

Australian shopping centre investment trust, Centro, faces collapse

Richard Phillips
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The US subprime crisis has claimed another Australian corporate victim—Centro, the country's second biggest property investment trust, which went into a precipitous decline just days before Christmas. Centro is now the largest local company to be hit by the escalating US credit squeeze; it follows last year's collapse of the RAMS Home Loans Group and Basis Capital, a local investment fund, which ran hedge funds linked to US mortgages.

Centro went into financial free fall on December 17, after admitting it had been unable to refinance short-term debt on its heavily leveraged \$10 billion expansion into the American shopping centre market during the past 18 months. While Centro was not directly involved in American subprimes, the implosion of this market triggered major asset write-downs and losses by US and international financial institutions that pushed up the cost of credit.

As a result, the cost of servicing Centro's growing debt increased, and by December 17 its line of credit had dried up. The Melbourne-based company was given an ultimatum by its bankers—to find \$3.9 billion to service its debt by February 15 or face closure. A stunned Centro chairman Brian Healey admitted to the media: "We never expected, nor could reasonably anticipate, that the sources of funding that have historically been available to us and many other companies would shut for business."

Healey's statement precipitated a sharp fall in the company's share value, which dropped by almost 90 percent to 42 cents in two days, down from a \$10.02 high last May. Centro currently controls over 800 shopping centres in Australia and internationally, and in May had an estimated local market value of \$10 billion. By mid-December the figure had plummeted to just \$1.35 billion.

Centro chief executive Andrew Scott attempted to calm investors by claiming the company would not collapse and could refinance its debts through new loans or the sale of its American property. Scott's appeal had no effect on the local share market, however, which lost \$50 billion over two days.

Australian listed property trusts (LPTs), previously considered one of the market's safest investments, were among the stocks hardest hit, with over \$1.8 billion wiped off the sector's value that week—its worst performance since the 1987 market crash.

Centro first emerged in 1991 and grew rapidly over the next 15 years, attracting investors and average annual returns of 20 percent. The company's complex structure is based on a combination of institutional funds and more than 20,000 individual investors. Its bankers include the Commonwealth Bank, ANZ, National Australia Bank, JP Morgan Chase and the Royal Bank of Scotland.

In 2003 Centro bought its first shopping centre in Los Angeles and, using low interest short-term loans, began acquiring shopping centres across the country. This activity reached a peak in 2006-7 when it bought Heritage Property Investment Management for \$2.1 billion and New Plan Excel for \$5.8 billion.

By June, the company controlled property worth \$26 billion and, with more than 680 shopping centres, became America's fifth largest shopping centre investment trust. The Heritage and New Plan purchases, however, were heavily geared and came with additional debt components—\$1.5 billion and \$US1.4 billion respectively.

New Plan was bought in the midst of the subprime meltdown, but Centro management believed that the crisis would have little effect on the retail property market and that the company would have little

difficulty financing its operations through the commercial mortgage-backed securities (CMBS) market in America. The company's 2007 annual report entitled "Resilience for growth", for example, declared that its business model provided "a reliant basis" for Centro to "operate, grow and drive investor returns".

While Centro secured \$300 million through CMBS finance in August, questions started being asked about the company's massive \$18 billion debt—almost 70 percent of its asset value.

In September, the Australian Stock Exchange discovered that Centro had understated by \$1.1 billion the debts it had to pay within 12 months. Eyebrows were also raised when Centro management suddenly paid itself a 2007 bonus before the end of the year.

Remarkably, Centro management claimed it did not discover until early December that the cost of refinancing its debts had blown out and that it would have "material difficulties" obtaining finance.

Since December 17, Centro and its financial advisors have attempted to talk up the company, claiming that various rescue plans, including a fire-sale of its US property, have attracted "widespread interest". But each day has brought grimmer news, with ongoing falls in the American housing and commercial property market, low Christmas retail activity in the US and tightening global credit. In such a climate, Centro's American sell-off may not save the company from collapse.

Investment pundits are advising their clients to sell Centro shares. Ian Randall, an analyst from Deutsche Bank, told the media there was "little to get excited about" in Centro management's most recent statements. He warned that any price Centro might get for its US holdings would reflect the fact that it was "a forced seller in a deteriorating market".

On January 4, Standard & Poor's slashed its credit rating for Centro NP, the US retail trust that Centro bought last year for more than \$4 billion, by six notches to CCC+, only five levels above default. S&P said there was a "substantially increased" probability that creditors could put the trust into default.

Following this announcement, Centro revealed—only minutes before the close of trade that day—that its bankers had refused to extend interest rate hedges on the company's debts. The company traditionally had about 75-80 percent of its debt on fixed lending rates,

protecting it from changes in the official benchmark rates, but this had now dropped, making it more vulnerable to predicted hikes in Australia's Reserve Bank lending rate.

On January 7, UBS, the Swiss finance corporation, announced it had slashed its holdings in Centro by 3.37 percent, down to 5.26 percent. UBS Property Securities Fund had invested almost 14 percent of its total funds in the company. Predictions are now being made by some local analysts that Centro shares could drop to 26 cents.

While Centro continues to claim it will avoid bankruptcy, its precipitous fall is only the sharpest expression of a serious decline in the position of Australian LPTs. By the end of December, the local sector, which has more than 35 percent of its assets in the US, had lost more than 11 percent over the previous 12 months, its first annual decline in seven years.

The sector continued to fall in the New Year, impacting on blue chip property companies such as Westfield, Goodman Group and GPT. On January 3, for example, it dropped another 3 percent, the biggest decline since December 17.

Various local LPTs told the *Australian Financial Review* on January 5 that they could "ride out the credit crunch". However, Citi Investment Research analyst Peter Cashmore told the business newspaper that the sector had suffered "the equivalent of a capital market tsunami".

Whether Centro averts a total collapse or not, its rapid decline is another demonstration of the global impact of America's subprime crisis. According to some estimates, the subprime meltdown has led over the past nine months to the loss of more than \$97 billion in asset write-downs and credit losses by the world's largest financial institutions. This global process has driven up the cost of borrowing and is fuelling conditions for a US recession, which will have even greater international repercussions in the coming weeks and months.



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