian debt capital markets, characterised by unprecedented regional investor liquidity.

Lorna Greene, William Gillespie and Michelle Wong

2017 was another record-breaking year in Asia Pacific ("APAC") bond markets, with a strong focus away from domestic assets, in favour of APAC credits denominated in hard currencies as investors continued in the hunt for yield.

Apart from an increase in issuance volumes, as more borrowers sought to tap the large pools of liquidity in the region, Asian bond markets also saw a marked increase in depth and sophistication of both the issuer and investor base, resulting in increased diversification by way of debut borrowers, new issuance formats and issuance in a broader range of domestic markets and local currencies.

Underpinning this unprecedented growth and development is a confluence of long-term macroeconomic trends such as shifting global capital flows from West to East and demographic changes including the growing Asian middle class.

In addition, a prolonged low interest rate environment coupled with ongoing quantitative easing in key regional and global economies is fuelling the investor hunt for yield, evidenced by the unprecedented growth of the US$ Reg S market, as well as the strong bid from the Asian investor base for AUD denominated assets.

Asia's bond markets also showed increased resilience amid bouts of geopolitical volatility, including escalating tensions on the Korean peninsula as well as concerns around Brexit and European elections.

All of these factors serve to highlight the emergence over the last 2 years of the Asian investor base as a key source of global liquidity.

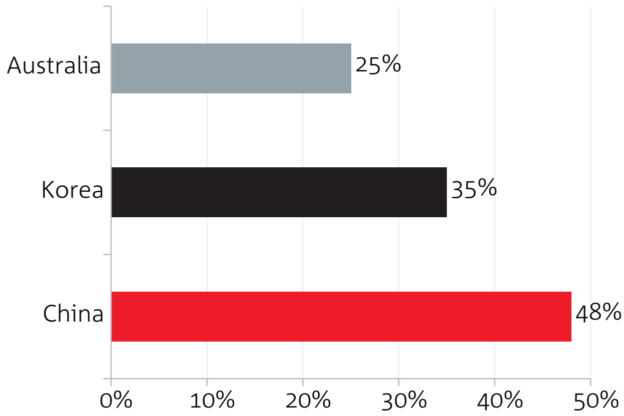
Strong Asian liquidity driving global markets

The APAC region's growing wealth has seen the Asian investor base reach critical mass, with the ability to drive orderbooks for USD and AUD public benchmark transactions, in addition to increased participation in EUR and GBP denominated bond issues.

Indeed, the Australian dollar market has been a key beneficiary of increased Asian liquidity. Over the last 2 years, Asian participation in AUD trades has increased significantly, comprising up to 30-70% of total allocated orderbooks, from a previous average of 10-15%, depending on the credit.

This increased liquidity in part reflects the shift in funds flow from the West, as well as decreased reliance in global capital flows driven by the region's high household savings rates.

Gross domestic savings (% of GDP)



Source: World Bank Group, Gross Savings (percentage of GDP as at 31 December 2016)

Asian sovereign wealth funds, pension funds and insurers are demanding assets which generate stable investment returns, including bonds, to support ageing populations.

The convergence of these long-term trends has helped to elevate the profile of the Asian investor base to one of strategic importance for global borrowers in line with US and European investor bases.

US$ Reg S comes of age

In the past, US$ Reg S only issuance was viewed as a way for issuers to raise supplementary funding and to target the European investor base with US$ demand. Demand from Asian investors was only viewed as incremental.

However, growing Asian regional economies, led by China, are fuelling the rapid pace of development of Asian bond markets. It is therefore unsurprising that the US$ Reg S market has been a key beneficiary of this growth as investors gravitate toward the unmatched liquidity provided by USD denominated assets and borrowers capitalise on strong investor demand for USD assets and record-low borrowing costs.

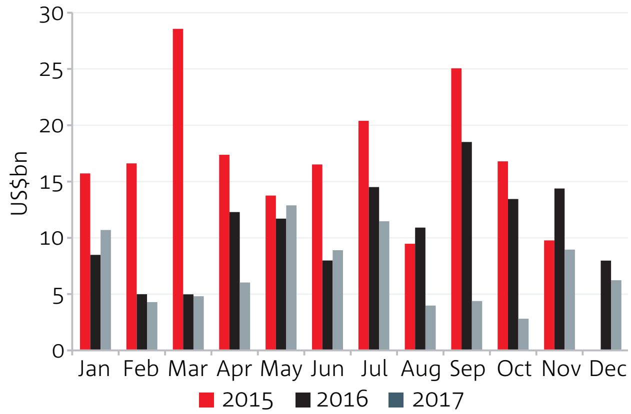
The deep liquidity in the region, coupled with the increased sophistication of the Asian investor base, has resulted in the unprecedented development of the US$ Reg S market in 2017, both in terms of increased depth and diversification, making the US$ Reg S market an important source of core funding, not only for Asia-Pacific issuers, but also for global borrowers.

Year to date issuance volumes of US$190 billion[1] are already in excess of full year 2016 totals representing a 46% increase. The market's robust performance is highlighted by flat to low single digit new issue concessions and an average orderbook oversubscription of three times.

Chinese borrowers continue to account for the largest percentage market share, however this year has seen increased issuance from Japan, India, Indonesia, South Korea and Australia as more borrowers recognise the benefits of tapping the US$ Reg S market.

Three debut Australian corporates tapped the US$ Reg S market in Q3 (Incitec Pivot, Santos and Mirvac), drawn by the format's ease of execution, flexible minimum issuance size and attractive pricing for long-dated issuance.

APAC US$ Reg S monthly issuance, 2015-2017 YTD



Source: Dealogic, 7 November 2017, excluding short term issuance and volumes ≤US$100m

Although the growth of the APAC US$ Reg S market is expected to moderate in the near-term, NAB forecasts 20-25% year on year growth over the next 3-5 years as investor demand is expected to remain robust and as more issuers continue to recognise the pricing and diversification benefits which can be achieved in the US$ Reg S market.

NAB has been at the forefront of the developments in the US$ Reg S space and has taken a number of clients to market this year, some of the highlights of which include:

- QBE insurance Group Australia Ltd. US$300 million, 5.625yr transaction (NAB JLM)
- China Development Bank HK branch's US$2 billion, 3 & 5yr dual tranche transaction (NAB JLM)
- ICBC, HK branch's US$750 million, 3 and 5yr dual tranche transaction (NAB Joint Global Co-ordinator & JLM)

China market update

Much of 2017 was characterised by RMB volatility amid strong depreciation pressures which saw China put in place capital controls towards the end of 2016 and which, although have been relaxed, remain in place.

In the medium term, the People's Bank of China ('PBOC') has signalled plans to push ahead with corporate deleveraging policies aimed at cutting China's debt risk, as well as to speed up plans for RMB internationalisation.

[1] NAB Capital Markets & Advisory, Dealogic (7 November 2017) ex. short term issuance and volumes ≤US$100m.

The introduction of the Bond Connect scheme on 1 July 2017, allowing foreign investors to access domestic bond issues, represents a another step in the opening of markets as Panda bond issuance stalled amidst concerns around the ability of borrowers to expatriate funds raised through the format.

Slow moving Panda

Panda bond market activity has remained slow this year with RMB65 billion in issuance across 27 deals year to date, from issuers including RUSAL, Hungary and Maybank.

The growth of the market continues to be constrained by a lack of clarity around issuance requirements, accounting treatment and the ability to expatriate funds offshore.

A long-awaited Panda bond framework from the PBOC will reportedly be finalised by the end of 2017 and is expected to streamline the application process and provide more clarity on issuance requirements.

Likewise, China's interbank bond market regulator, National Association of Financial Market Institutional Investors ('NAFMII') has indicated that further steps could be taken to remove the requirement for domestic credit ratings as well as the requirement for audited financials restated in accordance with China GAAP, making it easier for foreign borrowers to come to market.

Dim Sum appetite wanes

Dim Sum issuance dropped sharply in 2017 as a result of RMB volatility. Many investors faced higher CNH funding costs, as the currency veered off its steep appreciating trajectory. This has resulted in many investors now limiting investments to natural CNH inflows rather than taking foreign exchange risk.

Year to date issuance of CNH26 billion is only 23% of year-on-year 2016 volumes. However October saw a brief reopening of the market due to a spike in bond redemptions against a backdrop of policy-induced currency stability leading up to the 19th National Party Congress with the Commonwealth Bank of Australia, BMW, Korea Development Bank and BOC Aviation printing new benchmark (CNH1 billion+) sized transactions.

Formosa market paces along

Issuance volumes in the Formosa market stabilised in 2017 driven by fewer redemptions and higher US rates. US$40 billion in supply is forecast by year end, representing an 18% decrease year on year.

A large proportion of 2017 issuance was driven by pre-funding in H1 ahead of perceived global risk events including Brexit, European elections and the introduction of new regulations from the Financial Supervisory Commission requiring structured Formosa issuance to have a minimum non-call period of 5 years.

Formosa issuance volumes are highly correlated to movements in USD rates given the majority of issuance is structured to meet high investor yield targets from local life insurers with high premiums from legacy policies.

This year also saw an increase in demand for 5 year floating rate notes in Formosa format as Taiwanese banks experienced under-allocation in both the USD public bond and bank loan markets.

Deal sizes have decreased year on year, now ranging between US$250-500 million. This is largely attributable to the market normalising following the strong demand seen in the first 2 years since inception in 2014.

Volumes of US$1 billion+ volumes are still achievable by debut financial issuers and corporates (e.g. Verizon, AT&T, Pfizer, Comcast and Apple).

Taiwanese investors typically have a single name limit of US$2 billion per issuer, which has resulted in a preference to diversify away from frequent issuers including the global investment banks.

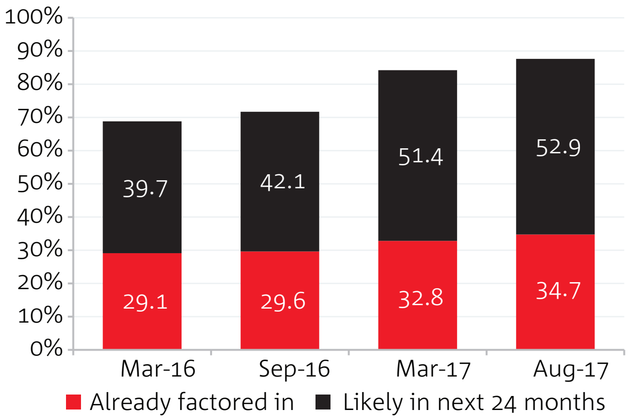
This has increased demand for corporate names particularly following regulatory revisions removing the cap on exposure to BBB+ assets and a reduction in permitted portfolio exposure to China

NAB has been active in the Formosa market this year having debuted back in March with a US$360 million, 30nc5*5yr callable zero coupon note. The transaction was so well received that NAB came to the market a second time in July, this time printing a larger US$655 million structured note mirroring the same format as that of our debut issuance.

Growing the Asian green bond market

The appetite of institutional investors for green bonds has grown substantially in recent years with an increasing number of mandates for socially responsible investments ('SRI'), impact investments and green bonds.

The impact of ESG factors on investor credit decisions



Source: J Horne, Asian Bond Markets, Connecting the Investment Dots, FinanceAsia (November/December 2017 Edition)

Indeed, the Asian investor base (Japan in particular) has been notable in terms of its intention to invest in SRI, making it now the second fastest growing market in terms of demand for green bond issuance.

Regional governments have also increased focus on the strategic growth of their respective domestic green bond markets.

With a forecast annual investment of RMB2-4tr (US$300-600 billion), Chinese green financing is expected to continue increasing to meet the goals set out in the Five Year Plan (2016-2020) to address severe pollution and climate change.

Last year, Chinese issuers accounted for a total volume of US$23 billion in the green bond market, which equates to 27% of total global issuance. 2017 also saw more Chinese borrowers including ICBC, Three Gorges and China Development Bank access the offshore green bond market with labelled green offerings which meet the requirements of international investors (for example, issuance aligned with the Climate Bonds Standard or Green Bond Principles).

India has also been taking major steps to develop its own green bond market principles. The Securities and Exchange Board of India recently published new disclosure requirements for the issuance and listing of green debt securities outlining categories which align with the Green Bond Principles and Climate Bonds Standards in an effort to attract further interest from international investors.

In Singapore, the Monetary Authority of Singapore launched the Green Bond Grant Scheme with the aim of further developing the local green bond market following debut USD green bond issues from Singaporean borrowers including City Developments and DBS Bank.

Under the scheme, qualifying issuances can offset up to 100% of expenses attributable to obtaining an external review for green bonds, up to a cap of S$100,000 per issuance.

Outlook for 2018

The key trends observed in 2017 are set to continue into 2018 and Asia's bond markets are well-positioned for another year of strong growth as underlying yields remain relatively low and markets remain constructive against a backdrop of rising US rates.

Looking ahead, one of the key themes fuelling the further future growth of the US$ Reg S market is the need for increased private sector financing in infrastructure investments across the APAC region.

China's One Belt One Road Initiative will require significant funding from the private sector to help achieve its goals. APAC countries including Australia and Indonesia also have significant plans for the improvement of local infrastructure as populations grow and develop, primarily around major cities. In this context, the US$ Reg S bond market is ideally positioned to provide unrivalled access to the liquidity required to fund these projects.

Furthermore, as many new projects are built in accordance with environmental and social considerations in mind, many of these projects could be eligible for financing via the issuance of green or sustainability bonds, further fuelling the expected strong growth of the SRI market.

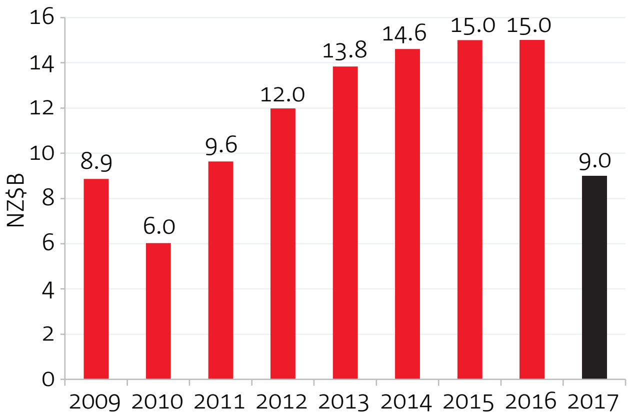
SPOTLIGHT ON *New Zealand*

A year of strength in the domestic retail market and the first ever NZ green bond.

Mike Faville

2017 YTD has seen NZ$9.0 billion priced across 73 transactions, including 27 LGFA tenders. This is significantly down on last year's volume which had reached NZ$13.0 billion at the same point in time. Kauri issuance is down almost 50%, with a red hot USD market leading to decreased reliance and focus on peripheral markets by Supranational Sovereign and Agency ('SSA') issuers. Another contributing factor was the September New Zealand general election which proved a distraction for domestic issuance, taking nearly a month to produce a new government.

Annual total market bond issuance



Source: BNZ Markets

Asian sovereign wealth funds, pension funds and insurers are demanding assets which generate stable investment returns, including bonds, to support ageing populations. This has benefited NZ dollar issuers as well.

Transaction spotlight: IFC prints first ever NZ green bond

Consistent with the global trend, there is a growing pool of Environmental, Social and Governance ('ESG') related mandates held by NZ investors, with more and more subscribing to the United Nations Principles of Responsible Investment ('UNPRI').

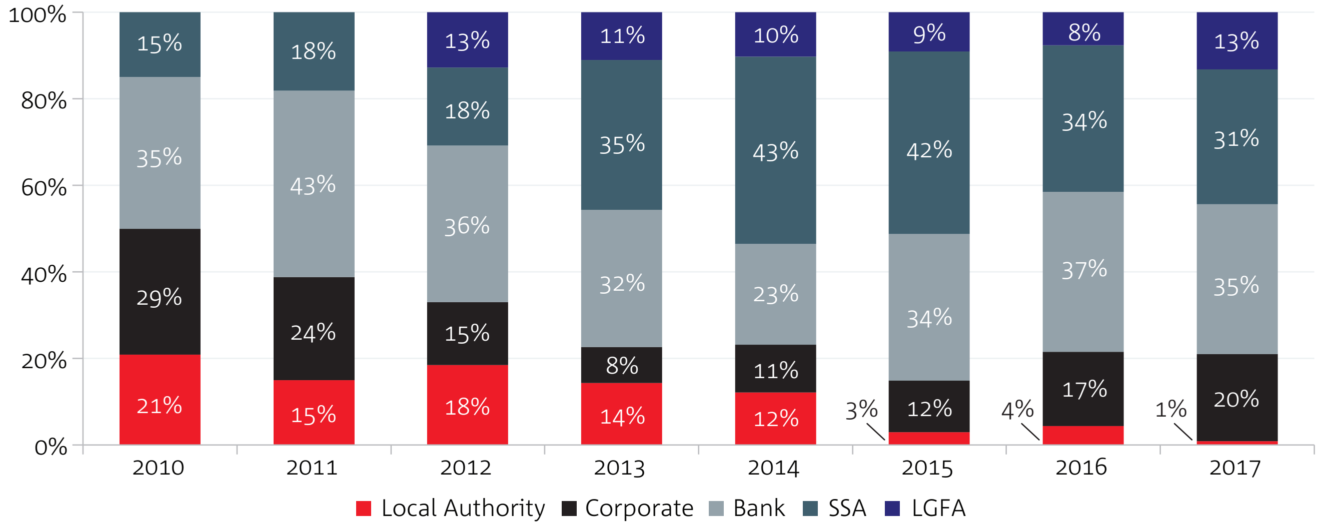
In July this year, International Finance Corporation ('IFC') printed NZ$125 million of 10 year green Kauri bonds - the first green bond in the NZ market. The deal was the first Kauri 10-year to be issued by a Washington-based supranational, demonstrating the additional push green issuance can provide. BNZ acted as Arranger and Joint Lead Manager on the transaction highlighting the market leading expertise BNZ and NAB possess in ESG bond issuance. IFC launched its green bond programme in 2010 and has since issued approximately NZ$12 billion in green bonds across 12 currencies. Proceeds of these green bonds are allocated to lending operations for climate related projects in the areas of renewable energy, energy efficiency, resource efficiency, cleaner technology production, financial intermediaries and sustainable forestry.

The positive feedback IFC received in the media and capital markets community highlights the reputational benefits associated with green issuance. BNZ continues to be very active in exploring green issuance with SSAs and domestic issuers. Issuers are making tentative steps, and we hope to see strong development in this part of the market over time.

Another year of strength in the corporate retail market

It has been another year of strength in the NZ corporate market. Corporate issuance has accounted for 20% of total issuance, up from 17% in 2016, and 12% in 2015. Pricing and demand outcomes have been particularly strong, with a diverse range of issuance formats being utilised. Notably, Genesis Energy and Precinct Properties NZ issued subordinated bonds which were met with particularly strong demand. Genesis (BBB+) issued a ratings equity credit focussed hybrid, and Precinct (NR) a mandatory convertible note, once again demonstrating that although NZ's market is small on a global stage, it can deliver all types of structures for issuers.

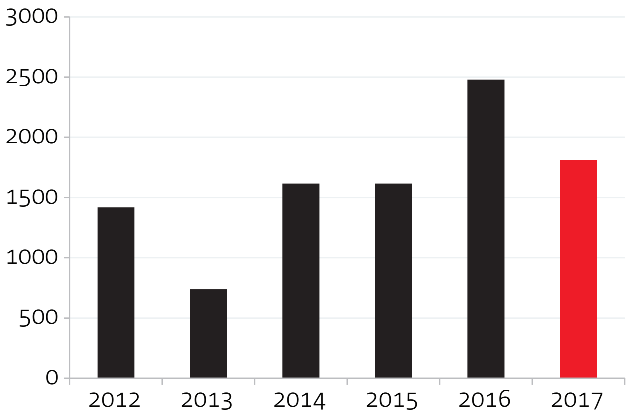
Historical issuance by issuer type



Source: BNZ Markets

The use of the Quoted Financial Product ('QFP') exemption for issuance to retail investors has become standard in the NZ market. This allows issuers to issue retail bonds with key terms but without the need for PDS documentation once they have a similar listed bond on issue. The increased speed to market that the QFP format affords has cut cost and management time, but most significantly it has allowed issuers to be much more opportunistic in capturing market windows.

Total corporate issuance (1 Jan – 15 Nov)



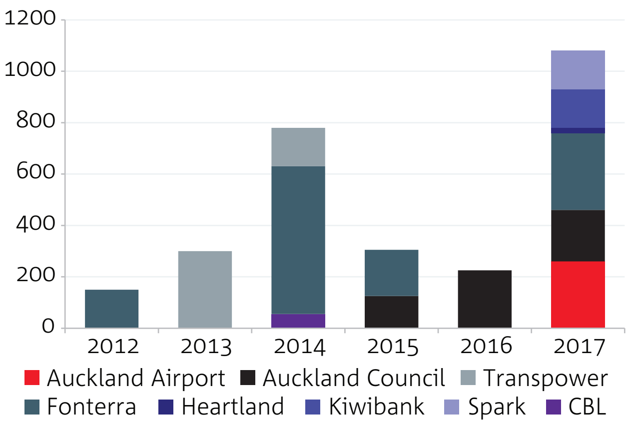
Source: BNZ Markets

NZ A rated corporates enjoy supportive conditions in A$ market

Substantial tailwinds in the A$MTN market has seen a bumper year of AUD issuance by NZ issuers. Notably, there was A$710 million of issuance in October alone as Auckland International Airport (A-), Fonterra (A-) and Spark (A-) successfully priced ~10yr AUD trades.

This was driven by attractive pricing levels relative to the NZ market, and the 10 year tenors on offer in the AUD market - which is longer than the tenor routinely available in benchmark size in New Zealand, enabled issuers to lengthen the duration of their debt portfolios.

Historical AUD issuance by NZ issuers



Source: BNZ Markets

High competition for term deposits

Competition for term deposits amongst NZ banks has been fierce, pushing 5 year term deposit rates as high as 4.30%. This represents a structural change in the NZ market, which we expect to continue. It has had a material impact on primary issuance activity, with retail investors seeing 4.50% as an effective yield floor for BBB rated corporate issuance.

INFRASTRUCTURE FINANCE *in Europe*

NAB is a keen supporter of the trend towards customer-centric infrastructure.

Nick Woolfitt

In most ways 2017 is an odd year to write a retrospective on the last decade, particularly in Europe and particularly from a financier's perspective. It was in the memorably wet and cold summer of 2007 that Northern Rock blocked withdrawals and thereby became the first bank in 140 years in the United Kingdom to endure a bank run. As we now know this was among the first signs of the near-collapse of a significant part of the financial system, the event which has since led to government bailouts, austerity, large scale unemployment and a rise in political populism. The last decade generally hasn't been a happy one, especially in Europe.

Transport

However, later in 2007 a key event in infrastructure delivery occurred. In November 2007 the previously derelict (and very nearly demolished) St Pancras Station was repurposed as the London terminus for High Speed One, the English leg of the cross-channel rail link. After a couple of decades connecting the dirty, overcrowded Waterloo Station with the dirty, overcrowded Gare du Nord, transiting St Pancras station was a revelation to cross-channel rail passengers. It was beautiful.

The successful redevelopment of St Pancras has been a Eureka moment for the transport infrastructure sector globally. Since then, Network Rail has redeveloped the adjacent King's Cross Station. Providing people with a nice environment and high quality service puts them at ease and encourages them to both come back and to maximise their time in the station. For that constituency of rail passengers used to being treated as human cargo (which is a very substantial subset of rail passengers globally) this is a remarkable change to the state of affairs. That it is now being championed by Network Rail – a government body with its lineage from the state-owned behemoth of British Rail via the failed Railtrack – to stations like King's Cross illustrates the revolutionary change of mindset.

At the same time as St Pancras was sending its first Eurostar services to Paris and Brussels, the finishing touches were being made to Terminal 5 at Heathrow Airport, which opened in March 2008. In 2007, 48% of passengers rated Heathrow Airport "excellent" or "very good", not a surprise for those of us who recall walking miles of corridors with head-height ceilings in the old Terminals 1 and 2. Earlier this year that rating rose to 84%. Notably, the airport has been thriving commercially – the growth in passenger satisfaction has certainly not been at the cost of financial performance. If anything it has been a real driver of that performance.

Utilities

With the current focus on austerity, utilities have – reasonably enough – been looked on to deliver more for less. It is again worth looking at the transformation in these sectors that has resulted in a change in focus from merely delivering power, water and gas and extracting sewage without incident to one where this is done in a way that has full regard to customers. The transformation of the water industry has seen Ofwat confirm that, over an admittedly longer period than the last decade, "Customers are 5 times less likely to suffer from supply interruptions, 8 times less likely to suffer from sewer flooding, and 100 times less likely to have low pressure". The focus on the quality of the environment has seen water quality at beaches and rivers come more into focus – as a result two-thirds of the UK beaches have water quality classed as 'excellent' and fish numbers in the Thames have increased.

How people have been given their voice

This year is also the 10th birthday of the iPhone and the 11th birthday of Twitter. In the UK it's also the 10th anniversary of the digital terrestrial TV switchover – the combination of which led to "on demand" and the ability to demand coming together. Standards have been raised – it isn't good enough now for customers to be left in an information vacuum without a voice.

The importance of infrastructure for the people

It is not surprising that this change has been spearheaded from Europe. Europe remains the world's most active private infrastructure investment market, accounting for 275 transactions completed in the first half of 2017 (according to IJ Online). More notably it is at the leading edge of driving productivity improvements, dealing with the challenges of an ageing population and of climate change. As an affluent market where the access to infrastructure is taken for granted, Europe has maintained its position as an exemplar on the transition to a digital, environmentally sustainable and connected world.

At NAB we are a keen supporter of the trend towards customer-centric infrastructure. It ties together so many of the megatrends that underpin tomorrow's world – the increase of digitisation, new sources of capital as governments are constrained, responding to the ageing society and the role of infrastructure to stimulate productivity. Our presence in Europe is the perfect place to learn, develop and influence global trends that emerge from this market before disseminating this expertise more widely. Despite a lean decade Europe continues to be the leading infrastructure market globally and one to which NAB is very much committed.

EUROPEAN ENERGY SECTOR – SPEARHEADING *the transition*

The transformation to a low-carbon economy is gathering pace.

Adam Coxhead

The energy sector in many countries globally is going through transformational change as the transition to a low carbon economy gains momentum – from the perspective of NAB's London-based European Energy business, 2017 was clearly a year in which this transformation gathered pace and some of the emerging trends became clearer.

The energy system in Great Britain is a leading example of the trend towards decarbonisation, decentralisation and digitalisation. The effect of these trends is pronounced in the Great Britain market due to there being a strong focus on decarbonisation and limited interconnection with other markets. In April this year the UK experienced its first day where electricity demand was satisfied without any coal fired power since the industrial revolution and then for the month of July just 2% of the UK's electricity needs came from coal generation, the lowest level in 135 years and sharply down from over 50% as recently as 2012, whilst contribution from renewables hit c.30% in Q2 2017.

Steep cost declines drive a one-way trend

Ongoing subsidy auctions in the UK, Germany, the Netherlands, France and Spain have delivered outcomes indicating renewables are close to or at grid parity in many countries. The German auction for offshore wind in April saw the astonishing result of zero subsidy offshore wind being bid for delivery in 2025, with bids reliant on significant increase in the size of turbines being deployed (up to 15MW from 8MW today). In the UK, the September CfD auction result saw the clearing price for offshore wind fall by 50% from the prior auction 2.5 years earlier.

We have also seen clear signs of investment activity in development of subsidy free renewables, with Anesco commissioning the UK's first subsidy-free solar and storage (Li-ion battery) site, NextEnergy's listed solar yieldco investing in a 62MW portfolio of development sites, a significant pipeline of onshore wind still under development in Scotland (and some hoping for re-introduction of CfD eligibility) and the largest solar park in the UK (a gigantic 350MW) being proposed on a subsidy free basis. These projects will need to contract their offtake either through Corporate PPAs, which are starting to re-emerge but for which supply is nowhere near meeting demand, or through long term utility PPAs, where lender-friendly fixed price periods tend to be relatively short (3-7 years) and floor price arrangements are not what they once were. Challenges remain but some developers and investors are confident that subsidy free projects are deliverable within 12-24 months.

The rise of flexibility

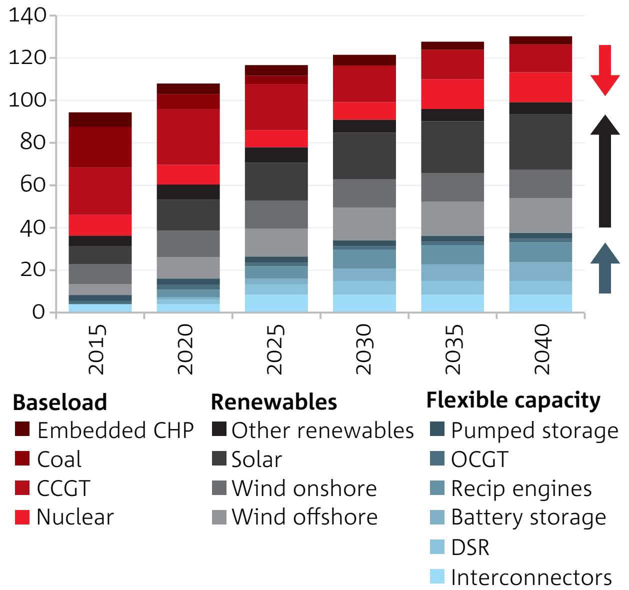
The drive to decarbonise the power sector is resulting in lower levels of baseload generation, increasing intermittent generation and increasing need for flexible generation (peaking capacity and storage). Delivery is being underpinned by the design of capacity, ancillary services and balancing markets to ensure there is a sufficient capacity margin to avoid blackouts.

In the Great Britain market, three key technologies are expected by market experts to capture growth in demand for flexibility: peaking plants (primarily gas reciprocating engines, which are becoming established as the main flexible technology because they are efficient and have relatively low emissions); storage, which given there's limited opportunity to develop new pumped storage capacity is leading to development of more utility scale lithium ion batteries; and demand side response, which is still in relative infancy.

With business cases under-pinned by capacity market contracts, ancillary service contracts with the grid operator and embedded benefits in various forms (some of the disappearing variety), there have been a number of platform companies that have successfully built substantial portfolios of flexible capacity assets in a relatively short period of time. 2017 has seen a number of M&A transactions in this space, with a few of these larger businesses currently in play (at time of writing).

Whilst there is a degree of long term contracting through the capacity market (if new build), this is a relatively minor portion of the overall revenue profile and investors are looking to take a view on the increasing importance of flexible assets to the evolving power system and investors' ability to monetise that value through renewal of shorter dated ancillary service contracts as well as the more merchant energy optimisation/price arbitrage revenue streams available. This comes back to fundamental analysis of the inherent value of flexible generation in a market place with increasing levels of intermittent generation and higher price volatility resulting from that. As a result, there are a range of investors interested in this flexible generation asset class: from earlier stage PE style investors, we are starting to see increasing interest from more traditional infrastructure investors who see this asset class as part of an evolving energy mix to balance out their energy investment portfolio.

Great Britain Capacity (GW)



Source: Aurora Energy Research

Capital inflows continue apace

Renewable energy is now clearly a mainstream infrastructure investment, with most managers targeting a meaningful allocation to renewables in their portfolios. This continues to drive a high level of M&A activity in a number of European countries, notably in the UK, as developers and early stage investors seek to recycle capital or realise value in their developments at a point when valuations are very attractive. The listed yieldcos in the UK, now with a total market capitalisation of £4.1 billion, are finding competition intense as consolidation of the market continues and they compete with other major investors managing private pools of capital or strategic offshore investors. Some are sticking to their original strategy of UK focus but others are choosing to widen their mandates and seek opportunities offshore in Europe and Australia.

In debt markets, an increasing volume of institutional capital in renewable energy is seeing very competitive financing terms on offer and more innovation in financing structures with many examples of different bank/institutional hybrid financings being implemented. NAB sees its role evolving from providing traditional project finance loans, which we still see demand for, to also assisting borrowers to access different pools of institutional debt capital depending on their specific requirements and providing facilities that complement those provided by institutional lenders.

EMBRACING PUBLIC PARTNERSHIPS – A SOLUTION FOR *local governments*

Local governments should look to the PPP model successfully used at the Federal and State Government levels to provide much-needed infrastructure in their communities.

Phillip Mak and Stephen Land

Local governments across Australia are faced with the challenge of maintaining and renewing infrastructure for their growing communities, particularly in the high growth corridor in East and Southeast Australia. As population growth continues and expectations are raised, many are faced with ageing infrastructure assets with increasing maintenance costs and a backlog for providing new or refurbished amenities.

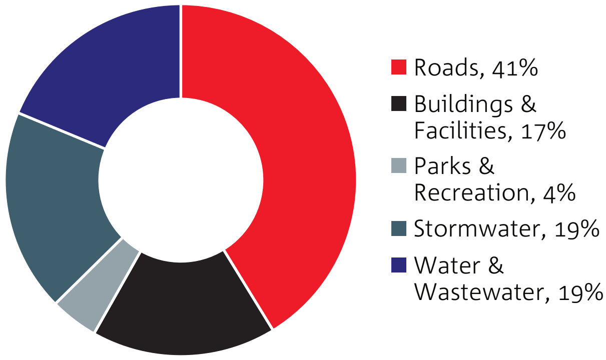
Local governments are administrated under state legislation. For example, in NSW the governing legislation is the Local Government Act 1993. Councils generally are responsible for delivering local services such as community development programs, assessing development applications, collecting rubbish and recycling, processing rates, fees and other charges, and running community facilities.

Local infrastructure isn't meeting the needs of the community

Infrastructure in local communities provides access to economic and social facilities which enhance everyday life. It can include transport such as road and bridge upgrades and carparks, sport and leisure centres, libraries, seniors centres and water services.

In many cases Councils have large balance sheets with assets that are have the potential to be better utilised to deliver the best financial outcome for their communities. The Australian Local Government Association's report in 2015 State of the Assets revealed Australian Councils collectively manage A$438 billion of infrastructure assets. An estimated 7% or A$31 billion of these assets are in need of upgrading to meet current demand.

Breakdown of infrastructure assets



Source: Australian Local Government Association 'State of the Assets' (2015)

There hasn't been an audit conducted since then, but anecdotal evidence suggests that the problem has got worse, as population growth and rate capping have constrained the options that councils have to provide these essential works.

One funding option utilised in NSW was the Local Infrastructure Renewal Scheme. NSW Treasury offered interest subsidies through three rounds of the scheme, which was used to fund $818 million of infrastructure projects across 96 councils for 166 projects. Such schemes are useful but aren't enduring sources of funding ongoing infrastructure needs.

Councils are open to new funding models to solve the infrastructure backlog. Where available to local governments, NAB is actively meeting local governments with the aim of providing better infrastructure solutions via the PPP model.

PPPs provide optionality to councils

Where governing legislation permits local governments to utilise public-private partnerships (PPPs), such as in NSW, PPPs can give Councils a robust structure in which to procure infrastructure projects that they may otherwise delay or be unable to raise private sector financing for.

A PPP with a 25 or 30-year concession allows the private sector to bring innovation and design, cost rigour and bid competitiveness to the process with no upfront payments required from Council. The asset is then managed under a contracted performance regime which the private sector must meet, otherwise the concession may be abated. The asset is handed back to the Council at the end of the concession in an agreed handover condition, having been maintained adequately over the concession.

A key advantage of PPPs is budgetary certainty. The long concession period may allow, if permitted by governing legislation, local governments to raise a levy over this period to meet the service payments, rather than having to seek a one-off upfront capital injection which they are often under pressure to repay within a short period.

Risk transfer is also a significant benefit under the PPP model. Local governments may be able to transfer the risk of cost overruns during construction or the pricing of maintenance during operations, so that such risks are borne by the private sector. The ongoing maintenance and operational risks can also be transferred to the private sector.

Local governments can take advantage of PPP guidelines released by the NSW Government earlier this year. These provide a toolbox of more than 60 document templates which may help to reduce bid costs and streamline the transaction process.

Asset recycling is a real opportunity

Where governing legislation permits, a real opportunity may exist to monetise existing assets through an asset recycling program. This could replicate on a smaller scale recent successes at the State Government level such as NSW's privatisation of its electricity transmission and distribution network which netted $23 billion, and Victoria's $9.7 billion long-term lease of Port of Melbourne. Proceeds from recycled assets can then be used to fund new infrastructure projects. For example, the Council could let a long term lease over a piece of land or a car park development. The developer would then charge for parking, with the whole car park handed back to Council at the end of the concession.

NAB's activities in meeting with local Councils and other stakeholders to further this strategy is linked to our identified trend of evolving government, where new and innovative models of funding and procurement are employed to deliver outcomes, or, in this case, where established models of funding and procurement are adapted to a new context.

AVIATION FINANCE *overview*

Global air traffic and demand for aircraft stays strong in 2017.

Greg Hampton, Jackson Flint and Alistair Monk

Since 2011, NAB has originated approximately US$4 billion of new lending volume in the in the aircraft finance sector, participating in the financing of about 400 aircraft to nearly 100 airlines in c.50 countries around the world.

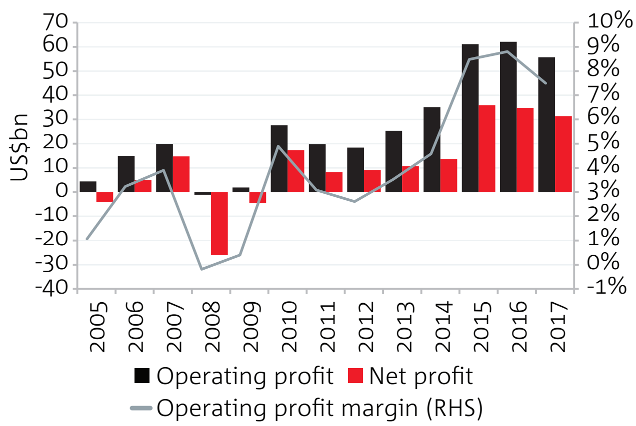
Importantly, and increasingly, a significant portion of NAB's financing is directed towards new-generation aircraft, such as Airbus' A320neo and A350 families and Boeing's 737-MAX and 787 families, which are greener, cleaner and quieter than the aircraft models they are replacing. During 2017 NAB participated in its first financing of an A320neo and Boeing 737-MAX aircraft, as well as its 12th Airbus A350 and 34th Boeing 787. NAB intends to continue expanding its financing for these next-generation aircraft types to support the industry's long-term sustainable growth.

Favourable aviation industry fundamentals continued throughout 2017 as global air traffic grew strongly, which boosted demand for aircraft, and airlines and aircraft lessors exhibited generally high levels of profitability. This robust backdrop is driving new financier and investor participation from regions around the world and competitive pricing for buyers of large commercial aircraft. The aircraft finance industry remains in a healthy state, with ample liquidity, a wide and growing range of aircraft funding options, and an overall positive outlook for the next few years.

NAB believes the increased interest in aircraft finance from investors has three parts to it:

1. **Steady value and cash flow properties:** Aircraft are generally durable, standardised products, flexible in deployment and limited in supply. Aircraft values have been proven to be generally stable through-the-cycle. Leasing aircraft via long-term operating leases provides for steady and stable cash flows.
2. **Airline profitability:** Airlines in recent years have generally been recording historically high levels of earnings, which lowers underlying credit risk.
3. **Growth sector:** As the diversity of aircraft funding sources grows and as more investment enters the sector, investors are becoming increasingly aware of aircraft as an asset class.

Airline industry profitability (2005-2017F)

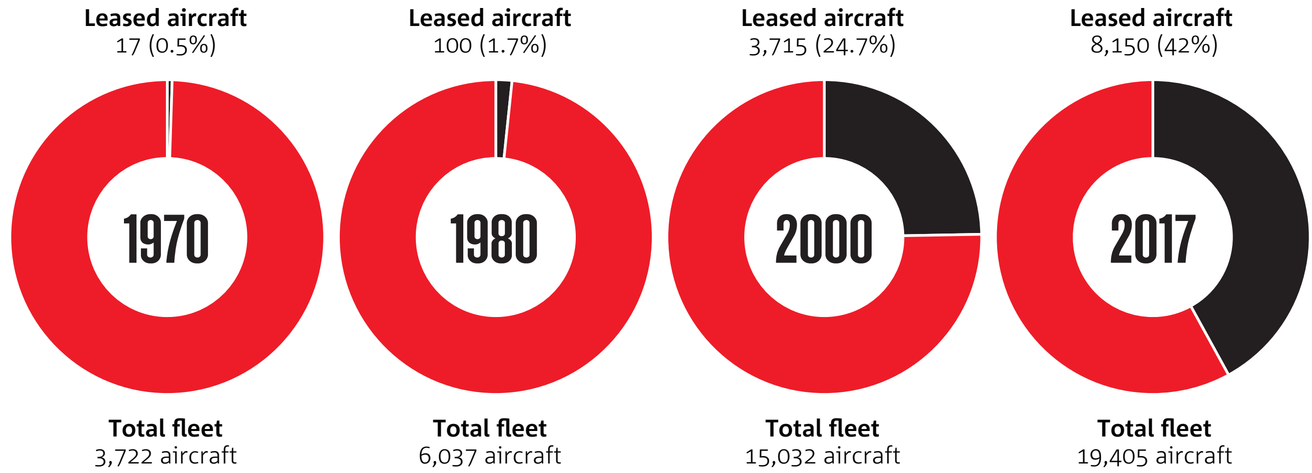


Source: IATA

A defining trend in commercial aviation has been the rise of aircraft leasing over the past three decades. Much of the new financing entering the industry has been directed towards aircraft operating lessors, which are specialist companies that own, lease and actively manage aircraft. Since its beginnings in the early 1970s, the growth of the aircraft leasing market has outpaced that of the global aircraft fleet over the same period. In the 1970s leased aircraft accounted for less than 1% of the global aircraft fleet. Today, leased aircraft represent about 42% of the global fleet, and aircraft leasing continues to grow in both size and importance.

Operating leasing of aircraft increasingly constitutes an important financing alternative for airlines. By leasing a portion of their fleet, airlines are able to improve their liquidity position and their balance sheet. In the face of high competition, most airlines are attempting to finance their aircraft fleet while maintaining as much liquidity as possible.

Total number of leased aircraft and total fleet size between 1970 - 2017



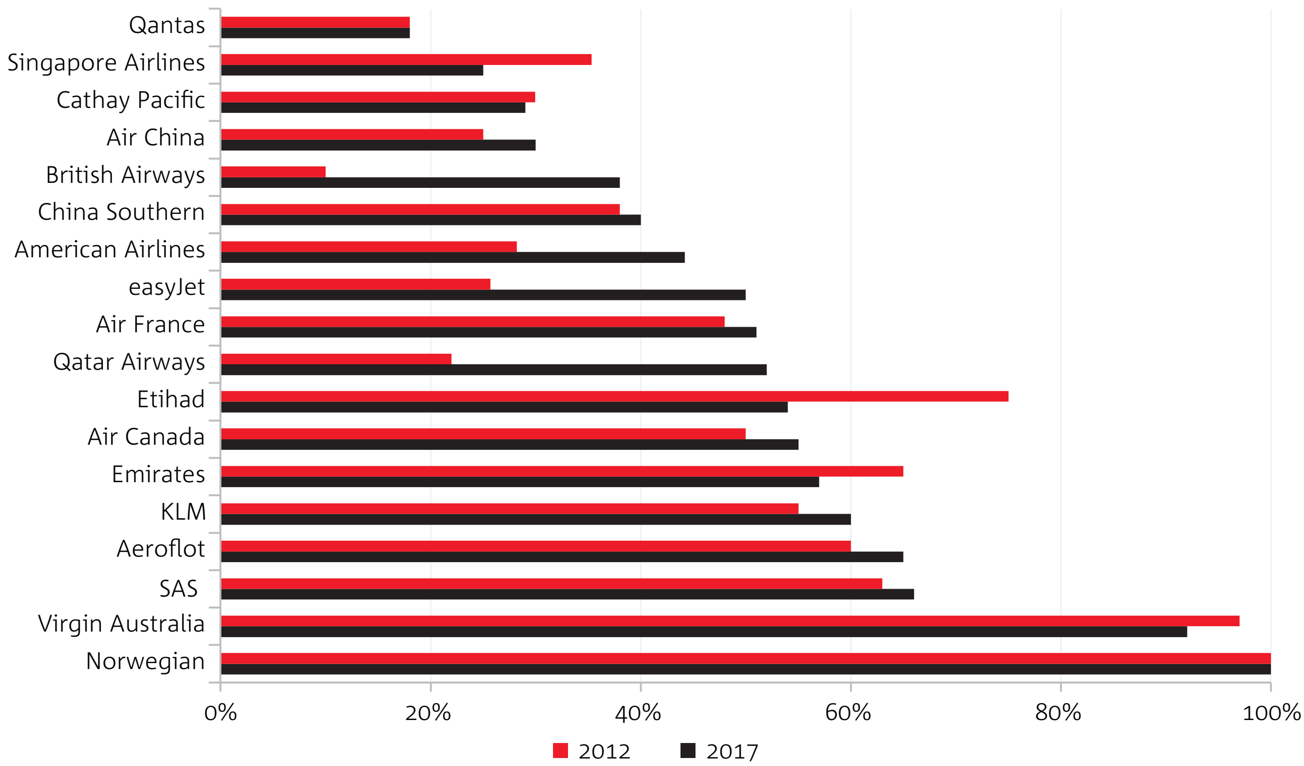
Source: Boeing

It allows airlines to respond to short- and medium-term fluctuations in demand without having to make capital-intensive investments in aircraft.

Major airlines are generally making increasing use of the operating lease product. Aircraft lessors account for an increasing portion of the manufacturers' order books and their share of the overall global fleet is expected to continue to climb steadily.

In 2017, the aircraft leasing industry saw the continuance of recent trends, including industry consolidation, frequent portfolio turnover, high use of bank debt and increasing use of capital markets (including the lessors issuing large volumes of asset (aircraft)-backed securities (ABS) and unsecured bonds) and the spread of innovative structures that have seen public capital markets being used as a source of equity.

Estimated percentage of fleet on operating lease



Source: Airline Financial Reports, NAB estimates

Large financial institutions from China and the Middle East, which remain keen to expand outside of their home markets and increase their exposure to long-term, cash-generative and US dollar-denominated assets, emerged further onto the aircraft finance stage during 2017. The strong growth in aircraft financing supply from China and the Middle East region mirrors the growth of the aviation in each region. Chinese financial institutions now own three of the world's 10 largest aircraft lessors and Emirates has grown to become the world's largest international airline and Dubai the world's largest international airport.

NAB conducts the bulk of its aviation financing activity via aircraft lessors. The merits of this financing model were on display during 2017, an eventful year that saw the high-profile insolvencies of several airlines in Europe: Alitalia, Air Berlin and Monarch Airlines. As usual, aircraft leasing companies acted decisively following the Air Berlin and Monarch insolvencies (Alitalia continues to operate), both of whom leased the majority of their fleets. Following the Air Berlin and Monarch insolvencies in August and October 2017 respectively, the various lessors with exposure to the two airlines quickly secured control of their aircraft, re-marketed and then re-leased their aircraft.

Unsurprisingly, many banks are using lessor financing as a low-risk entry point into the aviation finance space. Lessors' actions following the Air Berlin and Monarch insolvencies not only highlight the strong demand for aircraft but also the expertise of aircraft lessors' platform in moving aircraft, and the value for lenders and investors in partnering with lessors. NAB believes that lessors are well-placed to continue attracting investment from investors who increasingly see the diversification benefits of partnering with specialist lessors that have a wide mix of airlines and aircraft types in their portfolio, and the capability to actively manage aircraft to ensure they continue to generate cash flows.

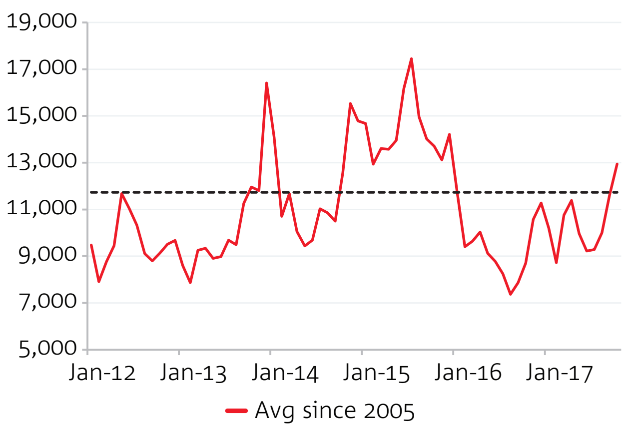
SHIPPING FINANCE *review*

Higher demand for commodities supports a recovery in freight markets.

Greg Hampton, Geir Bakkelund and Angele Davis

While one year is a short period in a vessel's life, a lot can change in the global freight markets for commercial vessels. Clarksons Platou, a leading ship broking firm, tracks earnings across all sectors in a weighted average index called ClarkSea. Towards the end of last year the index was at a five year low. Since then earnings have increased more than 70% and have now surpassed the five year average.

ClarkSea Index



Source: Clarksons Research

So what has happened?

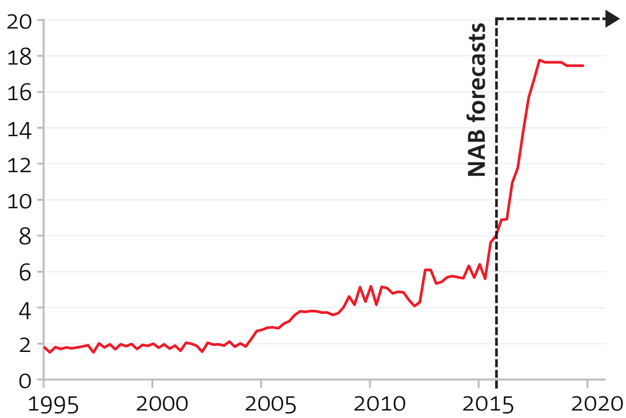
The lion's share of the improvement has come from the dry bulk sector which includes more than 11,000 vessels on water. Since early 2016, the dry bulk sector has seen earnings almost quadruple which shows the sector recovered quickly from its February 2016 lows. We attribute this improvement to a higher demand for commodities combined with low fleet growth, meaning we had higher demand for sea transport than there were vessels on water. As a result, the dry bulk segment saw earnings returning to more sustainable levels.

What does this mean to us?

In an Australian context, substantially all of our imports and exports travel by sea. At present, Australia ranks alongside Qatar as the largest exporters of LNG, a cleaner-burning energy source relative to oil and coal. In this regard, Australia is playing an integral role in the transition towards a low-carbon economy, and shipping is the means through which Australian LNG reaches the global market.

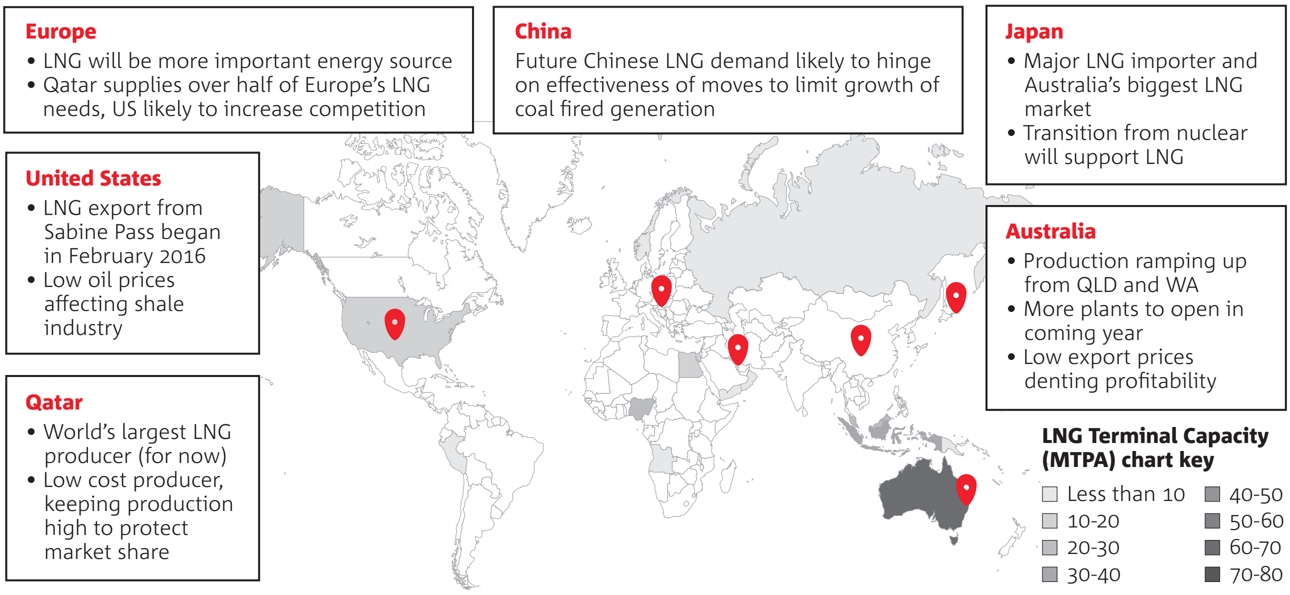
Australia's role in this market is expected to continue to grow over the next 12 months with a forward-looking expectation that Australian exports will account for more than 35% of total seaborne LNG trade. NAB Group Economics forecasts that by the end of 2017, Australia will export ~64 million tonnes of LNG and by 2018, will export over 70 million tonnes. Our plentiful supply of natural gas coupled with proximity to the developing markets in Asia means we are well placed to service the growing gas demand from our Asian neighbours.

Australian LNG export volume (million tonnes per quarter)



Source: Bloomberg, Poten & Partners, APPEA, Department of Industry, Australian Bureau of Statistics Oxford Institute for Energy Studies and NAB Group Economics

Global LNG capacity



Source: Oxford Institute for Energy Studies and NAB Group Economics

How does NAB help?

In addition to NAB's role financing LNG projects, NAB supports the financing of LNG vessels. At the time of writing, 43% of our shipping finance book was comprised of LNG vessels. NAB's selective entry into this market has enabled us to build strong and meaningful relationships with the top players in our chosen segments including LNG shipping companies such as GasLog Limited.

NAB has continued to take this measured approach in our entry into other shipping segments with our breadth now covering both industrial and energy vessel finance. This means that NAB financed vessels that carry the likes of commodities, oil, LNG, LPG and cars. The NAB vessel portfolio now sits at US$1.16 billion with continued growth prospects up to US$2.25 billion.

Looking forward to 2018, scheduled deliveries across the shipping market equate to 5% of the current fleet. Assuming a ship has 25 years of operating life, deliveries over the next 12 months will only be sufficient to cover replacements and net growth will be insignificant. Meanwhile, population, economic and trade growth should continue to increase vessel demand. Whilst we are unable to predict what will happen in each of the underlying shipping segments, we do know that over the past 5 years, both the world economy and seaborne trade in tonne-miles grew by an average of 3.4%. Going forward, NAB Group Economics forecasts 2018 world GDP to grow at a rate of 3.6%.

Other long term initiatives will also contribute to fleet growth and modernisation. Most notable is the International Maritime Organisation's decision to enforce a sulphur emission cap from January 2020. This cap will require vessel owners to be more accountable in terms of fuel emissions (via either burning cleaner fuel or by installing scrubbers to clean the exhaust). These changes will continue to improve the environmental footprint of the shipping industry and will also provide a competitive advantage for NAB's shipping customers who typically own and operate a modern vessel fleet.

We look forward to our continued partnership with these customers and will continue to provide vessel financing for these modern and more efficient fleets.

US$ REG S COMES OF AGE *in Asia Pacific*

The regional US$ Reg S bond market is fast emerging as one of the most promising from both the issuer and investor perspectives.

Jacqueline Fox, Melissa Gribble and Lorna Greene

The rapid development of Asia Pacific's debt capital markets, as institutions and corporates gear up to serve the region's growing economies, is creating a wealth of opportunities for issuers and investors alike. This paper focuses on one of the most dynamic — US$ denominated Regulation S (US$ Reg S) bonds[1]. These are offered to investors outside the United States, as opposed to Rule 144A issuances, which are sold to qualified US institutional buyers.

This market will continue to flourish as it acts as a channel for the region's rising prosperity. Asia's macroeconomic environment is shifting as wealth migrates from the West to the East and the middle class continues to grow. In addition, global quantitative easing (QE) is driving Asian investors' hunt for yield at a time when Chinese companies are adopting an international focus.

This year, total regional US$ Reg S issuance exceeded US$150 billion as at the end of September 2017, according to NAB data. That far exceeds the 2016 full-year figure of US$130 billion and represents over double the total for 2012.

The largest contributor to the growth of the Asia Pacific US$ Reg S market is the region's largest economy: China. China is the main source of issuance for US$ bond[2] in Asia, accounting as of September 2017 for 66% of total regional US$ Reg S issuance for the year, according to NAB. Chinese investors, including institutions, high net worth individuals and retail investors, also play a major role in the market as buyers of US$ Reg S debt.

Why US$ REG S?

The overall vibrancy and diversity of Asia Pacific bond markets provides a number of routes for potential issuers. Each of these has advantages and drawbacks, and some bond programs combine several.

Private placements, for example, can generally be executed more quickly and at a lower cost. Sterling and euro issuances are natural means to access investment from those regions.

Asia's local currency bond market also continues to demonstrate robust growth, with the corporate segment in emerging East Asia expanding 1.5% year on year in the first quarter of 2017 to almost US$3.7 trillion[3]. Local currency bonds offer investors the potential for additional currency gains, but also the possibility of additional volatility that limit their appeal to risk-averse investors.

US$-denominated issuance is typically the first choice and the biggest market for Asia Pacific issuers and investors, given its unmatched liquidity, supported by the dollar's status as the world's reserve currency.

The US$ Reg S advantage

Would-be dollar issuers have the choice of US$ Reg S or 144A issuance, or combining both, to reach the widest possible range of investors. Nonetheless the US$ Reg S-only format has emerged as a particularly attractive option for several reasons.

Firstly, the ability to access US investors comes with significant costs in terms of documentation and compliance. For Australian issuers, the US$ Reg S market is the easiest way to access offshore liquidity as many have established EMTN (Euro medium term note) programs and there are no additional documentation requirements for US$ Reg S issuance. The 144A market also requires additional covenants in the documentation which would allow the bonds to be sold to the US investor base. It's easier and cheaper for Asia Pacific issuers to access dollars via the US$ Reg S-only market.

[1] For the purposes of this paper, '144A' bonds refers to those issued in Rule 144A format only; 'Reg S' to those issued in Reg S only, and '144A/Reg S' to those issued in both formats. While Reg S bonds can be issued in a range of currencies, this paper focuses on US$-denominated (US$) Reg S issuance.
[2] The US$ bonds refer to bonds issued in both 144A/Reg S and US$ Reg S formats. China issuers' market share in US$ Reg S-only issuance is 70%.
[3] Asian Bonds Online 2017, retrieved from https://asianbondsonline.adb.org/documents/abm_jun_2017.pdf.

Secondly, in the past, bypassing the US market could have serious consequences for demand and deal sizes, but Asia's more prominent global role means this is no longer necessarily the case.

Now you can come to this market and achieve benchmark-sized volume. That's been the main advantage of the recent change and growth of liquidity in the region. The other advantage of the US$ Reg S market is that Asian investors are a bit more open to considering new credits and debut issuers.

The case for Australian US$ Reg S issuance

The market's growing depth and relative openness has convinced more Australian issuers, many of which were previously focused on the domestic dollar market, to explore US$ Reg S funding — which can also offer diversification and cost benefits, depending on the type of issuance.

For issuers targeting longer-dated funding, out to the 10-year point of the curve, the strong demand from the Asian investor base for those tenors and for Australian credit in general means they achieve more attractive pricing than if they went to the 144A/Reg S market.

The strength of the region's appetite also means it is increasingly Asia that sets the tone for global transactions.

Recent NAB data confirms the rising interest in US$ Reg S issuance among Australian corporates, with total issuance more than doubling from US$775 million for all of 2016 — the first year Australian firms accessed the market — to US$1.6 billion in the first nine months of 2017 alone. With Australian borrowers accounting for just 1% of the US$ Reg S market, there is ample room for growth, and that proportion is expected to rise to 2-3% by 2018.

Get to know your investors

As the regional US$ Reg S opportunity evolves, more potential issuers will be wondering how to approach the market. Australian issuers begin with a few natural advantages. Rapidly developing regional ties mean many Asian investors are already participants in the domestic Australian bond market and already have a degree of familiarity with Australian names. This creates a 'natural flow' of investors following these names into the US$ Reg S market.

Australia's strong legal and regulatory environment, and the generally high ratings and positive prospects for risk-adjusted returns on Australian assets, also make these assets attractive to Asian investors.

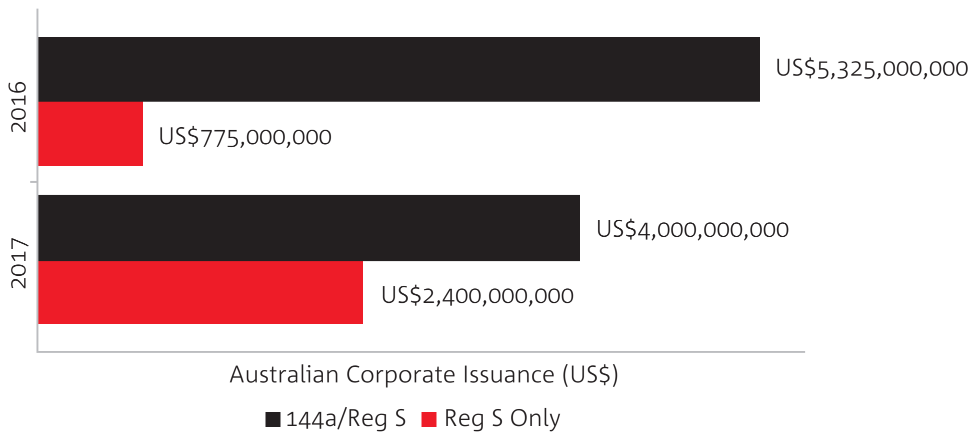
The broadest part of the Asian investor base is institutional, with commercial banks and asset managers in China, Hong Kong, Taiwan and Singapore, and insurance companies in Taiwan, Japan and Singapore among the main market actors. Some residual demand comes from banks in markets like Japan and South Korea. This mix tends to drive demand for longer-dated deals.

Future prospects

The 40-50% expansion rates seen in the Asia Pacific US$ Reg S market in recent years are likely to moderate as the market normalises. However given the region's strong economic growth forecasts and the funding needed by the infrastructure sector, NAB is still anticipating annual growth rates of 20% from 2017 onwards.

The pressing need to fund regional infrastructure under programmes such as China's Belt and Road Initiative (BRI) will be a major future driver of Asia Pacific US$ Reg S issuance, which is also likely to include more green and social bonds to meet rising appetite for sustainable assets.

Australia US$ Reg S-only issuance, 2016-2017*



NAB expects the proportion of Australian issuers will rise to **2-3%** in regional US$ Reg S market by 2018.

* As of October 2017
Source: Dealogic, National Australia Bank

SUSTAINABLE CAPITAL *markets*

Backing the bold to address the big social and environmental challenges.

David Jenkins and Jacqueline Fox

At NAB our goal is to make a positive impact on the lives of our customers, people, shareholders, communities, and the environment in which we operate. We do this by backing the bold who move Australia forward in economic, social and environmental terms. As part of this NAB recently updated our November 2015 climate change commitments including:

- Increasing NAB's environmental financing commitment from A$18 billion by 2022, to $55 billion by 2025 (between FY2016 – FY2025)
- Seeking to innovate across all of our key sectors and markets, supporting low carbon opportunities for our customers

Developing sustainable capital markets issuance is one way NAB continues to innovate and help our customers develop products and solutions to address big social and environmental challenges such as climate change.

Australian bond markets have seen a leap in sustainability themed bond issuance through 2017, from growing numbers of issuers across a range of markets including $A MTN, EMTN, US$ Reg S and USPP. In the Australian domestic markets alone, 11 deals had closed by the end of October 2017 raising $3.2 billion. New Zealand also saw its first green bond with the IFC's NZ$125 million Green Bond issuance in July 2017.

NAB has had another active year working closely with our clients to bring several innovative and award winning transactions to public bond markets over 2017, including:

- **Australia's first social bond –** arranging and issuing the A$500 million NAB Social Bond (Gender Equality), the first issuance globally to focus on workplace gender equality and awarded 'Asia-Pacific Green/SRI Bond Deal of the Year' at the 2017 Global Capital - Sustainable & Responsible Capital Markets Awards
- **Australia's first sustainability bond** – arranging the A$200 million ACU Sustainability Bond, the world's first sustainability bond from a university, the first issued under the 2017 ICMA Sustainability Bond Guidelines and the first Australian bond aligned and mapped to the UN SDGs
- **Australia's first offshore bank green bond** – arranging and issuing the €500 million NAB Climate Bond, the first benchmark green bond to be issued offshore by an Australian bank
- **Australia's largest ever green bond** – joint lead manager on the A$750 million QTC Green Bond
- **Australia's second green securitisation** – the ABS Flexigroup ABS Trust 2017-1 Class A2-G green note
- **New Zealand's first green bond** – NAB arranged the NZ$125 million IFC green bond, the first green bond issued into the New Zealand market
- **Canada's largest ever green bon**d – joint lead manager on the US$1 billion TD Bank Green Bond, the first USD green bond from TD Bank and largest Canadian green bond to date

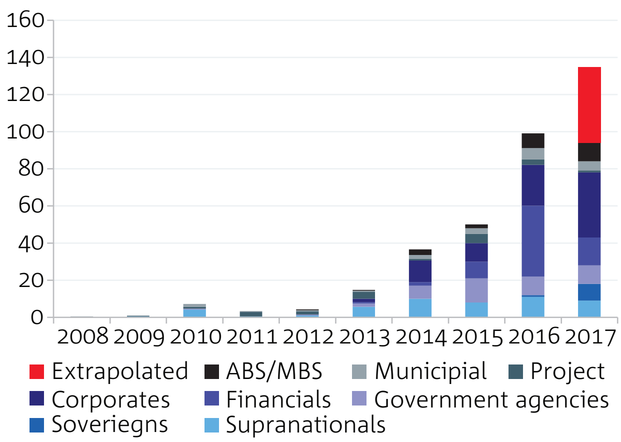
As with previous years, 2018 is shaping up to be an even more active year for Australian sustainable capital markets. Investor demand continues to grow, repeat issuance is expected, and new issuers continue to look to enter the market. NAB is also seeing an increasing focus on the SDGs and the opportunities this brings for both issuers and investors.

Our awards include the inaugural KangaNews Australian Sustainability Debt House of the Year 2017, the KangaNews Innovative Debt Deal of the Year 2017 for NAB's Social Bond (Gender Equity); and the 2017 Global Capital Sustainable and Responsible Capital Markets Award for Asia Pacific Green Bond deal of the year (NAB bond issue).

Globally, green bond issuance is on track for yet another record year with expectations for 2017 issuance of up to US$135 billion[1]. Corporate issuance has dominated 2017 issues as at the end of September. Key developments in global sustainable capital markets this year have included:

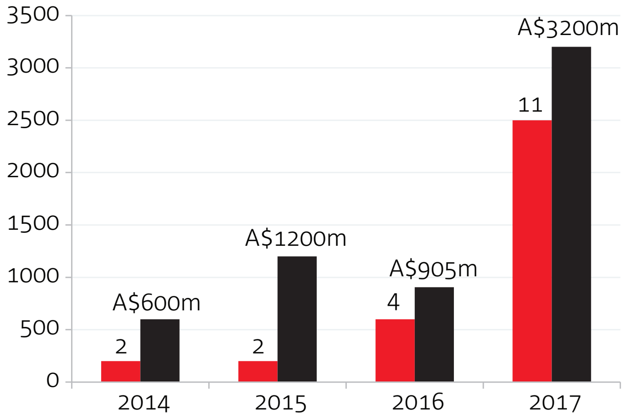
- The first sovereign green bond issuances led by Poland, France and recently Fiji
- Increasing diversity of green bond issuers with increasing corporate, city and sub-sovereign issuance
- Increasing diversity of green bond structures and formats across senior unsecured and subordinated, project bonds, equity linked notes, covered bonds, loans, securitisation, ETFs and Sukuk
- Country issuance led by China, America and European nations but with growing issuance from new markets such as India, Brazil, and South Africa
- The emergence of environmental impact bonds (EIBs) continued growth in investor demand driven by the inflows of SRI capital with strong levels of oversubscription and increased price tension the norm
- Increasing diversity in green bond use of proceeds, shifting away from renewable energy towards sustainable transport, green buildings and sustainable water projects
- Improving levels of post-issuance and impact reporting
- Move towards harmonisation of green bond guidelines
- Release of the ICMA Sustainability Bond Guidelines

Annual Green Bond issuance by issuer type ($bn)



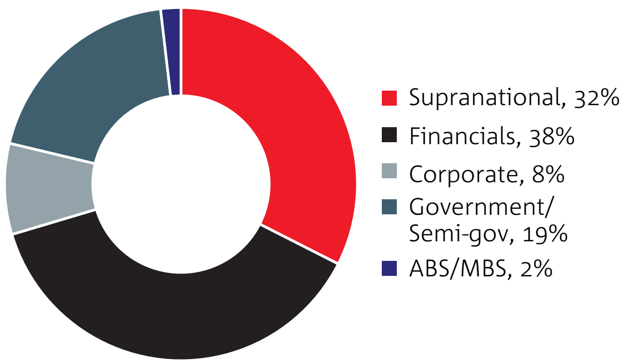
Source: Bloomberg New Energy Finance (BNEF). Green Bonds Monthly, September 2017

A$ Green, Social and Sustainability bond issuance



Source: NAB, as at 18 October 2017

A$ Green, Social and Sustainability bond issuers



Source: NAB, as at 18 October 2017

The United Nations Sustainable Development Goals

The Sustainable Development Goals (SDGs) were launched in 2015, an ambitious agenda outlining 17 goals targeting 169 outcomes for global sustainable development to be achieved by 2030. Focusing on three dimensions of global sustainable development (economic prosperity, social inclusion, and environmental sustainability), the SDGs act as a framework by which investors can assess the risks and investment opportunities, along with the positive real-world impact of their investments.

The UN Commission on Trade & Development (UNCTAD) estimates US$5 trillion to US$7 trillion is required each year until 2030 to meet the SDGs, with only US$1 trillion a year coming from the UN and member nations. This makes it critical for both companies and investors to re-allocate capital towards investments that contribute to the SDGs in order to fund this gap. This challenge applies equally to developing and developed nations.

[1] Bloomberg New Energy Finance (BNEF). Green Bonds Monthly, September 2017.

With such an ambitious agenda, the Principles for Responsible Investment ('PRI') have made a commitment to aligning responsible investors with the broader objectives of society, publishing 'The SDG Investment Case' in order to bridge the gap between the UN's targets and investment opportunities.

The SDGs have united the private sector, constructing a common language under which new products and solutions are being developed, providing an enormous growth opportunity for investors and the global economy. NAB continues to collaborate with our customers to develop new investable, SDG aligned, sustainable capital markets solutions to achieve this.

What's next in Sustainable Capital Markets?

The continued growth and inflow of private capital into socially responsible investment ('SRI') markets is expected to continue. The increasing use of the SDGs by investors and corporates alike is increasing levels of commitment to green and sustainable financing at both international and regional levels. NAB's continued collaboration, innovation and product evolution should only aid further development. The opportunities sustainable capital markets offer to borrowers are enormous and we expect 2018 to build on recent developments both domestically and abroad.

HOW BONDS ARE IMPROVING *gender equality*

In recent years, socially responsible investing has emerged as a hot-button topic.

James Waddell and Jacqueline Fox

Investors are increasingly eager to fund businesses making a positive impact rather than those that exacerbate the world's problems. Instead of relying solely on philanthropy or the government, people are turning to investment as a powerful tool to inspire global change.

NAB is leading the market with innovative products, such as the world's first social bond promoting workplace gender equality. Launched in March 2017, it finances organisations that are committed to improving women's representation and rights in the workplace.

"A really important impact of this social bond is to identify gender equality as a critical business issue and a critical sustainability issue," says Jackie Woods, Engagement Executive Manager at the Workplace Gender Equality Agency. "I think absolutely it builds momentum to promote change."

NAB was proud to receive the KangaNews award for Australian Innovative Debt Deal of the Year 2017 for this bond issue – an award that is voted for by our clients and peers in debt markets.

How it works

The bond proceeds were used to fund 14 companies that were cited as Employers of Choice for workplace gender equality by the federal government's Workplace Gender Equality Agency ('WGEA').

The initial portfolio includes Lend Lease, Mirvac and Stockland; KPMG and PwC; Monash University and others. It represents a combined asset value of A$1.08 billion and investors have contributed $500 million, which will go towards financing or refinancing these companies' assets.

In addition to applying positive screening based on gender credentials, the firms also underwent a negative screening process. This excludes companies implicated in environmental, social or governance controversies, or those primarily involved with alcohol, gambling, tobacco, and other controversial industries. The five-year fixed-rate bonds have attracted investors including superannuation funds and other investors from Australia, the United Kingdom, Hong Kong, Singapore, Switzerland, Korea and Taiwan that focus on socially responsible assets.

Why it's important

As one of the United Nations' Sustainable Development Goals, gender equality is a global imperative and a fundamental human right.

Australia still has a long way to go in resolving gender imbalances. According to the WGEA, the gender pay gap in Australia is currently at 15.3%. While women are becoming increasingly educated, making up 58.7% of graduates in undergraduate programs, they're less likely to be engaged in paid employment and are paid less than their male counterparts. Women perform more unpaid work than men in the form of childcare, elder care and housework.

There are also economic benefits to achieving gender equality. Research shows that companies with greater gender diversity in their leadership and across the business enjoy improved performance, productivity and reputations.

"What organisations are really interested in is how to be a better, stronger organisation," says Woods. "There's really a lot of research now... that if your workforce is dominated by one group, you're not going to be as productive and have this healthier culture as a workforce that is balanced and removes barriers to people's participation."

Impact

By launching the gender equality bond, NAB is reinforcing its commitment to creating an inclusive and diverse workforce which aligns with the values of its customers and shareholders. Using its status as an influential Australian corporation, NAB is making a public statement about the importance of gender equality, making it a business priority and encouraging other organisations to follow suit. The move will help empower working women and encourage their voices to be heard.

By rewarding companies that are committed to workplace gender equality, the bond is an important step in creating equal opportunities for women and striving towards a more balanced, fair and equitable Australian workforce.

As the first of its kind, the bond adds to the options available to the responsible investment industry. It provides a unique opportunity for investors to support a worthy cause and make a tangible impact on the world around them. Investors are taking note: the bond was named the Asia Pacific SRI/Green Bond of the year by Global Investor Magazine.

Looking towards the future, NAB will continue to be at the forefront of socially responsible investing, developing bonds that promote the advancement and empowerment of disadvantaged groups in the Australian community.

NEW APPROACHES TO *old problems*

Ethical investment options aim to address sustainability goals and help address social issues.

James Waddell and Jacqueline Fox

In today's world, the need for sustainability is becoming ever more evident. There is an urgent requirement for social and environmental change to preserve our quality of life for future generations and ensure the long-term survival of the natural environment. In response, investors are adopting a Socially Responsible Investing ('SRI') approach to investing, offering ethical investment alternatives that aim to address the challenges of these economic and social issues.

To meet this demand, NAB has developed a number of socially responsible investment options. For example, its inaugural Green Bond was launched in 2014, an A$300 million corporate bond that financed 17 renewable energy facilities, including wind and solar farms, across Australia. The bond prioritised environmental concerns alongside financial returns.

Continuing on this path, NAB has delivered Australia's first sustainability bond. Created in partnership with the Australian Catholic University (ACU), it is also the first in the world for a university. A sustainability bond is a hybrid of a green bond and social bond: its proceeds are used to finance or re-finance a combination of both Social and Green projects. The ACU bond is the first bond globally to align with the 2017 Sustainability Bond Guidelines set out by the International Capital Market Association.

This bond shows how positive outcomes for communities and our environment can be incorporated into business decision-making. It is a critical step forward for the responsible investments market. Growing numbers of investors want to act on social and environmental issues, and are looking for options that demonstrate impact; NAB is developing ways to make that happen.

Funds raised by a sustainability bond are earmarked to fund a mix of both social and green projects that make a positive contribution to society and the environment. The proceeds of the ACU bond will go towards education and research in the areas of healthcare, education, social justice or gender equality that have a positive social impact. They will also be used to finance or refinance environmentally-friendly buildings.

PLACES FOR *People*

National Australia Bank has been working with Places for People Plc (PFP), a social infrastructure company providing over 180,000 affordable and social houses across the UK, for a number of years. We recently expanded on our capital raising activities to assist them to access the AUD bond market. Following a road show across Sydney and Melbourne in July 2017 and good engagement from investors, PFP was able to launch its inaugural 5-year A$100 million AMTN. Strong demand during the book building process presented the opportunity to upsize and print A$150 million. The transaction was very well received internally at PFP, delivering on their plans to diversify away from their local GBP market.

The new issue was the first Social Infrastructure bond in the Australian market and lays the groundwork for local issuers as the Australian Social Infrastructure market develops. Investors were keen to be involved with this sector as it also provided an opportunity to gain exposure directly to a socially responsible business. It was clear from the road show and feedback that mandates in this sector are growing.

In addition to strong interest in future PFP issuance opportunities in AUD, we also had a lot of interest from other UK social infrastructure companies to issue in this market over time, now that PFP has demonstrated the ability to diversify into AUD.

LIFE WITHOUT *barriers*

With NAB's help, the first social benefit bond was launched this year in the field of youth reoffending with the support of the Queensland government. The Queensland government is combating high rates of youth reoffending in partnership with investors and Life Without Barriers, one of Australia's largest not-for-profit agencies. The $8.2 million proceeds from the social benefit bond are being used to finance YouthChoices, a multi-systemic therapy (MST) program run by Life Without Barriers that rehabilitates young people who have been given a court order. Multisystemic therapy offers a broad and intensive approach to treating offenders. Therapists are on call 24/7 to address all factors that affect young people's lives, including their families, homes, schools, neighbourhoods and friends. In doing so, they can better resolve the root causes of criminal behaviour. First developed in the United States, multi-systemic therapy has proven highly successful, reducing reoffending behaviour by 25-70%.

The financial return to investors will vary depending on the program's success: the bigger the improvement, the higher the annual coupon. After the first 3 years, the annual coupon will vary from 3-12% depending on the reduction in the frequency and the seriousness of offending by participants. Investors can earn a financial return that is directly related to the program's social impact and support a program that has a positive impact on local communities. Social benefit bonds like these are a great example of the public and private sectors working in tandem for the common good.

Bonds for social benefit

Social benefit bonds, also known as social impact bonds, are another asset class that saw significant growth in 2017. These tripartite agreements debuted in the UK in 2010, followed by Australia in 2013. To date, there have been more than 89 social benefit bonds launched globally and more than eight in the Australian market. They provide a unique opportunity for the public and private sectors to join forces and make a difference in our communities.

Social benefit bonds involve a multi-stakeholder agreement between a government agency, a social service provider (i.e. non-profit organisation) and investor(s). Their goal is to raise funds for preventative programs that address areas of social need.

A COMMUNITY-LED APPROACH TO *social infrastructure*

Opportunity to renew public assets and help communities across Australia.

NAB is leading new thinking on social-infrastructure models that will empower and strengthen communities – and spark the next wave of projects.

As Australia's leading infrastructure bank[1], NAB is uniquely positioned to champion a community-led approach to projects built on collaboration and innovation.

The future, argues NAB, is communities, investors and business working together to solve problems, and communities taking greater control of their infrastructure needs. Working to reimagine how social infrastructure projects are conceived, funded and delivered. This will lead to new financing models and a 'do-it-yourself' approach for communities.

NAB's vision is timely. An estimated A$47 billion of community infrastructure requires renewal/upgrade, according to the Australian Local Government Association's (ALGA) 2015 National State of the Assets report.

Local governments have a critical role. They managed assets with an estimated gross replacement value of more than $438 billion in 2015, according to ALGA. These assets influence the way of life for millions of Australians and the liveability of communities.

But local government is receiving less government funding to maintain and renovate infrastructure – a shortfall compounded by a growing ageing population.

Another recurring issue is overreliance on governments to solve social-infrastructure problems. Over the last century, governments have increasingly taken on a substantial role in funding community infrastructure. As a result, communities have largely been displaced from identifying and meeting their own infrastructure needs as do-it-yourself protagonists[2].

As the inaugural Global Leadership Partner of the Better Infrastructure Initiative at the John Grill Centre, NAB is encouraging a new conversation on social infrastructure. Most of the focus is understandably on large privatisations and Public Private Partnerships, but community-based micro projects must be part of the equation.

Australian and international investors traditionally come together on billion-dollar infrastructure projects. The challenge is how to leverage this experience into financing new sporting ovals, parks, schools, hospitals, university projects and social housing.

That challenge is complex. Australia has 537 local government bodies and different State and Territory laws are a complication. Innovative financing models that encourage stakeholders to collaborate, to reduce project-funding costs, are vital.

A new financing model

NAB has shown what's possible. In 2014, it led the delivery of a revolutionary financing model for the Municipal Association of Victoria, which has saved millions of dollars for councils through lower borrowing costs. The Local Government Funding Vehicle (LGFV) allows domestic fund managers to invest in council debt.

LGFV is an example of communities working together to raise capital. It reinforces the potential of using capital markets to fund social projects through bond issuance. There is an appetite among investors for these assets.

NAB knows the time is right to connect large and small investors with social projects. Superannuation funds are incorporating Environmental, Social and Government considerations into investment decisions, and they want to do the right thing and fund significant community projects that help members.

Excerpt from article originally written by Tony Featherstone, published in Future Building 2017, published by Executive Media Pty Ltd.

1 NAB has been active in the clean energy finance sector since 2003, and is the #1 arranger in clean energy finance, arranging $24.4bn aggregate of the total debt volume (not NAB's share) in each transaction NAB provided debt finance, 2003 – March 2017.

2 Garry Bowditch, Executive Director of the John Grill Centre for Project Leadership at The University of Sydney, in a May 2017.

Australia's booming A$697 billion Self-Managed Superannuation Funds sector is another opportunity. Through developing new types of asset classes that aid portfolio diversification and have an appropriate risk/Return profile, retail investors could potentially invest in community projects. These investments could provide attractive long-term financial and social returns.

This could address affordable housing and other social problems. NAB has funded social-housing projects in Australia, Europe and the United States and wants to do more. Communities need affordable housing, it's vital for social inclusion, and institutions want to fund it. NAB is working hard to develop new models to fund social-housing projects, but there's a long way to go.

NAB's work in student housing projects shows the potential for affordable housing. NAB is the market leader in organising capital-market deals for Australian universities and funding student-housing developments.

THE RENAISSANCE OF THE LISTED INVESTMENT *company*

Listed Investment Companies evolve and thrive in 2017.

Nick Chaplin and Stefan Visser

Listed investment companies (LICs) and trusts (LITs) in the Australian market have had a chequered history – some performing materially well, while others have barely got off the ground before falling into obscurity and underperformance.

In 2017 the potential for LICs and LITs, as they are more colloquially known, has improved markedly following a structural change whereby the costs of the initial public offer are met by management rather than by the investors in the company or trust. There is an immediate benefit here that can be readily observed as the LIC lists at its par price, rather than the discount previously expected.

The first issuer to consider this structural change was VGI Partners who brought their very successful Global Equities LIC in October with NAB as Arranger. The VGI issue broke volume records as, at A$550 million (after scaling), it is the largest LIC to ever come to market in Australia. Retail investors were delighted with the ability to access the skill base of the VGI portfolio managers for global equities – an asset class to which Australians still remain materially underexposed. With its new structure, the issue has performed strongly in its first six weeks of trading having reached a high of $2.14 versus a $2.00 listing price.

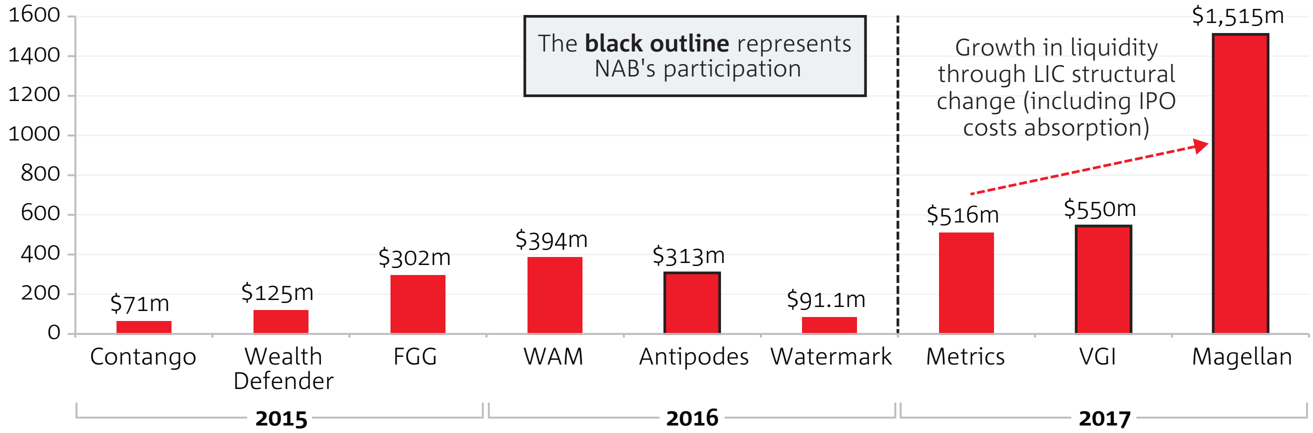
Similar positive volume and secondary trading outcomes have been experienced in the LIT market (structured as a Trust rather than a Company) with Magellan's global equity LIT raising $1.55 billion (another record) where NAB was Joint Lead Manager. Additionally, the Metrics Credit Partners LIT raised $515 million in its issue focussed on domestic syndicated loan exposures. Both issues are also in positive territory on the ASX since listing. The materially higher volumes have provided a natural benefit for fund liquidity – a key requirement for investors, even with an ASX listing.

The chart below shows how fund liquidity has improved in recent years, mainly driven by increasing investor demand for the new enhanced structures:

A chance to diversify

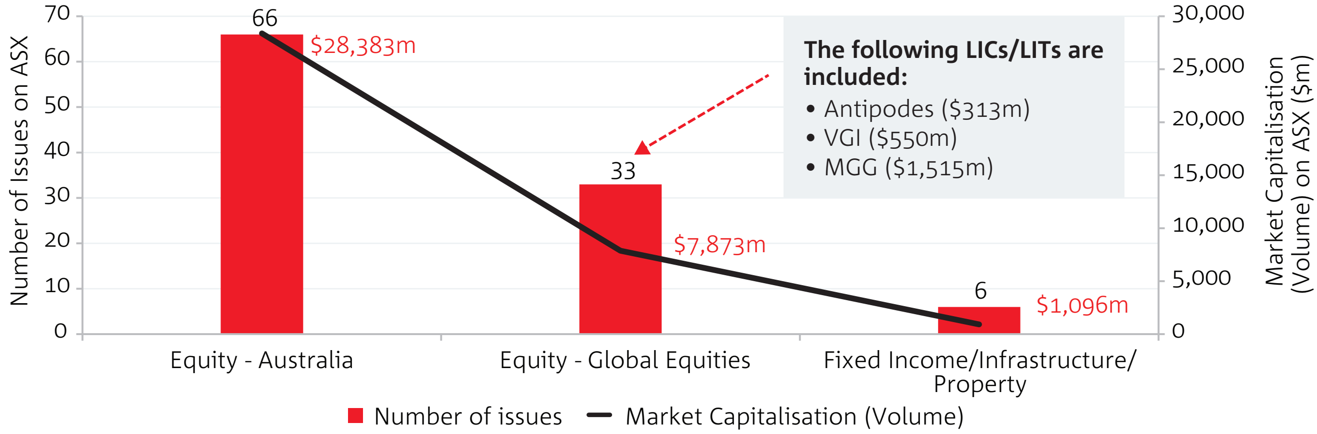
LICs offer investors exposure to asset class diversity and are managed by experts in their fields. With Australian investors generally exposed to a very limited breadth of assets generally – usually including Australian equities, physical property or cash, the ability to gain exposure to professionally managed funds that provide meaningful portfolio diversity is an attraction in these days of limited product offerings for retail investors.

Growth in liquidity through LIC/LIT structural change



Source: ASX website, Bloomberg, NAB Originations

Market capitalisation (volume) of ASX-listed LITs/companies as at 1 November 2017



Source: ASX website, NAB Originations

Considering the LIC market is currently still dominated by underlying Australian Equity strategies, representing ~80% of the current marketplace, the opportunity for investors to diversify their portfolios remains considerable as new high quality differentiated strategies consider this market under the new preferred structures. The chart above depicts the limited asset diversity focus in the current LIC market.

Issues recently have begun to address the need for fund diversity with the Listed Investment Company/Trust market issuing more than $2.5 billion in the months of September and October 2017 in non-Australian Equity related strategies. The individual size of each raise is also evolving as structural progression endures, attracting new investors and quality Issuers to this segment of the market. Issues coming to market in the last year include material expertise in global equities management from Antipodes, VGI and Magellan. Additionally, some quality Australian equity strategies have also listed, offering investors exposure to unique strategies including the ability to short markets in volatile conditions or times of broader under-performance.

A separate key structural change has been the elimination of attached call options in recent issues. Historically, the options have been provided as compensation for the discount expected in the listed price on issue. With IPO costs being absorbed in the issues noted above, the need to issue options has been taken away enabling multiple benefits for investors. This is because, historically, LIC options have often expired with little or no value given trading discounts to the net tangible asset ('NTA') value have continued over the period to option expiry.

Additionally, the dilutive effect of call options being exercised below the NTA isn't good for incumbent holders that don't exercise their options. Overall, the market has welcomed recent issues not offering a stapled call option.

Outlook for LICs

The signs are good that future LICs and LITs will further diversify investor portfolios with high quality managers of RMBS and ABS product, high yield investments, and alternative assets giving serious consideration to this market. Additionally, global asset management experts in global syndicated loans, USD high yield, and ethical assets are being courted for potential issues.

NAB has been at the forefront of the structural development of the LIC market over the last 12 months. The bank's breadth of investor cover has assisted greatly in allowing us to accumulate feedback on not only the types of asset classes preferred at present, but views on the structure of LICs generally. As a consequence, NAB has been able to assess the LICs that were most likely to have sufficient liquidity and secondary performance in advance of a decision to participate and offer these structures to our investors.

The lack of sufficient fixed income product in the domestic capital markets in recent years has driven enhanced acceptance of well-structured LICs and LITs that provide portfolio diversity. This trend is expected to continue into 2018 as the search for yield continues.

The potential for rising interest rates in various global markets, including here in Australia, will also have an effect on investor product preferences and potentially, a tempering in typical Australian investor desire for investing directly in domestic equities.

A BUSY YEAR FOR LEVERAGE *finance*

Private equity and buyout activity hits a post-GFC peak in 2017.

Mark Magnus

The first half of 2017 has been one of the most active periods for leverage acquisitions in the Australian and New Zealand market since the financial crisis. The combination of increased liquidity in the global debt finance market seeking yield and strong fundraising conditions with committed capital looking for a home has seen buy-out activity increase significantly from the lows of 2009 and 2014.

During the year, NAB has continued to lead the leverage finance market in terms of lead arranging roles. Of the private equity investments during the past 12 months, NAB led 11 of these leverage financings for key relationship sponsors. NAB financed transactions include Goldman Sachs consortium acquisition of Icon Cancer Care; Ascender's buyout of NGR payroll software; PEP's acquisition of Allied Mills flour milling business; NEXTDC's acquisition and capital facilities; PAG's buyout of The Cheesecake Shop; KKR's acquisition of Dixon Hospitality Group; Brookfield/Qube Consortium's acquisition of Asciano Ports and Rail business; the Hastings/First State acquisition of NSW Land Registries; the Potentia/Ascender acquisition of NGA; and Morrison & Co's acquisition of Canberra Data Centres.

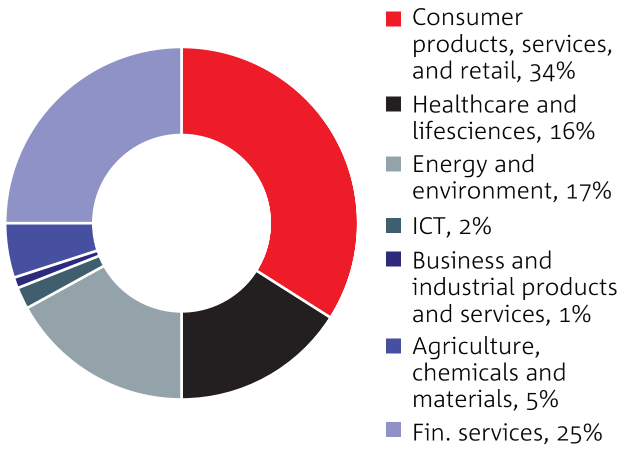
The most significant hurdle for the large global equity funds is the scarcity of investment opportunities to deploy sizable equity cheques. Successful global fund acquisitions include Advent International's acquisition of Zip hot water systems from Quadrant (via a portfolio company) and Bain Capital's acquisition of after school care provider Camp Australia. Unsuccessful bids include TPG and Hellman & Friedman takeover offers for Fairfax Media and KKR and Affinity proposals to acquire the telecommunication business of Vocus.

Where scale has not been able to achieved initially, the funds have been looking to invest in platform businesses with the aim of consolidating the market via bolt-on acquisitions. A highly successful example of this strategy can be seen in Quadrant's consolidation of oncology, pharmaceutical and compounding operations within the Icon Group, where NAB played a material role in the financing from the original platform acquisition.

Favoured sectors

Private equity sponsors are showing the most appetite for the consumer products, healthcare and financial services sectors. The sponsors are often competing in bid processes against Asian funds and/or conglomerates where the sector is of particular interest due to such considerations as intellectual property, management or operational expertise, food security or domestic healthcare considerations.

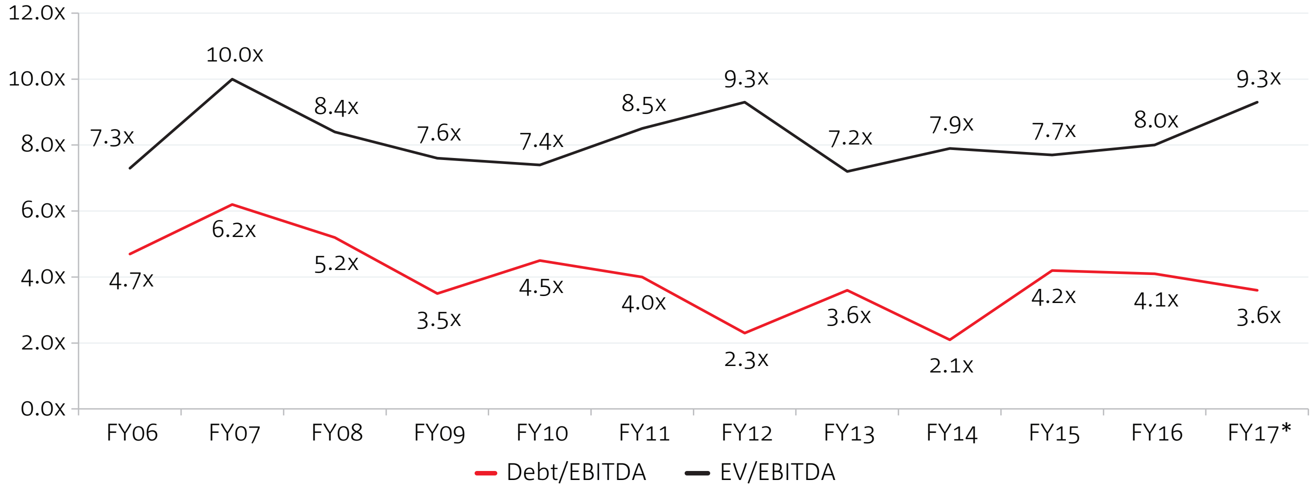
Private equity investment by sector (A$m)



Source: Avcal 2016 Yearbook

In 2014/15 private equity took advantage of the public markets opening and exited many of the investments onto the ASX. Listings, to name a few, included Estia aged care by Quadrant, Healthscope private hospitals by TPG/Carlyle, oOh! Media outdoor advertising by CHAMP, Spotless by PEP, APN Media outdoor advertising by Quadrant, MYOB accounting software by Bain and Link Administration by PEP. NAB financed all these leveraged transactions and funded the businesses post IPO.

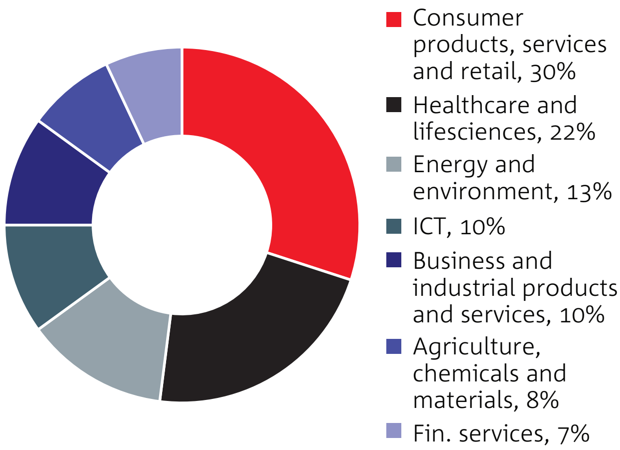
Historical debt and EV multiples



Source: AVCAL 2016 Year Book and Deal Metrics Survey (FY2016); FY17 is NAB deals only.

In contrast, 2016/17 has remained challenging for private equity exits via the IPO market. This has not been specific to PE but related to general IPO market conditions and investor sentiment. Some prospective PE IPOs such as Zip Water by Quadrant, Accolade Wines by CHAMP and QSR by Archer were withdrawn. Zip was subsequently sold via a trade sale.

Private equity investment by sector (by number of companies)



Source: Avcal 2016 Yearbook

Senior leverage has remained relatively stable notwithstanding the large amount of bank debt liquidity seeking yield. Banks are still conscious of the lessons learnt from the GFC. As a rule of thumb, senior leverage of 4.0-4.5x EBITDA is generally achievable for quality businesses. Characteristics of businesses that attract such leverage include stability of earnings, strong historical cash flow generation and conversion, strong defensible market share, not exposed to market cyclicality, well diversified customer base, strong stable margins and strong stable management team. Higher leverage is possible for market leading businesses that exhibit all the above characteristics. For businesses that may exhibit most but not all (e.g. size and market share) of the above characteristics, senior debt leverage of 3.0x to 3.5x is seen as an average for the Australian leverage market.

Enterprise value (EV) multiples in leverage financed acquisitions have been steadily increasing since 2013 with average EV/EBITDA at c. 8.0x. For assets in growth sectors, such as the health sector, we have seen multiples increase to materially above this average. Given the banking market has remained relatively disciplined post the GFC, the EV multiple expansion has been funded principally by larger equity contributions and Holdco Mezzanine debt. The Mezzanine debt is structurally subordinated to the operating company debt and is provided normally to the same legal entity that is funded by the equity participants. It is provided by institutions/funds that specialise in funding this type of structurally subordinated debt.

An alternative structure

As an alternative to debt funding leverage acquisitions using a combination of the senior bank debt market and mezzanine debt, we have seen the emergence of the institutional debt funds that provide debt facilities structured as a uni-tranche. A uni-tranche facility essentially combines the senior debt and the mezzanine debt into one facility, applying a blended margin that reflects the increase in leverage and the more relaxed terms, such as covenants and other senior bank debt restrictions. Deals in 2017 that have applied the Uni-tranche structure include Carlyle and PEP's acquisition of Inova Pharmaceuticals' business and KKR’s acquisition of Laser Clinics skin care and cosmetics business. NAB provided the businesses working capital facilities for the Laser Clinics deal in the form of a Super Senior facility to the uni-tranche.

There are a number of leverage finance deals currently in the market that are likely to close before the end of the year, resulting in what has been a relatively active year for leverage finance in Australia. It’s difficult to forecast activity, however with the amount of capital raised looking for a home and the institutional and bank debt liquidity searching for yield, it would seem the only question will be the volume of target opportunities that become available.

SUBSCRIPTION FINANCE: *A primer*

The growth of the Capital Call facility.

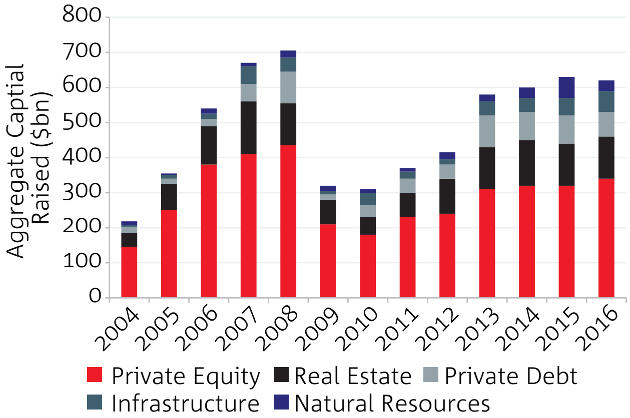
Theo Gavrilos

Private capital funds are closed-ended investment vehicles that employ a range of investment strategies and asset classes including private equity/venture capital, private debt/distressed debt, infrastructure, property or natural resources. Funds are structured in a manner that is customary for their jurisdiction, including limited partnerships, discrete trusts, parallel trusts, stapled vehicles, or co-investment vehicles.

2017 has witnessed continued momentum in private capital fundraising, with capital commitments exceeding US$500 billion per annum every year since 2013, and capital globally distributed (albeit weighted to North America) by both opportunity focus and investor domicile. Correlating with the continued growth of pension pools (including Australian superannuation funds) and government sovereign wealth funds, institutional investors represent a growing proportion of total sector investment.

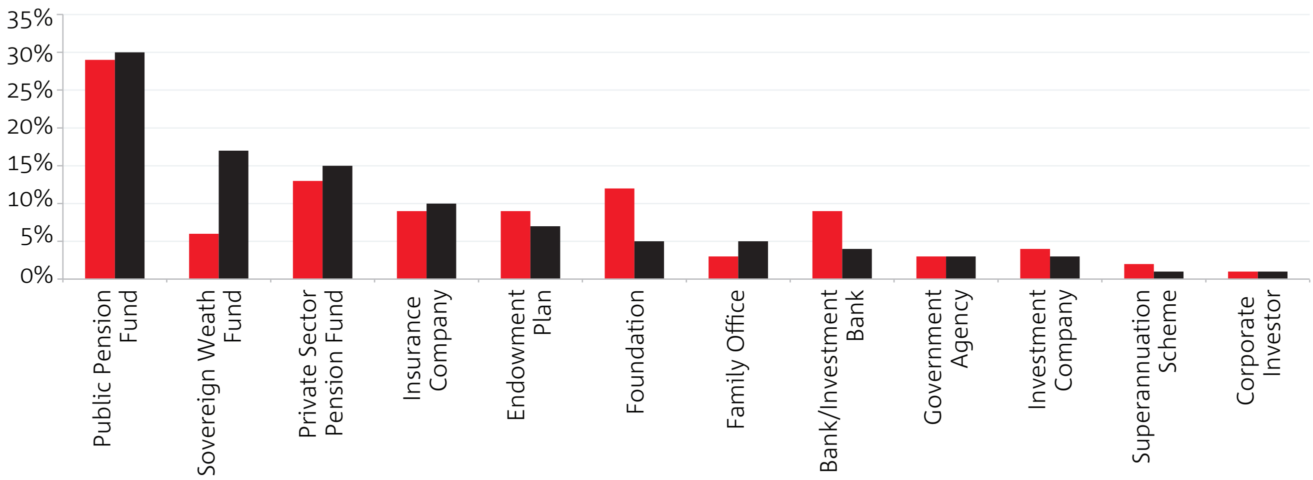
The size of Asia-Pacific focused private capital funds has been trending to a larger fund raise (albeit off a lower base than Northern Hemisphere focused funds), currently averaging around US$425 million in committed capital. Fundraising in 2017 has been strong with 95% of investors looking to maintain or increase their allocation in Asia, and 86% of fund sponsors looking to invest the same or more capital in Asia in 2017 than in 2016[1].

Annual aggregate private capital raised by asset class (2004-2016)



Source: 2017 Preqin Global Alternatives Reports

Breakdown of aggregate capital currently invested in private equity by investor type (2011 vs 2016)*



* Excludes FoFs and Asset Managers

[1] 2017 Preqin Global Alternatives Reports.

Capital call subscription facilities

Coinciding with the growth of private capital funds, the use of capital call subscription facilities has become an increasingly popular financing tool with both investors and sponsors.

There are a number of reasons for this, including:

- A reduced administrative burden for both investors and sponsors, with the sponsor only needing to deal with a facility agent to access liquidity, rather than each individual investor, in as little as one day versus a process than can take 10 business days or more. For instance, if a fund anticipates the need to make a distribution to LPs on one investment, but anticipates it will need funding for another investment, a subscription facility can bridge that timing gap
- For sponsors that have longer term investments such private equity, infrastructure or property, subscription facilities provide certainty during bid phase. For sponsors that have shorter term investments with prepayments such as debt funds, the subscription facility can provide an IRR boost
- Subscription finance can incorporate revolving or term facilities but also letter of credit/bank guarantee options, which are requirements of certain acquisitions to collateralise items such as pre-hedge or break-fee liabilities
- Cost of debt funding and access to credit for sponsors are improved under subscription finance structures, because credit quality and advance rates are assessed against the sponsor's right to call on capital from the investors to pay back a subscription facility drawing, versus cashflows from downstream fund investments which may be illiquid or subordinated

Subscription finance facilities are sized off an advance rate against an eligible borrowing base of investors, as well as a due diligence on the structural features and enforceability of the underlying fund documents. Because subscription finance facilities are covered by more than 110% of undrawn investor equity at all times, they do not leverage the buying power of the fund. Eligible investors are generally experienced, investment grade institutional investors with an understanding of and history of participation in subscription facilities.

Subscription finance facilities are secured by the rights to call the unfunded capital commitments of the investors and enforce the associated rights under the fund documents, as well as a charge over the bank accounts to which the investors deposit their capital call proceeds. Security is not generally taken over the underlying assets of the fund.

Historically, in the Asia-Pacific market capital call facilities have been bilateral; however the market is growing in sophistication with a rise in syndicated and bespoke capital call facilities over the past few years. Another emerging trend that we are seeing is the use of subscription agreements as credit enhancements to traditional non-recourse asset financing, giving the lenders the ability to both look 'up' the structure to investors, and 'down' the structure to assets/investments thereby improving both pricing and bankability of transactions.

Conclusion

The uptake of capital call facilities in the Australian market has accelerated in recent years, although it still lags the rapid upward trajectory of the market in the United States and, to a lesser extent, Europe. As lenders become more familiar with the different fund structures and the methods for assessing credit risk on investors, and as sponsors and investors awaken to the benefits that a capital call facility can bring, we see this market continuing to grow.

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