

HOW TO UNLOCK VALUE THROUGH WORK OUT SOLUTIONS

“Our recommendation to lending clients faced with defaulting property loans is to avoid the temptation for a fire sale of the assets, and undertake a ‘work out’ solution prior to a sale.”

In January 2007, the US Government introduced legislation requiring investor institutions to declare all types of investments in their company accounts. It meant that every investment needed to be assessed on its value. This exercise unearthed a large number of worrying US residential investments which had little or no value. The knock-on impact was colossal and spiralled into the worldwide crash we are now all experiencing.

Current market conditions mean that our clients can rarely borrow for investments and developments and the values of property have decreased annually by up to 20%. The effect has been that many banks have schemes that breach the agreed loan to value ratios with additional equity being required to fill the gap. In some cases, the developers are not even able to pay off the interest.

As a result, the lending banks have an unprecedented volume of defaulting property loans across Europe.

Our recommendation to lenders faced with such situations, is to avoid the temptation for a fire sale of the assets, and undertake a “work out” solution prior to a sale.

A work-out solution will state the financial exposure, and propose a plan to mitigate losses and maximise values from defaulting loans. It is best carried out by an integrated team of experts.

Our case studies demonstrate that funders recover 25% higher values from a work-out solution.

Typically, a built asset consultant will achieve this with the funder’s team by renegotiating S106 contributions, re-positioning the assets for alternative tenants and buyers, re-phasing, recovering tax credits, re-procurement and stepping in to take control of the outstanding development.

Another option to unlock value is through lease gearing. This process can both increase the capital value of the asset through a review of the lease structure. In some cases this can be achieved with reductions to the tenant’s rental.

Funders will achieve exceptionally high returns when, following a work-out solution, the improved assets are retained until more benign market conditions return.

Case Study: How to improve returns by 25% against a falling market

The bank commissioned the EC Harris team when a developer for a £1 billion regeneration scheme breached the loan to value covenant following a collapse of 30% in property values.



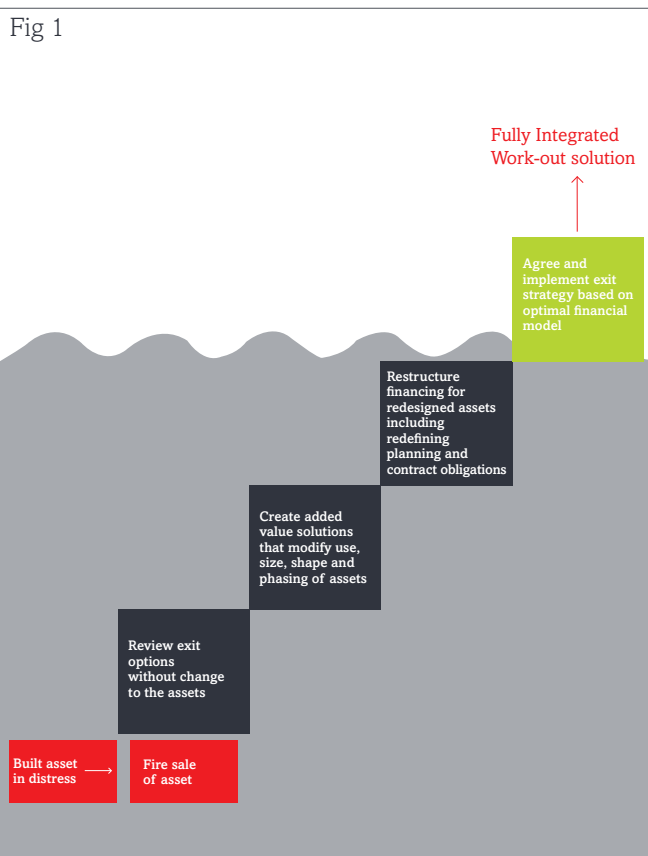
Our brief was to provide the bank and their borrower with the most appropriate work out solution to maximise the returns. The bank was also concerned about certainty of the CAPEX spend and requested a thorough diagnosis of contractual liabilities to identify all unplanned future spend.

We revised the master plan to add value and renegotiated the Section 106 to reduce costs. Phase one is now a forward funded food retail store with a well known operator. The procurement strategy was changed to fully realise the benefit of falling tender prices and to avoid risk premiums.

The current site value has been increased by circa 25% over a fire sale based upon the original master plan. Also, the cash flow has significantly improved and is now self financing by bringing forward the affordable housing phases.

Key to the success of this commission was the bank's realisation that they did not have all the key skills and processes in-house. We deployed a multi-skilled team, alongside the bank, comprising of development managers, contract experts, and cost engineers led by a project re-structuring expert.

The four key steps to unlock value for this project, and other projects 'in distress' are summarized in Fig 1. For each step we have developed detailed processes to ensure a consistent approach to maximising the value for our clients.



Contact

Matthew Cutts

Partner, Head of Lenders & Investors

e property@echarris.com

w echarris.com/property