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fresh ideas...

Stay Positive…It Will All Be Over Soon!

I've been writing these bulletins for many years now and inevitably one runs out of interesting stuff to say. Most months I build a mental picture of what I'm going to write about, procrastinate until the deadline date and then frantically try to render what's in my head into something comprehensible. I often find it difficult to find things to write about, hence the sometimes rabbling social commentary and hopefully amusing anecdotes.

In fact, the only time it's easy to come up with content is when something extraordinary happens. Something like a global financial crisis, a surprise election outcome or a pandemic. In recent times the GFC has been the reference point for the mother of all meltdowns but sadly I suspect we have a new contender on the doorstep. I have tried to think of a positive spin for what comes next, but I simply don't have one. I guess our coordinated response, banking industry and government support and likely long-term economic survival are positive touchpoints on an otherwise bleak situation.

In order to get some sense of the scale of our new benchmark look no further than the raw statistics. The economic response to the GFC in Australia was government stimulus of about $50 billion. So far the government response to Covid 19 is $320 billion in fiscal and balance sheet support. Our previously expected 20-21 budget surplus of $6.1 billion is now projected to be a deficit of $24.8 billion, a $30.1 billion swing. The negative impact on GDP is estimated at 10% best case scenario. Recently our Prime Minister quite rightly lamented the loss of 600,000 jobs in April alone. Unemployment rose to 5.2% in March and increased to 6.2% in April. Some analysts were expecting April unemployment to hit 8% or higher so a glimmer of good news in this sea of woe. It's also worth noting that unemployment numbers include those who are seeking work. Participation rates have tanked since the crisis started unfolding and as such give the statistics a more negative aspect.

The cost to the big four banks (and their shareholders) of supporting consumers, borrowers and businesses is expected to hit $10 billion this year and $35 billion over 3 years. Bad debt provisions may well exceed expectations and I think there is a real possibility that banks will postpone dividend payments as they work to sure up their capital positions. With 98% of all Australian businesses with bank loans now taking some form of relief from their bank and deferred payments on 430,000 mortgages worth $153 billion, it's easy to see that we have a potential ticking time bomb on our hands. Add the additional repayments business will need to make to repay Covid 19 assistance loans and the picture looks potentially grim. Throw in a stoush with our largest trading partner and maybe we need to retitle this bulletin to Hold Tight,This Might Sting a Bit.

The challenge is that we are currently in a Jobkeeper (6 million workers) and loan repayment holiday ($211 billion in total) bubble and that bubble simply has to burst in the near future. At this stage it's the end of September. As such most analysts are taking a stab in the dark as to the likely economic impact once government stimulus measures start to be wound back. Most bank analysis seems to point to expectations of a relatively rapid recovery while the broader investment advisor community are expecting higher bad debt provisions, lower dividends and a slower recovery.

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Anyway, that's the situation we find ourselves in and I am guessing that until a vaccine is available life and business won't go back to "normal". In fact, I suspect the old normal we used to know is gone forever. I expect some businesses to use the forced work from home dynamic to review how they operate and potentially adopt that model long term. As a result we may well see commercial office vacancy rates rise as business owners realise they don't need that expensive CBD space to conduct business. Many in the retail sector had this worked out long before Covid 19 and had abandoned high visibility and high cost locations for a move to bulky goods warehouses and online trade. Surely office jobs will follow, just from home rather than a big shed.

In the accommodation sector the permanent management rights Armageddon of rental arrears, vacancies and falling rents seems yet to manifest itself outside of some inner-city accommodation. Certainly buildings catering to overseas students will have seen an impact but in the 'burbs all seems relatively calm. Early days but so far so good. The real impact on permanent management rights and tenant driven investment more broadly will only be known once all the economic support mechanisms and eviction embargos are behind us. Of course, with travel restrictions, holiday and short stay rights, motels and caravan parks have been ghost towns to be sure. In the case of management rights, the benefits of a monthly caretaking salary are obvious and a certain confirmation of MRs as a lower risk operating model.

There has been much discussion around the sale of management rights once the immediate crisis has passed. Clearly a model where the business is sold on a one-year historical P and L will be found wanting, particularly for holiday and short stay. I think we find ourselves at a unique crossroads in the history of management rights with a once in a generation opportunity to move to a much more sophisticated sale and financial verification model. That is, a model that does not expose the industry to negative asset value impacts driven by single trading period events. A model that looks more closely at sustainable net profit and as a result a model with the potential to underpin higher valuations for these assets. And most importantly, a model that banks in the post Covid 19 environment will find appealing and acceptable from a risk perspective.

I will leave you with this prediction. The accommodation sector will survive and prosper. People need somewhere to live and we all like a holiday.

PS : A lot of people have asked me if taking a loan repayment holiday will impact their credit rating. The answer is No. The Australian Prudential Regulatory Authority (APRA) has stated that bank assistance provided as a result of financial stress brought about by the Covid 19 crisis does not constitute a loan default. Be aware however that at this stage missing repayments once the repayment holiday ends will trigger a default.

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