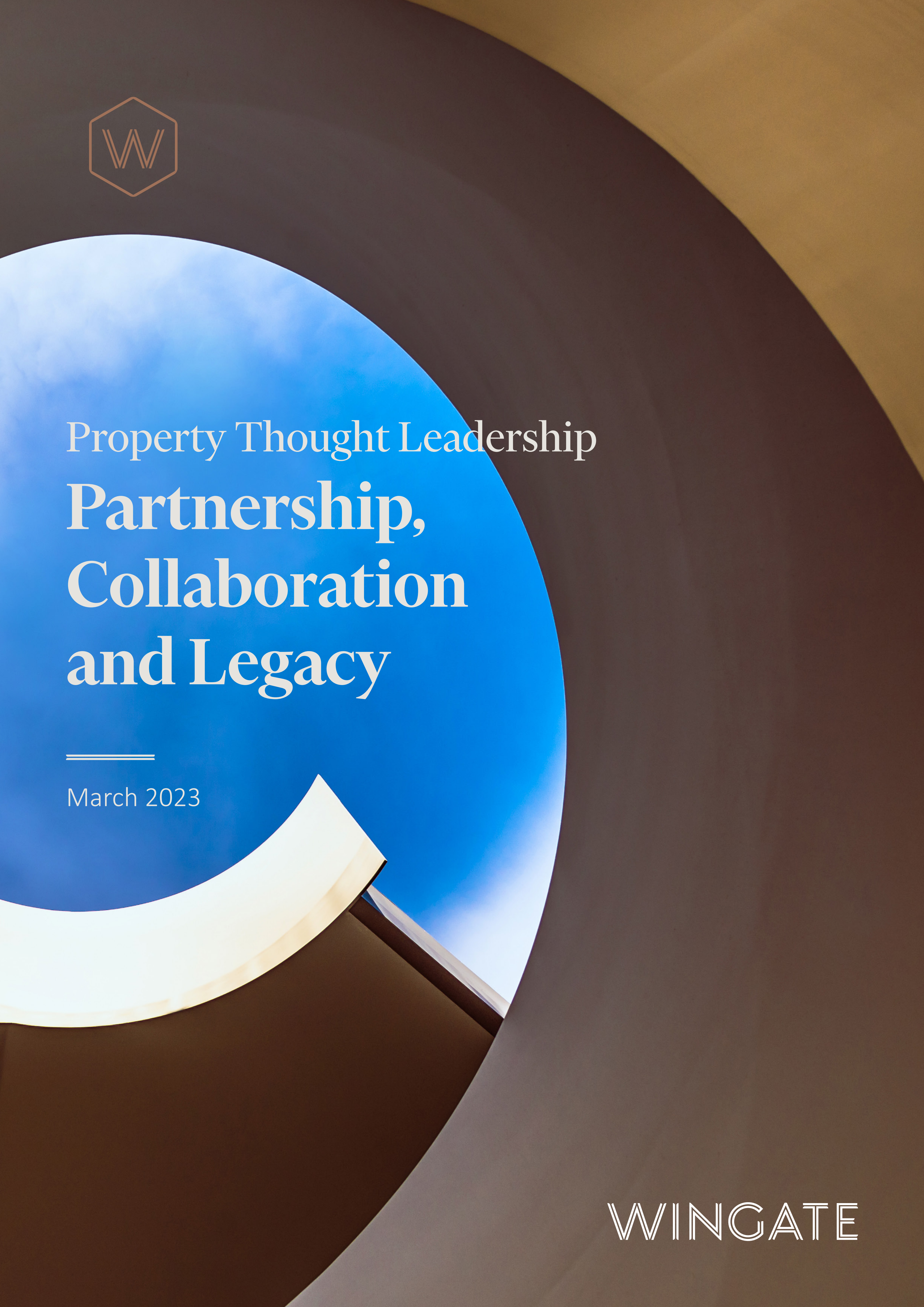
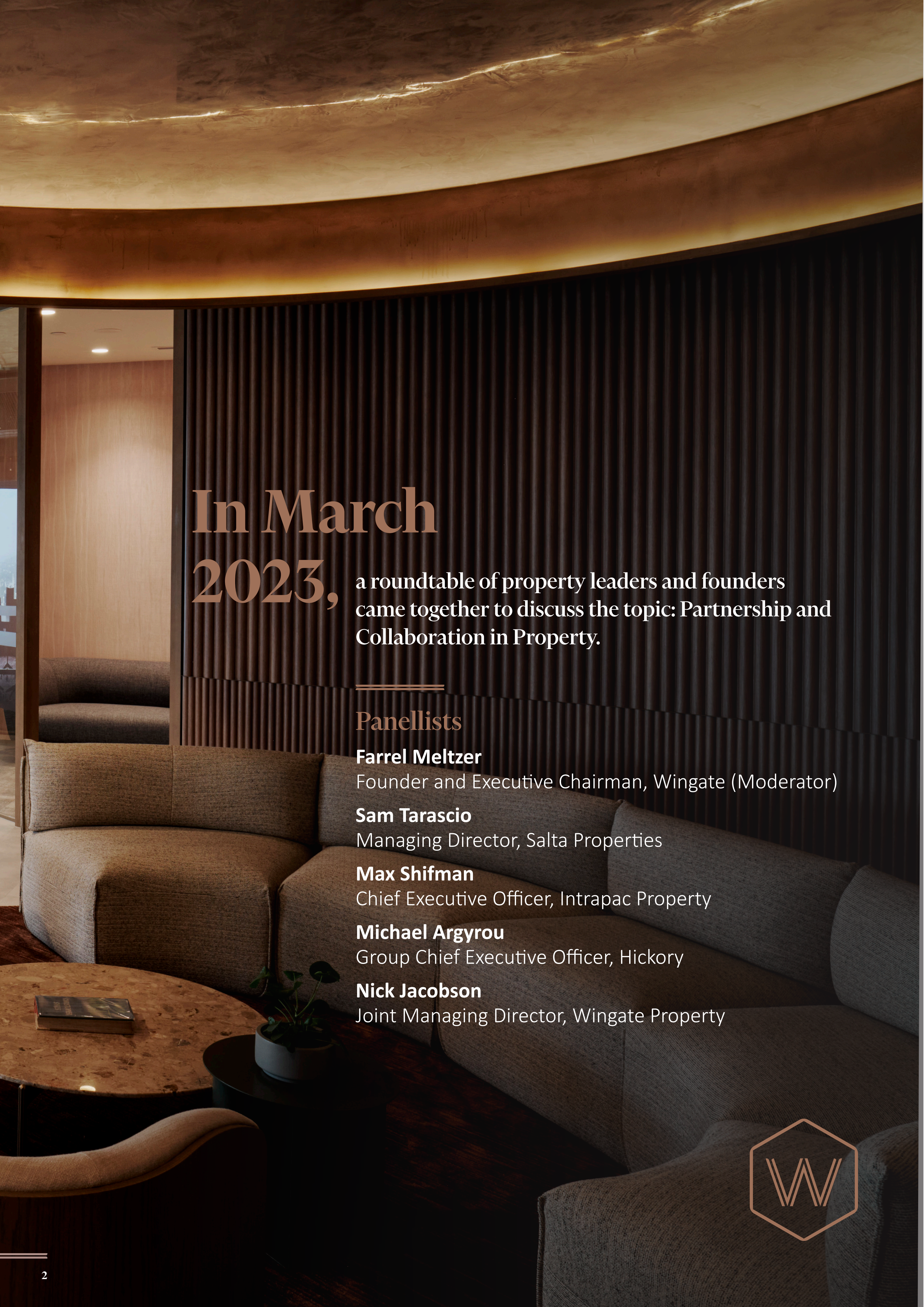


Property Thought Leadership

Partnership, Collaboration and Legacy

March 2023

WINGATE



In March 2023,

a roundtable of property leaders and founders came together to discuss the topic: Partnership and Collaboration in Property.

Panellists

Farrel Meltzer
Founder and Executive Chairman, Wingate (Moderator)

Sam Tarascio
Managing Director, Salta Properties

Max Shifman
Chief Executive Officer, Intrapac Property

Michael Argyrou
Group Chief Executive Officer, Hickory

Nick Jacobson
Joint Managing Director, Wingate Property

Partnership and working hand-in-hand

Michael Argyrou started Hickory Group with his brother George in their Melbourne garage in 1991. Bob Hawke was prime minister of Australia, Paul Keating treasurer and the nation was in deep recession.

"I feel like I started in an extraordinary time in the 1990's. I feel like I have been training for those extraordinary times again," Argyrou says of his firm, which evolved from a family-owned small business doing renovations and small builds to become one of Melbourne's largest construction companies.

Fast forward more than three decades, and he believes those extraordinary times have now returned. After navigating the depths of the COVID pandemic and the lengthy supply chain issues that emerged and remain, through to battling the surging prices of manufacturing costs, the property industry is now facing a long-term reckoning as rising costs and interest rates bite.

"I'm trying to think about how we create a dynamic business model that can move with the times and the volatility that will probably continue in some shape or form. I don't think the idea that things will settle is realistic," Argyrou told the forum.

In his opening commentary, Panel moderator and Wingate Founder Farrel Meltzer shared the context of the current times. Reflecting on the geopolitical unrest in the world, the economic machinations of central banks and the social influences shaping conversations, he reflected that there is both a sense of change and of positivity in the world.

"For astute investors and businesses who 'play the long game', whilst these are uncertain times, they are also a time of great opportunity."

"At Wingate, that ethos of taking a true partnership approach to each negotiation, to each investment and each individual, is how we built our business and our brand and it is what we are seeing come to bear in these times of uncertainty.

"We talk a lot about managing risk, but we also focus on identifying opportunity."

In such an environment, property owners, developers, builders and financiers are increasingly working hand-in-hand, recognising that their success is mutually dependent and that the value of the whole is almost always greater than the sum of the parts.

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>
> FARREL MELTZER

Michael Argyrou believes it is time to bring decency back to negotiating tables, especially in an environment where Hickory has shouldered 30 per cent price increases on some projects that were negotiated on a fixed price basis prior to the pandemic.

He says Hickory will no longer deal with clients that play hardball. “Sometimes the customers have been terrific. The partnership response has been refreshing and the price is adjusted,” he says.

“But more than half the time the response is ‘I can’t help you. We have a contract and you need to adhere to it.’ You just have to live with the cards you are dealt and work through it. It means you redefine what your future customer looks like. You work with other customers that you want to have a relationship with in the future.”

Sam Tarascio, the Managing Director of Salta Properties and Immediate Past President of the Victorian Division of the Property Council of Australia says the key for developers and contractors is to assess the risks in contracts at the outset - before disputes occur.

“The model we prefer is really about identifying the risk upfront. So particularly at the moment, we have a lot of ECI - early contractor involvement - arrangements where we are actually working with the contractor upfront to get documentation to a very high standard,” he told the forum.

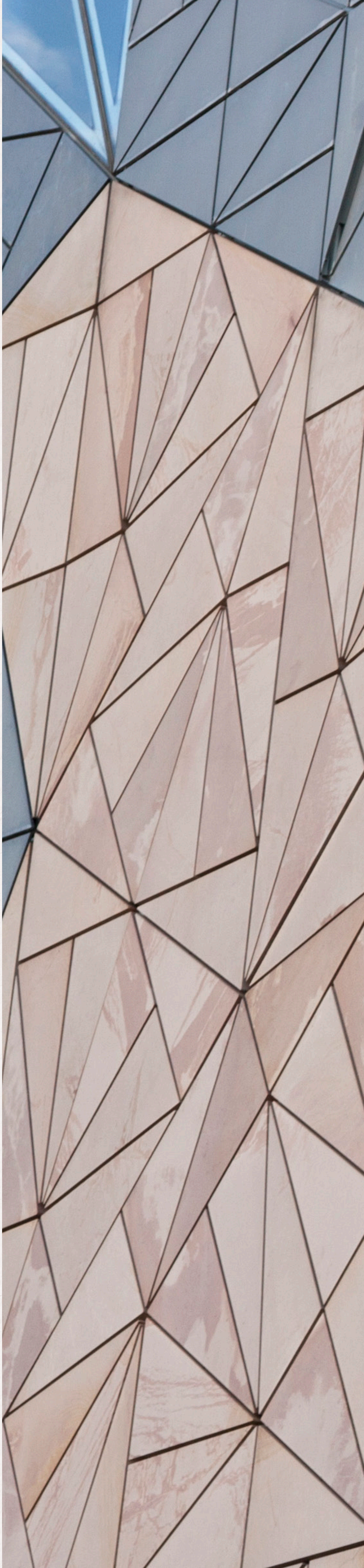
“We are trying to figure out where are the risks, what is the likely cost of those risks if they come to bear and figuring out upfront what is the best way to do it from a contractor point of view.”

Most importantly, he wants governments to stay out of these commercial relationships.

The national code of conduct for commercial tenancies established during COVID decreed that landlords could not terminate leases due to non-payment of rent during the pandemic and, additionally, were forced to provide rent concession based on a poorly thought through formula.

“Some of those who have benefited from those situations are now making record profits, paying record dividends and the landlords are still struggling with the impact of rising interest rates,” he says.

“We have to let the market figure out how to share risk. Because when the government does it, they usually muck it up exceptionally badly.”



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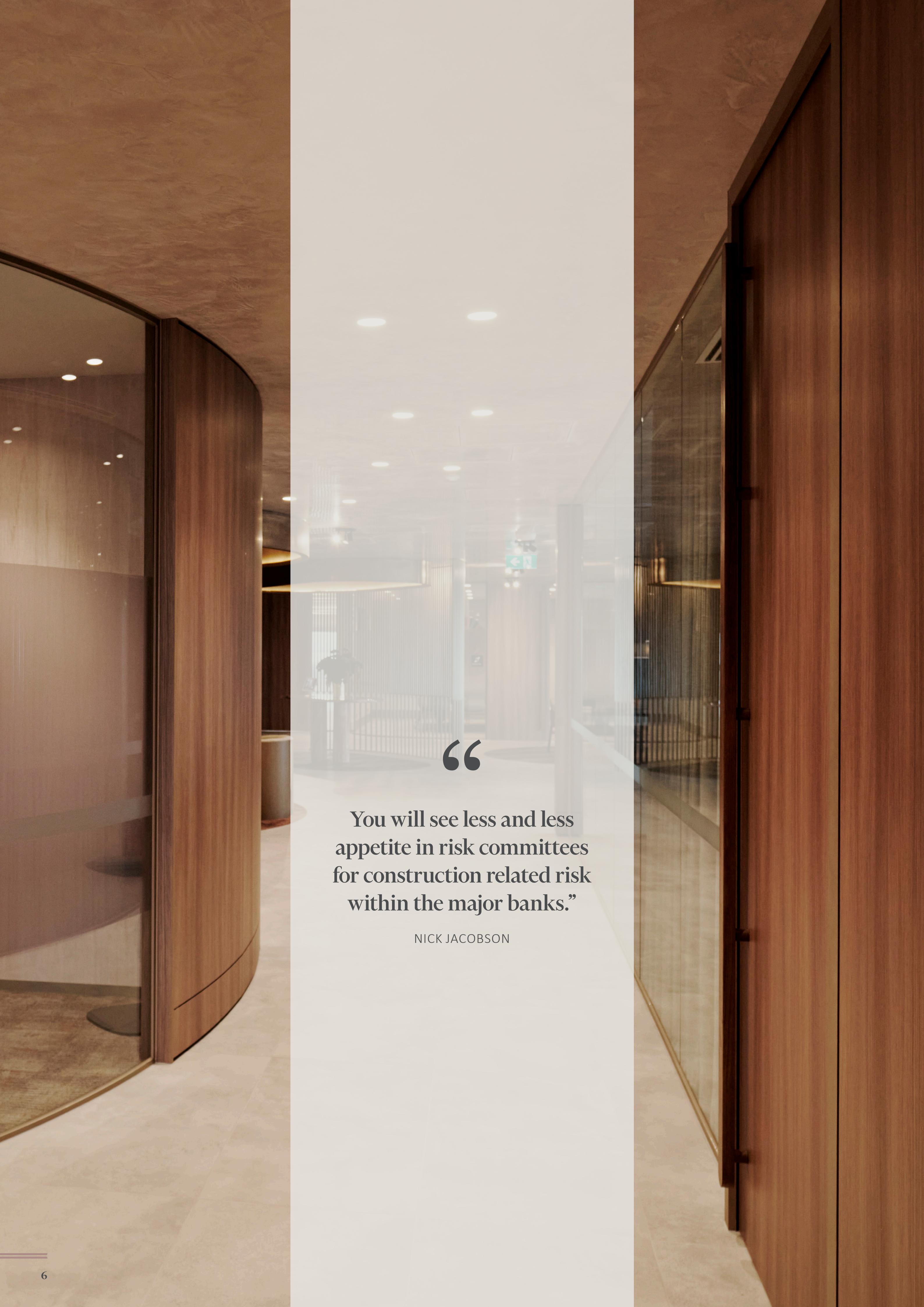
SAM TARASCIO



"You will see less and less appetite in risk committees for construction related risk within the major banks."

NICK JACOBSON

Partnerships creating innovation across the finance ecosystem

Partnerships across the property industry are now extending to innovation in financing.

While the major banks continue to have strong market share in lending for residential mortgages, they still lack the capacity to be flexible for other forms of commercial property lending because of their reticence to be exposed to construction risk.

Banks tend to refuse to lend against a cost-plus contract unless the buyer bears the risks, which has opened the door for non-bank lenders such as Wingate to be more innovative with financing options.

Nick Jacobson, Joint Managing Director, Wingate Property, told the forum that going forward, "you will see less and less appetite in risk committees for construction related risk within the major banks."

"Unfortunately, the impact of rate rises has had significant impacts on the valuations they provide credit to. Until that stabilises, we will see resistance within risk committees to advancing or renewing," he says.

On a risk adjusted basis, he says private credit has been an outstanding asset class for Wingate, especially in secured lending.

Michael Argyrou believes that out of the 15 major commercial property construction projects currently underway in Sydney and Melbourne, only "2 or 3" are being funded by the major banks.

Most are backed by offshore banks or non-bank lenders like Wingate.

Farrel Meltzer, Wingate's founder, says "the best of the best" are now borrowing from private lenders.

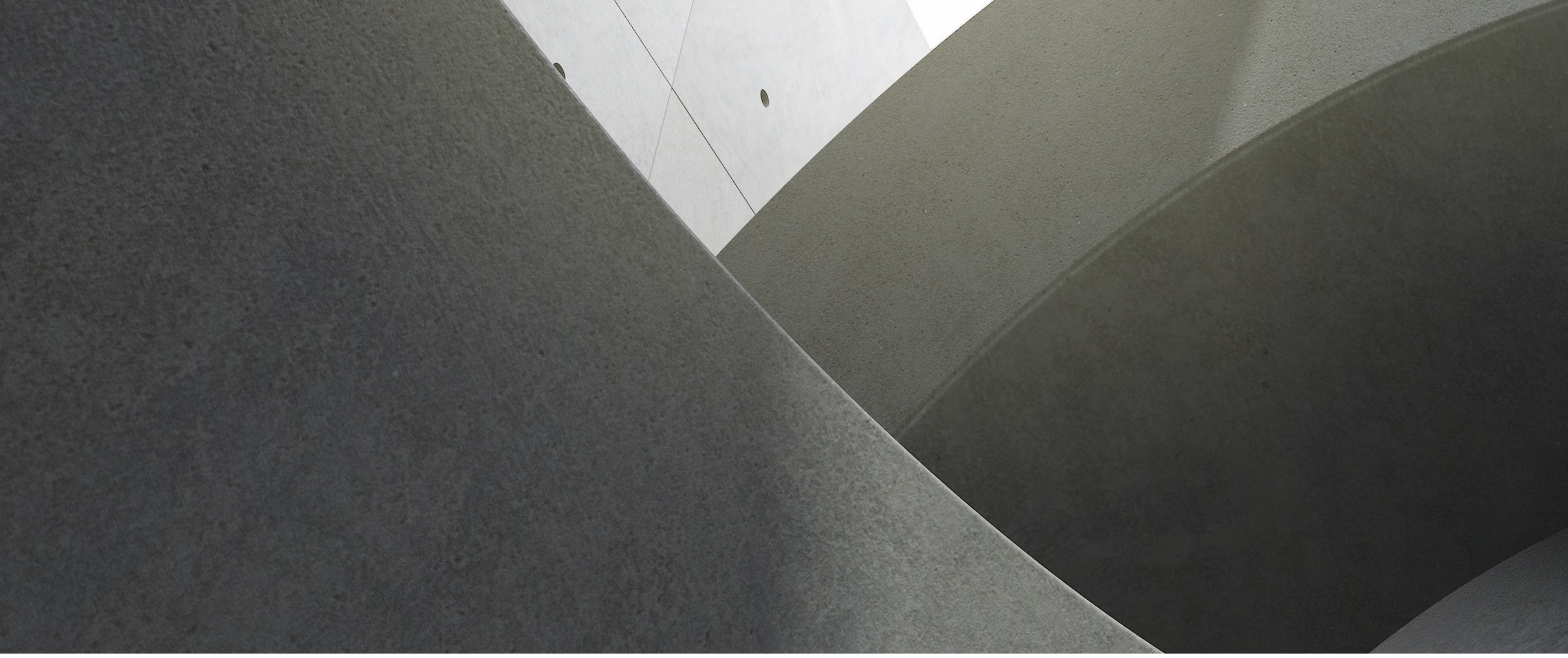
"Because that is where they get the best deals and form long-term partnerships," he told the forum.

Non-bank lenders such as the Wingate-backed ORDE Financial, an Australian non-bank mortgage lender, are now also providing growing competition to the banks in mortgage lending.

But Meltzer warns that as mortgage volumes across the market decrease that the actions of some non-bank lenders could have unwelcome consequences for borrowers and the economy.

APRA has told the major banks it expects they will assess new borrowers' ability to meet their loan repayments - the serviceability test margin - at an interest rate that is at least 3.0 percentage points above the loan product rate.

"What is happening now is this tremendous amount of competition as people are moving their mortgages around to try and find the cheapest rate. Many of the non-banks - not including us - have dropped their serviceability test margin to 1%," Meltzer says.



Property as a driver of the Australian economy

Navigating the affordability challenge

Intrapac Property has been doing residential land subdivisions and mixed-use developments for over 35 years, but the firm's CEO, Max Shifman says government policies, supply chain issues flowing from COVID and weather delays are now providing unprecedented challenges for land developers.

Shifman, who is also the National President of the Urban Development Institute of Australia, told the forum that land sales had "fallen off a cliff" in the wake of the Reserve Bank's initial move to increase interest rates last May. There have been a further nine increases since.

This is in stark contrast to the spike in sales over the previous two years, driven by government stimulus packages.

"Builders that were busier than ever are going to go from that to now having really little to do," he says, noting this was manifesting in increasing construction-related insolvencies across the country, which he expects to grow in coming months.

"The data is very clear: we are selling a lot less land now than in past years. Governments don't want to release more greenfield land because of policies trying to focus on infill instead. Yet at the same time, we are seeing apartment market approvals, which have been the release valve for big quantities of housing – at decade lows, virtually universally around the country. GFC-level lows. At a time when rental vacancy rates are less than 1 per cent and people are flooding back into the country."

He said something "simply has to give."

"Any sustained housing recovery will come down to borrowing capacity. It's the number one thing that can make a difference. Whether it's civil works, apartment or house building costs, all have risen 30 per cent over the last two years. You've got to reach a point where consumers can afford to pay a price which reflects the new input costs, whatever they are. But until then, we will be sitting in a viability crisis where new development just does not happen at scale for a while. I think we are just at the start of that crisis. I can't say how long it will last, but I think it will take a number of years."

The affordability crisis, Shifman believes, will force a change in people's expectations for housing.

"Consumers will either have to buy really small lots in greenfield with smaller homes, or they are going to look to urban infill, primarily in the townhouse space," he says.

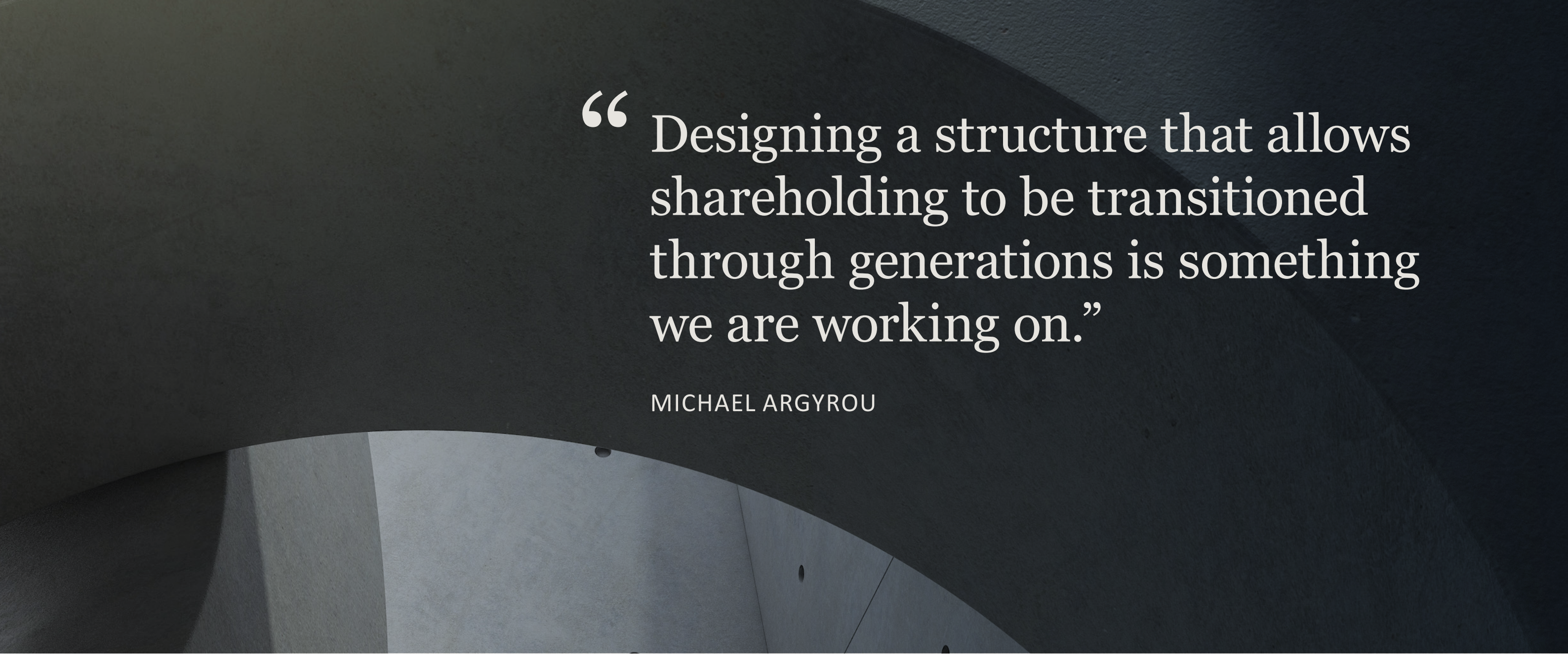
"They will need to give up some of the dream of having the big backyard and everything that comes with a large house. I think that is where we will trend purely because of the affordability challenges."

While Nick Jacobson says that longer term, investing in residential property is still "a really good place to be" in the Australian property market, the current affordability crisis can only be addressed by collaboration and co-operation.

"We can't blame the Reserve Bank. Unfortunately, there are other regulators, state governments and local governments which have to come to the party to change the paradigm for the affordability of property. It is not about the cost of money only," he says.

"As we have seen elsewhere in the world, it will be resolved. But under duress."

> "It still just comes back down to borrowing capacity. It's the number one thing that can make a difference."
>
> MAXWELL SHIFMAN



Succession and succeeding

Preserving property legacy

According to some figures, around $4 trillion is projected to be transitioned between Australian generations over the next 20 years. A significant proportion of that is in property.

Sam Tarascio told the forum that in 2018 Salta Properties agreed to bring in an external consultant to help the Tarascio family establish a formal business board and a family board - which he chairs - as well as a family charter and a set of values for Salta.

"I worked with my father for over 20 years and learned a lot from him. But it is not easy. People who have founded businesses and have done things a certain way, to let go of the reins can be a real challenge," Tarascio told the forum.

"I have been running the business for 17 years but my father still comes in every day. We have a set of rules and formulas which dictate how the family business is run and how decisions are made. Tarascio says the rules apply for the transition to the next generation and post the transition when his parents are no longer alive.

"Upfront planning is the most critical aspect to that," he says.

Intrapac Property founder David Payes is another founder who has learned to let go, agreeing to pass the CEO reins to Max Shifman - his son-in-law. Neither of Payes' two daughters are involved in the business.

Shifman spent nine months in discussion with Payes before he agreed to join the business in 2011. He then spent almost seven years as Chief Operating Officer before taking the top job.

"To David's credit, he is brilliant at giving people enough rope and helping them find their own way. In terms of pipeline, we are around eight times bigger now than when I joined. That is about being more aggressive about growth and also looking at new areas of opportunity. It has worked out really well for all of us," Shifman says.

"It came down to the fact that for the business to succeed long term, David realised he had to let someone else take the reins."

By contrast, more than 30 years after starting Hickory Group, Michael Argyrou is in the midst of plotting his succession planning journey. One of his sons has just started a Cadetship at Hickory. But Argyrou is clear: there will be no special favours for family.

"My philosophy for my four children is 'Don't expect to just be taking our spots in the business'. If they are interested, they can go through the programs and where they get to, they get to. If you aspire to be the boss, fight with the 700 others in the business and let the best person win," he says.

"Designing a structure that allows shareholding to be transitioned through generations is something we are working on. Hopefully, we get that right. I'm sure there will be some tumult, turmoil or whatever you want along the way. But we are prepared for it."

"We have a set of rules and formulas which dictate how the family business is run and how decisions are made."

SAM TARASCIO

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MICHAEL ARGYROU

As part of the closing of the forum, Farrel Meltzer invited the panellists to forecast to March 2024 and provide their estimates on where the Reserve Bank of Australia cash rate will sit.

3.6%

March 2023 official cash rate

March 2024

Estimates were as follows:

4.5%
MICHAEL ARGYROU

3.0%
SAM TARASCIO

4.35%
MAXWELL SHIFMAN

4.1%
NICK JACOBSON

WINGATE

MELBOURNE

Level 48,
101 Collins Street
Melbourne, VIC, 3000

Ph: +61 3 9913 0700

SYDNEY

Governor Phillip Tower
Level 37
1 Farrer Place,
Sydney, NSW, 2000

Ph: +61 2 8039 0900