Risk Assessment in RE Projects

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Knowledge Bytes S1-E9

Recap

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- COMPLETED — Ep 1 : Introduction to Investment Banking
- COMPLETED — Ep 2 : Debt Products in RE- Plain Vanilla CF
- COMPLETED — Ep 3 : Receivables Funding & LAP
- COMPLETED — Ep 4 : Structured Financing in RE
- COMPLETED — Ep 5 : LRD & Vanilla CF + LRD
- COMPLETED — Ep 6 : Deal Process Flow in RE Financing
- COMPLETED — Ep 7 : Investment Memorandum (IM)
- COMPLETED — Ep 8 : Preparation of Cashflow forecasts
- Ep 9 : Risk Assessment in RE Projects

Introduction

Once the transaction is forwarded to the credit team of the FI, they assess the proposal considering various factors like sales risk, execution risk, approval risk & repayment risk. Apart from the above the most important factor in risk assessment is financial closure.

Financial Closure means sufficiency of future collections from the project {committed (sold) receivables + unsold receivables}, promoter equity, and future disbursements in meeting the balance (remaining) project cost.

Assume the balance cost to complete the project to be Rs 80 Cr.

Financial Closure	80	100%
Developer Funds	0	0%
Future Receivables	30	38%
Loan	50	63%

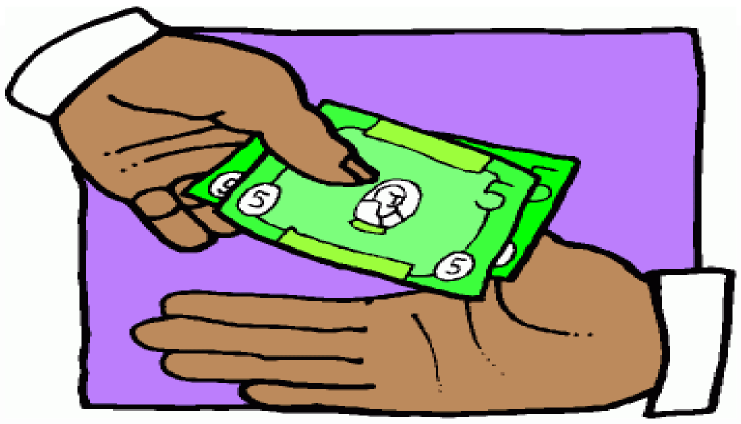
It is preferable to have lower dependency on unsold receivables and the promoter equity.

Other factors in risk assessment include -

- Implication of current legal cases on borrower/co-borrower/guarantors in business.
- Current appeals/ disputes pending with income tax and any contingent liabilities arising out of this.

Key Risks in Real Estate

Repayment Risk



Regulatory Risk

Execution & Approval Risk

Sales Risk

Repayment Risk

The risk of non-repayment of loan along with interest

Mitigants:

- ✓ CIBIL Score
- ✓ Past performance of prepaying or repaying the loan on time
- ✓ Assessing bank statements
- ✓ Assessing balance sheets of major entities at group level to check availability of liquid funds
- ✓ Assessment of past 12 months' group level cashflows and future cashflows
  - Ongoing projects stages
  - Future debt obligations
  - Upcoming projects
- ✓ Additional collateral in few cases

Regulatory Risk

The risk brought about by the changes in laws & regulations which will materially impact both at industry and at entity level

Mitigants:

✓ The developers' team and consultants should be well versed with the regulatory requirements and be aware of and prepared to any changes in the regulatory framework.

Execution & Approval Risk

- This risk is higher in early stage of funding
- The risk of timely execution of the project within the given cost schedule, plays a crucial role **(This risk is low in ready inventory funding)**

Mitigants:

- Check for past track record of the developer in timely delivery of projects.
- The developer should have a history of developing a particular type and scale of project (Malls, townships, warehouses etc.).
- In case he is developing a new concept, then selection of the project partners (Architects, contractors etc.) becomes critical.
- Minimum dependency on unsold receivables for financial closure.

Sales Risk

The risk of selling the units in the project is based on developers' brand, location and current market scenario.

Mitigants:

- ✓ Marketing & sales strategies and their execution play an important role in mitigation of sales risk.
- ✓ Developer’s experience in selling similar size of project reduces the risk.
- ✓ Existing physical and social infrastructure along with the proposed ones in the vicinity also reduces this risk.
- ✓ Units’ sales price (ticket size), target customer segment along with the general economic conditions and market trends would also impact the sales risk.

The Cost of Preventing Mistakes is Generally Much Less Than the Cost of Correcting Mistakes

Stay tuned for more knowledge

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