

remara.

Private Credit Quarterly

A comprehensive look into the markets
& what may lie ahead.

Q1-2024



• Welcome

Welcome to the 'Private Credit Quarterly,' an in-depth resource for investors to explore the inner workings of the markets and what may be instore moving forward.

The credit market has not experienced the expected negative effects of rising interest rates due to a stable economy and resilient business and consumer markets. A surplus of liquidity is still available to Australian issuers. While this is the case, we see no case for rates to decline as credit will be available to borrowers.



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● Insights

Just enough liquidity... The current environment continues to surprise, with expectations early in the rate rise period that credit market carnage would ensue, given the wall of fixed-rate borrowing rolling to variable rates.

By Andrew McVeigh & David Verschoor



This has not eventuated as many market commentators suggested. We have seen resilient business and consumer markets, and whilst confidence may still be low, incomes have increased, and excess liquidity has been used to service debt. Performance has remained strong, whereby we have seen limited arrears across the market, and house price stability has provided a floor to the overall economy.

We continue to see excess liquidity within the system, which provides credit to those needing it. While this continues, we don't anticipate a negative market environment to eventuate.

The RBA should be commended, as they have not gone as hard with rate rises as their overseas counterparts. As a result, we have a stable economy that will work through the current factors in an orderly manner.

The benefit of our credit platform is its vertical integration; we have four originating businesses that now sit across ten credit contract types, covering SMEs, Asset & Equipment Dealerships, Consumer credit and Real Estate development/construction.

● Insights

Our platform underwrote 3,249 credit contracts during the March quarter, settling 1,872 of these for a total advance of \$176m. At the March quarter close, our platform is invested across over 15,000 contracts with Assets Under Management of \$950m.

The consensus from our credit teams is that our underlying cohort of borrowers is performing well and holding up with higher interest rates. Our credit methodology is focused on Prime borrowers [those with a credit score of >600 and no past defaults] coupled with secured contracts against tangible assets [primarily equipment and real estate].

“We believe that further time is needed to allow the impact of interest rate rises to work through the system. Given how the RBA has played the current scenario, we expect the 4.35% RBA rate to hold deep into 2024 and potentially early 2025.”

During the quarter, we launched our Credit Opportunities Fund, which seeks to provide investors with a higher [equity-like] return with the structural downside protections usually incorporated in credit contracts. The Fund will focus on securitised credit opportunities for both exiting and established issuers and act as an “incubator” for new and upcoming securitisation platforms. In addition, the Fund will also have exposure to Real Estate loans generally in excess of senior funding levels.



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● Market Overview

The market has faced significant headwinds for what is now a prolonged period...What has been the impact?

In data, not much, but the data is a lagging indicator and what we are seeing in market is a different story. Capital is still available for borrowers, however, each of the markets that we operate in are facing distinct impacts that will lead to challenges as we move through 2024. Let's look at our core sub-markets.

01 Small & Medium Enterprise (SME)

The sector has adapted well to the pressures; however, we have seen a substantial change in borrower cohorts. Prime borrowers have maintained their capacity to service; however, we see issues starting to form in subprime sectors of the SME market. These issues are generally experienced within businesses under 24 months old and are focused on the consumer discretionary industries. We are seeing through our originators the following key types of businesses seeking finance:

Equipment & Asset Finance

- Mainly established businesses with a clear credit history
- Operating in capital-intensive industries
- Typical Capex requirements are for the expansion of the business to take on additional work
- Seeking competitive pricing outside the banks and mainstream leasing companies
- Businesses that are family owned/operated and principals that are property owners

Business Loans

- Well-established businesses with a clear credit history
- Facing working capital shortfall due to the nature of the industry (stock/debtors) or expansion
- Seeking competitive pricing outside the banks and below our key competitors
- Debtor Finance is seen as a complex option
- Businesses that are family owned/operated, and principals are property owners





02 Insurance

We have seen an influx of overseas insurers reentering selected Australian insurance markets as they can assume positively skewed risk opportunities. This is a positive for the local market, increasing competition and reducing premiums. Premiums have stabilised over the last six months in most industries, and insurers are now receiving improving returns on their investment portfolio, which will strengthen the industry overall. We still see performance across our insurance premium finance book as strong, with very limited defaults experienced.

03 Real Estate

The real estate market is holding on; with limited stock, we are experiencing a market that will maintain its position for the foreseeable future, subject to listings remaining subdued. Let's quickly explore each class:

Residential

Prices have continued to trend sideways; however, this is driven by the national sales listing being far below the five-year average. We have noticed that sellers (especially at the higher-end value) still believe that their property is worth today what it was worth at zero rates. This juxtaposition has a little time remaining before there will be, in our view, some substantial readjustment of values for these higher-end properties.

We still believe residential real estate (overall) will benefit from two main factors, both working in tandem. Significant positive net migration into Australia will provide continued demand for dwellings, while poor state development planning and policy incongruent with federal migration policy will continue to limit new supply. These factors should provide a floor to certain sub-markets. If we start to see declines in interest rates, we will be off for a further bull market in prices.

Without any rate changes or nominal increases, we anticipate a market that will continue to trend sideways and oscillate between +/- 2% growth. However, the luxury end of the market may see a 10% to 20% decline in value as their nominal price points limit potential all cash buyers.

Industrial

We anticipate continued strength in industrial property; however, caution must be noted, given the environment and prior commentary on the SME market. If we see degradation in the SME market, this will flow onto Industrial tenants and then property values. It should also be noted that capitalisation rates are not reflective of a 4.35% base rate market. While not our base case, if stress is incurred and forced selling is needed, the Industrial sector could be materially impacted.

Commercial

We have had a negative view of commercial office for the last 24 months, and this view has not changed. Commercial office towers are an investment class we have avoided and will continue to avoid, and our view is that further stress is needed within this market before it normalises. The counter to this would be the reversal of any work-from-home mandates that have existed since COVID; however, given the current environment, we see this as an unlikely outcome in the short term. Although, we expect it in the mid-term if Australian corporates look to rationalise their workforces.

"The real estate market is holding on; with limited stock, we are experiencing a market that will maintain its position for the foreseeable future, subject to listings remaining subdued"

● Market Overview

04 Development Finance

Remara participates across the equity and debt stack of real estate, and a core aspect of our operations is development and construction finance. Through our activities as both a principal and financier, we have seen continued challenges in the market, driven by a few key factors:

Planning & Approvals

Planning policy and approvals continue to be challenging; we outlined this in our report for Q3-23, and everything has stayed the same within the market. We see this impact lasting for a further prolonged period as it will take extreme housing pressures and potential price escalations to require the government policy changes needed to rectify the situation.

Construction

Construction costs have stabilised to a new high; while this creates pressure on feasibility, it also limits speculative development, which is positive for the market. We do not see mass unemployment of trades; however, we have noticed underemployment of certain trades, with it now being easier to get trades faster, which is positive for the market overall as it increases the efficiency of development.

Employment

The Australian employment rate has performed better than the market had anticipated; this strength has certainly limited any significant foreclosures mooted by industry commentators upon the outset of the rate hiking cycle. This is a surprise on the upside and has created strength within the market. We see no short-term change to employment, and it will continue to provide confidence to the market.

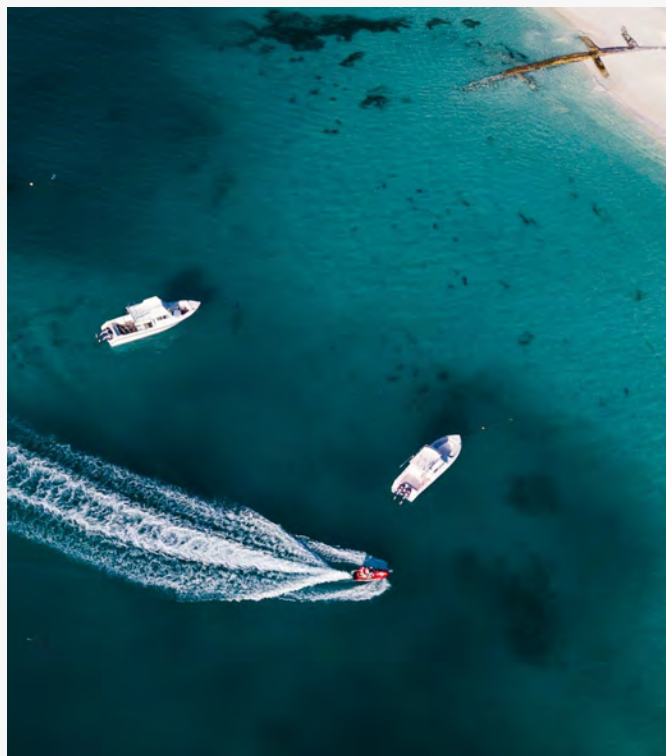
Remara continues to focus on the investment and funding of land projects, which provides the greatest risk/reward opportunity as the stock can be delivered over a period of time to meet local market demand. Demand for detached housing post-COVID has escalated, with both investors and owner occupiers seeking the security of their own stand-alone dwelling, and we don't see this

shifting back anytime soon. We see a risk to mass-scale apartments that will be less desirable for owner occupiers and will be primarily investor and rental stock.

05 Dealer Finance

The floorplan finance market continues to perform nicely, with distribution networks making necessary adjustments to macroeconomic conditions, which impact our asset classes in different ways. Dealers are optimistic about the buying behaviour of end users despite seeing higher interest rates and normal seasonal purchase patterns slowing stock turnover towards the mean.

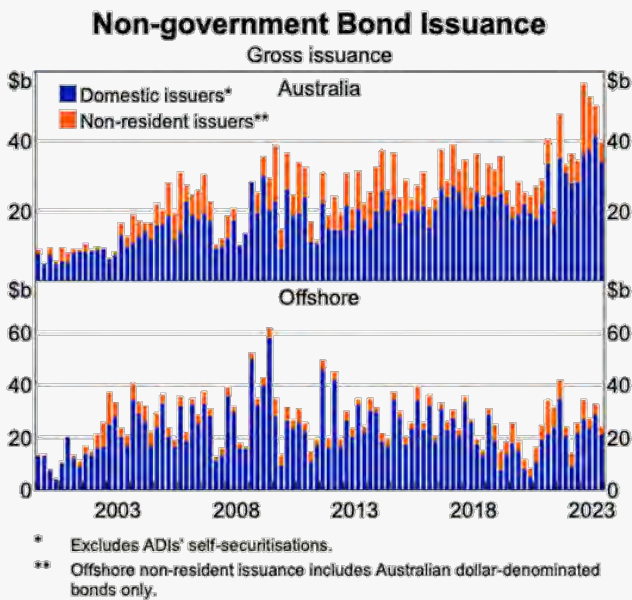
Following COVID and the subsequent period of heightened demand, dealers are adjusting their stock and inventory levels to manage market fluctuations. Demand for credit limits and requirements for various lenders continues within our channels as we continue to scale our operations with an eye to risk and operational controls.



● Market Overview

06 Australian Funding Market

The Australian funding market was extraordinarily strong for the first quarter of 2024, with most publicly issued securitised deals being well oversubscribed. This follows a period of surprising strength for the Q3 and Q4 2023 periods. The strength during Q1 has led to a tightening of spreads for investors, indicating surplus liquidity in the market searching for a home.



Sources: Bloomberg; KangaNews; Private Placement Monitor; RBA

RMBS issuance momentum has increased with spreads as noted above competitive, and the market is anticipating home lending to pick up its pace with rate rises near their peaks. S&P notes in their latest market overview the following:

Arrears

Yet to peak with unemployment rising, we counter this with the stable unemployment figure but point to rising underutilisation and underemployment. However, we believe this is primarily within the younger demographic, which will have a limited impact on Australian credit performance.

Prepayment Deceleration

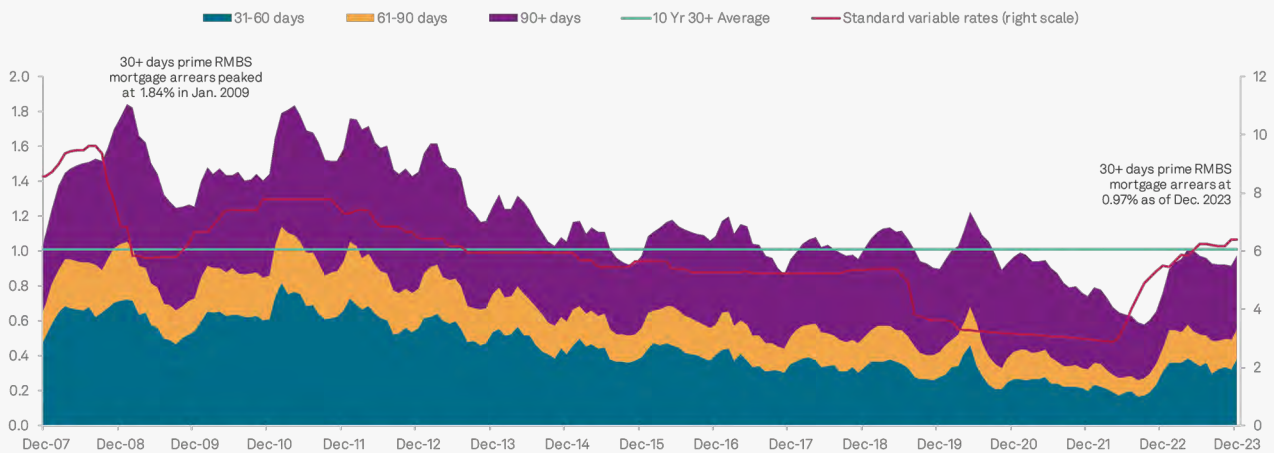
The fixed-rate cliff is nearing conversion, which is anticipated to result in a convergence to the long-term prepayment average. Borrowers will become rate-sensitive as they move from low fixed to higher floating rates.

We believe a surplus of liquidity is still available to Australian issuers, and while this is the case, we see no case for rates to decline as credit will be available to borrowers. If this surplus liquidity continues through FY24, it will place further upward pressure on rates.

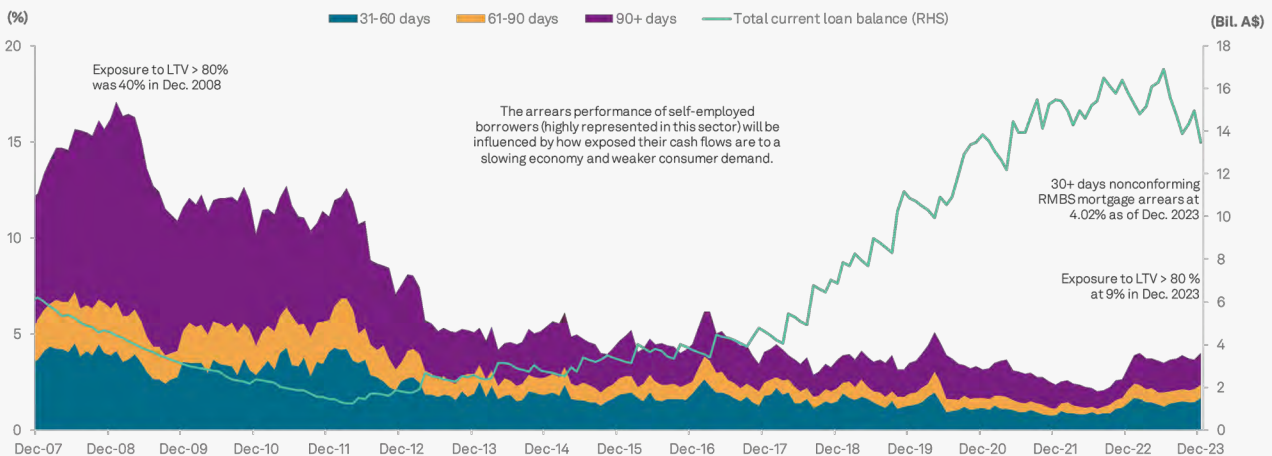
Please turn overleaf to view detailed performance charts.



Market Overview



Prime data SPIN shown excludes non-capital market issuance transactions. Prime RMBS arrears exclude non-capital market issuance transactions. Standard variable rates are based on outstanding mortgages. Source: RBA; S&P Global Ratings



LTV - Loan to value ratio. BL - Billion. Source S&P Global Ratings



Source: S&P Global Ratings. Investor and owner occupier arrears are included in prime RMBS transactions rate by S&P Global Ratings excluding non-capital market issuance transactions

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● Economic Outlook

As of early 2024, the Australian economy faced challenges and moderate growth expectations. Economic growth in Australia is currently subdued, impacted by inflation and previous interest rate hikes that have dampened consumer demand. The near-term outlook for GDP growth has been slightly revised downward, reflecting weaker consumer spending.



High construction costs and capacity constraints continue to affect building approvals & dwelling investments. However, strong population growth and the rebound in tourism are expected to support domestic activity and offset some domestic weaknesses.

Inflation remains a significant concern, although it has declined partly due to lower energy prices and a slowdown in core goods price inflation. Yet, core services price inflation remains relatively high, influenced by ongoing tightness in the labour market.

The employment sector shows a high participation rate, supported by government policies to increase workforce participation, especially among women. This is coupled with a tight labour market where low unemployment rates have shown slight increases recently.

The economic outlook is also affected by global factors such as China's economic slowdown, which may impact Australia due to their significant trade relations. Additionally, global inflation risks and supply chain disruptions continue to pose risks to growth.

● Economic Outlook

The RBA recently highlighted a range of economic challenges and factors influencing their monetary policy decisions:

Economic Growth & Inflation

The RBA notes that economic growth in Australia is expected to remain subdued in the near term due to the impacts of inflation and previous interest rate hikes. The soft outlook for GDP growth primarily reflects weaker consumer spending influenced by pressures on household budgets from declines in real incomes over the past few years.

High construction costs and ongoing capacity constraints also continue to impact building approvals and dwelling investments.

Labour Market

The RBA describes the labour market as gradually easing but remaining generally tight. There are signs of increased unemployment rates and declines in job vacancy-to-unemployment ratios, indicating some softening. However, wage growth has dropped from its peaks but remains strong.

Monetary Policy & Interest Rates

The forecasts are based on assumption that the cash rate has peaked in the current cycle and will remain stable until the middle of 2024. The RBA's stance is influenced by the need to manage inflationary pressures, which remain above the target range in many advanced economies, including Australia. The central bank acknowledges the delicate balance required to manage monetary policy amidst these pressures.

Overall, these insights from the RBA reflect a cautious approach to monetary policy, considering both domestic economic conditions and broader global economic risks.



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