Long Term Financing Strategies For Real Estate Developments in Nigeria

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EXHIBITIONS
CONFERENCE
AWARDS
NETWORKING

- Economic Realities
- Alternative Financing Strategies
- Sourcing Long Term Capital

01 Operating Realities

Why Real Estate is still a strong Industry in Nigeria

Market Outlook

- The Nigerian real estate market, similar to a number of international markets, has experienced a reduced rate of growth in recent times due to economy downturn in 2015 to 2017.
- A strong driver of the development of the real estate industry in the country is the estimated growth potential of the Nigerian economy in relation to other developed nations.
- Another stimulus of growth for the real estate market is the continued reform in the financial markets, specifically the success of the ongoing FGN Mortgage Finance Initiative Plan which will potentially engender increased lending activity in the medium term will be beneficial to the real estate industry.
- Lastly, a major determinant of the direction of the real estate market for the different segments of the industry will be the success of the supply of new well serviced land lots currently being explored by developers in cities such as Lagos, Ogun, Abuja and Port Harcourt.

The Need for Long Term Financing…..in Real Estate Developments

Financing is a very important part of every business and is the life blood of every Real Estate business.

- The common sources of financing for Real Estate Companies (not development) are capital that is generated by the firm itself and sometimes, it is capital from external funders, which is usually obtained after issuance of new debt and equity as well as spontaneous financing (i.e Pre-Sales)

- A firm's management is responsible for matching the long-term or short-term financing mix. This mix is applicable to the assets that are to be financed as closely as possible, regarding timing and cash flows

- Real Estate Development firms often need financing for construction of real estate projects. Many often depend on the term "PRE-SALES"….but this always creates a hole for equity needed to play its role.

- Even when land has been included as Equity in a project, there has been a shift of the Capital Structure is RE projects moving from 70:30 Debt to Equity ratio to almost 55:45 ratio, as the general investors become more risk adverse.

- As the Economy gets tougher and markets get tighter there is a need to look beyond spontaneous financing in terms of "PRE-SALES" and attract core long term finance into REAL ESTATE companies.

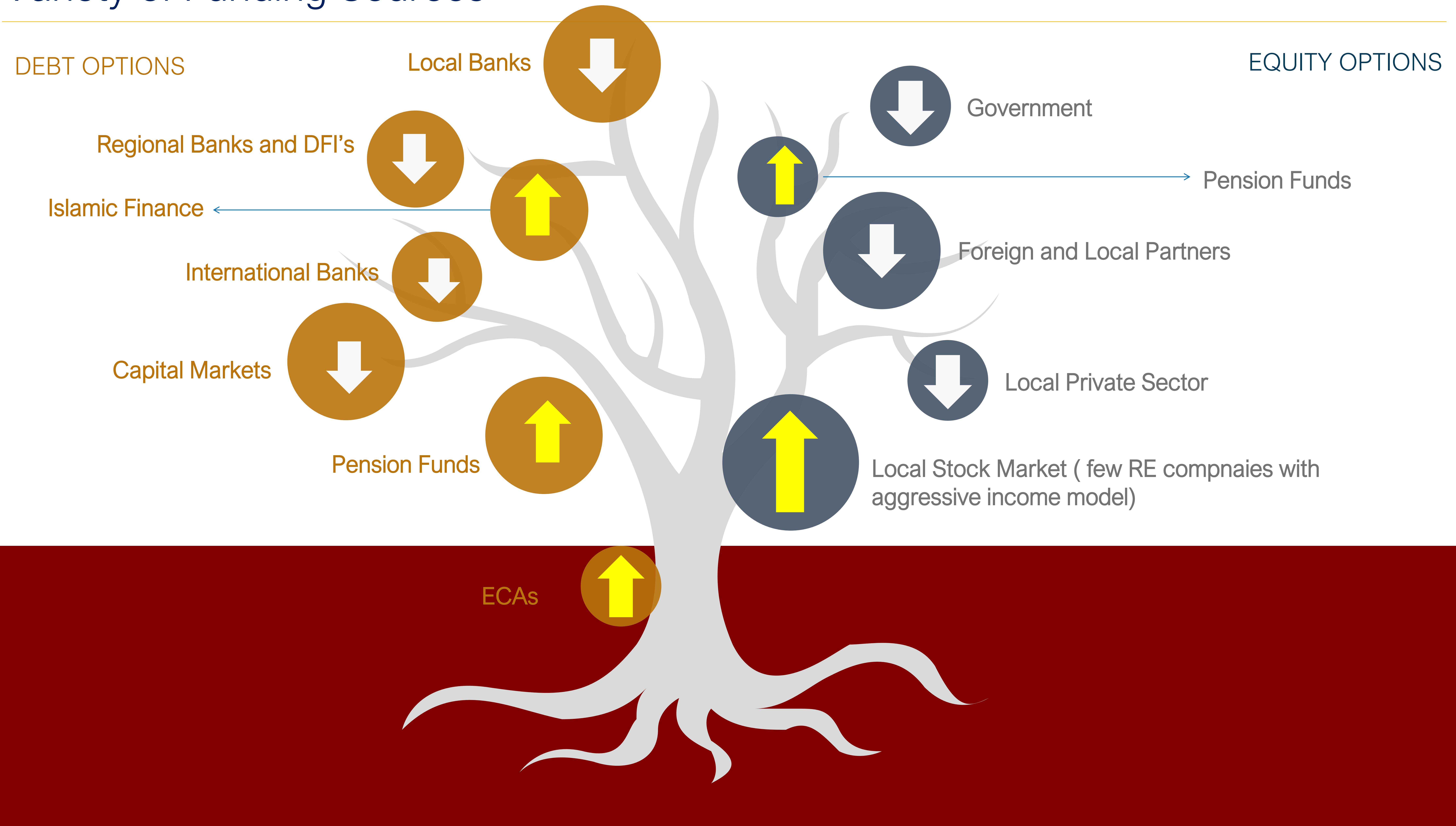
The Need for Long Term Financing…..in Real Estate Developments

Need for long term Equity Financing for RE Companies

1. Getting Project Approved and Provision of early work in Project Sites
2. Long term vs. short term (working capital) funds requirements
3. Development Planning take so much time and core equity is required for such
4. For diversification of RE Asset Type (especially when moving from Housing to Commercial Developments);
5. Illiquid Land Asset - Cashflow Needs mismatch,
6. Trying to avoid Interest rate risk.

02 Alternative Financing Strategies

Variety of Funding Sources



Limitations of Traditional Financing Options

ASSETS

Value

Real Estate Company

Future

Cashflows

LIABILITIES

DEBT

- Contractual interest & Principal
- No upside
- Senior claims
- Control via Restrictions

EQUITY

- Residual payments
- Upside and downside
- Residual claims
- Voting control rights

CLAIMS ON FUTURE CASHLOW

Scenario 1

Company's Claims Are Inadequate?

Scenario 2

Company's Returns Are Inadequate?

EXOTIC OPTIONS

- OFF-BALANCE SHEET
- STRUCTURED NOTES

- CONVERTIBLES
- WARRANTS
- PREFERRED

EXOTIC OPTIONS falling between debt and equity – are critical at this point to meet the special needs of Real Estate Development.

They are designed to solve problems that are not easily solved by conventional debt or equity financing

Analysis of Non-Traditional Alternative Financing Options

● High

○ Low

	Shares Dilution effect	Covenants and Pledges	Cost of Funds	Maximizing return on equity	Probability of Success in Economic Realities
WARRANTS	●	○	●	○	○
STRUCTURED NOTES	○	●	◐	●	○
PREFEENCE SHARES	●	◐	●	○	○
CONVERTIBLE FINANCING	●	○	●	○	○
OFF-BALANCE SHEET FINANCING,	○	○	○	●	◐

The Alternative Options falls between debt and equity which are critical at this point to meet the special needs of Real Estate

They are designed to solve problems that are not easily solved by conventional debt or equity financing

Most are however privately placed when been invested through institutional investors

03 Sourcing Long Term Real Estate Capital

Planning for Privately Placed Equity Financing

Steps

1	2	3	4
• Demand forecasting • Value chain analysis • Competitor profiling • Risk analysis • Entry barrier analysis • Cost driver analysis	• Vision and objectives • Internal core competencies • Asset Optimization • Internal SWOT	• Mapping internal capabilities to market opportunities • Agree investment criteria • Prioritization of potential market opportunities	• Evaluation and prioritization of potential entry modes (e.g., acquisition , joint venture) based on market and internal capability assessment

Key Outcome

- The above procedure is aimed at establishing the rationale for Long Term Financing and creates a path for the screening, analysis and evaluation of Long Term Financing.
- The procedure begins with the understanding of the financing needs of the organization. Understanding the needs assists the Company to decide on <u>the target sub- sectors in real estate sector</u>. It leads to the gathering of as much information as possible on the potential target and the target sectors. At this stage, the sector of the target, price, and other parameters are decided.
- Through this process, the Long Term Financing needs of the organization is drawn and this leads to <u>understanding the potential impact of the Debt & Equity on the business</u>.

When Long Term Capital is raised?

How traditional structure is influenced when institutional investors become involved

When private equity or institutional investors invest a substantial amount in a Long Term Capital, they may require certain protections and controls as a condition to their investments. A sponsor may be required to make the following concessions when dealing with these larger, typically more sophisticated investors.

1 Improved Returns

- Institutional investors may be more demanding in their return on investment expectations. This could manifest in a few ways.
- First, institutional investors may require higher preferred returns and higher hurdle rates.
- Lastly, when quick sale of the property has been discussed as a possible liquidation event, an institutional investor may require that the hurdle rate be computed as the greater of a certain return and a multiple of its investment.

For instance, an institutional investor may require that the sponsor's promote not kick in until the investor has received the greater of a 15 percent compounding return or two times its original investment. This type of structure ensures the institutional investor of receiving a sufficient return in an exit scenario on an absolute naira basis

When Long Term Capital is raised?

How traditional structure is influenced when institutional investors become involved

2 Budgetary controls

- In a typical investment structure, investors may not enjoy any particular controls on the sponsor's ability to spend other than protections afforded by fiduciary duties (to the extent not limited or eliminated).
- Institutional investors may require approval over, and adherence to, annual budgets. This would naturally limit, among other expenditures, the type and amount of fees that a sponsor or its affiliates could charge for rendering services to the project.
- In these cases, the failure of the sponsor to adhere to an approved budget can result in liability to the sponsor, removal of the sponsor as the decision- maker and operator of the project, and/or forfeiture of the sponsor's promote.

3 Participation in Future capital needs

- An institutional investor may require that it have the right, but not the obligation, to provide any future funding to the project, or that it at least have a pre-emptive right to fund its share of any capital calls.
- Similarly, an institutional investor may require that it provide any loan required by the project, or that it have a right, but not the obligation, to fund a pro rata portion of any required loan. Moreover, an institutional investor may require its consent as a condition to the sponsor making any additional capital call or incurring indebtedness other than trade debt in the ordinary course.

When Long Term Capital is raised?

How traditional structure is influenced when institutional investors become involved

4 **Participation in certain decisions**

- Institutional investors may require approval over certain decisions concerning the project. Examples of such decisions include:
  - Selling the property;
  - Incurring indebtedness over and beyond trade debt and other indebtedness expected to be incurred at the onset of the project;
  - Raising capital and the terms of any capital raise;
  - Redeeming any equity;
  - Approving annual operating budgets

5 **Tighter controls On reporting**

- Institutional investors typically require much more elaborate and frequent reporting than traditional passive investors.
- Institutional investors may also require that financial reports be independently verified by third parties.

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In business, there is always someone better than you. The minute you think you are the best, you are doomed to fail.

Andrew Grove, former CEO of Intel once said, “Success breeds complacency. Complacency breeds failure.…Only the paranoid survive.

”Oct 24, 2012.”
— Andrew Grove

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