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From:	[redacted] [redacted]@vadoprivate.com.au>
Sent:	Sunday, 27 April 2025 8:34 PM
To:	markets consultation
Subject:	Australia's Evolving Capital Markets - Discussion Paper Feedback

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To Whom It May Concern,

My name is [redacted]. I am Director and Responsible Manager of Vado Private. We are licenced with ASIC (AFSL # 526 189) and are a specialist real estate private credit investment manager.

I have reviewed the ASIC discussion paper and am responding on two questions, as outlined below.

Question 9

Have we identified the key risks for investors from private markets? Which issues and risks should ASIC focus on as a priority? Please explain your views.

Response

In private credit, there are several risks that ASIC need to address. These include:

Conflict of interest

We are seeing more examples of conflict.

The first is with mortgage / finance brokers that also are lenders. Brokers act as intermediaries between borrower and lender. Their client is the borrower. That's who they champion. Under Best Interest Duties they have obligations to achieve the best terms for the borrower. Sometimes that's the best bank deal, other times it's the best non-bank deal or in our world it's the private credit deal.

As a lender, the investor is the client. We have a responsibility to ensure investor capital is safeguarded. This is not negotiable.

A conflict arises when a party is acting for both borrower and investor.

This is particularly concerning when some of these brokers do not have a licence to raise capital.

A similar analogy is a vendors real estate agent also acting as buyer's agent for the same transaction.

The second is private credit managers with dual roles as commercial property developers. This conflict of interest can compromise the integrity of investment decisions.

Such private credit managers may be tempted to use the fund's capital to support their own development projects, potentially prioritising their interests over those of investors.

This conflict can lead to biased lending decisions, unfavourable loan terms for the lender, or the fund being used to bail out troubled development projects. This becomes more problematic when multiple investors are participating in different parts of the capital stack including senior debt, mezzanine finance, preferred equity and equity.

<u>Pooled Mortgage Funds</u>

Pooled funds do have a place in private credit. They are marketed for the benefits of diversification and liquidity.

Investors agree to an investment mandate. Some, of the parameters include:

- Loan types
- Geography
- Security type
- Tenure
- Overlaying all this is a weighted average loan to valuation ratio (LVR)

But what does all that mean?

Investors have no visibility of where their money is invested and there no market-to-market position of the portfolio.

Pooled funds must continually deploy cash, so there is pressure to lend money. This becomes problematic when there is more capital than deal flow. It’s a cash drag on the IRR and some managers (without the discipline to say no) will fund deals that otherwise wouldn’t or shouldn’t be funded.

<u>Valuation Policy</u>

Valuations are one of the single biggest issues in real estate private credit.

In many cases the valuers get it wrong. This occurs because:

- Incorrect assumptions or qualifications are made
- The valuer is incorrectly instructed
- The valuer is asked to increase the figure to make the deal work. It’s usually the broker or landowner advocating this
- The private credit manager is incentivised to report a higher valuation figure

<u>Inexperience</u>

We are seeing the rise and rise of private credit. With growth comes opportunity. Real estate private credit is becoming very crowed. Some of the managers are good but many aren’t. We are seeing more examples of new groups that are lacking the key fundamental risk assessment processes around property and credit. Only recently we were up against a firm of stockbrokers who were rising money for a real estate private credit transaction. In this example the firm held an AFSL, but the authorisations did not allow them to operate an MIS and raise funds on deposit. They were successful in winning the business because of irresponsible underwriting.

Arrears Reporting

Arrears are becoming a bigger issue in private credit as the market grows.

This largely because of poor underwriting from inexperienced managers.

Managers should be actively reporting arrears with a typical breakdown of < 30 days, 30-60 days and > 60 days.

Licensing

Private credit and lending money can be very risky. There are two counterparties here that are important – investors and borrowers.

For investors it is critical there are safeguards in place to ensure their capital is managed diligently and reporting is transparent.

It is critical that all parties raising money are licenced and that licence has the appropriate authorisations.

Whilst not the basis of the discussion paper, there needs to be some regulations and licenses around lending. Presently there are no protections are many managers operate outside of the NCCP Act.

Question 10

What role do incentives play in risks, how are these managed in practice by private market participants and are regulatory settings and current practices appropriate?

Response

We have seen examples where private credit managers are generating a higher return than investors. Whilst an interest rate return is paid to the investor, the manager earns:

- Net interest margin (management fee)
- Application fees
- Extension fees
- Variation fees
- Default fees
- Default interest

While there is cost of doing business, there should be an equitable distribution of renumeration and alignment of interest.

Particularly under pooled funds, there is a propensity for some managers to roll over non-performing loans or loans that are in breach of covenants. They do this to earn more fees, hoping that the market will correct their mistake.

I happy to elaborate further and welcome the opportunity to participate in roundtable discussions.

Regards,

[redacted]
Director & Responsible Manager

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