Fixed Income: **Australian Debt Securities Update**

6 December – 10 December 2010

This will be our final edition of Australian Debt Securities Update for 2010. We would like to wish all our readers a Merry Christmas and a successful 2011.

Australian $MTN Market Update

Issuer (Format)	Rating		Maturity	Amount	Coupon	Spread to Benchmark
	Issuer	Issue				
Stockland Trust Management Senior Unsecured	A-	A-	Jul-16	A$150m	7.50%	Swap + 195
Australian Rail Track Corporation Senior Unsecured	Aa2	Aa2	Dec-17	A$200m	7.25%	Swap + 145
National Australian Bank (NAB) Senior Unsecured	AA / Aa1	AA / Aa1	Nov-15	A$600m New total A$1.4bn	BBSW + 120	BBSW + 117
AOFM CGS Tender	AAA / Aaa	AAA / Aaa	Jan-18	A$650 New total A$1.450bn	5.50%	Weighted Average Yield 5.4727%

Issuer (Format)	Rating		Maturity	Amount (Buyback)	Margin at Issue	Buyback Margin
	Issuer	Issue				
National Australia Bank Government Guaranteed	AA / Aa1	AAA/ Aaa	Mar-12	A$173.2m Outstanding A$1.16bn	Swap + 60	Flat to Swap
				A$557m Outstanding A$1.064bn	BBSW + 60	
Stockland Trust Management Senior Unsecured	A-	A-	Jun-11	A$78.2m	Swap + 50	Par + accrued interest
				A$40.3m	BBSW + 50	
			Jun-13	A$25.15m	Swap + 125	Swap + 125
				A$5.5m	BBSW + 125	

- Domestic primary markets remained open last week with issuance from Australian Rail Track Corporation Limited (ARTC), NAB and an exchange offer from Stockland. ARTC priced their inaugural A$MTN transaction, a A$200m 7.25% Dec-17 at Swap + 145. The transaction was initially launched with a volume of A$150 million and was subsequently upsized to the A$200m following strong investor demand. Stockland completed an exchange offer with a A$150 million, 5.5 year transaction. Stockland partially bought back fixed and floating rate MTNs maturing June 2011 (A$118.5 million at par plus accrued interest) and May 2013 (A$30.65 million at Swap/BBSW + 125bps) and issued a 7.50% A$150m Jul-16. The buyback and new issue closely follows the company's A$160 million 10 year issue, which was completed in November 2010. CBA acted as the Joint Lead Manager for both the ARTC and Stockland transactions.
- NAB confirmed volumes of their A$2.95 billion Mar-12 Government Guaranteed fixed and floating lines, which was announced in the prior week. NAB bought back A$557m FRNs and A$173.2m 4.25% fixed rate notes at a buyback price of Swap flat. Following the buyback the new total outstanding volume for the fixed and floating rate tranches are A$1.16bn and A$1.064bn respectively.
- Secondary market trading activity was strong in both fixed and floating rate formats last week, with observed turnover more than double compared to the turnover observed in the prior week. Demand for both fixed and floating rate NAB and Westpac paper drove the increase over the week. This interest was generated from domestic, Asian and European investors. We also noted significant turnover in Telstra fixed rate paper from both domestic and European investors over the week.

Offshore Issues by Australian Borrowers ***sizeable issuance only***

Issuer (Format)	Market	Rating (Issuer)	Tenor	Amount	Coupon	Issue Margin
National Australia Bank Senior Unsecured	US144a	AA / Aa1	Jun-12	US$500m	Libor + 20	Libor + 20
			Nov-15	US$600m	Libor + 120	Libor + 120
FMG Resources Senior Unsecured	US144a / RegS	B / BB+ (Fitch)	Feb-16	US$600m	6.375%	T + 443
			Feb-18	US$900m	6.875%	T + 420

- FMG Resources, a unit of Fortescue Metals Group, priced US$1.5 billion in two tranches. Fortescue announced it would use net proceeds from the issue for its iron ore mine and expansion into Western Australia's Pilbara region. This transaction follows FMG Resources' 5 year US$2.04 billion issue in October.

Australian Debt Capital Market Developments

COVERED BONDS

On Sunday 12 December 2010, the Australian Federal Government released its much hyped reforms to help promote a competitive and sustainable banking system. Whilst the report lacks many key details, one of the package reforms announced included allowing the banks, credit unions and building societies to issue covered bonds to broaden access to cheaper, more stable and longer term funding, and harness our national superannuation savings to domestically fund more productive investment in our economy.

What are Covered Bonds?

Covered bonds are backed by mortgages, offering bondholders with preferential recourse to a specific pool of assets, and also the proceeds arising from them if the issuer defaults. Whilst they are similar in feature to ABS, the distinction between covered bonds and ABS is that covered bonds remain on the issuer's consolidated balance sheet, rather than part of a separate legal entity (which is the case of ABS).

As a result of this structure, covered bonds can in many instances carry ratings higher than those of the issuer itself, leading to more favourable funding costs, and also broadening the potential investor base. Covered bonds also enable investors to diversify funds into higher-yielding AAA issues, whilst still retaining the benefits from strong credit quality.

The Domestic A$ Covered Bond Market

The domestic covered bond market is currently limited solely to Kangaroo issuance, since Authorised Deposit-taking Institutions (ADIs) are currently prohibited by the Australian Prudential Regulation Authority (APRA) to issue covered bonds. APRA's in-principle objection to covered bonds stems from their interpretation of the Banking Act 1959 that; structures that, *in substance, subordinate the interests of depositors of ADIs to the interests of the covered bond holders*, are not consistent with the provisions of the Banking Act.

Covered bond issuance in the domestic A$ market is shallow, and has been dominated by two issuers (DEXIA Municipal and Compagnie de Financement Foncier). While issuance has remained relatively thin, Canadian Imperial Bank of Commerce entered the market in October 2010 with their inaugural Kangaroo covered bond issue. Currently, outstanding A$ covered bond issuance stands at A$3.25 billion.

Current developments

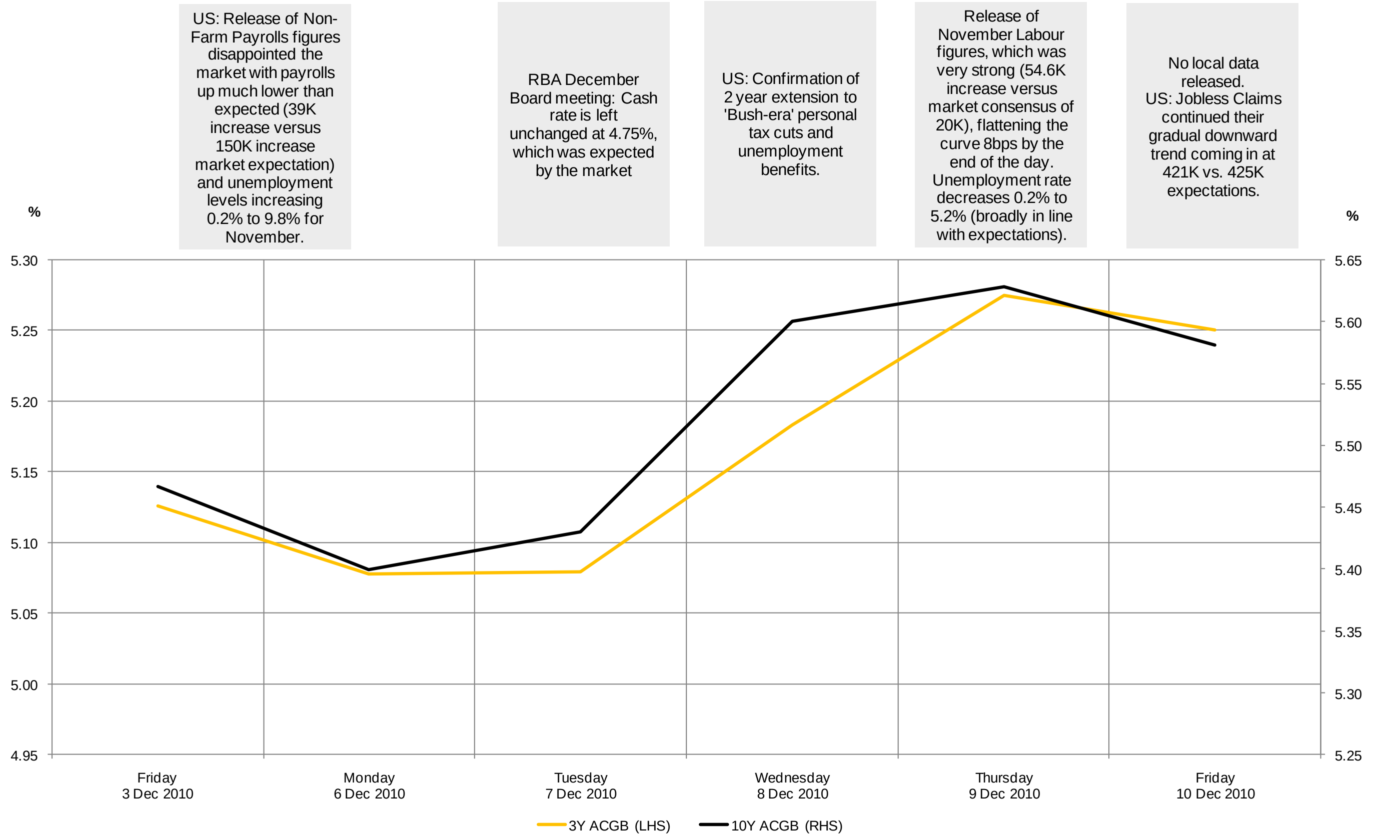
Under the proposed Banking Act reform, the domestic A$ covered bond market is expected to deepen significantly.

Given the time delay in amending the Banking Act, seeking approval from APRA and setting up the required legal regime to support A$ covered bonds, it is likely the first covered bond issuance from a domestic bank in the A$ market is still 12 – 18months away.

A lot of details are yet to be worked through, nonetheless, the Government will put though a covered bond bill when Parliament resumes in 2011.

Australian Government Bonds

Figure 1: 3Y and 10Y Australian Bond Curve



- Australian 3 and 10 year Government bond yields closed the week 12 and 11 bps higher while the 3/10 curve remained largely unchanged at 48 bps. The market was primarily driven by the strengthening of the domestic labour market.
- The Australian Government Bond curve opened slightly steeper on Monday morning, following the events offshore, namely the release of US Non-Farm Payroll figures on the prior Friday night. The data was overwhelmingly disappointing with payrolls increasing by 39K against the market consensus for an increase of 150K. On Tuesday the domestic market was focussed on the RBA Board Meeting. The RBA left the cash rate unchanged at 4.75%, as expected by the market. The general tone in the accompanying statements suggested that the RBA is comfortable with current interest rate levels, prompting our economists to revise forecasts for the next move from 4.75% rise between February to April 2011. November Labour force figures released on Thursday were once again surprisingly strong, with an overall increase of 54.6K (which was more than double the market's expectation of around 20K), the unemployment rate decreased from 5.4% to 5.2% and the participation rate increased to a record high of 66.1%. Following this, the recent steepening trend of the Australian bond curve quickly flattened by 8 bps by the end of the day driven by the front end sell-off.
- AOFM tendered its final issue for 2010 on Wednesday, a A$650m increase to the 5.50% Jan-18 bond. The issue received strong interest with a with a bid/cover ratio of 3.65 times.

Swaps

AUD Swaps: The Australian Swap curve closed largely unchanged over the week. The 3/10 year Swap curve ended the week at +63bps.

AUD/USD Basis Swap: Bills/Libor rose around 3 – 4 bps across all tenors over the week. Improved sentiment following the strength in last week's labour figures increased demand for A$ funds.

Term	AUD Fixed / Float Swap		AUD / USD Basis Swap	
	Mid Rate	Swap/Bond	BBSW v Libor	Change (week)
1 Yr	5.21% q/q	35.4	5.80	+3.8
3 Yr	5.47% s/s	29.8	18.50	+3.5
5 Yr	5.84% s/s	50.6	24.50	+2.7
7 Yr	6.00% s/s	46.9	26.00	+3.0
10 Yr	6.10% s/s	47.5	26.00	+4.0

Asset Backed Securities

- It was a strong week in the Australian securitisation market, with Capital Finance Australia, Wide Bay Australia and Bendigo & Adelaide Bank all pricing new transactions.

- Capital Finance Australia, which is a wholly owned subsidiary of Lloyds International Pty Ltd (member of Lloyds Banking Group), priced its second ABS deal for the year, **Bella Trust Series 2010-2**. The transaction was upsized from A$367.5m to A$500m and had the participation of 14 investors, both banks and fund managers. The transaction rated by Fitch and Moody's, had split ratings in the transactions from the Class C notes (BBB by Fitch and A2 by Moody') which is uncommon. The underlying pool of auto loan receivables has a WAS of 13.5mths and WA balloon value of 100.2%. The new and used vehicle compositions represented 65.2% and 34.8% respectively. Average loan size is around A$22K

Class	Amount	WAL (yrs)	Rating (Fitch / Moodys)	Pricing
A1	A$87.0m	0.35	F-1+ / P-1	+60bp
A2	A$320.0m	1.9	AA / AA	+155bp
B	A$58.5m	2.7	AA / Aa2	Undisclosed
C	A$11.0	2.7	BBB / A2	Undisclosed
D	A$4.0m	3.7	BB / Baa1	Undisclosed
E	A$7.0m	3.7	B / Ba1	Undisclosed
Seller Notes	A$11.5m	3.7	Not Rated	Undisclosed

- Wide Bay completed its first $250m prime RMBS for 2010, **WB Trust 2010-1**. The underlying portfolio has a current WALTV of 63.2% and WAS of 45.5mths. Wide Bay Australia is the fifth largest building society in Australia and given its location geographic concentration of the pool is high in Queensland (84.2%). All loans are full doc comprised of amortising (66.1%), IO for up to 20yrs (8.3%) and line of credit for up to 10yrs (25.6%).

Class	Amount	Rating	Pricing
A1	A$138.0m	AAA / AAA	+105bp
A2	A$81.2m	AAA / AAA	+125bp
AB	A$23.0m	AAA / AAA	+200
B	A$7.8m	AA- / NR	Undisclosed

- Bendigo and Adelaide Bank priced their third RMBS for 2010, a A$1bn prime transaction (which was upsized from an initial launch volume of A$775m), **TORRENS Series 2010-3 Trust**. Similar to Bankwest's SWAN 2010-12 transaction (which occurred in November), the complex nature of TORRENS was structured to ensure the notes were eligible to be included in the UBSA Composite Bond Index (UBS Index). Class A1 notes were floating rate hard bullet notes and Class A2/A3 were fixed rate soft bullet notes. Class A1 was structured with two tranches, Class A1f fixed rate notes (for inclusion in the UBS Index), and Class A1v floating (hard bullet) with the final structure dependent on investor demand. The unique feature of the

Class A4 notes is a redemption fund which will be issued to the redemption facility provider, NAB if the redemption fund amount built up by the trust is insufficient at the time of repayment of the Class A1 notes.

- Both the Bankwest and Bendigo & Adelaide Bank deals retain principal collections against a redemption/retention schedule to meet redemption dates on the bullet notes, principal amounts collected are invested in GICs for mitigating yield strain in transactions. Other characteristics of TORRENS include: WALTV of 64.9% and WAS of 43.5%. The concentration of South Australian mortgages was high (36.5%). Fully amortising loans of 72.6% and IO for up to 10yrs of 27.4%. The AOFM participated in all of the Class A5 and A$20m AB notes, a total of A$415m in the trade.

Class	Amount	Rating (S&P / Moody's)	WAL (yrs)	Pricing
A1v (hard bullet)	A$250m	A-1 / P-1	0.98	+65bp (FRN)
A2 (soft bullet)	A$150m	AAA / Aaa	1.99	6.25% Fixed (Equivalent 105bp over BBSW)
A3 (soft bullet)	A$130m	AAA / Aaa	2.99	6.50% Fixed (Equivalent 115bp over BBSW)
A4	Nil	AAA / NR	n/a	n/a
A5	A$395m	AAA / Aaa	4.58	+110bp (FRN)
AB	A$45m	AAA / Aaa	4.72	+180bp (FRN)
B1	A$20m	AA- / NR	3.52	Undisclosed
B2	A$10m	NR / NR	7.13	Undisclosed

Rating News

New Rating / Withdrawal	- Nothing to report.
Upgrades or Downgrades	- S&P affirmed **Westfield's** A- rating with a Stable outlook. The rating was taken off CreditWatch Negative. - S&P downgraded **Woodside Petroleum Limited** from A-(Neg) to BBB+(Stable)
Credit Watch / Outlook	- Moody's revised its outlook on **Bank of Queensland's** A2 rating from Stable to Negative.
Other News	- Nothing to report.

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