Structured Financing in Real Estate

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Knowledge Bytes S1-E4

Recap

- Ep 1 : Introduction to Investment Banking
- Ep 2 : Debt Products in RE – Plain Vanilla CF
- Ep 3 : Receivables Funding & LAP
- **Ep 4 : Structured Financing in RE**
  - Project Stage & Product Availability
  - Introduction to Structured Debt
  - What is Structured Finance?
  - Transaction Snapshot
  - Features
  - Forms of Lending
  - Types of Structured Deals in RE
  - Loan Structure

Project Stage & Product Availability

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Stage	Product
1. Land or Pre Approval Stage	Structured Debt
2. Plinth/Under Construction Stage	Structured Debt; Plain Vanilla CF
3. Near Completion Stage	Receivables Funding
4. Completed (OC* received) Stage	LRD; LAP

*Occupancy Certificate

Introduction

Need for Structured Financing arises in the early phases of real estate projects where Land & Approval Costs form a substantial portion of the Total Project Cost. Sales picks up only with increasing completion %, hence there remains a shortage of funds in the initial years of the project.

2009-12

RE industry in boom, increase in demand along with an increase in selling price.

Prior to 2016

Hassle-free project launch & sales collection without RERA. Booking amount collected at launch was sufficient to kickstart the project.

Post 2016

Events and reforms like RERA, GST, Demonetization, and NBFC crisis caused demand to stagnate and led to high inventory buildup.

This further caused correction of property prices with price increases in a project on near completion or at completion stage.

Hence the developers seek External Financing for Growth Capital and to pay for Approvals.

What is Structured Finance?

Structured Finance deals with offering customized Debt Products where the financing needs of the borrowers cannot be catered to by standard debt products/instruments.

End use of funds

Plain Vanilla CF

- ✓ For construction & development purpose

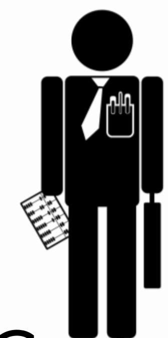
Structured Debt

- ✓ For construction & development purpose
- ✓ Pre-acquisition & approval
- ✓ GCP
- ✓ Stake buyout

Transaction Snapshot

Promoters/Developers in Need of Funds

Unable to access common debt products



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Customized Product Proposals

- Private Equity
- Term Loan
- NCDs

Funding received on customized terms for the developer by forming an SPV*

*Special Purpose Vehicle

Features of Structured Debt

- Offered by: FIs and Fund Houses (considering the developer's profile)
- Approval Risk, Execution Risk, Sales Risk (depends on stage of funding)
- For commercial properties, CF+LRD - a hybrid product is offered
- Security and receivable cover is high & ranges between 1.75x to 2.25x
- Free cashflows of other projects to be offered in addition to project security (based on the developer's profile and the stage of project)
- Detailed due diligence i.e. Corporate DD & Financial DD done (in addition to Legal, Technical & Valuation)
- Loan approval process is complicated & involves higher turn around time unlike other products.

Forms of Lending

Term Loans/NCDs

A **Term Loan** is a debt product offered by a lender for a fixed return that is repaid in regular payments over a set period of time.

In an RE transaction, disbursement is done in tranches linked to sales and construction milestones.

Non-Convertible Debentures (NCDs) are debt instruments offered by fund houses and FIs for a fixed tenure and fixed returns.(IRR or Fixed Coupon or structured to be a mix of both)

Private Equity

Private Equity is an alternative investment class and consists of capital that is not listed on a public exchange. It is composed of funds and investors that directly invest in private companies. The tenure (Investment Horizon) of such funds can be anywhere between 5-10 years with an option of annual extension.

Types of Structured Deals in RE

- Growth Capital & Approvals Payment
- Acquisition of a Stressed/NPA Asset by another investor/developer
- Financing income generating asset at a pre-approval or under-construction stage
- Financing nearly completed projects where utilization of funds is towards business expansion

Loan Structure

Term Loans/NCDs	Private Equity
Borrowing entity constitution – Term Loan: LLP/Company (Public or Private) NCDs: Company (Public or Private)	Borrowing entity constitution – LLP/Company (Public or Private)
Interest Rate – 16-19%	IRR (Internal Rate of Return) – 18-24% or upside sharing in proportion to investment
Loan Tenor – 48 to 72 months (Including 24-45 months of moratorium)	Investment Tenor – Fixed or as per project lifecycle
Processing Fees – 1% to 2%	Investment Manager Fees – Part of IRR
Additional Security – Can be free cashflows or collateral	Additional Security – Not required
Risk – Secured compare to PE as recourse is simpler	Risk – In case of an event of default, recourse options are complex

If you have knowledge,
let others light
their candles at it.

- Margaret Fuller

Stay tuned for More Knowledge

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