Land Bank: The deadline is looming and key decisions need to be made

A flash update

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It's been almost a month since Futuregrowth's last update on the ongoing Land Bank drama – and despite a lack of useful progress in the resolution, we offer the following.

Land Bank first went into default in April 2020 - almost a year ago - and the default remains unremedied. There have been a series of "liability solution" proposals from Land Bank, its advisors and its shareholder (RSA National Treasury) to the debt-holders. We are now working on "Version 3" of the proposed liability solution. Notionally, each liability solution was aimed to put Land Bank on a sustainable footing, but in fact each successive proposition has trended toward both degrading lenders' position and reducing the scope and sustainability of the Land Bank.

- Version 1: This consumed most of 2020 with terms that proposed, inter alia, a partial government guarantee of Land Bank debt, and staggered maturity terms of the new notes.
- Version 2: This arrived as a storm in January 2021 following National Treasury declining approval for the partial government guarantee contemplated in version 1. This version asked all funders to term-out their loans into a single 5-year amortising note (as opposed to the staggered maturities contemplated in version 1). As previously highlighted, the 5-year term is a problem for certain funds that have regulatory constraints around the proposed 5-year term. Further, version 2 proposed that creditors have recourse only to Land Bank's lending book and not to the general balance sheet of Land Bank. Notably, version 2 showed the government's intention to materially shrink the size and scope of the Land Bank.
- Version 3: This is the most recent iteration of the liability solution and remains the subject of ongoing discussion and negotiation. Version 3 is similar to version 2 except that it envisages a notional splitting of the Land Bank's lending book – into a "corporate and commercial" book and a "development and transformation" book. Recourse for bank and institutional funders have been proposed to be limited to the "corporate & commercial" book, while the "development and transformation" book being funded by the DFI and guaranteed funders. This version also seemingly imposed some conditionality to the proposed R7 billion equity injection that was allocated in February's budget by Minister Mboweni.

We believe the most recent proposal, similar to our view on version 2 (scroll down to read the article published on 25 February 2021), is unsatisfactory on a number of fronts. It does not adhere to INSOL principles which Land Bank has publically agreed to adhere to, and it continues to seek a substantial preference for guaranteed creditors and for the shareholder (National Treasury) as was previously contemplated in version 2. Further, as analysts we are not satisfied with the relatively weak and incomplete information provided to date - and on which we are being asked to make decisions - and it seems to us that there are some optimistic assumptions baked into the initial numbers.

There are concerns about the time it's taking to get to a solution, as well as, the increased complexity and increased uncertainty introduced by version 3 of the liability solution. These are compounded by the likely repayment of Standard Chartered Bank in April 2021 following the court outcome of last year. (You will recall that in December 2020 the court imposed certain conditions which needed to be met by 31 March 2021 in order for Land Bank to defer repaying Standard Chartered to April 2022.)

At this stage, the Noteholder group is in the middle of negotiations of the liability restructure. The deal terms remain uncertain and thus we cannot know where it's going to land. There are a range of possible outcomes and so it would be premature to talk about a conclusive result. That said, we hope to see more information, a more satisfactory set of terms and a settlement during the second quarter of 2021.

We will keep you updated once we have further clarity and certainty. As Futuregrowth, acting as fiduciaries for our investors, we continue to be deeply engaged in the process and negotiations, and we are actively working towards the most sustainable outcome for you, our clients.

Article first published on 25 February 2021

Our last update on the Land Bank saga identified key shortcomings in the revised liability structure announced on the 13 January 2021.

Since then, we have seen some limited forward momentum on the resolution of the bank's debt restructuring. The court-imposed deadline of 31 March 2021 for a revised liability solution remains a risk and is at risk of being missed. The implication of failing to meet this deadline is that Standard Chartered Bank will be repaid the roughly R400 million owed to them, ahead of other creditors and before the resolution of the restructure. We believe this elevates the risk of a disorderly wind down.

Where possible this note will provide an update on the outstanding aspects of the liability solution and a brief commentary on the results released on 9 February, of the nine months up to 31 December 2020.

Not much progress has been made on the key issues identified in the liability solution

1. *The previously offered guarantee and the impact on money-market funds*

The original liability solution (version 1) proposed a staggered maturity profile and a partial government guarantee. One of the consequences of the guarantee being declined by National Treasury is that all noteholders are "forced" into a 5-year unlisted and unrated note in the revised liability solution (version 3).

The 5-year term is unsuitable for CISCA-regulated funds as it breaches the regulatory term maximum of 13 months. Further some funds are not allowed to hold unlisted assets, and others require officially rated assets. This means that some noteholders may be unable to accept the terms of the revised liability solution – as to do so would breach regulations or mandates.

Furthermore, as has become evident in the revised proposal, noteholders are being asked to rely on the cashflows generated by Land Bank's lending book for ultimate repayment. Currently there is much uncertainty about the timing and adequacy of these cashflows to fully redeem the notes.

This problem has been raised by noteholders – individually and collectively - at multiple levels as well as via ASISA, to National Treasury and to the FSCA. It is not known at this stage whether any decision has been made that changes the revised liability structure. To date, there has been no change to the proposed term of the new notes to consider this regulatory restriction or the likely valuation volatility. This remains a key concern and a risk to the acceptance of the revised liability solution. How can noteholders accept a solution that puts them in violation of the regulations?

2. *The proposed equity injection*

Finance Minister Tito Mboweni's October MTBPS statement devoted one sentence to Land Bank: "The (Land) Bank will require an additional R7 billion over the medium-term to support its restructuring."
At the time of the MTBPS, we were advised that this is the strongest "signal" that the Minister was able to give at the time and that further detail would be made available in the February 2021 Budget.

Wednesday's budget has affirmed this signal, with R5 billion allocated in this fiscal year and an additional R1 billion in each of the following two fiscal years.

This equity injection is but one part of the solution to return Land Bank to operational sustainability and it is positive to see this intent being actioned in the Budget. We are waiting to hear whether there are any conditions imposed on this R7 billion equity. We will review this within the holistic package of the terms of the liability solution which we are busy negotiating.

3. *Land Bank's strategy*

Historically, Land Bank's strategy has been to follow a hybrid model of funding established commercial farmers and co-operatives, as well as providing finance to developmental or emerging farmers. The book has historically been tilted towards the commercial farming side of the business and the profits generated by this business line have been used to support the developmental book.

From our discussions it appears that Land Bank's business model and strategy is in a state of flux. The intention seems to be to wind down the commercial farming lending business and to focus more exclusively on developmental finance.

The evolving nature of the strategy and the lack of clarity on the way forward poses risks to the restructure.

Noteholders are being asked to take a 5-year view on Land Bank. In order to do so, there needs to be line of sight and certainty on Land Bank's strategy and management's ability to execute on this strategy, as well as certainty on shareholder support for this strategy. At this late stage in the process, we have none of these and we are being asked to sign off on a liability solution that poses unacceptable risks to noteholders.

It is imperative that we have clarity on this issue prior to the 31 March deadline, so that we are able to assess the risks identified in the revised liability structure and ensure the risks have been adequately mitigated.

4. *Contagion effect on other SOEs*

Noteholders have long been sounding the bell of SOE contagion risk arising from a drawn-out or sub-optimal resolution of the Land Bank restructure.

Land Bank first went into default in April 2020. The intention as stated in the SENS of 17 June 2020 was to have this matter concluded by 31 August 2020. As of today, 24 February 2021, the restructure has not yet been resolved and there is still much uncertainty about the way forward.

The uncertainty and negative sentiment created by the Land Bank event of default, combined with the weak economic outlook, has likely resulted in other SOEs pulling back on their planned issuance in the debt capital markets (DCM).

In 2019, SOE's issued over R35 billion of debt in the DCM. RMB, in a research report entitled "Credit Year Ahead: Outlook" estimates that this will be around R15 billion[1] in 2021 with downside risks to that number.

[1] RMB Markets Research, Credit Year Ahead Outlook, January 2021, p8

Table 2: Local listed debt capital market term issuance and RMB forecast for 2021

Issuer Type	2019	2020	2021F	Driving factors	Risk
Banks/financials	72.9	40.1	40.0	Limited requirements by banks	Upside
Corporates	44.6	25.1	28.0	Alternate bank funding	Downside
Municipal	0.0	1.7	2.0	Refinancing	Downside
SOEs	35.8	19.5	15.0	Limited capex, negative sentiment	Downside
Securitisations	15.4	6.0	8.0	Mostly non-bank issuance	Upside
Total	**168.7**	**92.4**	**93.0**		**Downside**

Source: JSE, RMB Markets (data as at January 2021)

The draft term sheet is inadequate in key areas

Under the revised liability solution, we are advised that noteholders need to look to the cashflows generated by Land Bank's loan book for repayment. A draft termsheet has been circulated and we believe that the draft terms presented are not suitable for the proposed restructure in several key areas, nor are standard commercial lending terms included.

This is the subject of an ongoing negotiation between the noteholders, Land Bank and its shareholder. We will continue to work towards an outcome that ensures suitable risk-mitigated terms and pricing that are suitable for the risks inherent in the loan book.

Alarm bells ring in the updated quarter 3 financial results for the period ended 31 December 2020

On 9 February 2021 Land Bank released, via a SENS announcement, a summarised version of the quarter 3 financial results for the 9 months ended 31 December 2020.

The results indicated that Land Bank made a loss of R472 million for the 9-month period from 1 April 2020 to 31 December 2020. Several factors contributed to this loss:

- the declining gross loan book;
- the bank's credit rating downgrades and event of default situation, which resulted in a higher cost of funding in this period and margin compression; and
- a resultant decline in net interest income.

Operating expenses in the 9 months were lower when compared to the prior year, mainly due to lower personnel costs and travel expenses, although the cost-to-income ratio is still unsustainably high and in excess of 110%.

Of concern is the R1.1 billion increase in non-performing loans (NPLs) in the 3 months since the results for the half year ended 30 September 2021, released in January 2021. Management has indicated that the reason for the material increase in NPLs, and ultimately impairments, was due to the inclusion of NPLs from an SLA[2] partner, which previously incorrectly recorded NPLs at 120 days, when it is Land Bank's policy to record NPLs from 90 days in arrears. This ultimately increased the NPL ratio from 19.5% to 23.6% during the 3-month period as more loans fell into the non-performing bucket. NPLs increased by R1.1 billion to R9.1 billion (from R8.0 billion in September 2020) as at 31 December 2020.

As a result of early repayments from certain clients and limited disbursements during the period, net loans and advances declined by R2.9 billion during the 3-month period, which enhanced the cash position at December 2020. As at December 2020, the total capital adequacy was 11.6%, including guarantees.

[2] Service Level Agreement

The steep decline in NPLs and the loss for the 9 months to 31 December 2020 is of deep concern to us and we have requested updated information so that we can better assess the forward-looking financial position of Land Bank.

The current information points to an alarming, rapid decline in the quality of the loan book, which, if not arrested, will have significant impact on the collectability of the almost R38 billion of loans outstanding, and, by implication, on the cash generated by this book to repay the noteholders under the revised liability solution.

There is lots to do

Restructures are by their nature complex, difficult and time consuming. The Land Bank restructure is made more complex by the i) the legal nature of the entity, ii) the identity of the shareholder and the constraints under which it operates, iii) the large number of institutional and bank funders - all with varying mandates and constituencies - and iv) the complexities of doing a restructure when the business model is in a state of flux.

We are at the sharp end of the restructure – a time when key decisions, outcomes and deliverables are necessary.

Tough negotiations and discussions will be needed in the coming weeks as we approach the 31 March deadline.

There is lots to do, and we will endeavour to keep you informed of important developments as they arise.

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