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Navigating The Funding Maze

What Developers Can Expect From Bank and Non-Bank Lenders in 2017

DFP Development Finance Partners / Turning plans into reality

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TUD

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Summary - Last 12-18 Months

The Australian Banks reduced appetite for Construction Finance has been well publicised. The are several contributing factors for this and they include:

- A fundamental decline is presale sales rates.
- Heightened *settlement risk* and concern pertaining to the Banks existing exposures created by amongst other things the Banks own Retail Banking Divisions being forced by APRA to limit rate of residentially secured credit growth to 10% pa.
- Heightened settlement risk due to valuation write downs of up 30% of purchase price.
- A lack of funding for FIRB purchasers.

Summary - Last 12-18 Months cont.

- From a perspective of return on equity, development finance is not as attractive/profitable when compared to other financing opportunities such as lending to going concern businesses which have sound maintainable earnings with high transaction volumes.

- The short to medium term fundamentals has declined in the markets where construction finance approvals have been historically high in recent years.

Resulting Practical Effects

- More stringent credit risk assessment especially with respect to new to bank Clients
- Reduction of loan to value ratios reduced from 80% TDC to 65%-70% for construction finance.
- Land bank facility approvals are exceedingly difficult to obtain any LVR.
- Increased presale levels from 50% to as high as 130% debt cover
- Increased complexity with respect to credit assessment and approvals
- Slower approval and settlement timeframes

Resulting Practical Effects cont.

- Increased financing costs due to increases in Loan Establishment Fees, Margin and Line Fees.
- Facility Limit approvals greater than $20m are becoming increasingly more difficult to obtain.
- FIRB presales are non qualifying
- Heavier reliance upon the strength of the Developers Net Worth vs TDC
- Presales are taking longer to settle
- Developers holding higher levels of stock on completion

Resulting Practical Effects cont.

- Developers are increasingly financing working capital via residual stock facilities.
- An increase in number of non bank lenders have entered into our debt market.
- A long period of competitive construction tenders and escalating construction costs has resulted in several small to mid tier builders going bust. We expect more builders won’t make it out of this cycle.

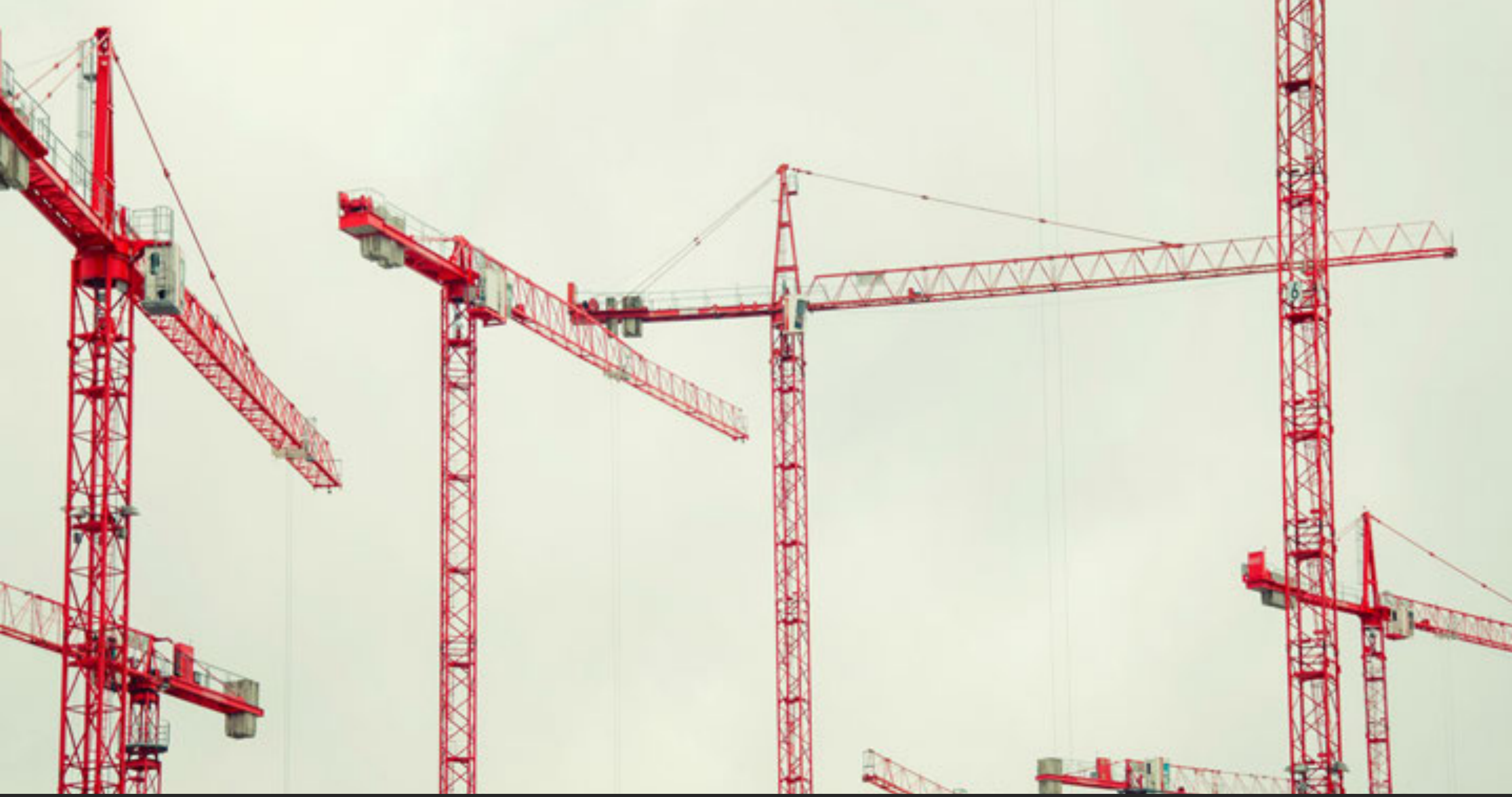
Implications For The Year Ahead

Opportunities

- Adapt and Innovate your financing strategies at both a group level and at an individual project level
- Opportunistic acquisitions
- Reduction in construction starts will decrease competitive supply levels
- Increased levels of Non Bank Capital

Challenges

- Increased cost of sales
- Increased cost of capital
- Declining values of committed sites
- Declining presale rates
- APRA will pressure Banks not to accept subordinated debt
- APRA will pressure Banks to not accept project site related valuations



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Case Study

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Scenario 1

- Client required us to finance the acquisition of the land via company share sale agreement and finance the construction costs associated the development of thirty eight (38) residential apartments located in Northern Brisbane.

Financing Challenges

DFP were retained to provide advice and recommendations on the following:

- Developers had no development experience.
- Developers price list was well below market rates.
- Valuation came in significantly lower than land purchase price.
- No presales at land settlement.
- Client has insufficient equity to finance the development.
- Local apartment market in oversupply.
- Builder was forced to renegotiate construction contract due to cost escalation.

DFP Funding Table

Funding Table	Soft Equity	Cash Equity	Purchase	Vendor Finance	Mezzanine	Senior	Total
Land	-$550,000	$1,225,000	$2,750,000	$550,000	$975,000	$0	$2,200,000
Land Transaction Costs	$78,572			$0	$0	$0	$78,572
Construction Costs	$0	$602,000		$0	$485,000	$7,613,000	$8.700,000
Consultant & PM fees	$0			$0	$0	$405,448	$405,448
Statutory fees	$0			$0	$0	$978,218	$978,218
Project Contingency	$0			$0	$0	$435,000	$435,000
Land Holding Costs	$0			$0	$0	$38,000	$38,000
Miscellaneous	$0	$329,865		$0	$0	$287,421	$617,286
Finance Charges	$0			$0	$174,000	$152,400	$326,400
Interest	$0				$610,000	$353,842	$963,842
TOTAL COSTS	**-$471,428**	**$2,156,865**		**$550,000**	**$2,244,000**	**$10,263,329**	**$14,742,766**

Results

DFP's recommendations were adopted by the client and DFP were retained to implement those recommendations which has resulted in the following outcomes:

- DFP raised the required capital to settle the share agreement which effectively settled the Land.
- DFP negotiated a vendor finance facility.
- DFP advised, arranged and settled a construction finance from a Retail Bank on favourable terms.
- DFP advised, arranged and settled a mezzanine finance facility to fund the equity gap.
- DFP negotiated a significant reduction to the Builders Construction Cost Escalation based upon unconditional finance offers.
- DFP advised upon a 5% increase in the sale prices of the 38 apartments.
- 25 Apartments were achieved on the increased sale
- Construction is underway

Summary of Financial Results Achieved:

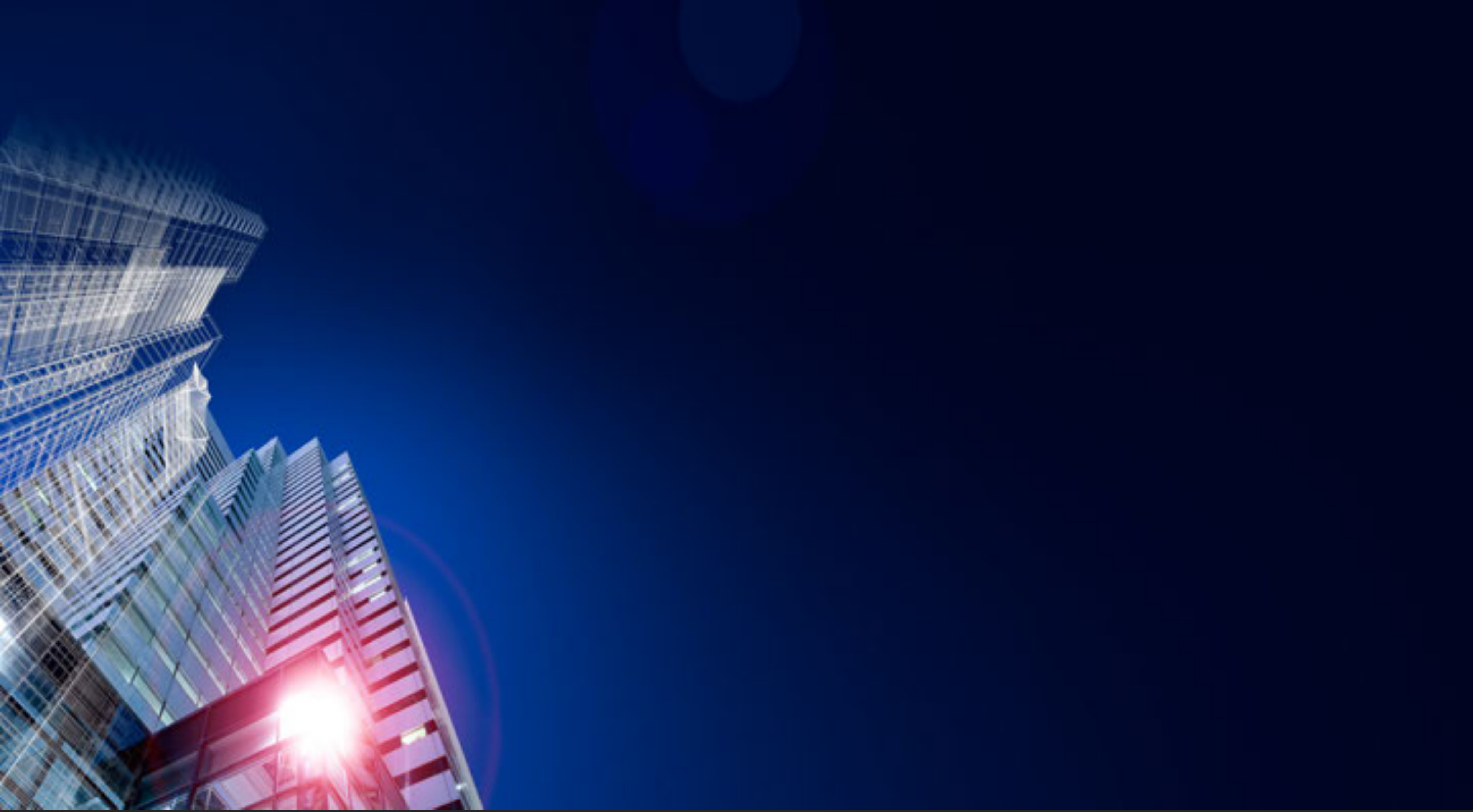
- Senior Debt: 60% of GRV and 73% of TDC
- Mezz: 73% GRV and 85% TDC
- Vendor Finance: 90% of TDC
- Development Profit Margin - 22% at Land Value

  $2,200,000 net project profit vs forecasted loss of $750,000
- Return on Investment 115%

Market Pricing for Risk

Market Risk and Pricing

Product	Bank	Non Bank	Non Bank >5m	Mezzanine	Corp Pref Equity
Interest Rate	BBSY + 2.5% + 1.5% Line	9.95%	11%-14%	15%-20%	15%-17%
Fees	0.5%	1%-2%	1%-2%	2%-4%	3%
LVR TDC	70%	80%	80%	85%	50% of Levered Equity
LVR GRV	60% On Comp	65% On Comp	65% On Comp	75% On Comp	NA
LVR Lank Bank	35% on Land Only	65% on Land Only	35% on Land Only	70% Land Bank	NA
Presales	100-130%	0%-50%	50%	80%-100%	NA



Top 4 Construction Finance Tips

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Top 4 Tips

- Take Control of Finance Be your own Banker!
- Think in the 4th Dimension
- Focus on the overall cost of your capital both within individual projects and more importantly across your group
- Micro Manage Settlement Risk

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Kerry Shambly

Advisory Board and Capital Management

Development Finance Partners

Implications For The Year Ahead

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Financing Strategies

Traditional Sources of Capital

- Bank Senior Debt
- Mezzanine
- Equity

Sources of Capital Emerging

- Institutional capital
- Joint venture with Fund Manager (APN Steller Development Fund)
- Quasi Equity – mezzanine and sub-ordinated debt
- Investment Bond issue (corporate and individual project level)
- Hedge funds

Capital Raising Experience

Raising institutional capital (big end of town)

- Raised a $1bn for an IPO for newly listed real estate trust and capital raising for real estate pub portfolio – capital easily raised – Why?
  - Corporate rated A+, on going corporate business generating cashflow
  - Institutional investors spend as much management time on $500,000 as they would on $50m

Private equity/hedge funds

- US based with Sydney office – interested in individual deals @$50m and interest to look at the opportunities but lacked the capacity to deal at the risk levels

Large Fund Manager – Challenger style

- Projects at medium to large end of town – office towers etc
- Interested in office towers, large developments of $500m +

Capital Matching

Large Developer

- $70m+ projects – Institutional capital, Investment bond Issue, Hedge Funds

Medium Developer

- $15m+ - Investment bond Issue, Equity (Wholesale), Quasi Equity, JV with Fund Manager

Small Developer

- $5m projects – JV with Fund Manager, Equity (retail or wholesale)

Capital Raising - Opportunities

Developers

- Build corporate cash flows so that business becomes a maintainable earnings business not a one-off project by project business i.e Move from project finance to business finance so that become attractive to greater sources of capital

Covenants on LVR's, pre-sales, etc

- Based on previous track record of the developer then attach a financing structure within the covenant

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David Kenney

Managing Partner

Hall Chadwick

Why effective structuring is important in a tightening market

Structuring

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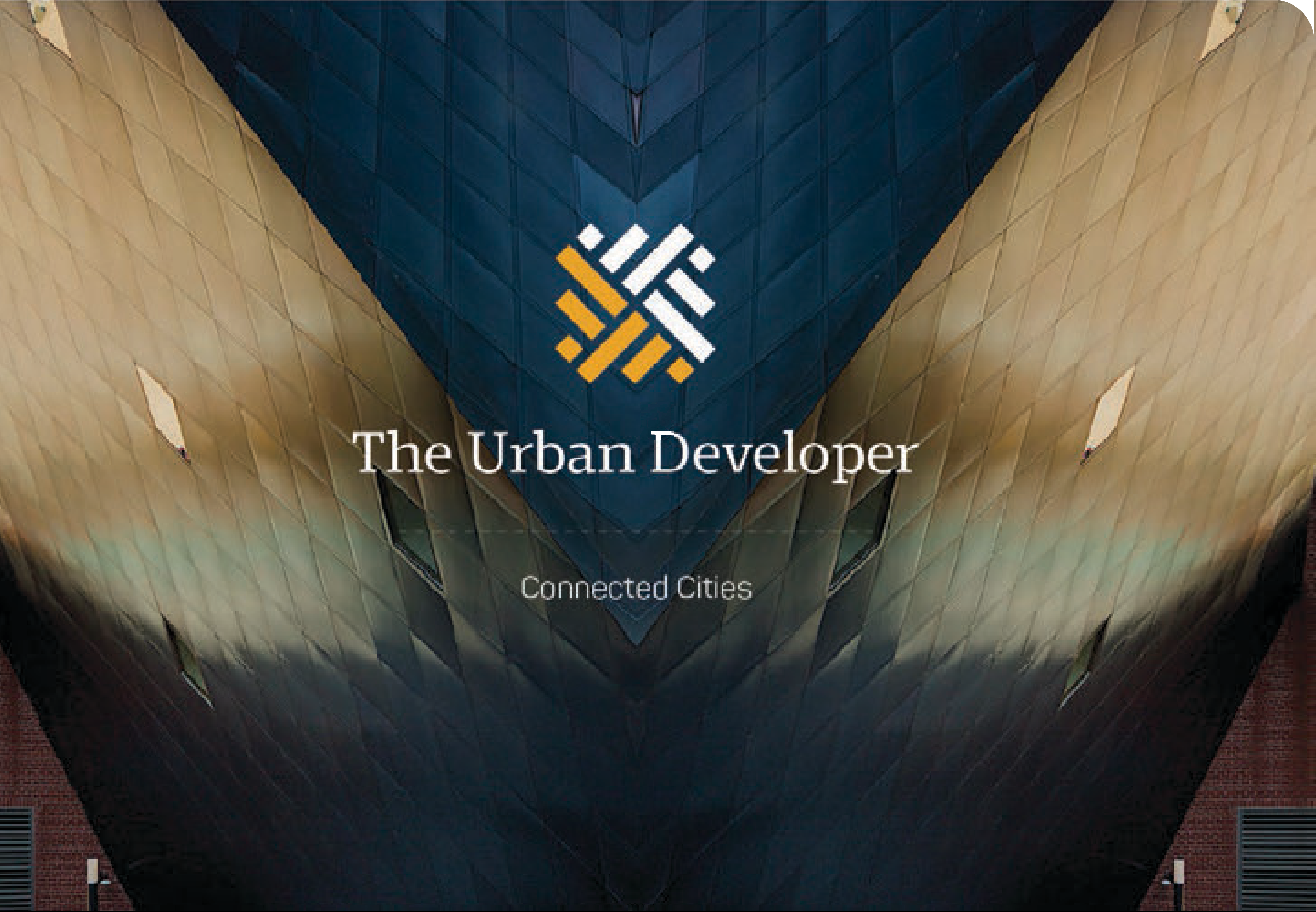
Common Risks

- Cost allocation, timing and risks
- Asset protection strategies – do you have the right structure?
- What if your FOREIGN buyers can't complete the sale (GST, stamp duty, FIRB)
- Should property be held in a trust? – impact for unrelated parties
- Ownership / building times of longer than 6 months on new home – Will you miss out on the main residence exemption?
- Holiday homes
- Managing tax risks - what are the commercial reasons for your structure?

Opportunities To Consider

- When should you convert to or from trading stock.
- Sale of partially completed development projects the going concern GST exemption.
- Triggering gains on a development and use of a development manager – careful!
- Accounting - Establishing your structure to provide flexibility to exit pre, during and post development.
- Partitioning, thin capitalisation, security, funding – spaghetti.
- Where will your next development be located?
  - Reducing stamp duty and land tax in Victoria for foreign purchasers by establishing contribution to the State economy
  - Phasing out of stamp duty for land other than residential / primary production land in South Australia, fully exempt by July 2018
- Property development joint ventures
  - Tax admin, invoicing and cash management?
  - Restructuring, super, pensions pre 30 June


The Urban Developer
Connected Cities