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National Australia Bank

A world of INSIGHT

International Round Table – Non-banks and Securitisation

May 2019

A WORLD OF INSIGHT
NON-BANKS AND SECURITISATION: MORTGAGE LENDERS PRIMED FOR GROWTH

In May 2019, National Australia Bank invited Treasury representatives from four non-bank financial institutions and one UK based asset manager – Liberty Financial, La Trobe Financial and Resimac Group in Australia and Kensington Group and TwentyFour Asset Management in the UK -- to a virtual International Round Table to discuss the opportunities and challenges in their respective mortgage and securitisation sectors.

The growth of the non-bank mortgage sector in recent years shows no signs of slowing and lenders have a range of strategies in place to capitalise on new opportunities, the NAB hosted Round Table was told.

As well as lending to traditional prime borrowers, non-bank mortgage providers specialise in financing borrowers who may not meet the banks' standard lending criteria. Regulatory change, consumer sentiment, technology, and new product offerings have all contributed to growth in recent years.

"We're able to operate with a different balance sheet and capital basis, and that affords long term structural opportunities for the non-bank sector in the Aussie market," said Andrew Marsden, General Manager Treasury at Resimac Group.

In 2015, tighter capital requirements were introduced that required the major Australian banks to tighten lending standards and hold higher levels of capital against future economic downturns.

Borrowers with more complex loans moved to non-bank (also known as Specialist) lenders which are able to assess and manually underwrite those loans. Examples include self-employed workers whose income may be "lumpy" or salaried workers with varying amounts of overtime who do not fit traditional lending criteria.

"That in our view is going to represent a permanent structural shift in the Australian mortgage market. Banks are going to be more restricted to those mum and dad loans and an automated underwriting model, and speciality loans will be funded by alternate lenders," said Chris Andrews, Chief Investment Officer at La Trobe Financial.

PARTICIPANTS IN THE NAB INTERNATIONAL ROUND TABLE

Participants

Kensington Group
Alex Maddox
Capital Markets Director

La Trobe Financial
Chris Andrews
Chief Investment Officer

Martin Barry
Chief Corporate Treasurer

Liberty Financial
Peter Riedel
Chief Financial Officer

Resimac Group
Andrew Marsden
General Manager Treasury

TwentyFour Asset Management
Rob Ford
Portfolio Manager

Moderators

Sarah Samson
Head of Securitisation Origination, NAB

Jacqueline Fox
General Manager, Capital Markets & Advisory, NAB

Non-standard mortgages

Peter Riedel, Chief Financial Officer at Liberty Financial, said he expects to see a material change in how a non-standardised mortgage is defined. Whereas today, much of the decision is around whether the customer is insurable, looking ahead that will be more to do with the purpose of the loan and the nature of the asset.

"With banks changing their appetite, we as an alternative lender have benefited and we feel that's likely to persist for some time," Mr Riedel said.

The major banks dominate the A$360 billion a year market for housing credit, but the share of non-bank mortgage providers is growing and estimated to be up to A$75 billion for prime, specialist and non-conforming borrowers[1].

In the UK, the structure of the mortgage market is quite different. Specialist bank lenders cater to non-traditional loans and make up around 10-15 per cent of the market and the true non-bank players are smaller again, but have used technology and innovative product design to grow rapidly.

"We've been growing at 25 per cent a year since we were formed (in 2015), but we do think that's tailing off," said Alex Maddox, Capital Markets Director at Kensington Group.

"There are a number of headwinds, there's more competition in the market, the High Street lenders are under pressure to grow volumes, and they are all awash with cash."

Funding options

To ensure they are able to capitalise on opportunities, Australian non-bank financial institutions have employed a range of funding options to support growth. They are frequent issuers of prime and specialist residential mortgage-backed securities (RMBS) in the securitisation market, with issuance to 30 April of A$4.85 billion equivalent – the highest for the first four months of the year since the 2008 Global Financial Crisis.

La Trobe Financial stands apart from its peers in that it runs a retail credit fund of nearly A$3.5 billion, which provides 45 per cent of its funding requirements.

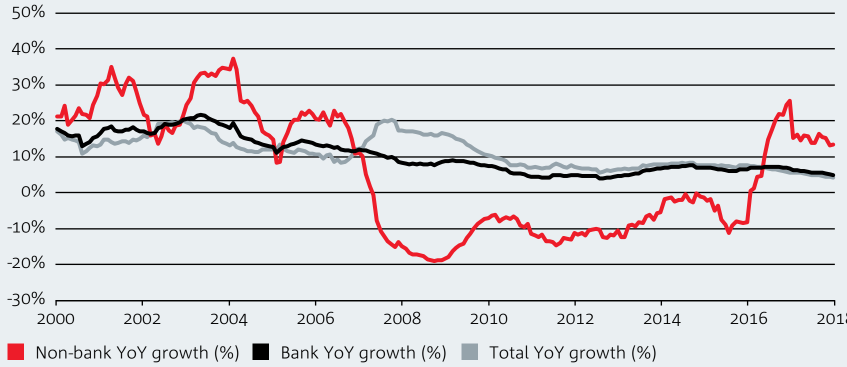
"That is a significant source of diversification for our funding, which means that compared to some of our peers, we are not as dependent on the debt capital markets channel for supporting our growth," said La Trobe Financial's Mr Andrews.

Most of the other Australian non-banks see funding capacity and capital as the ultimate constraint on growth of their assets under management.

"We can only originate an asset we can eventually securitise. That's an important principle to call out," said Resimac's Mr Marsden. "Funding diversification is where we differ to La Trobe Financial, we do have sole exposure to different forms of secured funding," he said.

Offshore investors have a keen appetite for Australian RMBS and good understanding of the domestic market, helping lenders diversify their investor base. The large Australian issuers have all attracted a diverse set of investors in the European, Australian and Asian markets.

Australian bank and non-bank housing loan growth



Source: RBA

1. https://www.apra.gov.au/media-centre/media-releases/apra-releases-statistics-adi-property-exposures-december-2018

A WORLD OF INSIGHT
INTERNATIONAL ROUND TABLE – NON-BANKS AND SECURITISATION

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>
> **— Andrew Marsden**, Resimac.

Resimac aims to raise half of its funding through non-domestic sources and last year a A$750 million Australian RMBS issue included $US210 million of 144a notes, which were 2.8 times oversubscribed.

Similarly, Liberty has frequently tapped the euro market as part of public mixed RMBS transactions and has attracted a 50-50 split between domestic and offshore investors.

Bias towards equities

However, all of the Australian participants at the NAB Round Table lamented the structural bias in the Australian investment landscape that has traditionally seen limited interest in bond and fixed income assets.

Australian investors generally favour equities and property, and fixed income represents a far smaller allocation in portfolios both for individual investors and for large superannuation funds compared with the US and European investors.

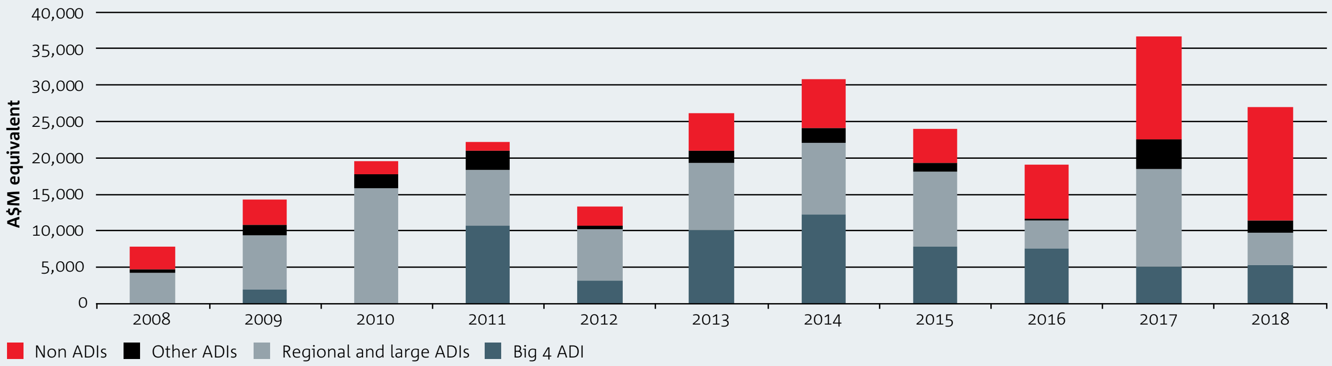
Until recently, most companies relied on mainly traditional bank loans for their financing needs and various attempts to open up the corporate bond market to retail investors, including simplified prospectuses, have been met with a distinct lack of interest.

"In Australia there is unfortunately a very low allocation by asset managers to fixed income relative to other global markets," said Liberty's Mr Riedel. "We need to be alive to this market structure when considering how to establish and manage a funding strategy."

Participants agreed that more needs to be done to educate investors about structured credit and fixed income in general – at super funds, the A$725 billion self-managed super sector, and individuals. This is especially the case as population dynamics shift and baby boomers retire, seeking steady income after years of chasing capital growth in their super funds.

"It's also about behavioural change with mum and dads. We're a very equity-centric market here and when they think about wealth creation it's either shares or property investment," Mr Marsden said, adding tax changes would help.

Australian Collateral Backed RMBS Issuance



Source: NAB, Bloomberg

Elephants in the room

The mortgage lenders at the NAB Round Table saw quite different risks on the horizon, with the main focus for the UK non-banks still related to the uncertainty among buyers, borrowers and investors caused by the Brexit stalemate.

"It has caused enormous uncertainty and a massive stagnation in the housing market," said Rob Ford, Portfolio Manager at TwentyFour Asset Management, although he expects a recovery if the Brexit issue is resolved and pent-up demand is unleashed.

In Australia, much has been written about the slump in house prices after a sharp run-up in Sydney and Melbourne but the lenders agreed the decline has been orderly, with arrears and defaults still at low levels.

"Investors are looking beyond the headlines, and have a more nuanced understanding of the housing market by geography and valuation. Sydney and Melbourne prices had previously risen by 85 per cent and by 65 per cent – so this is the injection of reality we had to have," said La Trobe Financial's Martin Barry, Chief Treasurer and Strategy Officer.

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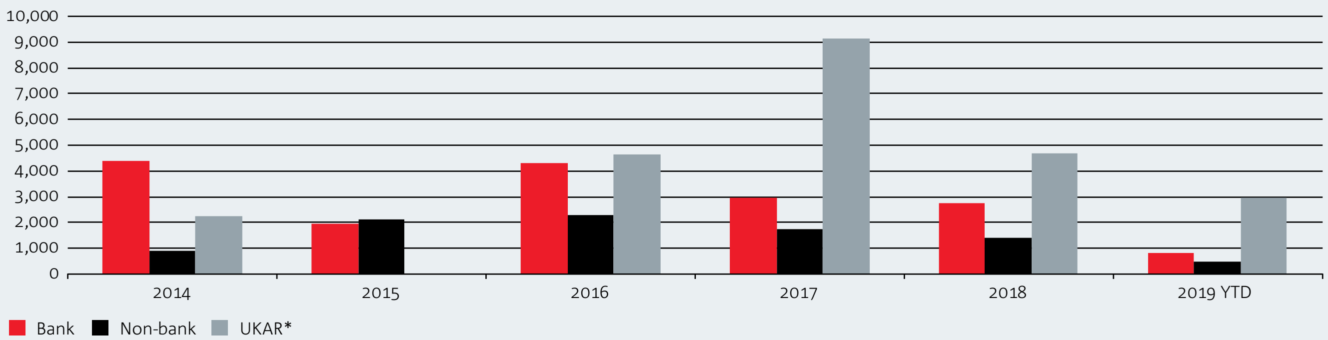
— **Martin Barry**, La Trobe Financial.

UK RMBS by issuer type



* UKAR (UK Asset Resolution) relates to the sale and resulting securitisations of mortgage portfolios acquired by the UK Government during the GFC.
Source: Informa Global Markets

NEW BACKERS FOR THE NON-BANKS

The non-bank sector has seen the entry of private equity in recent years. The Kensington Group was formed in 2015 and purchased by funds managed by Blackstone and TPG, while Blackstone took an 80% equity stake in La Trobe Financial in 2017. Both lenders suggested the partners have opened new doors for the business.

Martin Barry
Chief Treasurer & Strategy Officer
La Trobe Financial

"La Trobe Financial and Kensington – albeit at different times – have entered into a strategic partnership with Blackstone. The two CEOs, Mark Arnold at Kensington and Greg O'Neill at La Trobe Financial, know each other very well and have a good level of dialogue there, so that's a nice feature of this ownership structure.

Blackstone has been incredibly supportive of the business and our strategic plan. There have been no changes to our operating model under Blackstone, and no changes to our Executive Team.

On a practical level, having Blackstone in your corner is really helpful. Blackstone is one of the largest borrowers in the world and at a practical level assists us with investor and financier introductions from time to time. This connectivity is of course very welcome in this high growth environment!"

Alex Maddox
Capital Markets Director
Kensington Group

"We have Blackstone and TPG as partners. We had a slightly different journey in that we were looking for private equity backers as a management team back in 2014. We were trying to attract capital and it snowballed from there, what looked like a relatively small equity ticket rapidly turned into what is now a significant equity ticket for them.

We did identify that we wanted to be backed by big private equity firms, so that if ever there were substantial opportunities in the market we could take advantage of those.

It's worked much better than any of us would have expected. They do get involved in strategic matters and we find that very helpful. Whenever we're talking to banks whether to get warehouse lines or whatever it may be, there is a relationship with Blackstone or TPG, which has a big platform in Asia. They can bring a lot of value."

GET IN TOUCH WITH US

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