



# FUNDING PROPERTY PROJECTS WITH A FINANCIAL GUARANTEE

## *Financial Guarantee*

A Financial Guarantee can be used in a variety of ways for funding property projects. The Financial Guarantee is structured to reduce project risk, for example providing additional security to meet financiers project LVR; provide additional security to secure land purchase; providing additional security for vendor finance; reduce or eliminate the need for pre-sales and provide additional security for debt, equity or mezzanine funders.

The objective is to structure a Financial Guarantee so it satisfies both lenders(s), investor(s) and borrower(s) requirements. Equilinx works with, the parties to a property transaction, to secure the best outcome for all parties and meet their unique requirements.

## *How does a Financial Guarantee work?*

The Financial Guarantee facility provided by Equilinx to approved developments is created by using an insolvency risk instrument that provides the vendor/financier with an irrevocable, non-cancellable security. It provides a secured undertaking to promptly pay any deferred amounts should the developer default.

The Underwriter of a Financial Guarantee will honour the financial obligations of the developer, providing a commitment to pay the bonds face value if the developer fails to settle the amount on the agreed future date.

For the vendor/financier to be able to fully rely on the Financial Guarantee in the event of a claim, bonds are only arranged with insurers with a credit rating of A or higher.

## *Where can a Financial Guarantee be used?*

Equilinx can structure a Financial Guarantee with the property owner for all (100%) of the fair market value of the property or an agreed percentage of the fair market value. The percentage agreed will depend to a large extent on the amount the Vendor is willing to defer or how much the financier is prepared to provide as equity.

The type of property projects considered to be applicable for a Financial Guarantee are:

- ❖ Resort Developments.
- ❖ Residential high rise.
- ❖ Residential sub-divisions.
- ❖ Retail developments.
- ❖ Commercial developments.
- ❖ Hotel developments.



- ❖ Retirement Villages.
- ❖ JV's with related entities or third parties.
- ❖ Purchases of land and buildings.
- ❖ Replacement or lowering of pre-sales.
- ❖ Guaranteeing any pre-sales shortfall or gap
- ❖ Construction Finance
- ❖ Development Finance
- ❖ Project Refinancing

## *Benefits to the Developer*

Some potential benefits are summarised below:

- ❖ Increased equity reducing LVR.
- ❖ Ability to receive/eliminate pre-sales due to reduction in LVR.
- ❖ Increased project profitability due to decrease in capitalized interest and the possible non-requirement to discount selling prices associated with pre-sale requirements.
- ❖ Deferred payment for land purchase to project completion.
- ❖ Reduction in the amount of equity required by the Developer.
- ❖ Significant increased return on developer's equity (ROE %).
- ❖ Reduction in capitalised interest on debt finance
- ❖ Deferred Stamp Duty charges where applicable in certain states.
- ❖ 72 hour turnaround on approvals (if all documentation available).
- ❖ Substantially cheaper than private equity & other forms of mezzanine finance.

*See example over...*



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## AN EXAMPLE

The following is a real life transaction completed by Equilinx where a developer has utilised an Equilinx Deferred Payment Guarantee:

### The Transaction

Development proposal for residential sub-division lots.

### Development Costs:

Land: \$11.5m  
Earthworks: \$2.0m  
Soft Costs: \$1.83m (excluding finance costs, fees & charges)  
Financing Costs & Capitalised Interest: \$3.3m  
Other Costs: \$0.552m  
Total Costs: \$19.182m

### Objective

The developer wanted to structure a cost effective financing strategy that resulted in maximizing his return on invested equity and optimise cash flow.

### Solution

Equilinx negotiated a Deferred Payment Guarantee for 26% of the Land acquisition costs (\$3.0m) with the Vendor. The deferred amount of \$3.0m to be paid by the developer on project completion in 15 months.

The vendor was secured with a Financial Guarantee with a face value of \$3m.

### Developer's Benefits:

This resulted in the following benefits to the developer:

- ❖ A reduction in financing requirements.
- ❖ A reduction in capitalized interest.
- ❖ Reduced LVR on senior debt finance.
- ❖ Improved project profitability.
- ❖ A 500% improvement in the developer's return on investment (holding period return).
- ❖ The Deferred Payment Guarantee proved to be the better option when compared with using debt funding and developer's equity; using a combination of debt funding, developer's equity and private equity as highlighted by the ROE% in the graph below.

### Vendor's Benefits:

- ❖ A high proportion of the property acquisition price paid up front.
- ❖ An uplift in the total acquisition price compensating for the delayed payment over 15 months.
- ❖ Security in the form of a Financial Guarantee guaranteeing both the capital (deferred amount) and the price uplift (vendor interest).

## RETURN ON EQUITY - PROPERTY DEVELOPER

