

# Land, Rights, Laws: Issues of Native Title

## Native Title Research Unit

Australian Institute of Aboriginal and Torres Strait Islander Studies

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*The High Court Mabo decision in 1992 and the passing of the Commonwealth Native Title Act in 1993 mark a fundamental shift in the recognition of indigenous rights in Australia. The Act, like the High Court decision on which it is based, transforms the ways in which indigenous ownership of land may be formally recognised and incorporated within Australian legal and property regimes. The process of implementation, however, raises a number of crucial issues of concern to native title claimants and to other interested parties. Many of these will have to be decided in the courts. Nevertheless, information about and discussion of the issues are important for those needing to address the matters raised by the claim process. This series of papers is designed to contribute to this information and discussion.*

*Progress to native title determinations under the Act has been slow and now the Government is seeking to amend key provisions. The amendments are justifiably the major current preoccupation. However, with this paper, we make the optimistic assumption that there will be determinations of native title and that native title holders will want to know what they can do with their land so they can become economically self-sufficient.*

*This paper addresses the financial implications of native title, including extending commercial credit to Aboriginal landowners, and argues that financiers such as banks must shift some of their current attitudes to take into account current developments relating to land ownership in Australia. Joe Nagy is a Canadian born Consultant and Trainer specialising in Finance/Management and Credit/Marketing.*

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## **RAISING FINANCE ON NATIVE TITLE AND OTHER ABORIGINAL LAND**

**Joe Nagy**

### **Introduction**

There is concern that the Mabo decision and the subsequent native title legislation will make it more difficult to raise finance, especially development funding. This concern is not without a history. In the Northern Territory, for example, a number of Aboriginal-owned pastoral leases have been converted to Aboriginal land – that is,

inalienable freehold - under the *Northern Territory Land Rights Act (1976)*.

Traditional owners have then found themselves unable to raise finance - an essential component of the pastoral industry - to maintain or develop the pastoral enterprise. Issues relating to the granting of commercial finance will be examined with specific references to development or project finance.

### **The problem**

The liberalisation of financial markets has not made it any easier for many Aborigines, especially those living in 'the bush', to procure finance. They must frequently overcome entrenched attitudes and bankers' fears of making a bad loan, especially as unpleasant memories of the past decade's lending indiscretions exist. Some lenders are loath to extend credit, particularly for real estate development, to borrowers who are located in remote parts of the country because of the difficulty of managing the loan in a timely fashion. Nor do they like to make loans where the security they retain cannot be sold, or must be sold for less than the value of the loan.

Even so, loans have been extended to clubs, schools, churches and mines, and their highly specialised assets used as security, even in isolated regions of Australia, in spite of the risks involved. Mortgagees in possession of a private school or a licensed club, for instance, would be unlikely to find buyers easily. Mining equipment from a failed salt mine in the middle of Australia was left to rust away because the costs of repossession, renovation and sale made the exercise uneconomic. Furnishings and fittings in retail stores or office buildings have been taken as security even though it is unlikely they will ever be repossessed and sold because of their poor resale values. Nevertheless, holding these assets as security is justified since it enables lenders to adhere to their loan policies and to maintain some control over the borrower, who would be unable to pledge this asset as security for another loan.

Perhaps loans like these should not have been approved in the first place because of the poor security. Yet not all of them are poor risks; some are, some are not. Nor is it necessarily true that loans which are distant from the lender are necessarily riskier than others. Better analysis, a more appropriate loan structure and tighter loan management can minimise problems arising. Lenders are, or should be, aware of the prospects for sale of the securities before they lend. Approvals are regularly based on the comfort with the borrower, outweighing the negatives in the loan. This is the outcome of a thorough knowledge of the borrower, the key to a good quality loan portfolio, notwithstanding the security or location of the loan.

Native title presents a challenge to financiers because of legal problems concerning the sale of land which is, more often than not, in isolated locations. But it should not be one they are incapable of successfully undertaking, if experience overseas is any guide. In the United States and Canada, for example, title to reservation land is commonly held in trust for a particular Native American community and, under federal law, usually it may not be sold, taxed or encumbered. Yet this has not stopped banks, like the Bank of Montreal and other successful financiers, which

have formed special units responsible for extending commercial credit to Native American communities. Their success, measured by the level of losses, which on average are half of those of other commercial loans, and by profit margins of around 275 basis points, is largely due to the emphasis on cash flow and knowing the borrower.

There may be lessons in this for Australian banks. Regardless of whether the land is subject to native title, they, like the Bank of Montreal and others, should first focus their attention on the developer and the development. If the developer is acceptable and the project is viable, then the loan should be made 'bankable'. Banks can still reach their portfolio objectives in the Aboriginal market (as in other markets) provided they have studied the market and have experienced, qualified and knowledgeable staff who follow sensible business strategies and realistic budgets and adhere to sound credit processes.

Practice overseas, as well as in Australia, indicates that there are several alternatives to taking a mortgage over land that lenders can use to strengthen their position. One is to secure a charge over the building, structure, improvements and so on in a fashion similar to a Canberra leasehold or the air rights above government-owned property such as railway stations. Aboriginal peoples, like Native Americans and their communities, have numerous untapped resources which may be used to secure development loans. In America, loans are frequently collateralised (used as a deposit) with the assignment of income or revenues that are deposited into cash accounts handled by the Bureau of Indian Affairs. These accounts contain funds from the collection of lease rentals from grazing and farming, oil, gas, and tax revenues and admission fees. Other options include taking charge of the developer's business assets or the developer's guarantee, secured by personal assets such as bank deposits or investments. It may even be possible to arrange a letter of credit.

Failure to provide funding, some of it concerning sub-standard pastoral leases and other lands, means that these properties will not be put to a better or higher value use, as has happened with the development of Kings Canyon resort and certain cattle stations in the Northern Territory. In contrast, urban developers like Sydney's Meriton Properties have received funding for high-rise home units located on sites which have been vacant for many years. Lenders may rationalise their willingness to risk financing the improvement of marginal urban land on the basis of the developer's creditworthiness and high net worth, even though their recourse is often limited to the project and excludes the developer's personal assets.

### **Choosing finance**

Development projects are often 'big ticket' items and are usually highly leveraged (used as security) by the traditional secured loan, provided mainly by banks. Be that as it may, fund seekers should be aware that there are other options. Deregulation and the increase in competitive spirit have expanded the number of banks and other commercial credit providers to include life insurance companies, superannuation funds, credit unions and merchant banks as well as the representative offices of foreign banks. To get the most out of the increased rivalry in capital markets,

developers (as well as other borrowers) should prepare a finance plan which addresses alternative types of financial products, finance structures and providers. A variety of scenarios should be explored, ranging from best to worse case and not simply limited to a 'blue sky' outlook. In addition, the plan should not just focus on obtaining the lowest cost financing, but also on funding which best meets the developer's needs.

A financier's expertise and market standing are crucial factors in a project's success. It is therefore important that criteria and parameters are established to select the financier, financing type and terms and conditions. The size and type of development, its objectives and level of risk should be reflected in the eventual choice. Consideration must include the prospective financier's understanding of the project and what its plans are to ensure that the relationship, which is in a sense a partnership, will be successful and mutually beneficial. Just as a financier's expertise and management ability can contribute to a development's success, so, too, can its incompetence lead to failure.

Procuring development finance, especially for real estate projects, is often difficult, particularly when the project is distant from the lender. It is essential to keep a close watch over the loan because cost overruns, construction and labour problems and delays can quickly set a project back. It is no surprise, therefore, that not all financiers are prepared to provide development loans in their product line. As banks are painfully aware from their experiences in the 1980s, the lack of skilled lending personnel usually results in unpleasant surprises. Consequently, development funding, whether for infrastructure, resources or real estate, is often handled by a specialised unit.

Fortunately, there are other means of funding a development. Depending on the type of project, sale and lease-back may be more appropriate. In some cases, equity may be more suitable. Although some lenders occasionally provide 100 per cent funding, developers are commonly required to inject equity or 'hurt money' into their projects. In America, banks, under certain circumstances, accept equity from Native American communities in the form of a pledge of liquid collateral (security held by the lender which can be quickly converted to cash), consisting of certificates of deposits and government securities. The ultimate mixture of debt and equity represents a compromise between the combination the borrower would like to employ and the willingness of the lender to advance funds.

### **Loans**

Unlike equity investors (people who have invested money hoping for a profit), who are often prepared to take bigger risks and supposedly are willing to wait longer for a return, commercial lenders will not extend credit unless they feel confident they will get their money back. Their loan decisions are, or should be, made in the expectation that they will be repaid in the first instance from the cash flow of the day-to-day operations of the borrowing enterprise. This is commonly known as 'the first way out', which is demonstrated in good loan proposals with realistic projections. If the cash flow from daily operations is not adequate to service the loan, then it *should not* be approved.

In the event 'the first way out' fails, there should be an alternative repayment source, or a 'second way out' of the loan. This is the support or security the borrower pledges as collateral for the loan. The problem with 'the second way out', as mentioned earlier, is that the proceeds from liquidating the security may take time and may not be sufficient to extinguish the debt. Bad as this may be, worse is the accompanying unwanted publicity of 'selling a borrower up.' In some loans, there is a 'third way out', such as a guarantor who may be called on by the lender to pay out the loan when the borrower has defaulted. This is usually after the security (assuming there is security) is liquidated. Thus there are, or should be, at least 'two ways out' for every loan. But, as good lenders are aware, reliance on the second and third way out can carry pain for them too.

This was the case in the early 1990s when banks reported huge losses due to loans which could not be repaid, even though they were secured by real estate. Journalist Tessa Denton, in her article, 'Banks have failed to heed 1980s lessons' in the 11 June 1996 edition of *The Australian*, described a case of a failed loan secured by real estate. She quoted an English High Court finding "... that the property's sale should have been the last resort in the loan recovery process, not the automatic first resort." Australian courts have also sent similar messages that banks must concentrate more on making loans that are repaid from cash flow. As a result, lenders have again learned the importance of understanding the whos, the whys and the hows of a loan, that is, the borrower, the loan purpose and the loan exits, and not just relying on or taking comfort in security margins.

However, even though banks, like the National Australia and the Commonwealth, periodically announce their intention to market cash flow loans, they, as well as others, still appear to be asset-oriented, clinging to a culture which sees security as the principal ingredient of sound loans. Antiquated habits and the pervasive climate of fear of making bad loans has led to some lenders being overly concerned with security rather than cash flow. Consequently, outmoded credit analysis practices have remained at the expense of seizing prudent lending opportunities. Changing culture will not be easy in risk adverse environments. It will require more than just training programs, seminars and credit memoranda. Lending officers must take the initiative by espousing and practising cash flow lending to restore risk tolerance margins. Their efforts must be supported by the hierarchy's commitment and understanding.

While lender anxiety can result in rejecting good loan proposals, it can also lead to other unsound practices such as imposing superfluous conditions on loans which should otherwise be rejected. Structuring a loan with conditions does not make an uncollectable loan collectable, any more than security does. What it does (or should do) is increase the lender's comfort that the borrower is locked into and committed to repaying the loan. It can also create difficulties for the lender in monitoring and enforcement.

## **Development finance**

Development or project finance is different from general commercial finance in that it encompasses the financing of infrastructure such as bridges, roads and dams as well as constructing various types of buildings or improving land. It embraces the funding of an asset, in many cases land, to bring it, or transform it, to the stage where it generates, or, is capable of generating, income. Buildings include residential, commercial, industrial, retail and leisure and hospitality. Land developments comprise industrial and residential subdivision, rural, residential, pastoral and mining leases, and native title land. Development finance also concerns offshore projects, like oil wells and sea-bed mining.

In a development finance loan, the 'first way out' is the cash flow from the sale or rental of the development, other than where there is a long-term lender who provides the original lender with a 'take out'. The developer or sponsor of the project, on whom success depends, represents 'the second way out' and consequently their character, abilities and resources must be carefully assessed.

Evaluation of development finance proposals requires an understanding of the development process. Paul Zahara, a Brisbane based consultant, details nine steps in the development process in his book on 'Property Lending'. As he points out, the property development business is quite different from the typical retail or manufacturing business and, not surprisingly, so, too, is loan assessment. Well-known methods such as the five Cs of credit, financial statement analysis and industry and company comparisons are appropriate for process type businesses that produce and annually sell a multitude of standard products and services through established distribution channels. Their value, however, is more limited when applied to development or project finance loans because performance comparisons are less valid. The unique characteristics of each development - features, time, location, management, and so on - present different risks. Since a developer's experience may have little relevance to the current project, track record and financial analysis, common procedures in standard commercial finance proposals become a less reliable tool when determining the success of a development finance loan.

Lenders should be mindful of the different mix and degree of skills and attributes required for a successful development. Since there is a long production cycle from conception to completion and use, frequently several years in length, vision becomes a critical success factor, as it is in other businesses. The possibility that changes could occur during any stage of the development, resulting in failure, justifies its label as a bet-your-future-business. For instance, projects conceived and commenced in times when demand for the development is high may be completed at a time when demand is low, making marketability more difficult, delaying success and jeopardising loan repayment. More so than for many other businesses, developers must not only possess the ability to identify current and future needs, but must also be able to understand how political, economic, demographic and lifestyle changes will influence the outcome of their project.

The development process and its once-off nature demonstrates the need for lenders to manage these loans more intensely than most other kinds of loans. The

monitoring of the critical components of time, cost and quality involves site visits, constantly attending project meetings and studying progress reports. Good project loan management is important to success and, hence, to repayment.

Another difference between development loans and other loans is demonstrated by an Aboriginal handicraft shop in a tourist complex which has a particular item which is not selling well. This does not necessarily mean the demise of the store or the tourist group. Other products may generate sufficient profits for the shop's survival. But even if the shop crashes, its failure does not necessarily signify that the tourist venture will collapse. Other revenue sources in the complex and the addition of a new shop operator can prevent this from happening. However, a development, because it is a start-up with no cash flow, does not have this cushion. Usually, the project must be successfully completed or completed to an established stage before it can be sold or rented to generate cash flow to repay its financiers.

In most businesses, management longevity is usually a sign of strength. In the development business, a team is assembled for the purpose of completing the project to prescribed standards, within budget and by a certain date. Once it is finished and the project sold, the team is disbanded. Given the uniqueness of each project, and, hence, its different requirements, management permanence may lead to problems caused by its inability to handle new situations. This can arise, for example, when the developer moves into a new area or undertakes a substantially larger or different type of development requiring different skills. Success in a \$10 million project does not necessarily lead to success in a \$100 million project, as Sydney's troubled World Square project painfully illustrated.

Thus, it is essential that the developer's management team be thoroughly and specifically evaluated in relation to the size, type and location of the project. The lender must be satisfied that the borrower has the expertise and management depth to supervise all phases of the development. Without this, there is no basis for success and therefore no justification for the loan. Because developments are time-sensitive, changes in management can delay completion, substantially increasing costs. Lenders, therefore, often encourage the developer to keep the team together by imposing covenants, stipulating no change in management and specifying the retention of key individuals during the term of the loan.

### **Conclusion**

In the past, banks achieved success by exploiting opportunities and balancing risks with rewards in responding to their customer's needs as they served the community. The maturing and restructuring of the Australian capital market and the growth of the nation's cultural diversity is changing how this is achieved. Financiers will have to show a greater sensitivity to other cultures and groups and an increased respect for the differences among peoples. If they do not, they run the risk of alienating segments of society and suffering the consequences. Loan submissions now increasingly address community concerns and demonstrate a greater degree of empathy for environmental and social issues.

Whether Australian banks and other financial institutions will approach native title with the same spirit of enterprise as have those in other countries, such as the US and Canada, remains to be seen. It does not make moral, business or financial sense for them to prevent Aboriginal peoples from achieving their economic potential. Indeed, it is business which profits everyone. Innovative financiers who encourage Aboriginal peoples to develop their own resources will be rewarded with the development's success. Government will experience lower unemployment levels and Aboriginal peoples will be less dependent on public money, which should benefit taxpayers, including Aboriginal taxpayers. Finally, success will enable Aboriginal peoples overall to improve their living standards.

Loan proposals are complex matters involving judgement in picking winners. Native title or inalienable Aboriginal freehold is only one of several hurdles which careful analysis and innovative funding from clever financiers can overcome. While there have been successful Aboriginal ventures and developments, such as the Mt Todd gold mine and the Kings Canyon resort in the Northern Territory, they have all been predominantly funded with equity from the Aboriginal and Torres Strait Islander Commercial Development Corporation. Absence of debt funding from banks and other commercial credit providers is a serious concern which can and must be rectified.

This can happen if financiers approach their tasks fairly, professionally and with an open mind. Only then will institutions have fulfilled their legal, financial and ethical responsibilities to everyone, not only to a group of people who have long been denied these courtesies and considerations but also to their shareholders, who are voicing concerns that their institutions be socially responsible - beyond motherhood statements, donations and public relations exercises.

### **Further Reading**

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