

School of Design and the Built Environment

**An Improved Model for Assessing the Viability of Small developers
During Lending Applications**

**Monica Martin
19211765**

**This thesis is presented for the Degree of
Doctor of Philosophy of
Construction Management
of
Curtin University**

November 2021

DECLARATION

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

The research presented and reported in this thesis was conducted in accordance with the National Health and Medical Research Council National Statement on Ethical Conduct in Human Research (2007) – updated March 2014. The proposed research study received human research ethics approval from the Curtin University Human Research Ethics Committee (EC00262), Approval Number HRE2018-0746.

Signature: 

Date: **24 June 2022**

ABSTRACT

Property development projects require intensive capital, and many players in the sector are small in size and have had unique limitations. Small developers share attributes with small businesses in terms of employment size; however, they undertake commercial activities that require substantial financing, more extensive than a typical small business in other sectors. Lenders often struggle to understand the strength and commercial opportunities of small developers as the industry knows them. Thus, small developers applying for finance are seen as high-risk small business borrowers that will struggle to succeed or as borrowers in a high-risk business environment where success may become highly unlikely. Clear implications of these views are default pessimism, prejudice and disempowerment of a sector that contributes significantly to the economy.

This study explores why and how lenders' loan application assessment processes of small property developers are complex and onerous. In particular, the study examines how lenders understand and interpret small developers' corporate capacity, whether as a strength or limitation; factors that influence lenders' perceptions regarding the viability of small developers during finance application processes are examined. A systematic review of extant literature suggests lenders' considerations focus on seven credit risk areas: regulatory restrictions, lenders' risk appetite, the physical nature of property development, capital input, ineffective limited liability, securities and guarantees, and small developers' experience.

These themes were tested using evidence reported by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The Commission recommended a clarification and expansion of the Australian Banking Association's small business definition. In order to maintain access to affordable credit, no appetite for increased protections on small businesses' part was found. While the Commission's findings point to problems in lenders' broad credit processes, its focus was not on credit viability assessments of small developers. Small developers are assessed as complex and sophisticated borrowers compared to other small businesses due to their high loan values and access to specialists during

the development process. Credit viability appraisals of small developers are more burdensome than those of large developers, as an all-moneys approach is followed. An all-moneys approach affords lenders more flexibility when evaluating a small business' serviceability potential and security quality by considering the financial position and assets of small development businesses and their owners as the same. Extant credit assessment models do not effectively address the complexity of small developers' proposals' credit assessment process. A small developer acts as a project manager that coordinates input provided by their network and specialists; these role players may not be aware of the implications of their reporting on credit assessment processes. This study proposes a more appropriate model to assess small developers' credit applications.

The proposed improved credit risk assessment model for credit viability of small developers focus on lenders' seven risk assessment areas and introduce antecedent and intervening factors that affect their credit risk assessment. A first research design stage considered evidence provided to the Commission to identify all possible variables affecting credit risk assessment processes of small developers' proposals. Interviews, conducted with two small developers and a banker, and a focus group of two bankers addressed limitations of the Commission's investigations into small developers' credit viability assessment. A conceptual credit viability risk assessment model of small developers' proposals was developed from data analysis of this research stage. During data collection stage two, a small group of experts provided external conceptual model validation. This conceptual model was then tested through an industry survey with 217 participants.

Using mixed methods in an integrated and structured pragmatic research design avoided utilitarian use this research paradigm. A dynamic pluralist epistemology and non-singular reality ontology allowed the inclusion of individuals' vantage points, added depth to the research, and supported data triangulation. Value-laden axiology balanced potential biases by considering opposite perspectives and objective evidence. Internal validity of survey results was considered against Chronbach's alpha, which indicated high internal consistency of questions relating to lenders' seven risk assessment areas. A principal component factor analysis indicated eight factors, suggesting that an additional factor could be derived from independent and

antecedent variables of two credit risk assessment areas: ineffective limited liability and small developers' experience. This difference could be explained by the non-linearity of antecedent and intervening variables in the proposed improved credit risk assessment model. The sample size was considered against the lowest response rate to a question and the original number of factors. A ratio of 13,9:1 was sufficient to conduct a principal component factor analysis and, therefore, achieving saturation.

Findings from this study support lenders' seven credit risk areas identified and indicate a high correlation between antecedent and intervening variables relating to the independent variables. The proposed improved credit risk assessment for small developers' loan applications will assist small developers to understand better how their loan applications are assessed and judge their propensity to succeed. Lenders will find this model helpful to conceptualise areas of credit risk assessment processes that could be simplified to improve their borrowers' experience of loan viability assessment. This study contributes to small developer credit assessment knowledge, a discussion currently lacking in academic discourse and extant literature. The impact of quality legal and financial advice on small developers' success during credit viability assessment presents an opportunity for future research.

Key words: Small developer, Property development, Development loan, Construction loan, Credit risk assessment, Credit proposal viability, Credit application.

ACKNOWLEDGEMENTS

Thank you to my supervisors from the Department of Construction Management, School of the Built Environment at Curtin University. I am grateful for Associate Professor Oluwole Alfred Olatunji. Your enthusiasm for the industry, academia and research is contagious, and provided me great encouragement to complete this thesis. Thank you also to Dr Chamil Erik Ramanayaka for your valuable support.

This research would not have been possible without the input from interviewees, specialists and industry experts. I appreciate their generous sharing of information, time and knowledge. I would also like to thank Professor Daan Nel, who assisted me with the principal component analysis of survey results.

Anthony Martin, my loving husband, your support, encouragement and patience cannot be overstated. You have been my inspiration for this study and share in this achievement. Thank you for many conversations about this work and believing in me. I would also like to acknowledge my parents, who have always encouraged me on my education path. I appreciate your constant interest and support towards reaching this academic milestone. Thank you to my three boys, Ethan, Liam and Aaron for asking about my “school-day” often. I hope this achievement will be an inspiration to you to follow your dreams.

I am grateful to lecturers and colleagues at Curtin University for continuous interest in my work and their encouragement. Thank you also to friends who asked about my progress. I would also like to thank previous lecturers and supervisors who encouraged me to complete this degree. Thank you to the friendly staff at Whitfords Library (Hillarys, WA) where I have spent much time working without distraction.

This research is supported by an Australian Government Research Training Program (RTP) Scholarship.

TABLE OF CONTENTS

| | |
|--|--------------------|
| DECLARATION | <i>i</i> |
| ABSTRACT | <i>ii</i> |
| ACKNOWLEDGEMENTS | <i>v</i> |
| TABLE OF CONTENTS | <i>vi</i> |
| LIST OF FIGURES | <i>xi</i> |
| LIST OF TABLES | <i>xiii</i> |
| GLOSSARY OF TERMS | <i>xv</i> |
| LIST OF DEFINITIONS | <i>xvi</i> |
| CHAPTER 1 INTRODUCTION TO THESIS | <i>1</i> |
| 1.1 General introduction | <i>1</i> |
| 1.2 Background | <i>4</i> |
| 1.2.1 Economic significance of small businesses..... | <i>4</i> |
| 1.2.2 The importance of small developers..... | <i>5</i> |
| 1.2.3 Access to finance | <i>8</i> |
| 1.2.4 Risks and risk-taking behaviour | <i>11</i> |
| 1.2.5 Technology and paradigm shifts as drivers of change..... | <i>11</i> |
| 1.3 The research problem | <i>13</i> |
| 1.3.1 Importance of the research..... | <i>15</i> |
| 1.3.2 Research aim and objectives | <i>16</i> |
| 1.3.3 Research questions..... | <i>16</i> |
| 1.3.4 Research methods | <i>18</i> |
| 1.3.5 Research design..... | <i>20</i> |
| 1.4 Delimitations | <i>21</i> |
| 1.5 Thesis structure | <i>22</i> |
| 1.6 Summary of General Introduction | <i>25</i> |
| CHAPTER 2 CONCEPTUAL FRAMEWORK: REVIEW OF DEFINITIONS, LEGISLATIVE PROTECTION AND ACCESS TO FINANCE | <i>27</i> |
| 2.1 Introduction of research concepts | <i>27</i> |
| 2.2 Small business definitions and characteristics | <i>29</i> |
| 2.2.1 The use of outer-limits for small business definitions..... | <i>29</i> |
| 2.2.2 Small business characteristics..... | <i>30</i> |
| 2.3 Small business definitions in Australian legislation | <i>32</i> |
| 2.3.1 Background to credit legislation around small businesses | <i>32</i> |
| 2.3.2 Australian legislative definitions relevant to this study..... | <i>33</i> |
| 2.3.3 A note on government policy interventions during economic downturns..... | <i>38</i> |
| 2.4 Defining a small developer | <i>39</i> |
| 2.4.1 Conceptual understanding of a property developer | <i>39</i> |
| 2.4.2 Categories of property developers | <i>39</i> |
| 2.4.3 Small developer definition for this study | <i>40</i> |

| | | |
|---|--|------------|
| 2.5 | Access to finance | 41 |
| 2.5.1 | Limited finance sources and financial bricolage theory | 41 |
| 2.5.2 | The development process and finance methods..... | 43 |
| 2.5.3 | Two models for conceptualising credit risk assessment..... | 46 |
| 2.5.4 | Financial literacy | 51 |
| 2.6 | Summary of Chapter 2 | 53 |
| CHAPTER 3 RESEARCH METHODOLOGY AND DESIGN | | 56 |
| 3.1 | Introduction to research methodology and design | 56 |
| 3.2 | Development of the research paradigm | 59 |
| 3.2.1 | Background to the utility of a research paradigm..... | 59 |
| 3.2.2 | Pragmatism as an alternative paradigm..... | 60 |
| 3.2.3 | A dynamic pluralist epistemology..... | 61 |
| 3.2.4 | Ontology: A non-singular reality | 62 |
| 3.2.5 | Axiology (ethical considerations) | 64 |
| 3.3 | Research approaches | 66 |
| 3.4 | Data collection methodology | 66 |
| 3.4.1 | Plowright’s structure for mixed-methods research..... | 67 |
| 3.4.2 | Defining mixed-methods research and its limitations for this study..... | 69 |
| 3.5 | Research design | 74 |
| 3.5.1 | Data collection..... | 74 |
| 3.5.2 | Case selection criteria and sampling strategy..... | 76 |
| 3.5.3 | Data analysis and validity | 79 |
| 3.5.4 | Limitations and disclosures | 83 |
| 3.5.5 | Reliability..... | 85 |
| 3.6 | Summary of Chapter 3 | 86 |
| CHAPTER 4 ANALYSIS OF THE EVIDENCE OF THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY (2017 – 2019) REGARDING FINANCING OF SMALL BUSINESSES AND PROPERTY DEVELOPMENT | | 87 |
| 4.1 | The relevance of the FSRC Round 3 Hearings to this study | 87 |
| 4.2 | Research methods used in analysing the FSRC Round 3 data and reports | 91 |
| 4.2.1 | Background to the FSRC data analysis..... | 91 |
| 4.2.2 | The data sources, their treatment and limitations | 94 |
| 4.2.3 | Disclosure notes..... | 95 |
| 4.3 | Conclusions of the Final Report: Round 3 Hearings | 97 |
| 4.3.1 | FSRC recommendations related to Round 3 Hearings..... | 97 |
| 4.3.2 | Refinement of the definition of a small business..... | 98 |
| 4.3.3 | Regulation and protection of small businesses | 100 |
| 4.4 | General notes on the FSRC data analysis | 102 |
| 4.4.1 | Relationship banking and mistrust..... | 102 |
| 4.4.2 | Reliance on a prudent banker..... | 106 |
| 4.4.3 | Flexibility in lending: the all-moneys instrument and the ineffective limited liability conundrum..... | 107 |
| 4.4.4 | Lenders’ opinion about the small developer | 111 |
| 4.4.5 | Non-monetary clauses apply to small developer credit contracts..... | 113 |
| 4.5 | FSRC property development case studies | 115 |
| 4.5.1 | Background to the FSRC Round 3 property development case studies..... | 115 |

| | | |
|---|--|------------|
| 4.5.2 | Data management and analysis of FSRC property development case studies..... | 119 |
| 4.5.3 | Data analysis using co-occurrence matrices..... | 120 |
| 4.5.4 | FSRC property development case study analysis findings..... | 125 |
| 4.6 | Contribution of Chapter 4 to research questions and objectives..... | 127 |
| 4.7 | Summary of Chapter 4 | 130 |
| CHAPTER 5 UNDERSTANDING RISK CONSIDERATION BY BANKS IN SMALL DEVELOPERS' CREDIT APPLICATIONS..... | | 132 |
| 5.1 | Introduction to understanding banks' risk considerations regarding small developers' credit applications..... | 132 |
| 5.2 | Participation by banks and sample challenges | 133 |
| 5.3 | Research methods of banks' risk considerations during small developer credit assessment | 135 |
| 5.4 | Data analysis of banks' risk consideration during small developer credit assessment | 136 |
| 5.4.1 | An overview of the data analysis of research with bankers..... | 136 |
| 5.4.2 | Interview with P1..... | 139 |
| 5.4.3 | Focus group with P2 and P3 | 147 |
| 5.5 | Co-occurrence matrix analysis of banks' risk considerations during small developer credit assessment | 157 |
| 5.5.1 | Summary of results from the co-occurrence matrix of banks' risk consideration regarding small developer credit..... | 158 |
| 5.6 | Discussion of bankers' key risk considerations during small property development credit assessments..... | 161 |
| 5.6.1 | Tiers of small developers..... | 161 |
| 5.6.2 | A separate building contract splits the financial risk..... | 162 |
| 5.6.3 | Second-tier commercial lenders in the property development market | 162 |
| 5.6.4 | Large builders are involved in the small property development market..... | 163 |
| 5.6.5 | Goods and services tax (GST) | 164 |
| 5.6.6 | Exposure and serviceability..... | 164 |
| 5.6.7 | Other banker-perceived red flags relating to the borrower's position..... | 165 |
| 5.7 | Contribution of Chapter 5 to the research questions and objectives..... | 166 |
| 5.8 | Summary of Chapter 5 | 169 |
| CHAPTER 6 SMALL DEVELOPERS' PERSPECTIVES OF RISK CONSIDERATIONS OF CREDIT APPLICATION ASSESSMENT | | 172 |
| 6.1 | Introduction to interviews with small developers..... | 172 |
| 6.2 | Participation by small developers and sample challenges..... | 173 |
| 6.3 | Research methods of small developers' risk considerations of credit application assessment | 174 |
| 6.4 | Data analysis of small developers' risk perspectives during the credit viability assessment process | 175 |
| 6.4.1 | An overview of the data analysis of research with small developers..... | 175 |
| 6.4.2 | Interview with P4..... | 177 |
| 6.4.3 | Interview with P5..... | 183 |

| | | |
|--|---|------------|
| 6.5 | Co-occurrence matrix analysis of connections between small developer interview nodes..... | 191 |
| 6.5.1 | Summary of results from the co-occurrence matrix of small developers' risk perception during credit viability assessment..... | 191 |
| | | 194 |
| 6.6 | Discussion of small developer interview analysis and results | 195 |
| 6.6.1 | Access to finance is critical | 195 |
| 6.6.2 | Use of non-bank finance | 196 |
| 6.6.3 | The importance of a reliable and financially capable contractor..... | 196 |
| 6.6.4 | P5's notes on GST..... | 197 |
| 6.6.5 | The small developer's business model and risk awareness..... | 197 |
| 6.6.6 | Loans declined..... | 199 |
| 6.7 | Contribution of Chapter 6 to the research questions and objectives..... | 199 |
| 6.8 | Summary of Chapter 6 | 202 |
| CHAPTER 7 DEVELOPING AN APPROPRIATE MODEL FOR ASSESSING RISK IN CREDIT APPLICATIONS OF SMALL DEVELOPERS..... | | 204 |
| 7.1 | Introduction | 204 |
| 7.2 | Background to the conceptual credit risk assessment model..... | 205 |
| 7.2.1 | Internal validation of the conceptual model | 207 |
| | | 210 |
| 7.2.2 | A conceptual credit risk assessment model for the viability of small developer lending applications..... | 211 |
| 7.3 | External validation of the conceptual credit risk assessment model | 216 |
| 7.3.1 | Background to expert panel evaluation of the conceptual credit risk assessment model | 216 |
| 7.3.2 | Data analysis of expert panel feedback..... | 217 |
| 7.3.3 | Updates to the conceptual credit risk assessment model for the viability of small developer lending applications | 218 |
| 7.4 | Summary of Chapter 7 | 221 |
| CHAPTER 8 A QUANTITATIVE MODEL FOR AN IMPROVED RISK ASSESSMENT OF THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS | | 222 |
| 8.1 | Introduction | 222 |
| 8.2 | Research methods for an industry survey | 222 |
| 8.2.1 | Background to the industry survey research methods..... | 222 |
| 8.2.2 | Industry survey design and participant selection | 223 |
| 8.2.3 | The data sources, their treatment and limitations | 225 |
| 8.2.4 | Saturation and reliability..... | 229 |
| 8.3 | Data analysis of industry survey results | 230 |
| 8.3.1 | Overview of statistical correlations..... | 230 |
| 8.3.2 | Regression analysis results of each question..... | 238 |
| 8.3.3 | Summary of additional factors noted in written comments to Question 9..... | 242 |
| 8.4 | Principal component analysis results and discussion | 244 |
| 8.5 | Survey findings and an improved model risk assessment model for the viability of small developers during lending applications..... | 249 |
| 8.6 | Contribution of Chapter 8 to research objectives..... | 254 |

| | | |
|---|---|------------|
| 8.7 | Summary of Chapter 8 | 254 |
| CHAPTER 9 DISCUSSION OF AN IMPROVED CREDIT RISK ASSESSMENT MODEL FOR THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS256 | | |
| 9.1 | Introduction to the discussion of an improved credit risk assessment model | 256 |
| 9.2 | Discussion of the study's findings | 257 |
| 9.2.1 | Exclusion from small business protections..... | 257 |
| 9.2.2 | Other regulatory hurdles..... | 257 |
| 9.2.3 | Lenders' main risk assessment criteria..... | 258 |
| 9.2.4 | The assessment process is complicated | 258 |
| 9.2.5 | Bank risk-mitigating measures..... | 260 |
| 9.3 | Implications of the research..... | 261 |
| 9.3.1 | The larger context: small business credit | 261 |
| 9.3.2 | A focus on experienced, prudent and diligent bankers..... | 262 |
| 9.3.3 | Taking advice | 263 |
| 9.3.4 | A fundable business model | 264 |
| 9.3.5 | Implications of additional bank risk mitigation measures..... | 265 |
| 9.3.6 | A market gap created..... | 266 |
| 9.3.7 | Complex technology needed to simplify the assessment process..... | 267 |
| 9.4 | Research gaps | 267 |
| 9.5 | Summary of Chapter 9 | 268 |
| CHAPTER 10 CONCLUSION OF THE DEVELOPMENT OF AN IMPROVED CREDIT RISK ASSESSMENT MODEL FOR THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS.....270 | | |
| 10.1 | Introduction | 270 |
| 10.2 | Conclusory remarks on the improved credit risk assessment model for small developers' viability | 272 |
| 10.3 | Synthesis..... | 274 |
| LIST OF REFERENCES..... | | 276 |
| APPENDICES | | 288 |
| APPENDIX 1: Research approval by Curtin Human Ethics Committee | | 288 |
| APPENDIX 2: Survey questions (demonstration document) | | 290 |
| APPENDIX 3: Sample section of part of focus group transcript | | 295 |

LIST OF FIGURES

| | |
|--|-----|
| Figure 1.1: Local economic importance of small developers during tough economic contractions | 7 |
| Figure 1.2: Theoretical rationale of the research..... | 14 |
| Figure 1.3: Research area: the loan viability assessment process | 22 |
| Figure 1.4: Illustration of thesis outline..... | 23 |
| Figure 2.1: Property development process and financing stages | 46 |
| Figure 2.2: Suggested project business plan aligning with documentary requirements | 49 |
| Figure 2.3: GST steps for residential property | 53 |
| Figure 3.1: Circular approach to research thinking..... | 56 |
| Figure 3.2: Summary of research thinking for this study | 58 |
| Figure 3.3: General framework of a bank acting as an intermediary agent..... | 64 |
| Figure 3.4: The extended FraIM..... | 68 |
| Figure 3.5: The FraIM research design as a simple three-dimensional model | 69 |
| Figure 3.6: The mixed-methods used for this study indicated in the three-dimensional FraIM | 73 |
| Figure 3.7: The research design, informed by the proposed theoretical rationale | 76 |
| Figure 4.1: The assessment process indicated in the interaction between the bank and small developer during the credit process..... | 93 |
| Figure 4.2: A mirrored overview comparing small business and bank characteristics affecting the loan process..... | 106 |
| Figure 4.3: Data management and analysis strategy, using cases in NVivo software, for two property development case studies extracted from the FSRC Round 3 Hearings Transcript of Proceedings and the FSRC Interim and Final Reports..... | 120 |
| Figure 5.1: Mind-map from interview with P1 | 144 |
| Figure 5.2: Coding frequency of nodes from interview with P1..... | 147 |
| Figure 5.3: Mind-map from focus group with P2 and P3 | 154 |
| Figure 5.4: Coding frequency of nodes from a focus group with P2 and P3..... | 157 |
| Figure 6.1: Mind-map from the interview with P4..... | 181 |
| Figure 6.2: Coding frequency of nodes from the interview with P4..... | 183 |
| Figure 6.3: Mind-map from the interview with P5..... | 189 |

| | |
|--|-----|
| Figure 6.4: Coding frequency of nodes from the interview with P5 | 191 |
| Figure 7.1: Conceptual credit risk assessment model for the viability of small developers during lending application..... | 215 |
| Figure 7.2: Updated conceptual credit risk assessment model for the viability of small developers during lending applications | 220 |
| Figure 8.1: The drivers of the linear regression of the independent variables indicated on the updated conceptual credit risk assessment model..... | 242 |
| Figure 8.2: Scree plot of principal component analysis indicating eight factors | 244 |
| Figure 8.3: The distribution of the eight factors of the principal component analysis of the 29 statements indicating their positions in the conceptual credit risk assessment model | 249 |
| Figure 8.4: An improved risk assessment model for the viability of small developers during lending applications..... | 253 |

LIST OF TABLES

| | |
|--|-----|
| Table 1.1: Relationship of research questions to objectives | 18 |
| Table 2.1: Summary of small business definitions | 37 |
| Table 2.2: The 'Five C's' of credit assessment | 50 |
| Table 4.1: High co-occurring nodes from the FSRC property development case studies | 124 |
| Table 4.2: Contribution of reports and testimonies given at the FSRC to research questions and objectives | 130 |
| Table 5.1: Summary of participant codes | 135 |
| Table 5.2: Summary of the relationship between the research questions and the interview questions to bankers | 138 |
| Table 5.3: Summary of banks' risk consideration regarding small developer credit assessment co-occurrence matrix analysis | 159 |
| Table 5.4: Matrix of high co-occurring nodes from interviews with banks | 160 |
| Table 5.5: Contribution of data analysis of banks' risk consideration regarding small developer credit | 169 |
| Table 6.1: Summary of the relationship between small developer interview questions and the research questions | 177 |
| Table 6.2: Summary of small developers' risk considerations during the loan application assessment process co-occurrence matrix analysis | 193 |
| Table 6.3: Matrix of high co-occurring nodes from interviews with small developers | 194 |
| Table 6.4: Contribution of data analysis of interviews with small developers | 201 |
| Table 7.1: Summary of integrated high co-occurring nodes from Data Collection Stage 1 | 209 |
| Table 7.2: Matrix of high co-occurring nodes from interviews with small developers | 210 |
| Table 8.1: Summary of reasons from participants that formally declined to participate | 224 |
| Table 8.2: Completed number of responses per survey question | 225 |
| Table 8.3: Table of statement numbers and question numbers relating to the statements | |

Error! Bookmark not defined.

Deleted:

| | |
|---|-----|
| Table 8.4: Summary table of internal consistency of composite scores using Chronbach's alpha | 230 |
| Table 8.5: Summary of statistical correlations of 29 statements of industry survey | 233 |
| Table 8.6: Correlation summary of 29 statements of industry survey | 237 |
| Table 8.7: Linear regression analysis of each statement relating to each independent variable | 239 |
| Table 8.8: Principal component analysis indicated as a covariance matrix with eight factors | 246 |

GLOSSARY OF TERMS

| | | |
|----------|---|---|
| ABA | - | Australian Banking Association |
| ABS | - | Australian Bureau of Statistics |
| ACCC | - | Australian Competition and Consumer Commission |
| AFCA | - | Australian Financial Complaints Authority |
| ANZ | - | Australia and New Zealand Banking Group |
| APRA | - | Australian Prudential Regulation Authority |
| ASIC | - | Australian Securities and Investments Commission |
| BEAR | - | Banking Executive Accountability Regime |
| CBA | - | Commonwealth Bank of Australia |
| CEO | - | Chief Executive Officer |
| CIO | - | Credit and Investments Ombudsman |
| Covid-19 | - | Corona Virus Disease (2019 novel coronavirus) |
| DLT | - | Distributed Ledger Technology |
| FOS | - | Financial Ombudsman Services |
| FSRC | - | Financial Services Royal Commission (Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry) |
| FraIM | - | Framework for an Integrated Methodology |
| G20 | - | Group of 20 |
| GDP | - | Gross domestic product |
| GFC | - | Global financial crisis |
| LVR | - | Loan-to-Value Ratio |
| NAB | - | National Australia Bank |
| NCCPA | - | National Consumer Protection Act |
| OECD | - | Organisation for Economic Co-operation and Development |
| SCT | - | Superannuation Complaints Tribunal |
| SME | - | Small and medium enterprises |
| WA | - | Western Australia |

LIST OF DEFINITIONS

Small developer

For the purpose of this study, a small developer is defined as an entrepreneurial owner-manager that engages in small to medium scale property developments, have ineffective limited liability and falls within a small developer category as defined by lenders.

Small business

The definition of a small business varies between industries in Australia. Small businesses definitions set outer-limits for legislative and business purposes. This study does not attempt to refine the definition of a small business. Section 2.2 explores the background of such definitions while Section 2.3 details the use of small business definitions in Australian legislation.

CHAPTER 1

INTRODUCTION TO THESIS

1.1 General introduction

Property developers play an important role in local economies since they use local supply chains and local experts. They also invest directly in the local economy through their networks of personal and business relationships. Property developers contribute to meeting the complex demands for real estate (Forlee 2015; Isaac, O’Leary, and Daley 2010). Small developers focus on residential developments such as subdivisions, strata developments, small apartment developments, small mixed-use developments and in-fill developments (Forlee 2015; Baccarini and Kraus 2005). This business strategy aligns with densification strategies of Australian cities, which plans for future population growth while allowing infrastructure maximisation (Gurran, Pill, and Maalsen 2021; Scutt 2016; Forlee 2015).

Small businesses drive economic growth; access to finance is crucial for their viability (Kersten, Harms, Liket and Maas 2017; Byrd, Ross, and Glackin 2013; Beck 2007; Berger and Udell 2006). Research into the financial inclusion of small businesses in formal financial services is supported by the Organisation of Economic Co-operation and Development (OECD) and the Group of 20 (G20), to which Australia reports its progress and results (OECD 2020; 2015). In the case of small developers, the capital-intensive nature of construction projects, high financial entry-level, the scale of the product and delay in delivery necessitates access to affordable credit (Bauchet and Morduch 2013; Psilander 2012; Baccarini and Kraus 2005; Isaac et al. 2010)

Definitions of a small business prove to be inconsistent. Most definitions focus on financial and employee limits to set boundaries for legislative protections and other specific business purposes (Godwin, Paterson, and Howell 2018; Anastasia 2015). These outer-limit definitions are less useful in research, as they include a range of varying types of small businesses that are not comparable (Newman 1996; Ang 1991). For the purpose of this study, a small developer is defined as an

entrepreneurial owner-manager, who engages in new small-scale property development projects (Isaac et al. 2010; Wilkinson and Reed 2016; Ang 1991). The definition includes small developers with ineffective limited liability who secures credit with personal assets (FSRC 2019).

Moreover, credit is not readily available to small developers (Bryant 2012; Psilander 2012). Some of the reasons include the complexity of assessing the credit risk through an all-moneys approach, a preference of banks to lend to larger developers first, return benchmarks and preferred shorter lending periods (Bryant 2012; FSRC 2018a). Access to credit has been further affected by recent tough economic times and an overall market failure by lenders to provide debt to the small and medium enterprise (SME) sector (Healy 2019; Byrd 2013; Bryant 2012). While the impact of significant losses by lenders during Global Financial Crisis (GFC) has led to retractions in lending (Bryant 2012; FSRC 2019b). Regardless of economic situations, lenders have a duty of care in assessing lending applications and lend to their customers, however, they must do this prudently. In turn, borrowers must meet set requirements to prevent unscrupulous lending practices (Forlee 2015; Psilander 2012; Isaac et al. 2010).

The loan application viability assessment process is onerous and requires extensive financial literacy and property development experience on the part of the small developer. Also, this process is not transparent and not identical among institutions (Bryant 2012). In terms of SME lending in Australia, loan application assessment process is further complicated by a loss of competent SME bankers, in favour of centralised and often impersonal credit departments (Healy 2019). The FSRC stressed the importance of a prudent banker in the initial assessment process while insisting in their recommendations that borrowers should make use of the external advice of accountants and lawyers before finalising a credit contract (FSRC 2018a; 2019b).

Government policies and national financial structures could directly affect economic activity in targeted industries (Hoffmann and Shcherbakova-Stewen 2011; Berger and Udell 2006). This seems to have been the case in Perth, Western Australia, from

May to September 2020 after the first Covid-19 lockdown restrictions were lifted within Western Australia (WA). The government offered various incentives, related to the construction of new homes, to boost the economy and applied pressure on interstate workers to relocate to WA (Weber and Piesse 2020; The Australian Workers' Union 2020a). On a macro level, the requirements set by financial institutions, when assessing small developers' loan applications, could have an unintended consequence, such as urban sprawl (Wilkinson and Reed 2016; Pierce 1995). While the Australian Bureau of Statistics (ABS) indicates an increase in new loans to owner-occupiers from June 2020 in their August 2020 reference period, a downward trajectory of new business loans for property construction and property investment purchases are noted during the same period (ABS 2021). The increase in loans to owner-occupiers correlates with low interest rates and incentives offered related to the construction of new homes. It is unclear whether a lack of business confidence or additional caution towards the property development market, bearing in mind the uncertain economic outcomes of Covid-19, affected banks' lending to the construction sector and property investment sector.

Further, small business finance issues have caught government attention. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, established in 2017. This Financial Services Royal Commission (FSRC) overseen by the Commissioner, the honourable Kenneth Madison Hayne. The FSRC's focus was on allegations of misconduct relating to personal finance, superannuation and small business. These matters were inquired into by the Royal Commission as set out in the Letters Patent (Commonwealth of Australia 2017) The Letters of Patent describe the main focus of the inquiry into financial misconduct and financial practices below community expectations. The commission inquired to the potential attribution of the culture and practices and internal systems of specific financial industries or subsectors and their practices (like risk management, recruitment and remuneration) to the aforementioned two focus areas. Regulators' effectiveness in identifying misconduct was interrogated by the FSRC. Potential reforms to legal frameworks and the regulators themselves were considered to ensure that misconduct is effectively identified and addressed by the regulators. The FSRC Round 3 Hearings into small and medium size businesses and the reports of the

FSRC were of particular importance to this study in providing an objective basis for the research.

The research problem focuses on how lenders view and assess the viability of credit applications of small developers. A model is proposed in this study that will assist small developers to understand their vulnerabilities and navigate the complex credit application assessment process. While banks are the main providers of credit for small developers, other commercial lenders are increasingly finding market gaps. These gaps are created by conservative credit application assessments, stringent market tests, such as pre-sale requirements and a low-risk appetite for small property development lending by banks (Kariv and Coleman 2015; Graeber 2014). Bank and small developer interviewees indicated that second-tier lenders often omit pre-sale clauses, that are difficult to meet during economic downturns and have less complex monitoring systems. Lenders use these clauses in their loan contracts to mitigate various risks, as they are profit-taking intermediaries with a fiduciary responsibility to their depositors and shareholders (Brei and Schclarek 2015)

1.2 Background

1.2.1 Economic significance of small businesses

Small and medium enterprises (SMEs) drive the economic growth of a nation (OECD 2020; Gordini 2014; Zeneli and Zaho 2014). They create resources, employment and wealth (Kersten et al. 2017; Beck 2007; Drummond and Chell 1994). According to Background Paper 10 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Australia's SME sector employs 65% of all people employed in the private sector (Godwin et al. 2018). The Australian Bureau of Statistics reports that businesses with 1 to 4 employees comprise 69.1% of all businesses, while 62.8% of all business were non-employing in the 2018-2019 reporting period (ABS 2020a). In the same reporting period, 93% of all businesses had an annual turnover of less than AU\$2 million and employed less than 20 people (ABS 2020a).

A high failure rate of SMEs in tough economic times and the high social costs associated with these failures (Drummond and Chell 1994) have prompted much

research into the development of an “effective credit risk system” for SMEs (Gordini 2014). The survival of SMEs depends on many factors, of which the access to and the cost of finance is often the tipping point for small companies (Byrd et al. 2013; Beck 2007) SME finance is thus valuable as a government policy instrument to stimulate the economy and research and experiments in this sector is well-supported by philanthropists and public donors (Du, Bian, and Gan 2017; Kersten et al. 2017).

1.2.2 The importance of small developers

The business of small developers is different from that of other small businesses. Property developers provide real estate solutions by reacting to specific needs and demand (Forlee 2015; Isaac et al. 2010; Miles, Berens, Eppli and Weiss 2007). They are involved in the whole process of development: from identifying an opportunity, arranging finance for the project, designing a real estate solution, obtaining authorisations for development and constructing facilities (Wilkinson and Reed 2016; Miles et al. 2007).

A substantial financial investment by the small developer is necessary, while facing possible changes in the market and only realising profit at the end of the project (Forlee 2015; Psilander 2012; Baccarini and Kraus 2005). Small developers engage mostly in the residential market or on a small scale in the commercial market. Their projects include renovations, subdivisions, speculative homes, small units, group housing, niche residential homes, small apartment buildings, storage facilities, small scale warehousing and mixed-use developments (Baccarini and Kraus 2005; Forlee 2015). This market position is important, especially where local authorities are promoting densification and affordable housing strategies (Isaac, O’Leary, and Daley 2010)

With the Australian population predicted to rise from 23 million (in 2015) to 40 million in 2066, housing provision is a critical aspect of the property development industry (Forlee 2015). Scutt (2016) citing an Australia and New Zealand Banking Group (ANZ) research note released in March 2016, indicates the housing stock in 2016 at 9,6 million with an estimated deficit of 250 000 dwellings. At current levels, housing stock will have to double to keep up with the predicted population growth

and demand (Scutt 2016). As the residential market is where small developers are most comfortable, the growth in this market segment could lead to sustainable business growth for small property development businesses in an otherwise volatile industry (Forlee 2015)

Further to the expectation that large amounts of new housing stock could be provided by small developers, it is common for small developers to out-compete large developers in terms of cost-effectiveness, as long as the building type is within the scale and complexity of the developer's reference framework (Psilander 2012). The increased cost-effectiveness of small developers is linked to the nature of a small developer. Small developers act as entrepreneurial owner-managers who use project management skills to coordinate their developments while outsourcing various aspects of the overall development process (Psilander 2012; Isaac et al. 2010; Wilkinson and Reed 2016). This personal involvement of the owner of a small property development company, coordinating the whole development process, has large benefits to their businesses, the local economy and, potentially, lenders. The small developer relies on local supplier networks, service providers and personal relationships with financiers while reducing project risks through contracted exposure periods due to condensed internal processes (Psilander 2012).

A different approach to small property development is necessitated due to the physical immovable nature of property, the inability to effect changes to market demands quickly, the time-lag in supply and the market domination of second-hand stock (Isaac et al. 2010). Property developers often focus on specialised areas of the market and anticipate growth periods after economic slumps or find areas within their specialisation that are profitable even in a contracting economy (Psilander 2012; Isaac et al. 2010). The contribution of developers could be important in times of recessions, as government investments and incentives can "create an economic multiplier... job creation and up-skilling of the workforce" (Isaac et al. 2010).

Small developers focus on local market opportunities and contribute to the local economy and densification. They rely on local networks and personal relationships for information and services and can adapt fast due to their small internal decision-

making and management structure (Psilander 2012). They can capitalise on opportunities during tough economic times. Lower interest rates present opportunities for investors to consider the potential of higher returns from property development and property investment as an alternative to long term bank-deposits (Lowies et al. 2018). Reduced superannuation growth also leads to retirees to consider subdividing and selling a section of their property or down-sizing, while remaining in their current suburb (Hughes 2018; Cranston 2021; Deeter 2016; Sanders Greer 2008). While small developers may be able to capitalise on these opportunities, they face reduced bank lending to businesses and may have to rework their finance model (Santos, Borini, and Pereira 2020).

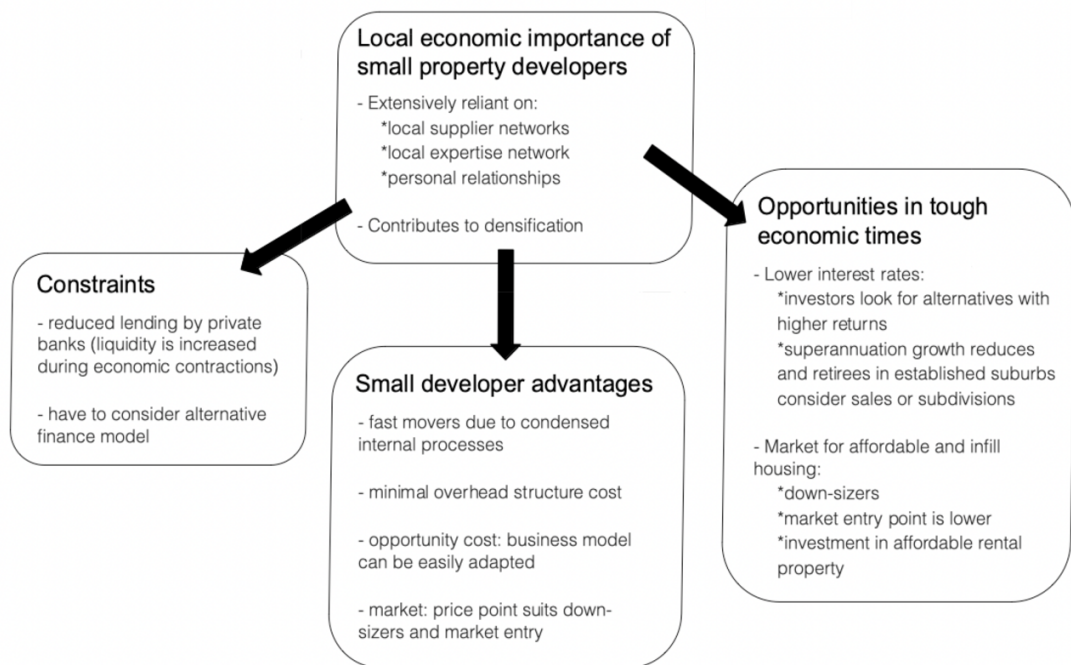


Figure 1.1: Local economic importance of small developers during tough economic contractions

Source: Adapted from multiple literature sources – see Psilander (2012), Lowies et al. (2018), Isaac et al. (2010) Wilkinson & Reed (2016) and Santos et al. (2020)

1.2.3 Access to finance

Home ownership has decreased slightly between 2001 to 2012 while the housing market saw prices rise (Naoi, Tiwari, Moriizumi, Yukutake, Hutchinson, Koblyakova and Rao 2019; Ferreira 2014; Yates 2014). The GFC caused the considerable slowing of the gross domestic product (GDP) of Australia, however, because Australia did not hold asset-backed securities, the impact of the GFC was contained, and the GDP did not become negative (Naoi et al. 2019). Nonetheless, residential development was affected negatively by a retraction in funds available as a result of the GFC (Bryant 2012). New loans to owner-occupiers have shown a steady increase, barring a notable retraction during 2008 and have sharply increased since June 2020 (ABS 2021). New loans to investors in the housing market increased from June 2020 onwards, after a steady decline since 2016 (ABS 2021). On the other hand, the lending pattern to construction businesses and business loans for the purchase of property indicates extreme volatility, with lending sometimes doubling or halving month on month (ABS 2021). Even so, lending to these groups shown a slow recovery since 2011 while loan conditions are currently at its tightest levels (ABS 2021; Dietz 2020).

A notable increase in activity in residential lending to owner-occupiers since June 2020 has largely been driven by purchases of existing dwellings and refinancing due to lower interest rates available as a result of the impact of Covid-19 (ABS 2021). Considering the slow recovery and the decrease in construction loans available, compared to a peak in 2008-2009, indicates the widening the gap between demand for housing and residential builders' access to credit (Dietz 2020).

Property developers are, like residential builders, heavily reliant on loans to finance project opportunities and alleviate cash-flow challenges, due to the capital-intensive nature of their projects. However, lenders often follow a conservative evaluation process of construction loan applications (Chiang and Cheng 2011; Beck 2007; Bryant 2017; Naoi et al. 2019). These challenges are no surprise; commercial lenders tend to balance their portfolios in terms of the type of property developments that they extend finance to and the risk exposure that they are willing to accept (Wilkinson and Reed 2016). While banks heavily invested in residential property

development as a high-return growth strategy before the GFC, significant losses were incurred due to falling asset prices during the GFC (Bryant 2012; Naoi et al. 2019). These losses lead to Australian banks retracting lending to the property development market and adopting a “near zero risk position” (Bryant 2012, 118).

Where municipalities in Australia follow a model of developer-paid infrastructure development of a large piece of land or mother block, an up to 400% charge is over-passed to the homeowner (Bryant 2017). This inflationary effect directly impacts lending for residential construction, as it raises questions around the value of the of the asset and the stability of the asset-value during economic downturns (Bryant 2017; 2012; Naoi et al. 2019). As small developers buy properties where these over-passed service costs are inherent, it would be to their advantage to develop a refined business model that clearly demonstrates the potentially reduced risk and cost-effectiveness of their projects (Psilander 2012; Berger and Udell 2006). These advantages can include being fast movers, due to condensed internal processes, low overhead structure costs, ability to adapt business models to match desirable opportunity costs and delivering a high-quality affordable product to the market (Scutt 2016; Forlee 2015; Bryant 2012; Psilander 2012; Isaac et al. 2010). The minimal options for credit-access and tight lending criteria leads small developers to develop business models to comply with what lenders are most likely to finance (Wilkinson and Reed 2016).

Due to the amounts borrowed and the intricate nature of property development, small developers and are assessed as complex and sophisticated borrowers (FSRC 2018a). While the amounts borrowed by small developers are not comparable to that borrowed by many other types of small businesses, the same all-moneys approach that drives small business lending is followed in their assessment (FSRC 2018a). The availability of credit to small business does not rest with commercial lenders alone (Kersten et al. 2017; Bryant 2012). Government policies and national financial structures influence the way that institutions make finance available. In addition, it is essential to investigate the transactional technologies through which financing is facilitated (Berger and Udell 2006). To this extent, the FSRC did not extend the protections offered to consumers through the Australian Competition and Consumer

Commission (ACCC) to small businesses, in order not to further constrain small business lending (FSRC 2018a)

Small businesses are often viewed by lenders as opaque borrowers, who are only suited for relationship lending while other profitable tools or lending technologies, that could give a specific lender a competitive advantage, are not considered (DeZoort, Wilkins, and Justice 2017; Wilkinson and Reed 2016; Aysan, Sili, Ng and Ozturk 2016; Berger and Udell 2006). When small companies are opaque informationally, much of the information needed by lenders to build a risk profile for credit applications, could be based on the history of the owner, rather than the business (Berger and Udell 2006). Transparency by both parties, during credit profile building, will allow appropriate lending tools to the benefit of both parties (Berger and Udell 2006; Bryant 2012).

It is critical and strategic for small developers to convince their lenders, such that the former can correctly predict the factors that influence feasibility and viability of a return on investment. They must achieve this while considering their own business risks and through effective use of the money borrowed (Gordini 2014; Sharam 2020a). Central to ensuring the effective use of finance extended by commercial lenders is lenders' understanding of the lending technologies best suited to small developers and matching the lending criteria to the right credit products (Berger and Udell 2006). The importance of access to credit for small businesses is rooted in the improvement of a small business' ability to survive economic downturns as it boosts their ability to access and extend trade credits (Tsuruta 2015).

In addition to traditional methods, more rigorous, experimental finance methods and assessment tools need to be considered (Kersten et al. 2017; Gordini 2014). Easy access finance (like microfinance and co called low-doc loans) is not available to small developers as these types of credit finance tools are not suitable for the size of loans and lending periods required by small developers (Kersten et al. 2017) This leaves small developers with a high documentary load to prove competency, financial stability and strength, repayment capacity, project profitability in varying market conditions and security provision (Bauchet and Morduch 2013).

1.2.4 Risks and risk-taking behaviour

Risk is an inherent part of the property development process (Forlee 2015; Baccarini and Kraus 2005). Small developers have a strong risk-averse attitude with a focus on projects where the reward greatly outweighs potential risks (Baccarini and Kraus 2005). The performance of a small business is influenced by contextual factors and the company owner's cognitive biases while engaging in risk-taking behaviour, but these could be tapered through proper planning and problem-solving while engaging in risk-taking behaviour (Newell and McGreal 2017; Gudmundsson and Lechner 2013).

It is crucial to understand the risks inherent to the property development industry to evaluate the links between industry risks and risk-taking behaviour of small developers (Newell and McGreal 2017; Baccarini and Kraus 2005). Forlee (2015) differentiates between general property development risks and risks specific to property development. General property development risks could include economic risk, taxation risk and terrorism risk, while risks specific to property development focus on market risk, development risks, liquidity risk, borrowing risk, risk of bad purchases, construction risk and business failure (Forlee 2015).

Lenders evaluate general property development risks and inherent risks when borrowing money to property developers. Lenders also have a responsibility towards their depositors, and adhere to liquidity provisioning regimes while investing in viable business proposals. Extensive security provisioning, serviceability tests and market tests are used to ensure responsible lending and risk proportioning (Cummings and Durrani 2016; Healy 2009). [Section 2.5.3](#) details lenders' risk perceptions and presents two models for credit risk assessment.

1.2.5 Technology and paradigm shifts as drivers of change

Natural England (2009) predicted that technological advances will be one of the most important global drivers for change while triggering fundamental paradigm shifts that could affect small businesses. This new interconnectedness has become evident

through open-source collaboration, self-organizing social networks, block-chain technologies and the rise of the prosumer (consumers as producers of information) (DeRuyter, Brown, and Burgess 2018; King 2017; Sadleir and Mahony 2009). Governments are rushing to introduce new restrictions around the regulation of areas like foreign investment in property (Sadleir and Mahony 2009; Wong, Higgins, and Wakefield 2017). In Australia, focussing on investment property, the uptake by the Asian market has been substantial in major cities (Wong, Higgins, and Wakefield 2017; Mendelsohn and Fels 2014; Wilkinson and Reed 2016).

The use of cutting-edge technologies envisage collaboration between project owners, engineering and contracting companies to enhance business processes (KPMG International 2016). These technologies could be useful tools for contracts, project planning, project financing, project implementation and project control on macro and micro level as well as robotic automation (Guo, Li, and Skitmore 2010; Booyens, Burger, and Bouwman 2013; Olawale and Sun 2010). In addition to the increased complexity of projects, the business environment and the regulatory environment, the new range of available technologies often adds additional pressure to keep up (KPMG International 2016; Booyens et al. 2013). Small businesses are behind in terms of technology adoption, with the owner-managers of small business often carrying the burden of finding and assessing technologies that are cost effective and appropriate to their operations (KPMG International 2016).

While it is predicted that technologies like blockchain could be useful for low-risk lending to low-risk SME companies, the Distributed Ledger Technology (DLT) basis of blockchain could be supported through smart contracts in syndicated lending (Petrov 2020; Wang, Lin, and Luo 2019). Public authorities are cautiously exploring the possibilities of implementing regulatory compliance tools, using blockchain technology, in areas like property registration systems (Banwo 2018; Goderdzishvili, Gordadze, and Gagnidze 2018). However, the quality and sophistication of the information required and the lagging of the legal system that supports electronic contracting is problematic (Goderdzishvili, Gordadze, and Gagnidze 2018; Australian Government and Department of Industry, Science 2020). With rapid developments foreseen in the technological sphere, research into future comparative

studies of the implementation of blockchain in easing the documentary burden during the credit assessment process of small businesses will be valuable.

1.3 The research problem

Lenders consider their risk appetite at the time of the loan application and adhere to their own internal processes, which aligns with regulatory controls (Cummings and Durrani 2016; Healy 2009). Credit decisions concerning small business are often purely on the financial position of the borrower (De Zoort et al. 2017; Kersten et al. 2017). Such decisions could be affected by lenders' financial reporting frameworks and the quality of the information supplied by applicants (DeZoort et al. 2017; Gordini 2014). In the case of small developers, the credit application assessment is more complex. Various research indicates that the amount of the information needed by financiers for credit profiling could be extensive (Sharam 2020b; Kersten et al. 2017; Psilander 2012).

The credit risk assessment of small developers is similar to the process followed for large developers with extensive documentary requirements (Forlee 2015; Bryant 2012; Hormozi et al. 2002). These requirements are affected by their business model, previous successful projects and their credit profile. Also, they are considered as small businesses and characteristics like ineffective limited liability, use of personal assets as security and flexible remuneration models require further investigations by lenders (Bauchet and Morduch 2013; Ang 1991). The asymmetrical structure or architecture of information required by different financiers complicates the position of the small developer when applying for loans (Zeneli and Zaho 2014; Bryant 2012).

A certain level of skills and management capacity is needed to obtain finance, which is indicated by a positive relationship between SME finance education programmes and the financing obtained (Kersten et al. 2017; Halabi, Dyt, and Barrett 2010). Developing and presenting a credit application to a commercial financier seems to be especially hard for small developers as the owner-manager takes responsibility for the complete process of development, with obtaining finance being key (Psilander 2012; Forlee 2015). Existing academic literature does not address variables specific

to small developers as assessed by lenders when considering small developer loan applications.

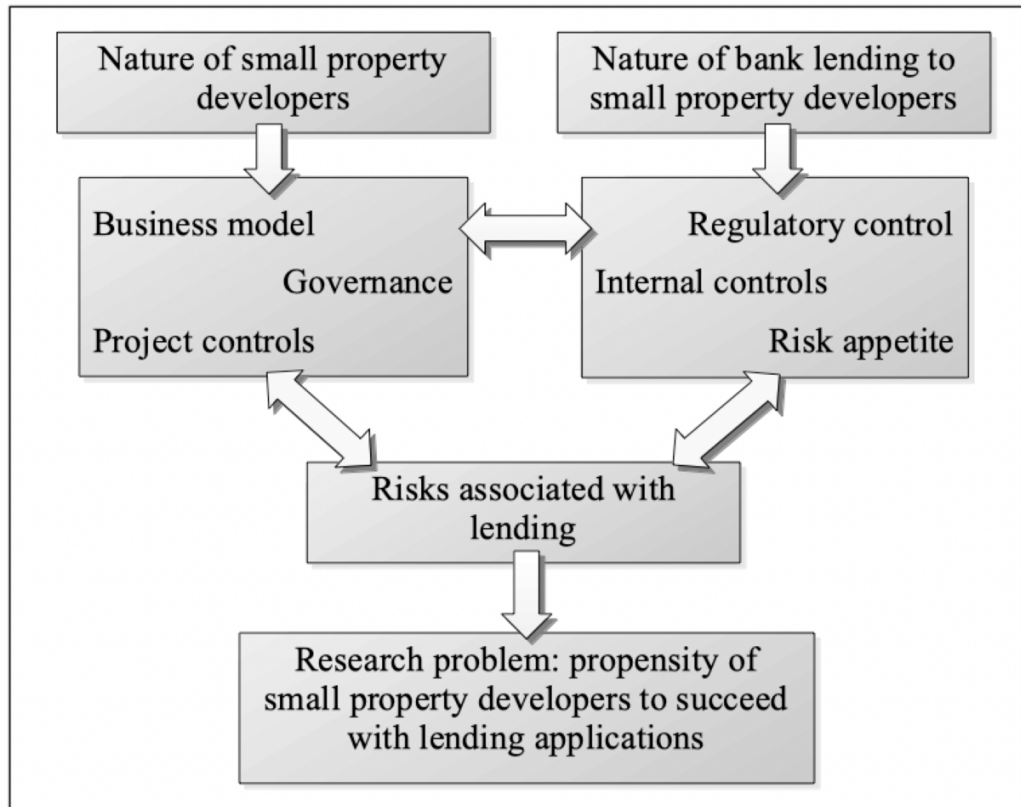


Figure 1.2: Theoretical rationale of the research

Source: Adapted from multiple literature sources – see DeZoort et al. (2017), Gordini (2014), Kersten et al. (2017), Psilander (2012), Forlee (2015), Hormozi et al. (2002), Bryant (2012), Bauchet and Morduch (2013), Halabi et al. (2010) and Zeneli and Zaho (2014).

The nature of small developers sets them apart from other small business. They display small business characteristics, in particular ineffective limited liability, which allows an all-moneys approach during loan assessment (FSRC 2018a; Ang 1991). The scale and complexity of their product necessitates the borrowing of larger amounts than most small businesses, which triggers an assessment similar to what lenders would use for large developers (Psilander 2012; Baccarini and Kraus 2005). Larger developers have more resources which are focussed on addressing such complex assessments while an owner manager of a small company relies on their

own skills and those of external consultants, who may not understand implications of the information they provide during a specific application (Psilander 2012).

Lenders are increasingly risk averse and a low success rate of loan applications for development have been prevalent since the GFC (Dietz 2020; Baccarini and Kraus 2005). While the banking industry incurred significant losses in the property sector, during the GFC, the recovery over the last decade has been slow and loan conditions are at their tightest (Dietz 2020).

The research problem focusses on how lenders view and assess the viability of credit applications of small developers. The research rationale sets out the conceptual thinking about the research problem.

1.3.1 Importance of the research

The Australian property industry was reported as the largest industry in Australia in 2015-2016, with an estimated contribution of AU\$202.9 billion to the gross domestic product (GDP) and an estimated further flow on demand of AU\$254 billion (Property Council of Australia 2017). This industry encompasses activities of development and operating residential and non-residential facilities, with the residential sub-sector being the largest contributor to the industry (Property Council of Australia 2017). While the residential sector is where most small developers are comfortable, the activity of this group is not measured separately.

The OECD and the Group of 20 (G20) indicate that SME finance gaps are often not identified (OECD 2020). Research is encouraged in areas of access to non-traditional financing, promotion of financial inclusion, the design and regulation of financing instruments, improving transparency in finance markets and enhancing skills and strategic vision (OECD 2020; 2015). Small developers find it difficult to obtain finance, potentially even more so than other small businesses or large property developers and loan processes are not transparent (Bryant 2012; Psilander 2012; Kersten et al. 2017).

This research aims to produce a model that will assist small developers to understand how their loan applications are assessed and identify areas or elements in the assessment process that makes access to finance increasingly difficult for small developers. While this model will outline the loan application assessment process, whether small developers will be able to access credit through the major banks in the near future will require further research. The Australian Government's policy responses during Covid-19 provides a glimpse into the direct effect of these types of interventions on stimulating the economy, but as these interventions are temporary, their long-term impact cannot be measured at this stage (Weber and Piesse 2020; The Australian Workers' Union 2020b). Promoting responsible access to finance can improve the image of the banking industry to their perceived attitude towards lending to small businesses, while potentially improving the risk exposure of financial institutions (FSRC 2018a).

1.3.2 Research aim and objectives

This research aims to analyse extant models and develop an appropriate risk assessment model for small developers' loan application. The model could facilitate small developers' understanding of their risk of failure during lending applications and could be useful for lenders to assess small developers' lending applications. Objectives of the study are:

- to identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders;
- to analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success;
- to develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders.

1.3.3 Research questions

Following the knowledge gap described in the research problem above, the focus of this proposed research is to provide answers to the research questions. Through a robust review of extant literature, the following research questions were addressed

through review of the recent FSRC Round 3 Hearings and FSRC Reports, interviews with small developers and the banking industry, experts and an industry survey.

RQ1: How do lenders assess the lending applications of small developers?

RQ2: What are the criteria on which lenders base their decision to extend or refuse credit to small developers?

RQ3: Does the small developer's business model influence the lending decision?

RQ4: Do commercial lenders view small developers as a viable business opportunity?

RQ5: What are the regulatory constraints in terms of financing small developers?

RQ6: What is the success rate of credit applications by small developers?

RQ7: What outside advice do small developers make use of during their credit applications?

RQ8: Do lenders monitor the effective use of finance extended to small developers?

These research questions support the research objectives. RQ1 to RQ7 support Objective 1, while RQ3, RQ4, RQ6 and RQ8 support Objective 2. Objective 3 is supported by all the research questions. A summary of the relationship between the research questions and objectives is set out in Table 1.1 on the next page.

Table 1.1: Relationship of research questions to objectives

| Research question number | Research Question | Contribution of data analysis of FSRC Round 3 Hearings and Reports | | |
|--------------------------|---|--|---------------|----------------|
| | | Objective 1* | Objective 2** | Objective 3*** |
| RQ1 | How do lenders assess the lending applications of small developers? | X | | X |
| RQ2 | What are the criteria on which commercial lenders base their decision to extend or refuse credit to small developers? | X | X | X |
| RQ3 | Does the small developer's business model influence the lending decision? | X | X | X |
| RQ4 | Do commercial lenders view small developers as a viable business opportunity? | X | X | X |
| RQ5 | What are the regulatory constraints in terms of financing small developers? | X | | X |
| RQ6 | What is the success rate of credit applications by small developers? | X | X | X |
| RQ7 | What outside advice do small developers make use of during their credit applications? | X | | X |
| RQ8 | Do lenders in Australia monitor the effective use of finance extended to small developers? | | X | X |

*Objective 1: identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders

**Objective 2: analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success

***Objective 3: develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders

1.3.4 Research methods

The strategy devised to undertake the investigation follows a deductive approach. Conceptual thinking around the research problem and the approach to the research design was guided by the theoretical rationale. The theoretical rationale indicates that

the nature of small developers and the nature of banks necessitate a complex loan viability assessment process. Lenders consider all possible lending risks, through a detailed investigation into a small developer's potential credit worthiness. These assessments are conducted in line with the bank's internal processes and regulatory controls (see Figure 1.2 in [Section 1.3](#)). Plowright's (2012) exploratory sequential design or Frameworks for Integrated Methodology (FraIM), detailed in Chapter 3, formed the basis of the research design.

The FraIM structured the research thinking and allowed for the inclusion of narrative and numerical data (Plowright 2012). This structured way of approaching mixed-methods research suited the small scale of the study while allowing the opportunity to study a complex phenomenon in its context (Plowright 2012; Baxter and Jack 2008). Pragmatism is used as the research paradigm and is supported by the structure provided by the FraIM, thus, avoiding a utilitarian use of pragmatism, which could affect the credibility of findings (Hall 2013; Feilzer 2010).

The assessment process of the loan applications of small developers are only a small part of a larger process, which necessitates the validation of the research questions within the professional, organisational, policy, national and theoretical contexts (Brei and Schclarek 2015; Plowright 2012). The background to the research methods is set out in Chapter 3. A dynamic pluralist epistemology and non-singular reality ontology presented an opportunity to create the clearest possible picture during the small-scale research of the loan assessment process (Kivunja and Kuyini 2017; Thayer-Bacon 1997). Considering various vantage points allowed for clarification where questions were not adequately answered by one group or where the group was not sure how a specific requirement could impact another group.

A value-laden axiology formed the basis for the ethical considerations. This approach to the research supported the exploration of human activity and the existence of pre-supposed power relationships (Gonzalez 2013). Value-ladenness, within a contextual setting, should have with imposed limits (Gonzalez 2013). For this study, various vantage points of individuals are considered to represent those of lenders and small developers.

1.3.5 Research design

The research design followed a two-stage data collection process (detailed in Chapter 3), based on the theoretical rationale presented in this chapter. Data collection during Stage 1 involved a three-part process:

- A review of the transcripts of the FSRC Round 3 Hearings on Small and Medium Businesses, and the Interim Report and Final Report relating to SMEs. The testimonies of bankers and property developers during two case studies of the FSRC, were analysed. This review is presented in Chapter 4.
- An in-depth interview was conducted with a banker and a focus group session was held with two bankers in Western Australia. These session and findings are detailed in Chapter 5.
- In-depth interviews were conducted with two small developers in Western Australia. Chapter 6 details these interviews and findings.

The findings were combined and a conceptual credit risk assessment model for the viability of credit applications of small developers, which is presented in Chapter 7 (see Figure 7.1 in [Section 7.2.2](#)).

The conceptual model was then tested in a second stage of data collection. Data collection during Stage 2 involved a two-part process:

- Feedback from experts on the conceptual model by using the Delphi method. The experts were identified through purposive sampling and included persons who has experience of small property development loans. The conceptual model was sent to the experts for a first round of feedback. Their input was moderated and incorporated into the model and the updated model was sent to the same panel for a second round of feedback. No additionality was indicated after the second round of feedback and the model was accepted by the expert panel. Chapter 7 details the external validation and updates to the conceptual credit risk assessment model.
- An industry survey was conducted through an anonymous link in an email which was sent to 2033 potential participants in the property development and related industries. A follow-up email was sent to encourage participants

to complete the survey. The sampling was done through purposive sampling and viral sampling. A total of 217 participants attempted the survey. The survey contained 29 statements, based on the independent variables presented in the conceptual model. The 7 independent variables identified were: regulatory restrictions, bank risk appetite, physical nature of property development, ineffective limited liability, securities and guarantees, small developer capital input and small developer experience. The 29 statements were graded on a five-point scale by participants in terms of how much they agree or disagree with the statements. Chapter 8 presents the industry survey results and the proposed improved model for assessing the viability of the loan applications of small developers.

1.4 Delimitations

The area of focus of this study is the assessment process of small developer loan applications as followed by lenders in Australia. Exploratory interviews were conducted with small developers and a banker based in Western Australia. A focus group session was conducted with two bankers in Western Australia. Evidence from the FSRC, input from an expert panel and a national industry survey balances potential biases and allows generalisability of the results.

The research area is a part of a process where a small developer proposes an investment project to the business banking unit of a bank (Brei and Schclarek 2015). A business banker acts as the gatekeeper for credit application proposals that will be passed on to the credit department and follows an extensive process of considering the viability of the proposal in terms of profitability and default risk (Brei and Schclarek 2015; Sharam 2020a). This study focusses on factors that affects a small developer's exposure to risk of failure during the assessment process and whether key risk factors assessed by lenders supports small developers' strategic structure for business success. The effects of the GFC, potential further complications in the tightening of lending conditions due to Covid-19 and the loss of competent SME bankers are considered (Heller and Phillips 2020; Healy 2019).

The aim of the research was to develop an improved model to facilitate small developers' understanding of the assessment process and risk factors. The research area, namely the loan assessment process is indicated in Figure 1.3 below.

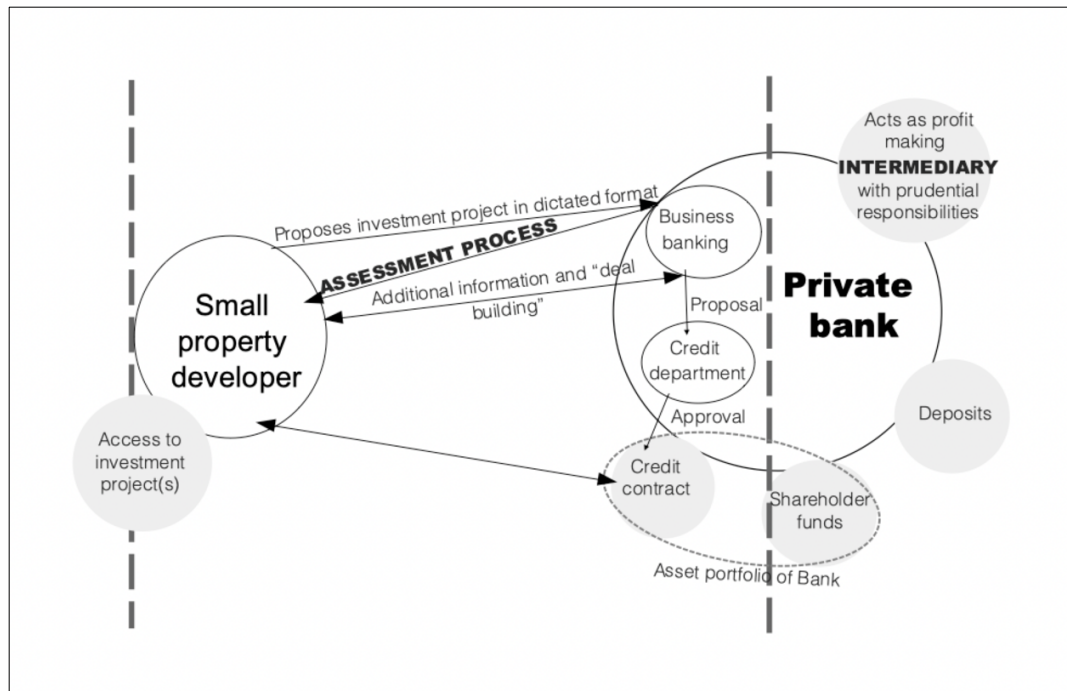


Figure 1.3: Research area: the loan viability assessment process

Source: Adapted from Brei and Schlarek's (2015) general framework of a private bank

1.5 Thesis structure

Plowright's (Plowright 2012) main extended FraIM (outlined in Figure 1.4 below), guided the research process and thesis structure. The main extended FraIM indicates the contextualisation of the research questions in Chapter 1 and Chapter 2. The professional, organisational, policy and theoretical background to the study is described and set within the national context. Chapter 3 describes the methods used to conduct the research and indicates how cases were identified. Plowright's (Plowright 2012) exploratory sequential design or Frameworks for Integrated Methodology (FraIM) is further detailed in Chapter 3 (see [Section 3.4.1](#)).

Chapter 4 to Chapter 8 present the research data, data analysis, evidence from the data and claims. Chapter 9 concludes the research and outlines the. The theoretical rationale outlines the conceptual thinking around the research problem and forms the basis for the research design (see Figure 1.2 in [Section 1.3](#)).

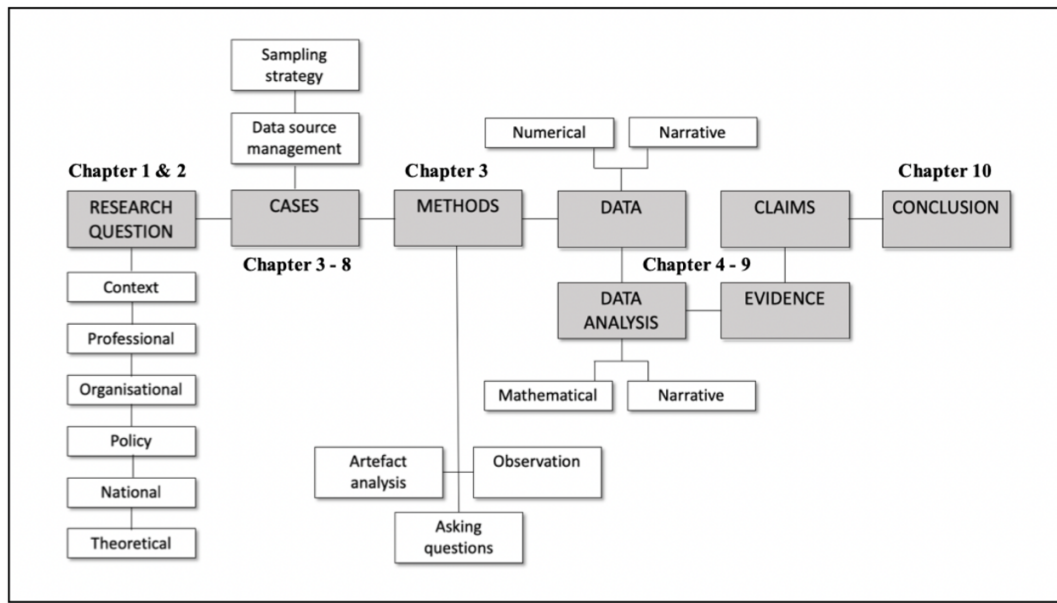


Figure 1.4: Illustration of thesis outline

Source: Adapted from Plowright's (2012, 9) extended FraIM model.

Chapter 1: Introduction to Thesis, provides the background to the research problem and introduces the theoretical rationale that guided conceptual thinking. The research problem, research aims and research methodology are outlined.

Chapter 2: Conceptual Framework: Review of Definitions, Legislative Protection and Access to Finance, introduces the research topic within the context of small business' access to credit and the regulation of credit to small businesses in Australia. A definition of a small developer, for this study, is developed to delineate the research parameters and allow for comparability of findings of future research.

Chapter 3: Research Methodology and Design, presents the research framework and philosophical position of the study, as motivated against the theoretical rationale proposed in Chapter 1. Plowright's (Plowright 2012) FraIM, proposing a mixed-

methods research framework, allowed for a structured exploratory sequential design. The levels of research thinking that was used to deliberate external and internal consistency as well as the research strategy are outlined in this chapter. The reasoning behind the paradigmatic choice, epistemology and ontology is described, while the axiology details how potential biases were addressed.

Chapter 4: Analysis of the evidence of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry regarding financing of small businesses and property development. This chapter details findings from the Round 3 Hearings of the Financial Services Royal Commission (2017-2019) around small businesses and property development as well as findings from the Interim and Final reports. FSRC Background Papers were consulted to clarify concepts and terms. The evidence specific to property development, given by two property developers and bankers, were analysed and coded using NVivo software. Further evidence presented during the FSRC Round 3 hearings, relevant to this research, is outlined.

Chapter 5: Understanding risk considerations by banks in small developers' credit applications, presents the findings from an in-depth interview and a focus group with bankers from Western Australia. The lending application process and assessment process was explored through open-ended questions, based on the research questions. Regulatory restrictions, bank policies and perceived red flags when assessing small developers' lending applications during the in-depth interviews were noted. These interviews were analysed and coded in NVivo software and the findings are discussed.

Chapter 6: Small developers' perspectives on risk considerations of credit application assessment, details the in-depth interviews with two small developers. Their experiences and understanding of the credit application process and assessment process is explored through open-ended questions, based on the research questions. Various personal and business successes and challenges, related to access to finance were documented. The interviews were analysed and coded in NVivo software and the findings are outlined.

Chapter 7: Developing an appropriate model for assessing risk in credit applications of small developers. This chapter integrates the results from Data Collection Stage 1 and describes the internal validation process. The conceptual credit risk assessment model of small developer lending applications is presented (see Figure 7.1 in [Section 7.2.2](#)). External validation through expert feedback, using the Delphi method, is outlined and an updated conceptual credit risk assessment model is presented (see Figure 7.2 in [Section 7.3.3](#)).

Chapter 8: A quantitative model for the improved risk assessment of the viability of small developers during lending applications. The data analysis of the industry survey is presented in this chapter. Internal consistency (using Chronbach's Alpha) is discussed and findings from linear regression analyses and the correlation matrix is presented. A principal component analysis tested the relationships between antecedent and intervening variables. This chapter concludes Data Collection Stage 2 and the improved risk assessment model for the viability of small developers during lending applications is presented (see Figure 8.4 in [Section 8.5](#)).

Chapter 9: Discussion of an improved risk assessment model for the viability of small developers, presents the academic and practical implications of the study and of the improved risk assessment model. The findings of the study are outlined and proposes future research opportunities related to the findings.

Chapter 10: Conclusion of the development of an improved risk assessment model for the viability of small developers. This chapter presents concluding remarks regarding the development of an improved credit risk assessment model.

1.6 Summary of General Introduction

Small developers are a unique group that face significant challenges when applying for credit from banks. Lenders conduct conservative risk assessments of small developer's lending applications. Further, lenders have a low risk appetite for small property development lending. The volatility of the industry and the size of the loans are specific risks that are considered in lenders' exposure assessments. Chapter 1 provided a general overview of the background to the research problem. The

conceptual research thinking is explained against the theoretical rationale. An overview of the thesis structure is presented and the research problem, research aims and research methodology is outlined.

Chapter 2 explores the status of small businesses in Australia and the problem of defining small developers within the Australian credit context. The effect of small businesses characteristics on credit approvals is considered. Regulatory frameworks that affects small business lending and protections are identified and the economic significance of these frameworks are discussed. The property development process and finance methods are outlined, and two existing credit assessment models are examined.

CHAPTER 2

CONCEPTUAL FRAMEWORK: REVIEW OF DEFINITIONS, LEGISLATIVE PROTECTION AND ACCESS TO FINANCE

2.1 Introduction of research concepts

The purpose of this chapter is to theorise the framework of the research in terms of the attributes of small developers and their access to finance. The chapter outlines definitions of small business and develops a definition of a small developer. While definitions provide broad categories for legislative protections and business purposes, small business characteristics are explored as the drivers behind small businesses' ability to access credit (Ang 1991). A review of the definitions in Australia that affect perceptions around credit legislation in relation to small businesses, is undertaken to outline the outer-limits of definitions. These outer-limits are used to provide specific protections to small businesses; for the purposes of reporting and other business purposes (Anastasia 2015).

Small developers display small business characteristics, but their finance requirements are more complicated and comprehensive. This chapter touches on the limitations of small business definitions and the effect of these limitations on protections for small developers.

The research topic is focussed on how lenders assess loan applications of small developers, thus, the definition of small business by the Australian Banking Association (ABA) is particularly relevant. A definition of small businesses is provided in the in the new Australian Banking Code of Practice by the ABA (2020), approved by the Australian Securities and Investment Commission (ASIC). The ABA (2020, 12) defines a small business through a three-part test, of which all three criteria must apply. The definition includes small businesses when:

- i. it had an annual turnover of less than AU\$10 million in the previous financial year; and
- ii. it has fewer than 100 full-time equivalent employees; and

- iii. it has less than AU\$3 million total debt to all credit providers including: any undrawn amounts under existing loans; any loan being applied for; and the debt of all its related entities that are businesses.

FSRC Commissioner Hayne's Recommendation 1.10 (FSRC 2019) indicated the expansion of the small business definition in the Code:

The ABA should amend the definition of 'small business' in the Banking Code so that the Code applies to any business of group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than AU\$5 million (FSRC 2019a, 22).

The lack of implementation this recommendation on small developer protections is further described in Chapter 4.

Further to defining a small developer, this chapter presents the challenges facing small developers in accessing finance. Finance sources are scarce and access finance is crucial for small developers. Some literature exists around the credit application and assessment process of property developers. However, the challenges of small developers during the credit application and assessment process have not had adequate research discussions. The credit application and assessment processes are not transparent (Bryant 2012). Property developers and small businesses alike face a large documentary burden of proof (Forlee 2015; Hormozi, Sutton, McMinn and Lucio 2002). In addition, over-regulation through the offering of extensive protections to small businesses could affect this credit market segment and potentially decrease the availability of finance (Australian Government Treasury 2018; Berger and Udell 2006). A small developer should therefore have a comprehensive understanding of the implications of financial reporting, small business characteristics and the nature of property development on the potential viability of a credit proposal. They often do not have resources to do this, and sometimes do not understand why they fail credit applications (Cole and Sokolyk 2016).

Banks consider the assessment of small business loans a costly and tedious process (Healy 2019). Research indicates that small developers are more risk-averse than

small businesses in general, however, it is not clear that this has a positive impact on their loan assessments (Baccarini and Kraus 2005). A definition for a small developer is delineated in this chapter for selecting research participants and to allow for future comparability of the research. Two models, which conceptualise the extensive documentary requirements for the bank's viability assessment process of small developer loan applications are examined.

2.2 Small business definitions and characteristics

While small business definitions are useful for legislative and business purposes, these definitions do not adequately describe a small business. Ang (1991) argues that it is small business characteristics that drives their access to credit.

2.2.1 The use of outer-limits for small business definitions

Anastasia's (2015) review of research definitions of small businesses in America points to an overwhelming focus on outer-limits for employee-numbers and annual income. This author notes that additional defining criteria are outer-limits for assets owned by the company, the age of the company and the type of entity. Definition criteria are applied on their own or in combinations, with variances in standards between industries. These definitions do not take into consideration, for example, that a manufacturing company with a high employee count could produce lower profits compared to a second similar company. Such a discrepancy in employee-to-profit ratio could be due to various reasons, such as higher mechanisation at the second company. Anastasia's assertion is that the use of outer-limits as the basis of definitions is to delineate definitions which are understandable and are enforceable easily. Thus, a clear delineation can be used for legislative protection or specific business purposes. Defining a small business is therefore crucial as it could impact their access to resources: financial resources, business assistance or affordable legal recourse.

Hamilton and Fox (1998) and Reijonen (2008) argue that employee-limits or annual turnover alone may not be sufficient to draw comparisons between businesses, as the driver for each company may be different. Age-limit definitions are used less often.

There is no clear link between the age of a small company and its debt-to-total asset ratio (Halabi et al. 2010; Hamilton and Fox 1998). This is because the time a company has been in business poses an opportunity to build a solid credit record. These outer-limit definitions, therefore, include a range of small companies, including micro-enterprises (Reijonen 2008; Ang 1991).

While cut-off points are necessary for policymakers and for business purposes, discrepancies indicate that the subject itself is not consistent, which could lead to ambiguity in research when comparing data (Newman 1996). This study does not attempt to develop a new definition of a small business. However, it explores the various uses of the definitions to delineate the criteria for selection of participants and for the results to be comparable in future research.

2.2.2 Small business characteristics

Ang (1991) suggests that the starting point to identify small business characteristics is in the model of a stylised theoretical corporate firm – an entity that has access to an external capital market and many shareholders and which operates under limited liabilities and owns diverse portfolios. Ang's view is that small businesses seldom have such patronage; however, they are distinguishable by their unique characteristics. These include ineffective limited liability and companies' inability to have public-traded securities. Their owners' un-diversified personal portfolios. They are first-generation, entrepreneurial and prone to risk-taking. Also, they have an incomplete management team and are vulnerable to the high cost of their market and institutional imperfections. Their relationships with stockholders are less formal and they have a high degree of flexibility in designing compensation schemes.

Various literature supports Ang's (1991) perspective of a small business. In particular Halabi et al. (2010), Herranz, Krasa & Villamil (2009), Newman (1996) and Drummond and Chell (1994) agree that small businesses do not have effective limited liability and that the business owner remains directly affected by the financial outcomes of the performance of the business. The main difference between corporate companies and small businesses is therefore in the "assumption that a firm and its

owners are separate” (Newman 1996, iii). While this may be true for large corporate firms, small businesses and their owners are not separable entirely.

The ineffective limited liability characteristic allows lenders more flexibility in lending to small businesses. Lenders consider the owner’s financial position and assets during a credit application of their small business as if these two were the same (Halabi et al. 2010; Herranz et al. 2009). While the ineffective limited liability characteristic increases a small business’s potential to access to credit, it also exacerbates the owner’s risk of personal financial loss and personal bankruptcies (Drummond and Chell 1994).

Small business characteristics could have a direct effect on the lending decision. The inability to have public-traded securities would require a complex valuation of the business to determine its equity (Ang 1991). An un-diversified asset base, usually comprising of a residential home, could be used to secure the business loan (Herranz et al. 2009; Drummond and Chell 1994). In the case of property development loans, lenders require securities and guarantees where borrowers (and their guarantors, where applicable) are held severally or jointly (in the case of multiple owners) responsible if the loan is called or in default (Forlee 2015). Available research suggests that lenders view the assessment of small businesses loans as a costly and time-consuming process which requires dedicated bankers with an extensive understanding of small business lending (Kariv and Coleman 2015; Healy 2019; Herranz et al. 2009).

Risk-taking behaviour is less pronounced in the case of small developers, as they focus on projects where the perceived reward outweighs potential risks (Baccarini and Kraus 2005). Their risk-taking behaviour seems to be tempered by their necessity for access to specialists, a personal network and a personality trait what involves planning and problem-solving during the development process and higher cost of capital (Baccarini and Kraus 2005; Forlee 2015; Newell and McGreal 2017). The literature is unclear on whether these characteristics, specific to small developers, cause lenders to view their applications more favourably compared to loan applications of other small business.

2.3 Small business definitions in Australian legislation

The legislative definitions of a small business in Australia are not consistent. Policymakers have different purposes for the outer limits used in their definitions, however, there is agreement that protections are necessary for vulnerable groups.

2.3.1 Background to credit legislation around small businesses

In the early 1980s to 1990s, small business lending became an emerging sector of the market for lenders to expand their business to (Graeber 2014; Geoff 1988). This expansion was driven by the success of the Grameen Bank in Bangladesh, who touted the provision of low-interest loans to small businesses as “a human right” (Graeber 2014, 380). Access to affordable credit is important for the growth of small businesses (Kersten et al. 2017; Berger and Udell 2006). Because of the high financial and personal risk to the owner of a small business in borrowing, assessments of loan applications must be done honestly and responsibly (Gordini 2014). While policymakers realised the importance of supporting small business growth, as they are employers, innovators and drive economic growth, it also became clear that vulnerable businesses will need legislative protections (Geoff 1988; Reijonen 2008; Halabi et al. 2010).

Legislative protections concerning credit transactions are thus designed to safeguard small businesses from conduct that is unconscionable, misleading or deceptive and unfair contract terms (Godwin et al. 2018). It also affords small businesses fair and appropriate recourse when these occur (Australian Government Treasury 2018). Over-regulation of these protections offered, could affect the small businesses’ ability to access affordable credit (Berger and Udell 2006; Australian Government Treasury 2018). In this context, small businesses are defined in Australian credit legislation in terms which mostly consist of outer-limit criteria, tailored to include vulnerable groups in specific sets of legislation (Australian Government Treasury 2018). It would seem that the inconsistency in defining small businesses between various economic, research and legislative spheres are mostly due to pragmatic reasons. (Godwin et al. 2018; Newman 1996). While legislative protections for small businesses are important, they can also restrict small business’ access to reasonably

priced finance, as lenders will factor in the implications additional risks incurred due to protections into their pricing (Godwin et al. 2018). Gilligan (2018, 178) questions the implementation protections, by citing ASIC's reliance on negotiations through agreements with lenders, rather than taking "strong enforcement action", pointed out during the FSRC.

Outer-limit benchmarks mostly focus on setting employee-limits and monetary-limits like total turnover or total debt (Anastasia 2015; Newman 1996). For example, The Australian Bureau of Statistics (ABS) uses an employee-limit definition of fewer than 20 employees (5 to 19 people). ASIC uses a three-step financial-year test which sets out an employee-limit of fewer than 100 people, an annual revenue-limit of AU\$50 million and an annual asset-test of AU\$25 million consolidated assets. As good as the intention to protect small businesses is, policymakers do not have a perfect definition for the entities they intend to protect. The protections afforded to small businesses implies the importance of the knowledge and power gap that exist between lenders and borrowers (Graeber 2014).

2.3.2 Australian legislative definitions relevant to this study

Small business definitions related to credit appear in the following legislation:

- Australian Government Corporations Act 2001 (Parliament of Australia 2001) has allowances for protections for 'retail clients' concerning financial products and services, but excluding credit (Chapter 7, section 761G (12) and 761GA). 'Retail client' can include small businesses under specific conditions and include some amendments due to the Australian Financial Complaints Authority (AFCA) Act, which replaced the Financial Ombudsman Service (FOS) and other existing external dispute resolution schemes (Godwin, Paterson, and Howell 2018; Australian Government Financial Complaints Authority n.d.). In the Corporations Act 2001 the small business definition is set as an employee-limit of a) less than 100 people if the business is a manufacturer or includes the manufacture of goods or b) less than 20 people otherwise.

- The Australian Securities & Investments Commission (ASIC) administers the Corporations Act 2001. ASIC is the regulator for “all companies, financial markets and providers of financial services and consumer credit in Australia” (ASIC n.d.). Godwin et al. (2018, 6) (Godwin et al. 2018, 6) note that the ASIC Act allows “for the purpose of implying the conditions and warranties of quality in contracts for financial services” concerning small businesses (sections 12 ED and 12 BC(2)) and their contracts (section 12BE). The definition for a small business is based on the financial year starting 1 July 2019 and includes an employee-limit (less than 100 employees at the end of the financial year), a revenue-limit (less than a AU\$50 million annual limit) and an asset-value limit (less than AU\$25 million consolidated gross asset value at the end of the financial year).
- The AFCA Act (5 March 2018) enables legislation for the Australian Financial Complaints Authority. This legislation gives certain regulatory powers to ASIC and replaces various external dispute resolutions schemes (Australian Government Financial Complaints Authority n.d.). AFCA uses employee-limits to define a small business of 100 employees and excludes certain business entities linked to the employee-limit requirement.
- The Australian Competition and Consumer Commission (ACCC), enforces The Competition and Consumer Act 2010. Unfair contract terms are covered by this law that applies to standard contracts. These contracts could be for “the supply of good or services or the sale or grant of an interest in land” (Australian Government Competition and Consumer Commission 2016). An employee limit of fewer than 20 people, including regularly employed casual staff is set, where at least one party meets this requirement in the contract. Other limits are the upfront price payable of less than AU\$300 000 (or less than AU\$1 million if the contract is longer than 12 months).
- Australian Prudential Regulation Authority’s (APRA) Small and Medium Enterprise Scheme indicates a revenue upper-limit of less than AU\$50 million (Pottinger 2020).

Further legislative definitions for small business that affects reporting by commissions, agencies and authorities on national and state or territory level include:

- The Australian Bureau of Statistics (ABS) definition with an employee-limit of between 5 to 19 people, is a popular basis for specific small business legislation of states and territories in Australia. A micro-business employs between 1 to 4 people. The prevalence of the ABS definition implies the reliance of this second level of government on ABS census data and other small business data for reporting and information purposes. For example: In New South Wales, the Small Business Commissioner Act 2013 (No 22, current version 15 January 2016) allows for businesses with an employee-limit of fewer than 20 people who are incorporated or unincorporated.
- Australian Taxation Office (ATO) sets an annual aggregate turnover-limit at less than AU\$10 million for sole traders (individuals), companies, trusts and partnerships (Australian Government Taxation Office 2020).
- New South Wales' small business definition includes a AU\$2 million revenue-limit and a 20-person employee-limit definition for small businesses, while other states only sets a 20-person employee limit (Pottinger 2020).

A voluntary organisation, the Australian Banking Association (ABA) is noted in this section in terms of its small business definition as it provides small business protections in its Banking Code of Practice. This code has been approved by ASIC (ABA 2020; Pottinger 2020). The ABA Banking Code of Practice defines a small business in terms of a three-part test which includes:

- i. an annual turnover of less than AU\$10 million; and
- ii. less than 100 full-time equivalent employees; and
- iii. less than AU\$3 million total debt.

This definition is proposed to be updated in 2023 after an independent by Pottinger (2020) of FSRC Commissioner Hayne's Recommendation 1.10. The three-part test will remain, while an update to the total aggregate debt is proposed to AU\$5 million.

The Customer Owned Banking Association (COBA) does not explicitly indicate lending to small businesses in their Customer owned Banking Code of Practice (COBCOP) published in 2018. The COBCOP is under review and the CEO of COBA indicated that they will consider a definition to include “businesses or groups with 100 [full time equivalent] employees with loans up to AU\$5 million” (Lawrence 2019, 5). The updated COBCOP has not been published and has therefore not been included in the summary table. Table 2.1, on the next page, summarises the different definitions used by Australian authorities.

Table 2.1 : Summary of small business definitions

| Authority | Employee limit | Revenue limit (AU\$) | Asset/debt value limit (AU\$) | Business entity |
|---|---|---|--|--|
| Australian Government Corporations Act 2001 | <100 employees if business is manufacturer or <20 employees otherwise | | | |
| Australian Securities & Investment Commission (ASIC) | <employees at end of financial year | <\$50m annual limit | <\$25m consolidated gross asset value at end of financial year | |
| Australian Financial Complaints Authority (AFCA) | <100 employees | | <\$5m facility limit | Partnership, incorporated trustee, company, not-for-profit, clubs, some registered charities. Excludes business that is part of a group with >100 employees. |
| The Australian Competition and Consumer Commission (ACCC) | One party a small business with regular casual employees) | Contract size: Uprfront price of <\$300 000 or <\$1m (more than 12-month contract) for supply of services or sale/grant of interest in land | | |
| Australian Taxation Office | | <\$10m aggregated annual turnover. Additional rules for <\$2m and <\$5m | | Sole trader (individual), partnership, company or trust |
| Australian Prudential Regulation Authority (APRA) | | <\$50m turnover | | |
| Australian Bureau of Statistics | 1 to 4 employees (micro-enterprise), 5-19 employees (small business) | | | |
| New South Wales | 1-19 full-time equivalent employees | <\$2m aggregate annual turnover. | | |
| Other States | 1-19 full-time equivalent employees | | | |
| Australian Banking Association Code of Practice | <100 full-time equivalent employees | Annual turnover of <\$10m in previous financial year | <\$3m total debt to all credit providers (aggregate credit) | |

2.3.3 A note on government policy interventions during economic downturns

The Organisation for Economic Co-operation and Development (OECD) reports tightening credit conditions for SMEs in various countries during economic contractions (OECD 2020; 2015). Growth in lending to small business has been sluggish since the global financial crisis (GFC). Admittedly, the OECD indicates that these contractions and recoveries can vary between countries, sectors, industries, and companies of different sizes. During economic contractions, banks make less credit available and increase lending criteria which hamstrung lending to industry sectors. The OECD cautions that rejection rates of small business loan applications may not be an accurate reflection of lenders rationing credit alone. It could also indicate a deterioration in the creditworthiness of applicants. As small businesses are major employers and drive growth, government policy interventions often follow economic downturns to encourage recovery.

Various literature supports the use of government policy interventions to stimulate activity in specific industries (Hoffmann and Shcherbakova-Stewen 2011; Berger and Udell 2006). An example of this correlation is evident from ABS data, following government policy intervention in Australia in response to Covid-19 (ABS 2020b; 2021; 2020a). Various grants and subsidies have been made available for the construction of new homes during Covid-19. An example is the AU\$20 000 subsidy for new-builds or the purchase of off-plan single-tier developments before construction finish, offered from 4 June 2020 to 31 December 2020 (Western Australian Government 2020). A notable increase in loans to owner-occupiers from June 2020 was reported by the ABS (2020b), shortly after this subsidy came into effect. While short term, this intervention indicates a direct relationship between policy and economic activity in specific sectors.

The Pottinger (2020) review of the small business definition as proposed by the FSRC Commissioner, indicated a support for raising the total aggregate debt limit of the three-part small business definition of the ABA. This support is based in their perception of the need for the small business sector to “access debt capital to support them through the current period of weakness... and enable subsequent rebuilding” (pp. 31).

2.4 Defining a small developer

2.4.1 Conceptual understanding of a property developer

Development projects are vastly different and it is hard to put a property developer in a specific box (Isaac et al. 2010). A property developer could be considered a “disciplined professional with an entrepreneurial flair who specialise in creating new developments and successfully marketing and selling them” (Forlee 2015, 2). Miles et al. (2007, 8) compare a property developer to a movie producer, who “assume[s] responsibility [and risk] for managing individuals” in realising the development process.

Some authors define a property developer as a project manager or someone who acts as a project manager (Psilander 2012; Isaac et al. 2010). A property developer can act as a project manager on their own, or their company can act as a project management company for their developments (Wilkinson and Reed 2016).

2.4.2 Categories of property developers

Isaac et al. (2010), Wilkinson & Reed (2016) and Miles et al. (2007) suggest that property developers can be broadly classified as public developers and private developers. Public developers take on various forms and include local authorities or government agencies. These authorities and agencies construct institutional facilities, often in conjunction with private partners, by investing in areas where private developers would not find sufficient return. The authors note that this category can also include public corporations established with specific development goals. Private developers can be divided into part-time developers or full-time developers.

Forlee (2015) indicates that part-time developers are often individuals, who have a full-time job outside of property development or act as a project development manager for a small syndicate of friends. In the latter role, they organise project finance and manage the property development process. Forlee further argues that residential projects are less complex with a shorter development process than commercial property development and that this is where small developers are most comfortable. While the residential market provides an entry point for small

developers, they also participate in small-scale commercial developments and can be full-time developers.

The following categories for full-time developers are suggested by Forlee (2015), Isaac et al. (2010):

- Corporations – property development companies or financial institutions involved in a specific goal through property development as a means to an end;
- Voluntary, charitable or not-for-profit organisations – often associations that provide housing for specific charitable causes;
- Fee developers – qualified professionals that offer a development service;
- Combinations of the above developers could form partnerships, joint ventures and special purpose vehicles for specific purposes or special developments.

2.4.3 Small developer definition for this study

Due to the large range of different types of developments, it would seem that every small developer (much like small business in general) could be unique. Extant research indicates that small developers have low numbers of employees (due to outsourcing), take on small-scale developments and share many small business characteristics although they are more risk-averse (Psilander 2012; Baccarini and Kraus 2005). Legislative protections offered through the Corporations Act 2001, ASIC, AFCA will therefore include small developers in terms of the employee-limits, annual turnover-limits and asset-limits. Small developers could be included as either micro-enterprises or small businesses in the ABS definition. Small developers are deemed to be excluded from the ACCC unfair contract terms regime. This exclusion is due to the loan sizes and the uniqueness of their projects that leads to a negotiation process followed by the bank, often resulting in non-standard contracts. The ATO aggregated turnover of AU\$10 million for a financial year, could exclude small developers in some years. Small developer turnover can fluctuate dramatically year-on-year, due to a range of variables including the length, size and scale of projects, their ability to access credit and market conditions relating to the sale of their product (Naoi et al. 2019; Chiang and Cheng 2011).

While the FSRC's Recommendation 1.10 would include a larger range of small developers, this recommendation was not accepted by industry and the existing ABA small business definition is still in effect. Existing literature does not address banks' rationale behind the current ABA small business definition. The Commissioner's reasoning behind the recommendation and the arguments that were presented by banks against changes to the small business definition is set out in Chapter 4 – see [Section 4.3.1](#) and [Section 4.3.2](#).

As small developers borrow larger amounts and rely heavily on credit, their potential omission from the small business definition has significant implications for a small developer's credit assessments and contracts. Ramifications include increased exposure to high debt-to-equity tests, extensive monitoring covenants allowing unilateral variations in lending contracts, and a larger burden of proof of loan viability (Chiang and Cheng 2011; Hamilton and Fox 1998).

Considering that the definition criteria must be measurable and observable, congruent with the market system and meaningful (Anastasia 2015, 89), the following parameters have been identified for small developers:

- A property developer or entity who engages in new small-scale property developments. This includes private property developers (part-time or full-time) as well as fee developers or combination of these in a partnership, as well as the establishment of a special development company for a specific project. It also includes owner-builders and mom-and-pop developers;
- A property developer with ineffective limited liability, due to the use of large amounts of credit, secured with personal property, or who uses other personal securities or personal guarantees to obtain finance.
- A property developer, in a category as defined by lenders as a small developer.

2.5 Access to finance

2.5.1 Limited finance sources and financial bricolage theory

Small businesses often have limited sources of capital and financing options, especially when starting out or when anticipating prospective company growth (Hormozi et al. 2002; Hamilton and Fox 1998). The financing gap is filled by small

businesses through the use of bricolage, which could also support affordable and rapid business growth (Kariv and Coleman 2015; Karra, Tracey, and Phillips 2006; Vanevenhoven et al. 2011).

Kariv and Coleman (2015) indicate that young, opportunity-focussed businesses (like small developers) and businesses with a necessity-based focus are faced with similar challenges. They often fail to secure finance because of asymmetric information that they provide during the loan application and are constrained by lack of “access to a full range of funding alternatives” (Kariv and Coleman 2015, 199). They are also constrained by the intense competition for limited financial resources (Vanevenhoven et al. 2011). As businesses mature and develop the ability to access more funding options, the production of asymmetrical information may have a more severe impact on their finance application success (Kariv and Coleman 2015; Halabi et al. 2010).

Financial bricolage is argued to be first internal, and when a company runs out of internal resources, their focus shifts to attracting external resources (Liu et al. 2020). Vanevenhoven et al. (2011) also suggest a differentiation between social external bricolage (making use of a network of social relations) and physical external bricolage (calling on social and physical resources). Financial bricolage corresponds with small businesses’ preference for less-intrusive finance and to “meet their finance needs from a pecking order of, first, their ‘own’ money...; second, short-term borrowings; third, long term debt; and, least preferred of all, from the introduction of new equity investors” - see Hamilton & Fox (1998, 240) or bootstrapping – see Hormozi et al. (2002). For example, in terms of bank’s capital adequacy ratios, house mortgages take preference over business loans and borrowers use these types of loans (including re-mortgaging) to finance their businesses (Hamilton and Fox 1998).

Small businesses should be encouraged to develop a broad perspective of their financial position and financing needs while generating and exploiting the use of internal and external bricolage creatively and resourcefully (Kariv and Coleman 2015; Vanevenhoven et al. 2011). The innovative use of bricolage is even more essential in tough economic times when resources are scarce (Santos, Borini, and Pereira 2020).

2.5.2 The development process and finance methods

Hormozi et al. (2002) suggest that once companies have proven to be viable and sustainable, they often engage in two types of external financing: debt financing or equity financing. Debt financing refers to short-term and long-term borrowings from lenders or private capital providers. Equity financing, other than using personal or business savings, could be obtained by small companies with a proven track record and through relationship building with venture capital providers. Venture capital providers are usually larger companies or private equity providers. Hormozi et al. note that, similarly to financial bricolage, “angels” can provide equity financing. This type of financing is usually secured through personal or business networks and can be individuals, investment syndicates or other small companies, confident with past performance of the small business. This type of financing could suit a small developer who is comfortable with incorporating the high annual investment returns of 20-50% associated with equity finance or profit-sharing in their business model.

Bankers prefer shorter loan terms, which may be denying small business “access to more appropriate forms of finance” such as long-term debt (Hamilton and Fox 1998, 240). The assessment process for long-term debt can be costly to the lender, who may decide to absorb the transaction cost, depending on the loan size (Kariv and Coleman 2015). The main funding method used for property development is through a combination of debt finance and equity finance of which the ratio dependent on a range of varying circumstances surrounding the project, the lender and the borrower (Wilkinson and Reed 2016). This ratio is expressed as the loan to value ratio (LVR) and is dependent on various risk factors as assessed by the bank (Bryant 2012). The size of debt financing required by small developers would ordinarily require collateral. Collateral is derived from a) assets and equity from the business, b) private property of the directors that is used as security, or 3) guarantors that could provide the collateral (Bryant 2012; Hormozi et al. 2002).

Wilkinson and Reed (2016) argue that the finance-needs of a property developer is best understood by aligning the financial requirements to the property development process. They indicate that project phases for property development and the process is not necessarily linear, due to the uniqueness of each project and the type of

developer. Factors such as pre-sale requirements for financing can affect the sequence or lead to phases overlapping or being omitted. Wilkinson and Reed indicate that debt finance through banks for property development predominantly takes the form of:

- Seed capital, private funding or other finance sources (could also include bridging loans, mezzanine finance etc.) are usually needed to do all the leg-work for a project for it to be construction-ready. The amounts needed and the phases that it is needed for will depend on a developer's ability to access development loans and construction finance that will supplement or replace the need for seed capital, private funding or other sources;
- Development loans, allows for the debt financing of various aspects of the development process, depending on various conditions as stipulated by the lender. These types of forward-funded loans are hard to obtain for small developers, due to strict guarantee requirements;
- Construction finance (a loan for the construction phase of the development), released at specific completion stages of the construction process;
- A complimentary lending arrangement to development finance or construction finance, as long-term finance. These loans are investment loans, used for holding the completed development or sections thereof. The original loan (a construction or development loan) is thus converted into a second loan as an investment loan, similar to a mortgage-type arrangement.

Forlee (2015), Isaac et al. (2010) and Miles et al. (2007) sets out the property development phases. While some phases could be omitted or run parallel to align with project requirements, the first phase in the development process as is usually the inception phase, where the potential project idea is considered. The authors indicate that next phase will consist of an assessment and evaluation, by refining the project idea and conducting market research to understand the project potential and limitations. If the outcome of the second phase is positive, the developer will conduct due diligence, in-depth assessment of the viability of the project. This investigation assesses the site conditions, physical and planning limitations. A business case is developed for finance by conducting valuations and projecting potential returns.

Commitment is the next step in the property development process and project-specific negotiations around the acquisition of the property could form part of this step, or precede it. Once the property has been acquired, planning permissions are submitted for approval to relevant authorities and detailed costings are developed around the developing building plans and other technical and engineering requirements of the project. The sell or hold decision could be made at any stage of the property development process. It has been included at this point, as the developer would have clarity around financing opportunities available and would have decided on whether they will sell serviced blocks or a complete constructed product. A hold-decision could affect the development finance options and may require additional arrangements for long-term finance. The marketing phase follows a sell-decision and development loans often have requirements for marketing plans and the achievement of pre-sales. Technical requirements are met in the next phase. The technical phase could run concurrent with the marketing phase, as architects or graphic designers will produce marketing material based on the detailed plans and working drawings. If the developer plans to contract a civil contractor or builder, tender documents and construction contracts are developed. The last phase of property development is the physical construction of the project. This phase and could involve both civil works and construction. In cases where sub-divided land will be sold, only civil works will be done in the construction phase while other developments may involve building construction only, where serviced land was bought. These phases may differ from one unique project to another and can overlap or be consolidated.

Figure 2.1, on the next page, outlines the development process and indicates how funding arrangements could align with the development phases but do not address the credit risk assessment process followed by lenders. Section 2.5.3, hereafter, presents two models for conceptualising this process.

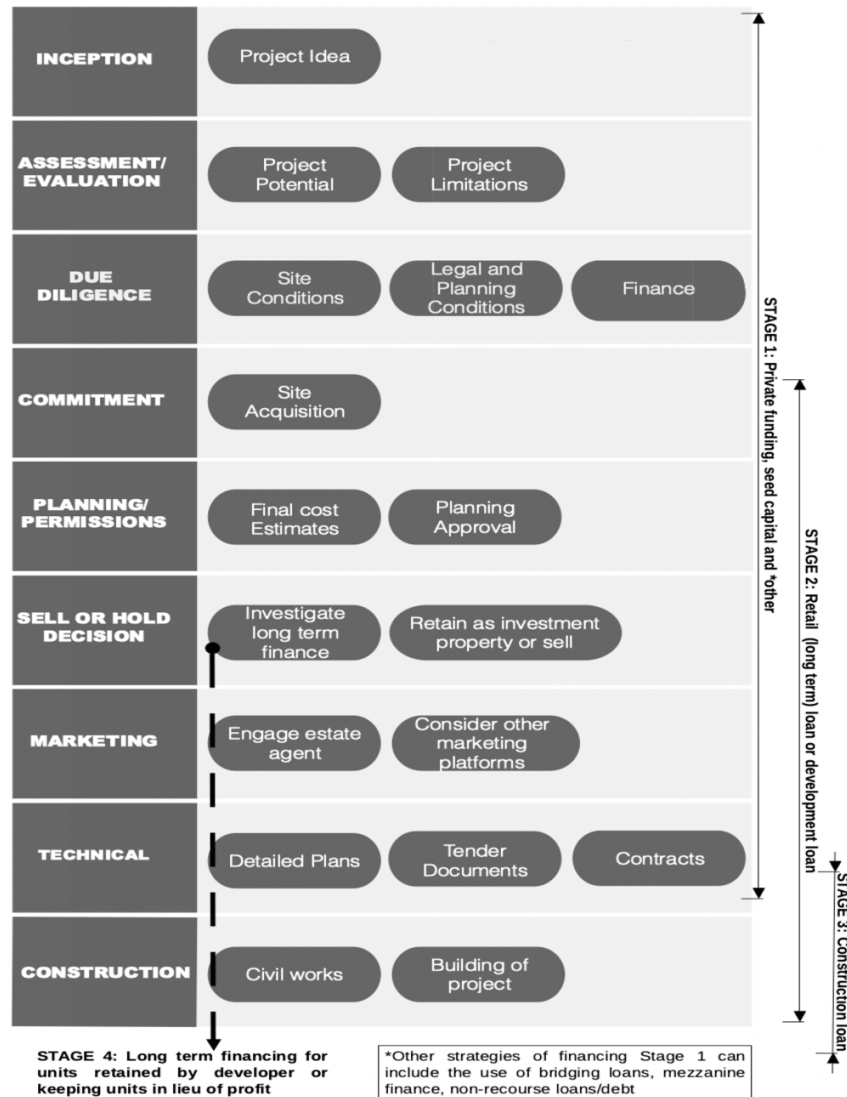


Figure 2.1: Property development process and financing stages

Source: Adapted from Forlee (2015), Isaac et al. (2010), Wilkinson and Reed (2008) and Miles et al. (2007).

2.5.3 Two models for conceptualising credit risk assessment

Banks are key role players in the property development process and small property development industry. They also have a responsibility towards their depositors when extending finance and have to adhere to liquidity provisioning regimes, while also recycling capital by extending loans to businesses with viable proposals (Cummings and Durrani 2016). Banks use extensive security provisioning and serviceability tests, and consider market conditions to ensure that lending is done responsibly (Drummond and Chell 1994). Like their borrowers, lenders also have varying levels

of expertise and specialisation, which could affect the risk proportioning (Drummond and Chell 1994; Healy 2019).

Due to the nature of lending to a small business and to determine their risk proportioning, the bank requires a thorough examination of various aspects finances of the business and its owner, leaving small developers with a heavy burden to prove viability (Bauchet and Morduch 2013). In addition to this burden of proof, the omnipresence of the owner-manager complicates the assessment process, making it difficult to distinguish between finances of the owner and the business (Halabi et al. 2010; Reijonen 2008; Hamilton and Fox 1998). With an owner-manager responsible for various aspects of the finances of the business, from the production to the interpretation thereof, the risk of potential asymmetry in the information is increased and the bank may need additional verification processes or require additional security (DeZoort, Wilkins, and Justice 2017; Aysan et al. 2016; Berger and Udell 2006). Ultimately, lenders assume the lending-risk at a fee, which is charged in the form of interest and service charges and is based on the motivator for lending: the direct financial long-term gain of the bank (Wilkinson and Reed 2016).

Forlee (2015) and Hormozi et al. (2002) propose that lenders' documentary requirements for credit risk assessment can be aligned with a company's business plan. Such a business plan can also be used to attract investors. The business plan would require various a comprehensive working document. It must provide an introduction, that explains the project background, development goals and contains the site information. Town planning reports and development approvals should follow, indicating the suitability of the proposal for the specific site. An industry or market research section must include an analysis of the environment and the findings of research around target markets. The market research must include share analysis and awareness of competitors and combine the information into a marketing plan. Graphic presentations will provide visual clarity to potential investors and financiers and will support the marketing information and project proposal. Architectural documents will provide clarity around specifications and should include design reports, like engineering reports. The economic viability of the project proposal must be addressed through detailed product information, projections, costing report and must indicate the amount of finance required and the period for which finance will be

required. In the pricing section, a detailed analysis must be provided of the sell or hold decision. A sell decision must be supported by valuations and sale contracts prepared by real estate agents. A decision to hold the property/parts of the property will require a schedule of leases, prepared by leasing agents. The developer and support team section outline the developer's profile and explains the legal structure of the developer's business or the project arrangement. This section will also include the industry experience of the applicant, the competence of their team to the lender and contingency plans. The section with the business's financial information should include the company's overall business objectives, outline the financial management structure and provide the financial statements. The company's asset statements and the asset and liability statements of the directors are to be included in this section. As bank requirements for loan application assessments may differ, appendices can provide further information. Figure 2.2 on the next page, outlines Forlee (2015) and Hormozi et al.'s (2002) suggested business plan format. A business plan approach provides a tick-list of documents which required by a lender during the credit assessment process. However, a business plan approach does not indicate the purpose, weighting or impact of each document in a lender's assessment process.

| | | | | |
|--|--|--|--|--|
| General/ Introductory information | Executive summary | Outline and goals of development | Background (site history) | Site information (location, title particulars, land area etc.) |
| Town planning report | Rezoning (if required) | Development approval | | |
| Industry/ Market research | Environment analysis | Research findings: target market, customer make-up | Market share & competitors | Marketing plan |
| Graphic presentation | Illustrations, maps, diagrams, photographs of site and neighbourhood | | | |
| Architectural documents | Plans and specifications | Other design reports: engineering etc. | | |
| Economic viability | Product information | Period that finance is required for | Projections: sales, expenses, net income, asset growth | Quantity surveyor report Development manager report |
| Pricing | If SELL: schedule of prices/sales contracts and valuation of land or sales contracts | | If HOLD: schedule of leases/offers to lease | Prepared by leasing/estate agents |
| Developer and support team | Legal structure of company or development arrangement | Developer profile | Previous completed projects | Competencies/capability statements of professional team |
| Financial information | Overall business objective | Explanation of financial management | Company financial statements | Statements of assets Assets and liabilities of directors |
| Appendix | Assumptions | Contingency plans | Risk management plan | Addressing of investor concerns |

Figure 2.2: Suggested project business plan aligning with documentary requirements
Source: Adapted from Forlee (2015, 189) and Hormozi et al. (2002).

Bryant (2012) argues that a business plan may not be sufficient, as the loan assessment process involves lengthy negotiations, is project-specific, case-specific and circumstantial. He suggests that banks engage in a process of complex credit assessment through a “Five Cs” model which analyse the borrower’s character, capital, capacity conditions and collateral (Bryant 2012, 121). Each of these assessment aspects is an integral part of a lender’s credit-risk assessment and pricing process, which varies between banks. The model does not specify the documentary requirements which is, admittedly, extensive. The character appraisal of a borrower tests their integrity by considering their skills sets, competence, social and financial stability and their honesty and reliability. Evaluation of a borrower’s capital involves

an assessment of their financial strength by assessing the financial information provided, doing background searches and assessing the borrower's gearing. The capacity of a borrower to repay the loan is considered against their financial information, in particular, their cashflow and confirmed income and revenue. External and internal conditions are based on key factors, whether market-related or case-specific and could affect specific loan conditions and covenants. Loans are secured by collateral and the bank will undertake an assessment of the securities that the borrower have available. The lender's assessment of the borrower's collateral could include an investigation into mortgages, guarantees, liens, and multipartite agreements that are available as security. Bryant's "Five Cs"-model considers five areas of risk that will be assessed. If the outcome is positive, the risk perception that was developed through the credit risk assessment process will have affect the amount of credit that the bank will make available, the cost of the credit, the loan period and could affect various contractual clauses and covenants (Bryant 2012).

Table 2.2: The 'Five C's' of credit assessment

| Five "Cs" | Description | Includes |
|------------|--|---|
| Character | Appraisal of the borrower's integrity | Character Competence identification Social and financial stability Honest and reliable |
| Capital | Appraisal of the borrower's financial strength | Assets and liability statement Title searches Gearing |
| Capacity | Analysis of the borrower's capacity to repay | Cashflow Confirmation of income/project revenue |
| Conditions | Analysis of key external and internal factors | Loan conditions and covenants Market and economic conditions |
| Collateral | Appraisal of security available to support the borrowing | Mortgage Guarantee Lein Multipartite agreements Fixed/floating charges |

Source: Bryant (2012, 121).

The detailed project business plan (Forlee 2015; Hormozi et al. 2002) as well as the “Five Cs” model (Bryant 2012), offers an insight into the extensive documentary requirements by lenders when engaging in credit transactions that are considered complex and sophisticated. With small loan generation costs high, the assessment process requires staff that are highly skilled in all aspects of small business lending (Healy 2019). Lenders will require substantial evidence from small developers during the loan assessment process (Hamilton and Fox 1998). Where proposals prove viable, and loan contracts are extended, the bank will become actively involved in the process. Small developer loans will be monitored through the monitoring of the use of finance various agreements in the form of drawdown schedules, the monitoring of non-monetary covenants and valuations throughout the loan period and the process of development – considerable effort relative to the size of the loan (Forlee 2015; Bryant 2012; Hamilton and Fox 1998). The differences in requirements by lenders in terms of their credit assessment processes, and the case-by-case assessment, taking market conditions into consideration, appears to be the reason for the lack of an exhaustive list of documentary requirements (Bryant 2012).

2.5.4 Financial literacy

Various authors indicate that a small business owner must take substantial responsibility for their own financial literacy and financial planning skills. Banks use financial ratios to provide a better overview of a company’s financial performance based on the information submitted in the loan application (Cole and Sokolyk 2016; Halabi et al. 2010). Healy (Healy 2019), Cummings and Durrani (2016) and Drummond and Chell (1994) indicate that a small business owner should have the financial literacy to predict the implications of the collection and format of financial information and its impact on their ability to access credit. Financial information should not merely be collected by a small business for taxation purposes. It will be critical that they employ a reliable accountant who understands the implications of how the information is collected and presented (Cummings and Durrani 2016).

The section on financial information required from small developers can vary between the type of entity, such as sole proprietors, partnerships and incorporated firms (reporting or non-reporting entities). At a minimum, lenders need balance

sheets, income statements, balance and loss statements, statements of cash flow, asset statements, net worth statements, break-even analysis and various projections (Halabi et al. 2010, 164; Hormozi et al. 2002). Property developers must also demonstrate financial planning skills, as contractual covenants in loan contracts will monitor their financial stability during the loan period, while profit is only realised at the end of a project (Chiang and Cheng 2011; Halabi, Dyt, and Barrett 2010; Hormozi et al. 2002). Many costs cannot be capitalised as part of the loan and could include the servicing of the land, earthworks, professional fees, land and property transfer costs, finance charges, letting and sales fees, advertising fees, ancillaries, company taxes, interest rate changes, contingencies, cost of delays etc. (Isaac et al. 2010). Cole and Sololyk (2016, 58) insist that a small business' ability to "accurately assess their credit quality" is key in obtaining "credit and reach their optimal capital structures".

2.5.5 A note on the GST on a new property

While small businesses in Australia only need to register for goods and services tax (GST) when they have sufficient turnover, GST registration for the sale of a property, other than private property (family home or property from which only residential rent is received), is necessary (Australian Government Taxation Office 2020). When a business is registered for GST, credits can usually be claimed when buying property for development and on costs related to the construction process. The process of paying tax on new property, effective from 1 July 2018 on new residential premises and "potential residential land" (Australian Government Taxation Office 2020) could impact a small developer's cash flow. The same process will apply when a small developer buys "potential residential land" from a larger developer, compared to when the small developer sells a completed new residence or when a small developer sub-divide land for re-sale.

While the property developer notifies the purchaser of the GST withholding amount and the purchaser pays the GST directly to the Australian Taxation Office (ATO) on property settlement confirmation. The ATO then allocates the GST credits to the property developer's Credit Withholding Account. The property developer can claim GST for the sale of new residential property or potential residential land and can claim GST credits for construction and related costs (if they are registered for GST,

with some exclusions applying). The process is set out in Figure 2.3 (on the next page) and requires careful cashflow planning on the part of the developer.

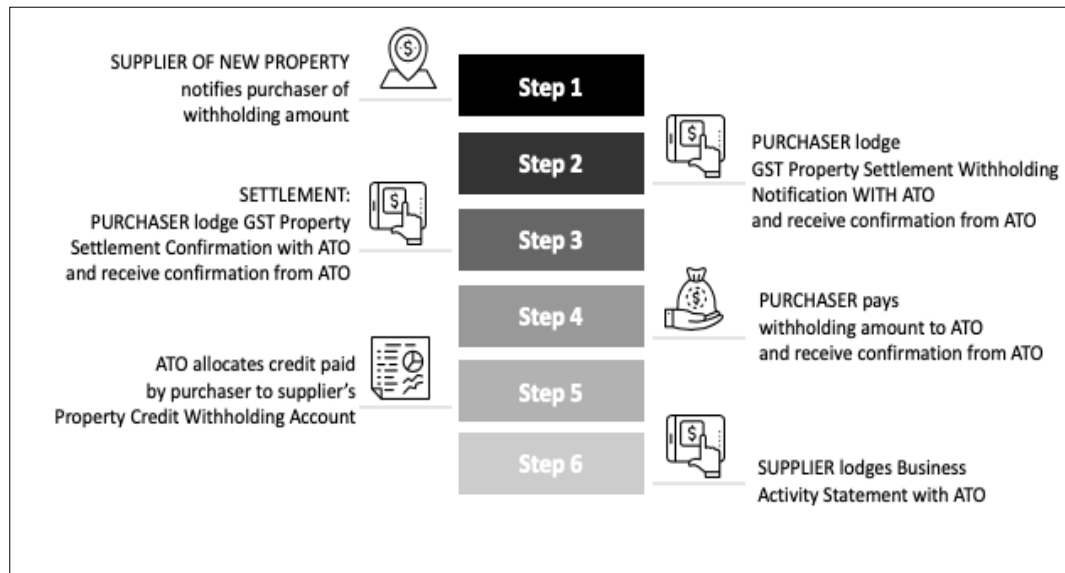


Figure 2.3: GST steps for residential property
Source: Adapted from the Australian Taxation Office (2020).

2.6 Summary of Chapter 2

Small business definitions in Australian legislation serves the purpose of affording specific protections for vulnerable businesses. Small business definitions with outer-limits do not accurately define small businesses. This is particularly true, considering close to 70% of all businesses in Australia have no more than 4 employees (ABS 2020a). Definitions that include upper combined-credit limits could potentially exclude some small developers, whose credit requirements for projects often overlap. Whilst each property developer is different, this chapter sets out a definition for a small developer to delineate criteria for participants and allows for future research to be comparable.

Small developers share small business characteristics. This chapter points to specific differences that should conceivably be an advantage for small developers when borrowing. For example, whilst small business owners are perceived as risk-prone, small developers display a risk-averse attitude. However, they are prone to

opportunistic framing and availability bias. These small developer qualities are “tempered by a personality trait that promotes proper planning and problem-solving when engaged in risk-taking behaviour” (Baccarini and Kraus 2005, 179) due to more expensive capital (Kariv and Coleman 2015). Generally, small businesses lack a complete management team (Ang 1991; Kariv and Coleman 2015). The nature of the property development process affords small developers access to specialists for input and advice (Newell and McGreal 2017; Gudmundsson and Lechner 2013).

While their risk-averse attitude and access to specialists set small developers apart from other small businesses, they are subject to an extensive documentary burden during credit assessments, similar to large property developers (Forlee 2015; Bryant 2012). Small developers share the ineffective limited liability characteristic with other small businesses, which increases flexibility in lending. This necessitates an additional assessment of the business owner’s personal credit history (Hamilton and Fox 1998). Even though small developers borrow smaller amounts, relative to the loans of large developers, they are subject to a more intensive assessment and similar monitoring procedures. Considering the costs linked to small business lending whilst keeping in mind that small property development loans are secured, it is unclear from the literature whether banks view lending to small developers as a viable business opportunity.

The literature review considered two models of credit risk assessment. A business-plan approach to credit assessment provides a documentary tick-list. While this approach may seem simple, Kariv and Coleman (2015) suggest that asymmetry in the information provided could lead to a failed credit risk assessment. Further, a lack of understanding by the small property developer of the implications of the financial information provided and the format in which it is provided lead to failure (Cummings and Durrani 2016). A second approach, based on Bryant’s (2012) “Five Cs” model, analyses the borrower’s character, capital, capacity conditions and collateral. While Bryant’s model is used to explain the credit assessment process to small businesses, it may not be tailored to small property developers, whose credit assessment process is more complex. Banks consider the inherent risks of property development as well as the risk regarding each unique loan during the risk assessment process.

The viability assessment of an investment project, in the form of loan application, is a small part of a complex credit process (Brei and Schclarek 2015). Banks are private corporations who act as profit-making intermediaries. They are represented by individuals in the loan assessment process to small developers, who are legal entities. The interaction between parties is dependent on a sophisticated motivational framework, which is not sufficiently explained by the assumed power and knowledge gap. Chapter 3 details how the research methodology and design supported the investigation of the research problem. Challenges and opportunities perceived from different vantage points during the viability assessment of small developer loan applications is central to the research methodology and design. The theoretical rationale guided the conceptual thinking about the research and formed the basis for the data collection strategy. An integrated approach to the levels of thinking research and a methodology for systematic research is presented in the next chapter.

CHAPTER 3

RESEARCH METHODOLOGY AND DESIGN

3.1 Introduction to research methodology and design

This chapter outlines the methodology and the approach to the research design. The suitability of the methodologies chosen and the research design is justified in this chapter. Trafford and Leshem's (2008) circular approach frames much of the work. The circular approach proposes four levels of research thinking, which start with developing a research paradigm. Next, a research approach is developed within the context of the research paradigm. The research methods are developed to correspond to the suggested research methodology. Lastly, following a reverse auditing process supports internal consistency. Four decisions, considered during the research development process, are addressed by the circular approach: the research paradigm, the research approaches, the methodology and research methods design. Each decision considers validity in terms of its suitability and support of the next decision. The auditing process examines whether a subsequent decision supports the previous decision. Figure 3.1 below illustrates the circular approach to research thinking.

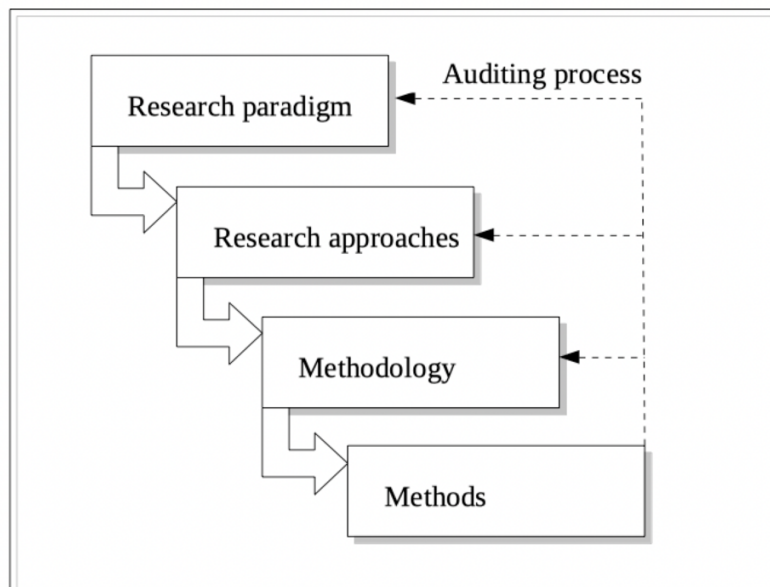


Figure 3.1: Circular approach to research thinking

Source: Trafford and Leshem (2008, 94).

The research design, methods, approaches and procedures are well linked, conforming with Kuvunja and Kuyini's (2017, 28) definition of an overall methodology: "the logic and flow of the systematic processes followed in conducting a research project as to gain knowledge about the research problem". The authors also argue that adopting a research paradigm clarifies the impact of choices around research approaches, methodology, and data collection and analysis methods. Further, a research paradigm should consist of four elements: epistemology, ontology, methodology and axiology. Epistemology describes a lens through which to view thinking and the nature of knowledge creation (Spender 1998; Palmira 2018). Ontology points to how thinking about the nature of the research problem are orientated (Kivunja and Kuyini 2017, 207). Axiology concerns ethics and values and their effect on knowledge creation (Morgan 2007).

The use of pragmatism as a research paradigm to investigate the research problem is motivated in this chapter. Critical shortcomings of pragmatism are addressed through the contextualisation of this research paradigm. This study focuses on how banks view and assess the viability of the credit applications of small developers, and a dynamic pluralist epistemology and a non-singular reality ontology provided such context. Value-laden axiology allowed the inclusion of participants' personal experiences, opinions and ideas regarding the loan assessment process of small developers. The cyclical nature of research processes and limited academic discourse on small developers' loan applications motivated an deductive research approach. Data collection, through a mixed-methods methodology is outlined. Plowright's (2012) Framework for an Integrated Methodology (FraIM) structures the use of mixed-methods data collection.

The theoretical rationale, which guided conceptual thinking, points to the different perspectives of small developers compared to lenders when considering loan risks (see Figure 1.2 in [Section 1.3](#)). The theoretical rationale formed the basis of the data collection methods through a two-stage strategy. *Data Collection Stage 1* followed an exploratory sequential design through a narrative data analysis of the FSRC Round 3 information and in-depth interviews conducted with banks and small developers. The narrative analysis of data collected during Stage 1 delivered a conceptual credit risk assessment model as an outcome. *Data Collection Stage 2*

involved testing the conceptual credit risk assessment model through expert opinion and an industry survey. A proposed improved credit risk assessment model was the outcome of data collection in Stage 2. This chapter discusses the details about the selection of data collection strategies, the challenges, and the data's validity.

Figure 3.2 below illustrates the followed research design process, based on Trafford and Leshem's (2008) circular approach to ensure internal consistency between the results and research design. Internal theoretical consistency was deliberated using the study's theoretical rationale as the basis for the research design and the data collection strategy. External consistency was considered against the generalisability of the results through structured mixed-methods data collection strategies.

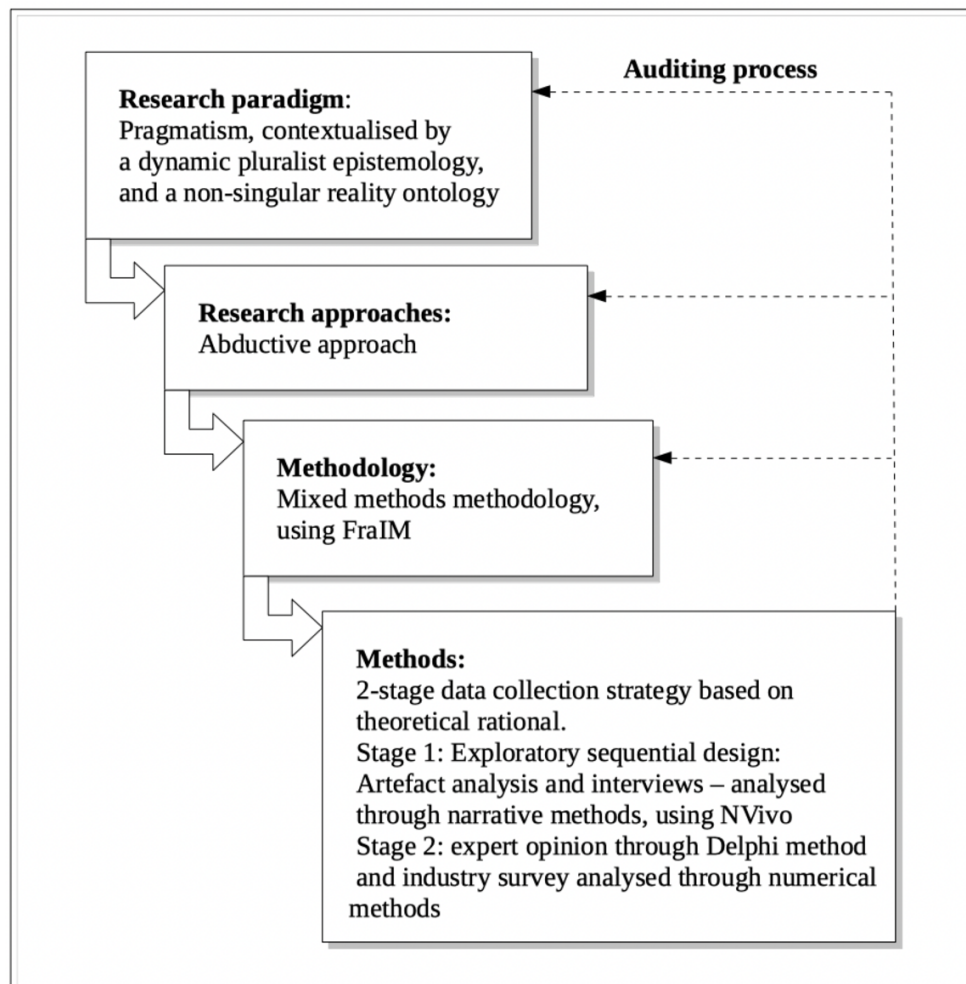


Figure 3.2: Summary of research thinking for this study

Source: Adapted from Trafford and Leshem (2008).

3.2 Development of the research paradigm

The utility of an appropriate research paradigm to ground the study is considered. Defining the research paradigm outlines how the philosophical position affected the decision-making processes throughout the research.

3.2.1 Background to the utility of a research paradigm

Kivunjay and Kuyini (2017) suggest that it is strategically crucial to articulate the philosophical position taken concerning the research project to describe how meaning will be inferred from the data. They argue that the research paradigm influences decisions throughout the research process and impacts data collection and dissemination choices. The lack of agreement and overlaps in defining the term “paradigm” in educational research has been problematic and confusing, particularly in higher degree research in the social sciences. Kivunjay and Kuyini suggest that a paradigm should include epistemology, ontology, methodology and axiology in higher education research.

Plowright (2012) suggests a paradigmatic reconciliation between the two traditional paradigms. The positivism lens offers a paradigm through which the world exists as an ontological reality, independent of our perception and understanding.

Constructivism provides the juxtaposition by claiming “that reality is mind-dependent and is socially constructed through the relationships, psychological activities and shared understandings that we all take part in” (pp. 177). While posed as incompatible or bipolar opposites, Plowright argues that a paradigmatic philosophical reconciliation could be possible by considering that the social transitive, mind-dependent world “is contained and constrained by the intransitive”, mind-independent-realist world (pp. 180).

Pascale (2010) questions Plowright’s suggested reconciliation. They argue that the positivist and constructivist lenses carry baggage of being developed in conjunction with the rise of the nation-state. Pascale proposes that the coinciding of the two developments indicates built-in biases that could limit cultural contextualisation when exploring a particular phenomenon. Further, Pascale questions whether philosophy should determine the research method. They argue that the scientific

models, based upon philosophical theories for research, may not be compatible with research in the social sciences.

According to Hall (2013) and Morgan (2007) such an a-paradigmatic stance leads to the convenient utilitarian use of methodology and avoids considering the underlying research paradigm. Such use, which values expediency over reflective approaches, could lead to methodology-driven research without depth. The lack of depth could be damaging to the reputation and credibility of the research.

Developing a clear paradigmatic position further allows the creation of the setting in research communities to determine which beliefs within the paradigm is “meaningful and the actions [which are accepted] as appropriate” (Morgan 2014). For this study, a paradigm is defined as a system of ideas, a belief system or theoretical principles which “determine[s], maintain[s] and reinforce[s] our way of thinking about an issue or a topic” (Plowright 2012, 177).

3.2.2 Pragmatism as an alternative paradigm

Morgan (2014), Hall (2013) and Feilzer (2010) support the use of pragmatism as a paradigm as a more radical possibility. While pragmatism has often been used as an epistemology, they argue that pragmatism, as a metaphysical paradigm, provides the basis for a more integrated research approach.

According to Feilzer (2010), a pragmatist view focuses on the importance of the consequences of a specific research problem. Also, pragmatism orients towards accepting multiple realities, elements, and layers, which could help solve “practical problems in the ‘real world’” (pp. 8). Feilzer argues that both quantitative and qualitative methods are needed to investigate these layers, elements and realities. Their support for using both methods is in the commonalities that they share “at an epistemological or ontological level... in their approaches to enquiry” (pp. 8).

The value of pragmatism as a methodology-driven philosophical position is noted by Pascale (2010). On the other hand, Hall (2013) and Morgan (2014) warns against practical use or mere methods-driven use of pragmatism. They insist that pragmatism as a research paradigm must be applied beyond “what-works”. Thus, the

application of pragmatism as a paradigm should not only be for the practical uses thereof, as the credibility of the findings could be affected. As a research paradigm, pragmatism grounds the use of research methods, therefore avoiding the trap of methods-driven research posed by pragmatism as epistemology. For this study, Feilzer's (2010) focus on the consequences of the research problem, and the utility of data collection methods in examining the multiple realities, layers and elements were considered.

Pascale (2010) insist that pragmatism is practical when investigating power-relationships. Pascale's rationale centres on their position that both positivism and constructivism are outdated for investigating power relationships in social sciences in the 21st-century, as both these philosophical positions have their origins in the 19th-century philosophy of science. Morgan (2007) cautions that clear axiology is required when investigating power relationships, because pragmatism presents a link between research and politics, as indicated by Pascale's position. Concerns about the ethical issues of pragmatism are centred on its use to "gain knowledge in the pursuit of desired ends" (Morgan 2007, 69). Therefore, Morgan concludes that the use of axiology contributes to continuity when using pragmatism as a paradigm. Axiology must disclose ethical considerations around power relationship investigations.

3.2.3 A dynamic pluralist epistemology

While a paradigmatic stance indicates thinking about the topic, epistemology is described as the foundation of knowledge, knowledge creation and belief about reality (Spender 1998). Epistemology thus provides a specific perspective: thinking about an object is not the same as thinking about it "via a special epistemic relation" (Palmira 2018, 3963).

While positivism's presentation of processes in the form of models of static entities presents a starting point, it does not suffice when investigating firms that operate in a fast-changing environment. Spender (1998) favours a more dynamic framework when investigating firms. He argues that pluralism presents a better framework. As an inherently dynamic epistemology, pluralism allows the exploration "of the incommensurability and interplay of knowledge types" (pp. 242). Adopting a

dynamic pluralist epistemology allows for exploring corporate culture and knowledge, and individuals' knowledge, how these types of knowledge interact and how knowledge-making is affected by various sets of vantage points (Griffith 2015; Spender 1998).

This epistemological approach acknowledges that propositions would not be helpful, as they would be true at certain points in time, under specific conditions, but untrue in another set of circumstances at a different point in time – thus, dependence relations would differ (Griffith 2015). By following a pluralist approach to epistemology, set in a dynamic environment, this study explores the research problem and questions in a changing environment. Through a two-stage process of data collection, a proposed improved credit risk assessment model was developed. The model presents the antecedent and intervening variables that affect the perceived viability of small developers' loan applications. The variables indicate the effect of the complex circumstances on the research question.

The dynamic pluralist epistemology supports deductive reasoning to develop a likely explanation of the perception of the viability of small developers' loan applications by lenders through a proposed improved credit risk assessment model (Awuzie and McDermott 2017).

3.2.4 Ontology: A non-singular reality

Ontology is the “assumptions, concepts or propositions help to orientate... thinking about the research problem, its significance and how you might approach it to answer your research question, understand the problem investigated and contribute[d] to its solution” (Kivunja and Kuyini 2017). The pragmatic research paradigm supports this interpretation of the ontological positioning, which focuses on the research question and research consequences in multiple-reality environments (Feilzer 2010).

Spender's (1998) dynamic pluralist epistemology contextualises using the pragmatic paradigm and a non-singular reality ontology within a changing environment.

Lawson (2016) proposes that social research presents the opportunity to investigate the emergence of social reality in the context of social agreements (ways of doing things), whether these are legal, collective or institutional. Businesses exist within a

legal structure and are positioned as legal persons. Within these corporations, “human beings are harnessed as amongst their components... [within] an appropriate legal structure (pp. 384). A non-singular reality ontology considers that viewpoints of the parties involved in the small property loan assessment process may differ. These viewpoints can be different between legal entities, but also between individuals within these legal entities.

In the context of this study, small developers may view the risks around credit transactions different, not only between themselves but also compared to the perspective of banks, who will evaluate their exposures against the lending applications. A multi-faceted interpretation of reality is helpful, as the relationship-building between the banker and small developer is only a tiny part of the overall credit process. While the bank (the corporation) articulates its views through policies and procedures, the complex nature of small business lending requires real humans (with potentially different motivational drivers) to assess the loan applications (Healy 2019; Lawson 2016). These human representatives have specific motivational drivers, whether personal or related to the bank’s responsibility towards their depositors and shareholders, while acting as a profit-making intermediary and a prudent and diligent banker. On the other hand, the small developer is often an owner manager who may not distinguish between personal and business goals (Herranz et al. 2009). A non-singular reality ontology considers that these interactions are not necessarily viewed the same by the parties involved in the interaction.

Figure 3.3 (at the end of this section) indicates the research area and illustrates the interaction between a bank and an entrepreneur – a small developer in this study. Entrepreneurs have access to investment projects, which they propose to the bank. The nature of property development indicates intensive capital input as a requirement. Lenders consider the nature of a small developer’s business when they apply for financing. Lenders evaluate their risk factors concerning each credit proposal. Banks also have a fiduciary responsibility to their shareholders and investors when considering credit proposals. The research investigates the risk factors that lenders consider during the assessment process that could affect the

viability of a small developer's credit proposal. A non-singular reality ontology enables the consideration of these risk factors from various vantage points.

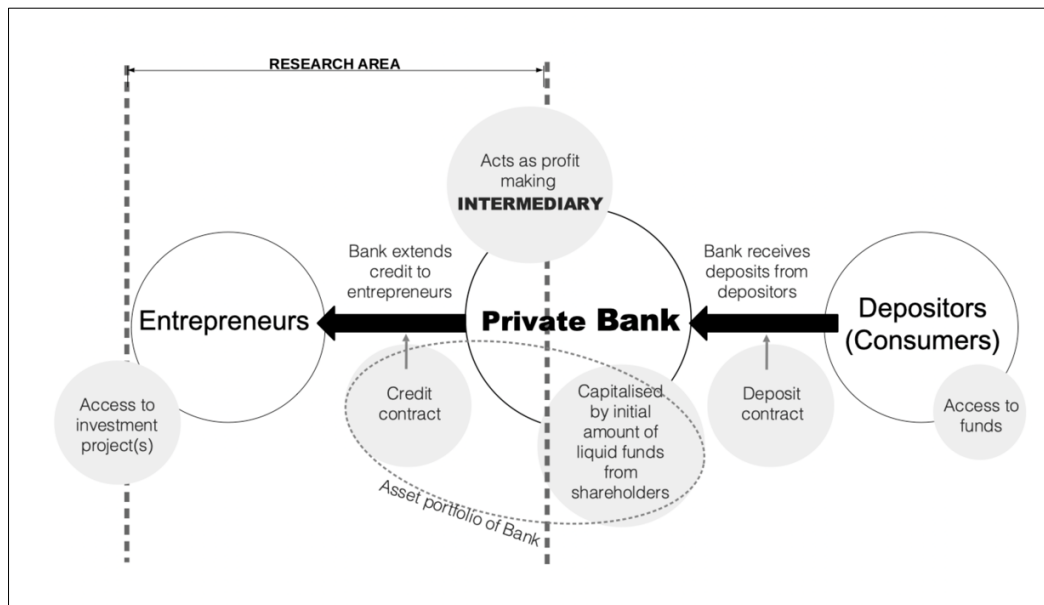


Figure 3.3: General framework of a bank acting as an intermediary agent
Source: Adapted from Brei and Schclarek (2015).

3.2.5 Axiology (ethical considerations)

Graeber (2014) explains that a power imbalance exists in the lending process between lenders and small businesses, based on the nature of small businesses. This study investigates the relationship. Potential biases are balanced by considering the evidence presented in the Round 3 hearings around small and medium businesses in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and the Commissioner's findings.

Royal Commissions in Australia provide authoritative evidence through their public inquiries into breakdowns in public and private processes and alleged unconscionable conduct or misconduct (Gillian 2018). The evidence is gathered through hearings under oath of selected, impartial specialists and case studies of complainants and respondents. Witness statements preceded evidence given under oath. The FSRC inquirers thoroughly questioned witnesses, and in some cases, the evidence was cross-examined by private lawyers for banks. The FSRC Round 3

Hearings examined the entire credit interaction between lenders and small businesses and when breakdowns and misconduct in these processes occurred. The value-laden axiology allowed for exploring individuals' experiences and their perceived challenges relating to the research problem through evidence presented in the FSRC Round 3 Transcript of Proceedings (2018b).

In many cases, these experiences and perceived challenges were countered with evidence from other parties during the case studies. The FSRC compiled an Interim Report (2018a) and Final Report (2019b) with objective observations and summaries of the case studies. The case studies were considered in the Final Report within Australia's legal and policy context, and Commissioner Hayne made recommendations for specific interventions they deemed necessary.

The FSRC Round 3 hearings' evidence is examined in Chapter 4 and played a crucial role in focussing the research questions. The evidence provided by the FSRC Round 3 Transcript of Proceedings (FSRC 2018b) covered gaps that are not addressed in existing academic literature. While a power and knowledge gap are assumed to exist, care has been taken not to follow a feminist philosophy around a social justice agenda. The research question is not viewed against a simplistic power gap only but is contextualised by the organisational, professional and economic environment (Morgan 2007; 2014; Plowright 2012). It further illustrates the importance of the research area within the national discourse around the ability of small businesses to access credit and the effect of imbalanced power relationships on such access.

In-depth interviews with bankers and small developers were based on the research questions and evidence from the FSRC Round 3 Hearings. The evidence provided under oath during the FSRC Hearings was elaborate and made available to the public. The evidence is recent, empirical, practical and devoid of application gaps in theoretical or industry implementation. Considering the lack of academic discourse on this topic, the data from the FSRC hearings eliminate guesswork and situate the research in reality. In-depth interviews allowed exploring additional themes, which were tested through expert opinion and an industry survey.

3.3 Research approaches

There is a reasoning that the research process is circular (Kivunja and Kuyini 2017; Trafford and Leshem 2008). Also, academic literature available around the assessment of small property development loans is limited. Considering these – the cyclical nature of research processes and limited academic discourse on small developers – a deductive research approach was followed. Using an abductive approach as a starting point, allows the researcher to engage with research by going backwards and forwards “between theory and data in a bid to develop new or modify existing theory” (Awuzie and McDermott 2017, 357). The deductive approach allowed the systematic development of an improved credit assessment model.

This approach is supported by the pragmatic paradigm, within which this small-scale study is set and the use of a dynamic pluralist epistemology, contextualised by a non-singular reality ontology. The deductive approach thus allowed the exploratory collection of data, informed by the various perspectives of participants and the engagement of new ideas that emerged from these perspectives. The existing theory and exploratory data were combined in a conceptual credit risk assessment model, tested with experts and through an industry survey and concluded in the proposed improved credit risk assessment model for small developer loans. The limitations of this model are set against the dynamic pluralist epistemology, which indicates that various combinations of conditions at specific points in time can affect the risk perceptions around the assessment of small developers’ loans.

3.4 Data collection methodology

Much of Plowright’s (2013; 2012) work has been used to structure the study. Plowright sets out a framework for mixed-methods research that contextualises the research and validates the research question. They argue that quantitative methods and qualitative data collection methods are closely linked to positivism and constructivism, respectively and that these terms should be renamed to clarify their use in mixed-methods research.

3.4.1 Plowright's structure for mixed-methods research

Plowright (2013) asserts that the use of mixed methods in higher education research can be ambiguous and unreliable. They suggest a comprehensive, integrated framework and a three-dimensional integrated framework improve mixed-method research methodologies. The former structure the research while the latter improves data validity by outlining the methods used and how they were mixed.

3.4.1.1 Avoiding “mythologies”

Plowright (2012, 16) cautions that researchers should be “increasingly concerned about how research really [is] based on a number of disturbing inconsistencies and misleading ideas... a mythology.” They challenge the use of the traditional use methods of quantitative and qualitative data collection as these terms do not necessarily make it easier to understand the research process and could lead to:

- Creating a highly conservative methodology and epistemology in research;
- Creating confusion as research strategies and approaches described in methodology guides are often sophisticated and lacking a coherent approach;
- Create expectations and assumptions about what we “believe we can do... [or] what we are supposedly allowed to do” (2012, 19) within a specific research paradigm or domain; and
- Attaching a label to research activity, which may not be consistent with the “characteristics and realities of the [particular] research process” (2012, 17) and thus misleading or inaccurate.

The solution suggested by Plowright is an integrated methodology, based on “warrantable empirical research that is rigorous and systematic” (2012, 21), is better suited to prevent a “mythological” use of research methodology.

Plowright (2012) suggests that the risk of confusion is avoided by presenting a clear research structure. Articulating the mixed methods used enhances the credibility of the findings. Plowright suggests distinctly setting out “what is being mixed and what are the methods that are being realised?” (pp. 66), the credibility of findings is enhanced. This study adopts the FraIM, proposed by Plowright to structure the research (pp. 9). The research question is validated by providing the professional,

organisational, policy, national and theoretical contexts within which it is embedded. A sampling strategy and data source management are based on cases selected. Plowright suggests using three types of data collection methods: artefact analysis, observation and asking questions. The data can be collected in a narrative or numerical format. Data analysis allows for both types of data collection methods to be analysed through mathematical or narrative methods. The data analysis provides evidence for the claims made through the research. A conclusion summarises the results and claims.

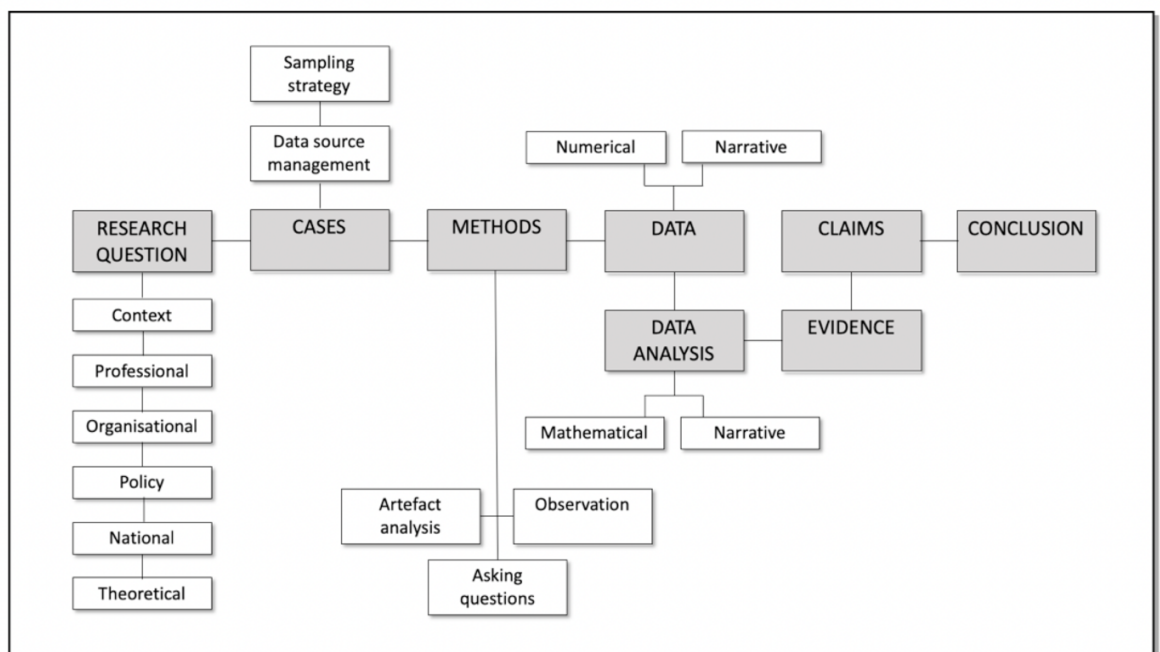


Figure 3.4: The extended FraIM

Source: Plowright (2012, 9).

3.4.1.2 Plowright’s three-dimensional FraIM

Plowright’s (2012, 19) *three-dimensional FraIM* visualises the data source management strategies, the methods of data collection and the types of data collected. Data source management is achieved by selecting cases. He cautions that methodological issues can arise when using cases as a data source management strategy. The first potential challenge being the number of cases selected. Using too few cases does not allow for generalisability of the information, and using too many could lead to less in-depth detail collected. A second methodological challenge could

be the degree of control that the researcher will have when allocating cases. Plowright suggests that data source management occurs through case study research, surveys or experiments. They argue that case studies alone provide a low level of control while the level of control and that control will increase when using surveys. The highest level of control over cases is provided when conducting experiments.

The three-dimensional FraIM allows the researcher to indicate the combination of mixed methods that were used. These combinations include *data sources* (case studies, surveys and experiments), *data collection methods* (observations, asking questions and artefact analysis), and the *types of data* (narrative or numerical). Figure 3.5 (below) indicates the potential combinations in a three-dimensional model.

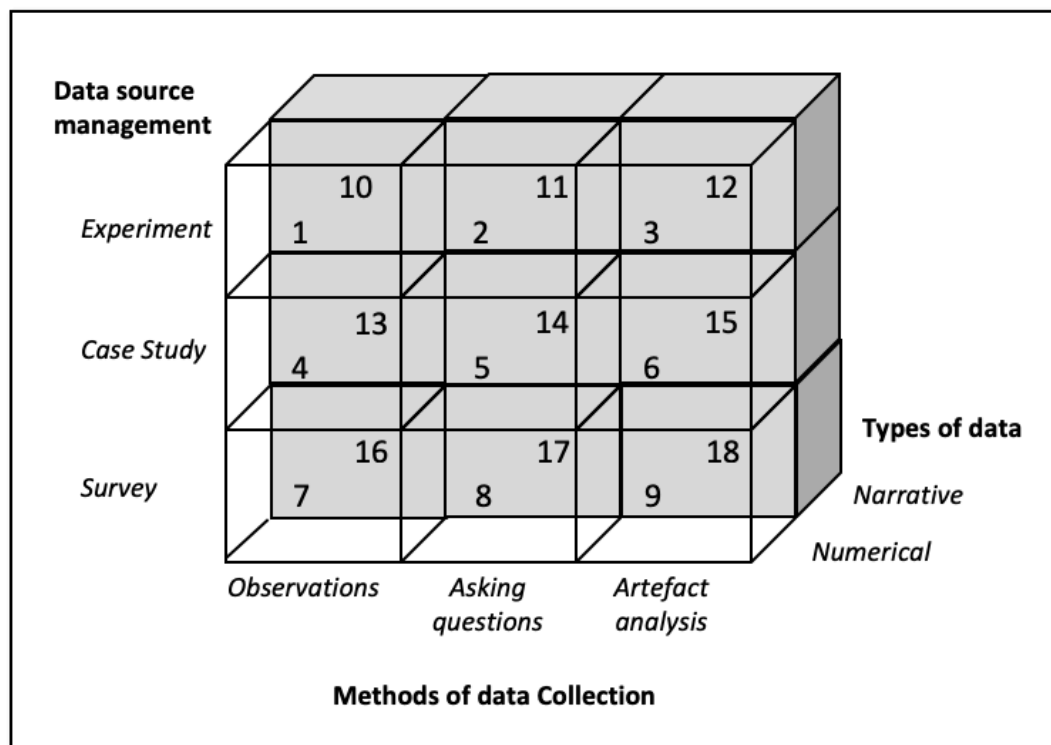


Figure 3.5: The FraIM research design as a simple three-dimensional model
Source: Plowright (2012, 19).

3.4.2 Defining mixed-methods research and its limitations for this study

The design of this research considered the critique of the FraIM as potentially a methodology-driven approach (Anderson, Dodd, Huggins and Kelly 2011). It has

indicated that the philosophical perspective grounds the methodology (Hall 2013; Morgan 2007; 2014). A reverse auditing process of the paradigm, research approaches, methodology and methods ensure internal consistency (Trafford and Leshem 2008). The data source management strategy selected for this study was through cases, data sources being case study research and surveys. Methods of data collection included asking questions through interviews, an expert survey and an industry survey. Following a case study approach, artefact analysis was done using the FSRC Round 3 Hearings' transcripts, Interim Reports and Final Reports.

The mixed-methods used for data collection during this study are located in the following positions in the three-dimensional FraIM:

- *Data Collection Stage 1*, FraIM Position 15: This mixed-method included two sub-stages of artefact analysis through a case study approach. The FSRC Round 3 Hearings Transcript of Proceedings (2018b), as well as the Interim Report (FSRC 2018a) and Final Report (FSRC 2019b), were analysed. Important themes around the credit process between banks and small and medium businesses were presented in the text as narrative data. The second stage of artefact analysis involved the detailed analysis and coding in NVivo software of two property developer case studies analysed by FSRC during their Round 3 hearings. Codes were developed based on recurring themes. The witnesses are identified in the data.
- *Data Collection Stage 1*, FraIM Position 14: Three in-depth exploratory interviews and one focus group session were conducted following a case-study approach. The participants are anonymous and are re-identifiable. The sampling strategy was purposive. Banks were contacted through a request for interviews with bankers who were experienced in assessing small property development loans. Bank 1 provided an experienced business banker (P1) who was interviewed on their own. The branch manager (P2) and an experienced business banker (P3) from Bank 2 participated in a focus group session. Small Developer 1 (P4) was selected based on the definition criteria. Small Developer 2 (P5) was introduced by Small Developer 1's real estate broker and met the definition criteria. The small developers were interviewed separately. Research information and interview questions were sent to

participants ahead of the interviews and focus group. The interviews and focus group session involved asking open-ended questions, based on the research questions, and follow-up question. Narrative data was collected. The interviews were recorded and transcribed into text documents. They were imported into NVivo software and were coded and analysed. Recurring codes from the analysis of FSRC data were used as the basis of the themed coding, and additional codes were added as further themes emerged during the analysis of interviews and the focus group session.

- *Data Collection Stage 2, FraIM Position 17:* Experts provided narrative input on the conceptual credit risk assessment model through the Delphi method as external validation of the conceptual credit risk assessment model. Two rounds of written comments were requested from three experts. Individual emails were sent to the participants that included background information to the study and the conceptual credit risk assessment model. Expert participants were selected based on their personal experience of successfully applying for various property development loans for their projects or their experience with developers that have successfully applied for property development loans. The expert participants included a property investor, a property developer and a property investment specialist. Their participation was anonymous, and they are re-identifiable.
- *Data Collection Stage 2, FraIM Position 8:* The source management for this data collection method was a survey with questions based on the conceptual model. The answers were graded through a five-point scale. The sampling strategy was purposive, and snowballing was used. The profiles of potential participants were examined online. Participants were selected based on their experience with small developer credit challenges. Survey participants included contractors, small developers, real estate agents, finance brokers and finance specialists. Participants were encouraged to forward the survey to small developers who met the definition criteria. The survey was sent to 2033 potential participants in individual emails explaining the research and providing an anonymous link to the survey. The survey and information provided were approved by the Curtin Human Research Ethics Office – see

Appendix 1. The survey was conducted using Qualtrics software. Participants graded 29 statements on a five-point scale – the statements related to the seven independent variables identified in the conceptual model. Participants could provide an optional written response to one question and leave a contact email address for feedback regarding the results. The participation rate was 10.61%. A total of 217 participants attempted the survey, while not all participants completed the survey in full. Surveys where a participant did not complete any question in full were excluded. Participants are not re-identifiable concerning their survey answers.

The industry survey analyses were conducted through mathematical methods and included a correlation matrix, linear regressions and a principal component (factor) analysis. The participation rate was considerable, weighed against the loss of SME bankers (Healy 2019) and the pause or exit of many small developers due to a decline in the availability of construction finance since 2009 (ABS 2021; Dietz 2020). The saturation point was deemed to have been reached when the linear regression of the last data collection period corresponded with six out of seven key drivers when compared to the linear regression analysis over the entire collection period. The sample was sufficient to confirm the validity of the antecedent and intervening variables and to consider minor discrepancies between the survey results and the conceptual model. The internal consistency of composites scores of statements was indicated by using Chronbach's Alpha.

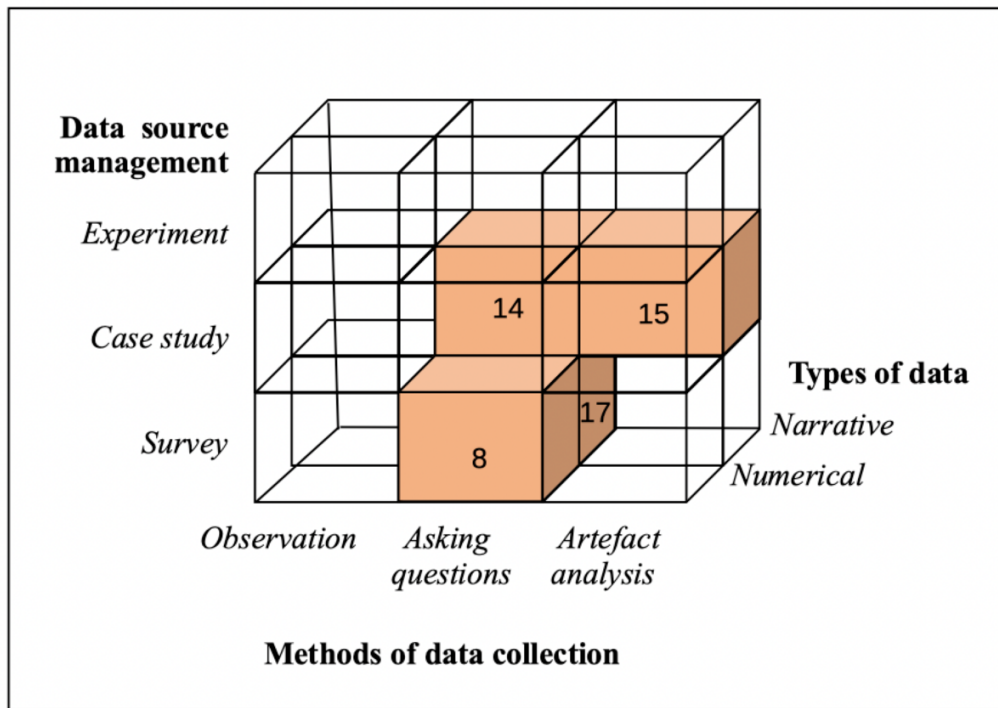


Figure 3.6: The mixed-methods used for this study indicated in the three-dimensional FraIM

Source: Adapted from Plowright's FraIM (2012, 19).

The limitations of using cases as a data management strategy were addressed in the following ways:

- The number of cases selected was few-to-many to allow for in-depth analysis and generalisability;
- Firstly, the generalisability of the research was addressed through analysis of the FSRC Round 3 Hearings. These hearings scrutinised pre-selected samples out of a larger pool. Secondly, generalisability was improved by conducting a national industry survey with contractors, real estate agents and finance brokers with experience of small property development finance challenges;
- In-depth detail analysis was addressed through in-depth interviews with small developers and bankers in Perth, Western Australia. Desktop case study research (artefact analysis) of the two property developer case studies investigated by the FSRC Round 3 Hearings added further detail to the data analysis;

- The level of control of using cases as a data management strategy was addressed by conducting surveys, which provided more control than case studies alone; and
- While interviews were only conducted in Perth, Western Australia, the use of the FSRC Round 3 Hearings Transcripts and a national industry survey assisted in expanding the study's boundaries beyond Western Australia and allowed for more generalisable results.

3.5 Research design

3.5.1 Data collection

The proposed theoretical rationale was used to guide the staged research design (Baxter and Jack 2008). Plowright's (2012) extended FraIM was used as an anchor for the data collection methods, while their three-dimensional FraIM illustrated mixed-method data collection strategies. The data collection strategies and data management plan were approved by the Curtin University Human Research Ethics Office.

Data Collection Stage 1 involved exploratory sequential design. The FSRC Round 3 Hearings were analysed through two sub-stages. Firstly, the Transcript of Proceedings (FSRC 2018a), the Interim Report (FSRC 2018a) and the Final Report (FSRC 2019b) were analysed, and the main themes relating to small developers and their credit applications were outlined. These main themes were coded in Nvivo software. The FSRC documents used contain authoritative evidence, given under oath to the Commission and the Commissioner's summary of findings and recommendations. The second sub-stage involved the detailed analysis and coding through of two FSRC property developer case studies in NVivo software. Chapter 4 presents the data and findings of these two sub-stages. The objective of the exploratory research around the FSRC Round 3 hearings was to develop a clearer picture of the credit assessment process of small developers, as this discourse is lacking in academic literature. The FSRC Round 3 hearings assisted in focussing the research questions, where these topics the FSRC did not address these topics.

Data Collection Stage 1 also involved in-depth interviews with bank employees (Chapter 5) and small developers (Chapter 6), following a case study approach. Case studies of small developers were selected based on the small developer meeting the definition criteria for this study as set out in Section 2.4.3. Case studies of banks were selected by contacting banks, who then put forward individuals with extensive experience of the small developer credit process. These interviews were recorded and transcribed into text documents. The findings from this data collection stage, building on the FSRC data analysis, are presented in a conceptual credit risk assessment model, indicating the independent and intervening variables that affect the positive assessment of small developer loan application viability (Chapter 7).

Data Collection Stage 2 coincided with Covid-19 and infection prevention strategies implemented by the Australian Government, states and territories and local governments (Australian Government Department of Health 2020). The initial response focussed on minimising the spread of the disease. Strict personal distancing recommendations and limitations on social interactions were introduced. The original data collection strategy through focus groups was omitted, and expert opinion, using the Delphi method and an industry survey were introduced. Experts were selected purposively based on their personal experience with many successful loan applications for property development as the owner of a property development company; or their regular interaction with the property development market and the credit applications of small developers. The findings and analysis of the expert-panel input are presented in Chapter 7, with updates to the conceptual model. Chapter 8 discusses the results and the data analysis of the industry survey and presents the proposed improved credit risk assessment model for assessing the viability of small developers during loan applications was developed by incorporating data analysis from Stage 2 and presented in Chapter 8. All numerical and narrative data were analysed through appropriate methods and software.

The data collection, data analysis, findings and claims are presented in Chapters 4 to 8. Figure 3.7 (on the next page) illustrates the alignment of Data Collection Stage 1 and Data Collection Stage 2 with the theoretical rationale (see Figure 1.2 in [Section 1.3](#)).

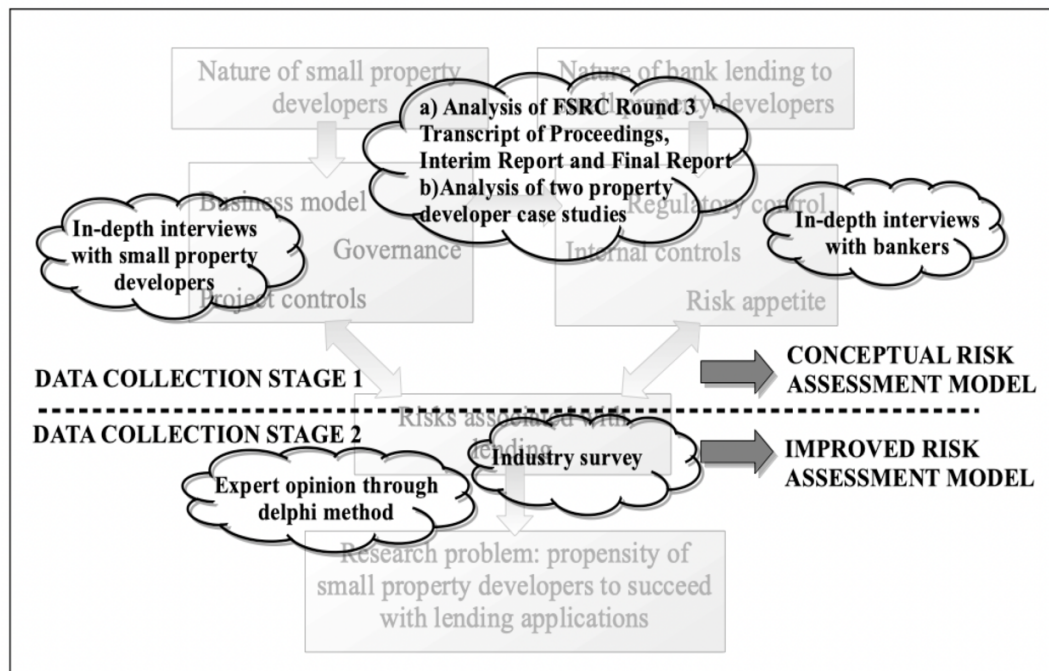


Figure 3.7: The research design, informed by the proposed theoretical rationale

3.5.2 Case selection criteria and sampling strategy

The definition of small developers proposed in Chapter 2 was used to select small developer participants. The definition indicated that a small developer engages in small-scale property development. They also have ineffective limited liability. Such a developer would be defined by a bank in a category that indicates they are a small developer.

The selection criteria for cases were as follow:

- *Data Collection Stage 1*, three-dimensional FraIM position 15, artefact analysis through a case study approach: The FSRC Round 3 Hearings Transcript of Proceedings (2018b), the Interim Report (FSRC 2018a) and Final Report (FSRC 2019b) were selected as authoritative evidence on the credit interactions between small and medium enterprises in Australia. The fourth topic of the FSRC hearings explored the two property development case studies. Topic Four focussed on the reduction of exposure of Bankwest’s loan book after it was acquired by the Commonwealth Bank of Australia (CBA). These two property development case studies were selected as

representative of many submissions to the FSRC related to topic four.

Evidence was provided by the two property developers and representatives from banks and regulators. The first case study focussed on two properties that were bought for development. The timeframes of these projects were extended due to various practical and market-related challenges related to the GFC. Dealings between the bank and the property development syndicates, loan terms, credit contract covenants and the rolling over of the loans were analysed. The second case study involved the development of a hotel by a hotel group. This case study focussed on the breach of non-monetary covenants and the resulting implications for the property developer and bank.

- *Data Collection Stage 1*, three-dimensional FraIM position 14, asking questions through a case study approach: Bank employees participating in in-depth interviews were selected based on their experience with small developer loan applications. Participants included two business bankers and a branch manager; The first banker interviewed is experienced in business banking and have worked in this position at various lenders. They noted that their current bank is smaller and follows a similar assessment process for small and large property development loan applications. The second bank provided two interviewees: the bank manager and a business banker. The bank manager deals with mom-and-pop developers, who access finance through a mortgage type arrangement. The second business banker deals with small developers but does not currently have much finance available for this market segment. They further indicated that their bank first lends money to more prominent developers and then consider small developers. This bank outlines property developer categories in its policy documents.
- *Data Collection Stage 1*, three-dimensional FraIM position 14, asking questions through a case study approach: Small developers participating in in-depth interviews were selected based on the definition of small developers. The first small developer is a husband and wife team that also owns a plumbing company. They have completed various projects successfully and outlined their challenges to access finance. The second small developer interviewee develops most of their projects through partnerships or syndication arrangements. They use a third-tier lender, as this lender does not

require pre-sales in their credit contracts. They noted that obtaining finance from lenders has become increasingly tricky, further complicated by their syndication arrangement.

- *Date Collection Stage 2*, three-dimensional FraIM position 17, asking questions through a narrative survey: Experts were selected based on their experience and included a property investor, a property developer and a property investment specialist. These experts have experience within the Perth, WA, property development market. The selection criteria for these specialists were:
 - their personal experience with many successful loan applications for property development as the owner of a property development company; or
 - their regular interaction with the property development market and property developers who have had many successful loan applications.
- *Data Collection Stage 2*, three-dimensional FraIM position 8, asking questions through a numerical survey: Survey participants' profiles were examined online. They were selected based on their experience with small property development credit challenges. The survey participants included building contractors, small developers, finance experts, finance brokers and real estate agents. Individual emails were sent to 2033 potential participants containing information about the study and an anonymous link to the survey. Participants were encouraged to also send the survey to small developers and specialists with experience in small property development finance.

Sampling was done through non-random sampling:

- Purposive sampling was critical to this research, as this is a narrow research topic (Bonevski, Bryant, Lynach and Paul 2005), and limited academic discourse is available around small developers' credit applications. Small developers in Perth who met the selection criteria and experienced business bankers in Perth (through the appropriate approval channels) were interviewed. Experts who gave feedback on the conceptual model were identified based on their experience with small developers and their loan

applications. Lists were compiled of potential survey participants: relevantly experienced building contractors, finance brokers, small developers and real estate agents that were contactable via email. These lists were compiled from internet searches, using Google's search engine, of the Master Builders' (Australia) member lists and company websites of real estate agencies, financial brokerages and small developers. Using internet searches for participants allowed scrutiny of their professional profile summaries, which improved the criteria for a participant's suitability for this study.

- Snowballing encouraged survey participants to forward the anonymous survey link to persons who met the criteria set out in the survey introduction.

The two-staged data collection strategy and the selection of cases supports the research objectives. The first stage of data collection identified independent, antecedent, and intervening factors that influence a small developers' exposure to the risk of failure during credit applications to lenders. A conceptual credit risk assessment model was developed that indicated these factors that affect the viability assessment of a credit application.

Data Collection Stage 2 tested the validity of the factors in the model and their effect on each other. A proposed improved credit risk assessment model, supported by the results from this data collection stage, was the outcome of Data Collection Stage 2. The proposed improved credit risk assessment considers perspectives of small developers, lenders and the opinion of industry related to small development and lending regarding the viability of the loan applications of small developers. This model provides a more complete view of the credit risk assessment process of small developers' loan applications.

3.5.3 Data analysis and validity

The FSRC Round 3 Hearings Transcripts (FSRC 2018b), Interim (FSRC 2018a) and Final Reports (FSRC 2019b) were treated as artefacts and the PDF documents were downloaded from the official website. These were analysed in NVivo through qualitative methods. Using software assisted in overcoming manual coding limitations like the time-consuming nature of the former and a rater bias (over-

emphasising codes) (Illia, Sonpar, and Bauer 2014). The first sub-stage of analysing the FSRC data included narrative summaries of the complete transcripts of the FSRC Round 3 Hearings and the FSRC Interim Report, and the FSRC Final Report. Data was analysed to contextualise small and medium business lending and identify themes or codes (called Nodes in NVivo). While the whole of the Round 3 Hearings did not directly relate to the defined research area, identifying these themes assisted in a detailed analysis of the two identified property development case studies. During the second sub-stage of FSRC data analysis, a coding system (through nodes), was used to analyse the two FSRC Round 3 property development case studies. A co-occurrence matrix analysis tool in NVivo helped to identify nodes that have high co-occurrence rates of themes (nodes), which were used as the basis for analysing interviews with banks and small developers. High frequency codes do not give an accurate overview of the importance of codes, while co-occurrence matrices are “systematic and transparent ...and offers a set of well-documented procedures that are often lacking in qualitative analysis” (Illia et al. 2014, 370) In the case of an inquiry, like the FSRC, the frequency with which codes occur is exacerbated by repeated questions and answers to clarify meaning and intent. Using cases as a data management strategy in NVivo proved useful to compare the data of evidence provided by each witness separately while allowing the opportunity to combine the analysis of bank witnesses and small developer witnesses. Combining data across the two FSRC property development case studies minimises the potential skewing of data, such as a bias in evidence provided by one witness. Triangulating the evidence of bankers and property developers provided to the FSRC by combining the analysis of high co-occurring nodes of the cases across the case studies improved the reliability of the results. Using cases as a data management strategy to analyse the two FSRC property development case studies is illustrated and discussed in [Section 4.5.2.1](#). Chapter 4 presents the data analysis of the Round 3 Hearings Transcript of Proceedings (FSRC 2018b) the Interim (FSRC 2018a) and the Final Reports (FSRC 2019b) through narrative summaries as well as numerical co-occurrence matrices.

Interviews with banks (Chapter 5) and small developers (Chapter 6) were recorded and transcribed to text documents from the original audio files, and the text files were analysed in NVivo, using qualitative methods. A mind-map was developed for

each interview, based on frequently recurring themes through coding. These mind maps assisted in visualising the themes. The coding of each interview was analysed through a co-occurrence matrix that indicated codes with high co-occurrence rates. By following a case study approach, the cases could be combined in co-occurrence matrices, and the analysis bank interviews could be compared to the analysis of interviews with small developers.

A survey was conducted with a limited number of industry specialists (following the Delphi method). Written responses to three questions, based on the conceptual risk assessment of small developer loan applications (Chapter 7), were moderated and included in a revised conceptual model for assessing small developer loan applications. The revised conceptual model was sent to the four participants for the second round of written responses. The specialists indicated no further changes in the second round, and the revised conceptual model was accepted.

The conceptual risk assessment of small developer loan applications was also used as the basis for questions for an industry survey. Participants received the survey through an email with an anonymous link to the survey in Qualtrics. The email stipulated that participants should have experience with small property development financing. Participants were asked to grade 29 statements through a five-point grading scale. The last survey question presented an opportunity for participants to indicate further perceived factors that could affect small developer loan viability. The validity of the survey results was considered through different statistical tests and is presented in Chapter 8.

A summary of data collection through mixed methods is set out in Table 3.1 on the next page. The FraIM position, the number of cases selected, data collection method, data type and sampling strategy is indicated for each method. A description outlines the method of data collection. The relationship of the data collection strategy to the research objectives and research questions are indicated – see Chapter 1 (1.3.2 Research aim and objectives and 1.3.3 Research Questions)..

Table 3.1: Data collection through mixed-methods summary

| FralM Number | Data source | Data collection method | Dominant data type | Description | Sampling strategy | Research objectives addressed | Research questions addressed |
|---|-------------|------------------------|--------------------|-------------|---------------------------|---|--|
| Data Collection Stage 1 | | | | | | | |
| 15 | 2 | Case study | Artefact analysis | Narrative | Purposive | Objective 1 Objective 2 | RQ1, RQ2, RQ5, RQ7, RQ8 |
| <p>Overview of FSRC Round 3 Hearings, including the FSRC Interim and FSRC Final Report relating to the Round 3 Hearings. Two property developer case studies (evidence provided by two each property developers and bankers) were then analysed and coded. Chapter 4 describes the data collection, data analysis and findings.</p> | | | | | | | |
| 14 | 4 | Case study | Asking questions | Narrative | Purposive | Objective 1 Objective 2 Objective 3 | RQ1, RQ2, RQ3, RQ4, RQ5, RQ6, RQ7, RQ8 |
| <p>In-depth interviews and a focus group with bankers and small developers through open-ended questions. Data collection, data analysis and findings of banker interviews are detailed in Chapter 5 and small developer interviews are described in Chapter 6.</p> | | | | | | | |
| Data Collection Stage 2 | | | | | | | |
| 17 | 3 | Survey | Asking questions | Narrative | Purposive | Objective 1 Objective 2 Objective 3 | RQ1, RQ2, RQ3, RQ4, RQ7 |
| <p>Expert input (property investor, property developer and property investment specialist) on conceptual credit risk assessment model through Delphi method of two rounds with written answers. Conceptual credit risk assessment model was sent to participants, who provided written feedback. Feedback was moderated and incorporated into the model for a second round of comments. Expert participants accepted the model with no further comments. The moderation of the comments and validation of the conceptual model is described in Chapter 7.</p> | | | | | | | |
| 8 | 98-124 | Survey | Asking questions | Numerical | Purposive and snowballing | Objective 2 Objective 3 | RQ1, RQ2, RQ3, RQ4, RQ5, RQ7, RQ8 |
| <p>Industry survey with statements, based on the conceptual model, with a five-point grading scale. Sent through an anonymous email link to 2033 potential participants in property development and related industries. 217 participants attempted the survey. Participants had an option to indicate additional perceived factors that could affect loan viability in one the last question. Data collection and analysis and findings are detailed in Chapter 8</p> | | | | | | | |

3.5.4 Limitations and disclosures

The FSRC Round 3 Hearings Transcripts were instrumental in understanding the context of SME lending in Australia, while the FSRC Interim Report and Final Report detailing the findings and their implications for the regulatory and policy environment. Through analysing the data presented by the FSRC Round 3 Hearings and Reports, themes were developed that assisted in the formulation of focussed interview questions to bankers and small developers. These questions were not evident from existing literature sources, and the FSRC Round 3 Hearings only partly addressed the research gaps. Property development was not the sole focus of these hearings, and the FSRC Round 3 transcripts and the FSRC Reports as the commission focussed on “what went wrong” on a larger scale. It would not have been practical to code all the transcripts in NVivo, as the themes may not have anything to do with property development and the loan application assessment. While the two case studies of property developments were coded and matrix analysis of the co-occurrence of codes was conducted, these codes were not combined with the data from interviews, as the questions that were answered during the FSRC Round 3 Hearings differed in purpose from those asked of small developers and bankers during interviews.

Contrasting the evidence of bankers with that of the property developers during the FSRC Round 3 Hearings were critical in developing an understanding of the use of a relationship-building approach that lenders follow. The contrast of evidence was also a useful starting point to exploring the differences in views and attitudes of persons during the credit process. It could be argued that these views were presented in the context of a formal enquiry, with visibly nervous participants, and cannot necessarily be replicated to the day-to-day credit process interactions between bank employees and their clients or customers. The in-depth interviews allowed an opportunity to explore these views in an informal setting and confirm the findings.

Sample challenges were experienced in identifying participants for interviews with banks. Banks were nervous after the FSRC and did not want to put forward participants. Repeated applications for interviews with business bankers through the four major banks' media departments were unanswered or ignored and rejected in one case. Anonymity was offered to the bankers (and their banks) who agreed to participate in the interviews. This opportunity was accepted by the three bankers who were interviewed.

They expressed their nervousness about participating in this study and accidentally disclosing information that could implicate them in wrongdoing. These lenders are not part of the four major banks. Further, the analysis of the FSRC Round 3 hearings provided a thorough overview of various aspects of large banks in Australia's attitude towards small businesses through their credit interactions with this market segment.

Further sample challenges were experienced in identifying small developers for interviews, as there is no registration body or institute for small developers. With members mostly being large property developers, property institutes, did not want to put forward their members for interviews. These challenges were mitigated by conducting in-depth interviews and by considering the findings from Chapter 4 (analysis of FSRC Round 3 hearings, Interim and Final Reports) to articulate questions to interviewees that could fill research gaps.

The development of a conceptual credit risk assessment model for small developer loan applications, which was used as the basis for expert opinion and the industry survey, provided a clearer picture of factors that could affect a positive loan viability assessment. The small sample of experts who provided opinions could affect the proposed improved model for assessing the credit risk of small developers' loan applications. This was mitigated by allowing input from industry survey participants. Participants provided additional factors that they perceived which could influence a positive loan assessment outcome in the survey's last question. The industry survey was based on the conceptual credit risk assessment model for small developer loan applications. An anonymous link was sent in an email to participants of the industry survey. The anonymous link provided an opportunity for employees of companies to participate without fear that their participation could affect their employment. A constraint of anonymous responses is that participants are not contactable, and no clarification of responses is possible.

The collection of narrative data through interviews allowed an opportunity to ask follow-up questions when the participant's answers were vague. It also allowed participants to introduce variables that could affect the success rate of their small property development loan applications that were not evident from the literature or FSRC Round 3 hearings.

3.5.5 Reliability

The auditing process, suggested by Trafford and Lesham (2008), was followed to ensure internal validity. A deductive research approach allowed systematic progression of research, focussed the research topic and guided data collection. A non-singular reality ontology and dynamic pluralist epistemology contextualised the pragmatic paradigm and is supported by the theoretical rationale. A method-driven approach was avoided by articulating the philosophical position and following a structured approach to the research by using the extended FraIM. The use of mixed-methods data collection was set out within the three-dimensional FraIM, and the shortfalls of using a few to many cases as a data management strategy were addressed. Potential biases were addressed through the use of a non-singular reality ontology. An example of how internal validity was deliberated is the presupposed power imbalance between small businesses and banks. Literature supports the existence of this power imbalance. Evidence from the FSRC Round 3 Hearings was also consistent with the existence of a power imbalance. Banks, however, were not found to have exploited their position of power in dealing with small businesses during the FSRC hearings. Unclear communication and human error were blamed for exacerbated losses by small businesses in some instances. These losses are consistent with a small business characteristic: a vulnerability to the high cost of market and institutional imperfections.

External validity was deliberated by balancing the views of small developers and bankers, which could be biased, against findings of the formal enquiry of the FSRC during their Round 3 Hearings, which related to small businesses. A two-stage data collection strategy allowed for exploratory design, the development of a conceptual credit risk assessment model and testing of this model to produce an improved credit risk assessment model. The analysis of the FSRC Round 3 Hearings transcripts, which investigated sample cases selected as representative of a larger pool of cases, allowed generalisability of the results. Using software for the narrative analysis addresses reliability concerns about manual coding around researcher fatigue and clear coding protocols between data-sets (Illia et al. 2014). A national industry survey based on the conceptual credit risk assessment model further bettered the generalisability of the findings. Chronbach's alpha was used to test the internal consistency of composite scores of the statements related to each survey question. Chronbach's alpha indicate the coherency of the items proposed to be related to each factor, and therefore, the

reliability. A last question allowed participants to note factors not considered in the survey and adds to the external validity of the model.

The ecological validity of the research was considered by viewing knowledge and its creation through a dynamic pluralist epistemology. This position considered that a static model would not explain the assessment process of small developer loan applications in varying market conditions, regulatory conditions and economic circumstances. Changes within these environments will affect bank policies and perceptions around the risks involved in the small property development market segment.

3.6 Summary of Chapter 3

This chapter details the pragmatic philosophical position of the research and motivates the dynamic pluralist epistemology and a non-singular reality ontology against the theoretical rationale presented in Chapter 1. The research structure follows Plowright's (2012) extended FraIM, whilst mixed-method data collection is defined within the three-dimensional FraIM. A circular approach was followed regarding the levels of thinking about research. The consistency between the levels were deliberated through a reverse auditing process.

A two-stage data collection strategy based on the theoretical rationale is described in this chapter. Data management strategies and the methods used to collect and analyse the data is outlined. The contribution of mixed-methods data collection concerning the research questions and objectives is discussed, and data validity and reliability are indicated.

The next chapter details the data and findings from the FSRC Round 3 Hearings, the interim report and the final report. Specific attention is paid to the two property developer case studies of the FSRC Round 3 hearings.

CHAPTER 4

ANALYSIS OF THE EVIDENCE OF THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY (2017 – 2019) REGARDING FINANCING OF SMALL BUSINESSES AND PROPERTY DEVELOPMENT

4.1 The relevance of the FSRC Round 3 Hearings to this study

Gilligan indicates that Royal Commissions are “an extremely powerful mode of inquiry” (2018, 177) in Australia. Royal Commissions “cast sunlight on the prevalence of nasty and malicious behaviour” (pp.180) and provide reliable outcomes to improve the conduct and regulation of the subject that it investigates. Royal Commissioners are given inquisitorial powers by all state governments and the Commonwealth of Australia through the Royal Commissions Act 1902 (Australian Parliament 1902). However, time and budget constraints can limit Royal Commissions’ inquiries (Gilligan 2018).

Australia’s Commonwealth Coalition Government has faced much criticism directed at the weak enforcement by financial regulators and has spent “years resisting intense pressure” (pp.175) to establish a Financial Services Royal Commission.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) was finally established on 14 December 2017 (FSRC 2018b). Chaired by the Honourable Kenneth Madison Hayne, the Commission received 10 323 online public submissions. The Commission’s dealings related to alleged misconduct in the financial services industry and focussed on these allegations in personal finance, superannuation and small business finance (FSRC, n.d.). A case study approach was adopted by the Commission to manage a large amount of information received and complete the hearings within the time and budget constraints set out in the Letters of Patent. The Letters of Patent outlined the Commission’s terms of reference (Gilligan 2018; FSRC 2018b).

Evidence analysed in this chapter was obtained from the official FSRC website. This website will be decommissioned and archived at the end of January 2022 in the National Library of Australia’s Web Archive. The website contained “information about the Commission, details about public hearings and the terms of reference” of the FSRC (FSRC, n.d.). All background and research papers, public submissions, final transcripts

of the hearings, witness lists, summons notices and witness submissions were downloaded from the website. Official recordings of the hearings could be requested via the website. The FSRC made initial inquiries of “financial services entities, industry associations, consumer advocacy groups and regulatory authorities” (FSRC 2019b, xxxv).

Seven rounds of hearings were held by the Commission. The hearings started on 13 March 2018 and concluded on 23 November 2018. Round 1 heard evidence on consumer lending practices, and Round 2 considered evidence on financial advice. Round 3 focussed on loans to small and medium enterprises. Round 4 heard evidence on finance issues of Australians living in remote and regional communities (including dealings relating to Aboriginal and Torres Strait Islander people) and farming. Round 5 focussed on superannuation, and Round 6 considered life insurance, general insurance and the regulatory regime. From the evidence presented by the seven major bank groups, APRA, and ASIC, policy questions were considered during the final round (Round 7) of the FSRC public hearing (FSRC, n.d.).

Chapter 4 analyses evidence presented in the text documents of the FSRC Round 3 Hearings Transcript of Proceedings (FSRC 2018b). The Round 3 Hearings focussed on the financial dealings between financial services providers and small and medium businesses, including two property development case studies. Witnesses provided written statements to the FSRC and in-person testimony as part of the case studies selected from the submissions. All witnesses were affirmed before providing evidence to the Commission. Affirmation of witnesses, to tell the truth, was done at the discretion of the Commission under the Royal Commission’s Act 1902 (Australian Parliament 1902). During the hearings, witnesses’ testimonies were examined by the counsel assisting (appointed by the Commissioner), and, in some cases, witnesses were cross-examined by legal representatives for lenders. Findings and recommendations relating to small businesses and property development from Interim Report (FSRC 2018a) and Final Report (FSRC 2019b) are also analysed in this chapter. FSRC Background Papers are cited to provide background and context to the Round 3 Hearings – particularly Background Paper 10 (Godwin, Paterson, and Howell 2018) and Background Paper 11 (Australian Government Treasury 2018).

The research presented in this chapter forms the first step of Data Collection Stage 1. Data collected during the first part of Data Collection Stage 1, using exploratory sequential design, is outlined in Chapter 3 against the theoretical rationale noted in Figure 3.7 in [Section 3.5.1](#). Chapter 4 analyses narrative data from the FSRC Round 3 Hearings Transcript of Proceedings, Interim Report and Final Report. Following the research design, the research in this chapter is divided into two sub-stages of data analysis (also outlined in [Section 3.5.1](#)). The first sub-stage involved the reading and analysis of the FSRC Round 3 Hearings Transcript of Proceedings (2018b), the Interim Report (FSRC 2018a) and the Final Report (FSRC 2019b). These documents were downloaded from the official website of this Royal Commission and were imported as text documents into NVivo. This study provided an overview of the main themes of small and medium businesses' complete credit interactions with lenders. In the first sub-stage, the documents were not coded as the Round 3 Hearings' transcript of proceedings does not pertain to small property development loan viability only. The second sub-stage involved a detailed analysis of the two property development case studies of the FSRC Round 3 hearings in NVivo through a themed coding system. Sub-stage two uses the FSRC Round 3 Hearings Transcript of Proceedings (2018b) as the base document for analysis.

Artefact analysis of the FSRC text documents was used as the research method, and the data analysis was narrative. This mixed-method research is indicated in position 15 on the three-dimensional FraIM noted in Figure 3.6 (see [Section 3.4.2](#)). The sampling method was purposive, focussing first on the complete FSRC Round 3 Hearings Transcript of proceedings, the FSRC Interim Report and the FSRC Final Report to identify critical themes in credit interactions between lenders and small and medium businesses. Secondly, the sample was narrowed, and only sections of these documents that directly relate to credit interactions between property developers and banks were analysed and coded. This method of data collection supported the all three research objectives:

- Objective 1: to identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders;
- Objective 2: to analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success; and

- Objective 3: develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders.

Research into the FSRC Hearings formed a vital part of this study to fill gaps in existing literature, consistent with the research methodology set out in the previous chapter. The research questions help to articulate these gaps. Specific research questions that were addressed through this method of data collection include:

- RQ1: How do lenders assess the lending applications of small developers?
- RQ2: What are the criteria on which lenders base their decision to extend or refuse credit to small developers?
- RQ5: What are the regulatory constraints in terms of financing small developers?
- RQ7: What outside advice do small developers make use of during their credit applications? and
- RQ8: Do lenders monitor the effective use of finance extended to small developers?

Artefact analysis allowed the exploration of the attitudes and positions of lenders and borrowers and the documented interactions between them. Legal, regulatory and policy frameworks are contextualised within the setting of a formal inquiry. While the full FSRC Round 3 Hearings Transcript of Proceedings (2018b) was analysed as sub-stage one, much of the information is not directly relevant to lenders' viability assessment of small property development loans. Sub-stage two analyses two property development case studies, with the evidence presented by property developers and bankers, through coding.

A general overview is provided of specific issues related to loan assessments. Parallels are drawn between the evidence presented by small businesses and bankers to the FSRC and the effects of small business characteristics as outlined in Chapter 2. In particular, the FSRC data highlights the characteristics of ineffective limited liability of small businesses, their un-diversified asset base and their vulnerability to the high cost of market and institutional imperfections.

4.2 Research methods used in analysing the FSRC Round 3 data and reports

4.2.1 Background to the FSRC data analysis

The FSRC conducted its enquiry into various aspects of the financial services industry. During the Round 3 Hearings, investigations focussed on alleged misconduct in the extension of credit and lenders' management of the credit process in their dealings with small and medium enterprises. This round of hearings explored the evidence provided by affirmed witnesses from various types of small businesses, including franchises, businesses owned by sole proprietors and property developers. Counter-evidence was provided by affirmed witnesses, including industry experts and representatives from banks and regulators. The objective of the FSRC data analysis was to create a background to understanding themes that relate to small business characteristics and property development when dealing with lenders and obtaining credit. Case studies selected by the FSRC provided a credible source of evidence as cases were selected as a representative sample of the many submissions received by the Commission of businesses' credit interactions with lenders.

The Round 3 Hearings were conducted from Monday, 21 May to Friday, 1 June 2018, in Melbourne, Australia, at the Owen Dixon Commonwealth Law Courts Building at 305 William Street. Exhibits, tendered during the hearings and referred to in the FSRC Transcript of Proceedings, are catalogued on the FSRC website. During the Round 3 Hearings, the following five topics were addressed:

- 1) Responsible lending to small businesses (5 case studies);
- 2) The approach of lenders to enforcement, management and monitoring of loans to businesses (2 case studies);
- 3) Product and account administration (1 case study);
- 4) Extension of unfair contract terms legislation to small business contracts (3 case studies); and
- 5) The Code of Banking Practice (2 case studies).

The FSRC accepted twenty-five written submissions from regulators, banks, business owners and other witnesses in response to the Round 3 Hearings and the initial inquiries made by the Commission. The two property development case studies were of particular interest to this research, as these focussed on the dealings between lenders and property developers while engaged in credit transactions. The first case study involved the

Wildlines and Silversun property developments in Geraldton, Western Australia. Michael Lawrence Kelly gave evidence on behalf of the developer, and Brett Robert Perry testified on behalf of the Commonwealth Bank of Australia. A second case study focussed on the Hadley's Hotel and Inner Collins development in Hobart, Tasmania. Michael Doherty (owner of the hotel and the developer) gave evidence on behalf of their company, and Peter Nathaniel Clark was the witness put forward by the Commonwealth Bank of Australia in this case study.

The FSRC Round 3 Hearings addressed the comprehensive process of extending credit contracts to small and medium businesses, including:

- Incentives provided to employees to acquire new clients;
- the bank's credit proposal process;
- the need of small businesses for credit;
- the role of the bank policy and individuals' interpretation thereof during the credit viability assessment process;
- the credit contract terms;
- the role of non-monetary clauses in contracts;
- provision of security and guarantees; and
- the process of the conclusion or termination process of the credit contract.

Questions asked by the FSRC and the information provided by witnesses related to aspects of the whole credit process: from the credit application assessment until the conclusion of the loan contract. Questions were posed about the bank and small business interactions throughout the FSRC Round 3 hearings. The credit assessment process is not a stand-alone process (Brei and Schclarek 2015). Evidence relating to small businesses' access to credit, the incentive structures of banks that encourage lending and the process of how credit is extended contextualise the research.

Transcripts of the FSRC (2018b) Round 3 Hearings indicate that the interaction between lenders and small businesses in the credit process starts with the loan application or an investment project proposal for which finance is being sought. This proposal is submitted to the business banking unit or a small business banking unit of a bank. A banker from this unit will assess the application, and after that, the banker will interact

with the small business to procure additional information when required as they test the viability of the application. Adjustments and negotiations can ensue to determine the correct financial product for the particular credit application. Once the banker is satisfied that the risk and policy requirements of the bank are met, the application is proposed to the bank’s credit department, who will conduct further assessments and tests with regard to the bank’s appetite for the credit proposal. If approved, a credit contract will be developed with various clauses imposing specific loan conditions, with both the bank and small business being parties to the contract. Credit viability assessment is, therefore, one aspect of a complicated process, as illustrated in Figure 4.1 below.

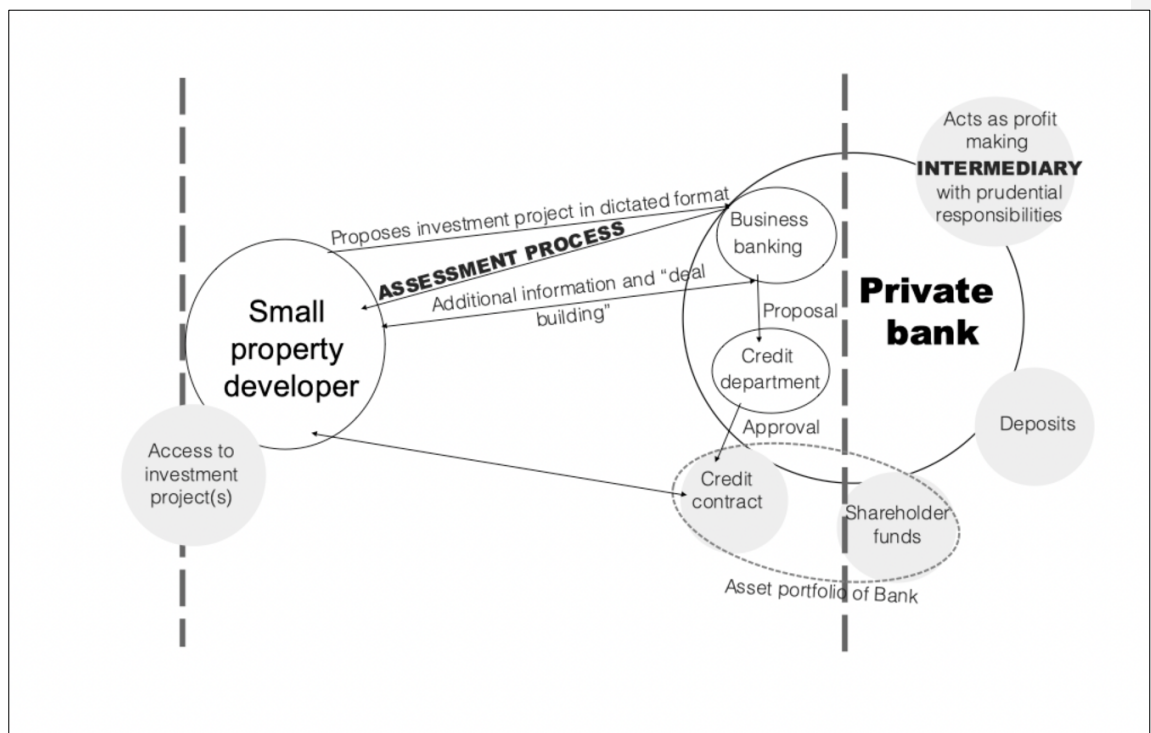


Figure 4.1: The assessment process indicated in the interaction between the bank and small developer during the credit process

Source: Adapted from Brei and Schclarek (2015).

Evidence FSRC Round 3 Hearings Transcript of Proceedings (2018b) indicates that the exact total of credit extended to small businesses is unknown. Data from December 2017 of the Reserve Bank of Australia (cited in the FSRC Round 3 Hearings’ Transcript of Proceedings) estimates small business credit to be around 27% of aggregated business credit provided by Australian banks, with 80% of this credit being secured with

real estate in. The FSRC counsel assisting noted that these figures highlight the importance of security provision in small business credit transactions. Therefore, they argued that small business lending is dependent mainly on the personal financial position and assets of the small business owner and their immediate family (FSRC 2018b).

4.2.2 The data sources, their treatment and limitations

Documents were downloaded in portable document format from the official websites of the FSRC (FSRC n.d.). The documents were read and analysed in NVivo software through two sub-stages of research. The following documents formed part of the data analysed from the official Royal Commission website:

- The Round 3 Hearings Transcript of Proceedings (FSRC 2018b), held in Melbourne at the Owen Dixon Commonwealth Law Court (from Monday 21 May 2018 to Friday 1 June 2018);
- the Interim Report (FSRC 2018a); and
- the Final Report (FSRC 2019b).

A circular approach was followed in analysing evidence presented to the FSRC. During the first sub-stage, the FSRC Round 3 Hearings Transcript of Proceedings (FSRC 2018b), the Interim Report (FSRC 2018a) and Final Report (FSRC 2019b) was read in NVivo, and the Maps function was used to create diagrams that mapped ideas and themes presented during the hearings. A summary was compiled in a spreadsheet format of the Round 3 Hearings.

Sub-stage two involved the analysis and coding of two case studies of property developments in NVivo. Evidence provided by bankers and property developers were analysed and coded, using cases as a data management strategy which allowed for the comparison of the evidence between cases. Data management of the two property development case studies is detailed later in this chapter – [see Section 4.5](#). The two property development studies contained in the Round 3 Hearings Transcript of Proceedings (FSRC 2018b) were analysed through a narrative case study approach in NVivo using a themed coding system. Codes (called nodes) were developed and

represented the themes. This method of data collection is indicated within the three-dimensional FraIM in position 15.

While the FSRC Round 3 Hearings Transcript of Proceedings (2018b) was pivotal in understanding the context of SME lending, coding the entire transcript would not have been helpful to this study. Various themes explored by the FSRC did not relate to the credit assessment process and, therefore, the research topic. The Interim Report (FSRC 2018a) and Final Report (FSRC 2019b; 2018b) were published after the conclusion of the FSRC Hearings and are used retrospectively to set the context for the research in this chapter and inform the findings.

The data analysis is presented in a narrative format in this chapter. Co-occurrence matrices provide numerical data based on the number of times nodes were coded simultaneously in the cases in NVivo. A limitation of this type of data analysis is that the development of the *nodes* is done at the researcher's discretion through a "tedious data cleaning process ...[while limiting] tonality of the discourse" (Illia et al. 2014, 352). However, co-occurrence analysis methods are systematic, transparent, and allow "visual outputs which are useful for interpreting results" (Illia et al. 2014, 352). Multiple readings of the text documents improved the development of nodes that accurately reflect a bank's property developer credit assessments. For this purpose, the co-occurrence matrices developed and presented in this chapter form part of exploratory research and informed the questions asked in the semi-structured e in-depth interviews with bankers and small developers (Chapters 5 and 6).

4.2.3 Disclosure notes

Some video recordings of the FSRC Round 3 Hearings were watched on YouTube, and other audio recordings were listened to on the FSRC official website. These provided context and clarification to documentation/artefacts presented or referred to in the FSRC Round 3 Hearings Transcript of Proceedings (2018b). Most participants were visibly stressed in the formal enquiry environment, and questions had to be clarified and repeated by the inquirer on various occasions. Participants from the banking industry were wary of answering questions that could implicate their institution or their institution's processes in wrongdoing. The inquirer had to reframe questions and noted that they were not trying to trap witnesses but were exploring the evidence provided.

Participants from the small business sector were often emotional, as the case studies focussed explicitly on the extensive financial losses or ruin incurred by small business owners or their direct relatives.

While the evidence provided by witnesses was confronting, and in many instances, invoked sympathy for the affected parties, little further evidence of intentional malice was noted by the enquiry. The evidence presented pointed to the need to review accepted practices, improvement in banking procedures, transparency, clear communication and additional care when engaging in credit transactions with SMEs. The conclusions of the FSRC relate to small business characteristics and these businesses vulnerability to excessive losses due to institutional errors and imperfections (Ang 1991). The FSRC Round 3 Hearings discovered no further instances of intentional misconduct, where these instances have not already been reported to the regulator or other previously admitted to in written submissions to the FSRC, before the commencement of the hearings (FSRC 2018a). The Commissioner indicated that the conduct by banks was below community expectation in some of the case studies.

The FSRC noted on several occasions that the personal losses of owners of small businesses are often devastating. Losses included elderly and sickly guarantors left destitute, breakdown of familial relationships due to losses. Other losses were business owners' family homes and repayment periods extending for many years beyond when the business was wound up. Lenders rely on an all-moneys approach, which drives small business credit access (FSRC 2018b; Bryant 2012). This approach considers the business' finances and the owner's finances as the same (FSRC 2018b; Ang 1991). While much evidence was provided on the positive and negative effects of small business characteristics on credit transactions, the Commission focussed on clarifying the definition of small businesses. Clarifying the inclusions and exclusions of the small business definition aligns with the five topics addressed during the Round 3 Hearings. These topics focus on the regulatory use of the definitions to provide protections to small businesses – see [Section 4.2.1](#). The adverse effects of small business characteristics during credit transactions highlighted by the FSRC Round 3 Hearings are expanded upon in [Section 4.4.3](#) of this chapter.

Minor discoveries during the Round 3 Hearings were often sensationalised by mainstream media, for example, the flaunting of a bank policy, making it difficult to be

impartial during the first reading of the Round 3 Hearings Transcript of Proceedings. Successive readings of the Round 3 Hearings Transcript of Proceedings, the Interim Report and the Final Report, and coding of the FSRC property developer case studies in NVivo assisted in identifying themes from the evidence presented and minimising a potential dissemination bias (Toews et al. 2017). These themes strongly correlate with the findings of the FSRC Final Report.

4.3 Conclusions of the Final Report: Round 3 Hearings

Even though the FSRC received 5500 individual applications for the Round 3 Hearings, not all applicants were granted leave to appear. Due to the sheer volume of submissions, Commissioner Hayne reiterated the Commission's case study approach:

... case studies ... is the best way of finding out what has happened, finding out what was done or not done in response to what happened, and trying to identify what could have been done, what should have been done, in response, and then thinking about what follows from those conclusions (FSRC 2018b, 1992)

Thirteen case studies were considered during the FSRC Round 3 Hearings. Findings regarding the case studies of the first four rounds of public hearings are set out in the FSRC Interim Report (FSRC 2018a). The FSRC Final Report (FSRC 2019b) sets out findings of the last three rounds of case studies and presents the Commission's recommendations. The FSRC based its recommendations on responses, reports and background papers from its initial industry inquiries and evidence presented by witnesses during the case studies (FSRC 2019b).

4.3.1 FSRC recommendations related to Round 3 Hearings

From the evidence presented in the hearings and submissions and presentations from industry, the FSRC Final Report (FSRC 2019b, 22) contains two recommendations regarding small and medium enterprises:

- *Recommendation 1.9 – No extension of the NCCP [National Credit Consumer Protection] Act*

The NCCP Act should not be amended to extend its operation to lending to small businesses.

- *Recommendation 1.10 – Definition of 'small business'*

The Australian Banking Association should amend the definition of ‘small business’ in the Banking Code so that the Code applies to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than AU\$5 million.

Initial inquiries received from the “financial services entities, industry associations, consumer advocacy groups and regulatory authorities” (FSRC 2019b, xxxv) were considered and referred to during the FSRC Hearings. A background paper, Paper 11, by the Australian Government Treasury (2018), references the extensive engagement process followed during the draft legislation process of the National Consumer Credit Protection Amendment Bill in 2012. Consumer advocacy bodies, small business organisations, the financing sector and the leasing sector were consulted and indicated concerns regarding credit access, should the act’s protections be extended to small businesses. Concerns included unnecessary duplication and compliance costs, restrictive conditions on lending, making the process more difficult and expensive. Small businesses would also have to spend more resources to access credit. Further, these measures “would not deter unfair credit practices” (pp. 6).

4.3.2 Refinement of the definition of a small business

The intention of Recommendation 1.10 was to replace the three parts in the ABA’s definition of small businesses, which sets limits for “annual turnover of less than AU\$10 million, fewer than 100 full-time employees and less than AU\$3 million total debt to all credit providers” (FSRC 2019b, 97). An objective of the recommendation was “to simplify the law to focus the boundaries of the application of the law and protections offered” (FSRC 2019b, 43). The recommended revision to the ABA Banking Code intended to provide protections for some small developers who borrow under the AU\$5 million limit (for a single loan). During their testimony, Alastair Derek Dawson Welsh, the general manager for commercial banking at Westpac Group, noted that property developers are likely to be excluded from the ABA definition.

Typically, with the price of Australian property today, it’s a little outside ...the [AU\$]3 million for the property developers (FSRC 2018b, 2228).

The ABA’s chief executive officer (CEO) testified that raising the monetary debt limits in the ABA Banking Code of Practice definition could unintentionally disadvantage

smaller lenders. These banks are subject to a standardised method of risk weight calculation, while larger and more sophisticated lenders use an internal rating. (FSRC 2018b, 2228). The ABA cautioned that a AU\$5 million monetary limit definition puts smaller lenders at risk, as multiple loans of AU\$5 million each could amount to the entire loan book of a small regional bank. This means that a small bank's entire loan book could comprise small business loans, which carry a high-risk weighting when using the standardised calculation.

...for banks that have high exposures to small businesses or particularly to certain sectors, they have to manage that risk on their loan book. They – particularly the non-major banks feel that there's already a hurdle there in moving into business lending, simply because of the fact that the risk rating is higher for their banks... than for the four large banks (FSRC 2018b, 2915).

While Recommendation 1.9 was accepted by the industry, Recommendation 1.10 was not implemented in the new 2019 ABA Banking Code of Practice or the updated version published in 2020. These ABA Banking Code of Practice publications have been approved by ASIC, the latest through their March 2020 Instrument. The apparent resistance of the ABA to implement Recommendation 1.10 and the subsequent approval of the three-part small business definition have significant implications for business finance literature. The currency of this has not gained appropriate attention in normative literature. An article in the Financial Review by Frost (2019) indicated government support for the small business definition while noting preliminary reasons offered by the ABA for its caution around implementing this definition. One reason was small banks' potential high credit exposure due to the AU\$5 million limit for a single loan (allowing multiple credit lines). Another reason offered in this article was that Recommendation 1.10 would afford around 20 thousand additional businesses protections through the Banking Code of Practice, if accepted.

Subsequently, Pottinger (2020) was commissioned to conduct an independent review of the suitability of changing the ABA small business definition to align with Commissioner Hayne's Recommendation 1.10. This independent review supported the improvement of the consistency of terminology and clarity to "enterprises whether or not they are... treated as small businesses by any particular bank" (pp. 6). Pottinger's review further argued for "reducing the number of different definitions of small

businesses... in Australia and clarifying why different definitions are used by different bodies” (pp.6). The report indicated that the three-part definition should be retained and that “all three criteria [must be met] to qualify as a small business... and [that the definition should be] applied at group level” (pp.7) “rather than [at] an individual legal entity level” (pp.8). Consideration of small businesses at the group level would recognise “unincorporated legal entities such as joint ventures, partnerships and trust structures” (pp. 8). Pottinger’s review recommended that the total debt value be increased to AU\$5 million and applied “to aggregate borrowings” (pp. 7). The review did not support an increase in employee or turnover numbers but recommended that an increase in total debt value is implemented by 2023 in the ABA’s small business definition.

An increase in the upper limit of the aggregate borrowed amount will allow access to protections for some small developers who engage in projects within this monetary range. A tendency to overlap project developments to create a sustainable pipeline of work, such as buying land for new development while another project is in the construction phase, indicates that the upper aggregate limit will exclude other small developers (Forlee 2015). Small developers will likely be unaffected by the lack of increased employee numbers, due to their tendency to outsource multiple development process tasks (Psilander 2012).

4.3.3 Regulation and protection of small businesses

Recommendation 6.1. of the FSRC Final Report (FSRC 2019b) included a focus on the joint responsibility and the improvement of information sharing between the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) as “The ‘twin peaks’ model of financial regulation” (pp. 37). This model sets APRA as the prudential regulator, which enforces prudential standards and practices, with ASIC as the conduct regulator.

These two regulators’ main powers are set out in the Australian Prudential Regulation Authority Act of 1998 (APRA Act) and the Australian Securities and Investments Commission Act of 2001 (ASIC Act), as well as various other related financial services acts (like the Superannuation Industry Supervision Act). The FSRC recommended that

both regulators administer the Banking Executive Accountability Regime (BEAR), set out in the APRA Act (FSRC 2019b).

Concerning small business protections, the FSRC asserted that “the ABA Banking Code of Practice is the main source of protections offered to small businesses” (FSRC 2018a, 164). Businesses excluded from these protections must defend their cases against banks in court. Some sections in the ASIC Act related to misleading or deceptive conduct, unconscionable conduct, warranties, and unfair contract terms describe specific recourses available for small businesses (FSRC 2018a). The counsel assisting for the FSRC Round 3 Hearings indicated that the unfair contract terms regime, outlined in the ASIC Act, would not apply to small developers (FSRC 2018b). Due to the value and duration of small developers’ credit contracts, evidence by bankers indicated that the exclusions would apply “where the contract has either an upfront price of less than AU\$300,000 or in the case of a contract which has a duration of more than 12 months, the contract price is less than AU\$1 million” (pp. 1996). Further, their credit contracts with lenders are negotiated contracts and, therefore, non-standard contracts.

During the FSRC Round 3 Hearings the ABA noted that they have requested that ASIC approve the Banking Code of Conduct. Evidence was provided that the approval was delayed due to a disagreement about the upper financial limit of the ‘small business’ definition in the ABA Banking Code between the ABA and ASIC (FSRC 2018b, 2969). While retaining the original small business definition, the subsequent approval by ASIC gives additional regulatory credibility to the ABA Banking Code of Practice, even though membership to the ABA is voluntary (FSRC 2018b).

Various acts and pieces of legislation exist to ensure accountability, as accountability “is not always achieved through the existing routes and has caused damage to the image of the financial services industry as an important role player in the economy” (FSRC 2019b, 4). A focus on accountability was preferred by the FSRC rather than additional protections for small businesses. In their Interim Report, the FSRC argued that additional restrictions could lead to restrictions in access to finance and noted that the ABA Banking Code of Practice provides a sufficient protection framework for small businesses (FSRC 2018a, 146). Small businesses, falling within the definition, recourse in terms of commercial lending disputes is through the Australian Financial Complaints Authority (AFCA), which replaced the Financial Ombudsman Service (FOS), the Credit

and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT) in November 2018 (ASIC n.d.).

4.4 General notes on the FSRC data analysis

4.4.1 Relationship banking and mistrust

Evidence from the Round 3 Hearings Transcript of Proceedings (FSRC 2018b) indicates that the relationship between the lender and the borrower in the lending transaction is based on false trust. Many murky areas exist in this relationship between the bank and its small business client. Lenders use the relationship-building approach to assist in the assessment process and throughout the credit contract. This mistrust-relationship is evident from the FSRC four observations:

1. the connection between conduct and reward;
2. the asymmetry of power and information between financial services entities and their customers;
3. the effect of conflicts between duty and interest;
4. and holding entities to account” (FSRC 2019b, 1).

Small business owners need access to credit, and bankers are responsible for diligently assessing each business opportunity proposal from their vantage point of being a profit-taking intermediary (FSRC 2018b).

Analysis of the evidence presented during the FSRC Round 3 Hearings of credit interactions between small businesses and lenders contextualises Research Objective 1 and 2 and aligns with the Research Rationale presented in [Section 1.3](#) (see Figure 1.2). Small developers share small business characteristics, and the credit assessment risk themes identified during NVivo mapping analysis provides a starting point to identify similar and additional risks faced by small developers.

The FSRC Round 3 Hearings Transcript of Proceedings (FSRC 2018b) highlights that human error and an individual or the company’s drive for profit may not always be self-evident to either one of the parties involved in the lender-borrower transaction. The lender-borrower relationship can be complex. The opposing views during the credit transaction were pointed out during the testimony of Peter Nathaniel Clark, chief credit officer of Commonwealth Bank of Australia:

And you would accept they knew that, from a borrower's point of view, factors might militate in favour of having a longer term facility as well?---There are some conflicting views between borrowers and bankers, yes (FSRC 2018b, 2678).

When engaging in small business credit transactions, due diligence obligations are high for both the bank and the small business. The FSRC Interim Report (FSRC 2018a) asserts that business owners should be aware of all borrowing risks as the bank sets the terms of engagement and determine the contractual risk allocation, “which typically have strongly favoured the interests of banks” (pp.162). Small businesses “lack the bargaining power and resources of larger entities... [and may] have limited access to legal and financial advice” (FSRC 2018a, 162). They should consider their ineffective limited liability risk as small business owners' personal and business finances often overlap, mainly when personal assets are offered as “security for a business loan” (FSRC 2018a, 162).

The conflicts between duty and interests of both the lender and borrower were explored in the Round 3 FSRC case studies (FSRC 2018b). Banks expect their employees to act with “due care and skill as a banker” (pp. 2092). Various policies are developed to create uniformity across bank branches and guide employees' behaviour (pp. 2081-2085; pp. 2111; pp. 2193). Evidence was provided to the FSRC about procedural errors that occurred and mistakes made by bank employees, even though these did not amount to misconduct. While the error may be small on the part of the bank, the financial losses and emotional distress of the small business owner or their affected family were evident during the Round 3 hearings. The distress caused by these mistakes and miscommunications was aggravated by a bank culture where mistakes were not admitted. Often problems were ignored, minor changes were not affected, and “transparent governance” (FSRC 2019b, 48) was lacking. Some of these witnesses' testimonies relating to exacerbated financial losses and emotional distress are summarised in [Section 4.4.3](#).

Evidence provided to the FSRC during Round 3 hearings supported the contribution of small business characteristics to the imbalance of power in the relationship between the bank and the small business (FSRC 2018b). An example is the owner-manager's responsibility for all business aspects, which necessitates specialist advice when engaging in credit transactions with the bank. This advice was often only sought when

things went wrong, as these services could be costly. First-generation entrepreneurs are not well-versed in dealing with complex banking processes and do not understand the implications of changes in their business' finances and market conditions on the contractual clauses. In one such FSRC Round 3 case study Mr Weller, a first-time business owner and certified practising accountant, testified about their confusion at the bank's belief that their business was deteriorating and that they may be unable to repay the loan. Mr Weller's business has not missed any repayments, and the assertion of the bank was made based on the bank's assessment of their businesses' financial decline during the GFC, calculated according to the relevant contractual monitoring clauses (FSRC 2018b, 2618-2631).

Further, when non-monetary covenants are breached, even by no direct fault of the business owner, the costs of evaluating the ongoing viability of the loan is passed on to the business owner (FSRC 2018b, 2620; pp. 2646). Breaches of non-monetary covenants could affect unilateral variation to the loan agreement terms, lead to increased interest rates, shorter repayment terms, and require additional capital input by the business owner (pp. 2622 – 2623; pp. 2653). The owner-manager of a small business carries all the risk for their decisions and often represent the company (a legal entity) as themselves (a natural person). Any loss or success, therefore, affects the small business owner directly.

Banks, who do not display small business characteristics, therefore hold the bargaining power, institutional knowledge, procedural knowledge, and their bankers operate within a corporate environment. This corporate environment allows bank employees access to internal advice and litigation. The primary difference in the relationship between a bank and its small business client is the effective limited liability of the former, compared to the ineffective liability of the latter. The bank is further represented by humans, who can make mistakes that could have minor repercussions, if any, personally, as indicated during the FSRC Round 3 hearings. One such FSRC Round 3 case study considered an employee's misjudgement of whether a guarantor was appropriately informed (pp. 2077). Another case study assessed a mistake made by an employee when assessing a property loan as residential where it should have been commercial and passing the cost the change to the customer through a loan restructuring process (pp. 2409). Borrowers who use an intermediary, like a broker, should be aware of the remuneration schemes

attached to the particular service provider's advice and note that this advice may not always be unbiased and may be opposed (FSRC 2018b). The same effect could also be internal to the bank in an environment where bank employee remuneration is driven by sales, which, in extreme cases, could lead to "unsuitable credit products offered to customers" (FSRC 2019b, 2).

Small businesses are often reliant on guarantors for security provision when applying for business credit. These guarantors are usually direct family members, which increase the chances of relational losses in addition to financial losses. Ms Beiglari from New South Wales Legal aid testified about her experience with clients who provided guarantees to their children for business loans during the FSRC Round 3 Hearings (FSRC 2018b). Often, a parental guarantor makes an emotional decision with minimal understanding of the far-reaching implications of potential enforcement. Even when provided with independent legal and financial advice, Ms Beiglari indicated that "I don't think that it has assisted people to understand what they're doing" (pp. 2054). Consequences of enforcement could include the loss of their home, a loss of relationship with their child and could affect their pension payments from the Australian Government age pension scheme, Centrelink (pp. 2053).

Figure 4.2 (on the next page) visualises the difference in perception of a banker and a small developer. Their responsibilities and focus regarding the an issue are not the same, as incentive structures are different and their motivation is not the same.

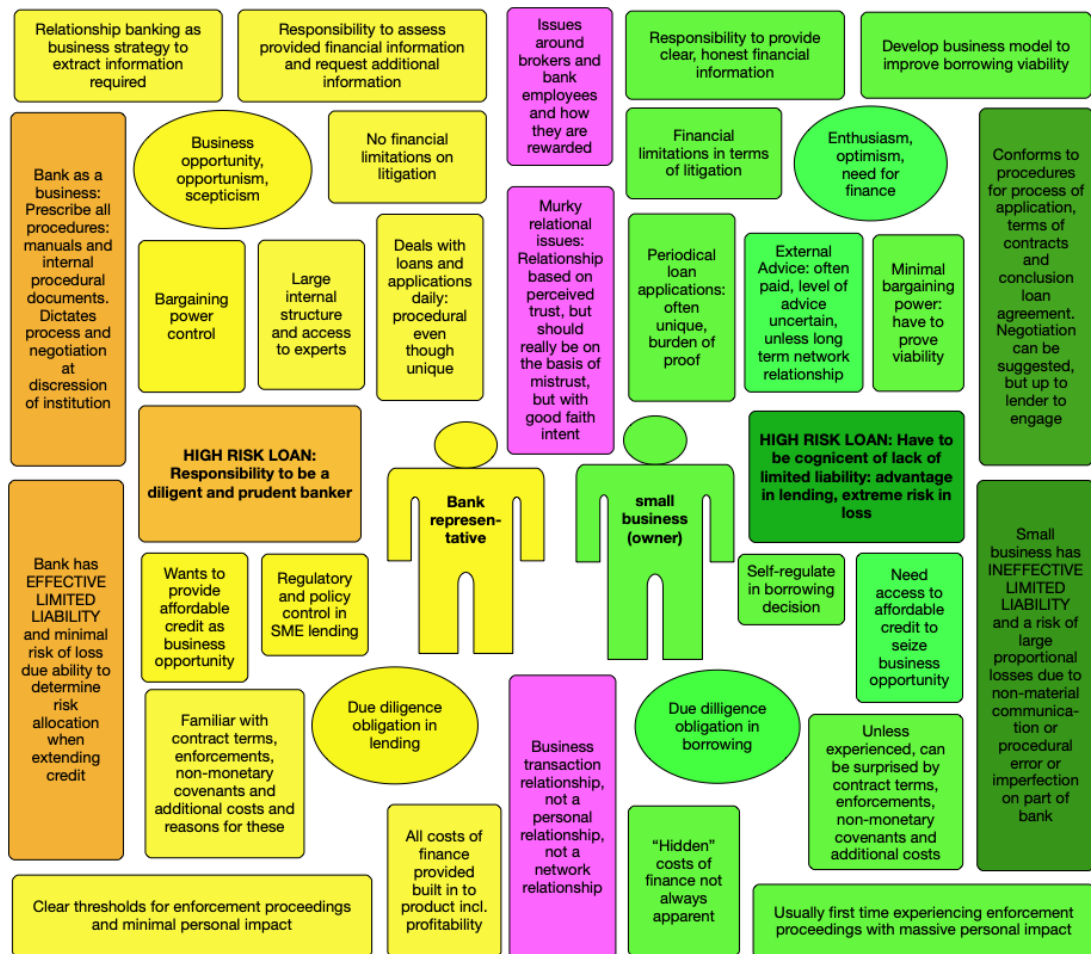


Figure 4.2: A mirrored overview comparing small business and bank characteristics affecting the loan process

Source: Analysis of the Round 3 Hearings Transcript of Proceedings (FSRC 2018b) in NVivo using the Maps function

4.4.2 Reliance on a prudent banker

The FSRC interrogated whether a banker acted as a “prudent banker” at various points during the testimonies of witnesses (FSRC 2018b). In the context small of business lending, a prudent banker rationally assess the borrower’s position to determine whether it would be reasonable to grant a loan to the applicant. The concept of a prudent banker requires a banker to balance “what is best for the bank” with the suitability of the loan for a small business while considering the small business’ serviceability potential and security provision (FSRC 2018a, 334). The banker often follows a relational approach and make a value judgement in line with bank policies:

...the standard that is imposed by the Code of Banking Practice might be that the bank ought to act to satisfy itself to a reasonable standard that the borrower will be able to

repay the credit facility. That is to say, the prudent and diligent banker is acting in order to protect the bank. The bank is not warranting the success of the borrower's business, nor is the bank acting as an advisor to the business borrower and nor can it be expected to be (FSRC 2018b, 3033).

Requirements set out in the ABA's Code of Practice for a banker to "exercise the care and skill of a diligent and prudent banker", does not only relate to professional conduct (FSRC 2019b, 60). Lenders must meet "prudential regulations and provisioning requirements" (FSRC 2018b, 2278). These prudential regulations, relating to verifying the client's financial situation, will "hold in general law" (FSRC 2019b, 57).

Conclusions of the FSRC in the Round 3 Hearings Transcript of Proceedings indicated that the premise "that banks are too willing to make loans to small businesses" based on security provision is not true (FSRC 2018b, 3034).

The FSRC indicated that this reliance on a banker to act prudently protects the bank and the small businesses from unscrupulous lending practices while not constraining access to credit for the latter through additional regulations (such as extending the NCCP Act). However, the Round 3 Hearings (FSRC 2018b) also explored small businesses vulnerability to human errors by bank employees. Where lenders made errors, they often chose to defend their actions rather than admit to an error or the breach of a policy (FSRC 2018b, 2082; pp. 2320; pp. 2335). Further, banks are profit-driven, and the incentive structures offered to employees to promote products and employees' key performance indicators (pp. 2211; pp. 2273) align with profit goals. While a bank is responsible for its credit decisions, "the customer is wearing the business risk or the investment risk" (pp. 2544).

4.4.3 Flexibility in lending: the all-moneys instrument and the ineffective limited liability conundrum

Evidence provided during the FSRC Round 3 hearings explains the use of the all-moneys assessment, which allows the bank flexibility in lending to small businesses. The all-moneys instrument presents an opportunity for the bank to develop a clear understanding of a small business and its owner's borrowing viability and how the loan will be secured (FSRC 2018b). This instrument is driven by the ineffective limited liability characteristic of small businesses. The all-moneys instrument allows a combined assessment of personal and business finances (pp. 2200). Lenders consider all

possible incomes of the small business owner, such as an income from another business, a spouse's income, income from fixed assets and income from other sources. Their spouse, child or parent could also provide guarantees or securities under specific conditions.

While an all-moneys approach improves the security provision, serviceability potential and borrowing risk profile of the small business, it also increases their risk of personal financial and relational loss in business failure. Family members' income (FSRC 2018b, 2211) or assets used during the all-moneys approach calculations, the provision of guarantees and securities "could be called upon" (FSRC 2018b, 2085). Ruinous effects of business failure on small business owners and their immediate families were evident throughout the FSRC Round 3 Hearings Transcript of Proceedings. The ineffective limited liability of a small business was demonstrated, for example, by the testimony of Marrion Angelika Messih. Years after having lost a business owned by herself and her sister in law, she was still paying back a business loan from the income of her now full-time employment (FSRC 2018b). This case study demonstrates that the owners are held jointly and severally responsible for loan repayments, regardless of a small company's incorporation status. Mr Welsh, testifying on behalf of Westpac as the general manager of commercial banking, indicated that there are trade-offs to the all monies approach:

[The small business owner] is not going through the all moneys calls and go, "What if something goes wrong?" Now, they know that if something goes wrong – in my experience – there's implications for that.... Because they are taking on big risks, and they know that. Are they alive to them as much and are they alive to them as to the details? I am not sure. You could say that you want to [have] a lot more detail and you want to add – and explain a lot more. That would add some complexity for them, and I think you would want to be very thoughtful about the trade-off here... Now, we want to support them, but we don't want to add more complexity to them. I don't want bankers making too many of the judgment calls on – on what they should or shouldn't do. You know, we need to set a framework very clear and I want our clients to be informed. I want them to understand what they're getting into, because that's absolutely critical... (FSRC 2018b, 2465).

While flexibility in lending through the all-moneys approach improves small businesses' access to finance, it also necessitates a monitoring mechanism in credit contracts to manage the bank's risk. Monitoring clauses are used in complex and longer-

term small business loans, such as property development loans, to ensure the ongoing serviceability and security of the loan. These clauses are called non-monetary covenants, each of which would have specific calculations and conditions attached (FSRC 2018b). Examples of non-monetary covenants include loan to value ratios (LVR) in a contract where the bank agrees to lend a specific percentage of the total value of a purchase amount for the land. If the LVR is 60%, the borrower's capital input will be 40% of the total price of the land. This ratio is monitored throughout the loan period at agreed intervals through valuations. If the land value deteriorates, and the LVR changes, the bank will require immediate additional capital input from the borrower (FSRC 2018b, 2653). Other non-monetary covenants include interest cover ratios and debt servicing ratios. These ratios require specific turnover targets and profit targets to be consistently met by a business. Lenders examine financial reports and statements of the borrower's business at agreed intervals throughout the loan period to determine the ongoing viability of the borrower to repay the loan (FSRC 2018b, 2621).

The complexity of non-monetary covenants and ensuing losses was illustrated through the evidence provided by Stephen Francis Weller. He bought a hotel with a partner, whom he later bought out and offered guarantees from both himself and his wife. The business defaulted on two non-monetary covenants in the credit contract. These covenants were related to a decline in the business' income, which caused a breach of the debt service and interest cover ratios. While a loan-to-value ratio (LVR) was not included as a covenant, the deteriorating valuation of the hotel indicated a deterioration of the LVR. The bank used a series of contractual variations to shorten the loan term due to other non-monetary covenant breaches affected by the deterioration in the LVR. There was no monetary default by the borrower regarding the repayment terms until the end stages of the loan, which coincided with a Deed of Forbearance issued by the bank. A Deed of Forbearance indicates that the lender could choose to take enforcement action based on the non-monetary defaults but will not do so immediately. In the case of Mr Weller's business' monetary default following the non-monetary breach, the bank decided to proceed with enforcement action. Receivers were appointed, and the personal guarantees provided by Mr Weller were called upon (FSRC 2018b).

A high proportion of emotional and financial costs of losses correspond with the emotional presentations of small business owners (or their relatives or representatives)

and the more businesslike testimonies of specialists and bankers during the FSRC Hearings. Rien Peter Low provided evidence regarding dealings between his family and the bank after Mr Low's father passed away, an experience described by Mr Low as highly stressful. Mr Low's mother was left with various loans from his father's business, including business loans and a business overdraft. She was unable to repay these loans and have suffered ill health due to stress. Mr Low had no relationship to the business but has noted that he has spent much of his own time for years trying to resolve these issues with the bank.

Mr Carter, representing the bank, did not have intimate knowledge of the dealings between bank employees and Mr Low as various employees handled this case, and not every interaction was recorded in detail. Further, Mr Low had to engage in legal action on numerous occasions. On the other hand, the bank provided a more objective response based on a reading of their files regarding the loans. The banker relied on an assessment of standard practices rather than engaging specifics around this case while admitting that some of the dealings could have been handled better (FSRC 2018b).

Bank lending above specific amounts requires security. For example, Westpac indicated that their threshold is AU\$50 thousand for lending to small businesses and security is required above this amount.

If you don't have an income that's sufficient to cover all of the family's expenses and the business loan, you shouldn't lend. And that would mean that somebody who wanted to start a business who didn't have a tangible security and didn't have a partner with an income sufficient to cover the business debt and all of the family expenses, would not be able to get a loan (FSRC 2018b, 2199).

Under one of Westpac's policies, small franchises can borrow against proven cash flow, used as security. Other small business lending is secured with assets. In case business assets are lacking, Westpac "will seek security over... freehold land" (FSRC 2018b). Further, "banks... have a limited appetite for lending without security" (pp. 2217). Lenders also distinguish "between residential security properties and commercial security properties because of the risks and characteristics of residential properties as opposed to commercial properties" (pp. 2430). Commercial properties can differ vastly in function, and condition, and this market segment is more volatile and less reliable as security and, therefore, requires more costly and specialised valuations (FSRC 2018b).

Before being accepted as security, valuations are carried out of properties intended as security. Valuation methods differ based on the type of property. Residential property valuations could rely on a contract of sale or could need a professional valuation carried out, depending on the banks' policies (pp. 2432).

Parent guarantors often provide this security as their family home. The ineffective limited liability characteristic of small businesses also extends to its guarantors.

Small businesses will tell you when start up there isn't any other way they can get – get a loan, without having some security that the bank can rely on... So the need for... reliance on a guarantor's assets is there (FSRC 2018b, 2032).

Carolyn Joy Flanagan provided a third-party guarantee for her children's business, and the guarantee was called upon when the business failed. She was in ill health and would have been left destitute. The bank eventually agreed she could remain in her property until her passing (FSRC 2018b).

The FSRC Round 3 Hearings Transcript of Proceedings (2018b) illustrated that, with small business finance being sparse and small businesses often desperate to access credit, many small businesses and bankers viewed the all-moneys approach as the only viable approach for small businesses to access credit successfully. However, many of the small business case study witnesses did not anticipate the extensive personal losses or even long-term effects of these losses and resulting repayment arrangements, supporting Mr Welsh's assertion noted earlier that the credit process is complex and that trade-offs are necessary. The FSRC Round 3 Hearings' conclusion \ remarks:

As we think these case studies have demonstrated, the dealings between any small business borrower and a financial services entity is almost always complicated. The relationship with the bank intersects and is intertwined with the operation of the business and often also the personal financial situation of the individual or individuals behind the business (FSRC 2018b, 3028).

4.4.4 Lenders' opinion about the small developer

Lenders consider small developers as complex lenders, due to the nature of the property development process and the skills these businesses access during the process. Lenders also consider the transaction's complexity, the loan's duration, the volatility of the

market and their current exposure to that section of the market. As the general manager for commercial banking at Westpac, Alastair Derek Dawson Welsh, explained:

So, property developers [are] more in the commercial business, and that's a pretty closely watched market, both by a number of regulators and also by banks... You also look at concentration risk for builders... banks have different appetite at different point in times because it depends where their – where their book is positioned and – and how they view the market, but you do a fair bit of research for the broader market on that (FSRC 2018b, 2228).

Small developers are also considered specialised and sophisticated lenders, with access to specialists. Small developers are therefore exposed to non-monetary default clauses in credit contracts. Ana Maria Bligh, the CEO of the ABA, indicated that in the case of small developers, this shifts the risk away from the bank:

...the code provisions will limit [non-monetary covenants] – for these small businesses, however defined, [and] will limit non-monetary defaults to those that go really to the lawful operation of the business. It will not apply financial indicators other than in the case of property development and specialised lending... Banks are of the view – and their view is based on their experience of their lending – that once a business gets into the 4 and 5 million dollar category, they become – one, if they're in the business of borrowing that sort of money then they're more likely to be of a more sophisticated nature and able to access both commercial and legal advice. (FSRC 2018b, 2919).

Small developers often conform to many small business definitions (see [Section 2.2.1](#)) and display small business characteristics (set out in [Section 2.2.2](#)). Many small developers, who access credit to sustain a pipeline of work or borrow more significant amounts, do not conform to the ABA Small Business definition as set out in their Code of Practice (ABA 2020) and would therefore not be eligible for to access small business protections offered under the Code.

Some lenders prefer to engage in “straightforward lending to less complex businesses” (FSRC 2018b, 2760) as part of their business strategy. Loans to businesses considered as complex are harder to monitor and more time is necessary to deal with these businesses' files. In particular, when complex business loans need remediation as they “take a lot longer to deal with and allowance would be made for that” (pp. 2809). Many more factors are considered when extending credit to complex borrowers, such as “the

borrowing structure... the loan structure [and] the circumstances of the borrower” (pp. 2811). Mr Cohen, the chief risk officer of the Commonwealth Bank of Australia, indicated that their bank also considers their risk appetite for complex lending against prudential obligations to protect depositors’ funds. Additional assessments include CBA’s role “in funding the economy... [by] recycling capital” (pp. 2814) and the specific customer’s interests. Sophisticated borrowers are considered to be “businesses that are large, capable [and] successful commercially” (pp. 2915). Small developers are deemed to be part of this group due to the amounts they borrow and the complexity of their loan contracts, even though they may not display the same characteristics as this group. Lenders expect small developers to engage comfortably in complex lending and to understand their contract terms. Non-monetary covenants are included to monitor a borrower’s ongoing serviceability potential and repayment ability (FSRC 2018b).

4.4.5 Non-monetary clauses apply to small developer credit contracts

Peter Nathaniel Clark, the chief credit officer of the Commonwealth Bank of Australia, noted that banks prefer shorter loan terms because “more things can go wrong [over time]” (FSRC 2018b, 2678). Mr Clark testified that the terms of mortgage-type loans (such as home loans) is usually set at a maximum of 30 years. He indicated that project-type financing is generally on 10 to 15-year terms, while commercial financing beyond five years is rare. Commercial credit contracts and project-type financing are considered complex credit arrangements which contain various non-monetary covenants that enable lenders to monitor, for example, the effective use of the credit. These non-monetary covenants allow lenders to determine the continued serviceability position of the borrower (various calculations that measure surplus cash available above interest obligations available for debt servicing). While the Unfair Contract Terms Regime has excluded non-monetary covenants in specific standard contracts, these covenants apply to small property development credit contracts. Credit contracts considered complex lending is managed by lenders’ business or commercial banking departments rather than a small business department (FSRC 2018b).

Evidence provided to the FSRC by Mr Clark indicates that lenders have regulatory and sometimes additional bank-specific policy obligations using pre-determined accounting constructs to measure the ratios contained in non-monetary covenants and calculate loan risk. The specific ratios used differ between larger and smaller banks and relate to the

risk rating applied to the loan. Ms Bligh, CEO of the ABA, noted that “the risk rating is higher for their [smaller] banks... than for the four large banks” (FSRC 2018b, 2916). APRA must approve larger banks to use a sophisticated internal risk rating, while all other banks use a standardised risk calculation method (FSRC 2018b). However, while a breach of a monitoring clause is not likely to lead to the termination of the credit contract, it could lead to a loan being considered troublesome, which may require remediation (FSRC 2018b). Evidence presented at the Commission suggests that non-monetary covenant breaches can trigger unilateral variations to the loan terms. These include higher interest rates, additional capital requirements to satisfy the LVR and additional invasive accounting reviews of the business’ records or “demands for more information” (pp. 2036).

Non-monetary covenants in contracts are a monitoring mechanism used by banks to determine the ongoing financial health of the borrower and the continued serviceability potential of the loan. These covenants, therefore, serve as red flags for potential defaults. The breach of a non-monetary clause usually results in moving the loan to a department better suited to deal with troublesome loans. The credit contract can thus be in breach in terms of non-monetary clauses and become troublesome to the bank, even though the borrower has “never defaulted on an interest payment” (FSRC 2018b, 2669). A breach of a non-monetary clause could also affect the bank’s enthusiasm in extending the loan agreement, agreeing to a “roll-over” of the loan or future lending to the borrower (FSRC 2018b, 2698). Changes in the market during the loan period and the borrower’s financial position could affect various covenants. For example, a reduction in business income or loss of a personal income tied to the loan could trigger clauses related to serviceability, or the devaluation of the security could affect the LVR. The small business also has to prove its good standing with the Australian Tax Office (ATO), and late payments or disputes could affect the conditions of non-monetary clauses.

As small developers are considered extra-ordinary borrowers by lenders, their loan contracts are subject to monetary covenants (relating to interest payments and capital repayment terms) and non-monetary covenants (relating to ongoing serviceability potential and repayment potential). A breach of the former is considered a material breach, while the latter could result in the renegotiation of various contract terms that could affect a borrower’s businesses’ cash flow. A change in the market conditions (like

a lower valuation of the project upon which credit is drawn) could affect the LVR and require additional capital input immediately to satisfy this credit contract covenant. As demonstrated through the two case studies of property developers in the FSRC Round 3 Hearings, one direct effect could be higher interest rates if roll-overs are granted and new credit contracts were extended (see [Section 4.5](#)).

Being considered sophisticated borrowers, small developers should take extra care to understand non-monetary covenants in their contracts. The implications of a breach of one or more of these clauses are far-reaching. Non-monetary clauses, like the loan to value ratios, could be breached through no direct fault of the borrower but as a result of a fluctuation in economic and market conditions over time (FSRC 2018b). Depending on market conditions, “as profit falls... you would expect the value of the whole enterprise would fall” (FSRC 2018b, 2706). Both economic fluctuations and market conditions affect the property development industry due to the inherent characteristics of the industry: the time lag in the supply of property and the considerable capital input required with profit only realised at the end of the construction period. While bankers indicated during the FSRC Round 3 Hearings that property developers are considered complex and sophisticated borrowers, this group was not explicitly excluded from the small business category.

4.5 FSRC property development case studies

4.5.1 Background to the FSRC Round 3 property development case studies

The FSRC explored two property development case studies in the Round 3 Hearings. Case Study 1 focussed on the Wildlines and Silversun Projects in Geraldton, Western Australia. Case Study 2 involved the Hadley’s Hotel and Inner Collins Development in Hobart, Tasmania. The two case studies were addressed related to reducing the exposure of Bankwest’s business book to commercial property after being acquired by the Commonwealth Bank of Australia (CBA) – thus from 2008 onward. These two case studies were selected as representative of various submissions received by the FSRC. The Round 3 Hearings Transcript of Proceedings (FSRC 2018b) and the Interim Report (FSRC 2018a) were consulted to develop the background to these case studies.

4.5.1.1 Case Study 1: Wildlines and Silversun Projects

The first case study involved developing two properties, Wildlines and Silversun, by two investment syndicates through two corporate entities. Evidence was given by Michael Lawrence Kelly (a shareholder and director of both syndicates) on behalf of the syndicates, and Brett Robert Perry (general manager of group credit structuring) represented CBA. Mr Kelly is an experienced banker and was a director of property finance before they left the bank to become involved in property development. Mr Kelly was involved in two syndicates who bought two properties, through loans secured by the land of the development projects. Both loans were obtained through the bank's commercial division and were over the value of AU\$5 million each per loan. The loan periods were exceeded by the rezoning application and development of the properties, and the syndicate applied for various extensions.

The evidence given by Mr Perry indicated that when a loan is extended or rolled over, it is, in fact, a new contract that is entered into and may not be extended on the same terms as the original loan. It is also the bank's prerogative to extend such a new loan contract or to refuse a roll-over. Mr Perry argued that the bank should be entitled to receive their money back after the original loan period. He further indicated that the new contract could include changes in the loan to value ratio (LVR). There could also be changes to the interest rate charged and any other additional terms that the bank may deem necessary when extending the loan period when assessing the risk grade of the loan for which is being applied. According to Mr Kelly, these changes could encourage a borrower to exit the loan rather than renew the loan. In this case, Mr Perry noted that Bankwest wanted to exit the loans as it was "overexposed to commercial property... [and wanted to] exit facilities at the end of the term" (FSRC 2018b, 3047).

From this case study, the FSRC found that the lender has the right to decide whether to extend a loan when it expires or not to do so. New loan terms can be decided and negotiated by the bank as a rolled-over credit contract is considered a new contract. The Commission indicated in the Interim Report (FSRC 2018a) that the Banking Code of Practice asserts that the lender does not have an obligation to extend a loan or re-finance an existing loan on the same terms as the original loan. If the bank does not intend to renew the loan, the bank must give a small business three months' notice of requiring loan repayment before the expiry of the facility. However, this case study of Mr Kelly's

projects is excluded from the ABA's current small business definition in the Banking Code of Practice (2020) due to both loan values being over AU\$5 million. Further, Case Study 1 would also not be included in the definition proposed in Recommendation 1.10.

4.5.1.2 Case Study 2: Hadley's Hotel and Inner Collins Development in Hobart

The second case study considered for this research was the development of a hotel in Hobart, Tasmania. Michael Edwin Doherty provided evidence on behalf of his hotel group, and Peter Nathaniel Clark (the chief credit officer) represented CBA. Mr Doherty's group obtained a loan of around AU\$50 million from Bankwest in 2008, with an expiry date in 2012. Mr Doherty alleged that additional costs, paid to external consultants required by CBA to satisfy the monitoring of non-monetary covenants, drew large amounts of money out of their loan account which impacted the project's cash flow. These additional costs followed the appointment of an investigative accountant following a new banker taking over the management of the file for this project in 2010. The new manager insisted that the additional investigation was due to concerns "over the June 2009 accounts of the borrower, and the 'worsening economy'" (FSRC 2018a, 339).

Mr Doherty further alleged that a change in the bank's valuation approach led to the breach of a non-monetary covenant (the LVR covenant). A mixed-use valuation method used during the assessment process considers the different use of spaces and potentially varying incomes that could be achieved. A second valuation, conducted to monitor the LVR, used an in-one-line valuation method and did not consider that the varying use of spaces could result in different income potential and resulting in a lower valuation. Mr Clark admitted that the original valuation method was the method used in the loan assessment and approval process but denied that the second valuation method was the sole reason for the breach of the LVR covenant. Mr Doherty repeatedly requested to view the revised (second) valuation, but the bank denied this request. Mr Clark admitted that their bank's policy at that time did not require the banker to share the valuation information with the borrower, even though the borrower paid for the valuation. Consequently, Mr Doherty was never given an apparent reason why the bank considered the LVR covenant potentially in breach. The CBA policy, relating to sharing valuation outcomes with borrowers, was updated later in the same year in order to improve the

transparency of the bank's calculations and decisions regarding non-monetary covenant breaches (FSRC 2018b).

Mr Clark admitted that this breach might have affected "a decision not to renew the facility" (FSRC 2018b, 3050) upon expiration of the facility in July 2011, although no formal breach notice was issued regarding the LVR covenant. The Doherty Hotel Group provided additional security, and the bank raised interest payments on the loan. The Hadley's Hotel and Inner Collins Development Project were not completed at the expiration of the facility. Mr Doherty tried to lease the accommodation part of the hotel at this time, which had received a certificate of completion, to another group. CBA refused to accept this arrangement under the loan conditions, as it would prohibit them from realising the security due to a 'do not disturb' clause in the contract with the group intending to lease the accommodation as serviced apartments. Mr Doherty was further unable to come arrange another financier to re-finance the debt. Subsequently, receivers were appointed as Mr Clark alleged that additional financial assessments indicated various financial difficulties experienced by the hotel group. Mr Doherty's hotel group paid for these assessments per non-monetary covenants in the lending contract. While Mr Doherty's group experienced extensive financial losses, the bank was also hard-hit by the outcome of the process and lost AU\$38 million on the project.

In the second case study, the FSRC found that the evidence provided did not support Mr Doherty's claims of unconscionable conduct by the bank about the meaning of such conduct in the ASIC Act (FSRC 2018a). The choice of the bank to not disclose the second valuation to the borrower was found by the Commission to be below community expectations. In the varying basis for the valuations, the Commission indicated that this was the bank's choice but made no further recommendations or rulings. As no enforcement action was taken based on the more conservative valuation method through the LVR covenant, the FSRC did not further evaluate whether a change in the valuation method constituted a breach of contract terms. The FSRC found that it was within the bank's rights to decide whether to extend further credit or enforce the loan through their internal risk assessment processes, even though enforcement resulted in both parties suffering substantial losses (FSRC 2018b).

4.5.2 Data management and analysis of FSRC property development case studies

4.5.2.1 NVivo and the use of cases to manage data

The portable text documents of the Round 3 Transcripts (FSRC 2018b) relating to the two case studies were read in the FSRC Round 3 Hearings' context and then imported into NVivo and analysed using a thematic coding (each code is called a node). NVivo allows data management of the nodes through *cases*. While cases can be used in various ways in NVivo software, this study uses cases to compare data from the evidence provided by bankers to that of property developers across the two FSRC case studies. Further, data management through NVivo cases allowed one to present an overall picture by combining the data from the two FSRC property development case studies.

Cases were used to code the two FSRC property development case studies as follows:

- Case Study 1: Wildlines and Silversun Projects, was coded as Case 1: Coded data from evidence given by Michael Lawrence Kelly (on behalf of the syndicate developing Wildlines and Silversun) was managed as Case 3. Brett Robert Perry's coded evidence (on behalf of CBA) was managed as Case 4.
- Case Study 2: Hadley's and Inner Collins Development in Hobart was coded as Case 2: Michael Doherty's coded evidence (property developer of a hotel in Hobart) was managed as Case 4. Coded data from evidence given by Peter Nathaniel Clark (representing CBA) was managed as Case 6.

The purpose of analysing the two FSRC property development case studies was to identify aspects of property developers' loan application assessment process that have not been evident in the limited existing literature. Data management through *cases* enabled the comparison of the coded data of evidence provided by bankers (Case 4 and Case 6) to that of property developers (Case 3 and Case 5) across the two FSRC property development case studies.

Using cases as a data management strategy further allowed the combination of both the case studies. High co-occurring nodes were queried through the co-occurrence matrices function in NVivo. Figure 4.3 (on the next page) indicates how the data of the two FSRC property development case studies were managed.

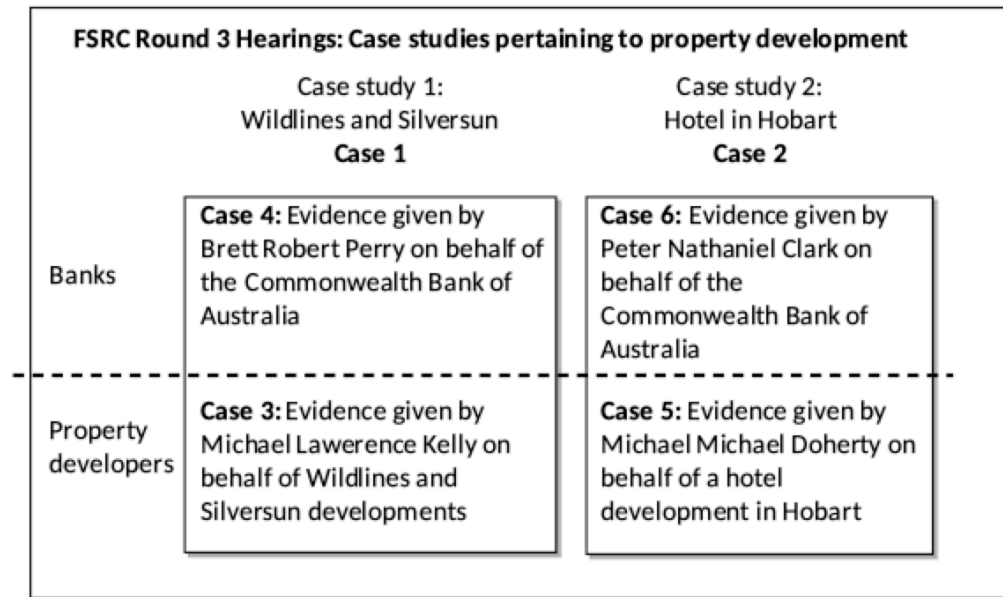


Figure 4.3: Data management and analysis strategy, using cases in NVivo software, for two property development case studies extracted from the FSRC Round 3 Hearings Transcript of Proceedings and the FSRC Interim and Final Reports

4.5.3 Data analysis using co-occurrence matrices

Nodes were developed from multiple readings of the two property development case studies from the FSRC Round 3 Hearings Transcript of Proceedings (2018b), the Interim (FSRC 2018a) and Final Reports (FSRC 2019b). Chronologically, during the two FSRC property development case studies, the property developers provided their evidence before the bankers (Case 3 and Case 5). Property developers detailed their dealings with the banks during the credit process, and the FSRC counsel assisting used an exploratory style of questioning. Their evidence covered broader aspects around the credit process, which the property developers deemed critical in their dealings with lenders. Therefore, Case 3 and Case 5 were coded over many nodes, as indicated at the end of this section.

Bankers (Case 4 and Case 6) provided specific responses to the FSRC counsel assisting's questions related to the property developers' testimonies. Bankers were often requested to explain their policies around the decisions taken during the credit process. Further, they were required to testify where these policies were misinterpreted by bank employees or where an employee's conduct potentially fell short of a policy's intent. Bankers also explained the reason for the existence and implementation of various

complex bank processes when queried by the FSRC based on the evidence provided by the property developers. Due to the specific nature of their feedback, fewer nodes were coded for Case 4 and Case 6, as the FSRC queries were focussed on specific issues related to the credit process.

NVivo software was used to compare nodes across the two FSRC property development case studies and by using cases as a data management strategy. The NVivo co-occurrence matrix function was used to develop co-occurrence matrices from all the coded nodes by analysing selected cases. The highest co-occurring nodes for the evidence provided by bankers (Case 4 and Case 6), property developers (Case 3 and Case 5) and the combined evidence of both case studies (Case 1 and Case 2) were interrogated. The co-occurrence matrices were exported to an Excel spreadsheet, and codes with occurrences and co-occurrences lower than five were omitted. The spreadsheet format allowed a visual comparison of the data and is presented at the end of this section in Table 4.1.

The highest co-occurring nodes of the analysis of the evidence provided by bankers (Case 4 and Case 6) were *Bank processes*, *Assessment process*, *Bank Risk appetite*, *Exposure*, *Market conditions* and *Lending contract*. Co-occurrence analysis of the evidence provided by property developers (Case 3 and Case 5) shared the six nodes with the highest co-occurrences with Case 4 and Case 6. However, an additional node, *Risk awareness*, was identified as a high co-occurring node for property developers (Case 3 and Case 5). Combined high co-occurring nodes of Case 1 (Case 3 and Case 4) and Case 2 (Case 5 and Case 6) indicated the *Cost of borrowing* as an additional high co-occurring node. The *Cost of borrowing* was not identified in the Excel summary of the co-occurrence matrices of bankers and property developers, as nodes with low co-occurrences were omitted. Combining the coded nodes of Case 1 and Case 2 *Cost of borrowing's* combined coded data included the node as a high co-occurring node in the combined Excel summary.

Codes that have a high co-occurrence for Case 4 and Case 6 with the six identified nodes from the evidence provided by bankers were:

- *Bank processes*: Assessment process, Bank risk appetite, Exposure, Market conditions, Cost of borrowing, Lending contract and Non-monetary clauses

- *Assessment process*: Bank processes and Bank risk appetite
- *Bank risk appetite*: Bank processes, Assessment process, Exposure, Market conditions, Cost of borrowing and Lending contract
- *Exposure*: Bank processes and, Cost of borrowing
- *Lending contract*: Bank processes and Bank risk appetite

Case 3 and Case 5, evidence provided by property developers, had the following high co-occurring nodes with the seven identified nodes:

- *Bank processes*: Assessment process, Own capital input, Bank risk appetite, Exposure, Market conditions, Security, Cost of borrowing, Lending contract, Non-monetary clauses, Use of valuer, Risk awareness, Experience, Project management experience, Ineffective limited liability, Invasive financial assessments
- *Assessment process*: Bank processes, Bank risk appetite, Exposure, Cost of borrowing, Lending contract
- *Bank risk appetite*: Bank processes, Assessment process, Own capital input, Exposure, Market conditions, Cost of borrowing, Lending contract, Non-monetary clauses, Use of valuer, Risk awareness
- *Exposure*: Bank processes, Assessment process, Bank risk appetite, Market conditions, Cost of borrowing, Lending contract, Non-monetary clauses, Use of valuer, Risk awareness
- *Lending contract*: Bank processes; Assessment process, Bank risk appetite, Exposure, Market conditions, Cost of borrowing, Non-monetary clauses, Use of valuer, Risk awareness
- *Risk awareness*: Bank processes, Assessment process, Bank risk appetite, Exposure, Cost of borrowing, Lending contract, Experience, Project management experience, Ineffective limited liability, Invasive financial assessments

By combining the nodes from both the case studies (Case 1 and Case 2), nodes that were omitted because they had an occurrence or co-occurrence lower than five for

evidence provided by bankers or property developers separately were included in this matrix. High co-occurring nodes for the combined cases were:

- *Bank processes*: Assessment process, Entity, Own capital input, Serviceability, Bank risk appetite, Exposure, Market conditions, Security, Cost of borrowing, Lending contract, Non-monetary clauses, Timeframes, Use of valuer, Risk awareness, Experience, Project management experience, Ineffective limited liability, Invasive financial assessments, Use of specialists
- *Assessment process*: Bank processes, Entity, Own capital input, Bank risk appetite, Exposure, Cost of borrowing, Lending contract
- *Bank risk appetite*: Bank processes, Assessment process, Own capital input, Exposure, Market conditions, Securities and guarantees, Cost of borrowing, Lending contract, Non-monetary clauses, Timeframes, Use of valuer, Risk awareness, Ineffective limited liability
- *Exposure*: Bank processes, Assessment process, Own capital input, Bank risk appetite, Market conditions, Cost of borrowing, Lending contract, Non-monetary clauses, Timeframes, Use of valuer, Risk awareness
- *Cost of borrowing*: Bank processes; Assessment process, Own capital input, Bank risk appetite, Exposure, Market conditions, Lending contract, Non-monetary causes, Use of valuer, Risk awareness, Ineffective limited liability, Invasive financial assessments
- *Lending contract*: Bank processes; Assessment process, Own capital input, Bank risk appetite, Exposure, Market conditions, Cost of borrowing, Non-monetary clauses, Timeframes, Use of valuer, Risk awareness, Invasive financial assessments, Use of specialists
- *Risk awareness*: Bank processes, Assessment process, Entity, Bank risk appetite, Exposure, Cost of borrowing, Lending contract, Non-monetary clauses, Experience, Project management experience, Ineffective limited liability, Invasive financial assessments, Use of specialists

Table 4.1 (on the next page) provides a summary of codes with high co-occurrences.

Table 4.1: High co-occurring nodes from the FSRC property development case studies

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|------------------|----------------|
| Bank processes | 23 | 9 | 17 | 13 | 10 | |
| Assessment process | 9 | 9 | 6 | | | |
| Bank risk appetite | | | 6 | | | |
| Exposure | | | | 6 | | |
| Lending contract | | | | | 10 | |
| Risk awareness | | | | | | 10 |

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|------------------|----------------|
| Bank processes | 41 | 14 | 23 | 20 | 23 | 18 |
| Assessment process | 14 | 14 | 10 | 10 | 6 | |
| Bank risk appetite | | | 6 | | | |
| Exposure | | | | 6 | | |
| Lending contract | | | | | 6 | |
| Risk awareness | | | | | | 18 |

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Cost of borrowing | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|-------------------|------------------|----------------|
| Bank processes | 64 | 23 | 40 | 33 | 30 | 33 | 20 |
| Assessment process | 23 | 23 | 16 | 13 | 10 | 9 | 6 |
| Bank risk appetite | | | 6 | | | | |
| Exposure | | | | 6 | | | |
| Cost of borrowing | | | | | 6 | | |
| Lending contract | | | | | | 7 | |
| Risk awareness | | | | | | | 6 |

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Cost of borrowing | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|-------------------|------------------|----------------|
| Bank processes | 23 | 9 | 17 | 13 | 10 | 7 | |
| Assessment process | 9 | 9 | 6 | | | | |
| Bank risk appetite | | | 6 | | | | |
| Exposure | | | | 6 | | | |
| Cost of borrowing | | | | | 6 | | |
| Lending contract | | | | | | 10 | |
| Risk awareness | | | | | | | 10 |

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Cost of borrowing | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|-------------------|------------------|----------------|
| Bank processes | 41 | 14 | 24 | 17 | 14 | 14 | 7 |
| Assessment process | 14 | 14 | 10 | 17 | 21 | 13 | 7 |
| Bank risk appetite | | | 6 | | | | |
| Exposure | | | | 6 | | | |
| Cost of borrowing | | | | | 6 | | |
| Lending contract | | | | | | 6 | |
| Risk awareness | | | | | | | 7 |

| | Bank Processes | Assessment process | Bank risk appetite | Exposure | Cost of borrowing | Lending contract | Risk awareness |
|--------------------|----------------|--------------------|--------------------|----------|-------------------|------------------|----------------|
| Bank processes | 64 | 23 | 41 | 30 | 21 | 21 | 8 |
| Assessment process | 23 | 23 | 16 | 13 | 34 | 19 | 7 |
| Bank risk appetite | | | 6 | | | | |
| Exposure | | | | 6 | | | |
| Cost of borrowing | | | | | 6 | | |
| Lending contract | | | | | | 7 | |
| Risk awareness | | | | | | | 8 |

Evidence provided by bankers (Case 4 and Case 6)

Evidence provided by property developers (Case 3 and Case 5)

Combined case studies (Case 1 and Case 2)

Note:

The numbers in the tables indicate the number of times that coded nodes co-occur in the co-occurrence matrix developed in NVivo for each data set. Codes with a co-occurrence lower than 5 were not used in order to focus on high density co-occurring codes

* Use of own money' added to 'Own capital input'

** Use of accountant and QS and broker' added to 'Use of specialists'

*** 'Timeframe impacts' added to 'Timeframes'

**** 'Complex syndicates' added to 'Entity'

4.5.4 FSRC property development case study analysis findings

The property development case studies investigated in Round 3 were relevant to the FSRC in the context of the adverse outcome of the entirety of the credit process and the viability assessment process followed by lenders. While not the focus of the FSRC hearings, the initial testing of the viability of the loan through the assessment process followed was queried by the FSRC during the property development case studies. Nodes with high-frequency recurrences point to often repeated themes from the cases but do not indicate the importance of these themes. Co-occurrence matrices highlight that nodes do not exist in isolation and infer meaning to the co-occurrence of nodes (Illia et al. 2014).

The credit process is complex, and interactions between bankers and property developers are affected by many variables. These variables could include varying bank processes and policies between lenders. Banks, their employees and customers rely on bank processes supported by policies to operate transparently and effectively. Property development case studies explored during the FSRC Round 3 Hearings demonstrated that these processes are often not transparent, can be ineffective and that there is often a reliance on individuals to interpret and implement policies that guide the processes. The credit assessment process is the starting point of the credit interaction between the bank and the property developer during the credit process. Mistakes and misinterpretation of information or circumstances during the assessment process could have far-reaching consequences throughout the credit interaction cycle.

Lenders' risk appetite for property development was declining during both property development case studies. This risk-averse attitude towards lending to property developers was driven by the GFC and a decline in property prices. A bank considers its risk appetite during the loan assessment process and at various monitoring points during the loan period. Risk appetite is based on various factors, including but not limited to the bank's current exposure to a market segment, their actual exposure to a specific loan, market conditions, and the quality of securities and guarantees attached to the loan. A declining risk appetite for financing property development in tough economic times is challenging for property developers. Property developers could

find it impossible to re-finance a loan upon the expiration of the lending contract during such periods. The banks in the FSRC case studies allowed some flexibility in terms through contract extensions until arrangements could be made to repay the loan amount. Further, the re-financing or rolling-over of a loan is not guaranteed and will be subject to a bank's discretion. Lenders keep a keen eye on market conditions in various economy segments and reduce lending to specific segments when overexposure is perceived.

Changes to the market conditions and securities during the loan period affect the bank's exposure and lead to variations in loan condition. These factors are considered during the loan assessment process and are subject to a monitoring process. Exposure, market conditions and serviceability potential affect the amount of capital input the bank requires to satisfy the LVR. The cost of borrowing (cost of credit) is priced at the perceived risks. Lending contracts contain monetary and non-monetary clauses. The costs related to procedures used to monitor the non-monetary covenants are passed on to the borrower. Invasive financial assessments and valuations are used to monitor the non-monitory covenants and negatively impacted both developers' cash flow. Breaches of covenants like the LVR requires immediate additional capital input or additional securities. Breaches of non-monetary covenants and additional monitoring could affect how a bank would view future credit applications by the property developer and whether a bank will grant extensions or roll-overs of the loan.

Property developers are aware of their borrowing risks during the credit process. Evidence presented by the property developers pointed to previous experience with property development and project management as an advantage during the loan assessment process. In particular, evidence by Mr Kelly (Case 3), who had vast experience and a background in banking processes related to property development, indicated the complexity of the credit interactions. The entity involved in the credit transaction could add complexity and additional documentary requirements, affecting the assessment and monitoring process. Property developers also consider that various lenders' exposure may not be the same at a specific time and they look to different lenders for financing or re-financing options. The property developers

that provided evidence during the FSRC Round 3 hearings experienced the impact of non-monetary covenants in their lending contracts. Property developers need access to credit, their credit contracts are considered complex, and the use of non-monetary covenants is necessary for the bank to measure ongoing exposure and serviceability to a particular loan.

Lenders assess the financial proposals of small developers on an all-moneys basis. This approach to financial assessment considers all possible income and assets of the property development company and the owner. Income from other businesses, as well as spousal income and assets, are considered. The all-moneys approach is driven by the small business characteristic of ineffective limited liability. Evidence provided by the two property developers of the FSRC Round 3 case studies indicated their awareness of their ineffective limited liability in their credit process, and they understood how this could be managed. Lenders require extensive securities and guarantees from the directors of property development companies. Often these securities and guarantees are required personally from the directors.

Small developers are likely excluded from regulatory protections, which are afforded to other small businesses. They are considered sophisticated and complex lenders. To create a sustainable stream of work, some small developers borrow more significant amounts than defined by the monetary limits of the ABA small business definition. Various factors inherent to property development contribute to the classification of small developers as complex and sophisticated borrowers. Property development requires large amounts of capital. A time lag in the supply of the product, combined with potential changes in market conditions over the loan period, increases the bank's risk in lending to property development projects. Each project development credit proposal to a bank is unique, and has to be evaluated against the appropriateness and viability of entering into a credit contract.

4.6 Contribution of Chapter 4 to research questions and objectives

The FSRC Round 3 Hearings Transcript of proceedings (FSRC 2018b), the two property development case studies and the FSRC Interim Report (FSRC 2018a) and

Final Report (FSRC 2019b) contributed to all three research objectives. Evidence from FSRC data analysis did not address RQ3, RQ4 and RQ6.

Small developers are considered sophisticated, complex and specialised lenders (RQ1). Their loan values are high, and loan periods can be long. The nature of property development and their access to specialists during the development process contributed to how lenders view their applications. Two property developer case studies, considered during FSRC (Round 3 hearings), are not defined as small businesses in the ABA Banking Code of Conduct (2019). They would also fall outside the limits of the FSRC Commissioner's Recommendation 1.10. The subsequent Pottinger (2020) Independent Review into the ABA small business definition indicated that the definition should be updated and should specify which businesses are not considered as small businesses by lenders.

The criteria on which commercial lenders base their credit decision was considered during the FSRC data analysis (RQ2). The bank's risk appetite could be affected by its exposure to a particular industry or sector and prevailing market conditions. The money that the bank has available is a deciding factor. The bank considers how the loan will be serviced and secured documentary proof from the small developer. A small developer must have access to capital to satisfy the LVR requirements of the loan. The loan period and development timeframes proposed could have affect the lending decision. The experience of the small developer and their team are further criteria.

In terms of regulatory restrictions (RQ5), the FSRC Final Report's (2019b) Recommendation 6.1 points to the joint responsibility of APRA (prudential regulator) and ASIC (conduct regulator). Lenders translate regulations into their policies and processes. Specific constraints with regards to small property development finance is not clear from the FSRC Transcript of Proceedings (2018b), Interim Report (FSRC 2018a) or Final Report (FSRC 2019b). Prudential requirements were noted during the Round 3 Hearings but were not detailed related to small business lending.

The FSRC property developer case studies indicated extensive reliance on personal experience in property development finance. The external advice (RQ7) that the property developers relied on included the experience of other syndicate members and various consultants. Consultants assisted with the costings, designs and compiling of the development application. Property developers from the case studies also relied on real estate agents and valuers for assistance with due diligence. Accountants and legal consultants were involved at specific stages of the property development process.

RQ8 considered how bank monitors the effective use of finance. The evidence from the FSRC Round 3 hearings points to the responsibility of a prudent and diligent banker in assessing the original lending application and monitoring the ongoing serviceability of the loan. Various non-monetary covenants in credit contracts support the monitoring of the effective use of finance. Table 4.2, on the next page, summarises the contribution of Chapter 4 to the research questions and objectives.

Table 4.2: Contribution of reports and testimonies given at the FSRC to research questions and objectives

| Research question number | Research Question | Contribution of data analysis of FSRC Round 3 Hearings and Reports | | |
|--------------------------|---|--|---------------|----------------|
| | | Objective 1* | Objective 2** | Objective 3*** |
| RQ1 | How do lenders assess the lending applications of small developers? | X | X | X |
| RQ2 | What are the criteria on which commercial lenders base their decision to extend or refuse credit to small developers? | X | X | X |
| RQ3 | Does the small developer's business model influence the lending decision? | | | |
| RQ4 | Do commercial lenders view small developers as a viable business opportunity? | | | |
| RQ5 | What are the regulatory constraints in terms of financing small developers? | X | X | X |
| RQ6 | What is the success rate of credit applications by small developers? | | | |
| RQ7 | What outside advice do small developers make use of during their credit applications? | X | X | X |
| RQ8 | Do lenders in Australia monitor the effective use of finance extended to small developers? | X | X | X |

*Objective 1: identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders

**Objective 2: analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success

***Objective 3: develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders

4.7 Summary of Chapter 4

This chapter considered evidence from the FSRC Round 3 Hearings Transcript of Proceedings (2018b), the Interim Report (2018a) and the Final Report (FSRC 2019b). Background to the FSRC conclusions of the Round 3 Hearings and the

Commission's recommendations related to small businesses are discussed. The FSRC Data analysis was conducted through a sub-stage process, based on the theoretical rational, involving two stages. Sub-stage one followed an exploratory approach and the evidence from the FSRC hearings and reports presented an overview of critical themes of the credit interactions between small businesses and banks. Sub-stage two analysed evidence presented during two FSRC property development case studies in NVivo, using high co-occurrence rates of nodes of the coded transcripts. The two property development case studies presented in-depth detail of the interaction between a bank and property developer during a specific loan period, the risk perception and challenges of both parties were analysed.

Recurring themes (nodes) identified from the FSRC property development case studies were used to focus in-depth interview questions interviews with banks (Chapter 5) and small developers (Chapter 6). The FSRC Round 3 Hearings Transcript of Proceedings (2018b), the Interim Report (2018a) and Final Report (2019b) provided valuable, objective evidence towards the research questions and objectives of this study. However, the focus of the FSRC inquiry was not on the loan viability assessment of small developers alone but the complete credit interaction between lenders and SMEs. The viability assessment processes of loans, followed by lenders, is further explored in Chapter 5, through semi-structured in-depth interviews with three bankers in Western Australia.

CHAPTER 5

UNDERSTANDING RISK CONSIDERATION BY BANKS IN SMALL DEVELOPERS' CREDIT APPLICATIONS

5.1 Introduction to understanding banks' risk considerations regarding small developers' credit applications

Chapter 5 details an in-depth interview and focus group conducted with three bankers in Western Australia. This chapter considers the depth of the Commission's findings of banks' credit risk assessment process and address research questions and objectives which were not sufficiently explored Hearings. Findings of the FSRC Round 3 Hearings, Interim and Final Reports are reported in Chapter 4. A dynamic pluralist epistemological framework allowed for the exploration of corporate culture while considering individual knowledge. This epistemological framework supports the relevance of multiple individuals' knowledge as a knowledge type within a corporation. In an ever-changing environment, lenders update their risk criteria to match economic and sector conditions and the interplay between individual knowledge, as representative of corporate knowledge, is critical – see [Section 3.2.3](#).

The evidence presented by witnesses to the FSRC was done under an affirmation, to tell the truth, and their testimonies focussed on specific case studies and questions asked by the FSRC regarding the credit interactions between lenders and SMEs. While findings of the FSRC analysis indicate key risk factors for success during the credit application assessment of small businesses and property developers, it is not evident that these are addressed similarly in the case of small developers. Though credit access is crucial for small developers, the FSRC, following its Terms of Reference, did not focus on the success rate of credit applications of a particular business sector. It is unclear from the FSRC findings whether banks view small developers as a viable business opportunity. Chapter 5 analyses the personal knowledge of three bankers in the context of the credit assessment process of small developers. Chapter 6 considers small developers' experiences and learnings regarding lenders' credit assessment process.

Participants were identified by and approved as authoritative representatives to participate in this research by their respective banks. Two banks agreed to participate in the research. Both banks were ranked in the top seven banks in Australia in 2021, and

one of the lenders ranks among the seven banks that hold the largest market share in Australia (Gara 2021). A semi-structured interview and a focus group session were conducted. The research questions formed the basis for questions to participants, and follow-up questions were asked during the sessions. Interviewees included two experienced business bankers who, at a minimum, have also held a similar position at one of the four major Australian banks. A third interviewee was a branch manager with experience in small business lending. The banks agreed to participate in the research based on anonymity. Interviewees are re-identifiable for the purposes of research integrity only.

Challenges, research parameters, and interview and focus group session results are outlined in this chapter. High co-occurring codes from the FSRC property developer case study analysis was used as the basis for coding bankers' view on the small property development credit assessment process. The interview and focus group data were analysed separately in NVivo software, and a mind-map of high-frequency nodes of each interview was developed. Co-occurrence analysis of the nodes of the combined data from the interviews and focus group session was conducted. The findings of this chapter contribute to identifying key risk factors that influence the success of small developers' credit assessments and the development of an improved credit risk assessment model.

5.2 Participation by banks and sample challenges

A list of the lenders that were contacted to request interview participants is available in the data. The "big four" in Australia, the four banks that hold the largest market share, can only be contacted through their national media departments who approve or decline all interviews. These banks are the Commonwealth Bank of Australia, Westpac Banking Corporation, Australia and New Zealand Banking Group and National Australia Bank. All four banks' media departments were contacted telephonically, and the research information summary was sent in an email to a media representative. They were contacted again (through follow-up), and only the National Australia Bank responded that they could not offer an interviewee for the research. At the time of the interview requests, the FSRC Final Report was recently published (February 2019), and, in particular, the big four banks, have had two years of media scrutiny during the FSRC

proceedings. One media officer indicated during the initial telephone conversation that they were hesitant to participate in research at the time.

In terms of market share, Australia's largest bank, the Commonwealth Bank of Australia (CBA), had a market cap of AU\$181.24 billion on 7 September 2021 (Australian Stock Exchange 2021). The remaining big four banks, Suncorp Group (an insurance company with a bank under its umbrella) and Macquarie Group (a multi-national bank), have market caps in the tens of billions of AU\$. All other Australian lenders currently have a market cap below AU\$10 billion and are generally referred to in media as smaller banks in Australia.

Smaller national banks with branches in Perth were contacted by telephone, and the research information summary was sent via email to secure interviews. The lenders were selected based on an online search of their consumer ratings at the time and their experience with small developer lending. Interviews were conducted with three authorised representatives, who obtained permission from their national head-offices to participate in the research. Participants were selected by their bank as authoritative in small developer credit assessment, based on their experience in their current position and previous positions held. These interviews were conducted in May 2019. Interview questions were sent to participants ahead of the interviews and were based on the research questions. Interviews were one to two hours long and were semi-structured. Participants were asked to answer the interview questions and to expand on their answers through follow-up questions.

A pre-condition for both banks to participate in the research was the anonymity of their authorised participants. Information provided in the interviews that could link participants to the interview such as the names of individuals, names of the banks, location, and documents provided does not appear in the transcribed interviews. The participants are re-identifiable through a coding system, and the coded identities were stored in a separate MS Word document which is password protected. The participants are coded as Participant 1 (P1), Participant 2 (P2) and Participant 3 (P3). A summary of participant codes is presented in Table 5.1 on the next page.

Table 5.1: Summary of participant codes

| | Bank and position | Code |
|----------------------|--------------------------|-------------|
| Participant 1 | Business banker, Bank 1 | P1 |
| Participant 2 | Branch manager, Bank 2 | P2 |
| Participant 3 | Business banker, Bank 2 | P3 |

5.3 Research methods of banks' risk considerations during small developer credit assessment

An interview and a focus group discussion with banks were treated as in-depth exploratory narrative data collection, using open-ended questions (see Appendix 2 for a sample section of an interview). The objective of these sessions were to investigate research questions that were not sufficiently discussed during the FSRC hearings. Questions put to bankers were based on the research questions. Bankers' perspectives regarding their experience in small developer credit assessment were examined and added to the knowledge of small developer credit risk assessment from Chapter 4.

The first interview was conducted with an interviewee from Bank 1 (hereafter referred to as P1). The interviewee is a business banker who travels between branches for appointments with potential and existing borrowers. They have extensive experience with small property development lending and have also held a similar position during previous employment at two of the big four banks. The research information summary and proposed questions were forwarded to P1. Afterwards, the interview audio recording was found to be corrupted, and notes were written down from memory. A second interview was arranged with this interviewee and answers from the first interview were confirmed during the second interview. Two recorders were used to record all subsequent interviews and the focus group discussion, to prevent a repeat of this failure. The interviewee considered their contribution essential to the research. They were further interested in the research results and noted that their bank was approving minimal small developer credit applications at the time due to hesitancy to lend to property development after the GFC. This interviewee provided details of brokers and

another business banker as potential participants,, however, these suggested participants declined to be interviewed. Before the recording was started, this participant indicated that they were aware of the FSRC recommendations and that the FSRC hearings were likely the cause of the hesitancy of the big four banks to participate in the research. They also noted that they believe the FSRC hearings to have restricted lending criteria, as lenders are nervous about being implicated in wrongdoing. Their bank was not implicated in the FSRC hearings for misconduct to the best of their knowledge.

The audio file from the second interview with P1 was transcribed and analysed in NVivo. A themed coding system formed the basis for the coding of the interview, and a mind map was developed to visually explain the connection between themes (nodes) raised by this interviewee. The coded interview was analysed by considering high recurring codes and high co-occurring nodes.

The second bank provided two participants: the branch manager (P2) and a business banker (P3). The branch manager asked a business banker to attend the interview as they deal with different size loans for which the assessment criteria differ. P2 provided the bank's policy document regarding small developer lending with the pre-condition that the document is not to be cited or stored electronically and should only be used as background information. The focus group session was conducted at the branch and recorded as an audio file, later transcribed by the researcher is available in the stored data. The transcribed interview was analysed in NVivo, using a themed coding system. A mind-map created from the themed coding system provides a visualisation of the insights from this interview. This interview was also analysed through consideration of high recurring and high co-occurring codes.

5.4 Data analysis of banks' risk consideration during small developer credit assessment

5.4.1 An overview of the data analysis of research with bankers

The data for this chapter is narrative and was collected and analysed through mixed methods. A mind-map was developed in NVivo for each interview and focus group with bankers from the coded transcripts. The mind-maps set out the two broad categories for each interview:

- The banker's understanding of their bank's processes and the institution's vulnerabilities; and
- The banker's understanding of the awareness of small developers of their risks when applying for a loan.

Sub-sets of nodes are set out in the mind-maps, are further expanded upon in the overview of interview with P1 and focus group with P2 and P3. The mind-maps are not based on high recurring nodes, nevertheless, is intended to visualise themes raised during the interview and focus group. These mind-maps are presented as part of the overview of each of the two sessions.

The highest recurring nodes are represented in an NVivo figure, containing a chart for each session. The main themes indicated in the mind-maps correspond with the graphs' high recurring nodes for each interview. Sub-sets of nodes from the mind-maps are not all represented in the recurring frequency graph. A discussion of the nodes with high recurrence frequencies contextualises the importance of the nodes.

A co-occurrence matrix was developed with NVivo software to explore nodes that frequently co-occur. The coded data from both the interview and focus group were combined to create the co-occurrence matrix of nodes with high coded co-occurrence rates. High co-occurring nodes are presented in a tabled summary and a visual table indicating the levels of co-occurrence in [Section 5.5.1](#).

The research questions were used as the basis of interview questions. A summary of the combined answers of participants to the research questions indicates the findings of the interview analysis and focus group with bankers related to the research questions. The discussion points to what bankers perceive as red flags during the loan application viability assessment process (see [Section 5.6](#)). Table 5.2 (on the next page) summarises the relationship between the research questions and the interview questions. Follow-up questions were asked in addition to the pre-set interview questions to clarify issues raised during the interview and focus group.

Table 5.2: Summary of the relationship between the research questions and the interview questions to bankers

| Interview question | RQ1 | RQ2 | RQ3 | RQ4 | RQ5 | RQ6 | RQ7 | RQ8 |
|--|-----|-----|-----|-----|-----|-----|-----|-----|
| 1. Do you have specific definition criteria for a small developer? | X | | X | | | | | |
| 2. Could you please describe the application process for finance that a small developer would have to follow? | X | | X | | | | X | |
| 3. Do you have products that specifically target small developers? | | | X | X | | | | |
| 4. What would be definite red flags when considering a lending application from a small developer? | X | X | | X | | | | |
| 5. Are there specific regulatory criteria that you would consider during the assessment process? | | X | | | X | | | X |
| 6. Do you find that small developers that move from another financial institution to yours have specific expectations in terms of the application process? | X | X | | | | | | |
| 7. In your opinion, which factors would increase the success rate of loan applications from small developers? | | | | | | X | | |
| 8. Do you monitor the effective use of finance by small developers? | | | | | | | | X |
| 9. Could you discuss the failure/success rate of small developers in their loan applications? | | | | X | | X | | |

RQ1: How do lenders assess the lending applications of small developers?

RQ2: What are the criteria on which lenders base their decision to extend or refuse credit to small developers?

RQ3: Does the small developer's business model influence the lending decision?

RQ4: Do commercial lenders view small developers as a viable business opportunity?

RQ5: What are the regulatory constraints in terms of financing small developers?

RQ6: What is the success rate of credit applications by small developers?

RQ7: What outside advice do small developers make use of during their credit applications?

RQ8: Do lenders monitor the effective use of finance extended to small developers?

5.4.2 Interview with P1

5.4.2.1 Overview of the interview with P1

P1 indicated that their bank “treat all property developers the same – whether they’re small or large... they have to meet a certain standard.” A loan to a mom-and-pop (legal person) developer is usually structured similarly to a mortgage arrangement. When a developer is a company, they are considered for construction loans by Bank 1’s business unit, and these loans are released in progress payments. Construction loans are considered commercial loans. P1 believes that the assessment criteria are the same when applying for a construction loan at different lenders. The value of the loan is not a specific criterion for Bank 1; however, larger banks allocate divide property developers into tiers:

...if you go to NAB or CBA – and I can only speak about them, because I have worked there before – if it is.... over AU\$10m, then it becomes a commercial space...or more of a corporate entity or banner. But it is the all the same loan, all the same criteria. They just put into a category: say business banking is up to AU\$10m, where corporate banking is AU\$10m and more. But actual going about the loan, our requirements – there are no separate products – they are all the same.

Bank 1 only considers property development loan applications from small developers if they have proven experience related to property development and construction, including specific trades experience. If a small developer is inexperienced, they could still submit a loan application but have to contract an experienced person to act on their behalf:

So, if it is someone like a bricklayer or someone in the trade.... We’d more than likely say yeah. But we’d want a contract and we’d like someone else to do it.

Construction management experience is valued by Bank 1, in particular for small building projects where the property developer manages various aspects related to the build, and P1 warned that such experience is essential:

...but even though me being in the finance industry, I’m not in the building industry... it is not as easy as people think!

This bank considers small developers as developers who subdivide land to sell, and developers that construct units to retain or sell. Mom-and-pop developers, who are individuals, are also involved in these development projects, but on a smaller scale.

They are more likely to subdivide the land to sell or construct one or two units at a time for sale. P1 emphasised that purpose for which a loan is applied for is critical to the credit assessment process. The purpose of the loan is discussed with the borrower to ensure that they meet the loan criteria, that they intend to use the loan for development and that the correct product is offered. The purpose of a loan must be clear for Bank 1 to tailor the project's credit arrangement and to provide direction to the assessment process. Bank 1 analyses the purpose of the loan and composes the loan deal accordingly and ensures that it aligns with their bank's policies. When the small developer's business plan indicates that units are to be retained, the bank will discuss the converting these loans to long term finance (mortgage-type finance) with the developer. In such cases, rental income potential will be considered as part of the serviceability criteria. In cases where developments will be sold, the bank will require pre-sales and specific return ratios. Loans used to develop and retain property as an investment will have different requirements for projecting rental income and will have a different LVR.

Both mortgage-type and construction loans are subject to the owner/developer "use [ing] their own money first". Small developers must have substantial capital at their disposal when applying for finance from Bank 1. Upfront costs and civil works are expected to be financed by the borrower. P1 indicated that Bank 1 considers upfront and civil costs to be too varying between projects to finance:

...if you start going up to the escarpment, to the Darling Ranges, like Chittering, it can cost \$50-\$60 000, because it is all granite... That's really to us "dead money". Yes, you need it, because it's for the construction of the house, but it doesn't add any value to the house.

Further, the borrower must have a contingency available, in addition to the capital input required by the LVR covenant in the lending contract. The small developer must allow at least a 15% contingency part of their credit proposal to the bank.

The LVR for property development loan application proposals could differ between companies depending on various factors. These factors could include a positive assessment of their financial position, the assets offered as a security, the details in the building contract and the percentage contingency they have available. If a small developer meets all the criteria of Bank 1 and is viewed as being a low risk, Bank 1 will

issue a maximum LVR of 70:30. In such a best-case scenario, the borrower must create (construct) a verified 30% of the value before bank finance is released. P1 admitted that this is the best-case scenario of an LVR ratio of 70:30 is not always the case, “it may be less... say 60%”, and Bank 1 could hire a quantity surveyor to verify the figures provided by a contractor. Further, the contingency, management fees and interest are not capitalised as part of the loan. P1 argued that novice developers are often surprised by the amount of money they have to lay out to have a development-ready project, before Bank 1 considers their credit application.

While each loan application is considered on its merit, P1 noted that it takes more time to evaluate new clients’ proposals, mainly when they are relatively young companies. The information provided by new clients, even if they have a good credit history, have to be verified by the banker, and this can be time-consuming:

I think, maybe with a small develop, if they are quite new... if they’ve just started off or if it is their second development, it takes a bit more time. But with the big corporations, everything is all worked out and everything is down pat. They will give you what you ask for. Half the time it has been through council...[and] the contracts are in place.

More significant developments may require a quantity surveyor contracted by the bank to assist with determining the initial project value during. Bank 1 does not consider owner-builders as a viable business opportunity. P1 indicated that their bank split the risk between the developer and a contractor. Therefore, the developer’s proposal should include a building contract from a separate building company, and the bank will assess this contract. P1 noted that this risk-mitigating measure does not prevent contractors from cross-financing projects. Small developers often engage larger building companies to complete their projects:

It is all about certainty as well... they know what they’re doing. They’ve got the means and the staff that can do that...So when you’ve got a start and finish date from a large builder, it’s going to in that period of time... Smaller builders juggle between developments... and that’s where you have blowouts.

The small developer must demonstrate a thorough understanding of the development and construction processes and monitor their contractor to avoid cross-financing of projects. Sufficient value must be created for releasing progress payments at specific threshold phases of the loan. Bank 1 recommends to small developers that they enlist the services of reputable contractors.

Small developers in the Western Australia (WA) market find pre-sales in lending contracts hard to achieve, as buyers “are not used to buying off the plan [and]...want to see the finished product” (P1). Even so, P1 insisted that pre-sales are important to the bank:

...banks aren't sure whether they are going to get their money back, and they can only make that kind of assertion if they've got the pre-sales.

P1 indicated that home-buyers in the WA market are nervous to buy “off the plan”, as the property market has been fluctuating since the GFC.

Bank 1 follows a strict assessment regimen and requires all the financials of a small developer. This assessment could include the credit profile, the position of the guarantor, private accounts of directors, securities, existing mortgages etc. The bank may also assess the financial strength of the contractor to be engaged. A surveyor, accountant or quantity surveyor could be employed by the bank to assist with assessing the application, depending on the size and complexity of the project. This bank considers the business model of the small developer and the returns. P1 admitted that small developers have to be substantially financially literate or use specialists like accountants to tweak their business models. Inexperienced small developers may have to consider tax specialists, as GST and capital gains tax can substantially impact the small developer's cash flow. Some property developers use a broker, but Bank 1 “ask for a whole lot of information”, and going through a third party for a property development loan complicates the process.

An area risk rating system is employed by Bank 1, and they monitor the risk ratings of these areas continually. Oversupply of a specific product in an area could result in the refusal of a loan application:

...but just past Rockingham the prices have just plummeted. There is an overstock of units there, they can't be sold... rent had to come down as well.

The proximity of a development project to good public high schools, infrastructure (freeways and train stations), and work opportunities may be considered in the risk rating of a specific area:

...everybody wants to get into Rossmoyne... there's high demand because of the school and more than likely these will have pre-sales.

In some rare instances, Bank 1 considers financing ground-breaking developments based on a unique development model proposed by the small developer. They use such projects as flagship projects for marketing purposes. The sale of existing homes (second-hand stock) in affluent areas during economic downturns could skew the price statistics in these areas, and Bank 1 corrects for this when considering the area risk rating during loan applications.

Bank 1 has a maximum lending period of 2 years for construction loans, upon which the facility expires. The bank may informally extend the loan period if the project is near completion (minor works outstanding like landscaping and cabinetry) without negotiating a new contract or rolling over the loan. The current success rate (in 2019) of small developer loan applications is around 1 out of 10, compared to around 2014, where about half of the loan applications would be successful. Bank 1 is also dependent on its credit department on the east coast of Australia, which is somewhat averse to the market in WA (P1).

Figure 5.1 (on the next page) represents the frequency of coded themes (nodes) of the NVivo analysis of the interview with P1. The mind map provides a visual overview of P1's explanation of the credit assessment process of Bank 1 as well as their understanding of the risks to small developers and the risks in lending to small developers. Three main themes of the coded interview were *Bank processes*, *Client's risk awareness* and *Use of non-bank finance*. Themes coded as sub-nodes under *Bank processes* indicated in the distribution hierarchy were *Assessment process*, *Bank risk appetite* and *Lending contract*. Sub-nodes to *Client risk awareness* were *Ineffective limited liability*, *Experience* and *Use of specialists*. *Contingency* and *Use of own capital upfront* were sub-nodes to *Use of non-bank finance*. Nodes with low coding frequencies were included in the mind-map.

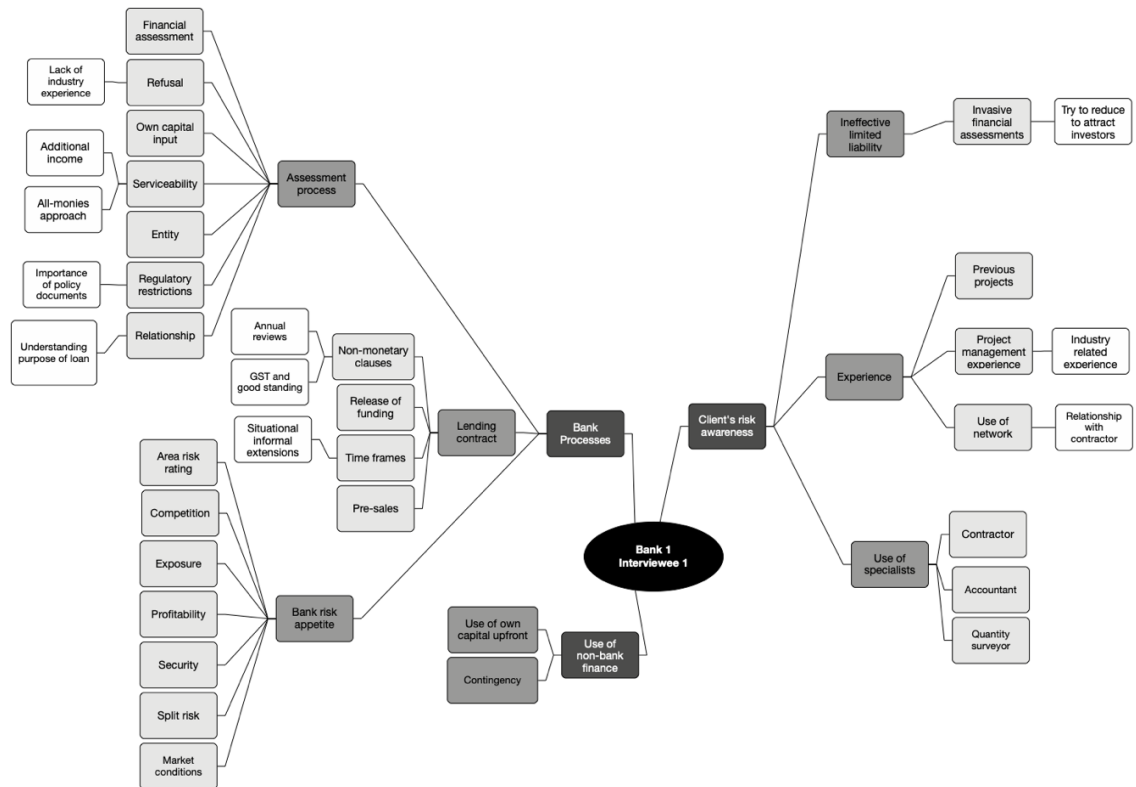


Figure 5.1: Mind-map from interview with P1

5.4.2.2 Discussion of high recurring nodes of interview with P1

While the mind-map of the interview with P1 provides an overview of all themes coded, the coding frequency of the interview with Bank 1 indicates themes raised with higher frequency. While frequency is not indicative of the importance of a node (Illia et al. 2014), it provides a starting point to identify key risk factors during the credit assessment of small developer loan applications.

The node with the highest recurrence, *Bank processes*, was coded with high frequency as P1 referred to all their actions, assertions and decisions related to the credit assessment process within the framework of the processes set out by their bank. This node was followed in recurrence frequency by the *Assessment process*, the topic of the research, and *Bank risk appetite* to small property development credit.

The *Assessment process* forms one branch of the investigation into the viability of a loan to a small developer. The *Assessment process* of Bank 1 includes various tests and examines the intended use of the loan in detail. Bank 1 will consider the amount of

capital that a client has available. The *Own capital input* (shared fifth-highest recurring node) of a client, which will cover the upfront costs, civil works cost, and satisfy the loan-to-value is appraised during the *Assessment process*. A financial assessment (shared 13th highest recurring node), is conducted to form an overview of the small developer's financial position. The type and structure of the *Entity* (shared 15th highest recurring node) is evaluated and the purpose for which the loan will be used is examined. Bank 1 also considers the *Profitability* (shared 24th highest recurring node) of the proposed project. The *Serviceability* (shared 15th highest recurring node) potential of the client is determined through various aspects of the *Assessment process* and is the outcome of the Assessment process. An *All-moneys* approach (shared 24th highest coded node) is used by Bank 1 to assess the company's finances and their small developer client's personal finances. Additional incomes that could be used to service the loan are considered in the *All-moneys approach*.

The *Bank['s] risk appetite* for loans to a particular market segment could increase the stringency of the assessment process or could be a deciding factor in whether a loan application will be considered. P1 considers their *Bank risk appetite* against their current *Exposure* (shared seventh-highest recurring node) and the potential of an increase in *Exposure* by entering into a lending agreement with a particular client. Current *Market conditions* (shared ninth-highest recurring node) are considered and an *Area risk rating* (shared 15th highest recurring node) is determined. The *Area risk rating* weighs the current development activity and economic activity around the proposed location of the development. The distance from the city centre and access to public infrastructures like schools, train stations, main bus routes and freeways affect the *Area risk rating*. This bank does not enter into loan agreements with owner-builders and Split [the financial] risk with [a] separate [construction] contract (12th highest recurring node). They suggest that property developers engage a reputable Contractor (shared 24th highest recurring node). Bank 1 will evaluate the construction contract and engage in the Use of specialists (shared 13th highest recurring node). Bank 1 may engage external services of a *Quantity Surveyor* (shared 21st highest recurring node) if the construction value is over a pre-set threshold. The bank will also assess the quality of the *Security* (shared 15th highest recurring node) that will be provided to secure the loan as part of determining the *Bank['s] risk appetite* for engaging in a lending transaction for a specific project proposal. During economic downturns, the

Competition (shared 21st highest recurring node) for access to small property development loans is high. Bank 1 may impose additional assessment criteria to ensure that they engage with high-quality borrowers and reduce their potential exposure to loss. These criteria could be relaxed when the economic condition improves and competition for clients increases.

The *Lending contract* (shared fifth-highest recurring node) is the document for the legal agreement for finance between the bank and the client upon a positive outcome of the bank's assessment of the client's serviceability potential and their own risk exposure. Clauses contained in this contract are used to monitor the financial position of the borrower and these clauses are the outcome of the lending-risk perception assessment of the bank. *Non-monetary clauses* (shared ninth-highest recurring node) in the contract are used to monitor the financial position of the borrower and these clauses can vary depending on the risk perception assessment of the bank. A *Pre-sales* (shared 15th highest recurring node) requirement in Bank 1's lending contract is a market test that has to be met for finance to be released. Once all the tests in the lending contract are met, the staged *Release of funding* (shared 15th highest recurring node) commences with specific benchmarks throughout the construction process. The *Timeframes* (shared 21st highest recurring node) for which the finance will be available, repayment dates and penalties are indicated in *the Lending contract*.

A high recurrence of the node *Risk awareness* indicates the banker's awareness of their client's risks in borrowing and securing a loan. *Experience* (shared seventh-highest recurring node) was coded as a sub-heading to the *Risk awareness* of a small developer client. The bank considers the *Project management experience* (shared ninth-highest recurring node) and track-record of successful and completed *Previous projects* (shared 24th highest recurring node) while assessing a small developer's *Experience*. Figure 5.2 (on the next page) summarises the nodes with the highest coding frequency of the interview with P1.

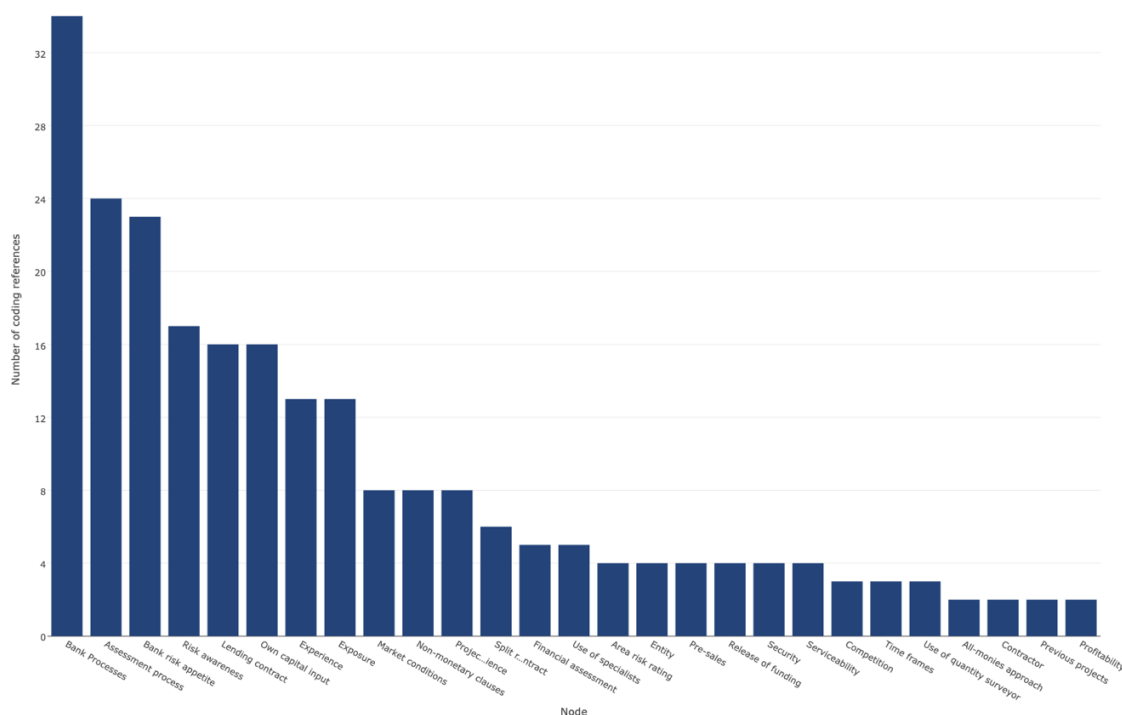


Figure 5.2: Coding frequency of nodes from interview with P1

5.4.3 Focus group with P2 and P3

5.4.3.1 Overview of focus group with P2 and P3

P2 and P3 have extensive experience in the banking industry. They noted that, from their experience, the global financial crisis (GFC) had a critical impact on the availability of finance for small developers, as most lenders re-evaluated their exposure to the property market. P2 indicated that the small property development market segment has not entirely recovered, and have declined in WA:

...[small property development] definitely has dropped off over the recent years and I assume it is because of the property market in WA.

According to P3, Bank 2 included more stringent information requirements and additional lending criteria around experience. These additional criteria were implemented due to the volatility of the local property market and Bank 2's national over-exposure to property development.

But we've had higher restrictions as well... If they didn't have experience, that's a big red flag. We wouldn't entertain that... we've developed our own spreadsheet... So we

basically input all the details of the project... it gives us a cash flow in great detail. But at the initial stage, it actually tells us whether the information [provided by the small developer]... satisfies our conditions and our policies.

Further, P2 noted that regulatory restrictions around investment lending and the government's curbing of interest-only lending have reduced avenues available for homeowners to purchase new properties:

We have basically said we won't do it. We're not doing any more new [interest-only and investment-type] lending, but now that's stopped for us as well [and all other banks]... the regulator said they want to reduce interest only lending and investment lending. The restrictions that they have put in place has definitely had a bit of a hangover. It's definitely dampened the enthusiasm.

Based on their projections for a declining market for new property, Bank 2 have had only a few property development loan applications and have not approved many of these.

In addition to regulatory restrictions and the complexity of property development, many lenders introduced specialist property development teams for developments over AU\$10 million and will finance these developments first. Further, developments on the east side of Australia would take preference, and this means that less financing is available for small property development, particularly small property development in Western Australia.

P2 and P3 clarified that they categorise property developers in tiers against the upper limit amounts of loans values. They also explained that they follow a strict process, in line with bank policies, when evaluating the viability of lending to a particular small developer. At the time of the focus group session, the mom-and-pop tier was capped at AU\$200 000, and the small developer category for the definition of a small developer was capped at AU\$3 million.

To qualify for a loan in the mom-and-pop tier, the borrower cannot be an entity and the development has to be residential up to a maximum of four units. These loans are usually mortgage-type loans, and Bank 2 has a small business banking team that specifically looks after loans between AU\$200 thousand to AU\$750 thousand.

I [P2] deal with consumer customers... [who borrow] less than AU\$200 thousand... there is a small business management team that looks after AU\$200-750 thousand... They wouldn't be doing much in the way of development... because it is complex.

P3 has business banking customers who borrow over AU\$750 000, and small developers who borrow from Bank 2 are mostly residential developers. According to P2, business banking customers are businesses:

...as soon as the borrowing entity is a company or a trust or a partnership or anything else other than an individual that comes to business. And to be fair, most property development would be complex and come through business.

The lending arrangements of business banking customers are more complex and requires a structured and tailored credit deal. While Bank 2 finances land acquisitions, they pre-determine the total development cost they are comfortable in terms of small developer lending.

Loans under AU\$200 000 carry an LVR of an 80:20 loan to capital, as the total loan amount is lower for this category of loan and thus not considered a high-risk loan by Bank 2. This ratio may be extended to loans up to AU\$1 million, where the borrower is an individual. According to P3, for loans to business entities up to AU\$3 million, the capital input has a minimum requirement of 25%, and the capital input requirement for loans over AU\$3 million is 30%. These ratios are dictated by Bank 2's property development policies (per tier) and details the costs which can be included in the overall loan amount, but this could vary between loans, depending on the bank's risk perception.

So, these are the maximums that the bank would went for each development, but what we're talking about is that that percentage is of what we're calling the total development cost.

Bank 2 rarely finance owner-builders, as they prefer to split the risk of the development with a separate construction contract contained as part of the lending contract. Owner-builders are considered higher-risk borrowers. P2 noted that higher equity is required from owner-builders as well as detailed costings:

...we would normally only lend 65% to owner-builders... generally, owner-builders take longer, they are normally involved in the industry, and therefore they do it on weekends... and we also make sure that owner-builders complete costings and this is

before the transaction... [owner-builders must provide] detailed estimates and the cost and provide quotes.

The bank will carefully consider an owner-builder's loan application, but P3 was sceptical about whether an owner-builder is a viable business opportunity:

We try and avoid owner-builders if we can. We do do them if we have to, but it is not our choice to deal with owner-builders.

Small developers must demonstrate previous experience, through completed projects to a similar complexity and scale of their new project proposal to Bank 2. P3 noted that the cost related to acquiring a new client is inherent to the process. The time and cost of assessing a new client's viability cannot be directly passed on to the new client, and it usually forms part of a loan origination fee if the loan is approved and is included in the cost of the loan to the borrower.

So, we have an interview with a prospect. The first thing we do is research that and do analysis... I mean, the bank doesn't get paid for the hours and hours.

P3 indicated that each project is assessed individually for loan viability, and Bank 2 will not issue one loan to cover more than one development. Bank 2 also assesses projects of the same company as individual projects and has controls in place to try to prevent developers from cross-financing projects. The bank uses external specialists like valuers to verify completion stages for draw-downs, outlined in the lending contract, which includes the building contract. P2 noted that a draw-down system is followed, which releases portions of the loan at specific stages of construction, which affords them the ability to monitor the effective use of finance.

Well, they're always assessed individually... we go through a very strict process to get the deal approve in the first place. And then once it's approved and once the project starts, there is a very strict process in place each time we need to do a draw-down.

Bank 2 follows an all-moneys approach, and P3 pointed out that all possible income streams are appraised:

... it is beneficial if they have the financial capacity. So, in other words, it might not be their main source of income. They might be a developer... you know, it is quite common for families... we've got a few families that are basically developers, but a few members of the family have got real jobs as well – if you know what I mean.

The serviceability of the loan is based on the provable income of the applicant, scrutinised through an extensive financial assessment, through a series of financial tests. Bank 2 has developed its own tool of financial ratios and considers these their own intellectual property. These tests and ratios give the bank an initial overview of the potential success of a loan application in terms of satisfying the bank's policies before the application is submitted to the bank's credit department. P2 noted that this serviceability assessment process makes it difficult for retirees, to secure a loan with an income from only assets or capital investments.

The financial assessment is complex and invasive and can vary, depending on the model proposed for the property development project. If the development involves retaining units, the small developer must demonstrate the likelihood of achieving market-related rental income. The projects overall feasibility plays a role in the decision of the banker to submit a credit application to their credit department. However, the profitability could be weighed against the small developer's previous successes and experience, depending on individual circumstances. P3 noted that returning customers would be familiar with Bank 2's requirements for the viability assessment and will more likely submit better proposals based on previous experience. In addition to the own capital input of the small developer, the bank requires that the developer has a minimum of a 5% contingency available. P3 noted that Bank 2's financial assessment tool is helpful for bankers to be able to give developers a clear indication of the potential success of a lending application to the bank's credit department:

But this is a really complex document that takes a lot of time to prepare, but this is what we got. But it saves me during an application, and [P2] knows how much work goes into an actual credit application. So, if I did this first, this would tell me whether I could progress with an application or not.

P2 noted that monitoring mechanisms in loan contracts include non-monetary covenants. These are used to evaluate the continued serviceability potential of the borrower and the bank's exposure during the loan period. Annual reviews are conducted and the project progress, market changes, the small developer's financial position, information from the ATO and any other specified contractual stipulations are re-evaluated. The bank may use accountants to verify the information provided. If any

criteria relating to the monitoring mechanisms are not met, this may effect changes to the lending contract.

...what we do is, 12 months from the [first] draw-down, we do an annual review... we look at everything again and make sure it is on track. And if there's things that they're not meeting... we'll have to write and say we need to make changes to the contract.

Lending contracts under AU\$200 000 could be excluded from the monitoring mechanisms, but depends on the contract's complexity.

Further to monitoring mechanisms, the loan contract of a small developer includes a pre-sale market test. This test applies if the developer plans to construct five or more properties, units or titles. The pre-sales requirement is based on the overall project value and could be a specified number of units or a percentage of the total loan value. P3 indicated that the pre-sale requirement has led to various repeat customers of Bank 2 only ever constructing a maximum of 4 units as this number of units don not trigger a pre-sales clause. Bank 2's participants admitted that the pre-sale requirement has been challenging for small developers to achieve during economic downturns. Further, in tough economic times, the pre-sale test may not be a reliable market test, as bank approvals for these pre-sales often lapse:

They are so hard to enforce because, you know, as soon as you commit to buy in one of my completed developments, and I require them [the buyer] to pay a 5% deposit, but if the project is not completed in time and there's all sorts of get-out clauses in the pre-sales. So... it's actually not... uncommon for pre-sales not to proceed... Obviously, someone's circumstances – the average development takes... 12 to 18 months – so, a lot can happen in that time. So, [a bank] may have a pre-approved loan, but if [the buyer's] circumstances change, his bank won't revisit the approval (P2 and P3).

P3 admits that pre-sale requirements can cause massive delays to construction timeframes as the bank will not release the financing until the pre-sale requirement is reached. Delays may lead to the borrower having to negotiate extensions to the loan period with the bank, which is not ideal for the small developer or the bank as exposure to the risk of default increases. The exit clauses related to pre-sales, applying to a buyer who cannot get a loan at the time of completion, can deter buyers. Buyers could lose the deposits that they had paid or be liable for interest on the purchase of the unit until it is sold to someone else. Time delays and lack of further sales can be catastrophic to the small developer's cash flow, as peak debt is reached near the completion of the project,

which is also the period of peak interest. Bank 2 allows small developers to capitalise only a portion of their interest, which means an extensive delay in construction will require the small developer to use their own capital to cover the interest during peak debt. Both participants noted that at least one of their previous employers (one of the big four banks) had similar lending criteria, financial assessments, pre-sales and non-monetary clauses in lending contracts.

The participants explained that a current second-tier lender (an insurance company, branching out to small property development credit) has been competitive in the Perth market. This lender does not require pre-sales. The lack of a pre-sales requirement may be due to inexperience of this second-tier lender, or it may be a strategy to build their property development financing business. P3 believes that Bank 2 could offer more competitive interest rates, but developers would consider the time delays caused by the lack of pre-sales in their own risk evaluations.

...we lost a bit of business... I don't know if you know that RAC, they're involved in the property development market... But in this segment [small property development lending] they do not take pre-sales into consideration. But that was a big enough incentive for my borrower to go and do a few developments with them.

Based on the coding frequency, Figure 5.3 (on the next page) provides a visualisation of the interview with the participants from Bank 2. The nodes represent their explanation and understanding of the credit assessment process that Bank 2 follows when considering lending applications from small developers. Similar to the mind-map of the interview with P1, the three main themes of the coded focus group session with P2 and P3 were *Bank processes*, *Client's risk awareness* and *Use of non-bank finance*. Themes coded as sub-nodes under *Bank processes* indicated in the distribution hierarchy were *Assessment process*, *Bank risk appetite* and *Lending contract*. Sub-nodes to *Client risk awareness* were *Ineffective limited liability*, *Experience* and *Use of specialists*. *Contingency* and *Use of own capital upfront* were sub-nodes to *Other financier*. Nodes with a low coding frequencies were included in the mind-map.

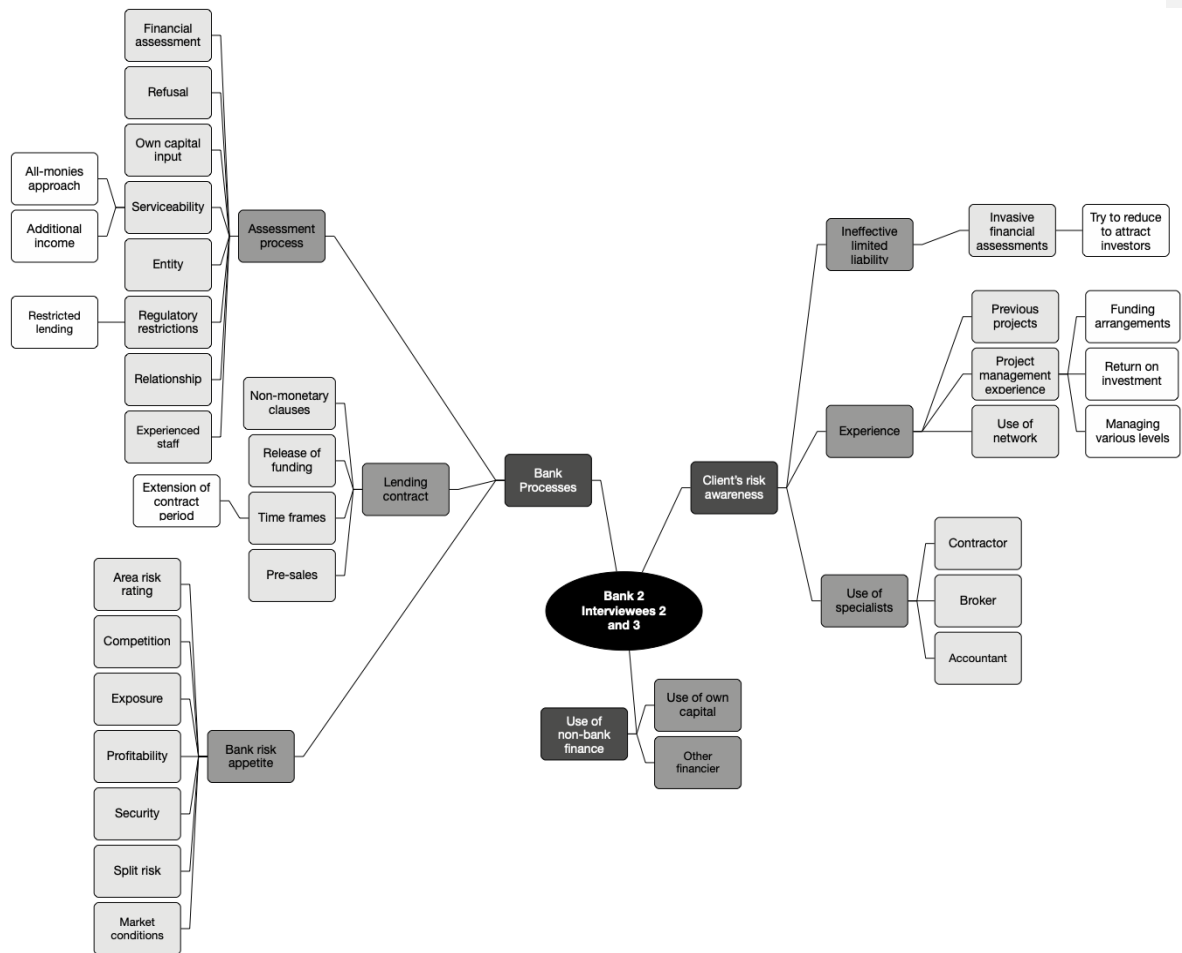


Figure 5.3: Mind-map from focus group with P2 and P3

5.4.3.2 Discussion of high recurring nodes of focus group with P2 and P3

The coding frequency of the focus group with the two employees from Bank 2 is was analysed in NVivo software. The 25 highest recurring nodes are indicated in the graph at the end of this discussion.

Bank processes were the highest recurring node in the coding frequency analysis. P1 and P2 described their reasoning behind lending decisions and assertions against the framework of Bank 2's processes, which are often dictated by policies. *Bank processes* were followed in recurrence frequency by the *Assessment process* and *Bank risk appetite* to small property development credit.

Like Bank 1, Bank 2's *Assessment process* forms one branch of the investigation into loan viability. *Regulatory restrictions* (shared sixth-highest recurring node) can

influence the *Assessment process* and assessment criteria. Bank 2 participants noted that *Regulatory restrictions* have to lead to more stringent assessment criteria for loans. P3 indicated that the borrower's *Entity* (shared eighth-highest recurring node) could affect the *Assessment process*, and those complex entities require additional reviews. Both participants noted that *Experienced [banking] staff* (shared 11th highest recurring node) could affect the *Assessment process*. *Experienced staff* will be familiar with *Bank processes*, policy documents and factors that could potentially influence the success of small developer loan applications. The *Own capital input* (shared 11th highest recurring node) of a property developer is essential to satisfy *LVR requirements*. Often the initial project development and approval stages and the contingency cannot be capitalised as part of the loan, and a small developer's *Own capital input* must cover these items.

Bank 2 considers the *Serviceability* (shared 15th highest recurring node) of the small developer and conduct a thorough *Financial assessment* (18th highest recurring node) to determine the *Serviceability potential*. Building a banking *Relationship* (shared 21st highest recurring node) with clients is vital for Bank 2 as this assists them to build a profile of a client. Bank 2 indicated that while new business can be significant, the assessment of a new client carries an inherent cost to the bank. Small developer clients must prove that they have an *Additional income* (shared 24th highest recurring node) other than property development projects. This bank follows an *All-moneys approach* (shared 24th highest recurring node) and evaluates incomes from outside business partners' business in their serviceability assessment.

Bank risk appetite of Bank 2 has changed after the global financial crisis. The over-exposure of Bank 2 to the property development market and subsequent repercussions for loan approval rates was a high recurring theme. Banks' *Exposure* (fourth-highest recurring node) is monitored closely as part of the *Bank risk assessment*. *Market conditions* (shared eighth-highest recurring node) dictate the lending amount to the property development sector. The *Profitability* (14th highest recurring node) of projects to be financed becomes more important during economic downturns and the projections of property developers are carefully considered against market-related selling prices and lease agreements. Increased *Competition* (shared 15th highest recurring node) allows lenders to choose the most suitable investment projects to finance during periods when lending is restricted. Lenders further mitigate their risk and *Split [the financial] risk*

with [a] separate [construction] contract (shared 19th highest recurring node) between the property developer and contractor.

The *Lending contract* contains contractual clauses, which considers changes to the economic environment of the property development sector during the loan period. Using *Non-monetary clauses* (shared 11th highest recurring node) in the *Lending contract* dictates the terms for ongoing assessments and remedies for the breach of the conditions of the clauses. *Non-monetary clauses* can relate to contractual conditions relating to Pre-sales (shared 15th highest recurring node). The *Cost of borrowing* (shared 19th highest recurring node) and *Time frames* (shared 21st highest recurring node) for the credit period and conclusion is indicated in the *Lending contract*. Clauses in the contract will indicate stipulations around the *Release of funding* (23rd higher recurring node) and the requirements thereof.

The *Client's risk awareness* (shared sixth-highest recurring node) of a borrower is addressed by assessing the small developer's *Experience* (shared eighth-highest recurring node). Bank 2 only considers property developers who have delivered successful projects. Figure 5.4 (on the next page) presents a summary of the highest recurring coded nodes of the focus group session.

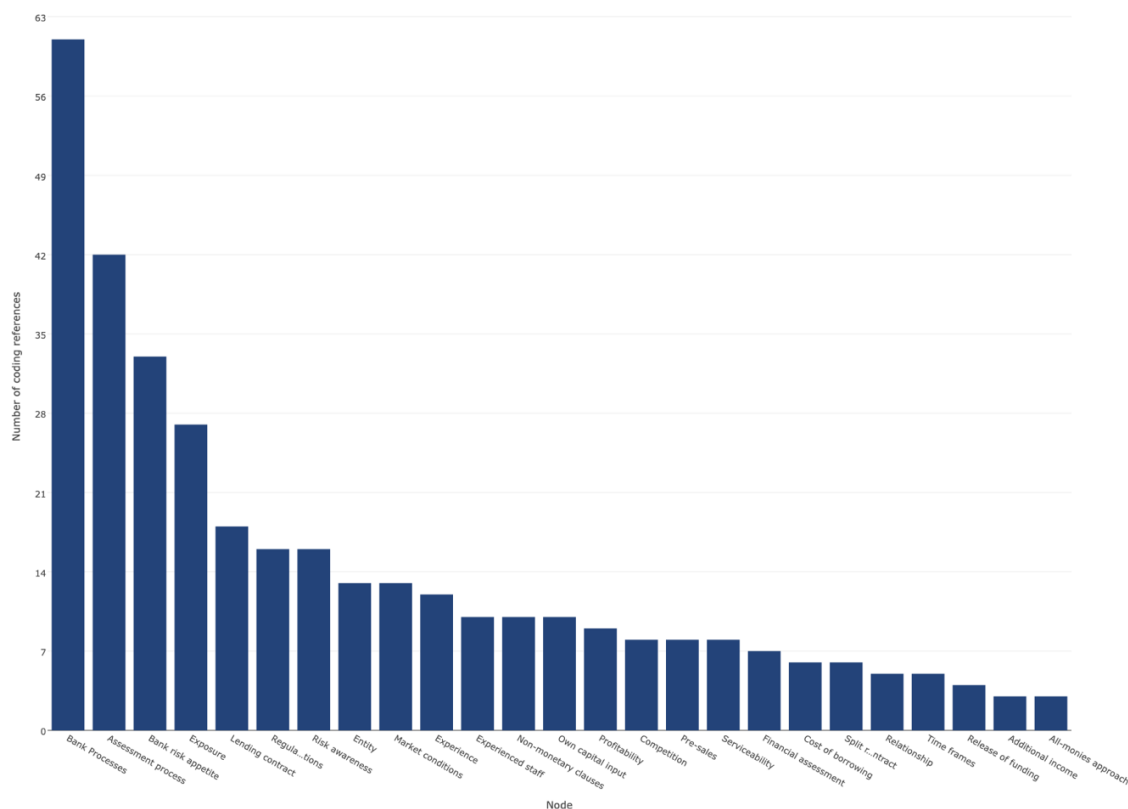


Figure 5.4: Coding frequency of nodes from a focus group with P2 and P3

5.5 Co-occurrence matrix analysis of banks' risk considerations during small developer credit assessment

The mind-maps developed for the interview and focus group session provide a visualisation of frequent themes discussed by participants, while the recurring frequency of codes indicates the number of times a theme was coded. While these two narrative analysis strategies provide valuable data regarding the interview structure and the relative importance of themes, they do not indicate the links between nodes. A co-occurrence analysis systematic and transparent analysis method and allows the visualisation of the results for interpretation. The co-occurrence matrix function in NVivo analyses the frequency at which nodes have been coded simultaneously, highlighting nodes with meaningful relationships with other nodes (Illia et al. 2014).

5.5.1 Summary of results from the co-occurrence matrix of banks' risk consideration regarding small developer credit

The co-occurrence of nodes was analysed in NVivo by combining interview and focus group coded data. Co-occurrences over 40 times are considered a high co-occurrence frequency, and co-occurrences between 20 to 39 times are indicated as a medium co-occurrence rate. When nodes co-occurred between 10 to 19 times, the co-occurrence rate was indicated as low. Co-occurrence rates under ten times have been omitted from the summary as these co-occurrences were considered negligible.

The nodes with the highest co-occurrences with other nodes of the combined coded data from the interview and focus group with banks were *Bank processes*, *Assessment process*, *Bank risk appetite*, *Lending contract* and *Risk awareness*. *Exposure* was not identified as having a high co-occurrence rate with all nodes but had a remarkably high co-occurrence rate with *Bank Processes*.

The node *Bank processes* has the highest co-occurrences with the nodes *Assessment process*, *Bank risk appetite* and *Exposure*. *Own capital input*, *Market conditions*, *Lending contract*, *Risk awareness* and *Experience* has a medium co-occurrence frequency with *Bank processes*. *Entity*, *Experienced staff*, *Financial assessment*, *Regulatory and policy restrictions*, *Serviceability*; *Competition*, *Split risk with [a] separate contract* and *Profitability* had a co-occurrence rate of between 10 to 19 times.

The *Assessment process* has a medium co-occurrence rate with the nodes *Own capital input*, *Bank risk appetite*, *Exposure*, *Lending contract* and *Risk awareness*. The nodes *Entity*, *Financial assessment*, *Regulatory and policy restrictions*, *Serviceability*, *Split risk with [a] separate contract*, *Non-monetary clauses* and *Experience* has a low co-occurrence rate with the *Assessment process*.

The co-occurrence matrix indicated a medium co-occurrence rate of the node *Bank risk appetite* with the nodes *Assessment process*, *Exposure*, *Market conditions*, *Lending contract*, *Risk awareness* and *Experience*. *Own capital input*, *Serviceability*, *Profitability*, *Split risk with separate contract* and *Pre-sales* had a low co-occurrence rate with *Bank risk appetite*.

The node *Lending contract* had co-occurrence of between 20 to 39 with *Bank processes*, *Assessment process* and *Bank Risk appetite*. *Own capital input*, *Exposure*, *Non-monetary clauses*, *Pre-sales*, *Risk awareness* and *Experience* had low co-occurrence rates with the *Lending contract*.

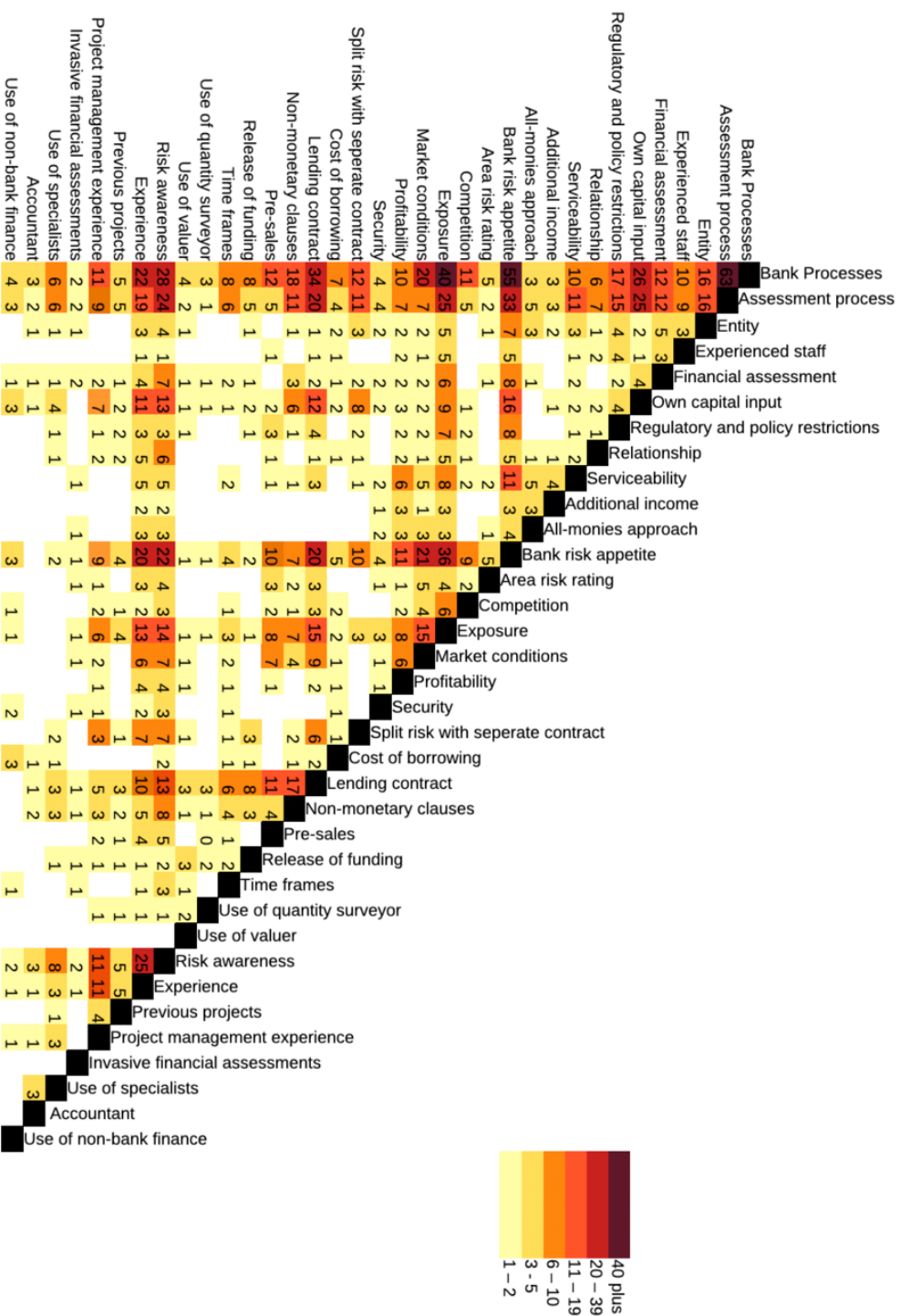
Risk awareness co-occurred between 20 to 39 times with *Bank processes*, *Assessment process*, *Bank risk appetite* and *Experience*. This node had co-occurrences of between 10 to 19 with *Own capital input*, *Exposure*, *Lending contract* and *Project management experience*.

The matrix structure used to analyse the co-occurrence frequency of nodes produce double co-occurrences. For example *Bank processes* have a high co-occurrence rate with *Assessment process*, but *Assessment process* also has a high co-occurrence rate with *Bank processes*. To avoid repeating co-occurring nodes in the summary, only the highest co-occurring nodes are recorded in Table 5.3 below. Table 5.4 (on the next page) indicates which nodes have co-occurrences with other nodes.

Table 5.3: Summary of banks' risk consideration regarding small developer credit assessment co-occurrence matrix analysis

| 40+ co-occurrences | 20 – 39 co-occurrences | 10 – 19 co-occurrences |
|---------------------------|-------------------------------|-----------------------------------|
| Bank processes | Own capital input | Entity |
| Assessment processes | Market conditions | Experienced staff |
| Exposure | Lending contract | Financial assessment |
| Bank risk appetite | Risk awareness | Regulatory restrictions |
| | Experience | Serviceability |
| | | Competition |
| | | Split risk with separate contract |
| | | Profitability |
| | | Non-monetary clauses |
| | | Pre-sales |
| | | Project management experience |
| | | Policy restrictions |

Table 5.4: Matrix of high co-occurring nodes from interviews with banks



5.6 Discussion of bankers' key risk considerations during small property development credit assessments

5.6.1 Tiers of small developers

During the interview and focus group conducted with the two banks, bankers noted that they divide property developers into tiers to assess their applications appropriately. From Bank 2's perspective, monetary thresholds regarding the loan value, as well as the type of entity applying for the loan, are the criteria that are used to divide small developers into the following categories:

- Mom-and-pop developers
- Small developers
- Larger developers

While the monetary value ranges for these tiers can differ between lenders, both banks' participants agreed that the first group is usually financed through mortgage-type arrangements (P1 and P2). These are long-term loans that are similar to consumer loans for the purchase of a home. Mom-and-pop developers usually exit these loans once they have completed a subdivision or built a second dwelling on their property and have sold one of the sections or dwellings. Mom-and-pop developers are considered naive and unsophisticated lenders who are individuals. Lenders do not place the same reporting and monitoring burden on them as they would for the second tier or group considered small developers. However, both banks require detailed costings for construction and often the property itself is used as security. A key consideration for both banks is the purpose for which the loan will be used, and mom-and-pop developers are required to explain the purpose of the finance in detail during the credit viability assessment process.

Both Bank 1 and Bank 2 consider the second group to be complex lenders who are business or commercial banking clients. The value of the loans is substantially higher and can range between lenders. Bank 1 noted that their business banking unit deals with construction loans up to the value of AU\$10 million. Bank 2 indicated that mom-and-pop developers could apply for loans up to the value of AU\$200 000, while small developers apply for loans ranging from AU\$200 000 to AU\$3 million. Loans above the AU\$3 million mark are not considered small property development loans by Bank 2.

These larger loans could also be dealt with by a completely separate property development department of a bank, instead of the general commercial loan division, depending on the proposal's complexity.

Evidence from the interview and focus group session with banks indicated that it is challenging to include small developers as a category in the ABA small business definition for similar reasons as identified by bankers during the FSRC Round 3 Hearings. Nevertheless, the banks interviewed use an all-moneys approach when assessing the serviceability potential of a small developer, and this approach is based on the ineffective limited liability characteristic of small businesses.

5.6.2 A separate building contract splits the financial risk

Both banks interviewed do not often consider owner-builder developers. Owner-builder developers may lack the construction experience and property development experience to complete their projects successfully. Further, owner-builders carry the entire cash flow of the build. Participants from both banks noted that insisting on a separate contractor is a risk-mitigating measure for the bank, and this arrangement splits the financial risk between the property developer and the contractor.

Finance for construction loans are released in stages (after the work has been completed), and during the construction process the contractor will carry the cost of the build to a specific completion point. The small developer will present the contractor's invoice to the bank as part of their claim, and the bank will confirm the completed work and process the payment from the loan (P1 and P2). Therefore, the property developer does not carry the entire cash flow of the build, and the contractor forward-funds the build.

5.6.3 Second-tier commercial lenders in the property development market

Participants from Bank 2 noted that a second-tier lender (an insurance company branching into small property development finance), is popular with small developers in Western Australia. Bank 2's clients indicated that the reason is the lack of a pre-sales requirement in the lending agreement this second-tier lender. While Bank 2 was still optimistic that they could offer finance at better interest rates, they admitted that second-tier commercial lenders are increasingly competitive.

Participants from both banks explained that pre-sales are not a regulatory requirement and that lenders use pre-sales as a market test. Bank 2's participants noted that the pre-sale test is unreliable during market volatility and economic downturns and that pre-sales are extremely hard to achieve. The reason for its unreliability is that a client purchasing a house or unit in a development project may be approved for a mortgage at the pre-sale stage, but their financial circumstances may change during the construction period. A change in personal or financial circumstances could lead to a rejection of their mortgage application when the project is completed. Bank 2 participants indicated that many pre-sale contracts contain ominous clauses that could include the loss of a deposit paid, additional advertising costs to sell the pre-booked property or a financial loss if the property is sold for less than the original pre-sale contract.

Both Bank 1 and Bank 2 participants indicated that they had approved minimal loans to small developers since the GFC. Both banks noted that their branches on the East Coast of Australia are preferential property development finance lenders, and Bank 2's branches in Western Australia have only received money for lending to small developers in early 2019 again. The economic downturn and property market volatility have played a part in both banks' perception of small property development as high-risk lending and have tapered their appetite for lending to small developers.

5.6.4 Large builders are involved in the small property development market

Field notes from signboards in "hot-spots" for small infill developments in Perth, Western Australia, indicated that many small developments were being managed and built by large, often multi-national, property developers. P1 noted that the requirement of lenders for a reputable contractor to build a small developer's project drives this phenomenon.

Using a large home building company could be a more expensive route for first-time developers, established small developers or investors. The attraction is the financial capacity, project management capabilities, the certainty around construction completion dates and the overall process clarity provided by large contractors. In addition to this, large companies have access to the market through their websites and advertising, which increases the chances of small developers or investors to obtain pre-sales for their developments. Large home-builders have the financial capacity to carry the phased

release of the loan and are experienced in managing the cash flow process of the build (P2). The effect of this inter-dependent relationship on the existence and viability of small developers that manage their own projects could warrant future research.

5.6.5 Goods and services tax (GST)

Both Bank 1 and Bank 2's participants noted that mom-and-pop developers sometimes avoid paying GST on their property transfers. Bank 2's Participants noted that they encouraged small developers to have a GST's impact on their cash flow. Neither bank interviewed allows capitalisation of GST as part of the property development loan and cautioned that small developers often get caught out by the way GST is transferred on new properties.

5.6.6 Exposure and serviceability

Both banks interviewed indicated that when a bank has money available for lending, the bank conducts its risk assessment based on the bank's exposure and serviceability potential of the small developer loan applicant. Bank processes, mainly where bank policies support those processes, helps to ensure that lenders comply with regulatory obligations. Regulatory obligations related to provisioning and over-exposure to a specific market segment are contained in the bank policies. Both banks mitigate their exposure to loss regarding a specific credit contract through detailed terms in the credit contract.

The participants from both banks indicated that their bank's risk appetite is linked to market conditions. Lenders consider the amount of money that it has available to lend to a specific market segment against their overall exposure. While property development could be a profitable avenue for investment, lenders keep a watchful eye on this market segment by monitoring of the creditor's financial position throughout the contract. The monitoring mechanism of the borrower's financial position and changes in market conditions are non-monetary covenants in the credit contract. Progress payment milestones ensure the borrower creates value before payment is made.

If market conditions change, non-monetary covenants may be breached, and this could lead to unilateral variations to the credit contract terms, like a change in the interest charged or an additional capital input requirement to satisfy the LVR. The interview and

focus group session with lenders confirmed that the assessment process of small property development lending applications is stricter during tough economic times and that lenders have made a concerted effort to reduce their exposure to the property market after the GFC and in line with evidence given during the FSRC Round 3 Hearings.

Determining the ability of a small developer to service the loan during the first assessment of the application and the continued serviceability during the lending period is complex. The monitoring clauses (non-monetary and monetary covenants) allows lenders to review the ongoing serviceability and changes to the small developer's financial position due to market changes. While lenders consider the profitability of a project, they do not consider the potential profit from the single development project at the time of the loan application, for this profit is not guaranteed in terms of servicing the loan. Additional income streams have to be proven. Both banks conduct a detailed financial assessment of the small property development company. Small developers must demonstrate serviceability through additional income streams and cannot rely on the project alone or on property development as a single income stream to service the debt. Additional income streams can also be monitored against market changes through non-monetary covenants in the lending contract. While this type of financial monitoring is invasive, the banks noted that these ensure continued serviceability of longer-term loans. Considering additional incomes from individual shareholders in a small developer's company improves a bank's serviceability perception of the borrowing company.

5.6.7 Other banker-perceived red flags relating to the borrower's position

Both banks' participants noted that the experience level of the property developer is a critical assessment criterion. Bank 1 will consider lending to a small developer with industry experience. This could include experience in managing construction projects or specific trades. The developer must prove a clear understanding of the process and pitfalls. Both Bank 1 and Bank 2 prefer small developers with a record of completed projects. Projects financed by the developer or another bank are considered. Neither bank will consider applications from first-time developers with no industry experience. The experience of a small developer is also considered as awareness of the inherent risks of borrowing for property development.

Small developers must have proof of substantial capital to develop a project to a point where a bank would consider financing the project. Capital is also required to satisfy the LVR, pay upfront costs and provide a contingency. During the interview and focus group session, the lenders noted that small developers have to provide their own capital input of a minimum of 25%. The LVR is set higher when loans are perceived as higher risk. In addition to LVR ratios, Bank 1 excludes the financing of civil works from their loan amount. Both banks noted that the final loan agreement would stipulate items that cannot be capitalised as part of the loan amount. These items require an additional capital amount that the small developer will use as a contingency and may not capitalise any fees or interest. Competition for finance can lead to small developers accepting more stringent terms in their loan contracts.

Further, Bank 1 and Bank 2 require securities and guarantees. The banks' participants did not elaborate on the specific requirements, as securities and guarantees can differ between credit contracts. The provision of securities is an accepted requirement for secured lending in the industry to satisfy banks' risk exposure. The quality of the security and guarantee and how it will be provided is assessed.

The participants noted that small developers often consider non-bank finance even though banks usually offer the lowest interest rates. Pre-sale requirements are hard to meet in tough economic times, and due to a historic oversupply of property, the Western Australian buyer's market prefers to buy a completed property rather than buying off the plan.

The provision of securities and guarantees were not highlighted in the analysis as these are non-negotiable for secured lending from the bank's perspective. Based on their quality, securities and guarantees are assessed, and arrangements regarding these will be included in the lending contract. Issues the effect of ineffective limited liability during security provision are discussed in [Section 4.4.3](#).

5.7 Contribution of Chapter 5 to the research questions and objectives

An interview and focus group session with bankers provided in-depth data on the nature of banks' credit viability assessment of property developers. The data analysis of this chapter adds depth to the FSRC's findings regarding small business and property

development credit assessment as outlined in Chapter 4. The research questions formed the basis of the open-ended questions posed to bankers (see Table 5.2 in [Section 5.4.1](#)). Follow-up questions provided clarity around the processes and policies of lenders that were not evident from the FSRC data. Data collected from the bank interview and focus group contributes to all three research objectives and is summarised in Table 5.5 at the end of this section.

Lending applications are assessed in various tiers, depending on the borrower's entity and the value of the loan (RQ1). Mom-and-pop developers are considered unsophisticated borrowers, while small developers, who are not individuals and borrow over the mom-and-pop tier's upper limit value, are considered complex borrowers. Lending assessment criteria consider the serviceability potential of the borrower and the risk perception of the bank. The potential exposure of the bank, the area risk ratings and current market conditions are assessed: the small developer's financial position; the capital the small developer has available; the securities they can offer; the experience of the small developer; and criteria contained in bank policies.

Lenders consider various criteria during the assessment process (RQ2). The banks interviewed based their assessments on the serviceability potential of the borrower, their financial position and the quality of the assets that they have available as security. Lenders also consider their own risk position and how a specific loan will affect their current position. They further consider the amount of finance that they have available to lend to projects. Banks are hesitant to lend to developers with none or minimal experience in the property development sector, and banks are also hesitant to lend to owner-builders. The banks also indicated that, while they base their assessment on the merit of each project proposal, they consider a small developer's business model (RQ3). They noted that some small developers adapt their business model from one project to the next to better suit the bank's assessment criteria.

Bank 1 and Bank 2 indicated that they view small developers as a viable business opportunity (RQ4). This position is affected by market conditions, and economic conditions, and the bank's current exposure to the property development market segment plays a deciding role in their risk appetite for small property development lending. Lenders consider that the same effort goes into assessing the applications of small developers as large property developers. Small developer assessments could be

even more time-consuming because information has to be verified and all possible incomes assessed. Regulatory constraints regarding the overexposure to the property market were noted by both banks (RQ5). Regulatory constraints are adopted in bank policies, and lenders have increased their assessment criteria since the FSRC.

Since the global financial crisis, small developers have had a very low success rate with loan applications (RQ6). The bankers indicated that the success rate for loan applications was between 1/10 and 3/10 in 2019. These low success rates were linked to lenders' risk perception of the property development market. Over-exposure, declining property prices, additional regulatory restrictions, volatility in the market and lack of finance available for property development, mainly small property development, contributed to low approval rates of credit applications. They noted that their clients use specialists to assist with their loan applications (RQ7). Small developers need substantial financial literacy to understand how the bank assesses their financial position and tends to outsource this function. Accountants and tax consultants prepare financials and profitability statements that lenders will assess. Bankers indicated that small developers use finance brokers in some instances to evaluate loan options.

Lenders monitor the effective use of the loan (RQ8) through non-monetary covenants in lending contracts. These covenants allow a bank to monitor continued serviceability and market changes. Lenders also use the staged release of finance and often verify the value created through quantity surveyors. Table 5.5, on the next page, summarises the contribution Chapter 5 to the research questions and objectives.

Table 5.5: Contribution of data analysis of banks' risk consideration regarding small developer credit

| Research question number | Research Question | Contribution of data analysis of interview and focus group with bankers | | |
|--------------------------|---|---|---------------|----------------|
| | | Objective 1* | Objective 2** | Objective 3*** |
| RQ1 | How do lenders assess the lending applications of small developers? | X | X | X |
| RQ2 | What are the criteria on which commercial lenders base their decision to extend or refuse credit to small developers? | X | X | X |
| RQ3 | Does the small developer's business model influence the lending decision? | X | X | X |
| RQ4 | Do commercial lenders view small developers as a viable business opportunity? | X | X | X |
| RQ5 | What are the regulatory constraints in terms of financing small developers? | X | X | X |
| RQ6 | What is the success rate of credit applications by small developers? | X | X | X |
| RQ7 | What outside advice do small developers make use of during their credit applications? | X | X | X |
| RQ8 | Do lenders in Australia monitor the effective use of finance extended to small developers? | X | X | X |

*Objective 1: identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders

**Objective 2: analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success

***Objective 3: develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders

5.8 Summary of Chapter 5

Chapter 5 explores the experience of bankers regarding small property development credit viability assessment through an in-depth interview and a focus group session. This chapter builds on the research of the FSRC Round 3 Hearings Transcript of Proceedings (2018b), The Interim Report (2018a) and the Final Report (2019b) and

aligns with the theoretical rationale and the research design (see Figure 1.2 and Figure 3.7), and provides depth to the findings presented in Chapter 4. While the big four banks did not participate in this research, participants from Bank 1 and Bank 2 have experience in similar positions previously held at the big four banks. Using Nvivo software provided structure to the systematic narrative analysis of the interview and focus group data. High-frequency recurring nodes provide an overview of themes raised during the sessions, while a co-occurrence analysis visualises meaningful relationships between nodes. Key risk considerations of bankers regarding the credit viability of small developers' loan applications were identified.

Bankers who participated indicated that their banks have limited financial resources (money available) to allocate to small property development loans. Both banks follow an assessment secondary to their internal bank processes, which are subject to bank policies. Bank policies set out and mitigate lenders' risk positions and encompass regulatory restrictions related to a specific process addressed by the policy. Each bank's risk appetite for small property development lending is dependent on a set of variables, the weighting ratio of which could vary at a specific point in time. The variables are the money available for lending, the lenders' current exposure to property development and prevailing market conditions. Experience levels of bankers in assessing specialised loan applications as a critical factor during the process.

A lenders' assessment process takes into consideration the bank's risk position and bank risk appetite. A borrower's financial capability to determine their serviceability potential, and the borrower must have substantial capital available to satisfy loan to value ratios, upfront costs (planning and development approval and possibly other costs) contingencies and to satisfy changes to non-monetary covenants. A small developer's serviceability potential is determined by assessing all possible income streams of the company, its directors and even close relatives. Further, the potential profitability of the development is considered.

The borrower's property development experience is scrutinised as part of the assessment process. Although the criteria vary somewhat between the two banks, experience in property development and construction management are considered. Small property development borrowers must understand their own risk position when borrowing, and previous experience is one such indicator for lenders. The banks prefer

not to borrow to owner-builders and split the financial risk with a separate construction contract, approved by the bank, which forms part of the lending contract. Lenders assess the quality of securities provided as part of the credit viability assessment process.

The final loan agreement is the outcome of a process of assessment that is followed and includes clauses as perceived by the bank relating to their risk position. A positive assessment by the business or commercial banking departments could still be rejected by the credit department or referred back to the business banker for additional information or review. In the case of a positive assessment by the credit department, the final loan agreement will contain various conditions and clauses related to the bank's ongoing risk-perception of the loan. These conditions could include market tests (like pre-sale tests) and monitoring clauses (non-monetary clauses). Pre-sales clauses are challenging to achieve in harsh economic conditions.

While this chapter examined bankers' views, Chapter 6 considers the experience of small developers of the loan assessment process of lenders. The views of small developers are explored through semi-structured interviews and findings are outlined.

CHAPTER 6

SMALL DEVELOPERS' PERSPECTIVES OF RISK CONSIDERATIONS OF CREDIT APPLICATION ASSESSMENT

6.1 Introduction to interviews with small developers

Chapter 6 details credit application risk considerations of small developers in Western Australia. This chapter contributes to the depth of the FSRC findings (Chapter 4) and bankers' views (Chapter 5) of small property development credit risk assessment. Examining the credit risk assessment evidence presented to the Commission, perspectives of bankers and the views of small developers allows for the triangulation of the data (Chapter 7). While Chapter 5 addresses knowledge gaps of the FSRC analysis regarding key risk factors during credit application assessment of small developers, Chapter 6 analyses the perspectives of two small developers in Western Australia.

Two in-depth interviews were conducted with small developers. Both small developers have completed numerous small developments successfully. They were selected based on their compliance with the small property definition set out for this study in [Section 2.4.3](#). The definition includes property developers that engage in small scale developments, have ineffective limited liability, and fall within a small developer category as defined by lenders. The purpose of these interviews was to examine the perception of small developers regarding the viability of their loan applications. Small developers agreed to participate in the research based on anonymity. Interviewees are re-identifiable for research integrity only.

Open-ended questions were asked of participants. These questions focus on the nature of the interviewees' small property development business. They were asked to describe the projects they undertake, how they finance their projects and outline critical factors during credit applications. The small developers also compared the application processes of the lenders, and the types of financial products used that support their business' success.

This chapter outlines challenges, research parameters and the results of interviews with small developers. High co-occurring codes from the FSRC property developer case study analysis and analysis of bankers' views on small property credit assessment was

used as the basis for coding interviews with small developers. A separate analysis was conducted of each interview in NVivo software, and a mind-map of high-frequency nodes of each interview was developed. The data of both interviews were combined to conduct a co-occurrence analysis of the nodes. Findings of the interviews with small developers contribute to identifying key risk factors that influence the success of small developers' credit assessments. These key risk factors contribute to the development of an improved credit risk assessment model.

6.2 Participation by small developers and sample challenges

Property development is not a regulated profession, and no specific qualifications or experience are required to engage in small property development. There are no regulatory criteria for small developers, and there are no registration lists (as with building companies or other professional disciplines). Small developers often do not advertise their companies or services and are known to work “under the radar”, as noted by the second small developer interviewed. Further, small developers often buy a property and hold such property during economic downturns or financial difficulty rather than developing the property, which makes it difficult to identify them.

While many signboards are visible at small-scale developments, most of the contact details lead to estate agents, builders (contractors) or professional service providers. Those mentioned were not willing to disclose the contact details of their small developer clients to third parties. Lists of the agents, builders and professional service providers to small developers (like surveyors, building inspectors and project managers) contacted are available in the data that will be stored. Some of these companies' details were obtained from internet searches and some from driving through infill development “hot-spots” in Perth (WA) and contacting companies from signboards on development sites. Areas visited included suburbs like Craigie, Padbury, Hillarys, Duncraig, Balcatta, South Perth, Waterford, Rossmoyne and South of River. The Property Development Institute in Perth was contacted, which noted that they do not represent smaller developers. Two small developers who were contacted from details on their “for sale by owner” signs declined to be interviewed. They engage in property development as a part-time occupation in addition to their full-time jobs. Only one estate agent that was approached was willing to contact a small developer client to ask for permission to disclose his details.

Two small developers were identified and agreed to be interviewed. In-depth interviews explored their experiences with banks related to their small property development businesses. These interviews provide further clarity around concepts and themes that were raised during the FSRC Round 3 Hearings.

6.3 Research methods of small developers' risk considerations of credit application assessment

The data source for this chapter is two interviews with small developers (audio files) and notes made during the interviews and the process of procuring the interviews and during site visits to infill development “hot-spots”. Interviews with small developers were treated as in-depth exploratory interviews, using open-ended questions. Chapter 5 explored research questions that were not sufficiently discussed during the FSRC hearings from bankers' perspectives. The objective of Chapter 6 was to explore the research gaps of small developer credit risk assessment knowledge from the perspective of small developers. The findings of this chapter contribute to the knowledge of small property credit risk assessment from Chapters 4 and 5.

Due to anonymity requests by the participants, the interview data, interviewees' names and a pre-interview record was recorded in a separate text document, protected by a security code. For research integrity purposes, the participants are re-identifiable but will remain anonymous for all publication and other purposes and are referred to as P4 and P5. The interviews with small developers were conducted early in 2019 and did not include the implications of or interviewees' responses to Covid-19.

The first small developer (hereafter referred to as P4) was contacted via phone and agreed to an interview based on anonymity. The research information sheet and proposed questions to guide the interview, were provided to the small developer via email, ahead of the interview and the interview was conducted at the small developer's home. This small developer is a husband-and-wife team who also owns a substantial plumbing company. Their plumbing company provides an income that they deem necessary when applying for property development loans. P4 have completed various successful projects but outlined some difficulties in applying for loans and complications during the borrowing process. The interview was recorded as an audio file and transcribed as a text file. NVivo software was used to analyse the transcribed

interview. Based on the results from the FSRC hearings and interviews with bankers, a themed coding system formed the basis for the nodes created. Additional nodes were added as themes emerged in the analysis. A mind-map described was created in NVivo that visualises the nodes from the interview with P4. The coded interview was further analysed by extracting high recurring and high co-occurring nodes.

It was anticipated that small developers would be referred to the study through “snowballing”, but due to the nature of small developers, as outlined in the sample challenges in [Section 6.2](#), this strategy proved impractical. However, the first participant contacted their real estate agent, who agreed to contact other clients for potential interviews. A second small developer (hereafter referred to as P5) agreed to an interview. The research information summary and proposed questions were sent via email to this participant. They agreed to the interview based on anonymity. This property developer has a background in running a software development company and has experience managing complex multi-national information technology projects. They entered the small property development market after deciding to wind up their software company. This company teamed up with a reputable building contractor and various friends who wanted to invest funds in property development. The interview was recorded as an audio file and later transcribed by the researcher and is available in the stored data. The transcribed interview was analysed in NVivo, using a themed coding system. A mind-map created from the themed coding system visualises the insights from the interview with P5. High recurring nodes and high co-occurring nodes were analysed in NVivo software.

6.4 Data analysis of small developers’ risk perspectives during the credit viability assessment process

6.4.1 An overview of the data analysis of research with small developers

Narrative data for this chapter was collected and analysed using mixed methods. Personal experiences, from the perspectives of the small developers, are valuable to this research, and these experiences assist in understanding the complex interaction between a lender and a borrower. Precautions were taken to ask questions and follow-up questions that would not lead the participants to repeat information as repeated information can skew the relative importance of a code. Similar to the data analysis methodology used in Chapter 4, a mind-map was developed in NVivo for each

interview from the coded transcripts. The mind-maps set out the two broad categories for each interview:

- The small developer's understanding of the loan application process and the risk position of the bank
- The small developer's awareness of their own vulnerabilities and strengths when applying for a loan

Sub-sets of codes are visualised in the mind-maps of the interviews of small developers. These nodes do not correspond with high recurring nodes but rather with the themes raised by small developers.

High recurring nodes for each interview is presented in an NVivo generated figure containing a chart. The highest recurring nodes correspond with the broad categories set out in the small developer mind-maps. A co-occurrence chart was developed in NVivo from the combined coded data. The use of the co-occurrence charts (see [Section 6.5.1](#)) validates the answers that small developers provided to the research questions.

The research questions were used as the basis of interview questions. A summary of the combined answers of participants to the research questions indicates the findings of the interview analysis related to the research questions. The discussion points to what small developers perceive as red flags during the loan application viability assessment process (see [Section 6.6](#)). Table 6.1 (on the next page) summarises the relationship between the research questions and the interview questions. Small developers were asked follow-up questions in addition to the pre-set interview questions to clarify issues raised during the interviews.

Table 6.1: Summary of the relationship between small developer interview questions and the research questions

| Interview question | RQ1 | RQ2 | RQ3 | RQ4 | RQ5 | RQ6 | RQ7 | RQ8 |
|--|-----|-----|-----|-----|-----|-----|-----|-----|
| 1. Could you please tell me about your property development business? | | | X | | | | X | |
| 2. What types of projects do you undertake? | X | | X | | | | X | X |
| 3. How do you finance your projects? | X | X | X | X | X | | | X |
| 4. In your opinion, what factors are important when applying for finance? | X | X | X | | X | | X | |
| 5. Have you had any applications for finance rejected? | | | | X | | X | | |
| 6. Do you find that different lenders have similar application processes? | X | X | X | X | | | X | X |
| 7. What types of financial products do you consider important for your business to operate successfully? | | | X | X | | | | |

RQ1: How do lenders assess the lending applications of small developers?

RQ2: What are the criteria on which lenders base their decision to extend or refuse credit to small developers?

RQ3: Does the small developer's business model influence the lending decision?

RQ4: Do commercial lenders view small developers as a viable business opportunity?

RQ5: What are the regulatory constraints in terms of financing small developers?

RQ6: What is the success rate of credit applications by small developers?

RQ7: What outside advice do small developers make use of during their credit applications?

RQ8: Do lenders monitor the effective use of finance extended to small developers?

6.4.2 Interview with P4

6.4.2.1 Overview of the interview with P4

The first small developer is a husband-and-wife team who engage in part-time property developments. P4 (one of the partners) indicated that they are responsible for the financial side of the business and dealing with the approval of finance. When they decided to venture into property development, they intended for this to become their full-time occupation. However, they soon realised that they would be unable to borrow from banks, partly due to their age, lack of local property development experience, and a lack of a separate income stream. They decided to establish the plumbing company as a primary source of income.

They want to know that you can support yourself. To be a developer... they must be able to see that there is money somewhere from which you can live. So, [plumbing business]'s money is very important to them [the bank].

This small developer acknowledged that this approach leaves them vulnerable. They leave their money in their business rather than putting it into superannuation:

They look at that... and at what you have. Now what you have to put away in super... That's the other problem with our age. You want to put money into super and create a nest egg, but you can't put it in there, because that doesn't count for the bank.

P4 indicated that they utilised their own capital to developed a property development portfolio. Their first project, a six-warehouse development, was funded through their own capital, as they could not obtain a loan. They were the developer and the builder on this project. A second project, two houses on a block, was also not financed by banks. These projects served as proof of property development experience for their third project.

We used our own money for warehouses... We sidelined the bank. We did about six warehouses complete. Then we took time off. Then we did a development where we put two houses on a block. We did not borrow money for that... but when we did the [block of] units in [Perth suburb], we dealt with the bank.

The third development project, a multi-storey development of six luxury units (during the global financial crisis), was cautiously financed by a bank. The bank insisted on a high LVR and a separate building contract within the loan agreement.

...they didn't want to lend money to property developers, because the banks were cautions... they were expecting us to put as much in as we wanted to [borrow] before the time..they did not like that we were the builder and the developer... because they say all the risk would be with one person.

P4 indicated that they financed the purchase of the land and the servicing of the land, subdivisions, development approvals and other upfront costs from their own capital. The loan was for the superstructure of these six luxury units only. Further, the loan was subject to a high pre-sales ratio due to a high development rate (potential over-supply) of units in the suburb where their development was done:

...they said we had to sell [units to the value] AU\$2 million [if you wanted to borrow AU\$4 million]... In the end, when we sold AU\$2 million, they said we had to sell one

more... [Perth suburb]'s risk rating was high. There was a large number of units going up... so they were not sure that they would get their money back.

The pre-sales requirements surprised P4 during their first bank-financed project. Pre-sale requirements for the first stage of their loan to be released was linked to market conditions and the area risk rating. The area risk rating changed before the first loan stage was activated, and funding was released, and the pre-sale value was increased. They also became aware of regulatory requirements in terms of foreign buyers and that these buyers are not counted as part of the pre-sale requirements. However, this project impressed the bank, which offered them additional finance for this project.

P4 was also surprised by the way that funding was released during their first bank-financed project. While they received deposits of the pre-sales, bank finance only started once the pre-sales requirement was met. The final income from sales is only received once the building is signed off. As interest was not capitalised for this loan, they were paying interest until the building was signed off and then received sales proceeds.

That is something that I didn't realise. The bank gives you money as you build – in stages. You only get the deposits of the [buyers]. You don't get all the money [from the buyers] until [the building] is signed off [and it could be] three or four years before... the building is signed off. In the meantime, you have your loan, and the bank pays the building as you go along, and you only pay interest. When the whole building is sold, then they pay.

P4 relied on a broker to find a bank that would be interested in financing their projects. This broker assisted them to find the institution and with initial documentation, but they dealt with the financial institution themselves after the initial approval process. They have been rejected for a loan before but were unclear about the reasons for rejection. P4 speculated that the bank's business banker approved the application but that the bank's credit department was not satisfied or that the bank did not have money to lend at the time.

He [the broker] would look at one bank, then the next. There were banks that took us to the last [through the process] and then said no.... they just said they can't [lend] at the time.... You can work with one person, then they send it to the credit people, and they decide that... they won't put money into this [property development].

And

At certain stages, the banks have money to borrow. Then you could be lucky and get money. Other times, they set out how much money they are going to lend to property development... it depends on which bank you end up with.

Even though P4 has built a relationship with a specific bank, they must provide complete financial disclosures for each new project. Due to the simplicity of the entity, invasive financial assessments are considered part of the loan application process by P4.

... you have to go through the whole process again ... They definitely asked our financial statements, business and personal. ... and they want to know what you earned less this year, compared to the previous year and what next year will look like.... they definitely want to know that you had other income and that you are not just dependent on the development if you borrow the money.

The interviewee noted that the lenders are still (at the time of the interview in 2019) cautious in lending to property developers:

Before we started again with property development, I wanted to know what the bank would want, because they are even stricter now... what you want to borrow, that is what you have to sell.... they [the bank] also want a large deposit.

P4 understands that lending risk is inherent to the property development process. They noted that lenders' appetite for lending could be connected to various factors. These factors include the availability of money to lend, the bank's risk appetite for property development, the world and local economic conditions, market conditions, supply and demand, risk ratings of areas, the security offered and the specific project risk. They indicated that these conditions could be different from one project to the next. Although they know bank processes well, they still rely heavily on their business banker to guide them through the details, forms and specific bank requirements.

You give them [the banker] an overview of your situation, and then, if they are interested, they will tell you what you need.... I will go look if I can find that list.

They further noted that the lengthy loan viability assessment process poses a risk of delays to their projects. The credit department could still refuse loans after much time has been spent on the assessment processes. P4 admitted that the process is onerous and that:

it also depends on how old you are... you may not have the energy for the process.

P4 make use of their network and use a real estate agent to advise them on land opportunities and use other professionals to design their projects and take them through the approval process. Figure 6.1 below visualises the factors discussed by P4.

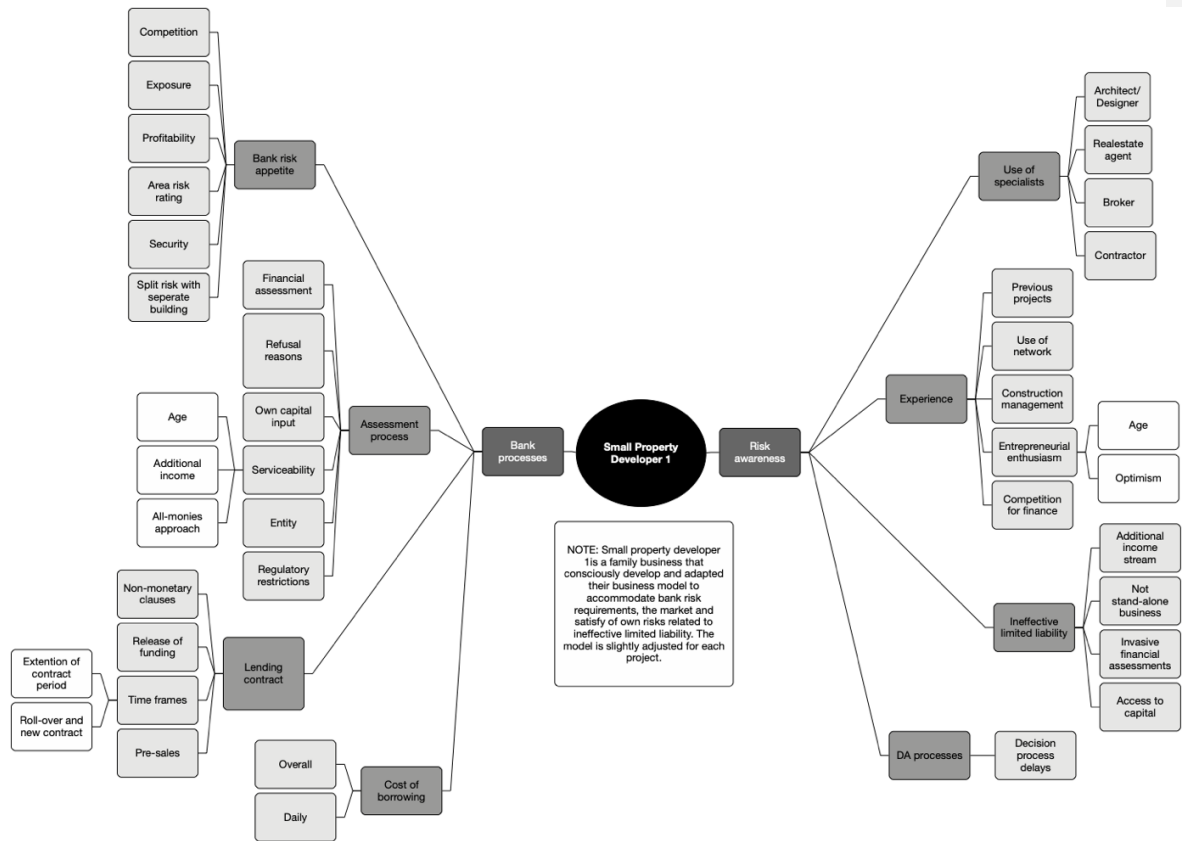


Figure 6.1: Mind-map from the interview with P4

6.4.2.2 Discussion of high recurring nodes from the interview with P4

High recurring nodes from the interview with P4 indicates the themes that were coded at the highest frequency. While the mind-map provides an overview of all the themes coded, the 25 nodes with the highest recurrence are discussed in this section. Some of these nodes had a similar recurrence frequency. Similar to the analysis of bankers' perspectives on the credit assessment process, the frequency with which nodes occur is not reliably indicative of the importance of nodes. However, high-frequency nodes present a starting point for identifying new factors that affect small developers credit application success.

Bank processes had the highest recurrence and were followed by the *Assessment process* and the small developer's own *Risk awareness*. The nodes *Bank risk appetite* and *Experience* shared the fourth-highest recurrence frequency.

From the perspective of P4, their bank's *Assessment process* includes criteria that examine the *Entity* (shared sixth-highest recurring node) of a property developer. This property developer's bank conducts a thorough *Financial assessment* (shared 19th highest recurring node) for each loan application. They also consider the *Own capital input* (shared 12th highest recurring node) of the small developer to satisfy *the LVR and other capital requirements*. P4 indicated that they had experienced loan *Refusal* (shared 12th highest recurring node) after spending much time on the assessment requirements.

The *Risk awareness* (third-highest recurring node) of P4 has developed along with their *Experience* (shared fourth-highest recurring node). They understand their *Ineffective limited liability* (eighth-highest recurring node) and the positive and negative effects of this characteristic on their ability to borrow money from their bank. *Use of own capital* (shared 12th highest recurring node) has been important for this property developer to develop a good record of experience. They also make *Use of specialists* (shared 12th highest recurring node) to develop their projects and inform them of market conditions. *Competition* (shared 22nd highest recurring node) for finance in challenging market conditions could affect P4's loan application success. P4 displayed *Entrepreneurial enthusiasm* (shared 22nd highest recurring node) by investing their own capital in their projects and adapting their business model according to their experience of their bank's assessment criteria.

The *Bank risk appetite* (shared fourth-highest recurring node) dictates some of the criteria during the *Assessment process*. P4 believes that a *Relationship* (shared ninth-highest recurring node) with their bank has helped them secure finance repeatedly and has made them aware of the requirements of the *Assessment process*. Even so, they are aware that their bank considers the *Serviceability* (shared ninth-highest recurring node) potential of the loan applicant for each proposed project. P4's bank follows an *All-moneys approach* (shared 12th highest recurring node) when assessing the *Serviceability potential* of a loan. This small developer indicated that their bank considers its *Exposure* (shared 19th highest recurring node) and have developed an *Area*

risk rating (shared 22nd highest recurring node) as an assessment and monitoring criterion.

The *Lending contract* (shared sixth-highest recurring node) becomes the binding agreement between the borrowing and lending parties. P4 discussed the requirement for *Pre-sales* (shared 22nd highest recurring node) to activate loan payments and the difficulty to achieve these. The coding frequencies of the interview with P4 are indicated in Figure 6.2 below.

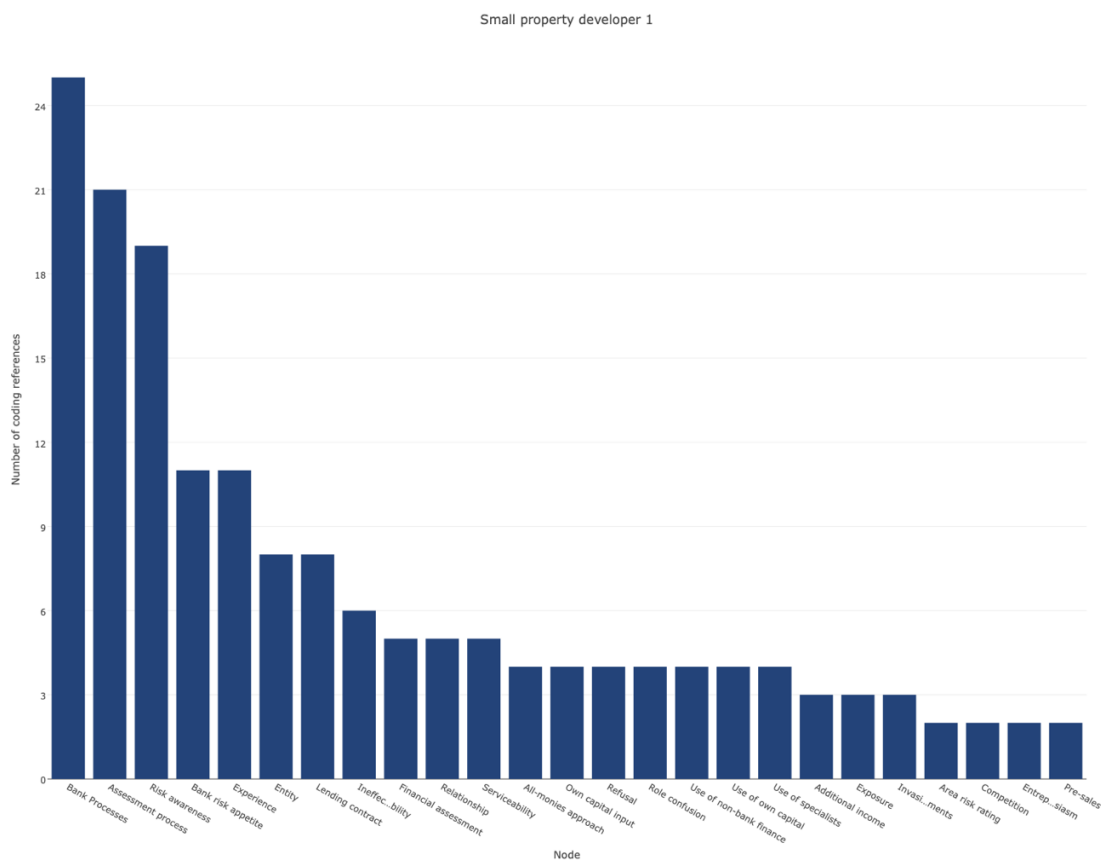


Figure 6.2: Coding frequency of nodes from the interview with P4

6.4.3 Interview with P5

6.4.3.1 Overview of the interview with P5

P5 is an individual that has previously owned a software company. They became involved in property development while being in the process of winding down their

software company. They were inexperienced in property development, but an informal partnership with a trusted builder provided credibility.

I got in by accident into property development... I built my house and the builder approached me to see if I was interested in working with him... we were transitioning to property development, using that vehicle [the software development company], because we already have the share structure, the capital structure, so we have an established trust for the developments going forward... But we've now been doing it for the last ten years... so, 10 to 15 projects.

P5's own experience in dealing with complex investor and developer networks, and a detailed understanding of financing assisted them to conceptualise the business model that they now follow. They are keenly aware of the reasons that contributed to the successes of their company, as well as learnings from other small developers. Having survived the global financial crisis, with extreme pressure on the business' finances, this developer is cautious about taking risks. A non-monetary covenant of a loan was breached due to a devaluation of the property value:

When the GFC came along, [the banks] then decided [that they] didn't want to do development at all. So we were left kind of stranded by the banks... [our experience with one bank was that] they pulled out mid-project... even though they didn't pay us the money, we still had to pay AU\$15 thousand exit fees.

They noted that even one failed development project could have devastating personal consequences:

...a lot of small developers would do one, two and then get their fingers burnt. They just get hammered. I know this one guy, he did two successfully and then he made a mistake. He paid AU\$100 000 too much for the block of land... and he's never done another development. He's still working to pay it off... You cannot make a mistake. The numbers are so thin. You get one wrong and you're not around anymore. The numbers are so thin.

P5 manages all their company's property development projects. They have developed a financing model specific to each development to improve the project's perceived viability. This property developer has built a reliable network over the years. They have a good relationship with their contractor, who also invest in their projects. They also have an investment network for their projects. P5 emphasised the importance of trust in their network in their business model.

[The builder] lacked financeand he didn't have much of a business background... we started a company [together]....to manage the acquired property. So, we put some money into that property development company [which] became the corporate trustee for unit trusts... we use third-party money as well as our own. I like to have a third or half of the project but to spread the risk, I'll syndicate the balance... the unit trust would purchase the block or land for cash... construction financing would be borrowed... The land would be security to the bank, so the risk to them was minimal.

Within the current economic conditions, this developer's investors are aware of the risks involved with property development but have few options for investing money in high-yielding long-term deposits. They view the returns on investment in property development as offsetting the risk. This property developer believes the ability to access private capital through their network helps them realise loans from banks and second-tier lenders more successfully. In addition to providing capital, their network also provides specialist input on market conditions and risks.

P5 indicated that their knowledge of the success of different business models had improved their ability to secure finance. They noted that the structuring of an entity and the type of development (size, number of units, type of use, and area demand) affects their business' assessment regarding the policies of financial institutions. They have built up extensive financial knowledge of small property development projects and the costs of financing these. P5 has developed comparisons between the lending costs of various financial institutions. They actively assess lending options from various lenders and other finance providers and make value judgements regarding their offerings. For example: even though the headline rate of a bank may be lower than that of a non-bank financier, the additional charges incurred during the bank's monitoring process of the loan and their pre-sales clauses may make borrowing from non-bank lenders more cost-effective:

I've done spreadsheets on CBA, NAB and RAC and over 15 months, and [second-tier lender] RAC is cheaper, even though their headline rate is 7.75% [much higher compared to the banks]... [RAC] have a 0.7% application fee, which is quite steep, and even though we've worked with them many times, they won't waiver it... Because they're the only game in town. They don't require pre-sales – that's the key... [Banks] also introduced line fees... a [monthly] percentage based on the amount of money that a developer borrows... so you are paying from day one [even if you are waiting for pre-sales].

This property developer is confident about their knowledge of the loan assessment process, to the point where they challenged a loan rejection. In this instance, the broker was not experienced in property development and filtered information crucial for loan approval.

So, I rang the manager up and said: “One of us has got this wrong, it is either you or me, and if it is me I need to know, but I think it is you. I think you made a mistake. Let’s catch up and go through it.” So, what happened, the broker... was basically filtering information or not having sufficient information available to present the case as it should have been. So, we got rid of the broker at that point and we only go direct now... what we found, we were only ever rejected when we were using a third party [broker].

They now compile all their own funding proposals. P5 is cautious about borrowing at high interest rates in the current market. They admitted, however, that some small developers become desperate for finance when there is competition between borrowers:

I talked to someone recently who is paying 12% for private funding ...the ramifications of the lenders tightening up, we’ve seen this path now being followed, where people, I believe, are taking some huge risks borrowing at 12%. I don’t know who’s putting the money in.

P5 believes that it is impossible to achieve the lenders’ pre-sale requirement in current market conditions, and the second-tier lender waives this requirement.

You are very exposed. They are always re-valued upon completion and there is a number that has fallen over in recent years. People had had pre-sales, they got started, then get to the end and the bank re-values, property values have gone down, pre-sales lapse... they can lose their deposit on that... pre-sales are a disaster in the current market because the only way you can pre-sale is to secure a completely unique location, with a completely unique product ...getting pre-sales means that they’ve got to discount like crazy. From memory, it took [another developer] 8 months to get the two pre-sales which enabled them to carry on.

These delays add to the difficulties experienced by this small developer during hard economic times, and they believe that this can lead to reckless behaviour by small developers.

It is a real cost. It is a real cost! It delays – every week costs you more money, once you trip the switch and you decide to borrow... in order to [achieve pre-sales requirements] they discounted and there is no profit in those units... they’re going to rely on [profit]

on the other four... now they're 12 months behind schedule, because of the delays in getting funding.

The business model used by this developer can be adjusted per project, but functions based on a company, which acts as a corporate trustee for unit trusts created per project. This company was set up to manage the acquired property. The unit trusts established per scheme, involve P5 splitting the risk by financing a third to half of the project themselves and then syndicating the balance of the project. The unit trust thus owns the block land, which is used as security for borrowing construction finance. Interest is not paid to investment partners involved in the syndicate during the development process, but their funding is returned after a specific period. Once profit is realised, it is divided as per the investment percentages of the unit trust. The business model developed by P5 allows invasive financial assessments of their company but protects its investors from this scrutiny.

... if [banks] want to do financial checks on all of the unit owners – that's totally impractical because you have people who just want to put the money in. They're not going to open their books up to the banks to look at... I don't mind being scrutinised, but third parties who [invest] money, I don't want them to be scrutinised... So, what we do now is we set up a bank account as the trustee company, not as the unit trust, because I can open a bank account as the trustee company just by turning up and saying I want an account. So, we avoid this ...we come up with a way around it that enables us to continue. So, we have a dedicated bank account, but the bank account is not linked to the unit trust. So that's where you need the trust level between the trustee against the unit trust... The people involved in the syndicate are... a circle of trust, so the money is handed over on a handshake. Again, you can't buy that... it is the trust factor.

The complexity of his projects' financial organisation makes the bank's risk assessment process more complex and adds additional assessment criteria and scrutiny. P4 noted that without the trust within their investor network, many of the routes they follow to adhere to administrative details of the process would not be possible.

P5 believes that they face additional financing challenges because of their age and lack of monthly income. They are over 60 years of age and do not have full-time employment. Their current income is from interest on capital and income from assets. Further, they only use the minimum amount from these income streams for their living expenses. This developer believes that these two factors make it difficult for lenders to

assess serviceability potential. This place an additional burden of proof of income and thus serviceability on P5. In addition, regulatory policies have complicated the financial assessment of income from assets.

[The banks] used to consider serviceability and asset base... and the Labour Party's policies [stopped] this. In my case, I have a lot of assets, but I don't have a salary... so I'd be crazy to pay myself more than I need [from income from assets]... because I use capital rather than income, and capital is treated more benevolently.

This property developer notes that the assessment process of RAC Finance (a second-tier lender) is simpler, and that RAC considers the credit viability assessment based on the merit of each project. The simpler process and project-based assessment allows P5 to leverage his income from capital and their assets more effectively while syndicating a part of the property development. Being able to syndicate their projects allows this developer to split the risk, stretch their own money further and achieve a better serviceability rating. It is further essential for this developer to maintain a pipeline of new developments to maintain interest from their contractor and investor network.

P5 believes that the impact of the Financial Services Royal Commission on the banking sector has negatively affected the ability of small developers to access finance. They argued that the

The banks are almost dysfunctional as a result of the Royal Commission... they are crossing t's and dotting i's, and it is just holding things up. The balance is key... there was some irresponsible lending, and [the banks] knew it about it... the combination of the Banking Royal Commission and the other negative publicity in Melbourne basically flattened the market... I know a lot of developers are not getting funding at the moment, and they're having to abandon projects.

Figure 6.3 (on the next page) outlines important themes from the interview with P5.

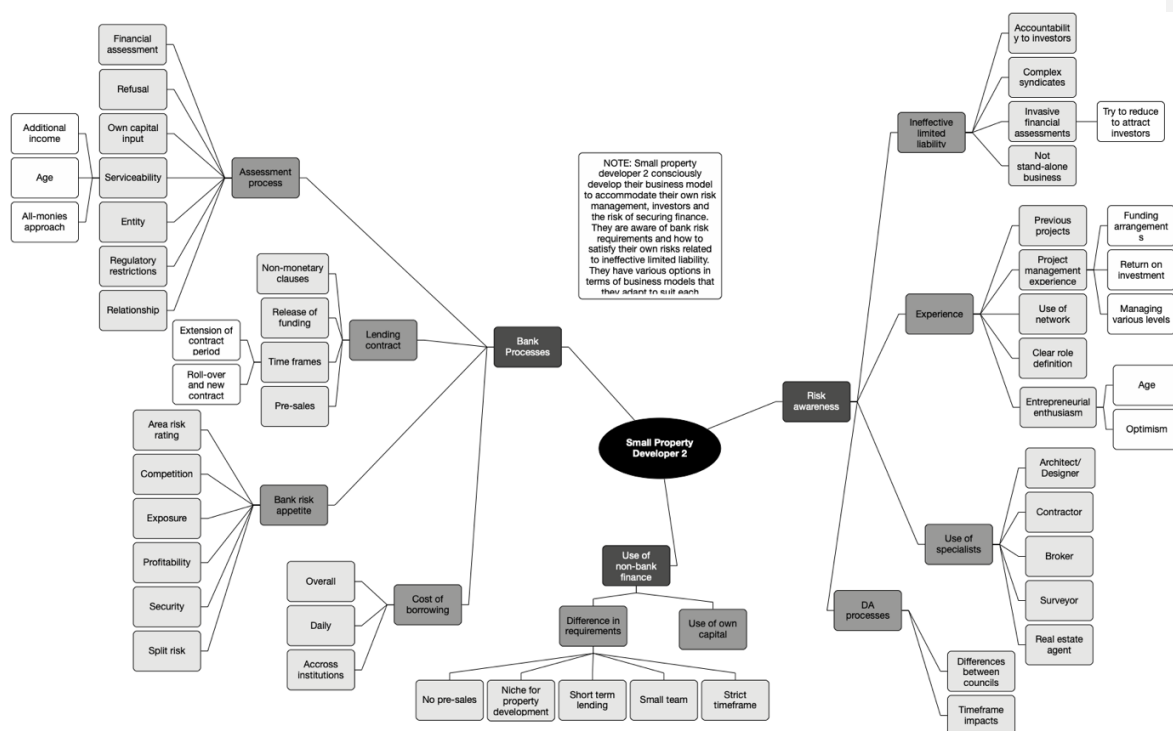


Figure 6.3: Mind-map from the interview with P5

6.4.3.2 Discussion of high recurring nodes from interview with P5

The P5 interview transcript was analysed in NVivo software against high recurring coded nodes. The highest recurring 25 nodes are discussed below.

P5's own *Risk awareness* was the highest recurring node. *Bank processes* had the second-highest recurrence, followed by the *Experience* (third-highest recurring node). The *Risk awareness* of this small developer is linked to their *Experience*, in particular, *Project management experience* (shared sixth-highest recurring node). They also have *Experience in the effective Use of [their] network* (eighth-highest recurring node). P5's projects are driven based on *Return on investment* (shared 12th highest recurring node). Their capacity to provide a *Return on investment* and their understanding of complex *Funding arrangements* (shared 18th highest recurring node) enhance their ability to attract and retain *Investment partners* (shared 18th highest recurring node). They have a record of successful *Previous projects* (shared 23rd highest recurring node) that prove property development experience to investors and lenders.

The *Risk awareness* of this small developer is further linked to their understanding of the advantages and vulnerabilities of borrowing as an entity with Ineffective limited liability (shared ninth-highest recurring node). P5 make *Use of specialists* (shared ninth-highest recurring node) to advise them regarding their projects and *Market conditions* (shared sixth-highest recurring node). They are fully aware of the *Cost of borrowing* (14th highest recurring node) and can compare the offerings of various institutions. Further, they have a long-standing relationship with a reliable *Contractor* (shared 15th highest recurring node).

This small developer indicated that they have a thorough understanding of *Bank processes*. *Bank risk appetite* (fourth-highest recurring node) was noted to affect their ability to borrow. The *Exposure* (shared 15th highest recurring node) of a bank to property development was noted by P5 to directly affect finance availability. The over-exposure of lenders to property development increases *Competition for finance* (shared 18th highest recurring node) among borrowers. This small developer deems it essential to maintain their long-standing *Relationship* (21st highest recurring node) with lenders for potential future loan opportunities.

P5 understands the *Assessment processes* (fifth-highest recurring node) of various banks and second-tier lenders. They go through extensive effort to prove their *Serviceability* (shared 12th highest recurring node) potential to banks. Their age and lack of monthly income directly affects P5's *Serviceability* potential. They further indicated that the complexity of the borrowing *Entity* (22nd highest recurring node) could affect the documentary load during the *Assessment process*.

P5 make *Use of non-bank finance* (shared ninth-highest recurring node) as their preferred second-tier lender omit the *Pre-sales* (shared 23rd highest recurring node) clause. Lenders deem this market test necessary as part of mitigating lending risks and is included in the *Lending contract* (15th highest recurring node). Figure 6.4 (on the next page) indicates the coding frequencies and the highest recurring nodes.

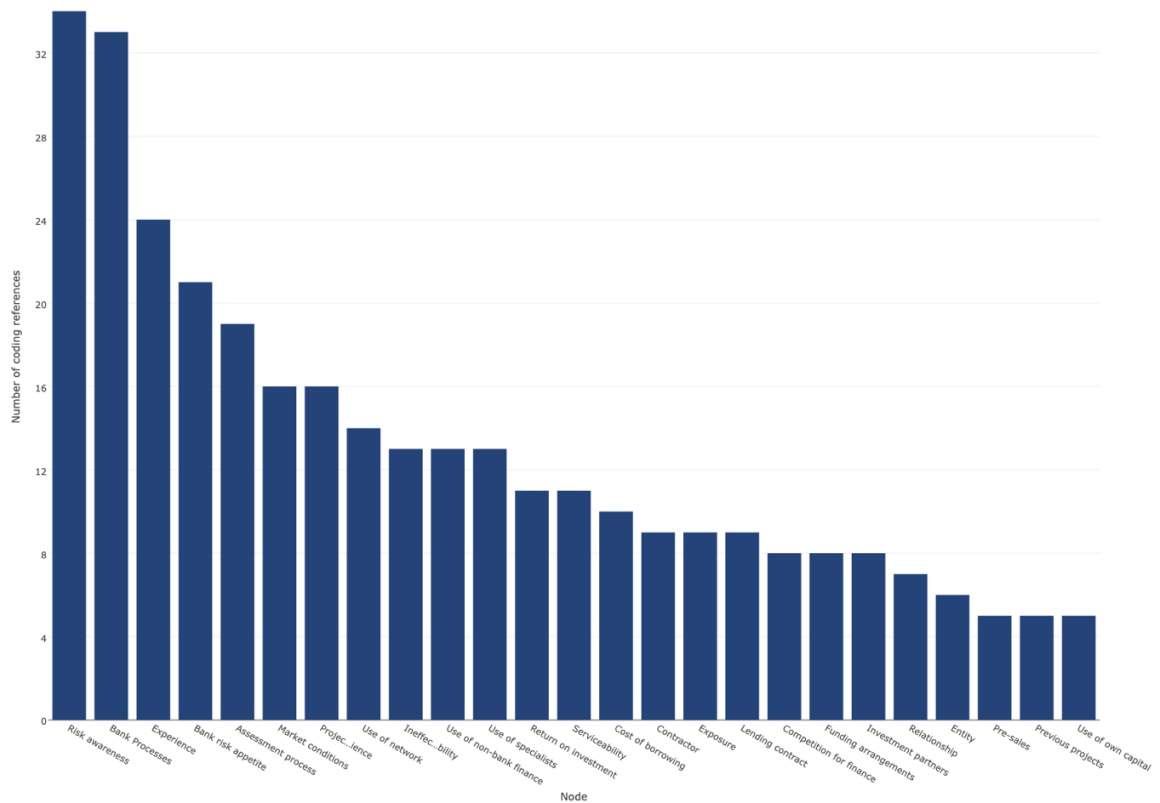


Figure 6.4: Coding frequency of nodes from the interview with P5

6.5 Co-occurrence matrix analysis of connections between small developer interview nodes

Relationships between nodes are not self-evident from high-frequency nodes. Interview mind-maps provide a visual overview of each interview, and high-frequency recurrence charts indicate the relative importance of nodes coded. However, they do not indicate overlaps between nodes. The co-occurrence matrix indicates the relationships between nodes of coded data from both interviews with small developers. Overlaps in themes, where these themes were coded simultaneously, are highlighted in the co-occurrence matrix.

6.5.1 Summary of results from the co-occurrence matrix of small developers' risk perception during credit viability assessment

NVivo software was used to code both interviews. The co-occurrence of nodes was analysed in NVivo software through a co-occurrence matrix tool. Data from this analysis was exported to Excel software and was analysed in a matrix format by colour-

coding high recurring nodes. Co-occurrences over 40 times were considered a high co-occurrence frequency, while co-occurrences between 20 to 39 times were considered a medium co-occurrence frequency. Co-occurrences between 10 to 19 times were considered a low co-occurrence rate. When codes that co-occurred under ten times were noted in the Excel matrix, it was omitted from the summary of co-occurring nodes as these co-occurrences were considered negligible. The matrix structure of co-occurrences produces double co-occurrences.

The matrix analysis indicated that the nodes with the highest co-occurrences from the combined interviews with small developers were *Bank Processes*, *Assessment Process* and *Risk awareness*.

The node *Bank processes* have the highest co-occurrence rate with the *Assessment process* and *Risk awareness*. *Experience* has a medium co-occurrence rate with *Bank processes*. The following nodes have a co-occurrence of between 10 to 19 times with *Bank processes*: *Entity*, *Relationship*, *Bank risk appetite*, *Market conditions*, *Exposure*, *Cost of borrowing*, *Lending contract*, *Project management experience*, *Ineffective limited liability*, *Use of specialists* and *Use of non-bank finance*.

The *Assessment process* has a medium co-occurrence rate with *Risk awareness*. It further has a low co-occurrence rate with *Entity*, *Relationship*, *Serviceability*, *Bank risk appetite*, *Lending contract*, *Market conditions*, *Experience*, *Ineffective limited liability* and *Use of specialists*.

The node *Bank risk appetite* co-occurs between 20 to 30 times with *Risk awareness*. Nodes with low co-occurrence rates with *Bank risk appetite* are *Bank processes*, *Assessment process*, *Exposure*, *Market conditions*, *Lending contract* and *Experience*.

Risk awareness has a medium co-occurrence rate with the *Assessment process*, *Bank risk appetite* and *Experience*. This node has an occurrence rate of between 10 to 19 times with *Entity*, *Serviceability*, *Market conditions*, *Lending contract*, *Project management experience*, *Return on investment*, *Use of network*, *Ineffective limited liability* and *Use of specialists*.

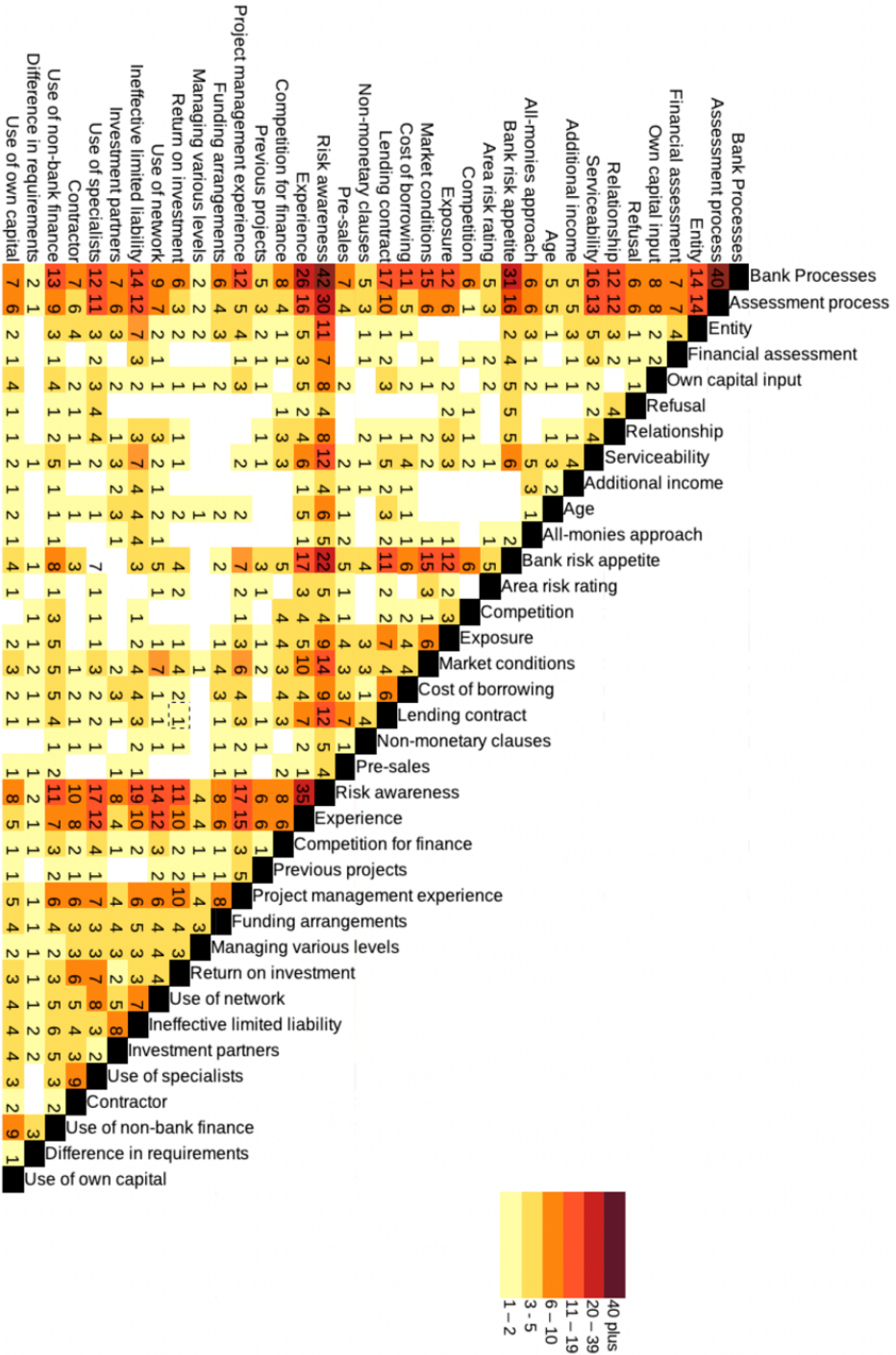
Experience was coded as a critical node in both interviews. This node has medium co-occurrence rates with *Bank processes* and *Risk awareness*. It has low co-occurrence rates with the *Assessment process*, *Bank risk appetite*, *Market conditions*, *Project management experience*, *Return on investment*, *Use of network*, *Ineffective limited liability* and *Use of specialists*.

Table 6.2 below presents a summary of the nodes with the highest co-occurrences. Double co-occurrences are not indicated in this table. Table 6.3, on the next page, visualises all the co-occurrences as discussed in this section and double co-occurrences between nodes are indicated.

Table 6.2: Summary of small developers' risk considerations during the loan application assessment process co-occurrence matrix analysis

| 40+ co-occurrences | 20 – 39 co-occurrences | 10 – 19 co-occurrences |
|---------------------------|-------------------------------|-------------------------------|
| Bank process | Experience | Entity |
| Assessment process | Bank risk appetite | Relationship |
| Risk awareness | | Serviceability |
| | | Market conditions |
| | | Exposure |
| | | Cost of borrowing |
| | | Lending Contract |
| | | Project management experience |
| | | Ineffective limited liability |
| | | Use of specialist |
| | | Use of non-bank finance |
| | | Return on investment |
| | | Use of network |

Table 6.3: Matrix of high co-occurring nodes from interviews with small developers



6.6 Discussion of small developer interview analysis and results

6.6.1 Access to finance is critical

The capital input required to deliver a property development product is substantial and not comparable to other small businesses. Small developers must have capital available or have access to large amounts of capital through other means, such as investor networks, described as “friends with deep pockets” by P5. Often, the first property development of a small developer is financed through their own funds, to build a portfolio of property development experience, which forms an integral part of loan application assessment. Lack of local property development experience is a deciding factor in a bank’s assessment process and would necessitate the use of own finance to build a record of such experience.

Both P4 and P5 borrow money to avoid having all their personal financial resources tied up and to be able to take on projects larger or more profitable than what they can finance from their own money. P5 noted that they develop a pipeline of projects and need access to finance to take on more projects than they have cash for and keep work flowing. Borrowing regularly from the same lenders is a strategy followed by P5 to keep a good relationship with a specific lender and an ongoing credit record that shows continuous property development income.

Both small developers interviewed follow a staged approach when borrowing money. This approach to financing aligns roughly with the development process presented in [Section 2.5.2](#) but can vary between projects. Depending on the availability of finance, the competition for finance and their own financial circumstances, small developers often finance different aspects of the development process through various strategies. P5 noted that they actively engage with banks and second-tier lenders to understand the lending criteria for property development.

While access to credit is critical for both small developers, they take a conservative approach to borrowing. They do not make use of bridging loans, mezzanine loans or non-recourse loans. Further, they steer clear of loans with high interest rates and high-risk borrowing and take their time to find suitable properties that will allow them to complete low-risk projects. In economic downturns, with low profit margins on

projects, expensive finance is not feasible. P5 noted that they know small developers who consider higher risk loans when they are desperate for finance.

6.6.2 Use of non-bank finance

P5 uses an investor syndicate to finance part of its projects. Their investor syndicate, similar to themselves, is asset and capital-rich and uses the least possible amount of income required to maintain their lifestyle. P5 had to develop financial reporting processes and a specific legal business structure to explain their credit applications' serviceability potential while avoiding invasive financial assessment of their investors.

Second-tier lenders have become popular due to the competition for bank finance and the difficulty facing small developers in meeting pre-sales requirements in bank loan contracts. P5 indicated that their preferred second-tier lender offers short terms on their loans and have higher interest rates compared to banks. However, there were no hidden costs and fees attached to these loans, making the overall borrowing costs comparable to credit offered at lower interest rates by banks. The second-tier lender further considers projects on merit, meaning the biological age of a small developer will not be an issue related to the serviceability potential of the loan. P5 noted that the crucial consideration when seeking credit from the second-tier lender is this lender's lack of pre-sales requirements.

6.6.3 The importance of a reliable and financially capable contractor

While P4 initially constructed their own developments (using their own money), they now use a contractor when developing, as their bank does not finance owner-builder projects. P5 has an ongoing relationship with their preferred contractor and actively finds new projects to create a pipeline of work to keep this contractor engaged in their projects. They sometimes refer the contractor to friends or previous investors to add to this contractor's workload. P5 has entered into a business partnership with their contractor, as it is crucial to their property development and loan application success. The contractor is also an investor in P5's projects.

Both small developers indicated that they rely on their contractors for transparent and accurate costings. They maintain good working relationships with their preferred contractors, as they have proven that they can deliver projects as required by the small

developers. The financial capability of their contractors is critical to the small developers as this is a credit assessment criterion of lenders. P5 indicated that the financial capability of large builders is often the reason for first-time developers or mom-and-pop developers engaging these builders rather than smaller contractors.

6.6.4 P5's notes on GST

P5 noted that various first-time developers or mom-and-pop developers can get around the general sales tax (GST) requirements for property development as they may not sell the property on completion. The current GST payment process requires the purchaser to withhold the GST amount and pay this directly to the Australian Taxation Office ATO. This arrangement prevents fly-by-night developers, who plan to dissolve companies at the end of each project, from remitting the GST to the ATO.

Further, small developers who borrow as individuals (like mom-and-pop developers) pay lower interest rates, as they are financed through mortgage type arrangements. This type of borrower can build up to three units and avoid GST in some instances as they only sell the units once the mortgage expires. P5 noted that, in their experience, this arrangement is not possible for other small developers who are companies, trusts or anything other than an individual. They are financed through development loans, construction loans, and can potentially convert these loans to long term finance only once construction or development loan expires.

6.6.5 The small developer's business model and risk awareness

The availability of finance is considered an inherent risk by both small developers. They have developed business models that enhance their chances of obtaining finance. Further, both small developers adapt their business models to suit a specific project, the current economic circumstances, and address the risks perceived by lenders.

P4 and P5 stressed that finance availability is constrained during economic and market down-turns. Also, the small developers found it hard, if not impossible, to meet market-tests like pre-sale requirements in loan contracts. P5 cautioned that these clauses could lead to extensive delays to projects and result in losses. Small developers become desperate to meet pre-sale requirements and heavily discount units to obtain sales. The

pre-sales risk is excessively high for small developers who are desperate to obtain finance, and engage in high-interest borrowing.

The serviceability potential of a small developer is a critical assessment criterion. The borrowing entity and the structure of the entity determine the bank calculates serviceability. Both small developers have engaged lenders that followed an all-moneys approach when assessing the serviceability potential of their entities. In addition to the borrowing entity's financial position, the income streams, securities, guarantees, and liquidity of the small property development business' owners or directors are judged. Both small developers indicated their understanding of the advantages that this approach provides in their ability to borrow larger sums. They are aware of the consequences of breaches and defaults. Both small developers indicated the importance of access to additional capital and actively developing their financial reporting to indicate additional income streams. Capital is used to pay upfront costs, forward-fund the build if necessary, contingencies, cover short-falls on the LVR and increased interest rates, and other costs related to the monitoring of the loan.

Bank financing requirements can vary between project models. For example: if properties are retained, the small developer has to prove the serviceability of the debt through rental income. This could depend on the quality of the rental (potential rental income), the quality of the market of tenants that will be targeted and varying market conditions with factors included for non-occupancy. Experience with a specific project model, and previous successes in financing that model, will often be the deciding factor regarding the type of project presented to the bank. Small developers interviewed pay considerable attention to sales risks, sunset clauses, the reliability of their contractor and the financial effects of potential changes to market conditions when preparing their proposals.

Both small developers indicated that it takes substantial financial literacy and often additional legal assistance to put a model together that proves serviceability potential to the bank. Both interviewees used a network of trusted experts to assist them in gauging market conditions and market appetite and determining preliminary costings of their projects. They employ professionals to design their projects and to take these projects to the development approval stage.

6.6.6 Loans declined

The loan application process can be tedious and take a long time. Both small developers noted that they try to ensure that time spent on an application process is productive.

They spend a substantial amount of time with a business banker who assesses the viability of the application and builds the deal. Even so, P4 indicated that the loan could still be declined when the documentation passes from the business banker to the bank's credit department for approval.

The small developer interviewees noted that lenders' policies, exposure, risk appetite and availability of finance could affect approvals at the point in time of the credit application. Lack of local property development experience was a deciding factor during P4's first loan application. P5 noted that finance brokers might not be experienced enough to understand the complexities of property development finance and could filter important information that they do not consider necessary, leading to a loan being declined.

The small developers interviewed understood the importance of considering the risk ratings of various suburbs when planning future developments and check these ratings with lenders or finance brokers before purchasing a property. They note that the lenders they borrow from have particular concerns when there is an oversupply of a specific product or when the properties are on the outskirts of a city. Good public schools (particularly high schools) were regarded as a positive factor when choosing a development site.

6.7 Contribution of Chapter 6 to the research questions and objectives

Interviews with small developers provided this group's perception of lenders' credit viability assessment of their loan applications. The data analysis of Chapter 6 adds to the FSRC's findings (Chapter 4) and bankers' views of the credit risk assessment process (Chapter 5). The additionality of the findings of this chapter is discussed in [Section 6.6](#). The analysis of the small developer interview data contributes to all three research objectives and is summarised in Table 6.4 at the end of this section.

Small developers indicated that lenders assessed their lending applications based on the entity-type and loan size (RQ1). Small developers perceive the critical criteria (RQ2) to

be their serviceability potential, provision of security and the property development experience of the small developer. Bank risk appetite, the bank's exposure, market conditions and the lenders' money available to lend can affect assessment criteria. The burden of proof rests with the small developer to understand the assessment process and the assessment criteria and provide the necessary documentation and information. The owner's age, their previous experience, the complexity of the entity and the availability of additional income can affect the assessment process and outcome. Serviceability is determined through an all-moneys approach. The financial capacity and financial health of the business and its owner are considered – the income of a spouse, investors and business partners can be considered in the assessment process. An experienced and financially capable contractor is critical. Small developers must have considerable capital input available and must be able to provide securities and guarantees.

The small developers indicated that aligning their business models and project proposals with lenders' critical credit assessment criteria improved the viability of their credit proposals (RQ3). Adjustments to P5's business model included the development of a specific legal business structure, splitting risk between their company, investors and bank finance, and insulating investors from financial scrutiny. P4's business model focussed on areas with lower risk ratings, developing high quality, small high-end developments and using their plumbing business' income to improve their perceived serviceability potential. Further, small developers noted that it is excessively difficult to obtain finance as a combined contracting and property development company. They have decided not to pursue this route when applying for credit from lenders.

The interviewees indicated that banks are cautiously and conservatively consider small property development loans after the global financial crisis (RQ4). The property market is volatile in Australia, and small property development is approached with extreme cynicism by lenders. Small developers' credit access has not improved much in the twelve years after the global financial crisis. Regulatory constraints (RQ5) that affect small developers include foreign ownership and the tightening of lending assessment criteria during and after the FSRC Hearings. The focus of the inquiry around irresponsible lending practices has narrowed small developers' options for credit access. Previously available finance options are no longer available from lenders. Policies

around lending to capital income earners have been challenging to mitigate for some small developers.

The success rate of loan applications (RQ6) is improved with increased property development experience and completed projects. The complexity of the entity, market volatility, bank risk appetite, and policies relating to capital income earners contributes to difficulty to prove serviceability potential. Second-tier lenders who do not have pre-sales clauses in their agreements are considered by small developers when bank lending criteria are perceived to be too stringent. The interviewees believed in an ongoing credit relationship with their bank to maintain multiple opportunities to access finance.

Small developers have made use of outside advice during their applications (RQ7).

They have used finance brokers for initial applications. Both small developers use real estate agents, architects and design teams and a separate contractor. They depend on this network for market research and costings. They discuss industry challenges with other small developers and real estate agents.

Lenders monitor (RQ8) effective use of finance. Non-monetary covenants are used to assess the borrower's ongoing serviceability potential and financial health throughout the loan. Banks rely on market tests, like pre-sales, to test uptake. Funding is released in phases during construction with a revaluation at settlement. When non-monetary clauses are breached, this often has a financial impact on satisfying the LVR or potential increased cost or can lead to loan cancellation due to the devaluation. Table 6.4 below summarises the contribution of Chapter 6 to research questions and objectives.

Table 6.4: Contribution of data analysis of interviews with small developers

| Research question number | Research Question | Contribution of data analysis of interviews with small developers | | |
|--------------------------|---|---|---------------|----------------|
| | | Objective 1* | Objective 2** | Objective 3*** |
| RQ1 | How do lenders assess the lending applications of small developers? | X | X | X |
| RQ2 | What are the criteria on which commercial lenders base their decision to extend or refuse credit to small developers? | X | X | X |

| | | | | | |
|-----|--|---|---|---|---|
| RQ3 | Does the small developer's business model influence the lending decision? | X | X | X | X |
| RQ4 | Do commercial lenders view small developers as a viable business opportunity? | X | | X | X |
| RQ5 | What are the regulatory constraints in terms of financing small developers? | X | X | | X |
| RQ6 | What is the success rate of credit applications by small developers? | X | X | X | X |
| RQ7 | What outside advice do small developers make use of during their credit applications? | X | X | | X |
| RQ8 | Do lenders in Australia monitor the effective use of finance extended to small developers? | X | | X | X |

*Objective 1: identify the antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders

**Objective 2: analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success

***Objective 3: develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders

6.8 Summary of Chapter 6

This chapter explored the views of small developers on lenders' credit viability assessment processes through in-depth interviews. A systematic narrative analysis was followed, using Nvivo software to code interview transcripts and analyse the data. Chapter 6 adds further depth to the findings of the FSRC (Chapter 4) and lenders' views on their credit assessment process (Chapter 5), and allows for the triangulation of the results. Small developer participants indicated key factors that, from their perspective, are critical for success during lenders' loan application assessment process.

Small developers' loans are assessed against lenders' perception of their serviceability potential and the securities that will be provided. Further, lenders appraised their risk position and the money available to lend to the property development sector. Small developers should take factors external to their loan application, like market conditions and the economic health of their local area, into consideration. A reliable network that shares market and economic outlook information is invaluable to a small developer.

Awareness of their risks and vulnerabilities assisted small developers to evolve their understanding of the risk of a potential negative assessment and develop mitigating measures. A fundable business model and access to substantial capital are critical. During tough economic times, there is more competition between small developers for finance. Such periods necessitate that small developers to explore all available options for access to credit. When credit options with high interest rates are considered, sales risks should be carefully calculated.

Chapter 6 concludes Data Collection Stage 1 as indicated in the research design (see Figure 3.7), based on the theoretical rationale (see Figure 1.2) and the contribution of this chapter to the research is discussed in [Section 6.7](#). Chapter 7 summarises Data Collection Stage 1 and presents a conceptual model for the viability of the loan applications of small developers. The internal and external validation of the conceptual model is discussed in the next chapter.

CHAPTER 7

DEVELOPING AN APPROPRIATE MODEL FOR ASSESSING RISK IN CREDIT APPLICATIONS OF SMALL DEVELOPERS

7.1 Introduction

This chapter integrates the results of Data Collection Stage 1, as per the data collection strategy presented in Chapter 3 (see Figure 3.7 in [Section 3.5.1](#)). Data Collection Stage 1 analysed the critical risk factors identified during lenders' credit viability assessments of small developers' applications. Chapter 4's analysis of affirmed testimonies to the FSRC during the Round 3 Hearings and the FSRC Interim and Final Reports presented reliable evidence regarding lenders' risk assessment of small developers' credit proposals. While the FSRC data is a valuable objective data source of affirmed witness testimonies, the focus of the hearings was on what went wrong. Remedial measures proposed by the Commission regarding small business credit included that the National Credit Consumer Protection Act (NCCP Act) should not be extended to include protections to small businesses. The Commission argued that evidence presented during the hearings indicate that over-regulation will likely limit small business access to affordable credit. A second remedial measure proposed that the Australian Banking Association amend their definition of small businesses in their Banking Code of Practice. The Commission interpreted evidence regarding small business protections to indicate the Banking Code of Practice the primary protection source for small businesses (FSRC 2018a, 164). Recommendation 10.1 of the Commission simplified the small business definition and increased monetary limits of the definition to extend protections to more businesses. The banking industry did not accept this recommendation, and commissioned an independent consultant to refine the small business definition for protection purposes (see [Section 4.3.2](#)).

However, the FSRC data analysis results do not sufficiently address the details of the credit risk assessment by lenders of small developers' loan applications, as this was not the focus of the Commission. The data analysed in Chapters 5 and 6 provided depth to the analysis of the FSRC data from the viewpoints of bankers and small developers, respectively. These two chapters explored the themes from the FSRC data within the limits of lenders' credit application assessment process. Bankers who participated in the

research were authorised representatives of their respective banks with extensive experience in small property development credit assessment. Small developer participants have completed numerous successful developments and were selected based on the small property definition for this study as set out in [Section 2.4.3](#). Evidence presented in Chapters 5 and 6 indicates that lenders consider small developers a viable business opportunity but that lenders' risk perception and the loan approval rate is strongly correlated to changes in economic and market conditions and regulatory restrictions. Small developers use extensive outside advice from specialists and consultants due to their businesses' nature to outsource various parts of the property development process. They further rely on their networks for information and support during the loan application process, as high-quality credit proposals are more likely to succeed when competition for finance is high (see [Section 5.5.1](#) and [Section 6.5.1](#)).

Chapter 7 presents a conceptual model for assessing risk in the credit applications of small developers. This model is novel and based on the data reported in Chapters 4 to 6. An internal validation process was followed through integrating the co-occurrence data from Chapters 4 to 6 (see [Section 7.2.1](#)). The conceptual model was presented to an expert panel for external validation, using the Delphi method. The input from experts was considered, and an updated conceptual model for assessing risk in the credit applications of small developers is presented.

7.2 Background to the conceptual credit risk assessment model

Extant models do not address the uniqueness of small developers' credit risks effectively. [Section 2.5.3](#) proposed two models for conceptualising credit risk assessment. While providing a starting point, these models are not tailored to small property development credit risk assessment. Significant evidence from the Commission indicates that small businesses need to be better understood. Further, small developers are excluded from many, if not all, small business protections, therefore, increasing their risk in borrowing. While the FSRC case study analysis demonstrates that lenders consider property development a complex and sophisticated credit transaction, the Commission's recommendations do not address that ineffective limited liability, a small business characteristic, is the driver of banks' lending to small developers (see [Section 4.4.3](#)).

The Commission could not prescribe the right solution that could elicit banks' understanding of small property development risk as unique, compared to other small business risks as understood by the finance sector (see [Section 4.4.4](#)). Small developers have intense cash requirements, but this should not be interpreted as high risk. Lenders have developed many tools to evaluate and mitigate the credit risk of this sector. Lending is secured, usually with real estate, and personal guarantees are provided. An extensive financial assessment of the small property development business and additional income streams is conducted. Loans are not extended to the total estimate of the project value (LVR) and finance is released as value is created. Markets are closely monitored, and risk is assessed periodically. Contracts can be adjusted unilaterally throughout the loan period when there are changes in market conditions, economic conditions, and the small developer's income.

The themes developed in Chapters 4 to 6 illustrate that lenders' loan viability assessment process is subject to other bank processes and aligns with bank policies. Lenders' risk appetite varies, depending on their exposure and market conditions at a specific point in time. Lenders have limited funds available to lend to small property development. When the market is buoyant, competition between lenders can increase their risk appetite for lending. The banker assessing a small property development project proposal will consider the potential of the small developer to enter into a lending contract. Monitoring clauses (non-monetary covenants) are used to mitigate and monitor the bank's risk position during the loan period, and compliance with these will be necessary. Specialists could be used to monitor these tests against serviceability while considering if the borrower's serviceability potential will be stable over the lending timeframes. Non-monetary covenants are monitored through invasive financial assessments. These are costly to borrowers and could affect their cash flow, mainly when substantial economic and market changes occur, and the borrower's provable income decreases.

The amount of capital (equity portion) that a small developer has available is a deciding criterion. Small developers must have ample capital reserves to satisfy loan conditions, carry upfront costs, allow a contingency amount and carry other costs not capitalised in the loan. An all-moneys approach drives small business lending. Lenders assess a small property development business and the owner's finances as if these are the same.

Lenders also considers any additional income provided by partners in the small business and other small businesses owned by the same partners. Securities and guarantees are required for secured lending and are likely to be provided by the small business owner rather than the small company. A small developer's experience is an essential criterion that the bank considers. The requirement for the level of experience could vary between institutions. Some lenders only consider projects successfully completed by the small development company, while others consider the applicant's personal experience regarding property development or project management.

The borrower's entity is a guiding factor in the loan assessment process and could require additional tests and investigations into the entity's financial position by a banker. In such cases, the experience of a banker is critical. Banks interviewed preferred to split the risk by requiring a separate construction contract with a reputable and financially capable contractor. While small developers value an ongoing relationship with their bank, bankers indicated that each project is assessed based on merit. If a borrower is a repeat client, they better understand the lender's assessment process, documentary requirements and the expected quality of the proposal. A small developer's experience relates to their risk-awareness of the challenges related to property development and the financing of their projects.

Lenders often use specialists to verify the financial information and project information provided by loan applicants. The funds that a bank has available to lend out, the bank's current exposure, and market conditions affect the bank's risk appetite during the loan viability assessment process. These factors could differ at a specific point in time between institutions.

7.2.1 Internal validation of the conceptual model

An internal validation process was followed by integrating results from Chapters 4 to 6. The triangulation of the FSRC data, views of bankers regarding credit assessment risk and interviews with small developers, added depth to the results. Further, an integrated co-occurrence matrix, presented in Table 7.1 and Table 7.2, at the end of this section, confirms relationships between nodes in the results from previous chapters (see the summaries of results from [Section 4.5.3](#), [Section 5.5.1](#) and [Section 6.5.1](#)). Nodes not included in co-occurrence data analyses of separate occurrence matrices in Chapters 4 to

6 have higher co-occurrence rates in the integrated co-occurrence matrix, due to higher data density. Therefore, more codes are included in the combined analysis.

Bands representing high co-occurrences (40 plus times), medium co-occurrences (20 to 39 times) and low co-occurrences (10 to 19 times) are similar to summaries of co-occurrences as presented in Chapters 4 to 6. A detailed discussion about the nodes was presented in [Section 5.5.1](#) and [Section 6.5.1](#).

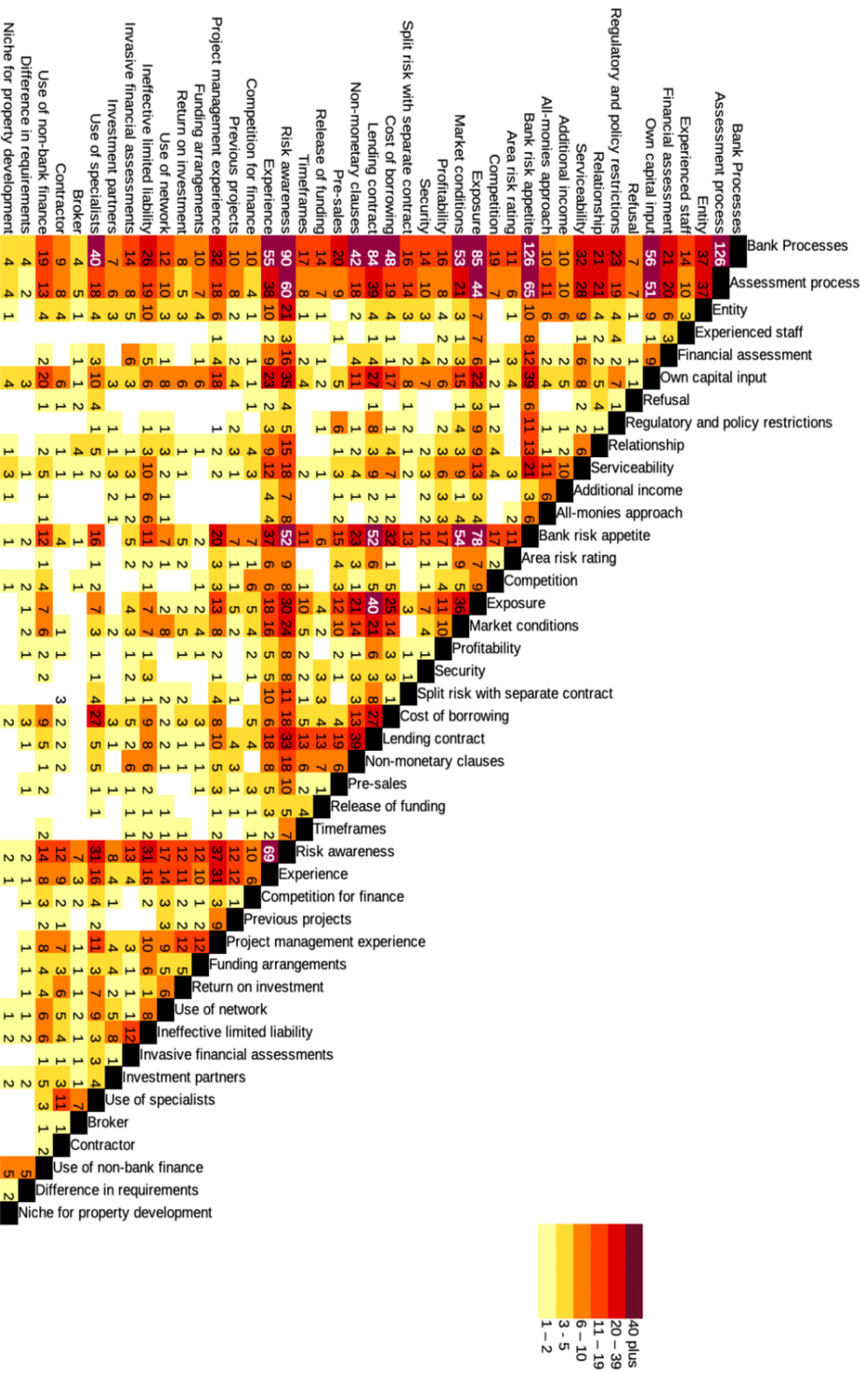
The integrated co-occurring nodes indicate that the nodes with the highest co-occurrences were *Bank processes*, *Assessment process*, *Bank risk appetite*, *Risk awareness*, *Experience* and *Exposure*. Other nodes with more than 40 co-occurrences in the integrated co-occurrence matrix were *Own capital input*, *Market conditions*, *Lending contract*, *Non-monetary clauses*, *Cost of borrowing* and *Use of Specialists*.

While the number of nodes with more than 40 co-occurrences increased in the integrated co-occurrence matrix, nodes with co-occurrences between 20-39 decreased. These nodes were *Entity*, *Financial assessment*, *Regulatory restrictions*, *Relationship*, *Serviceability*, *Pre-sales*, *Project management experience* and *Ineffective limited liability*. Nodes with 10 to 19 co-occurrences included *Experienced staff*, *Area risk rating*, *Additional income*, *All-moneys approach*, *Competition*, *Profitability*, *Securities and guaranties* and *Split risk with [a] separate contract*. Other nodes in this co-occurrence band are *Release of funding*, *Timeframes*, *Competition for finance*, *Funding arrangements*, *Previous projects*, *Use of non-bank finance*, *Policy restrictions*, *Return on investment* and *Contractor Quality*. Table 7.1 and Table 7.2 on the following page present a summary of the integrated high co-occurring nodes.

Table 7.1: Summary of integrated high co-occurring nodes from Data Collection Stage 1

| 40+ co-occurrences | 20 – 39 co-occurrences | 10 – 19 co-occurrences |
|---------------------------|-------------------------------|-----------------------------------|
| Bank processes | Entity | Experienced staff |
| Assessment processes | Financial assessment | Area risk rating |
| Bank risk appetite | Regulatory restrictions | Additional income |
| Risk awareness | Relationship | All-moneys approach |
| Experience | Serviceability | Competition |
| Exposure | Pre-sales | Profitability |
| Own capital input | Project management experience | Securities and guarantees |
| Market conditions | Ineffective limited liability | Split risk with separate contract |
| Lending contract | | Release of funding |
| Non-monetary clauses | | Timeframes |
| Cost of borrowing | | Competition for finance |
| Use of specialists | | Funding arrangements |
| | | Previous projects |
| | | Use of network |
| | | Use of non-bank finance |
| | | Policy restrictions |
| | | Return on investment |
| | | Contractor quality |

Table 7.2: Matrix of high co-occurring nodes from interviews with small developers



7.2.2 A conceptual credit risk assessment model for the viability of small developer lending applications

A credit assessment model based on a business plan, such as discussed by Forlee (2015) and Hormozi (2002), provides a systematic outline of the extensive documentary requirements of the credit assessment process. Bryant's (2012) Five C's model provides an overview of small business credit assessment and key considerations, analysis and appraisals of the borrower. While both models explain credit risk assessment process requirements, neither address the specific risk assessment of small developers' credit applications.

The proposed conceptual credit risk assessment model for the viability of small developers' lending applications is a novel model developed from the narrative data analysis of critical risk factors assessed by lenders during the credit assessment process (Chapters 4 to 6). This model is presented at the end of this section in Figure 7.1. The dependent variable served as the starting point for the development of the model as the desired outcome is a *Positive loan application assessment*. While all nodes coded were considered, not all nodes identified in the analyses of Chapters 4 to 6 were used in the model. Co-occurrence matrices, notably the integrated co-occurrence matrix (see Table 7.1 in [Section 7.2.1](#)), mind-maps and the narrative analyses of Data Collection Stage 1 formed the basis for the development of the model. The conceptual credit risk assessment model represents the consideration of nodes appropriate to the risk assessment of small developers' credit applications, and these nodes were included in the model for external validation.

Independent variables were identified as key risk factors that influence the success of a small developer's lending application. These factors were selected from high co-occurring nodes as well as from narrative data analysis as themes:

- *Regulatory restrictions;*
- *Bank risk appetite;*
- *Physical nature of property development;*
- *Ineffective limited liability;*
- *Securities and guarantees;*

- *Small developer capital input; and*
- *Small developer experience.*

Regulatory restrictions were identified both through a narrative analysis of FSRC data (see [Section 4.3.1](#) and [Section 4.3.3](#)) and as a high recurring node in the integrated co-occurrence matrix (see Table 7.1). *Small business protections* and the *Credibility of the financial industry* were identified as antecedent variables to *Regulatory restrictions*. These two themes were not coded as nodes but were highlighted by the FSRC recommendations and the finance industry's subsequent investigations regarding an appropriate small business definition for protection purposes (see [Section 4.3.2](#)). *Bank policy* (coded as *Policy* restriction) was identified as an intervening variable (mediator) to the independent variable *Regulatory restrictions*. Bank employees are required to follow policies in order to ensure uniformity and compliance. *Banker's experience* is indicated as a moderating intervening variable (coded as *Experienced staff*) that affects the application and interpretation of *Bank policies*. The two intervening codes were renamed in the model to clarify their purpose, as the node *Experienced staff* could be viewed as either a banks' or small developers' staff when the conceptual model is seen in isolation of the description. Both intervening variables have been identified from high co-occurring nodes.

The independent variable *Bank risk appetite* is indicated in the conceptual model with *Competition*, *Exposure*, *Market conditions* and *Bank funds available* as antecedent variables. *Bank risk appetite* is a node with a consistent high recurrence and co-occurrence rate in the FSRC data analysis and bankers' risk assessment views and the integrated co-occurrence data. This independent variable had high co-occurrence rates with *Exposure* and *Market conditions*. *Competition* between lenders was highlighted as a co-occurring node in the integrated co-occurrence analysis in this chapter. Due to low-frequency recurrences, *Bank funds available* was not coded, but was noted as a pre-condition for bank lending by banker participants and small developers (also see FSRC evidence on lenders' role in recycling capital in [Section 4.4.4](#)). While the purpose of the assessment process is to identify borrowers suitable to enter into a lending contract with, the non-monetary covenants (renamed *Monitoring clauses* for clarity of purpose in the model) are envisioned to mitigate ongoing credit risk during lending. The moderator *Market tests* (changed from *Pre-sales* clauses) affects the mediating intervening variable

Monitoring clauses. *Pre-sales* were identified as a high co-occurring node that affects the loan conditions, is a pre-condition for the release of finance and is challenging to achieve in during economic contractions (also see [Section 5.6.3](#)).

Market-tests is indicated as a moderator to both *Monitoring clauses* and the mediator *Time-lag in the supply of property*, an intervening variable to the independent variable *Physical nature of property development*. *Complex borrower* was identified as an antecedent variable to the *Physical nature of property development*. *Time-lag in the supply of property*, *Physical nature of property development* and *Complex borrower*; were not identified in the integrated co-occurrence matrix but were discussed in the literature review and the FSRC data (see [Section 4.4.4](#) and [Section 4.4.5](#)). These factors are considered critical in understanding small developers' propensity to succeed with lending applications; they were included in the conceptual model for external validation (see [Section 7.3](#)).

Ineffective limited liability, *Entity* and *Serviceability* were identified through a narrative analysis of FSRC data and as high recurring nodes in the integrated co-occurrence matrix (see [Section 4.4.3](#) regarding the all-moneys approach). *Entity* is indicated in the conceptual model as an antecedent variable to the independent variable *Ineffective limited liability*. The type of *Entity* of a small developer guides assessment process decisions. *Serviceability* (mediator) and *All-moneys approach* (moderator) were indicated as intervening variables.

The *All-moneys approach* is also indicated as a moderator to the independent variable *Securities and guarantees*. *Securities and guarantees* were coded as *Securities*. Similar to the antecedent variable *Bank funds available*, small property lending is secured, and lenders do not engage in unsecured lending to this sector. A further intervening variable to *Securities and guarantees* is indicated as *Guarantors* (a moderator). *Un-diversified asset base* and *Flexible compensation scheme* are identified as antecedent variables to *Securities and guarantees*. *Undiversified asset base* and *Flexible compensation scheme* are small business characteristics – see [Section 2.2.2](#). Both factors were considered critical to understanding small developers' security and guarantee provision and were included in the conceptual model for external validation.

Small developer *capital input* (coded as *Own capital input*), is an independent variable with a consistently high co-occurrence rate as a code in the FSRC data analysis and bankers' risk assessment views as well as the integrated co-occurrence data.

Contingency and *Investors* were noted as intervening variables (moderators), and *Loan to value ratio* and *Upfront costs* are indicated as antecedent variables. While *Contingency*, *Investors*, *Loan to value ratio* and *Upfront costs* were grouped during the coding process as *Use of non-bank finance* but they were separated in the model to clarify their purpose.

The last independent variable identified in the model is *Small developer experience* (coded as *Experience*) has a consistently high co-occurrence rate as a code in the FSRC data analysis and bankers' risk assessment views and the integrated co-occurrence data. The *Quality of project proposal* is indicated as an intervening variable (mediator). While not a coded node, this factor functions similarly to a business plan model for credit risk assessment and concentrates factors related to the project proposal quality. *Specialists*, *Network*, *Return customer*, and *Financial proposal* are indicated as moderators to *Quality of project proposal*. Figure 7.1 on the next page presents the conceptual credit risk assessment model for the viability of small developers during lending proposals.

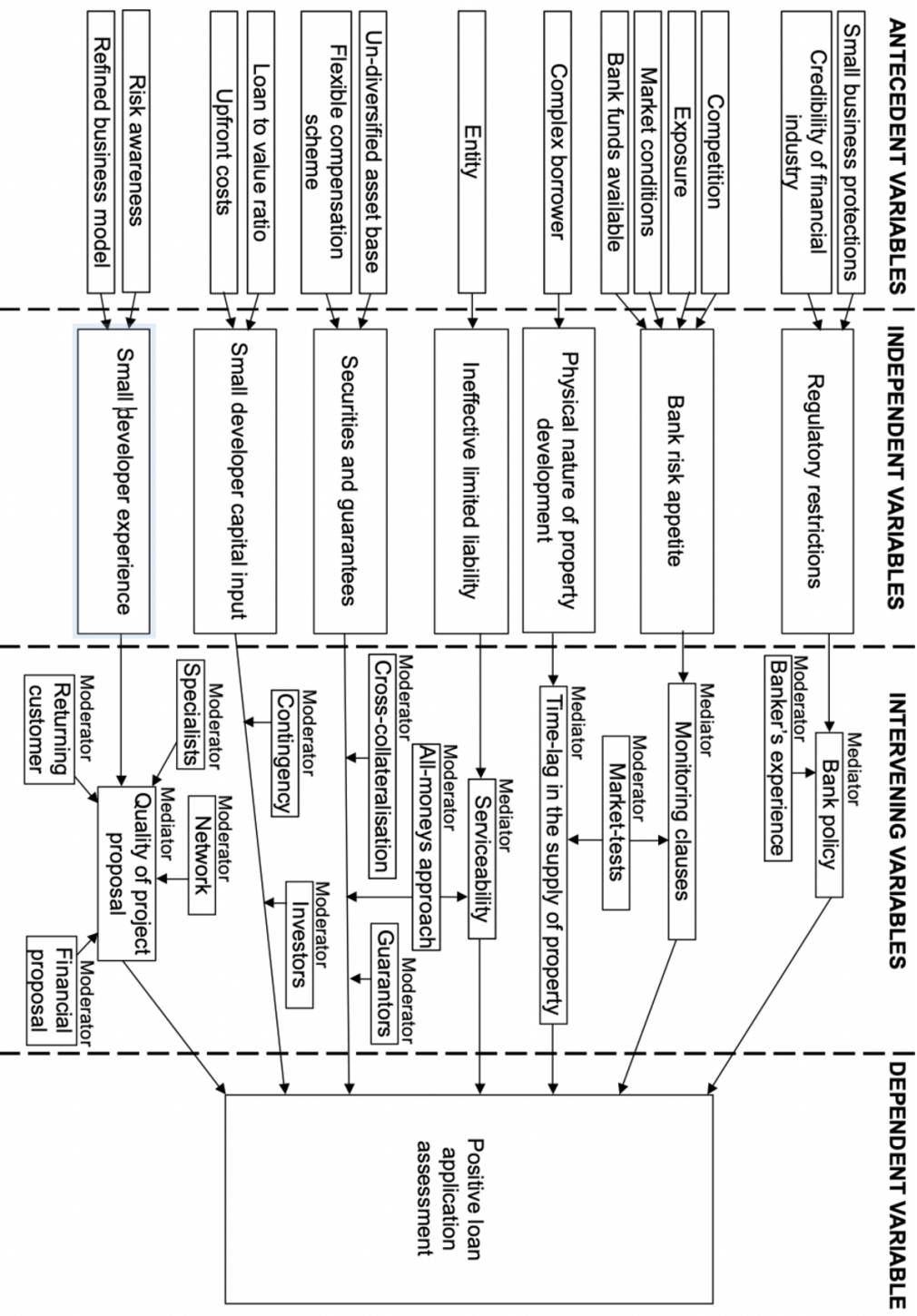


Figure 7.1: Conceptual credit risk assessment model for the viability of small developers during lending application

7.3 External validation of the conceptual credit risk assessment model

7.3.1 Background to expert panel evaluation of the conceptual credit risk assessment model

External validation of the conceptual credit risk assessment model, presented in Figure 7.1 (see [Section 7.2.2](#)), was through the Delphi method with a small expert panel. This method was selected to mitigate challenges posed by Covid-19 and restrictions on group gatherings (Australian Government Department of Health 2020). The Delphi method allows experts to provide their opinion in writing after thoughtful and objective consideration of the model. Experts were selected purposively based on the following criteria:

- Their personal experience with many successful loan applications for property development as the owner of a property development company; or
- Their regular interaction with the property development market and the credit applications of small developers.

Expert participants for this research included a property investment advisor (EP1), a property investor (EP2), and a property developer (EP3). A purposive selection process was followed. Participants were contacted via email to secure their participation. The research information summary, including the conceptual credit risk assessment model for the viability of small developers during lending applications, was sent to each participant separately in an email. This email contained a link to a website through which participants submitted their anonymous comments on the model.

Comments on the model were then evaluated, and the conceptual credit risk assessment model for the viability of small developers during lending applications was updated. The updated model was sent via email to the three participants, who were required to confirm their agreement with the updates made. All participants agreed with the changes and did not have further comments on the model after the second participation round.

Testing the conceptual model through an expert panel allowed for assessing the accuracy of the model and the links between themes. Experts provided their input, but their feedback lacked additionality. Minimal changes were implemented to the updated model. The data analysis describes experts' input, and an updated conceptual credit risk

assessment model for the viability of small developers during lending applications is presented at the end of [Section 7.3.3](#) (Figure 7.2).

7.3.2 Data analysis of expert panel feedback

Participants were requested to read the research information and consider the conceptual risk assessment that was emailed to them. The conceptual model was explained in the research information. Participants were then requested to follow a link to a website to respond to three questions.

The first question asked of expert participants to identify factors additional to those noted in the conceptual credit risk assessment model that, in their opinion, improve the loan application success of small developers. EP 1 indicated that they thought the model was clear and thorough, and EP2 responded that specialist bankers and a flexible application process for new businesses would improve the success rate of applications. EP3 listed a several factors:

Sales contract risk; Pre-Sales/Leasing quality; Deposit amounts; Financial Investment Review Board; Sales, Sunset clauses; Contractor quality/risk; Financial capability of builder/civil contractor.

Participants answered a second question asking their opinion regarding areas where the loan application assessment process could be improved or simplified. EP1 indicated that a good flow of information is valuable, and EP2 noted that they had experienced challenges regarding the LVR and the complex process of financing build-to-rent models. EP3 responded that a competent relationship banker or bank manager eases the process while a mortgage broker with property development credit application experience could assist the applicant during the assessment process.

The last question asked for general comments of the expert participants on the model from their experience relating to small property development credit. EP2 and E3 did not have further comments, while EP1 noted that

... valuations play a very important role in the ability to source funding, determining interest rates, and obviously the gearing and leverage on the investment.

Expert participants' feedback to the model were evaluated and the model was updated to reflect their input. The updated model was sent to the participants in an email,

explaining the effect of their feedback on the model. This explanation included notes to specialists that not all feedback resulted in updates to the model. For example, the role of valuations is covered under the impact of specialists on the quality of the project proposal.

Participants were asked to provide a second round of feedback regarding the model, by considering the appropriateness, positions and accuracy of the conceptual credit risk assessment model which included their input which resulted in updates. The experts responded that they do not wish to make further changes during the third round of feedback, and the updated model was accepted by all three participants.

7.3.3 Updates to the conceptual credit risk assessment model for the viability of small developer lending applications

The updated model was accepted as the validated outcome with no further changes indicated after the second round of expert feedback. The following changes were included as updates to the conceptual credit risk assessment model.

- As a regulatory restriction, *Foreign investment restrictions* could affect the success rate of applications as sales to foreign investors would be excluded from lenders' pre-sales calculations. This factor was added as an antecedent variable to *Regulatory restrictions*.
- A group of risks noted by EP3 in their comments to Question 1 were added as *Inherent development risks* to the conceptual credit risk assessment model as an antecedent variable to the *Physical nature of property development*.
- *Contractor quality* was added as a moderator to the mediator *Quality of project proposal*. These intervening variables relate to the independent variable *Small developer experience*.
- While a *Banker's experience* affects their interpretation of *Bank policy*, a *Specialist banker* focuses on the credit assessment of a specific market segment and could affect the perceived viability of small developers. This factor was added as an intervening variable (moderator that affects *Bank policy*) to the independent variable, *Regulatory restrictions*.

The updated conceptual credit risk assessment model for the viability of small developers was presented to the expert panel during a third round of feedback, and

all three experts indicated that they were satisfied with the changes and that they accept this model. Updates from the expert panel's input to the credit risk assessment model for the viability of small developers is presented in Figure 7.2 on the next page.

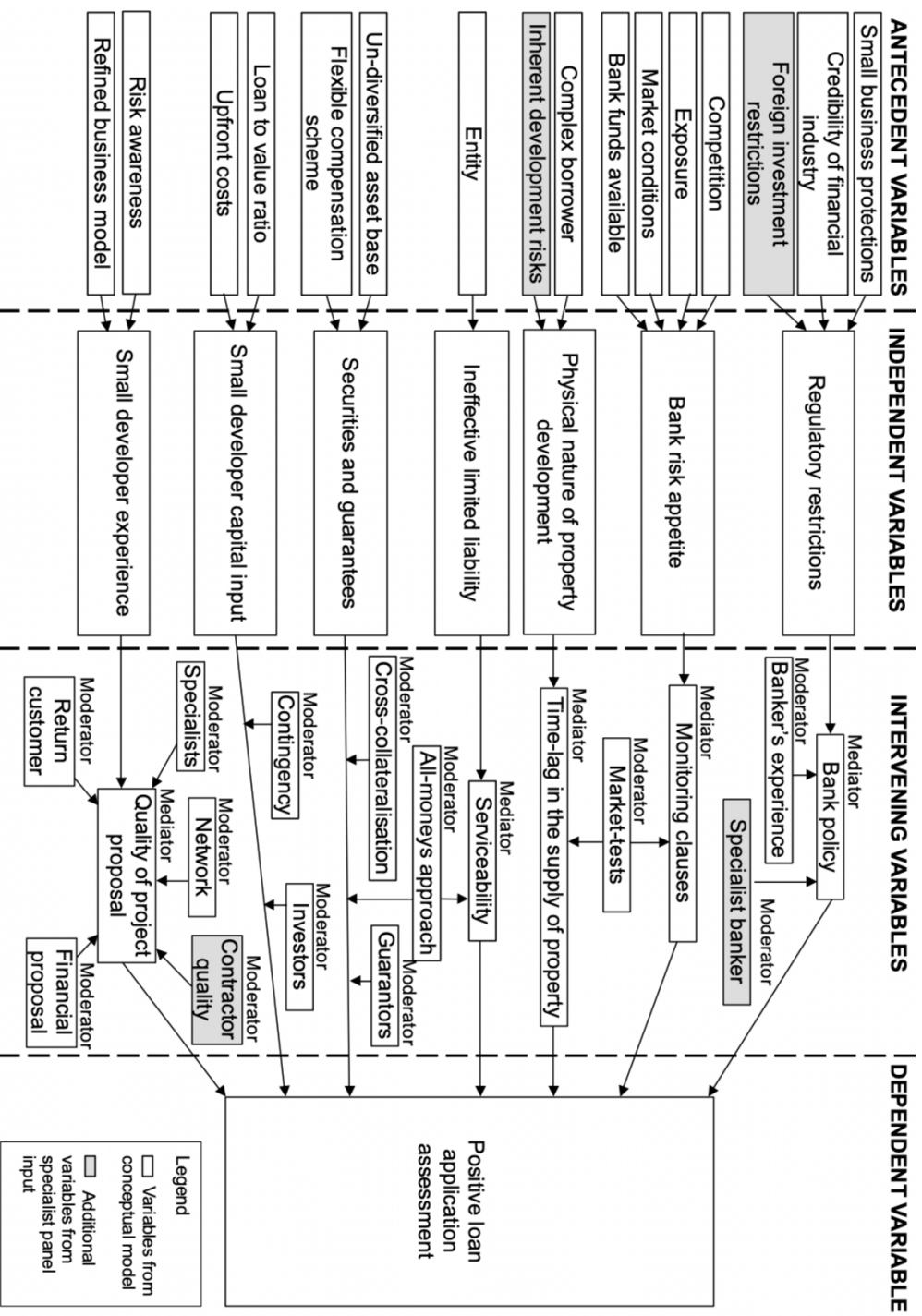


Figure 7.2: Updated conceptual credit risk assessment model for the viability of small developers during lending applications

7.4 Summary of Chapter 7

The research in Chapter 7 concludes Data Collection Stage 1 and the external validation of the conceptual credit risk assessment model (Data Collection Stage 2a). The updated conceptual credit risk assessment model for the viability of small developers during lending applications is a novel model. This model integrates the data collection as set out in Chapters 4 to 6. Triangulation of data allowed the identification of lenders' key risk factors pertaining to small developers' credit risk assessment by lenders. Co-occurrence matrices were used to identify themes with high co-occurrence rates from the narrative data analysis. An expert panel supported the conceptual credit risk assessment model for the viability of small developers during lending applications. Comments from experts were incorporated, and an updated conceptual credit risk assessment model is presented in this chapter. Chapter 8 describes the use of an industry survey to test the conceptual credit risk assessment model.

This chapter contributes to the research objectives by identifying factors contributing to small developers' risk of failure during credit applications to lenders (Objective 1). Key risk factors are assessed against their support for small developers' strategic structure for business success (Objective 2). Objective 3 is addressed by presenting key risk factors in the updated conceptual credit risk assessment model (see Figure 7.2 on the previous page).

CHAPTER 8

A QUANTITATIVE MODEL FOR AN IMPROVED RISK ASSESSMENT OF THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS

8.1 Introduction

Chapter 7 presented an updated conceptual credit risk assessment model for the viability of small developers during lending applications, and discussed the internal and external validation of this model. The conceptual model concluded Data Collection Stage 1 and the model was updated after input from a panel of experts (see Figure 7.2 in [Section 7.7.3](#)). The updates to the model included *Foreign investment restrictions* as an antecedent variable to the independent variable *Regulatory Restrictions*, with *Specialist banker* as a moderating intervening variable. *Inherent development risks* was added as an antecedent variable to the independent variable *Physical nature of property development*. An intervening variable (moderator) was added to the independent variable *Small property developer experience*.

Chapter 8 evaluates the independent variables of the conceptual credit risk assessment model and their relationship with antecedent and intervening variables against the results of an industry survey. The survey, conducted through online survey and analysis software, contained questions based on the conceptual credit risk assessment model. Chapter 8 concludes Data Collection Stage 2, and presents the data analysis and integrated results of the both data collection stages. A proposed improved credit risk assessment model for the viability of small developers during lending applications is presented (see Figure 8.4 in [Section 8.5](#)).

8.2 Research methods for an industry survey

8.2.1 Background to the industry survey research methods

The FSRC data analysis provided generalisable results (Chapter 4), while data collection through interviews and a focus group centered on collecting in-depth data relating to the research topic (Chapters 5 and 6). Evidence to the FSRC affords an objective perspective on lenders' small-business and property development credit processes, however, small developers' credit assessment was not sufficiently discussed.

In-depth interviews with a banker and small developers, and a focus group with bankers addressed this research gap. Sample sizes for interviews and the focus group was limited to Western Australia.

Chapter 8 triangulates the results of a nation industry survey with findings from Chapters 4 to 7. Findings from the survey were added to the updated conceptual credit risk assessment model an improved credit risk assessment model is presented. The use of an industry survey further improves the generalisability of findings from Data Collection Stage 1 and serves as an external validation of the model.

8.2.2 Industry survey design and participant selection

The industry survey was designed as seven matrix-table questions. These seven questions were based on the seven independent variables of the conceptual credit risk assessment model (*Regulatory restrictions, Bank risk appetite, Nature of property development, Ineffective limited liability of small companies, Securities and guarantees, Small developer capital input and the Small developer's experience*). The statements relating to each question were based on the independent and intervening variables identified in the conceptual credit risk assessment of small developers' credit viability (see Figure 7.1 in [Section 7.2.2](#)).

Participants were asked to grade statements containing the antecedent and intervening variables based on their agreement or disagreement with the positive effect of these statement on the independent variable. A five-point Likert grading scale was used and a score of 1 indicated strong agreement while a score of 5 recorded strong disagreement. An eighth question allowed participants to add written comments on additional factors which they perceived critical during the small developer loan application assessment process. This process adds to the external validation of the model and is described in [Section 8.3.3](#). The survey's cover page introduced the participants to the research background and Curtin University Human Research Ethics Committee approvals. Participants had the option to leave their email address at the end of the survey if they wished to receive a summary of the results. Appendix 2, at the end of this document, presents a sample of the survey sent to participants.

Participants for the survey were selected based on their perceived experience of small property development credit assessment challenges. The sampling method was non-random and purposive sampling was followed. The professional profiles of participants were briefly examined online to determine the suitability as a potential participant. Their experience regarding small developer credit applications was the main criterion for selection. Initial recipients of the recruitment email were encouraged to forward the survey link to their small developer clients to encourage a second non-random sampling technique, snowballing. Online profiles included participants' employer websites, personal websites or websites where they are registered with voluntary or professional bodies that provide summaries of registered persons' experience. Participants were contacted via an individual email, addressing them by name. Overall, 2033 individual emails were sent to potential contributors across Australia. Participants included contractors, small developers, finance experts, finance brokers and real estate agents. Demographic questions were not asked of participants as participation was expected to be based predominantly on the purposively selected sample. Therefore, the survey did not test levels of participation between categories of participants. Differentiating between and comparing the responses provides a future research opportunity for further validation of the conceptual credit risk assessment of the viability of small developers' loan applications. The email provided a brief research summary and an anonymous survey link. Also see [Section 3.5.2](#) for the complete research sampling strategy.

Some participants responded to the email and declined to participate. Due to the email response, their experience category could be recorded. Some participants indicated that they did not feel experienced enough to answer the questions or have not had any recent experience regarding the survey questions. Other reasons included that participants feel survey-fatigued due excessive surveys received during Covid-19. Some participants noted that they were restricted by their company's policies from participating. One participant noted that lenders have had no appetite for small property development lending and that this market is obsolete. A summary of email responses declining participation is indicated in Table 8.1 below.

Table 8.1: Summary of reasons from participants that formally declined to participate

| Reason for non-participation | Participant category |
|------------------------------|----------------------|
|------------------------------|----------------------|

| | Contractor | Small developer | Finance expert | Finance broker | Real estate agent | Project manager |
|--|------------|-----------------|----------------|----------------|-------------------|-----------------|
| Do not feel experienced enough / no recent experience | 4 | | 5 | 4 | 16 | |
| Survey-fatigued | 4 | 1 | 1 | 4 | 4 | 1 |
| Restricted by company policy from participating | 2 | 1 | | 1 | 2 | |
| No bank appetite for lending to small property development | | | | 1 | | |

8.2.3 The data sources, their treatment and limitations

The data collected were survey responses from participants through an anonymous link sent to them in an email, as well as a follow-up email, to a survey developed through online survey and analysis software. A total of 217 respondents participated in the survey, and 97 participants graded the all the matrix statements. Partial completions of the survey were included in the data only when participants completed the full matrix-table of a particular question. Between 97 to 124 participants completed at least one matrix-table question in full. A linear regression model explores the relative importance of each statements related to each of the seven independent variables (see Table 8.7 in [Section 8.3.2](#)). The adequacy of the participation ratio is discussed in [Section 8.2.4](#). Table 8.2 below summarises the number of participants that completed survey questions.

Table 8.2: Completed number of responses per survey question

| Survey question | Number of participants that completed the survey question |
|-------------------------------|---|
| Question 1 (research summary) | 217 |
| Question 2 | 124 |
| Question 3 | 110 |
| Question 4 | 104 |

| | |
|--|-----|
| Question 5 | 104 |
| Question 6 | 102 |
| Question 7 | 100 |
| Question 8 | 97 |
| Question 9 (optional written feedback) | 46 |

Survey questions tested the validity of the relationships of the antecedent and intervening variables to the independent variables, as identified in the conceptual credit risk assessment. These seven independent variables are *Regulatory restrictions*, *Bank risk appetite*, *Physical nature of property development*, *Ineffective limited liability*, *Securities and guarantees*, *Small developer capital input* and *Small developer experience*. Data Collection Stage 1 and the expert panel’s external validation of the conceptual credit risk assessment model, supported the relationship of the independent variables with the dependent variable, the *Positive loan application assessment* of a small developers’ proposal. A *Positive loan application assessment* is the desirable outcome of a lender’s credit risk assessment process, considered against the seven risk areas.

Because the antecedent and intervening variables do not have a linear relationship with the independent variables, a limitation of the survey is that only the validity of these variables’ relationship with their independent variable could be tested, and not their position in the model. Further, the two antecedent and two intervening variables added to the updated conceptual credit risk assessment model were not tested as both expert feedback and survey questions were based on the conceptual credit risk assessment model. The validity of these four factors was considered against feedback to the last question, where participants gave written feedback regarding additional factors which they perceive as critical to the credit assessment process of small developers’ loan applications.

Matrix-table questions of the survey were based on the relationships identified in the conceptual credit risk assessment model between the antecedent and intervening variables and the seven independent variables (see Figure 7.1 in [Section 7.2.2](#) and Appendix 2 for a sample survey). The survey tested 29 statements that were each graded

on a five-point Likert scale. Table 8.3, on the next page, summarises the relationships between the independent variables and the statements tested. Question 1 related to the introductory statement to the survey.

Question 2 focussed on *Regulatory restrictions*; participants were asked to use the five-point Likert grading scale to rate positive effect of four factors on the success of a small developer's loan application relating to *Regulatory restrictions*. Similarly, Question 3 tested *Bank risk appetite* against (6 statements) and Question 4 centred around the *Nature of property development* (2 statements). Question 5 focussed on the effect of the *Ineffective limited liability* of small companies (3 statements), while Question 6 related to *Securities and guarantees* (4 statements). Question 7 tested the factors relating to *Small developer capital input* (3 statements) and Question 8 (7 statements) centred on the *Small developer's experience*. Question 9 allowed written feedback from participants to indicate additional factors in addition to the factors tested in the survey and is not included in the summary table.

Table 8.3: Table of statement numbers and question numbers relating to the statements

| Independent variable | Question number | Statement description |
|---|------------------------|--|
| Regulatory restrictions | Q2_1 | <i>Regulatory restrictions and small business protections</i> |
| | Q2_2 | <i>Credible and transparent application processes</i> |
| | Q2_3 | <i>Bank policies that includes regulatory restrictions and protections</i> |
| | Q2_4 | <i>The experience of a banker dealing with small property developer loan applications</i> |
| Bank risk appetite | Q3_1 | <i>Strong competition between banks to obtain new small property development clients</i> |
| | Q3_2 | <i>The current exposure of the bank to small property development</i> |
| | Q3_3 | <i>Buoyant market conditions in the property industry at the time of the loan application</i> |
| | Q3_4 | <i>The money that the bank has available to lend out to property developers</i> |
| | Q3_5 | <i>The ability of the small property developer to achieve high pre-sales</i> |
| | Q3_6 | <i>A small property developer indicating that they will agree to a high number of monitoring clauses in their lending contract</i> |
| Physical nature of property development | Q4_1 | <i>The complex nature of financing each property development project</i> |
| | Q4_2 | <i>The time-lag in the supply of property (longer loan periods)</i> |
| Ineffective limited liability | Q5_1 | <i>The type of business entity (sole trader, company, trust etc.) of the small property developer</i> |
| | Q5_2 | <i>Allowing the bank to consider all possible income streams of the small property developer and their business partners</i> |
| | Q5_3 | <i>A clear indication to the bank of how the small property developer will service the loan payments for the duration of the loan</i> |
| Securities and guarantees | Q6_1 | <i>Using assets like a family home to secure the loan</i> |
| | Q6_2 | <i>The flexible compensation scheme (how the small property developer determines their own salary and benefits from their company)</i> |
| | Q6_3 | <i>Using cross-collateralisation to secure loans</i> |
| | Q6_4 | <i>Using first-party and third-party guarantors</i> |
| Small property developer capital input | Q7_1 | <i>Capital available to satisfy the loan to value ratio calculation for the loan</i> |
| | Q7_2 | <i>Capital available to cover the upfront costs to ensure that development approvals are in place</i> |
| | Q7_3 | <i>Capital available for contingencies and 'when things go wrong'</i> |
| Small property developer experience | Q8_1 | <i>Proven experience in the property development environment</i> |
| | Q8_2 | <i>Understanding the factors that the bank will consider during the loan application process</i> |
| | Q8_3 | <i>Using specialists, like accountants, lawyers and financial advisors to assist with the loan application</i> |
| | Q8_4 | <i>Using their network (brokers, real estate agents, building surveyors, friends etc.) to understand market conditions in property development</i> |
| | Q8_5 | <i>Understanding a specific bank's requirements by becoming a return customer</i> |
| | Q8_6 | <i>Engaging a competent and financially capable contractor</i> |
| | Q8_7 | <i>Developing a business model that is specific to bank requirements for financing</i> |

8.2.4 Saturation and reliability

Changes in the key drivers of each question was indicated in the linear regression analysis and were measured monthly over the survey period. This test only used surveys where one or more question was completed in full. Two respondents indicated via email that they started the questionnaire and did not feel qualified to answer the questions. This was judged to be a trend where questions were not completed and these surveys were omitted. Costello and Osborne (2005) argue that the initial pool of factors (the seven independent variables) should be used as the basis for the sample size. They indicate that a small sample size with “subject item ratios of 10:1 or less” (pp. 4) is sufficient, and that these can be used effectively to conduct a principal component factor analysis, discussed in [Section 8.4](#). Question 2 to 8 were used in the factor analysis, with the lowest response rate to a question being 97 participants, achieving saturation, sufficient to conduct a factor analysis at 13,9:1. See Table 8.2 in the previous section for completed number of responses per question.

Chronbach’s alpha was used to test the internal consistency of the items in the survey (statements) relating to each independent variable. The of composite scores of the statements related to each question was calculated. Question 2, Question 3, Question 6 and Question 8 had high composite scores (an α coefficient between 0.65 and 0.8), indicating a high internal consistency and reliable variance. Question 4 (focussed on the independent variable *Physical nature of property development*) and Question 7 (relating to the independent variable *Small developer capital input*) had very high α coefficients of 0.86 and 0.87 respectively, indicating an excellent internal consistency, and high reliable variance. Question 5 (statements about the independent variable *Ineffective limited liability*) had a moderate-low α coefficient of 0.54. A summary of the scores is presented in Table 8.4 on the next page.

Table 8.4: Summary table of internal consistency of composite scores using Chronbach's alpha

| Independent variable | Survey question number | Number items tested | Number of participants | Chronbach's alpha |
|---|------------------------|---------------------|------------------------|-------------------|
| Regulatory restrictions | Q2 | 4 | 124 | 0.75 |
| Bank risk appetite | Q3 | 6 | 110 | 0.70 |
| Physical nature of property development | Q4 | 2 | 104 | 0.86 |
| Ineffective limited liability | Q5 | 3 | 104 | 0.54 |
| Securities and guarantees | Q6 | 4 | 102 | 0.71 |
| Small developer capital input | Q7 | 3 | 100 | 0.87 |
| Small developer experience | Q8 | 7 | 97 | 0.73 |

8.3 Data analysis of industry survey results

8.3.1 Overview of statistical correlations

A summary of correlation provides an overview of the statistical importance of the relationships between the 29 statements graded in the survey. This correlation analysis explores the possible connections between variables. The Stats iQ function in Qualtrics software was used to develop two correlation matrices, and the data was exported to Excel. P-Values indicate the statistical significance of the correlation between two variables. While p-values of $P < 0.05$ are considered statistically significant, higher non-significant values does not mean that there is no effect (Amrhein, Greenland, and McShane 2019). For this reason, Amrhein et al. (2019) argue that low P values should be accurately reported and not merely be indicated as $P > 0.5$.

Statistically positively correlated statements, relating to the 29 antecedent and intervening variables of the conceptual credit risk assessment model (see Figure 7.1 in [Section 7.2.2](#)), which tested in the industry survey were indicated in the analyses as follows:

- Positive statistical correlations were found between Q2_1 to Q2_3, with the exclusion of Q2_3 (*Bank policy*) and Q3_1 (*Competition*) that had no statistical correlation. Variables with positive correlations are Q2_1 (*Small business*

protections), Q2_2 (*Credibility of financial industry*), Q2_3 (*Bank policy*), Q2_4 (*Banker's experience*), Q3_1 (*Competition*) and Q3_2 (*Exposure*).

- Q2_1 (*Small business protections*) had further positive statistical correlations with Q3_4 (*Bank funds available*), Q3_6 (*Monitoring clauses*), Q4_1 (*Complex borrower*), Q4_2 (*Time lag in supply of property*), Q5_1 (*Business entity*) and Q8_5 (*Return customer*). Additional positive statistical correlations were indicated between Q2_2 (*Credible financial industry*) and Q3_4 (*Bank funds available*), Q3_6 (*Monitoring clauses*), Q5_1 (*Entity*), Q5_3 (*Serviceability*) and Q8_5 (*Return customer*). Q2_3 also had positive statistical correlations with Q4_1 (*Complex borrower*), Q4_2 (*Time lag in the supply of property*) and Q5_1 (*Entity*). Positive statistical correlations were also indicated for Q2_4 (*Banker's experience*) with Q3_3 (*Market conditions*), Q3_5 (*Market tests*), Q3_6 (*Monitoring clauses*), Q5_3 (*Serviceability*), Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*), Q7_3 (*Contingency*), Q8_1 (*Quality of project proposal*) and Q8_2 (*Self-awareness*).
- Positive statistical correlations were indicated between Q3_1 to Q3_6, with the exception of Q3_6 (*Monitoring clauses*) that had no statistical correlation with Q3_1 (*Competition*) and Q3_4 (*Bank funds available*).
- Q3_1 (*Competition*) had further positive statistical correlations with Q5_2 (*All-moneys*), Q5_3 (*Serviceability*), Q6_2, and Q6_4 (*Guarantors*). Additional positive statistical correlations between Q3_2 (*Exposure*) and Q5_3 (*Serviceability*) and Q8_4 (*Network*) were indicated. Q3_3 (*Market conditions*) is also positively correlated with Q5_2 (*All-moneys*), Q5_3 (*Serviceability*), Q8_1 (*Project proposal equality*), Q8_3 (*Specialists*), Q8_4 (*Network*) and Q8_6 (*Contractor quality*). Q3_4 (*Bank funds available*) is further statistically correlated with Q6_2 (*Flexible compensation scheme*) and Q8_7 (*Refined business model*). Q3_5 (*Market tests*) is positively correlated to Q5_3 (*Serviceability*), Q7_3 (*Contingency*) and Q8_1 (*Project proposal quality*).
- Q4_1 (*Complex borrower*) and Q4_2 (*Time lag in supply of property*) are statistically positively correlated.
- Q5_1 (*Entity*) has additional positive statistical correlations with Q6_4 (*Guarantors*), Q7_1 (*Loan to value ratio*), Q8_1 (*Quality of project proposal*), Q8_4 (*Network*) and Q8_7 (*Refined business model*). Further positive

correlations are indicated between Q5_2 (*All-moneys*) and Q5_3 (*Serviceability*), Q8_2 (*Self-awareness*) and Q8_6 (*Contractor quality*). Q5_3 (*Serviceability*) is further positively correlated with Q6_4 (*Guarantors*), Q7 (relating to the independent variable *Small developer capital input*) and Q8 (relating to the independent variable *Small developer experience*), with the exception of Q8_5 (*Return customer*).

- Q6_1 to Q6_3 is positively correlated. Q6_1 (*Un-diversified asset base*) has additional positive statistical correlations to Q7_1 (*Loan to value ratio*) and Q7_2 (*Upfront costs*). Q6_2 (*Flexible compensation scheme*) is also positively correlated with Q7 (relating to the independent variable *Small developer capital input*) and Q8 (relating to the independent variable *Small developer experience*), with the exception of Q8_4 (*Network*) and Q8_6 (*Contractor quality*). Q6_3 (*Cross-collateralisation*) is positively correlated to Q8_1 (*Quality of project proposal*).
- Q7_1 to Q7_3 is indicated to have positive statistical correlations. Q7_1 (*Loan to value ratio*) has further positive correlation Q8_1 (*Quality of project proposal*) and Q8_5 (*Return customer*). Q7_3 (*Contingency*) is positively correlated to Q8_4 (*Network*).

The statistical correlation analysis indicated potential nonlinear correlations between variables. These overlaps are prominent for Q2_2 (*Credibility of financial industry*) Q5_2 (*All moneys approach*), Q5_3 (*Serviceability*), Q6_2 (*Flexible compensation scheme*), Q6_3 (*Cross-collateralisation*), Q6_4 (*Guarantors*), Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*), Q7_3 (*Contingency*). All the variables relating to Q8, which tested antecedent and intervening variables of the independent variable *Small developers' experience*, were indicated as potentially nonlinear. These are Q8_1 (*Quality of project proposal*), Q8_2 (*Self-awareness*), Q8_3 (*Specialists*), Q8_4 (*Network*), Q8_5 (*Return customer*), Q8_6 (*Contractor quality*) and Q8_7 (*Refined business model*).

Some potential non-linear correlations are indicated for Q2_3 (*Bank policy*), Q3_2 (*Exposure*), Q3_3 (*Market conditions*), Q3_5 (*Market tests*), Q3_6 (*Monitoring clauses*) and Q5_3 (*Serviceability*). The summary of statistical correlations is presented in Table 8.5 on the next page.

Pearson's r (Pearson correlation coefficient) is the measure of correlation where there were no outliers in the continuous/discrete data, and the relationship between the variables is linear (association between variables with best fit). Outliers are data points that do not fit the general data trend and were removed in the Stats iQ test to calculate Pearson's r to measure effect size. The linear association between the could be positive or negative. A positive effect size indicates that when one variable increases, the other will as well. Where the effect size is negative, the second variable will decrease while the first increases. Gignac and Szodorai (2016) assert that an effect size under 0.1 is relatively small, and an effect size of 0.2 is typical while 0.3 is relatively large. Previously, Cohen (1992) noted that an effect size of 0.5 is large. A significant effect size means that when one variable increases, so do the other.

While not statistically correlated, the following variables were indicated to have an effect on one another:

- Q2_1 (*Small business protections*) has a typical to medium effect on Q8_3 (*Specialists*), Q8_4 (*Network*) and Q8_7 (*Refined business model*). Q2_2 (*Credibility of financial industry*) tested against Q3_3 (*Market conditions*), Q4_1 (*Complex borrower*), Q5_2 (*All moneys*), Q8_2 (*Self-awareness*), Q8_4 (*Network*) and Q8_6 (*Contractor quality*) had a typical to moderate effect size. Variables that has an effect size, but not statistically correlated with Q2_3 (*Bank policy*) are Q3_5 (*Market tests*), Q6_3 (*Cross-collateralisation*), Q6_4 (*Guarantors*), Q8_4 (*Network*) and Q8_5 (*Return customer*). Q2_4 (*Banker's experience*) shared a typical to moderate effect size with Q3_4 (*Bank funds available*), Q5_1 (*Entity*), Q6_2 (*Flexible compensation scheme*), Q6_3 (*Cross-collateralisation*), Q6_4 (*Guarantors*), and Q8_3 (*Specialists*).
- Q3_1 (*Competition*) had an effect size with Q3_6 (*Monitoring clauses*), Q8_1 (*Quality of project proposal*), Q8_3 (*Specialists*) and Q8_4 (*Network*) of typical to moderate. Q3_2 (*All-moneys approach*) had a moderate effect on Q4_1 (*Complex borrower*), Q5_1 (*Entity*), Q5_2 (*All-moneys*), Q6_2 (*Flexible compensation scheme*), Q7_2 (*Upfront costs*), Q8_4 (*Network*) and a large effect on Q7_3 (*Contingency*). Variables that had a typical to moderate effect size, but not statistical correlation with Q3_3 (*Serviceability*) are Q5_1 (*Entity*), Q6_4

(*Guarantors*), Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*) and Q8_2 (*Self-awareness*). Q3_4 (*Bank funds available*) shared a typical to moderate effect size with Q3_6 (*Monitoring clauses*), Q4_1 (*Complex borrower*), Q5_1 (*Entity*), Q8_3 (*Specialists*) and Q8_7 (*Refined business model*) and a large effect size with Q7_3 (*Contingency*). Q3_5 (*Market tests*) had a positive effect with Q5_2 (*All-moneys approach (Guarantors)*), Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*), Q8_2 (*Self-awareness*) and Q8_3 (*Specialists*). Q3_6 (*Monitoring clauses*) had a typical to moderate effect on Q5_2 (*All-moneys approach*), Q5_3 (*Serviceability*), Q6_4 (*Guarantors*) and Q8_3 (*Specialists*).

- Q4_1 (*Complex borrower*) had a typical effect on Q8_1 (*Quality of project proposal*), while Q4_2 (*Time lag in supply of property*) has a positive effect on Q8_4 (*Network*). Q5_1 (*Entity*) has an effect on, but not a statistical correlation to Q5_2 (*All-moneys approach*), Q5_3 (*Serviceability*) and Q6_3 (*Cross-collateralisation*). Q5_2 (*All-moneys approach*) has a moderate effect on Q6_1 (*Undiversified asset base*), Q6_2 (*Flexible compensation scheme*), Q6_3 (*Cross-collateralisation*) and Q6_4 (*Guarantors*) and a typical effect on Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*), Q7_3 (*Contingency*) and Q8_4 (*Network*). Variables sharing an effect size with Q5_3 are Q6_1 (*Undiversified asset base*), Q6_2 (*Flexible compensation scheme*), Q7_1 (*Loan to value ratio*) and Q8_1 (*Quality of project proposal*).
- Variables that share an effect size with Q6_1 (*Undiversified asset base*) are Q6_3 (*Cross-collateralisation*), Q7_3 (*Contingency*) and Q8_7 (*Refined business model*), while Q6_2 (*Flexible compensation scheme*) shares an effect size with Q6_4 (*Guarantors*), Q7_3 (*Contingency*), Q8_3 (*Specialists*) and Q8_6 (*Contractor quality*). Q6_3 (*Cross-collateralisation*) shares a moderate effect with Q7_1 (*Loan to value ratio*) and Q8_2 (*Self-awareness*). Q6_4 (*Guarantors*) has an effect size with Q8_3 (*Specialists*) and Q8_6 (*Contractor quality*). While Q7_1 (*Loan to value ratio*), Q7_2 (*Upfront costs*) and Q7_3 (*Contingency*) share an effect size with Q8_1 (*Quality of project proposal*), Q8_2 (*Self-awareness*) and Q8_3 (*Specialists*), Q7_2 also shares an effect size with Q8_6 (*Contractor Quality*). Q8_1 and Q8_2 has a positive effect with variables Q8_3 (*Specialists*) and Q8_4 (*Network*), while Q8_1 has an effect with Q8_6 and Q8_2 has an effect with Q8_5 (*Contractor Quality*). Q8_3 has an effect with Q8_6 and Q8_4

has an effect with Q8_5 and Q8_7 (*Refined business model*). Q8_5 has a positive effect with Q8_6 and both have a positive effect with Q8_7.

Q2_3 (*Bank policy*) and Q7_3 (*Contingency*) are the only variables with a notable negative correlation. The correlation summary of the effect size is presented in Table 8.6 on the next page.

Table 8.6: Correlation summary of 29 statements of industry survey

| | Q2_1 | Q2_2 | Q2_3 | Q2_4 | Q3_1 | Q3_2 | Q3_3 | Q3_4 | Q3_5 | Q3_6 | Q4_1 | Q4_2 | Q5_1 | Q5_2 | Q5_3 | Q6_1 | Q6_2 | Q6_3 | Q6_4 | Q7_1 | Q7_2 | Q7_3 | Q8_1 | Q8_2 | Q8_3 | Q8_4 | Q8_5 | Q8_6 | Q8_7 |
|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Q2_1 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Q2_2 | 0.5 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Q2_3 | 0.8 | 0.4 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Q2_4 | 0.2 | 0.3 | 0.3 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | | | |
| Q3_1 | 0.3 | 0.4 | 0.1 | 0.4 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | | |
| Q3_2 | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 1.0 | | | | | | | | | | | | | | | | | | | | | | | |
| Q3_3 | 0.1 | 0.2 | 0.0 | 0.3 | 0.4 | 0.2 | 1.0 | | | | | | | | | | | | | | | | | | | | | | |
| Q3_4 | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 0.2 | 1.0 | | | | | | | | | | | | | | | | | | | | | |
| Q3_5 | 0.1 | 0.1 | 0.3 | 0.3 | 0.2 | 0.2 | 0.4 | 0.3 | 1.0 | | | | | | | | | | | | | | | | | | | | |
| Q3_6 | 0.4 | 0.3 | 0.4 | 0.2 | 0.2 | 0.2 | 0.3 | 0.2 | 0.3 | 1.0 | | | | | | | | | | | | | | | | | | | |
| Q4_1 | 0.3 | 0.2 | 0.3 | 0.1 | -0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.2 | 1.0 | | | | | | | | | | | | | | | | | | |
| Q4_2 | 0.2 | 0.1 | 0.2 | 0.1 | -0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 | 1.0 | | | | | | | | | | | | | | | | | |
| Q5_1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 1.0 | | | | | | | | | | | | | | | | |
| Q5_2 | 0.1 | 0.2 | 0.1 | 0.1 | 0.3 | 0.2 | 0.3 | 0.0 | 0.3 | 0.0 | 0.2 | 0.0 | 0.2 | 1.0 | | | | | | | | | | | | | | | |
| Q5_3 | 0.1 | 0.3 | 0.1 | 0.3 | 0.3 | 0.2 | 0.4 | 0.0 | 0.3 | 0.3 | 0.0 | 0.0 | 0.3 | 0.6 | 1.0 | | | | | | | | | | | | | | |
| Q6_1 | -0.0 | -0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | -0.0 | 0.1 | 0.1 | -0.0 | 0.1 | -0.0 | 0.3 | 0.2 | 1.0 | | | | | | | | | | | | | |
| Q6_2 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 | 0.0 | 0.0 | 0.1 | 0.3 | 0.3 | 0.3 | 1.0 | | | | | | | | | | | | |
| Q6_3 | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | -0.0 | 0.1 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | 0.4 | 0.4 | 1.0 | | | | | | | | | | | |
| Q6_4 | -0.0 | -0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | -0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 | 0.3 | 0.3 | 1.0 | | | | | | | | | | |
| Q7_1 | -0.1 | 0.1 | 0.1 | 0.3 | 0.0 | 0.1 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.6 | 0.6 | 1.0 | | | | | | | | | |
| Q7_2 | -0.1 | 0.1 | 0.0 | 0.3 | 0.0 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.1 | 0.1 | 0.2 | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.7 | 1.0 | | | | | | | | |
| Q7_3 | -0.1 | 0.1 | -0.3 | 0.3 | -0.0 | 0.8 | 0.1 | 0.2 | 0.5 | 0.4 | 0.2 | 0.0 | 0.1 | 0.2 | 0.4 | 0.2 | 0.2 | 0.1 | 0.2 | 0.6 | 0.8 | 1.0 | | | | | | | |
| Q8_1 | 0.1 | 0.1 | 0.1 | 0.4 | 0.2 | 0.1 | 0.2 | 0.1 | 0.2 | 0.3 | 0.2 | -0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 1.0 | | | | | | |
| Q8_2 | 0.1 | 0.2 | 0.1 | 0.4 | 0.1 | 0.2 | 0.1 | 0.1 | 0.2 | 0.1 | 0.0 | -0.1 | 0.0 | 0.2 | 0.3 | 0.0 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.6 | 1.0 | | | | | | |
| Q8_3 | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.0 | 0.2 | 0.1 | 0.1 | 0.2 | 0.0 | 0.2 | 0.2 | 1.0 | | | | | |
| Q8_4 | 0.2 | 0.3 | 0.2 | 0.3 | 0.2 | 0.2 | 0.4 | -0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | 0.3 | 0.0 | 0.1 | 0.0 | 0.1 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 1.0 | | | | |
| Q8_5 | 0.2 | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.4 | -0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | -0.0 | 0.3 | 0.0 | 0.3 | 0.1 | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 1.0 | | | | |
| Q8_6 | 0.1 | 0.2 | 0.1 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.2 | 0.3 | 0.1 | 0.2 | 0.1 | 0.2 | 0.1 | 0.2 | 0.2 | 0.4 | 0.3 | 1.0 | | | | |
| Q8_7 | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | -0.0 | 0.3 | 0.1 | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.0 | 0.3 | 0.2 | 0.4 | 0.3 | 1.0 | | | |

Effect size (Pearson's r)

Large effect |0.5|

Relatively large effect |0.3|

Typical effect size |0.2|

Trivial/relatively small effect |0.1|

8.3.2 Regression analysis results of each question

Survey data for each question were compared in Qualtrics through linear regression analysis. The default settings of the Qualtrics software was used in this analysis.

Statements were modelled against each other for each question. The R-squared value is the “percentage of the variation in the output variable that can be explained by the input variables [while the adjusted R-squared value] corrects for the number of explanatory terms in the regression model” (Qualtrics XM n.d.). In this analysis R-squared values < 10% are considered low, values between 10% – 20% are moderate low and values between 20% – 45% are moderate, while values > 45% are high.

P-values indicates statistical the statistical significance of the variables tested in the 29 statements. The linear regression analysis for each question is discussed after the presentation of the table of results (Table 8.7 on the next page). Figure 8.1, at the end of this section, visualises the drivers of each of the seven questions relating to the seven independent variables of the conceptual credit risk assessment model for the viability of small developers during lending applications. Darker green shading indicates the primary drivers.

Table 8.7: Linear regression analysis of each statement relating to each independent variable

| Independent variable | Question number | Sample size | R ² | Adjusted R ² | P-Value |
|---|-----------------|-------------|----------------|-------------------------|-----------|
| Regulatory restrictions | Q2_1 | 124 | 65.5% | 64.7% | <0.00001 |
| | Q2_2 | 124 | 35.2% | 33.6% | <0.00001 |
| | Q2_3 | 124 | 59.7% | 58.7% | <0.00001 |
| | Q2_4 | 124 | 14.5% | 12.3% | 0.000295 |
| Bank risk appetite | Q3_1 | 110 | 36.4% | 33.4% | <0.00001 |
| | Q3_2 | 110 | 28.5% | 25.0% | <0.00001 |
| | Q3_3 | 110 | 31.5% | 28.2% | <0.00001 |
| | Q3_4 | 110 | 14.7% | 10.6% | 0.00486 |
| | Q3_5 | 110 | 31.1% | 27.8% | <0.00001 |
| | Q3_6 | 110 | 21.5% | 17.7% | 0.00011 |
| Physical nature of property development | Q4_1 | 98 | 62.7% | 58.9% | <0.00001 |
| | Q4_2 | 99 | 57.9% | 55.2% | <0.00001 |
| Ineffective limited liability | Q5_1 | 104 | 3.7% | 1.8% | 0.15 |
| | Q5_2 | 104 | 37.9% | 36.7% | <0.00001 |
| | Q5_3 | 104 | 37.2% | 36.0% | <0.00001 |
| Securities and guarantees | Q6_1 | 102 | 18.2% | 15.7% | 0.0019 |
| | Q6_2 | 102 | 18.5% | 16.0% | 0.000155 |
| | Q6_3 | 102 | 36.4% | 36.4% | <0.00001 |
| | Q6_4 | 102 | 32.6% | 30.5% | <0.00001 |
| Small developer capital input | Q7_1 | 100 | 47.1% | 46.0% | <0.00001 |
| | Q7_2 | 100 | 69.0% | 68.4% | <0.00001 |
| | Q7_3 | 100 | 62.6% | 61.8% | <0.00001 |
| Small developer experience | Q8_1 | 97 | 40.0% | 36.0% | <0.00001 |
| | Q8_2 | 97 | 42.6% | 38.7% | <0.00001 |
| | Q8_3 | 97 | 24.4% | 19.4% | 0.00247 |
| | Q8_4 | 97 | 30.4% | 25.8% | <0.00001 |
| | Q8_5 | 97 | 33.9% | 29.5% | <0.00001 |
| | Q8_6 | 97 | 32.6% | 28.1% | <0.00001 |
| | Q8_7 | 97 | 26.2% | 21.2% | 0.0000984 |

Statements relating to Question 2: Cumulatively drivers explain a high proportion of independent variable *Regulatory restrictions*. *Regulatory restrictions and small business protections* (Q2_1) is the primary driver, while *Bank policies that include regulatory restrictions and protections* (Q2_3) is a secondary driver. *Credible and transparent application process* (Q2_2) explains a moderate proportion of the driver, while *The experience of a banker dealing with small developer loan applications* (Q2_4) is relatively unimportant.

Question 3 (four statements): The drivers cumulatively explain a moderate proportion of the independent variable *Bank risk appetite*. The primary driver is *Strong competition between banks to obtain new property development clients* (Q3_1), and the secondary driver is *Buoyant market conditions in the property industry at the time of loan application* (Q3_3). *The ability of a small developer to achieve high pre-sales* (Q3_5) and *The current exposure of the bank to small property development* (Q3_2) have a moderate effect. *A small developer indicating that they will agree to a high number of monitoring clauses in their lending contract* (Q3_6) is relatively unimportant. *The money that the bank has available to lend out to small developers* (Q3_4) has a minimal effect on the explanation of *Bank risk appetite*.

Question 4 (two statements): A regression analysis of the two statements of Question 4 in Qualtrics software indicated that each of the statements explains a high proportion (100%) of the other. These statements were therefore assessed against statements with which a positive correlation was indicated in the correlation matrix. Cumulatively, the drivers explain a high proportion of the independent variable *Physical nature of property development*. *The complex nature of financing each property development project* (Q4_1) is the dominant driver and *The time lag in the supply of property (longer loan periods)* (Q4_2) is the secondary driver. While the other drivers indicated a positive correlation, they were relatively unimportant.

Question 5 (three statements): Cumulatively, the drivers explain a moderate proportion of the independent variable *Ineffective limited liability*. *Allowing the bank to consider all possible income streams of the small developer and their business partners* (Q5_2) is the primary driver. *A clear indication to the bank of how the small developer will service the loan repayments for the duration of the loan* (Q5_3) is a secondary driver.

The type of business entity (sole trader, company, trust etc.) of the small developer (Q5_1) explains a low proportion of Ineffective limited liability.

Question 6 (four statements): The drivers cumulatively explain a moderate proportion of Securities and guarantees. *Using cross-collateralisation to secure the loan (Q6_3) and Using first-party and third-party guarantors (Q6_4) are the primary drivers. The flexible compensation scheme (how own salary and benefits are determined) (Q6_2) and Using assets like a family home to secure the loan (Q6_1) are minor drivers.*

Question 7 (three statements): The independent variable *Small developer capital input is explained in a high proportion by the cumulative drivers. Capital available to cover upfront costs to ensure approvals are in place (Q7_2) is the dominant driver. Capital available for contingencies or 'when things go wrong' (Q7_3) is a secondary driver and Capital available to satisfy the loan to value ratio calculation for the loan (Q7_1) is a tertiary driver.*

Question 8 (seven statements): Cumulatively the drivers explain a moderate proportion of the independent variable *Experience of a small developer. Understanding the factors that the bank will consider during the loan application process (Q8_2) and Proven experience in the property development environment (Q8_1) are the primary drivers. Understanding a specific bank's requirements by becoming a return customer (Q8_5) and Engaging a competent and financially capable contractor (Q8_6) and Using their network (brokers, real estate agents, building surveyors, friends etc.) to understand market conditions in property development (Q8_4) has a moderate effect. Developing a business model that is specific to bank requirements for financing (Q8_7) and Using specialists like accountants, lawyers and financial advisors to assist with the loan application (Q8_3) have a further moderate effect on Small developer experience.*

The first regression analysis focussed on the development of linear regression for each of the seven independent variables. *Small business protections and Bank policy are the main drivers of Regulatory restrictions. Competition and Exposure are the primary drivers of Bank risk appetite. The Physical nature of property development's drivers are Complex lender and Time-lag in the supply of property. Serviceability and All-moneys approach are the key drivers of Ineffective limited liability. The main drivers of Securities and guarantees are Cross-collateralisation and Guarantors. Upfront costs*

and *Contingency* are the primary drivers of *Small developer capital input*, while *Loan to value ratio* is a secondary driver. The dominant drivers for *Small developer experience* are *Self-awareness*, *Network* and *Return customer*.

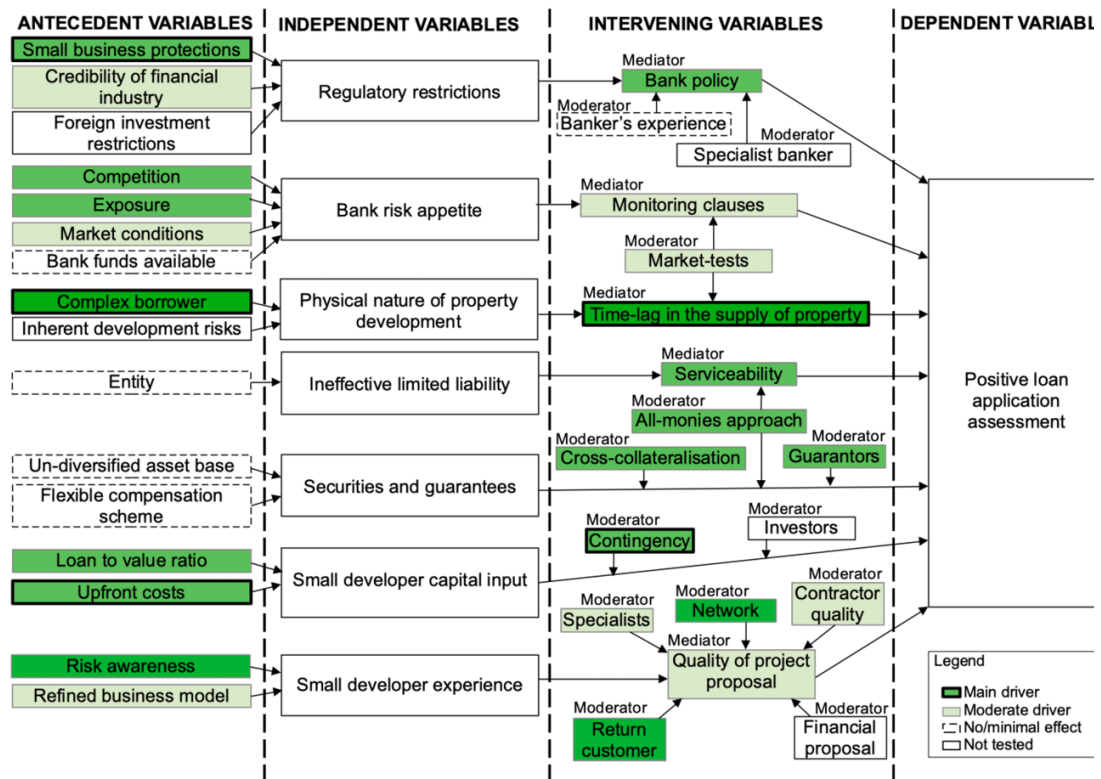


Figure 8.1: The drivers of the linear regression of the independent variables indicated on the updated conceptual credit risk assessment model

8.3.3 Summary of additional factors noted in written comments to Question 9

Question 9 allowed participants to add written comments on additional factors that they felt were not sufficiently addressed by survey questions. This question was answered by 46 participants. While the largest number of possible factors were considered during the literature review and further factors added after the FSRC data analysis, interviews with bankers and the focus group with bankers, two factors that were repeated by 14 participants. These two factors were not indicated in the conceptual credit risk assessment model (Figure 7.2 in [Section 7.2.2](#)):

- A record of successful projects; and
- A good credit record.

While these factors have been noted in FSRC data and interviews with bankers and small developers and the focus group with bankers, they were not included in the conceptual credit risk assessment model as they were deemed to form part of existing variables. Question 9 was included as further external validation of the conceptual credit risk assessment model, due to minimal additionality of the expert panel feedback. These two variables were added in the final credit risk assessment model (see Figure 8.5 at the end of [Section 8.5](#)). *Good credit record* was included as an antecedent variable to *Ineffective limited liability* and *Successful projects* was included as an antecedent variable to *Small developer experience*. These factors were included to provide further clarity to the model, rather than deem them to be understood by the model's users to be included within another factor. The high occurrence of these factors in the written feedback by participants were deemed to indicate that participants found these factors lacking in the survey. These concepts were not tested further in this study and presents an opportunity for clarification in future research, for example, lenders' perspectives on what a *Good credit record* should entail.

Nine participants indicated that the *Quality of proposal* contributes to the success of loan proposals. They further noted that the proposal must be development ready; have achieved all statutory approvals and contain a conservative *Financing proposal*. The mediating intervening variable *Quality of proposal* was updated to *Quality of development-ready proposal* in the final model to reflect this input.

Other factors noted by participants were already contained in the conceptual credit risk assessment model, but may have been considered critical by participants who chose to answer the written question. These factors noted by participants included *Serviceability potential* (two participants), *Banker's experience* (five participants), *Pre-sales* (four participants), *specialists* and *network* (seven participants), *Risk awareness* (three participants), *Undiversified asset base* (three participants) and *Loan to value ratio* (nine participants).

Eight participants noted that lenders lacked appetite for lending to small developers at the time of the survey and noted that banks were overly cautious as a result of the FSRC Hearings. Two participants noted that they no longer apply for finance from banks and only use private lenders.

8.4 Principal component analysis results and discussion

The correlation matrix indicates the effect of one variable on another. A positive correlation between variables means that when one variable increases, so do the other. Further, the linear regression model explains the relative importance of the statements related to each of the seven independent variables, which formed the basis of each question. While the linear regression investigated the validity of the survey statements related to each independent variable, a principal component analysis uses a covariance matrix that summarises how all the variables relate to one another. This is achieved by “projecting data into a smaller space... [that transforms the] data in different ‘directions’” (Brems 2017) or dimensions. The principal component analysis challenges the independence of the tested statements as well as their clarity. The scree plot of the principal component analysis indicates eight factors as constructs from the survey data.

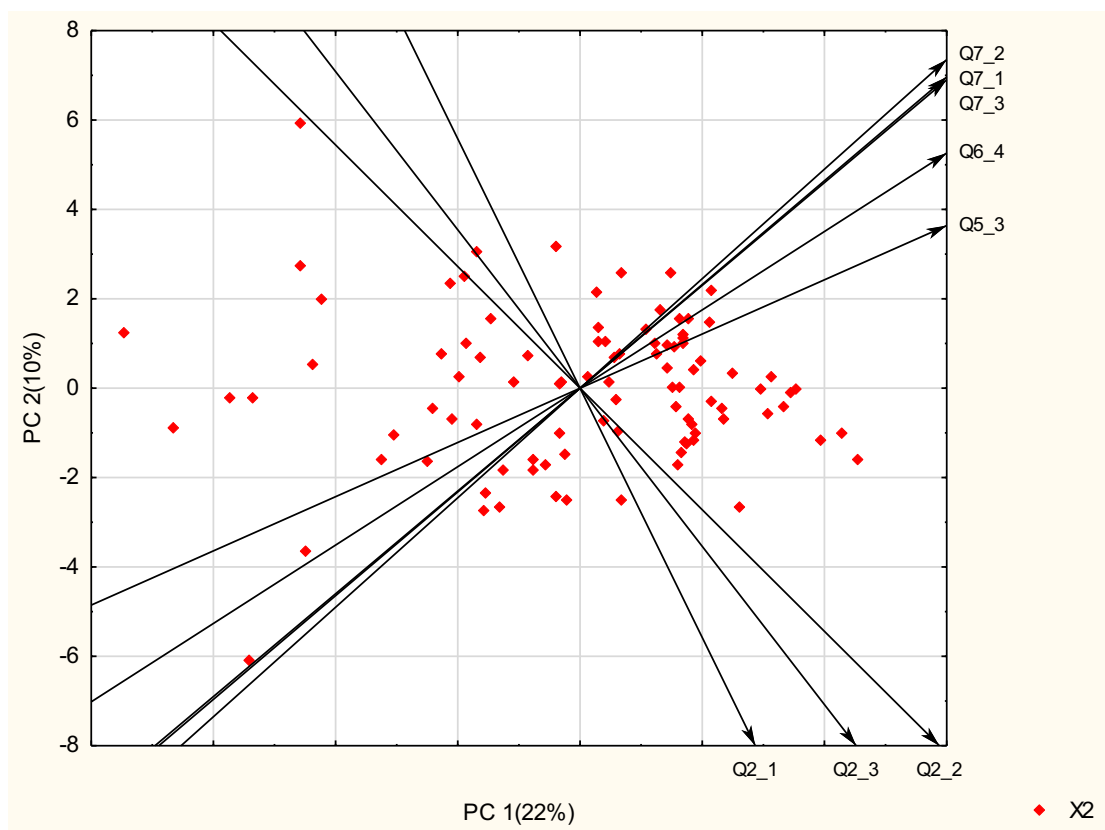


Figure 8.2: Scree plot of principal component analysis indicating eight factors

The distribution of the factors does not follow the question numbering (see the numbers in red in Table 8.8 at the end of this section). While the survey intended to test each

statement against a specific independent variable, the principal component factor analysis shows that the 29 survey statements tested are not independent. Except for Factor 3, the principal component factor analysis does not define identical constructs to the seven independent variables, represented by survey question numbers. This interdependence of variables could be explained by the non-linear positions of the antecedent and intervening variables in the conceptual credit risk assessment model for the viability of small developers during lending applications (see Figure 7.1 in [Section 7.2.2](#)). The overlap between the eight constructs identified through the principal component factor analysis and the original seven risk areas tested are indicated in Table 8.8 on the next page and visualised in Figure 8.3 at the end of this section.

Table 8.8: Principal component analysis indicated as a covariance matrix with eight factors

| Variable number | Factor 1 | Factor 2 | Factor 3 | Factor 4 | Factor 5 | Factor 6 | Factor 7 | Factor 8 |
|-----------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Q2_1 | -0.013220 | 0.875001 | 0.158918 | 0.167594 | -0.096965 | 0.064610 | 0.040024 | -0.044085 |
| Q2_2 | -0.067152 | 0.071122 | 0.002639 | 0.039968 | 0.079395 | 0.219119 | 0.205209 | 0.171395 |
| Q2_3 | 0.170825 | 0.833442 | 0.157187 | 0.087093 | 0.048265 | -0.091592 | 0.001027 | 0.010509 |
| Q2_4 | 0.064366 | 0.303240 | 0.015907 | -0.025260 | 0.252035 | 0.515001 | -0.035967 | 0.487766 |
| Q3_1 | 0.173091 | 0.240576 | -0.147638 | 0.032005 | -0.127650 | 0.772610 | -0.024939 | 0.143890 |
| Q3_2 | 0.025544 | 0.514141 | 0.070121 | -0.011795 | 0.106670 | 0.499543 | -0.036713 | 0.095473 |
| Q3_3 | 0.003890 | -0.139071 | 0.278257 | 0.188018 | 0.182208 | 0.649177 | 0.322712 | 0.010176 |
| Q3_4 | 0.008482 | 0.007152 | 0.094602 | 0.404755 | 0.031464 | 0.292725 | -0.361531 | 0.166607 |
| Q3_5 | 0.003817 | -0.053323 | 0.113536 | 0.221184 | 0.528380 | 0.470368 | -0.094284 | 0.034983 |
| Q3_6 | 0.047012 | 0.348865 | 0.388548 | 0.295864 | 0.405392 | 0.124769 | 0.087996 | -0.058897 |
| Q4_1 | -0.034080 | 0.151538 | 0.884461 | 0.053136 | -0.025828 | 0.013018 | -0.017774 | 0.126252 |
| Q4_2 | 0.076372 | 0.113342 | 0.874948 | -0.018903 | -0.057061 | 0.018908 | 0.089145 | -0.094747 |
| Q5_1 | 0.135621 | 0.232896 | 0.287369 | 0.287767 | 0.206839 | 0.068082 | -0.108918 | 0.173879 |
| Q5_2 | 0.623685 | 0.106013 | -0.012919 | -0.009294 | 0.045181 | 0.330263 | 0.395175 | -0.092647 |
| Q5_3 | 0.347057 | 0.111599 | -0.080661 | 0.040185 | 0.370462 | 0.401548 | 0.495050 | -0.030140 |
| Q6_1 | 0.693612 | 0.008356 | 0.055107 | -0.204399 | 0.231882 | 0.071766 | -0.052657 | -0.206149 |
| Q6_2 | 0.533881 | 0.055601 | -0.088366 | 0.314206 | 0.102179 | 0.052673 | 0.015384 | 0.210545 |
| Q6_3 | 0.748787 | 0.032598 | 0.108972 | 0.031714 | -0.014887 | -0.148205 | -0.064987 | 0.398075 |
| Q6_4 | 0.720090 | -0.014625 | 0.050521 | 0.242479 | 0.241653 | 0.094404 | 0.030755 | 0.114052 |
| Q7_1 | 0.389928 | 0.056039 | -0.019989 | 0.069645 | 0.741992 | -0.036377 | -0.100788 | 0.225581 |
| Q7_2 | 0.186741 | 0.043319 | -0.060443 | -0.033755 | 0.879190 | 0.064317 | 0.177555 | 0.057991 |
| Q7_3 | 0.074857 | -0.005276 | -0.021080 | 0.035181 | 0.831878 | 0.018987 | 0.211852 | 0.109065 |
| Q8_1 | 0.127001 | 0.014736 | 0.124568 | 0.245082 | 0.139675 | 0.107105 | 0.058155 | 0.773380 |
| Q8_2 | 0.105051 | 0.077577 | -0.121727 | 0.050174 | 0.134388 | 0.133484 | 0.385920 | 0.708635 |
| Q8_3 | 0.058306 | -0.001486 | 0.063868 | 0.655003 | -0.001153 | 0.218324 | 0.205020 | -0.034806 |
| Q8_4 | -0.097439 | 0.168152 | 0.163917 | 0.201289 | 0.316891 | 0.129859 | 0.576364 | 0.171593 |
| Q8_5 | 0.082337 | 0.174389 | 0.134864 | 0.653285 | 0.107201 | -0.175096 | 0.109520 | 0.221185 |
| Q8_6 | 0.421220 | 0.048845 | 0.040957 | 0.230511 | 0.031204 | -0.059371 | 0.766585 | 0.225494 |
| Q8_7 | 0.044379 | 0.114963 | -0.088025 | 0.792886 | 0.028731 | 0.031565 | 0.094840 | 0.056228 |
| Expl. Var | 2.694193 | 2.727946 | 2.082900 | 2.310647 | 3.062594 | 2.365304 | 1.949811 | 1.954672 |
| PrPTotl | 0.092903 | 0.094067 | 0.071824 | 0.079677 | 0.105607 | 0.081562 | 0.067235 | 0.067402 |

The eight factors identified indicate the combination of survey statements into eight constructs. The construct of Factor 3 is the only factor that matches an independent variable. Factor 3 matches Question 4 relating to the independent variable *Nature of property development*.

Factor 1 closely matches Question 6 relating to the independent variable *Securities and guarantees*, but indicates Q5_2 (*Allowing the bank to consider all possible income streams of the small developer and their business partners*) as an additional variable to this construct. While this variable was tested in Question 5, relating to *Ineffective limited liability*, it is indicated in the model as a moderating intervening variable to both independent variables. Factor 1's construct, therefore, supports the current position of the moderating intervening variable *All-moneys approach*.

Question 2, relating to the independent variable *Regulatory restrictions*, closely matches Factor 2, but Factor 2 indicates Q3_2 (*The current exposure of the bank to small property development*) as an additional variable. The FSRC data indicated that prudential regulations are used to limit lenders' exposure. This factor was updated in the final improved credit risk assessment model (see Figure 8.5 in [Section 8.5](#)). *Exposure* was included as a moderating intervening variable that affects *Bank policy* (a mediating intervening variable to the independent variable *Regulatory restrictions*) and *Monitoring clauses* (a mediating intervening variable to the independent variable *Small developer capital input*).

Factor 5 closely matches Question 7, relating to the independent variable *Small developer capital input*, but indicates Q3_5 (*The ability of a small developer to achieve high pre-sales*) as an additional variable to this construct. Items in the construct of Factor 5 are indicated in green in Figure 8.3 at the end of this section. The position of the independent variable *Small developer capital input* was changed in the final improved credit risk assessment model (see Figure 8.5). *Market tests*, a moderating intervening variable was updated to relate to both *Small developer capital input* and *Monitoring clauses* (a moderating intervening variable to the independent variable *Bank risk appetite*).

Three of the seven factors of Question 8 (relating to the independent variable *Small developer's experience*) is contained in the construct of Factor 4. The remaining four factors forms part of the constructs of Factor 7 and Factor 8. Factor 7 combines variables relating to the independent variables *Ineffective limited liability* and *Small developer experience*. The construct comprises of three intervening variables: *Serviceability*, *Network* and *Contractor quality*. Factor 8 indicates a construct of two

variables affecting *Small developer experience* and one intervening variable of *Regulatory restrictions*. The three variables are *Bankers' experience*, *Risk Awareness* and *Quality of project proposal*. *Banker's experience* (Q2_4) is a shared variable with Factor 6.

Factor 6 contains three of the six statements of Question 3. This factor shares Q2_4 (*Banker's experience*) with Factor 8 and Q3_2 (*Exposure*) with Factor 2. Statements in this construct relate to the independent variable *Bank risk appetite*. The three statements of Question 3 contained in this variable are related to the antecedent variables of the independent variable *Bank risk appetite* and are *Competition*, *Market conditions* and *Exposure*.

Three statements tested in the survey were not contained in the constructs of the eight factors identified through the principal component factor analysis.

- *The money that the bank has available to lend out to small developers* (Q3_4), relating to the antecedent variable *Bank funds available* of the independent variable *Bank risk appetite*;
- *A small developer indicating that they will agree to a high number of monitoring clauses in their lending contract* (Q3_6), relating to the mediating intervening variable *Monitoring clauses* of the independent variable *Bank risk appetite*; and
- *The type of business entity (sole trader, company, trust etc.) of the small developer* (Q5_1), relating to the antecedent variable *Entity* of the independent variable *Ineffective limited liability*.

These factors are, however supported in the data analysis from previous chapters. Bank lending without bank funds are not possible. Monitoring clauses relating to small developer loan agreements are not optional and bankers indicated in interviews and a focus group that the entity of a company guides the assessment process. These statements are visualised in Figure 8.3, on the next page, in black blocks.

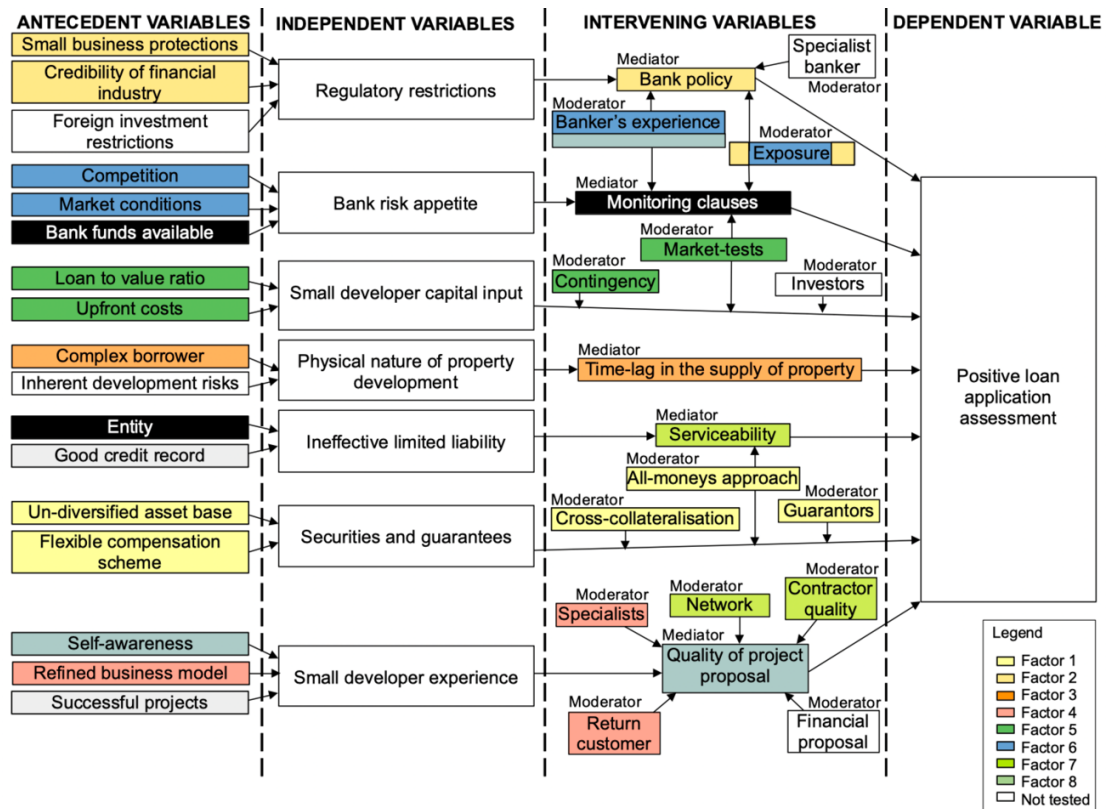


Figure 8.3: The distribution of the eight factors of the principal component analysis of the 29 statements indicating their positions in the conceptual credit risk assessment model

The principal component analysis identified eight constructs, compared to the seven independent variables tested. While the factors matched some of the independent variable constructs, changes were affected to the model through the principal component analysis as described in the discussion in the discussion above Figure 8.3. These are further discussed in Section 8.5.

8.5 Survey findings and an improved model risk assessment model for the viability of small developers during lending applications

The industry survey tested the validity of the antecedent and intervening variables, represented by 29 statements. The statements were divided into seven questions, which corresponds with the independent variables of the conceptual credit risk assessment model for the viability of small developers during lending applications. Chronbach's alpha was used to test the internal reliability of statements relating to the seven independent variables. Six of these constructs indicated high internal reliability, while

the independent variable *Ineffective limited liability* indicated a moderate-low internal reliability.

A regression analysis identified the drivers of each of the independent variables. Statements relating to each of the independent variables' main drivers are visualised in Figure 8.1, at the end of [Section 8.3.2](#). The main drivers of the independent variable *Regulatory restrictions* were statements relating to *Small business protections* and *Bank policy*, while *Banker's experience* had a nominal effect. *Bank risk appetite's* main drivers were statements relating to *Competition* and *Exposure*, while *Market conditions*, *Monitoring clauses* and *Market tests* had moderate drivers. *Bank funds available* was indicated to have a nominal effect on *Bank risk appetite*. Statements relating to *Complex borrower* and *Time-lag in the supply of property* were the main drivers of the independent variable *Physical nature of property development*. The main drivers of the independent variable *Ineffective limited liability Entity* were statements relating to *Serviceability* and *All-moneys approach*, while *Entity* had a nominal effect. Statements relating to *Cross-collateralisation* and *Guarantors* were indicated as the main drivers of the independent variable *Securities and Guarantees* and statements relating to *Undiversified asset base* and *Flexible compensation scheme* had a nominal effect. All the statements relating to *Small developer capital input* were indicated as primary drivers. The main drivers of *Small developer experience* were statements relating to *Risk awareness*, *Return customer* and *Network*. Statements relating to *Refined business model*, *Quality of project proposal*, *Contractor quality* and *Specialists* had a moderate effect.

To explore the relationships between statements, a principal component factor analysis was conducted. This analysis identified eight factors that, while not an identical match, largely corresponded with the survey questions (the seven independent variables). The discrepancies are partly explained by the non-linear positions of the antecedent and intervening variables in the conceptual credit risk assessment model for the viability of small developers during lending applications. Factor 1 matched *Securities and guarantees* (Question 6) but contained an additional statement from Question 5 (*Ineffective limited liability*). This survey statement represents *All-moneys approach* in the conceptual model and is also indicated as a moderator to *Serviceability* and *Securities and guarantees*. Factor 2 contains three statements from Question 2

(*Regulatory restrictions*) and one statement from Question 3 (*Bank risk appetite*). *Exposure* is indicated as an antecedent variable to *Bank risk appetite* in the conceptual model. In the proposed improved model, *Exposure* is shown as an intervening variable (moderator) to *Bank policy* and *Monitoring clauses* as this statement is also shared with Factor 6, which relates to *Bank risk appetite*.

Physical nature of property development (statements of Question 4) matched Factor 3. All three statements of Question 7 (*Small developer capital input*) are contained in Factor 5 as well as *Market tests* – a survey statement from *Bank risk appetite* (Question 3). In the proposed improved model, the independent variable *Small developer capital input* was moved adjacent to *Bank risk appetite* to acknowledge this connection. Factor 6 contains three statements from Question 3 (*Bank risk appetite*) and one statement from Question 2 (*Regulatory restrictions*). An additional arrow was added in the model to link *Banker's experience* to both independent variables.

Factor 4, Factor 7 and Factor 8 contains the statements of Question 8 (*Small developer experience*). Factor 4 indicates a relationship between *Return customer*, *Specialists* and *Refined business proposal*. Factor 7 indicates a relationship between *Network* and *Contractor quality* as well as *Serviceability*, a statement from Question 5 (*Ineffective limited liability*). The indication of a relationship between these statements contained in Factor 7 is likely the result of the low internal reliability of Question 5. Lenders prefer a risk-sharing arrangement, where the small developer and the contractor who will build the project are two separate entities. Factor 8 contains statements that relate to *Quality of proposal*, *Self-awareness* and *Banker's experience*, a statement from Question 2, but also shared with Factor 6. While an experienced banker can assist a small developer to improve their proposal *Banker's experience* was retained in the same position in the proposed improved model (a moderator to *Bank policy* and *Monitoring clauses*).

Lending is not possible without a bank having money to lend out. The goal of the lending proposal assessment process is to enter into a loan contract. If a small developer cannot meet or agree to the terms and requirements of the loan contract, this will be discovered during the assessment process. The type of business entity of a small developer will guide the assessment process, as more complex entities require additional assessments. *Bank funds available*, *Monitoring clauses* and *Entity* were not

indicated in the eight factors, but these variables are retained as they are sufficiently supported by the data from previous chapters.

Question 9 of the industry survey allowed participants to indicate items that they considered further relevant to an improved credit risk assessment model for the viability of small developers during lending applications. In addition to *Small developer experience*, the variables *Good credit record* and *Successful projects* were highly supported by participants to be indicated as separate variables, rather than to be deemed included in other variables. *Good credit record* was added as an antecedent variable to the independent variable *Ineffective limited liability*. *Successful projects* were added as an antecedent variable to the independent variable *Small developer experience*. *Quality of project proposal* was updated to *Quality of development ready project proposal*.

The improved credit risk assessment model for the viability of small developers during lending applications incorporates tested variables. Updates were made to the model to reflect the effect that each tested variable has on other variables. These changes were informed by the correlation matrix, the regression models and the principal component factor analysis and are presented in the improved credit risk assessment model in Figure 8.5 on the next page.

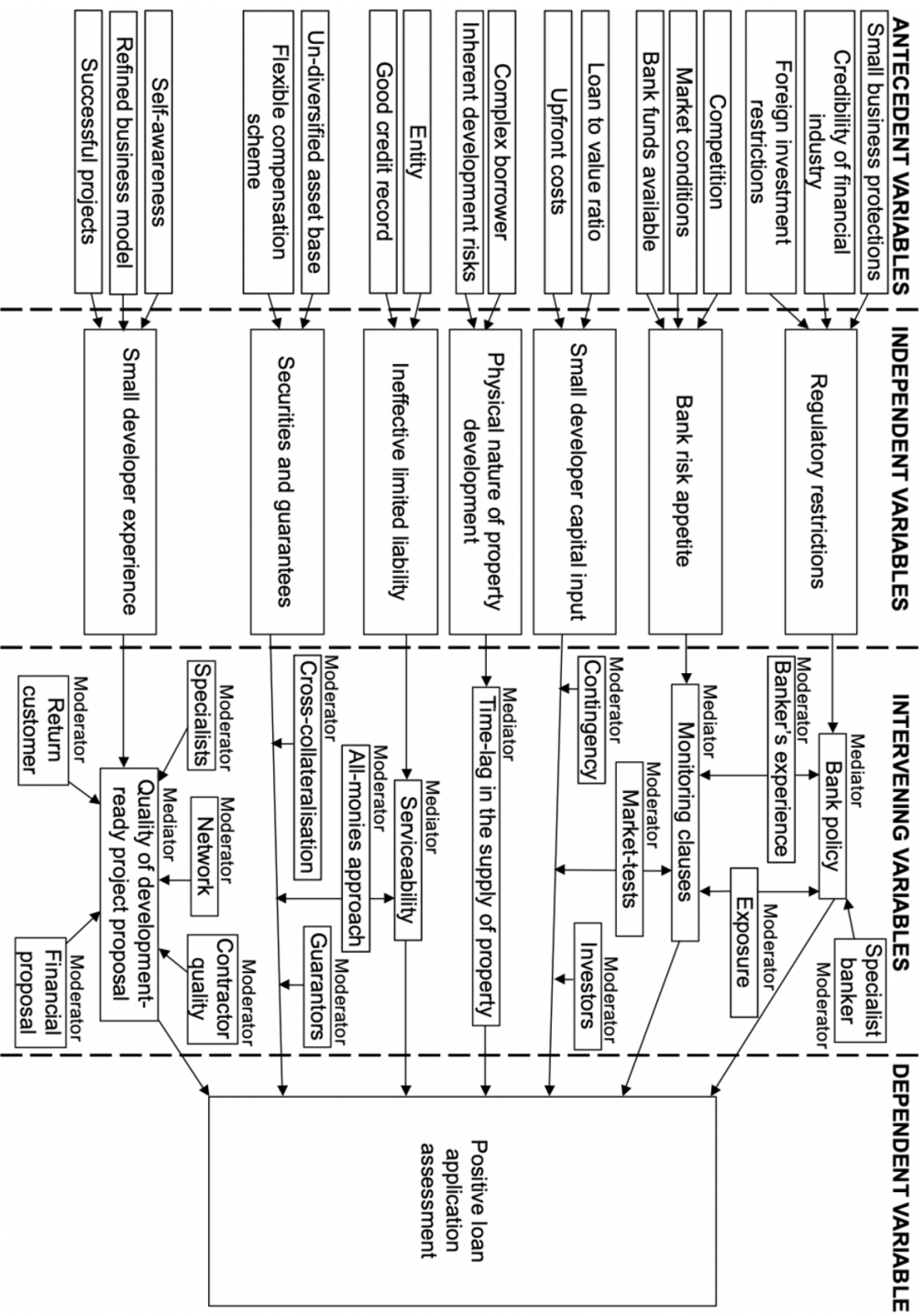


Figure 8.4: An improved risk assessment model for the viability of small developers during lending applications

8.6 Contribution of Chapter 8 to research objectives

This chapter focussed on analysing antecedent and intervening variables of the conceptual model for the assessment of loan applications of small developers. The survey data analysis contributed to Objective 2; to analyse key risk factors assessed by the lender and whether the assessment process supports small developers' strategic structure for business success. Objective 2 was addressed through statistical testing of the validity of antecedent and intervening variables, represented by survey statements. A regression analysis of statements identified the main drivers of statements relating to each of the independent variables. While the principal component factor analysis identified eight factors (constructs), there are overlaps between the constructs of the eight factors identified and 29 statements relating to the seven independent variables. These overlaps and discrepancies are visualised in Figure 8.3 at the end of [Section 8.4](#), and are partially explained by the non-linear positions of the antecedent and intervening variables in the conceptual credit risk assessment model.

The findings from the survey contributed to Objective 3, development of a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders. Survey results empirically supported the model, and minimal changes were affected to the conceptual credit risk assessment model. A final risk assessment model is presented and discussed (see Figure 8.4 in [Section 8.5](#)).

Question 8 of the survey (written responses) highlighted *Good credit record* and *Successful projects* as variables that were deemed to be included in other factors. These were included in the model for clarity and is supported by data analysis from Chapters 4 to 6. The strength of Chapter 8's contribution to the research is the empirical validation of the conceptual credit risk assessment model with minor alterations.

8.7 Summary of Chapter 8

Chapter 8 discussed the results from an industry survey that tested statements relating to the independent variables as indicated in the conceptual model for the assessment of loan applications of small developers. The survey contained seven questions with 29

statements. The matrix-format survey tested each question through a five-point Likert scale. An eighth question allowed participants to indicate additional factors that they perceive to be important in the assessment of small developer lending applications. The finding of Chapter 8 concludes Data Collection Stage 2 and presents an improved risk assessment model for the viability of small developers during lending applications (see Figure 3.7).

Further, the national industry survey improves the generalisability of the results. Chronbach's alpha supports the internal consistency of the survey questions related to the independent variables. A correlation matrix, two linear regression models and a principal component analysis empirically supported the validity of the survey results and minor updates were affected. An improved credit risk assessment model for small developers' lending applications is presented in [Section 8.5](#) (see Figure 8.4). Small developers can be confident that the improved credit risk assessment model, supported by empirical testing, will assist them in better understanding the credit assessment process when applying for credit from lenders. Lenders, on the other hand, will find the improved credit risk assessment model useful in identifying areas where their credit assessment process of small developers' lending applications could be simplified or supported.

Chapter 9 discusses the results this research and the contribution of this study to the knowledge around small developer lending application assessment and outlines future research areas.

CHAPTER 9

DISCUSSION OF AN IMPROVED CREDIT RISK ASSESSMENT MODEL FOR THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS

9.1 Introduction to the discussion of an improved credit risk assessment model

Chapter 9 discusses the study's findings and its contribution to the knowledge gap around lenders' assessment of small developer loan application risk. Small developers are considered complex and sophisticated borrowers by banks. This view is attributed to the nature of property development, market volatility, large amounts borrowed, and small developers' access to specialists during the property development process. Small developers face a similar, if not more significant, documentary burden of proof to verify the viability of their credit proposals compared to large property developers and other types of small businesses. This enormous documentary burden to prove their viability requires extensive corporate capacity on the part of a small developer, who often acts as an individual project manager for their own projects.

Further, small developers face non-standard contracts that contain onerous monitoring clauses and market tests and requires a substantial capital input on the part of the small developer to satisfy loan to value ratios. These additional hurdles complicate their ability to access credit. Small developers are also likely excluded from many, if not all, small business protections.

The main objective of a lender's credit assessment process is to identify viable investment projects that align with the lender's credit risk appetite. Small developers' loan application submissions should provide a clear overview of the quality of the project proposal, serviceability potential, and the quality of the assets that will secure the loan. The extensive credit assessment process' desired outcome is to propose viable projects to lenders' credit departments and finalise a credit agreement between the lender and the borrower.

9.2 Discussion of the study's findings

9.2.1 Exclusion from small business protections

Evidence from the FSRC hearings and interviews with a banker and small developers and a focus group with bankers suggest that many small developers will not pass the three-part ABA Code of Practice small business definition. While small developers share attributes of small businesses in terms of employment size, they are likely to fail the current total debt test of AU\$3 million. Bankers who presented evidence to the FSRC in the Round 3 hearings indicated that the AU\$3 million total debt requirement is low, particularly for property development in the Australian market. While Pottinger's (2020) independent report, commissioned by the ABA, after the FSRC recommendations, proposed an increase to the total debt test of AU\$5 million by 2023, this value still excludes many small developers. Further, small developers are considered sophisticated and complex borrowers that have non-standard contracts and access to specialists.

During interviews, small developers indicated that they use affordable bank finance to create a pipeline of work to ensure the sustainability of their companies. Borrowing from banks and other lenders also help them avoid having their capital tied up for extended periods. Credit from banks, combined with their own money, presents opportunities to pursue larger and more profitable projects. Exclusion from small business protections means that small developers will have to litigate their cases in court.

9.2.2 Other regulatory hurdles

Regulatory restrictions and transparency to achieve regulatory compliance is critical for the credibility of the financial services industry. Banks incorporate regulatory restrictions in their policies. Experienced bankers are more likely to understand the impact of these policies on credit risk assessments and bank risk appetite. Many of these restrictions relate to prudential requirements. Regulatory restrictions could affect larger banks differently compared to smaller banks. For example, FSRC witnesses noted that large banks use an internal risk weight calculation, while smaller banks must use a standardised method. The difference in calculation could lead to smaller banks considering lending to small businesses, over a specific amount, as a high exposure risk.

The identical amounts will not be considered a high exposure risk by large banks due to the differences between the two risk weight calculations.

Small developer interviewees indicated that foreign investment restrictions had impacted their projects, as these restrictions do not include pre-sales to foreign buyers as part of a bank's pre-sale ratios. Additional requirements in terms of transfer fees imposed on foreign buyers also affected property sales to clients.

9.2.3 Lenders' main risk assessment criteria

Lenders consider their exposure to the property development sector and, on the other hand, their risk exposure concerning a specific loan. Banks' risk appetite is affected by their exposure to the property development sector at the time of the loan application, and they tend to lend to large developers first. During favourable market conditions in this sector, competition between lenders for good project proposals could increase their propensity to extend loans to small developers.

Ultimately, banks are profit-taking intermediaries, and they have to ensure that their investments are profitable. All possible risks of a specific loan to the lender are carefully evaluated during the loan assessment process. The main criteria considered are the serviceability potential of the borrower and the security of the loan. To satisfy the loan to value ratio, a borrower's available capital and liquidity are considered; their ability inject additional capital if property values deteriorate and available capital to cover any project contingencies are evaluated. The assets and guarantees provided as security are evaluated for quality.

9.2.4 The assessment process is complicated

The credit risk assessment process of small developers is arduous for both the lender and borrower. While lenders view small developers as complex and sophisticated borrowers, they rely on small business characteristics, particularly ineffective limited liability, to allow flexibility when evaluating the borrowing capacity of small developers.

Lenders consider the financial capacity of a small business and its owner to service and secure the loan as if these are the same during the credit risk assessment process (see

[Section 9.2.4.1](#)). This assessment process requires small developers to compile and submit extensive documentary proof for a business banker to form an accurate view of the viability of the credit application. Changing market conditions, lenders' risk appetite, current exposure, and regulatory and policy requirements could necessitate further investigations. Therefore, additional proof on the part of the borrower as to the viability of their credit application. Monitoring clauses will be incorporated into the credit contract, and the assessment process evaluates the ability of a borrower to comply with these clauses.

The type of borrowing entity directs the assessment process, with various entities assessed according to different risk criteria. Credit applications by complex entities and syndicates require additional and often invasive investigations into the small development business's financial position and that of its owners, members and investors. Further, the business and its owners' ongoing financial health and serviceability potential will be monitored throughout the loan period.

Small developers' business models affect the assessment process. Lenders require small developers to clearly state the intent of their loans and use of the finance. Develop-to-retain models are assessed differently compared to develop-to-sell models. A high-quality, development ready project proposal should support their claims. Lenders vary in their requirements for the development proposal but would often require the financial proposal, profitability predictions, market assessments, cash flow predictions, a high-quality proposal from a financially stable contractor, specialist reports and a marketing plan. The size of the loan and the loan period, which affects a bank's risk exposure, affects the complexity of the assessment process.

Small developers rely heavily on specialists and their networks for information. Lenders consider small developers as specialised and complex borrowers with access to advice. Before applying for loans, small developers carry significant upfront costs, such as paying specialists to design their projects and achieve development approval. Further, they are not guaranteed access to finance once the development approval and project credit proposal are in place. To this extent, small developers keep these costs as low as possible and rely on free advice from networks and work-at-risk by specialists where possible.

9.2.4.1 All-moneys approach and ineffective limited liability

The ineffective limited liability of small companies drives their access to bank credit. Lenders use the all-moneys approach to assess the financial viability and serviceability potential of small businesses. The all-moneys approach also considers capital and assets of the small development business and personal assets of business owners as if these were the same. Lenders consider additional incomes from other businesses owned by the company owner(s) and can further consider any personal income of company owners, separate to the business applying for a loan, and even their spouses.

This approach allows small businesses to borrow more significant amounts by expanding their serviceability potential. FSRC evidence indicated that assets provided as security by small businesses are often un-diversified and likely to be family homes or personal investment properties. Third-party guarantors can also provide securities and guarantees under specific conditions. A good credit record of the owner(s), the company, and related companies, are critical.

9.2.5 Bank risk-mitigating measures

9.2.5.1 Splitting financial risk

Bank interviewees indicated that their banks prefer to split the financial risk between small developers and contractors, and these banks were unlikely to finance owner-builder property developers. Requiring a separate construction contract as part of the credit contract allows lenders to assess the quality and financial capability of the contractor that will build the project.

Finance for construction loans for property development is released in phases when value is created and upon completion of specific milestones. The contractor will forward-fund the build to specific points and will then receive payment upon reaching the milestone. For this reason, some lenders do not fund civil works and services, as these vary broadly between projects, and the bank does not consider these services as value created. Many small developers favour large, reputable builders to complete their projects as their balance sheet and project management capabilities could improve small developers' access to finance. Further, small developers often do not have work to keep

a small contractor continuously busy and may find that the small contractor is tied up with other projects when they are ready to develop a new project.

9.2.5.2 Non-monetary covenants

Lenders use non-monetary covenants in credit contracts as a monitoring mechanism to ensure the ongoing serviceability potential of the borrower and the exposure risk of the bank. Non-monetary defaults are not financial defaults (like missing an interest repayment). These covenants could be breached even if the borrower is at no fault. If used in the serviceability calculation, a decrease in the business' income (for reasons unrelated to the loan) or loss of a personal income can affect non-monetary covenants.

An economic downturn can affect the value of the property used to secure the loan. A valuation that indicates a reduction in property value impacts the LVR and will require immediate additional capital input by the borrower to satisfy this ratio. If non-monetary covenants are in breach, the interest rates of the loan could be affected. Breaches of these covenants could affect the view of lenders on future credit applications by the small developer.

9.3 Implications of the research

9.3.1 The larger context: small business credit

While small developers are likely excluded from the ABA's small business definition and protections, the increase of the total debt limit proposed by Pottinger (2020) and the FSRC (2019b) will be more inclusive of other small businesses in Australia. The ABA's Code of Conduct and its small business definition was considered the main source of protection of small businesses by the FSRC Commissioner (FSRC 2019b). Expanding the total debt limit to \$5 million is estimated to allow the inclusion of a further 10 000 to 20 000 small businesses in this definition (FSRC 2019b).

Pottinger (2020) recommended that the small business definition in the ABA is further refined, and that businesses are explicitly told whether or not they meet the small business definition criteria when engaging in a credit transaction with a bank. While the ABA is not a regulatory body, it represents the industry standards regarding credit engagement with small businesses. The FSRC (2020b) did not recommend the expansion of the NCCP to small businesses and, therefore, clarifying inclusions and

exclusions regarding access to protections will assist small business to make better informed decisions when engaging in lending.

While small businesses typically borrow less than small developers, they face the same challenges in providing clear information on which basis a lender will make a credit decision. Unless a small business can provide capital to satisfy the LVR, have the ability to secure the loan and can provide realistic projections in terms of the serviceability of the loan, it is unlikely that a lender will consider a credit transaction. Further, small businesses share characteristics with small developers: ineffective limited liability, an incomplete management team. This means that the small business owner is likely to carry the complete risk and burden of the loan application and credit assessment process. The experience of small business banker is of critical importance in this process.

9.3.2 A focus on experienced, prudent and diligent bankers

Lenders depend on the value judgement of an experienced banker, supported by bank policies and various financial ratio-tests, to decide the viability of a small developer's proposal to be financed by the bank. The risk assessment process keeps the end in mind: the potential of the particular proposal to result in a lending contract. The small developer's proposal is tested against their prospective ability to satisfy contractual clauses to mitigate the bank's perceived risk concerning the particular loan arrangement. While the FSRC pointed to the importance of a prudent and diligent banker, the literature review noted a loss of competent SME bankers in Australia. Lenders favour centralised and impersonal credit departments. The data analysis points to a relationship between the experience of a banker in understanding the bank's risk exposure and appetite and their understanding of the borrower's position.

The banker depends on reliable and verifiable information provided by the borrower and their specialists to make such a value judgement. The FSRC Round 3 hearings did not focus on the experience of SME bankers or the availability of experienced bankers. Further, set no specific criteria out for experience needed by SME bankers.

9.3.3 Taking advice

9.3.3.1 Legal and financial advice

The study demonstrated that substantial experience in property development and a high level of financial literacy is required for small developers to understand their credit assessment risks. Considering their likely exclusion from small business protections, small developers should take legal and financial advice before entering into a credit contract with a bank. Exclusion from small business protections implies that small developers will have to litigate their cases in court.

While ineffective limited liability allows lenders flexibility in lending more significant amounts to small businesses, this increases the personal risk of the company owner(s). Small developers should consider legal and financial advice against mitigating these risks to ensure their business' long-term sustainability. These legal and financial advisors must have a proven record of experience in property development credit contracts. This study did not analyse the extent to which small developers engage lawyers, accountants and tax specialists, nor the effect of the quality of these specialists' advice on the outcome of the assessment process. Small developers will benefit from future research regarding the effect of the quality of advice received from specialists.

9.3.3.2 Bankers are not advisors

The FSRC final report demonstrates that bankers are not to act as advisors to borrowers. Giving business advice to borrowers presents a conflict of interest. Bankers develop a business relationship with their clients to better build credit profiles and understand their customers' needs. This study indicated that the view of these relationships is different from a bankers' perspective compared to a small business client (see [Section 4.4.1](#) and Figure 4.2). The FSRC hearings noted that the relationship between a bank, a small business and its owner are intertwined. Bankers are considered experts in understanding and interpreting their bank's policies.

While small developers use brokers, the complexity of the assessment process often necessitates the company owner or representative's direct involvement. Small developer interviewees indicated that they use brokers for the initial introduction to lenders with policies that suit their credit requirements. They further noted that there are limited brokers with specialised experience in small property development credit applications.

Inexperienced brokers could filter information that they do not deem critical, leading to declined loans.

9.3.4 A fundable business model

Many factors can affect the complicated loan application assessment process. Such factors include market conditions, the business entity's complexity, the loan's size, the loan period, the small developer's capital input and property development experience. In addition, the contractor's quality, assets' quality, the project viability, the target market and the financial proposal are further such factors.

Evidence from the research indicates that small developers tailor their business models to meet critical assessment criteria. This trend is more prominent when credit is sparse during economic contractions, and lenders only consider the highest quality applications for credit. Thus, high-quality, development-ready proposals are critical during tough economic times.

Developing a sound business model is key to a sustainable property development business. Small developers who understand bank policy requirements and their bank's preferences when extending credit aim to develop projects in areas where their lender sees value. Such a model indicates an understanding of the macro-economic environment and long-term commitment to the industry. Further, a concise business model has a better chance to attract investors and second-tier lenders in cases where access to credit from banks dry up.

The small developer is the champion of their business plan, and they should support their enthusiasm with property development experience, a clear property development success record and a future vision. Small developers will particularly benefit from a business plan that considers future credit access by developing additional income streams and a clear vision of the provision of high-quality securities. While the evidence indicated that small developers tailor their business models to align with critical assessment criteria by lenders, the extent of the success of specific models compared to others were not investigated.

9.3.5 Implications of additional bank risk mitigation measures

9.3.5.1 Unintended exclusion of small contractors

From field notes and discussions with banks, circumstantial evidence points to the active involvement of large contractors and home-building companies in the small property development sector in Perth, WA. Banks interviewed prefer to split the risk between a small developer and a contractor by requiring a separate contract with a contractor in the loan application proposal. The split risk requirement between the developer and the contractor indicates a preference for financially competent contractors to forward-fund a build.

While larger contractors are potentially more expensive than small contractors, the perceived advantages are better price certainty and sound project management systems to complete the build in time. On the other hand, delays are expensive and cost overruns are onerous for small developers. In addition, potentially exceeding contract periods affect their future credit access. The effect on small contractors, of the involvement of large contractors and home-builders in this market sector, is not apparent. Moreover, it is unclear whether there is a reward structure for lenders to point small developers in the direction of large contractors.

9.3.5.2 Monitoring costs

Borrowers carry the costs of monitoring clauses in their contracts. These costs could include regular valuations by bank-approved valuers. Additional and invasive auditing of their financials by a bank-approved accountant is necessary when profits decline. The FSRC found that some lenders' policies prevented the valuations and audit outcomes from being made available to borrowers, even though borrowers are liable for paying these services. Breaches of non-monetary covenants, by the outcome of these investigations, could effect unilateral variations to contract conditions. These could include higher interest rates, shorter repayment periods (with higher repayment amounts), decisions by the bank not to roll over the loan and future credit access. The FSRC noted that these practices were below community standards. Banks have since addressed transparency around valuations and audit outcomes in their policies, while the ABA has included further guidelines in their Code of Practice.

While bank lending is considered the most affordable credit by small developers, additional costs, which increases borrowing costs, are not always anticipated by borrowers. While this study did not focus on borrowing costs, some anecdotal evidence indicates that borrowing costs are potentially comparable for banks and second-tier lenders. Where small developers calculate monitoring costs as part of borrowing-cost in addition to interest rates and loan-initiation fees, this seems conceivable.

9.3.6 A market gap created

Banks have stringent market tests as prudential measures. These tests assist in predicting the likely viability of a project and the bank's potential exposure. The pre-sales requirement is one such test for a property developer who intends to sell the development upon completion. Credit is released by the bank only when pre-sales targets are achieved. Foreign investment restrictions do not allow pre-sales to foreigners as part of the pre-sale quota calculation. Some developers circumvent this requirement by building only three to four units, which does not trigger this test. Other small developers consider alternative credit sources.

Bankers acknowledged that market tests are hard to achieve in tough economic times. However, lenders do not seem to have a better instrument to assess market risk. Second-tier lenders, who do not require pre-sales and do not have the same stringent monitoring criteria, have been pointed out by banks and small developer interviewees as potential competitors to banks. Second-tier lender, RAC, popular with Western Australian small developers due to their lack of pre-sales clauses in contracts, was contacted to contribute to this study but declined to participate. The extent of participation and market share of second tier lenders in property development finance provision is not apparent.

Investment syndicates also consider lending to property developers with a good record of successful projects as a viable investment opportunity. These syndicates consider potentially higher returns on property development projects when compared to interest-dependent investments when interest rates are low. However, syndication complicates the loan viability assessment process, requires high levels of trust between the syndicate members and a small developer, and extensive corporate experience on the part of the small developer. The attraction of syndication to some small developers lies in the opportunity for additional capital input from an external source, splitting the financial

risk further, and building a relationship with the syndicate for future investment in their projects.

9.3.7 Complex technology needed to simplify the assessment process

The credit assessment process of small developers' lending applications is complex. Bankers consider the financial health of a small property development company and that of its owner(s) and potentially also direct relatives and investors. The high documentary burden placed on small developers points to the fragmented nature of the information provided to prove their financial viability to enter into credit contracts. It does not seem likely that the credit assessment process can be simplified without substantial advances in technology.

While the introduction to the research discussed the potential of blockchain technology and smart contracts, current research discourses lack discussions around implementable solutions. Some progress has been made using these technologies to transfer property ownership, but legal and regulatory frameworks are lacking. Blockchain technologies could potentially provide building blocks to ease the current documentary burden on small developers in the future. Aspects like a capability for secure evidence provision, developing immutable records of identity, smart contracts and digital time-stamped ledgers will be a step in the right direction.

The extent to which the credit assessment system could be simplified depends on the quality of the information contained in these records, acceptance of these records as irrefutable evidence by the finance industry, and the market's uptake. The Australian Government's (2020) National Blockchain Roadmap proposed industry and sector engagement to identify opportunities.

9.4 Research gaps

While a small developers' business model affects the assessment process, it is unclear whether lenders favour specific models over others. Small developer interviewees pointed to this being the case. However, the research did not investigate whether lenders have specific preferences for develop-to-sell, develop-to-retain, combinations of these models or other development models.

Lenders' preference to split the financial risk between a small developer and a contractor and their assessment of the contractor's financial capability could exclude small builders from this market. This study noted that many small developers in Western Australia tend to favour large and reputable contractors to improve their access to finance, but the study did not focus on smaller contractors' role in this sector.

Small developer research participants know of the dual assessment of their business and personal financial position and understand the risks around personal losses linked to their business's performance. However, they were unsure that their business does not have effective limited liability, as is the case for large companies. Small business owners' comprehensive understanding of lenders' perspectives of their personal liability being intertwined with their business' liability will benefit from further research.

9.5 Summary of Chapter 9

Chapter 9 discusses the findings of this study and points out future research areas. Small developers are likely excluded from small business protections due to their large credit requirements. Prudential regulations require smaller lenders in Australia to use standardised risk ratings, which places small business loans in a higher risk category and potentially restricts lending to small developers. According to these guidelines, a limited number of well-resourced, larger banks can use an internal risk rating.

Further to considering their risk appetite, market conditions and available capital, lenders assess a small developer's serviceability potential and security. In the case of small developers, an all-moneys approach is followed to assess the serviceability potential and security of a loan. This approach allows the assessment of the business's finances and its owner's as if these are the same, rendering the business's limited liability ineffective. Lenders interviewed in this study prefer splitting the financial risk between a contractor and a small developer and carefully scrutinising the construction proposal. Developers who want to construct their own developments will find it harder to obtain finance from these lenders. Market tests, like pre-sales clauses, are used by banks to determine the potential viability of the project. During economic downturns, small developers find these tests challenging to meet and consider alternative financing sources. Small developers' credit contracts are non-standard, as this group is considered complex and sophisticated borrowers. Their contracts contain non-monetary covenants

that allow lenders to monitor the loan's ongoing serviceability potential and security during the loan period. These monitoring costs are carried by the borrower and could be extensive, depending on the risk perception of the lender.

Considering their vulnerability regarding lack of access to small business protections and lack of effective limited liability, small developers should consider substantial, high-quality legal and financial advice before entering into a credit contract. While relationship banking is helpful in better understanding lenders' policies and processes regarding borrowing, small developers cannot rely on their bankers for financial advice. Prudent and diligent bankers are expected to act in the best interest of their institution, while considering the appropriateness of entering into a credit contract with a borrower.

Chapter 10 summarises the arguments presented in this thesis. Conclusory remarks regarding developing an improved credit risk assessment model for small developers' loans are presented.

CHAPTER 10

CONCLUSION OF THE DEVELOPMENT OF AN IMPROVED CREDIT RISK ASSESSMENT MODEL FOR THE VIABILITY OF SMALL DEVELOPERS DURING LENDING APPLICATIONS

10.1 Introduction

This chapter concludes the study and explains the research contribution to the knowledge gap in small property development loan assessments. The study investigated how lenders assess the viability of small developers during lending applications and why small developers find the application assessment complex and onerous. Lenders consider small developers to have sufficient corporate capacity to compile project proposals to the same standard and quality as expected from large developers while facing a potentially higher documentary burden. Key factors that influence lenders' decision to accept or refuse a credit application are examined. Extant literature suggests lenders' considerations focus on seven credit risk areas: regulatory restrictions, lenders' risk appetite, the physical nature of property development, capital input, ineffective limited liability, securities and guarantees, and small developers' experience.

Small developers are primarily involved in the residential market and on a small scale in the commercial market. They act as entrepreneurial owner-managers and use project management skills to coordinate the whole property development process. They rely on local networks to provide advice regarding the market. Small developers are likely to use local suppliers and specialised service providers. Further, the financial entry-level of property development is high. Small developers undertake property development projects that require substantial financing. Access to credit is critically important for small developers as credit availability affords this group access to opportunities and the development of a pipeline of projects to ensure a sustainable business. Further, it alleviates tying up their capital for extended periods and cash-flow challenges.

The research problem focused on lenders' view of small developers and how they assess this group's viability of credit applications. The loan viability assessment process is onerous and requires the applicant to have extensive experience in the property development process and a high level of financial literacy. When conducting a credit risk assessment of a small developers' proposal, lenders face a substantial obligation to

act prudently and diligently. Significant experience assessing small developers' credit proposals is necessary to conduct an objective and reasonable assessment. The assessment process weighs the likelihood of the loan proposal resulting in a credit contract. Extant literature points to conservative evaluations of small developers' loan proposals that disempowers a sector that contributes markedly to local economies and cities' densification strategies. Lenders' overexposure to this market during the global financial crisis has led to significant losses as asset prices plummeted. While the property development industry could provide high returns, Australian banks take a low-risk approach to extending credit to this market.

Existing academic discussions around small developers' ability to access credit and extant credit assessment models do not address credit viability assessments of this group sufficiently. Three research objectives were identified to address the research gap:

- To identify antecedent and intervening factors that influence small developers' exposure to the risk of failure during applications to lenders.
- To analyse key risk factors assessed by the lender and whether the assessment supports small developers' strategic structure for business success.
- To develop a credit risk assessment model that could facilitate small developers' understanding of the assessment process when applying for credit from lenders.

This study investigated the role of the seven credit risk areas identified from literature on the outcome of small developers' credit proposal viability. Further factors that, in turn, influence the seven credit risk areas were proposed. A deductive research approach allowed a systematic progression from an abductive approach (going back and forth between literature and research) to developing a validated, more appropriate model to assess the viability of small developers during lending applications. This improved credit risk assessment model is presented in Chapter 8 (see Figure 8.4 in [Section 8.5](#)).

The theoretical rationale guided the conceptual thinking and the approach to the research design (see Figure 1.2 in [Section 1.3](#)). Further, the theoretical rationale supported the two-part data collection strategy (see Figure 3.7 in [Section 3.5.1](#)). Data collection methods included a narrative analysis of the Financial Services Royal Commission evidence around property development and small businesses, in-depth interviews with small developers and a bank and a focus group with bankers. Expert

opinion was used as external validation of the conceptual credit risk assessment model (see Figure 7.1 in [Section 7.2.2](#)). An industry survey was conducted, and statistical tests were used to analyse the data.

Plowright's (2012) exploratory sequential design or Frameworks for an Integrated Methodology (FraIM) structured the research methodology and supported the philosophical position (see [Section 3.4.1](#) and Figure 1.4 in [Section 1.5](#)). Pragmatism, when used as an epistemology, could lead to methods-driven and potentially biased research. Using pragmatism as a research paradigm allowed the exploration of pre-supposed power relationships using reflective approaches through mixed research methods. The research considered that companies operate in a fast-changing environment and that companies consist of individuals who contribute to the company's knowledge creation system. A dynamic pluralist epistemology and non-singular reality ontology grounded the research, while value-laden axiology indicates ethical considerations and balanced biases by considering opposing viewpoints and objective evidence.

10.2 Conclusory remarks on the improved credit risk assessment model for small developers' viability

Lenders view small developers as high-risk borrowers who engage in sophisticated and complex credit transactions and expect sufficient corporate capability. The proposed improved credit risk assessment model aimed to analyse literature and existing models and identify factors that affect small developers' credit risk assessment success. While assessment processes and requirements may vary between lenders, seven credit risk areas were identified from the extant literature. These seven credit risk areas were tested using evidence reported to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Interviews were conducted with competent small developers and a banker and a different focus group with bankers regarding their credit risk assessment knowledge. An expert panel provided external validation of the conceptual credit risk assessment model, and an industry survey allowed data triangulation.

Evidence provided to the Commission pointed to small businesses not being appropriately defined by lenders, and that small business characteristics are not well

understood. The Commission recommended expanding and clarifying the small business definition used by the Australian Banking Association to extend small business protections. Small developers, however, are likely excluded from many, if not all, small business protections; their project values are significant and their credit agreements complicated. A subsequent independent report, commissioned by the Australian Banking Association, indicated some expansion the aggregate credit value of the small business definition. Further, it noted that small businesses should explicitly be told when excluded from the small business definition and protections. Small businesses indicated that they do not have an appetite for increased protections, as these could constrain their access to affordable credit.

Lenders consider their own risks against exposure to a specific sector, market conditions and funds available to lend to small developers. Exposure of a lender to a specific loan is mitigated by extensive investigations into small developers' experience, access to capital and their ability to repay and secure their loans. Small developers' businesses environment is regarded as high-risk by lenders, and market tests are used to evaluate the potential of developers' projects to succeed. The time lag in realising the profit of a property development project contributes to the intensity of the scrutiny of a small developer's serviceability potential and lenders' additional exposure-risk calculations. While regulatory factors and bank risk appetite are outside of the control of a small developer when applying for credit, they significantly affect the credit viability assessment process. Further, non-monetary clauses in the credit may be used to monitor the loan's ongoing serviceability potential and security against some of these factors.

In the case of small developers, similar to other small businesses, lenders follow an all-moneys approach and considers the business's financial strength and assets of its owner as if these are the same. While the all-moneys approach allows lenders to consider higher value loans to this group and improves their access to credit, it renders limited liability ineffective and increases the risk of personal losses of the business owner. It is critical for small developers to obtain high quality financial and legal advice, as losses are often disproportional to a small business owner where an institutional imperfection or error occurs.

The structure of a small developers' business entity directs the assessment process and could affect its complexity. Lenders consider the purpose of a loan, the quality of a

development-ready project proposal, and the quality of specialists and the contractor involved in the development project.

While existing models points out documentary requirements and bank requirements, the proposed improved credit risk assessment model also indicates small developers' risk considerations and provide a more comprehensive model to understand small developers' credit applications' propensity to succeed.

10.3 Synthesis

This study contributes to the knowledge of small developers' challenges during lenders' credit risk assessment process. Small developers share small business characteristics but face unique challenges during the credit risk assessment process. Lenders consider this group is considered by lenders as sophisticated, high-risk borrowers who have access to specialists and have sufficient corporate capacity to engage in complex credit transactions. Their applications are conservatively assessed and are subject to a high documentary burden.

The proposed improved credit risk assessment model for the viability of small developers' proposals demonstrates the effect of lenders' seven credit risk areas on the propensity of a small developers' proposal to succeed. This proposed improved model contributes to small developers' understanding of the factors considered during the credit viability assessment process that could affect the success of their proposal. While small developers access to credit is critical, the study showed that small developers should prioritise high-quality legal and financial advice before engaging in a credit contract to manage their own risks.

Lenders will find the proposed improved model helpful to understand small developers credit risk assessment challenges and improve or simplify this group's credit risk assessments. The complex nature of property development and the high documentary requirements of banks to verify the suitability of a small developer to engage in a particular credit contract point to the fragmented nature of the information provided. Substantial technological development of secure and verified evidence provision, supported by legal and regulatory frameworks, are currently lacking but could simplify the credit assessment process in future.

This study conducted empirical research into lenders' credit risk assessment process when considering small developers' proposals' viability in Australia. The study considered objective evidence from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Subjective opinions of lender-approved representatives and small developers with extensive industry experience were considered. Expert opinion and an industry survey balanced potential biases and allowed data triangulation. The proposed improved credit assessment model of small developers' viability presents a more appropriate, novel model that contributes to the field of small developers' credit access.

LIST OF REFERENCES

- ABA. 2020. *Banking Code of Practice*. <https://www.ausbanking.org.au/wp-content/uploads/2020/06/2020-Code-A4-Booklet-with-July-1-COVID-19-Special-Note-WEB.pdf>.
- ABS. 2020a. “Counts of Australian Businesses, Including Entries and Exits.” Canberra. <https://abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/june-2015-june-2019>.
- . 2020b. “Business Indicators, Business Impacts of COVID-19.” Canberra. <http://www.abs.gov.au/statistics/economy/business-indicators/business-conditions-and-sentiments/oct-2020>.
- . 2021. “Lending Indicators.” Canberra. <https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release#housing>.
- Amrhein, Valentin, Sander Greenland, and Blake McShane. 2019. “Scientists Rise up against Statistical Significance.” *Nature* 567 (7748): 305–7. <https://doi.org/10.1038/d41586-019-00857-9>.
- Anastasia, Christina. 2015. “Exploring Definitions of Small Business and Why It Is so Difficult.” *Journal of Management Policy and Practice* 16 (4): 5–6. <https://www.sba.gov/content/determining->.
- Ang, James S. 1991. “Small Business Uniqueness and the Theory of Financial Management.” *The Journal of Entrepreneurial Finance* 1 (1): 1–13.
- ASIC. n.d. “Small Business.” Accessed November 13, 2020. <https://asic.gov.au/for-business/small-business/#what>.
- Australian Government Competition and Consumer Commission. 2016. “Unfair Contract Terms.” Australian Competition and Consumer Commission Website. 2016. <https://www.accc.gov.au/business/business-rights-protections/unfair-contract-terms#what-contracts-are-covered->.
- Australian Government Department of Health. 2020. “Australian Health Sector Emergency Response Plan for Novel Coronavirus (COVID-19),” February. https://www.health.gov.au/sites/default/files/documents/2020/02/australian-health-sector-emergency-response-plan-for-novel-coronavirus-covid-19_2.pdf.

- Australian Government, and Energy and Resources Department of Industry, Science. 2020. "The National Blockchain Roadmap: Progressing Towards a Blockchain-Empowered Future." <https://www.industry.gov.au/sites/default/files/2020-02/national-blockchain-roadmap.pdf>.
- Australian Government Financial Complaints Authority. n.d. "Information for Small Business: How We Define 'Small Business.'" Accessed November 13, 2020. <https://www.afca.org.au/what-to-expect/small-business>.
- Australian Government Taxation Office. 2020. "GTS and Property." 2020. <https://www.ato.gov.au/business/gst/in-detail/your-industry/property/gst-and-property/>.
- Australian Government Treasury. 2018. "Background Paper 11: Request for Information Reforms to Consumer Lending."
- Australian Parliament. 1902. *Royal Commissions Act 1902*.
- Australian Stock Exchange. 2021. "CBA Peer Analysis." September 7, 2021. <https://www2.asx.com.au/markets/company/cba>.
- Awuzie, Bankole, and Peter McDermott. 2017. "An Abductive Approach to Qualitative Built Environment Research: A Viable System Methodological Exposé." *Qualitative Research Journal* 17 (4): 356–72. <https://doi.org/10.1108/QRJ-08-2016-0048>.
- Aysan, Ahmet F., Mustafa Disli, Adam Ng, and Huseyin Ozturk. 2016. "Is Small the New Big? Islamic Banking for SMEs in Turkey." *Economic Modelling* 54 (October 2015): 187–94. <https://doi.org/10.1016/j.econmod.2015.12.031>.
- Baccarini, David, and Frank Kraus. 2005. "Influences on Risk Taking Behaviour of Property Developers in Perth, Western Australia." *ARCOM 21st Annual Conference* 1 (September): 179–89. http://www.arcom.ac.uk/-docs/proceedings/ar2005-0179-0189_Baccarini_and_Kraus.pdf.
- Banwo, Adedayo. 2018. "Artificial Intelligence and Financial Services: Regulatory Tracking and Change Management." *Journal of Securities Operations & Custody* 10 (4): 354–65.
- Bauchet, Jonathan, and Jonathan Morduch. 2013. "Is Micro Too Small? Microcredit vs. SME Finance." *World Development* 43: 288–97. <https://doi.org/10.1016/j.worlddev.2012.10.008>.

- Baxter, Pamela, and Susan Jack. 2008. "Qualitative Case Study Methodology: Study Design and Implementation for Novice Researchers." *The Qualitative Report* Volume 13 (4): 544–59. <https://doi.org/10.2174/1874434600802010058>.
- Beck, Thorsten. 2007. "The Financing Constraints of SMEs in Developing Countries: Evidence, Determinants and Solutions." In *Financing Innovation-Oriented Businesses to Promote Entrepreneurship*.
- Berger, Allen N., and Gregory F. Udell. 2006. "A More Complete Conceptual Framework for SME Finance." *Journal of Banking and Finance* 30 (11): 2945–66. <https://doi.org/10.1016/j.jbankfin.2006.05.008>.
- Bonevski, J., J. Bryant, M. Lynach, and C. Paul. 2012. "Money as motivation to quit: A survey of a non-random Australian sample of socially disadvantaged smokers' views of the acceptability of cash incentives." *Preventive Medicine* 55 (2): 122–126.
- Booyens, Derick, Michelle Burger, and Henk Bouwman. 2013. "The Status of Building Image Modelling in the South African Construction Industry." In *The 2nd Year of Advanced Research in Scientific Areas*, 422–30.
- Brei, Michael, and Alfredo Schclarek. 2015. "A Theoretical Model of Bank Lending: Does Ownership Matter in Times of Crisis?" *Journal of Banking and Finance* 50 (January): 298–307. <https://doi.org/10.1016/j.jbankfin.2014.03.038>.
- Brems, Matt. 2017. "A One-Stop Shop for Principal Component Analysis." <https://towardsdatascience.com/a-one-stop-shop-for-principal-component-analysis-5582fb7e0a9c>.
- Bryant, Lyndall. 2012. "An Assessment of Development Funding for New Housing Post GFC in Queensland, Australia." *International Journal of Housing Markets and Analysis* 5 (2): 118–33. <https://doi.org/10.1108/17538271211225887>.
- . 2017. "Housing Affordability in Australia: An Empirical Study of the Impact of Infrastructure Charges." *Journal of Housing and the Built Environment* 32 (3): 559–79. <https://doi.org/10.1007/s10901-016-9527-0>.
- Byrd, Kimble, Linda W Ross, and Caroline E W Glackin. 2013. "A Preliminary Causal Analysis of Small Business Access to Credit During Economic Expansion and Contraction." *Journal of Applied Finance and Banking* 3 (5): 1–6.
- Chiang, Yat Hung, and Eddie W L Cheng. 2011. "Revealing Bank Lending Decisions for Contractors in Hong Kong." *International Journal of Project Management* 29 (2): 137–45. <https://doi.org/10.1016/j.ijproman.2010.02.003>.

- Cohen, Jacob (New York University). 1992. "A Power Primer." *Psychological Bulletin* 112 (1): 155–59.
- Cole, Rebel, and Tatyana Sokolyk. 2016. "Who Needs Credit and Who Gets Credit? Evidence from the Surveys of Small Business Finances." *Journal of Financial Stability* 24 (March 2014): 40–60. <https://doi.org/10.1016/j.jfs.2016.04.002>.
- Commonwealth of Australia. 2017. *Letters Patent*. Australia: Our Letters Patent.
- Costello, Anna B., and Jason W. Osborne. 2005. "Best Practices in Exploratory Factor Analysis: Four Recommendations for Getting the Most from Your Analysis." *Practical Assessment, Research and Evaluation* 10 (7). <https://doi.org/10.7275/jyj1-4868>.
- Cummings, James R., and Kassim J. Durrani. 2016. "Effect of the Basel Accord Capital Requirements on the Loan-Loss Provisioning Practices of Australian Banks." *Journal of Banking and Finance* 67 (December 2003): 23–36. <https://doi.org/10.1016/j.jbankfin.2016.02.009>.
- Deeter, Karl. 2016. "Delivering a Win-Win Deal for Downsizers." *Sunday Business Post*, April 28, 2016. <https://link.library.curtin.edu.au/gw?url=https://www.proquest.com/newspapers/del>
- DeRuyter, Alex, Martyn Brown, and John Burgess. 2018. "Gig Work and the Fourth Industrial Revolution: Conceptual and Regulatory Challenges." *Journal of International Affairs* 72 (1): 37–50.
- DeZoort, F. Todd, Anne Wilkins, and Scot E. Justice. 2017. "The Effect of SME Reporting Framework and Credit Risk on Lenders' Judgments and Decisions." *Journal of Accounting and Public Policy* 36 (4): 302–15. <https://doi.org/10.1016/j.jaccpubpol.2017.05.003>.
- Dietz, Robert. 2020. "Construction Loan Volume Contracts During 2020." *Eye On Housing*, 2020. <https://eyeonhousing.org/2020/09/construction-loan-volume-contracts-during-2q20/>.
- Drummond, Helga, and Elizabeth Chell. 1994. "Crisis Management in a Small Business: A Tale of Two Solicitors' Firms." *Management Decision* 32 (1): 37–40. <https://doi.org/10.1108/00251749410050688>.
- Du, Jianhua, Chao Bian, and Christopher Gan. 2017. "Bank Competition, Government Intervention and SME Debt Financing." *China Finance Review International* 7 (4): 478–92. <https://doi.org/10.1108/CFRI-02-2017-0007>.

- Feilzer, Martina Yvonne. 2010. "Doing Mixed Methods Research Pragmatically: Implications for the Rediscovery of Pragmatism as a Research Paradigm." *Journal of Mixed Methods Research* 4 (1): 6–16.
<https://doi.org/10.1177/1558689809349691>.
- Ferreira, Renata Ribeiro. 2014. "Stepping Stones to an Exclusionary Model of Home Ownership in Australia." *Journal of Australian Political Economy* 77: 79–109.
- Forlee, Ron. 2015. *Australian Residential Property Development for Investors*. Milton: Wrightbooks.
- Frost, James. 2019. "ABA Resists Hayne's Definition of Small Business." *Financial Review*, February 27, 2019.
- FSRC. 2018a. "Interim Report." *Commonwealth of Australia*. Vol. 2.
 ———. 2018b. Transcript of Proceedings, Round 3.
 ———. 2019a. "Final Report." *Commonwealth of Australia*. Vol. 3.
 ———. 2019b. "Final Report." *Commonwealth of Australia*. Vol. 1.
 ———. n.d. "Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry."
<https://Financialservices.Royalcommission.Gov.Au/Pages/Default.Html>. Accessed August 13, 2021.
<https://financialservices.royalcommission.gov.au/Pages/default.html>.
- Gara, Antoine. 2021. "World's Best Banks 2021: Financiers to the Looming Economic Recovery." *Forbes*, April 13, 2021. <https://www.forbes.com/worlds-best-banks/#69f28f091295>.
- Geoff, Gallop. 1988. "The Management of Small Business.: Opening Address." In *Annual Conference of the Association of Consulting Surveyors (Western Australia)*. Rottneest.
- Gignac, Gilles E., and Eva T. Szodorai. 2016. "Effect Size Guidelines For Individual Differences Researchers." *Personality and Individual Differences* 102: 74–78.
<https://doi.org/10.1016/j.paid.2016.06.069>.
- Gilligan, George. 2018. "The Hayne Royal Commission and Trust Issues in the Regulation of the Australian Financial Sector." *Law and Financial Markets Review* 12 (4): 175–85. <https://doi.org/10.1080/17521440.2018.1548209>.
- Goderdzishvili, Nate, Eka Gordadze, and Nikoloz Gagnidze. 2018. "Georgia's Blockchain-Powered Property Registration: Never Blocked, Always Secured: Ownership Data Kept Best!" In *ICEGOV '18: Proceedings of the 11th*

- International Conference on Theory and Practice of Electronic Governance*, 673–75. Galway: ICEGOV '18. <https://doi.org/10.1145/3209415.3209437>.
- Goderdzishvili, Nata, Eka Gordadze, and Nikoloz Gagnidze. 2018. “Georgia’s Blockchain-Powered Property Registration: Never Blocked, Always Secured - Ownership Data Kept Best!” In *ACM International Conference Proceeding Series*, 673–75. <https://doi.org/10.1145/3209415.3209437>.
- Godwin, Andrew, Jeannie Marie Paterson, and Nicola Howell. 2018. “Background Paper 10: Credit for Small Business: An Overview of Australian Law Regulating Small Business Loans.” Melbourne.
- Gonzalez, Wenceslao J. 2013. “Value Ladenness and the Value-Free Ideal in Scientific Research.” In *Luetge C. (Eds) Handbook of the Philosophical Foundations of Business Ethics*, 1503–21. Dordrecht: Springer. https://doi.org/https://doi-org.dbgw.lis.curtin.edu.au/10.1007/978-94-007-1494-6_78.
- Gordini, Niccolò. 2014. “A Genetic Algorithm Approach for SMEs Bankruptcy Prediction: Empirical Evidence from Italy.” *Expert Systems with Applications* 41 (14): 6433–45. <https://doi.org/10.1016/j.eswa.2014.04.026>.
- Graeber, David. 2014. *Debt: The First 5000 Years*. New York: Melville House Publishing.
- Griffith, Aaron M. 2015. “Towards a Pluralist Theory of Truthmaking.” *Erkenntnis* 80 (6): 1157–73. <https://doi.org/10.1007/s10670-014-9717-7>.
- Gudmundsson, Sveinn Vidar, and Christian Lechner. 2013. “Cognitive Biases, Organization, and Entrepreneurial Firm Survival.” *European Management Journal* 31 (3): 278–94. <https://doi.org/10.1016/j.emj.2013.01.001>.
- Guo, H. L., Heng Li, and Martin Skitmore. 2010. “Life-Cycle Management of Construction Projects Based on Virtual Prototyping Technology.” *Journal of Management in Engineering* 26 (1): 41–47.
- Gurran, Nicole, Madeleine Pill, and Sophia Maalsen. 2021. “Hidden Homes? Uncovering Sydney’s Informal Housing Market.” *Urban Studies* 58 (8): 1712–31. <https://doi.org/10.1177/0042098020915822>.
- Halabi, Abdel K., Robyn Dyt, and Rowena Barrett. 2010. “Understanding Financial Information Used to Assess Small Firm Performance: An Australian Qualitative Study.” *Qualitative Research in Accounting & Management* 7 (2): 163–79. <https://doi.org/10.1108/11766091011050840>.

- Hall, Jori N. 2013. "Pragmatism, Evidence, and Mixed Methods Evaluation." Edited by D. M. Mertens and S. Hesse-Biber. *New Directions for Evaluation* 138: 15–26.
- Hamilton, Robert T., and Mark A. Fox. 1998. "The Financing Preferences of Small Firm Owners." *International Journal of Entrepreneurial Behaviour & Research* 4 (3): 239–48. <https://doi.org/10.1108/13552559810235529>.
- Healy, Joseph. 2019. "The Demise in the Craft of SME Banking." *Australasian Journal of Applied Finance*, no. 2: 11–17.
<https://search.ebscohost.com/login.aspx?direct=true&db=ecn&AN=1806629&lang=fr&site=ehost-live>.
- Heller, Joseph, and Gene Phillips. 2020. "Will the COVID Pandemic Spark a Return in GFC-Type Financial Market Litigation?" *Law and Financial Markets Review*, 151–55. <https://doi.org/10.1080/17521440.2020.1788264>.
- Herranz, Neus, Stefan Krasa, and Anne P. Villamil. 2009. "Small Firms in the SSBF." *Annals of Finance* 5 (3–4): 341–59. <https://doi.org/10.1007/s10436-008-0118-2>.
- Hoffmann, Mathias, and Iryna Shcherbakova-Stewen. 2011. "Consumption Risk Sharing Over the Business Cycle: The Role of Small Firms' Access to Credit Markets." *Review of Economics & Statistics* 93 (4): 1403–16.
https://doi.org/10.1162/REST_a_00123.
- Hormozi, Amir M., Gail S. Sutton, Robert D. McMinn, and Wendy Lucio. 2002. "Business Plans for New or Small Businesses: Paving the Path to Success." *Management Decision* 40 (8): 755–63.
<https://doi.org/10.1108/00251740210437725>.
- Hughes, Duncan. 2018. "Downsizer Deluge." *The Australian Financial Review*, June 30, 2018.
- Illia, Laura, Karan Sonpar, and Martin W. Bauer. 2014. "Applying Co-Occurrence Text Analysis with ALCESTE to Studies of Impression Management." *British Journal of Management* 25 (2): 352–72. <https://doi.org/10.1111/j.1467-8551.2012.00842.x>.
- Isaac, David, John O'Leary, and Mark Daley. 2010. *Property Development: Appraisal and Finance*. 2nd ed. Hampshire: Palgrave Macmillan.
- Kariv, Dafna, and Susan Coleman. 2015. "Toward a Theory of Financial Bricolage: The Impact of Small Loans on New Businesses." *Journal of Small Business and Enterprise Development* 22 (2): 196–224. <https://doi.org/10.1108/JSBED-02-2013-0020>.

- Karra, Neri, Paul Tracey, and Nelson Phillips. 2006. "Altruism and Agency in the Family Firm: Exploring the Role of Family, Kinship, and Ethnicity." *Entrepreneurship Theory and Practice* 30 (6). <https://doi.org/10.1111/j.1540-6520.2006.00157.x>.
- Kersten, Renate, Job Harms, Kellie Liket, and Karen Maas. 2017. "Small Firms, Large Impact? A Systematic Review of the SME Finance Literature." *World Development* 97 (2016): 330–48. <https://doi.org/10.1016/j.worlddev.2017.04.012>.
- King, Michael. 2017. "AI Revolution on Campus." *EDUCARE Review* 52 (5): 10.
- Kivunja, Charles, and Ahmed Bawa Kuyini. 2017. "Understanding and Applying Research Paradigms in Educational Contexts." *International Journal of Higher Education* 6 (5): 26. <https://doi.org/10.5430/ijhe.v6n5p26>.
- KPMG International. 2016. "Building a Technology Advantage." *Global Construction Survey 2016*. <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2016/09/global-construction-survey-2016.pdf>.
- Lawrence, Michael. 2019. "Submission: Customer Owned Banking Code of Practice Independent Review 2019 Report One." *Customer Owned Banking Association*. Customer Owned Banking Association.
- Lawson, Tony. 2016. "Comparing Conceptions of Social Ontology: Emergent Social Entities and/or Institutional Facts?" *Journal for the Theory of Social Behaviour* 46 (4): 359–99. <https://doi.org/10.1111/jtsb.12126>.
- Liu, Zhen, Yingzhao Xiao, Shiyao Jiang, and Shuang Hu. 2020. "Social Entrepreneurs' Personal Network, Resource Bricolage and Relation Strength." *Management Decision*, no. 71702085. <https://doi.org/10.1108/MD-05-2019-0674>.
- Lowies, Braam, Robert Brenton Whait, Christa Viljoen, and Stanley McGreal. 2018. "Fractional Ownership – An Alternative Residential Property Investment Vehicle." *Journal of Property Investment and Finance* 36 (6): 513–22. <https://doi.org/10.1108/JPIF-02-2018-0013>.
- Mendelsohn, Rebecca, and Allan Fels. 2014. "Australia's Foreign Investment Review Board and the Regulation of Chinese Investment." *China Economic Journal* 7 (1): 59–83. <https://doi.org/10.1080/17538963.2013.874068>.
- Miles, Mike E., Gayle L. Berens, Mark J. Eppli, and Marc A. Weiss. 2007. *Real Estate Development: Principles and Processes*. 4th ed. Washington: Urban and Land Institute.

- Morgan, David L. 2007. "Paradigms Lost and Pragmatism Regained." *Journal of Mixed Methods Research* 1 (1): 48–76. <https://doi.org/10.1177/2345678906292462>.
- . 2014. "Pragmatism as a Paradigm for Social Research." *Qualitative Inquiry* 20 (8): 1045–53. <https://doi.org/10.1177/1077800413513733>.
- Naoi, Michio, Piyush Tiwari, Yoko Moriizumi, Norifumi Yukutake, Norman Hutchison, Alla Koblyakova, and Jyoti Rao. 2019. "Household Mortgage Demand: A Study of the UK, Australia and Japan." *International Journal of Housing Markets and Analysis* 12 (1): 110–30. <https://doi.org/10.1108/IJHMA-03-2017-0029>.
- Newell, Graeme, and Stanley McGreal. 2017. "The Significance of Development Sites in Global Real Estate Transactions." *Habitat International* 66: 117–24. <https://doi.org/10.1016/j.habitatint.2017.06.006>.
- Newman, Derek L. 1996. "Financial Theory and the Definition of Small Business: The Role of Personal Liability As a Critical Variable in the Definition of Small Business From the Perspective of Financial Management." *Researcharchive.Lincoln.Ac.Nz*. https://researcharchive.lincoln.ac.nz/bitstream/10182/3279/6/yii_mcm.pdf.txt.
- OECD. 2015. "G20 / OECD High-Level Principles for SME Financing." Antalya. <https://www.oecd.org/finance/G20-OECD-High-Level-Principles-on-SME-Financing.pdf>.
- . 2020. "Financing SMEs and Entrepreneurs: An OECD Scoreboard." Paris. <https://doi.org/10.1787/061fe03d-en>.
- Olawale, Yakubu Adisa, and Ming Sun. 2010. "Cost and Time Control of Construction Projects: Inhibiting Factors and Mitigating Measures in Practice." *Construction Management and Economics* 28 (5): 509–26. <https://doi.org/10.1080/01446191003674519>.
- Palmira, Michele. 2018. "Towards a Pluralist Theory of Singular Thought." *Synthese* 195 (9): 3947–74. <https://doi.org/10.1007/s11229-017-1401-4>.
- Parliament of Australia. 2001. *Corporations Act 2001 (Cth)*.
- Pascale, Celine-Marie. 2010. "Epistemology and the Politics of Knowledge." *The Sociological Review* 58 (2_suppl): 154–65. <https://doi.org/10.1111/j.1467-954x.2011.01967.x>.
- Petrov, Dancho. 2020. "Blockchain Ecosystem in the Financial Services Industry." *FAIMA Business & Management Journal* 8 (1): 19–31. <https://ezproxy.aud.edu/login?url=http://search.ebscohost.com/login.aspx?direct=true>

ue&AuthType=cookie,ip,url&db=bsu&AN=142588821&site=eds-live&scope=site.

Pierce, Neal R. 1995. "A Megabank Joins the Critics of Urban Sprawl." *Nation's Cities Weekly* 18 (10): 18.

Plowright, David. 2012. *Using Mixed Methods: Frameworks for an Integrated Methodology*. 1st ed. London: Sage Publications Ltd.

———. 2013. "To What Extent Do Postgraduate Students Understand the Principles of Mixed Methods in Educational Research?" *International Journal of Multiple Research Approaches* 7 (1): 66–82. <https://doi.org/10.5172/mra.2013.7.1.66>.

Pottinger. 2020. "The Definition of 'Small Business': Independent Review." Sydney. https://www.pottinger.com/uploads/1/9/5/1/19512909/pottinger_-_independent_review_of_the_definition_of_small_business_-_26_october_2020.pdf.

Property Council of Australia. 2017. "Economic Significance of the Property Industry to the Australian Economy," 46.

https://www.propertycouncil.com.au/downloads/propsignificance/AUS_Full.pdf.

Psilander, Kurt. 2012. "Managing Production Costs of Small and Large Developers in Sweden: A Case Study on Multi-Family Construction." *International Journal of Construction Education and Research* 8 (1): 47–62.

<https://doi.org/10.1080/15578771.2011.608112>.

Qualtrics XM. n.d. "Qualtrics Stats IQ." Accessed October 19, 2021.

<https://curtin.au1.qualtrics.com/statwing/statsiq>.

Reijonen, Helen. 2008. "Understanding the Small Business Owner: What They Really Aim at and How This Relates to Firm Performance: A Case Study in North Karelia, Eastern Finland." *Management Research News* 31 (8): 616–29.

<https://doi.org/10.1108/01409170810892172>.

Sadleir, Chris, and Greg Mahony. 2009. "Institutional Challenges and Response in Regulating Foreign Direct Investment to Australia." *Economic Papers* 28 (4): 337–45. <https://doi.org/10.1111/j.1759-3441.2010.00041.x>.

Sanders Greer, Shelly. 2008. "Builders Fill In The Gaps; Demand for Space Has Developers Evolving into Infill Specialists." *National Post*, August 9, 2008.

<https://link.library.curtin.edu.au/gw?url=https://www.proquest.com/newspapers/bui>

- Santos, Leandro Lima dos, Felipe Mendes Borini, and Rafael Morais Pereira. 2020. "Bricolage as a Path Towards Organizational Innovativeness in Times of Market and Technological Turbulence." *Journal of Entrepreneurship in Emerging Economies* 13 (2): 282–99. <https://doi.org/10.1108/JEEE-02-2020-0039>.
- Scutt, David. 2016. "CHARTS: Australia's 'Significant' Housing Shortage." *Business Insider Australia*, March 23, 2016. <https://www.businessinsider.com.au/charts-australias-significant-housing-shortage-2016-3>.
- Sharam, Andrea. 2020a. "'Deliberative Development': Australia's Baugruppen Movement and the Challenge of Greater Social Inclusion." *Housing Studies* 35 (1): 107–22. <https://doi.org/10.1080/02673037.2019.1594712>.
- . 2020b. "'Deliberative Development': Australia's Baugruppen Movement and the Challenge of Greater Social Inclusion." *Housing Studies* 35 (1): 107–22. <https://doi.org/10.1080/02673037.2019.1594712>.
- Spender, J. -C. 1998. "Pluralist Epistemology and Knowledge-Based Theory of the Firm." *Sage Journals* 5 (4): 233–56. <https://doi.org/https://doi-org.dbgw.lis.curtin.edu.au/10.1177/135050849852005>.
- Thayer-Bacon, Barbara J. 1997. "The Nurturing Of A Relational Epistemology." *Educational Theory* 47 (2): 239–60. <https://doi.org/10.1111/j.1741-5446.1997.00239.x>.
- Cranston, Matthew. 2021. "Downsizers to Kick off Another \$10b in Sales." *The Australian Financial Review*, May 11, 2021. www.afr.com.
- The Australian Workers' Union. 2020a. "FIFO Travel Update (June 2020)." <https://www.awu.net.au/national/news/2020/06/12080/fifo-travel-update-june-2020/>.
- . 2020b. "Boom Time Ahead for the WA and QLD Construction Industry." February 2020. <https://www.awu.net.au/wa/news/2020/02/9395/boom-time-ahead-for-the-wa-and-qld-construction-industry/>.
- Toews, Ingrid, Andrew Booth, Rigmor C. Berg, Simon Lewin, Claire Glenton, Heather M. Munthe-Kaas, Jane Noyes, Sara Schroter, and Joerg J. Meerpohl. 2017. "Further Exploration of Dissemination Bias in Qualitative Research Required to Facilitate Assessment within Qualitative Evidence Syntheses." *Journal of Clinical Epidemiology* 88 (August): 133–39. <https://doi.org/10.1016/j.jclinepi.2017.04.010>.
- Trafford, Vernon, and Shosh Leshem. 2008. *Stepping Stones to Achieving Your Doctorate*. New York: Open University Press.

- Tsuruta, Daisuke. 2015. "Bank Loan Availability and Trade Credit for Small Businesses During the Financial Crisis." *The Quarterly Review of Economics and Finance* 55: 40–52.
- Vanevenhoven, Jeff, Doan Winkel, Debra Malewicki, William L Dougan, and James Bronson. 2011. "Varieties of Bricolage and the Process of Entrepreneurship." *New England Journal of Entrepreneurship* 14 (2): 53–67.
- Wang, Rui, Zhangxi Lin, and Hang Luo. 2019. "Blockchain, Bank Credit and SME Financing." *Quality and Quantity* 53 (3): 1127–40. <https://doi.org/10.1007/s11135-018-0806-6>.
- Weber, David, and Emily Piesse. 2020. "WA Homebuyers to Receive \$20,000 Grants for New Builds as Government Steps in to Help Industry." *ABC News*, June 7, 2020. <https://www.abc.net.au/news/2020-06-07/wa-housing-grant-for-new-home-builds-unveiled-by-wa-government/12330234>.
- Western Australian Government. 2020. "COVID-19 Coronavirus: Western Australian Government Response." Online. <https://www.wa.gov.au/organisation/department-of-the-premier-and-cabinet/covid-19-coronavirus-western-australian-government-response>.
- Wilkinson, Sara, and Richard Reed. 2016. *Property Development*. 5th ed. Oxon: Routledge.
- Wong, Peng Yew, David Higgins, and Ron Wakefield. 2017. "Foreign Real Estate Investment, Residential Tourism and the Australian Residential Property Market." *International Journal of Housing Markets and Analysis* 10 (5): 586–606. <https://doi.org/10.1108/IJHMA-01-2017-0007>.
- Yates, Judith. 2014. "Protecting Housing and Mortgage Markets in Times of Crisis: A View from Australia." *Journal of Housing and the Built Environment* 29 (2): 361–82. <https://doi.org/10.1007/s10901-013-9385-y>.
- Zeneli, Fjona, and Lavdosh Zaho. 2014. "Financing SMEs in Vlora City, Albania: Between Game Theory and Lack of Information." *Procedia - Social and Behavioral Sciences* 150: 126–31. <https://doi.org/10.1016/j.sbspro.2014.09.016>.

APPENDICES

APPENDIX 1: Research approval by Curtin Human Ethics Committee



Research Office at Curtin

GPO Box U1987
Perth Western Australia 6845

Telephone +61 8 9266 7863
Facsimile +61 8 9266 3793
Web research.curtin.edu.au

19-Aug-2020

Name: Oluwole Olatunji
Department/School: Department of Construction Management
Email: Oluwole.Olatunji@curtin.edu.au

Dear Oluwole Olatunji

RE: Amendment approval
Approval number: HRE2018-0746

Thank you for submitting an amendment request to the Human Research Ethics Office for the project **A model for assessing the viability of small developers during lending applications**.

Your amendment request has been reviewed and the review outcome is: **Approved**

The amendment approval number is HRE2018-0746-07 approved on 19-Aug-2020.

The following amendments were approved:

The previous data management plan indicated a questionnaire to be sent to participants. This will now be a survey. The following are included in the amendment request:

- Data management plan updated
- Promotional material
- Survey

Condition of Approval

It is the responsibility of the Chief Investigator to ensure that any activity undertaken under this project adheres to the latest available advice from the Government or the University regarding COVID-19

Any special conditions noted in the original approval letter still apply.

Standard conditions of approval

1. Research must be conducted according to the approved proposal
2. Report in a timely manner anything that might warrant review of ethical approval of the project including:
 - proposed changes to the approved proposal or conduct of the study
 - unanticipated problems that might affect continued ethical acceptability of the project
 - major deviations from the approved proposal and/or regulatory guidelines
 - serious adverse events
3. Amendments to the proposal must be approved by the Human Research Ethics Office before they are implemented (except where an amendment is undertaken to eliminate an immediate risk to participants)
4. An annual progress report must be submitted to the Human Research Ethics Office on or before the anniversary of approval and a completion report submitted on completion of the project
5. Personnel working on this project must be adequately qualified by education, training and experience for their role, or supervised
6. Personnel must disclose any actual or potential conflicts of interest, including any financial or other interest or affiliation, that bears on this project
7. Changes to personnel working on this project must be reported to the Human Research Ethics Office
8. Data and primary materials must be retained and stored in accordance with the [Western Australian University Sector Disposal Authority \(WAUSDA\)](#) and the [Curtin University Research Data and Primary Materials policy](#)
9. Where practicable, results of the research should be made available to the research participants in a timely and clear manner
10. Unless prohibited by contractual obligations, results of the research should be disseminated in a manner that will allow public scrutiny; the Human Research Ethics Office must be informed of any constraints on publication
11. Ethics approval is dependent upon ongoing compliance of the research with the [Australian Code for the Responsible Conduct of Research](#), the [National Statement on Ethical Conduct in Human Research](#), applicable legal requirements, and with Curtin University policies, procedures and governance requirement
12. The Human Research Ethics Office may conduct audits on a portion of approved projects.

Should you have any queries regarding consideration of your project, please contact the Ethics Support Officer for your faculty or the Ethics Office at hrec@curtin.edu.au or on 9266 2784.

Yours sincerely



Amy Bowater Ethics, Team Lead

APPENDIX 2: Survey questions (demonstration document)

Factors that influence the success of small developers' loan applications

Q1 Dear Participant

You have been identified as a participant for our study, due to your involvement in the construction industry/property development industry/property investment industry or because of your knowledge of lending to property developers.

Small developers often need access to finance, due to the nature and size of their projects. We are interested in your personal experiences and perceptions around the factors that influence the success of their loan applications.

To that end, your voluntary response to the following questionnaire is much appreciated and should take no more than a few minutes to complete. By completing this survey, your consent is implied. You are asked to rate 29 questions in total (under 7 headings) in terms of how much you agree. If you would like to receive the results of the survey, please leave your details on the form at the end of the survey.

Your response will be treated as confidential and will not be re-identifiable, unless you choose to receive feedback, by completing the form at the end of the survey, which will allow us to identify you. The responses will be stored for 7 years, after which it will be destroyed. You can contact Monica Martin for further information or to answer questions via email at monica.martin@postgrad.curtin.edu.au or Prof Oluwole Olatunji at Oluwole.Olatunji@curtin.edu.au via telephone on (08) 9266 7492.

Curtin University Human Research Ethics Committee (HREC) has approved this study (HREC number: HRE2018-0746). Should you wish to discuss the study with someone not directly involved, in particular, any matters concerning the conduct of the study or your rights as a participant, or you wish to make a confidential complaint, you may contact the Ethics Officer on (08) 9266 9223 or the Manager, Research Integrity on (08) 9266 7093 or email hrec@curtin.edu.au

Q2 Please rate the following statements (relating to regulatory restrictions) in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of a small developer's loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|---|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| Regulatory restrictions and small business protections (1) | • | • | • | • | • |
| Credible and transparent application processes (2) | • | • | • | • | • |
| Bank policies that includes regulatory restrictions and protections (3) | • | • | • | • | • |
| The experience of a banker dealing with small developer loan applications (4) | • | • | • | • | • |

Q3 Please rate the following statements in relation to bank's risk appetite in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of a small developer's loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|--|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| Strong competition between banks to obtain new small property development clients (1) | • | • | • | • | • |
| The current exposure of the bank to small property development (2) | • | • | • | • | • |
| Buoyant market conditions in the property industry at the time of the loan application (3) | • | • | • | • | • |
| The money that the bank has available to lend out to property developers (4) | • | • | • | • | • |
| The ability of the small developer to achieve high pre-sales (5) | • | • | • | • | • |
| A small developer indicating that they will agree to a high number of monitoring clauses in their lending contract (6) | • | • | • | • | • |

Q4 Please rate the following statements (relating to the nature of property development) in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of a small developer's loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|---|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| The complex nature of financing each property development project (1) | • | • | • | • | • |
| The time lag in the supply of property (longer loan periods) (2) | • | • | • | • | • |

Q5 Please rate the following statements (relating to small business issues) in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of a small developer's loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|---|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| The type of business entity (sole trader, company, trust etc.) of the small developer (1) | • | • | • | • | • |
| Allowing the bank to consider all possible income streams of the small developer and their business partners (2) | • | • | • | • | • |
| A clear indication to the bank of how the small developer will service the loan payments for the duration of the loan (3) | • | • | • | • | • |

Q6 Please rate the following statements (relating to providing securities and guarantees) in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of a small developer's loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|--|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| Using assets, like a family home, to secure the loan (1) | • | • | • | • | • |
| The flexible compensation scheme (how the small developer determines their own salary and benefits from their company) (2) | • | • | • | • | • |
| Using cross collateralisation to secure loans (3) | • | • | • | • | • |
| Using first party and third-party guarantors (4) | • | • | • | • | • |

Q7 Please rate the following statements (relating to the capital available) in terms of how much you agree. The following factors can have a POSITIVE EFFECT on the success of their loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|--|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| Capital available to satisfy the loan to value ratio calculation for the loan (1) | • | • | • | • | • |
| Capital available to cover the upfront costs to ensure that development approvals are in place (2) | • | • | • | • | • |
| Capital available for contingencies and 'when things go wrong' (3) | • | • | • | • | • |

Q8 Please rate the following statements in terms of how much you agree. The following factors in terms of the experience of the small developer can have a POSITIVE EFFECT on the success of their loan application:

| | Strongly agree (1) | Somewhat agree (2) | Neither agree nor disagree (3) | Somewhat disagree (4) | Strongly disagree (5) |
|---|--------------------|--------------------|--------------------------------|-----------------------|-----------------------|
| Proven experience in the property development environment (1) | • | • | • | • | • |
| Understanding the factors that the bank will consider during the loan application process (2) | • | • | • | • | • |
| Using specialists, like accountants, lawyers and financial advisors to assist with the loan application (3) | • | • | • | • | • |
| Using their network (brokers, real estate agents, building surveyors, friends etc.) to understand market conditions in property development (4) | • | • | • | • | • |
| Understanding a specific bank's requirements by becoming a return customer (5) | • | • | • | • | • |
| Engaging a competent and financially capable contractor (6) | • | • | • | • | • |
| Developing a business model that is specific to bank requirements for financing (7) | • | • | • | • | • |

Q9 Are there any other factors, from your experience, that could increase the chances of success of a small developer's loan application which you would like to note?

Q10 Thank you for completing the survey!

If you would like feedback with regards to the results, please leave your details below. The results will take approximately 6 months to finalise and will be sent in a blanket email with blind copy to those who requested the results.

First Name _____
 Last Name _____
 Email _____

END OF SAMPLE SURVEY

APPENDIX 3: Sample section of part of focus group transcript

P2 and P3

Interviewee: P2 (branch manager); P3 (business banking manager)

Interviewer: Monica Martin

Transcribed: Monica Martin

Place: Business premises of Bank 2

Date and time: 16 May 2019, 11:15

Folder name: *Bank 2_P2_and_P3*.

Recording name: *Bank 2_P2_and_P3* stored in MP3 format in *Bank 2_P2_and_P3* folder..

Artifact: Artifact 2 presented by interviewees. Artifact 2 is **not** to be identified or stored electronically, but only for review by interviewer to confirm percentages, criteria etc.

Consent: Consent forms were signed by both interviewees and scanned and stored as a PDF file in *Bank 2 Interview 2 and 3* Folder.

Interview record: *Bank contacted on 30/04/2019. Employee of Bank 2 promised to contact P2 (branch manager). P2 returned the call on 8/05/2019 and we arranged an interview. Interviewee had to get additional permission from the bank's head office to participate in an interview and suggested that he will also ask P3 to attend (business banking manager), as the branch manager only deals with loans up to \$200 000 and P3 deals with property development loans in the range of \$750 000 - \$3m. The interview took place on 16/05/2019 at the documented premises. P3 provided Artifact 2 (coded under artifacts). IMPORTANT: This artefact may not be stored as electronic data and is only to be used to support the points raised in the interview. Permission for interview was only granted on the basis that the bank and interviewees will not be identified in any publication.*

START OF INTERVIEW

P2: So, I am the branch manager of the [branch name omitted] branch. Normally I deal with consumer customers. And by consumer we just mean non-business or business customers \$200 000 or less. So, this is P3, this is Monica Martin. P3 is one of our business bankers. Obviously, he looks at larger connections or more complex connections.

MM: Okay.

P3: Normally with property developments.

P2: Yes, yes. And I guess that's why I have asked P3 to be here, because we do property development as well, from a consumer point of view, but if you're getting more into the complex business stuff, P3 is involved in that sort of stuff. Basically, I've been with Bank 2 for seventeen years, but at this branch for four. So, manager for seven-eight years. Like I say, I deal with customers, basically consumer customers and business customers less than \$200 000.

P3: I basically deal with business customers that are looking to borrow above \$750 000. Anything less than that, we've got in between myself and P2 there is a small business manager team that look after \$200 and \$750. They probably wouldn't be doing much in the way of development. Most of the developments, because it is complex, would come to us.

MM: So, has that to do mostly with the financial limit, or does it have to do with the complexity of the lending?

P3: Uhm, yeah, a bit of both. I would say that small business would not get involved in a structured property deal. And I guess that is what you do as well [directed to P2]. If it is a mom-and-dad residential... you know, if all they're doing is sub-dividing a block and building two units, that's...

P2: That's... we can do up to four units, that's me. Residential.

MM: All right.

P3: Everything has to tick the box for it to be residential. So, it has to be individuals, you know, mom-and-dad or whatever. As soon as there is a trust, I am talking about the borrowing entity, as soon as the borrowing entity is a company or a trust or a partnership or anything else other than an individual, that comes to business. And to be fair, most property development would be complex and come through business.

P2: I guess that “Do you have specific definition criteria for a small developer?” So, like P3 said... there are...

..... page 2 to 10 of interview text has been redacted and is available in the data stored on the Curtin University Research Drive.....

P3: But that’s for all banks, not just for us.

MM: Was that the regulator?

P2: APRA... ASIC... The regulator said they want to reduce interest only lending and investment lending. So, we said, right, we’re not doing anymore new lending. But... prior to that, most subdivisions would get through. Maybe 2 or 3 out of 10 we would decline because of servicing or whatever. And to be honest in the last 6 months I haven’t done too many investment loans. The restrictions that they’ve put in place have definitely had a bit of a hangover now. It’s definitely dampened the enthusiasm.

MM: Do you find that it affects your business as a whole?

P2 and 3: Yes.

P2: It has significantly affected our lending.

P3: And more so from my side, because we were known as a lender that was very keen on subdivision, property investment, commercial lending. Hence, that’s why we headed off being over exposed, because we were taking all this business, because people knew we did it and we were good at it. When the restrictions came into place, we were not able to take on any new business. I had to say no to some very good clients, but we just couldn’t do the business, so yes, it has had a big effect.

P3: Each manager had a set of clients that were developers... but the banks introduced the specialist property development team, who deals with the larger developers, \$10m and above. Especially over East, Sydney and Melbourne, we have got a team of about 6 managers over there, we’ve got one guy here that handles the larger transactions, but we don’t do many over \$10m. So, it is a different market, but that’s how the banks had gone. They would rather use up the allowance they had for property development, they’ll give it to these specialist lenders first, so, if they use up an allowance, there’s none left for me. But that’s fine, because the bank is using it for the bigger developers. But when there is room to move, we can pull up small cases. Bear in mind that a million dollars here and there does not make a huge difference to the overexposure that the bank has. I’m just saying that they’ve decided to go this way, since all these changes and set up these specialist property developers. Within my experience, I know ComBank for sure in Perth have a team that do all the property investment and development and it is a corporate team that deals with large business. You know, we’re not talking small million-dollar deals. I think most of the banks would have that.

P2: Yes.

P3: They would have a property specialist division.

P2: But for consumers, they would be done at branch level.

MM: Thank you for the interview... [Further confirmation around anonymity of interviewees and bank and explanation to interviewees on how data is stored].

END OF SAMPLE OF INTERVIEW