



Debt Products in Real Estate Financing



Knowledge Bytes S1-E2

S1-E1: Introduction to Investment Banking

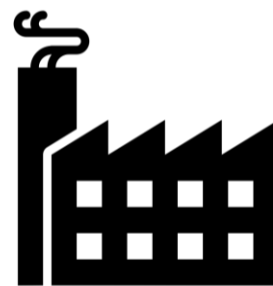
Real Estate

Real Estate is a piece of land + any natural or any man-made development that are attached or have been added to it.

- a) Natural Attachments: Trees, Mineral deposits and Oil.
- b) Man-made Attachments: Buildings, Sidewalks, and Fences etc.



Residential



Industrial/Warehouses



Commercial



Retail/Malls

Most of the financial products in RE are focused on these four asset classes.

Development Activity Flow

Any real estate project, be it residential or commercial is initiated by buying the land or going for a joint development agreement (JDA) or any other type of arrangement with the landowner.

Once the land is acquired and paid for, the developer has to seek approvals from various government authorities including RERA.

After the required approvals are received, the developer can start the construction.

Funding can be availed by a developer at various stages viz. partial land payment, approval costs, construction and development cost etc.



Debt Financing Products in RE

The types of financial products in RE are based on the construction stage of the project and utilisation of funds (end use of funds).

Following are the commonly used products offered by FIs (Financial Institutions)

Types of Funding

Plain Vanilla CF
/ Project
Construction
Finance

Receivables /
Last Mile
Funding

Structured
Debt

Lease Rentals
Discounting

Loan Against
Property

Explained Further

Products at Stages of Funding

Land Stage (Pre approval)

- ✓ Structured Debt



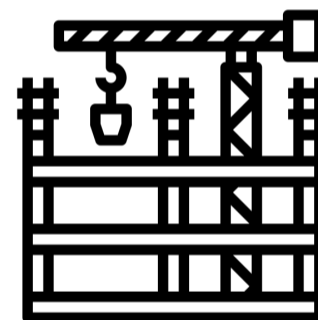
Plinth Level Stage

- ✓ Plain Vanilla CF ▶
- ✓ Structured Debt



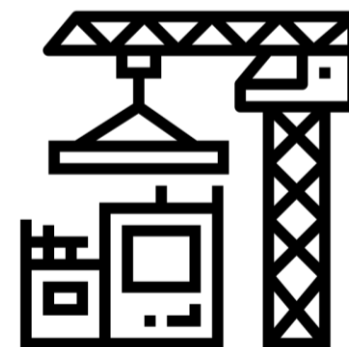
Under Construction Stage

- ✓ Plain Vanilla CF ▶



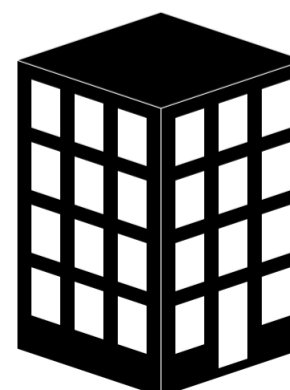
Near Completion Stage

- ✓ Receivables Funding



Completed Stage (with OC*)

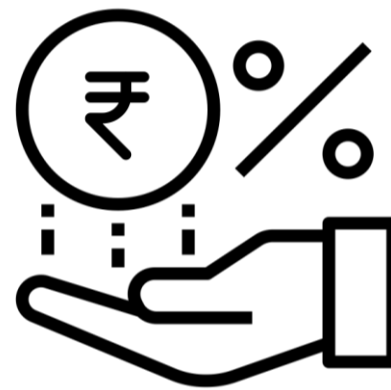
- ✓ Loan Against Property (LAP)
- ✓ Lease Rental Discounting (LRD)



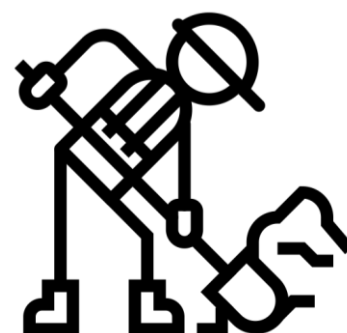
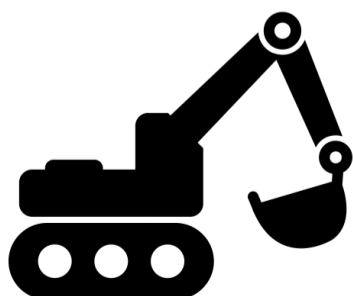
*Occupancy Certificate

Project Construction Finance / Plain Vanilla CF

Plain Vanilla is the most basic or standard version of a financial instrument. It is the opposite of an exotic instrument, which alters the components of a traditional financial instrument, resulting in a more complex security.



Funding under this product is available purely for construction & development of a real estate project. Lenders in India give preference to residential projects as the housing demand in the country is on rise.



Project Construction Finance / Plain Vanilla CF

The Project loan is sanctioned after –

- ✓ Promoter has paid for Land + Approvals (Promoter Equity).
- ✓ The Project Completion stage is usually between 10-40%.
- ✓ The Sales & Construction milestones are agreed upon in Cashflow Projections of the Project.



In general, 60-80% of construction cost can be funded.

Project Construction Finance / Plain Vanilla CF

Key Ratios in assessing a loan application under this product –

Receivable Cover

$$\frac{\text{Total Receivables} - \text{Balance Project Cost}}{\text{Proposed Loan Amount}}$$

Security Cover

$$\frac{\text{Property Value}}{\text{Proposed Loan Amount}}$$

Security cover and Receivable cover requirement generally would be 1.5 – 2.0x

Project Construction Finance / Plain Vanilla CF

Loan Structure

Loan Eligibility –

Total Receivables divided by 1.5x or 2x or 60-80% of (construction + development cost), whichever is lower

Interest Rate – Ranges between 12% to 15%

Processing Fees – 0.75% to 1.5%

Loan Tenor – 3 to 6 Years

Capitalization* Rate –

Ranges between 10-40% (Higher the completion %, higher the rate)

Purpose of the Loan –

Construction & Development of the project

Low Risk –

Disbursement of funds is linked to stage of construction

Based on
Developer
Category

Based on
Stage of
Construction



*Fixed % is deducted from Lender's Escrow account which is utilized towards Repayment of loan obligation

S1-E3: LAP & Receivables Funding

*Stay tuned for
More Knowledge*



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