Construction Finance Terms in Australia

HoldenCAPITAL

CONSTRUCTIVE FINANCE

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Foreword from Steve Wiltshire

"For those of us who have been around long enough to have experienced the cyclical nature of the economic markets and the resultant impact of the credit booms and busts on the property sector, we also know that there have always been solutions to achieve a positive outcome when funding Real Estate projects. Often those solutions appear to be a new finance product or structure. However, for the most part they distil down to a fairly basic formula and reflect the fact that there are always those people who have an innate understanding of both the drivers behind the finance sector and how to create a successful project, and who find a way to get the job done. It is great to see Holden Capital sharing some of their knowledge of the industry with their existing and prospective clients.This guide offers a simple means of understanding some of the key terms used by the construction finance industry and will be useful to new and old players alike.."

Steve Wiltshire – Executive Chairman of Holden CAPITAL

Table of Contents

Foreword	4
Contents	5
About the Author	6
The Lingo	10
Finance Terminology	10
Loan and Equity Options	24
Project Feasibility	26
Construction	29
Valuation Terminology	36
Town Planning	37
About HoldenCAPITAL	38
Index	44

About the Authour
Dan Holden

Dan Holden has advised on over $3 billion worth of construction projects since 2001. On a daily basis Dan sits down with property developers to talk about finance and the various options to improve their project and thought the best way to assist a number of people at once was to prepare a mini-guide to construction finance to allow everyone access to some ideas and tips that could make their project more profitable.

"My career started in acquisitions and development management. I found I spent a considerable amount of my time sourcing project finance and it made me realise that good funding can make or break a project and too often it can be the different between a project getting out of the ground or not. When the opportunity was presented to me in 2007 to join the biggest specialist firm in Australia providing developers with project finance I knew that was the road for me. Not only was I excited to be involved in finance where projects get made or broken, but compared to the development management game where you spent two to four years living and breathing a single project, we were looking at new projects every day, trying to assess and analyse the best way to get them funded. Moving from project delivery into project funding, I thought I was in the box seat, and then the GFC came along.

I was the final employee hired before the credit crunch and after five years of hard work and sleepless nights, I was the sixth last person to leave that firm. I still do exactly what I had always done, just under a different banner, which now has my name on it. I thought that if I could create a platform that delivered a range of options on both debt and equity, that would be valuable to so many projects and the people behind them.

As the saying goes, the mother of invention is necessity. Well, applying that on a smaller scale, the reason I became so passionate about construction finance was because I learnt through first-hand experience of sourcing funding myself, how integral project funding can be to delivering a great project."

Daniel Holden
Founding Partner

HoldenCAPITAL is a specialist construction finance group, recognised as a market leader through its successes in deal structuring and the sourcing of debt and equity solutions.

Voted #1 Commercial Brokerage in Australia

2015, 2016 & 2017

Our main focus is to leverage our collective skills, knowledge, resources and relationships to structure project finance solutions as well as the provision of equity to minimise the risks to our clients and maximise their return while taking into account the interests of all stakeholders involved.

Appointing the HoldenCAPITAL team to secure your debt and equity requirements enables you to tap into our collective ability to source and negotiate more flexible terms utilising our extensive network of banks, non-bank institutions, mortgage funds and our trusted relationships with private lenders.

Debt Solutions

The majority of the projects that HoldenCAPITAL settles are funded by the major banks enabling us to use our first-hand knowledge gained from participation in the finance markets and real-time data from other similar transactions to facilitate the best possible terms tailor-made to our client's requirements.

Mezzanine and Equity Solutions

As well as having a strong and successful record of sourcing and negotiating JointVenture Partnerships for medium to large sized projects, HoldenCAPITAL also provides direct mezzanine and equity solutions to qualified projects.

The Lingo

This quick guide aims to provide the reader with some explanations of some of the terminology used in securing construction finance. Naturally there will be many phrases and definitions that we will have overlooked but for the most part you will find the key terminology of most real estate finance transactions covered in this guide. And if you do come across a term that is not dealt with, please give us a call and we will be happy to explain it and add it into our next edition.

Finance Terminology

Some general terms used in the securing of finance include:

ASSETS

As part of their risk assessment, most banks focus on elements items when assessing the financial strength of a prospective customer, comprising their Asset & Liability statement (A&L's), their Profit & Loss statement (P&L) and their forward looking cashflow (refer relevant individual references).

For the purposes of the financier, Assets principally comprise of property, equities (shares) along with other significant valuables that someone owns either directly or via companies/trusts, which a lender considers to be capable of being readily sold or borrowed against in order to repay debt. Principal places of residence, furnishings and personal items such as jewellery are fully or partially discounted depending on the lenders view as to their accessibility.

ASSET & LIABILITIES STATEMENT

The A&L statement comprises a simplistic one-page summary of the borrower's assets and corresponding debts, listed (usually in table form) to demonstrate the net equity position of the person for credit purposes. Best practise is to add details of the relevant lender, loan term and repayment per month in respect of each debt to give the lender a clear understanding.

BALANCE SHEET

Refers to the accounting format used to represent a company's A&L position, usually prepared by an accounting team (internal or external) to provide management with an accurate assessment of its net shareholders position or net worth, but also prepared to assist financiers assess the business performance.

BALANCE SHEET STRENGTH

Refers to the overall position of the borrower (individual or company), and their ability to provide/security or realise assets in order to raise debt/capital for further investments or to meet obligations. Lenders review this document and apply standard ratio calculations based on known industry standards, in order to satisfy themselves that the borrower has the ability to meet its existing and proposed obligations, and therefore avoid any potential default situations.

CASHFLOW

Typically comprises a 12 month forward looking spread sheet detailing the borrowers income sources and payment obligations for the period, reconciled to their opening and closing cash position. Post the GFC, the emphasis on the borrower's cashflow by lenders has heightened, as it provides a better understanding of the risk profile of the group and any propensity towards over trading which could create unwanted pressure on their ability to service debt.

CAP AND COLLAR

Relates to an interest rate pricing mechanism, typically on longer term investment loans, whereby the Bank charges a risk fee to provide the borrower with a pre-agreed range within which the interest rate charged will fluctuate. For example, you might put in place a cap and collar at 6-7%, meaning that if the variable rate exceeds 7% the loan will only ever be charged at 7%. Equally if the variable rate fell below 6% you have elected to pay the minimum 6%. This is effectively an insurance policy, whereby you have traded the prospect of lower interest rates against the risk of incurring higher margins at the other end of the risk curve.

CREDIT RECORD

Refers to the records detailing the personal and corporate loan applications and defaults usually looking back over a 5 year period. Companies maintaining those records for the use of subscribing lenders include: Veda Advantage Limited (previously Baycorp Advantage), Credit Advantage Limited and CRAA.

COST TO COMPETE

A key requirement of lenders in a construction facility is to ensure that the undrawn loan facility balance is always sufficient to complete the project. Lenders do not want to be in a situation where they are reliant upon the developer to come up with additional cash to complete the project, which is their primary means of repayment. It is standard practise for the developer's cash to be committed into the project before the lender funds any costs; therefore ensuring the lender maintains the ability to

complete without reliance on the developer.

ICR

In the same way that Banks became more focussed on the LCR post the GFC, they have also heightened their requirement for borrowers to demonstrate a sound capacity to meet their interest obligations on a look forward basis. This "Interest Cover Ratio" is the measure by which the net income of the customer before interest and tax is measured as a ratio against their total interest bill. Cash-flowed on a monthly basis and typically tested over a 12 to 18 month period. Enabling the bank to assess the servicing capacity of the borrower and any risks that might impact that capacity.

INTEREST

Interest is a form of return earned by a Lender for providing financial support and can comprise of a number of components and come in many forms. It is usually calculated on a daily basis on the drawn funds and charged monthly in arrears.

CAPITALISED INTEREST

Refers to the practice where interest payments are accrued as part of the total loan facility rather than paid directly by the borrower from their cash-flow for a set period, usually coinciding with the loan expiry date or a reversion to monthly direct payments by the customer. In the case of a construction loan for a small project, say 20 townhouses, it would be normal to have 9 months of capitalised interest to accommodate the construction period where there is no available income generated by the project, after which the loan would be repaid via net sales proceeds or refinanced.

COMPOUND INTEREST

Is interest paid on both the principal and the interest accrued on that principal calculated at set periods (typically monthly) from the commencement date of the loan.

INTEREST ONLY LOAN

A loan where the principal amount remains the same at the end of each month and interest is calculated and payable at agreed intervals, typically monthly.

FIXED AND VARIABLE INTEREST RATES

A loan rate that is pegged to or varies in accordance with a nominated money market rate is a Variable interest rate, the most common of which is the 90-day BBSY (refer BBSY). This reference rate is the cost at which banks typically buy and sell money to each other and is published daily in the Australian Financial Review or can be viewed on-line.

MINIMUM INTEREST PERIOD

Is an agreed minimum period that the lender will require to receive interest An example where this is most commonly used is where funding is required for a development site acquisition where the loan period is circa 6 months. Typically the lender does not wish to incur the setup costs associated with the loan only to be repaid within a short period, so they will require a Minimum Interest Period of say 3 months to make it a worthwhile proposition.

PRINCIPAL AND INTEREST LOAN

A loan where both the principal and the interest form part of the instalments by which they are both progressively repaid over the term of the loan.

DEVELOPMENT COSTS

Refers to the costs associated with the acquisition, design, construction and usually sale, of a given project. The lines between what is considered Hard and Soft Costs (refer below), are often blurred depending on who is interpreting them and for what purpose. (Refer also the 'Construction' section).

HARD COSTS

The typical interpretation is that Hard Costs includes all those costs associated with the physical completion of the project to the extent required to ensure practical completion and the appropriate statutory certifications are in place, thus allowing it to function in accord with its intended use under the DA. This can include all directly related consultant and statutory costs.

SOFT COSTS

Soft Costs are all those cost items additional to those included as direct construction costs. Soft Costs can be interpreted to include preliminary architectural and engineering, legal, permit charges, financing fees, construction Interest and operating expenses, leasing and real estate commissions, advertising and promotion, and supervision fees. Note: the determination as to what Soft Costs a lender will allow as a fundable cost varies between financiers with most including interest, marketing and consultant costs. However, these should be carefully checked at the outset.

EARLY REPAYMENT FEE

A fee imposed by the lender on the borrower for repaying the loan prior to the agreed term. Particularly prevalent amongst non-bank lenders, the rationale behind it is that lenders such as mortgage trusts or contributory mortgage schemes raise their funds from investors targeting a return over say 12 months. If

the borrower repays early; the lender needs to re-lend those funds with the risk of a lost opportunity cost.

GSA (GENERAL SECURITY AGREEMENT)

Refers to a recently introduced registered security process controlled under the new PPSA legislation which replaced the old system of registering a charge over a company in support of its borrowing/ guarantor obligations. (Refer also PPSA). GSA's are registered on a National Register securing the lender's interest against the relevant security entity/asset. The Register also accommodates a priority system agreed between lenders secured over the same security, effectively allowing multiple lenders to ensure they receive the appropriate levels of security and priority in a similar manner to the old registered charge process.

LAND BANK LOANS

Refers to finance secured to acquire and hold development sites which are still in the planning stage and unlikely to be developed in the short to medium term. In the current climate this funding is difficult to secure given the lack of income usually associated with the type of security involved.

LCR

Loan to Cost Ratio is a key measure for a lender to determine that there is an adequate level of equity contribution from the developer and that they are not directly funding a disproportionately high level of the project costs themselves. Pre GFC the focus was more on the LVR as the ultimate limit on the amount lent. However, post GFC and the spate of litigation which occurred relating to the accuracy of project valuations, lenders shifted their focus to the LCR with the requirement to be below their predetermined maximums. For the major banks this policy is typically 70-75% LCR, however up to 80% is achievable where you can evidence to the bank that a 80% LCR is appropriately mitigated by other risk enhancements.

LOW-DOC LOAN

Refers to advances made to borrowers who don't have the ability to demonstrate a strong position in terms of past credit history/experience and the like. In essence the lender is agreeing to back the "security" more so than the borrower and the documentation reflects this. The lender offsets this risk by either (1) increasing the interest rate or (2) lowering the LVR.

LOAN CONDITIONS

Form part of the terms under which a Lender agrees to advance monies and can typically comprise most of the following:

CONDITIONS PRECEDENT

Refers to those conditions that the Lender requires to be satisfied before it will settle the first advance. These are usually detailed in the lenders Indicative Terms Sheet or Letter of Offer and are more fully documented in the Facility Agreement which encapsulates the full terms and conditions of the proposed facility.

Typically, the Lender Conditions Precedent will include but are not limited to satisfaction in respect of:

- Presales: in the case of residential built product projects there will be a requirement for a specific number of conforming or 'qualifying presales' which are usually required to equate to a percentage of the total debt to be provided. Typically the requirement is 100% coverage but this can vary dependant on other risk mitigants, refer "Presales".
- Building Contract: a signed building contract, with a reputable builder needs to be signed and the costings satisfactorily reviewed by the Lenders independent Quantity Surveyor or Engineer. Refer "Building Contracts".
- Valuation: a valuation report dealing with the current "as is" value as well as the gross realisation "on completion" value of the completed project. In the case of a "strata titled" product this will usually include an "in one line" value. Refer "Valuations".
- Survey Report: a report by a surveyor confirming that the land dimensions conform with the title searches and that there are no encroachments or other boundary/usage issues.
- Geotechnical/Site History: a geotechnical report confirming that in addition to the site not being listed on an EPA register, that there are no on site conditions including contamination or sub-strata conditions which would impact the proposed project physically or financially.
- Searches: All relevant property searches in respect of the security properties, which are typically undertaken by the lenders solicitors who then certify as to their acceptability.

CONDITIONS SUBSEQUENT

Refers to those conditions that the Lender requires to be satisfied by the borrower after the first advance but prior to a subsequent milestone as it determines appropriate. By way of example, a Lender may agree to settle the land but require additional cost analysis prior to advancing funds towards the construction of the project.

LIABILITIES

Are debts or obligations usually of a financial nature or having a financial impact in this context, secured or unsecured, which are associated with a borrower or guarantor, again either directly or via trusts (refer A&L').

JOINT AND SEVERAL LIABILITY

Where a joint and several liability condition applies, a lender has the ability to pursue recovery of their outstanding debt against all or as many of the guarantor parties as they deem appropriate. Typically this means that they will pursue the party with the most accessible asset position until they have obtained payment, and an unsatisfied judgment against one debtor will not be a bar to an action against the others.

LIMITED LIABILITY

Reflects a situation whereby the lender has agreed to place a limit on the debt obligation of a party, effectively capping their liability in a recover situation. This is typically used in a joint venture scenario where the liability is limited to reflect the capacity and obligations of different parties.

LVR

The Loan to Value Ratio reflects the ratio between the total debt and the projected "on completion value" as assessed by the bank instructed valuer. While this is still a requirement of lenders with typically requiring borrowers to achieve a LVR of <65%, for the most part the LCR is the critical ratio to be satisfied. By way of example, a project showing a 20% profit on TDC that is funded at a LCR of 75% equates to a LVR of 62.5%. From the lenders perspective, their ability to assess the elements making up the TDC are easier to quantify at the commencement of the project providing greater comfort than relying on the valuer's assessment of the project value on completion, particularly given the potential for the market to shift over time.

LOAN TERM

The length of a loan or a specific portion within that loan, usually expressed in months, rather than years.

MARGINS

The generic term for the amount calculated and charged by the lender above their base cost of funds, which equates to their return for advancing the loan

funds. Typically it comprises the lenders internal cost of 'raising' the funds from the financial markets (the Treasury cost), together with the 'margin', it is usually quoted as a percentage over a published market "Reference Rate". It can be calculated over any agreed period but is typically calculated on the daily balance of drawn funds and charged monthly in arrears.

BANKS TREASURY MARGIN

Most major banks pass on the cost of their Treasury Division having to raise funds in the inter bank markets in order to fund the bank's loan book. This is also referred to as their "internal cost of funds", and is in addition to the bank's reference rate, loan margin and any line fee charged.

LINE FEE

Typically in the case of construction loans, the lender will elect to split the total margin earned between the 'Margin' and a 'Line Fee'. This is where the 'Margin' is typically calculated on the funds drawn while the 'Line Fee' is calculated on either the undrawn balance of the facility or in most cases on the total facility limit. This is to ensure that the Bank earns the return it has budgeted on given that it has committed funds to be available at a cost to itself. This protects the bank in a situation where a borrower elects not to draw down under a facility by virtue of having found alternative capital resources but the bank is still committed to have the funds available at its cost.

LOAN MARGIN

Reflects the 'Margin' earned by the bank over and above its "cost of funds" typically expressed as a Reference Rate (refer also 90 day BBSY), with the two combined forming the total loan "interest rate". This margin is typically "capitalised" as a part of the agreed loan facility limit and can be calculated daily on the drawn funds or as at an agreed date and then charged monthly in arrears for construction facilities. For investment loans it is often charged monthly in advance, calculated on the balance drawn as at a prescribe date.

MORTGAGE DOCUMENTATION

Refers to the security documents which the borrower signs to provide security over the property to the incoming lender(s) but can loosely also include the accompanying facility agreement (loan agreement) and ancillary documents which detail the terms of the loan. For home loans, consumer loans and equipment finance these are usually generic in nature and prepared by the lender. For larger Construction Finance scenarios, there are often more complex and unique terms and conditions requiring them to be prepared each time by a specialist solicitor on behalf of the lender.

NON-CONFORMING LOANS

Are loans structured specifically to cater to those borrowers who can't meet the standard income verification and credit history criteria that mainstream lenders such as banks and mortgage originators require of ordinary borrowers. Typically this would include those who are self-employed, have a poor credit record or who have recently arrived in Australia. Non-conforming loans usually have higher interest rates to reflect the higher risk of these borrowers repaying. Non-conforming finance is also referred to as sub-prime lending. See also Low-Doc Loans, which have similar criteria.

ORIGINATION

The process of preparing, evaluating and submitting a loan application generally includes a credit check, collating of various consultants reports, along with verification of information in addition to preparation of a formal credit paper detailing the risks and mitigants in support of the application.

PERSONAL PROPERTY AND SECURITY ACT 2009 (PPSA)

The PPSA effectively replaced the old system of registering a charge over a company in support of its borrowing/ guarantor obligations. Under PPSA, "security interests" are defined as an interest in personal property provided for by a transaction that secures payment or performance of an obligation. But the new PPSA structure, which operates under a national register system, also replaces a wide range of former security forms including property, leased equipment and goods which relied on ownership for protection. Under PPSA Lenders require borrowers to enter into a General Security Agreement (refer "GSA"), which is then registered on a National Register securing their interest against the relevant security.

PRESALES

QUALIFYING PRESALES

Most major banks have similar presales requirements for residential built product projects. The criteria vary from lender to lender and can also be dependent on the level of debt and the prevailing market conditions. That said typical current requirements on qualifying presales are:

- Minimum 10% deposit by way of cash or bank guarantee;

- No more than 2 properties per buyer;
- A limit on the number of buyers domiciled overseas. (Note: the % limitation of this requirement can vary according to the project and structure of the transaction together with the prevailing market/economic conditions.

PRESALES UNDER-WRITING
This is an agreement between a wholesale investor and a property developer to expedite the procurement of presales in a project, to accelerate satisfaction of the finance conditions presale requirements. Usually the investor will receive a discount equating to 25-30% per annum on their funds invested. This is an expensive, solution given presales contracts are only secured by a 10% deposit and supporting guarantees but reflects the risk to the Investor who would in turn need to on sell the product in the event of settlements not occurring. Presales underwriting was occasionally used pre-GFC, and is generally viewed negatively by lenders as 'financial engineering' in the post GFC market, as it does not demonstrate market demand for the product being built.

PROGRESS PAYMENT
Construction loans are typically paid progressively as the project is being built with the lender advancing funds monthly against the loan limit (or fortnightly). While the obligation of the payment is ultimately from the developer/owner to the contractor, most of these payments are made by the lender under the loan facility to protect their security position. The bank's independent Quantity Surveyor report is key to this as it verifies the work completed then asesses it against the total project cost and determines the cost to complete (refer "Cost to Complete"), enabling the Bank to satisfy itself that the remaining undrawn loan funds are sufficient to complete the project.

The lender will typically want to see invoices for the major items and may require a statutory declaration from the borrower that the costs are genuine and that the project is on track and nothing untoward has occurred that they should know about. The lender will then either pay the contractor/invoice directly or if agreed, reimburse the developer for any invoices they have paid themselves. Lenders prefer to pay the principal contractor direct and satisfy themselves that key sub-contractors have in turn also been paid to avoid the risk of having to pay twice in the event of insolvency event impacting the principal/developer.

PROFIT AND LOSS STATEMENT (P&L)
As part of their risk assessment, most Banks focus on three key items in respect to satisfying themselves with the borrowing groups financial credibility and capacity. Comprising the A&L statement, the P&L Statement and the business cashflow, the P&L is an accounting form representing a company's profit or loss position after taking into account the income it earns adjusted for cost of goods sold or services provided, operating costs, expenditure, interest and tax along with all relevant deduction adjustments. Usually prepared by an accounting team (internal or external) to provide management with an accurate assessment of the business' profitability or otherwise, when assessed over a number of recent periods (usually the past three years), it can provide the prospective lender with an understanding of the businesses capacity to meet its financial obligations. This is usually assessed by the application of various ratio's.

REFERENCE RATES

BBSW
The most commonly used Inter Bank Reference Rate the banks will quote as their bench mark cost of funds and to which they add their lending margin is the Bank Bill Swap Rate (BBSW). For the purpose of defining this rate at a given point in time, the quoted BBSY bid rate is applied (BBSY). In many cases the bank will use an "Intra Bank Reference or "Base" Rate which will reflect BBSW plus an internal or "treasury" margin to reflect their internal cost of borrowing the funds.

90-DAY BBSY
The most commonly used published Reference Rate (refer BBSW).

INTER BANK REFERENCE RATE
Is the average interest rate estimated by leading banks in the relevant market that the average leading bank would be charged if borrowing from other banks i.e. BBSY (AUS), LIBOR (UK) and SIBOR (Singapore and SE Asia).

RENOUNCEABLE PRESALES CONTRACT
A contract structure that allows the developer/seller to renounce that contract at a later date. This is typically how presales underwriting agreements are documented. (refer Presales Underwriting).

STATEMENT OF POSITION
Refer Asset and Liability Statement.

STATEMENT OF PERFORMANCE
Refer Profit and Loss Statement.

UNENCUMBERED
A property owned free of encumbrances or restrictions.

Loan & Equity Options

The following outlines some the general terms used with reference to the various types of debt and equity options typically available in the market place:

DEBT

SENIOR DEBT

Also known as 'Primary Debt', refers to the principal debt piece that holds the primary or first ranking registered mortgage over the property. Senior debt is typically provided by the Banks or Major Mortgage Funds and is the desired source of funding by developers as its priority position is reflected in the typically lower margins applied. Senior Debt is also typically conditioned at more conservative ratios reflective of the risk appetite of those organisations. i.e. LCR's of <75% and ICR's of > 1.35 times.

MEZZANINE DEBT

Also known as 'Junior Debt', it refers to a subordinated debt piece that is secured by a second ranking registered mortgage over the property. Junior debt is an extension of debt beyond the LVR levels that a senior lender will typically provide. In order to secure junior debt, the developer will typically be required to have de-risked the project as much as possible. Normally this style of loan/ investment does not occur until the project is "shovel-ready". If investment is required prior to this status being achieved, it is typically viewed as equity rather than an extension of project debt. For shovel-ready projects where the developer has demonstrated they have minimised the project risk, this style of debt can typically be found at a cost of 20-30% per annum.

EQUITY

PREFERRED EQUITY

In situations where an investment or loan exceeds the levels normally ascribed to project and mezzanine debt and does not participate as equal ranking equity, it is viewed as Preferred Equity. For this style of investment, which is higher up the risk curve than Junior Debt, a higher return is expected and this is typically achieved via a profit sharing arrangement. Typically this return is broken up into a coupon (compounding interest rate) of 12-20% calculated on the equity invested and a share of the project profits. The waterfall of repayment on completion of the project will typically comprise (1) senior debt, (2) mezzanine lender (3) investor (4) developer hence the name 'preferred equity'

JOINT VENTURE

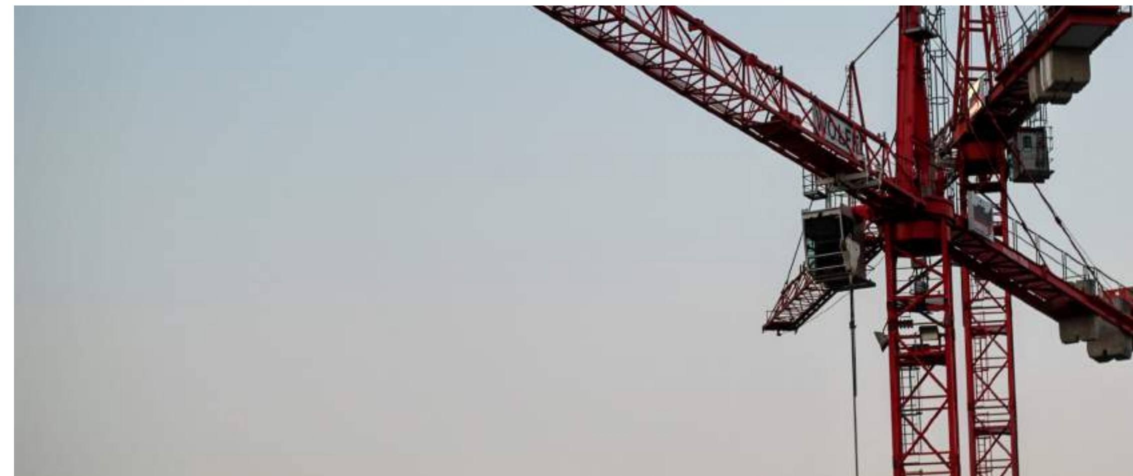
Joint Venture equity differs from the above junior debt and preferred equity products as it generally has some correlation inline with the amount of capital injected by the parties and what they bring to the deal. Typically this will be related to both their capital investment but also their "sweat equity", a term used to denote their contribution by way of the value added to the deal by virtue of their efforts/services and/or that of their consultants not directly billed as a cost.

EQUITY REDRAW

An Equity Redraw option is where an investor injects equity into an existing mature project for an agreed return, allowing the developer to redeploy some of their equity in order to progress their next project. The cost of the equity funds will vary dependant on the project risks and security provided, but essentially it is similar to a junior debt or preferred equity with less delivery risk.

NON-RECOURSE

This a an often misconstrued term which in property lending circles is more correctly termed "limited recourse", as it refers to the Lender's recourse being limited to the security asset/ property with no further recourse to the Borrower and their assets. Generally, Non Recourse is only provided in exceptional circumstances and usually only to customers with extremely strong financial positions.



Project Feasibility

Some terms commonly used when evaluating a Project's viability as measured by the 'Project Feasibility'.

CONTINGENCY

An allowance built into the project construction budget to fund unforeseen expenses encountered during the build. Typically a construction contingency of 5.0% of the total development cost can be required by lenders to safe guard against unforseen expenses. In some cases they will limit the 5% contingency to be applied to cover works completed under the building contract. However, in most cases it will also be applied across the balance of the project costs to cover unforseen expenses associated with the likes of marketing and other non-construction elements. (refer also Retentions)

FEASIBILITY

Refers to the means by which a projects financial viability is measured by deducting the total cost required to deliver it from the Net Income derived from its potential sale to arrive at the net profit which will be earned as a result.

GROSS REVENUE

The total revenue realisable from the sale of the completed Project.

GST

Refers to the Goods and Services Tax usually applied on all residential property produced and sold.

GST FULLY TAXABLE

Refers to the tax usually calculated at 9.09% (1/11th) of all taxable product produced and sold. Applied to Residential projects, retail, commercial and industrial projects typically do not attract GST (talk to your accountant to confirm).

GST APPLYING THE MARGIN SCHEME

If your accountant confirms your project is conforming and that this is applicable, it allows you to only pay GST on the 'margin' difference between the revenue realised from sale of the completed asset and the site purchase price. For example, if you paid $2m for a site and had gross revenue of $20m, you would only pay GST on the differential of $18m. It is important to get this assessed by your accountant prior to completing your feasibility and engaging a valuer or approaching a lender.

MARGIN ON DEVELOPMENT COST

Refers to the profit margin as a percentage of the total development cost. Generally speaking financiers will typically expect to see minimum returns ranging between 18-25% for most built product projects. This increases to 22-30% for land subdivisions, however these ranges can be significantly impacted by mitigants such as size of the transaction, presales and the economic factors such as demand and supply prevalent at the time.

NET REVENUE

The net proceeds from the sale of a completed project, being the Gross Revenue amount net of GST, the associated legal costs and sales or leasing commission's payable at settlement of each sale.

PROFIT

Refer 'Margin on Development Cost'.

PROJECT VALUATION

Refers to a valuation report prepared for the lender which will typically provide an assessment of the "on completion" value of the project (refer Gross Realisation), together with the "as is" value of the development site. This value is derived by way of a "reverse feasibility" which deducts the cost to deliver and sell the project together with a risk factor (typically 20-25%), to arrive at the current site value (refer 'Reverse Feasibility').

While the valuer is typically preparing this report on behalf of the lender, it is best practise for the developer to have completed their own research and assessment of the market to arrive at a reasonable estimate of these values prior to doing this work to ensure the project viability and its "bankability".

ROC

Return on Cost refer to Margin on Development Cost

TDC

Total Development Cost, this typically encapsulates all of the costs associated with completion of the project. Refer also Hard and Soft Costs under Finance Termination, 'Development Costs'.

Construction

BANK GUARANTEES

As an alternative to providing builder "retentions" (refer Retentions and Performance Guarantees), a builder can secure their performance obligations under the building contract via Bank Guarantees, Insurance Bonds or similar financial facilities (refer 'Performance Bonds). The Bank Guarantee is an unconditional promise to pay by the builders Bank in the event that there is an event as proscribed in the Building Contract, which calls for monies to be paid by the Builder. This effectively secures the builders obligations in the same way as the retention monies and the guarantee may be called by the developer/financier in the event of the builder's non-performance. It should be noted that lenders generally prefer a Bank Guarantee to an Insurance Bond because of its "unconditional" nature and as a consequence, may only accept bonds from a limited list of acceptable insurers.

BUILDING APPROVAL (BA)

Refers to the written approval provided by the local council's building approval authority which authorises the construction of a specific project in accord with a written submission including detailed working drawings, typically lodged by the developer/land owner's consultants or builder. A precursor to the BA is the DA (refer Development Approval).

CONTRACTS

There are various forms of contract available in the market and all of them can be varied to meet the needs of the respective parties involved. The following is a basic guide and it is recommended that developers seek appropriate legal advice prior to entering into a contract.

DESIGN AND CONSTRUCT BUILD CONTRACT

This involves the builder undertaking both the construction but also the full process of designing the project. This has advantages when the design parameters are not complex and reduces costs by eliminating the need for an architect and the ongoing interface between the architect and the builder. Conversely this can create cost issues where there is a need for more complex design solutions. This form of contract can also be structured to provide a 'Fixed Price and Time' requirement (refer Fixed Price

Contract).

CONSTRUCTION MANAGEMENT CONTRACT
An agreement between the developer and the builder that the builder will manage the construction process on a "cost plus" basis. This form of contract carries a higher risk for a lender as any cost increases or time over-runs are completely at the cost of the developer, therefore the builder is really just on a best endeavours basis to do the job, as opposed to a GMP (Gross Maximum Price) where there are cost and time penalties to motivate the builder to manage effectively. Again, this is not always a "bankable" option for financiers.

COST PLUS CONTRACT
A construction agreement where the contractor or the architect and engineer are reimbursed for their direct and indirect costs and in addition, are paid a fee for services. The fee can either be a fixed sum or calculated as a percentage of cost. This is not usually a "bankable" option from a financier's perspective.

FIXED PRICE CONSTRUCTION CONTRACT
This refers to the style of contract that generally construction finance lenders will want to see utilised. It entails a contract that is fixed in terms of both time and price to ensure that most cost over-runs and time delay risks are effectively transferred to the builder.

That said, it does not completely remove these risks. Refer: Cost Overruns, Variations and Liquidated Damages. Lump Sum Contract is another form of Fixed Price Contract (refer Fixed Price Contract).

GMP
A guaranteed maximum price contract arrangement which operates on the basis of a "not-to-exceed price". This is effectively another form of an open-book contract where the builder is paid for the costs incurred plus a fixed fee but subject to an agreed maximum price.

COST OVERRUNS
Generally referred to as costs that arise which are not included in the agreed terms of a contract such as a GMP contract and in excess of the contingency amount. This is a reason lenders require the developers provide an A&L in order to gain comfort that the developer can quickly access the funds required to meet a reasonable cost overrun on short notice. If the borrower is unable to demonstrate this capacity the lender will (should) add a higher risk rating to the transaction because in the event the developer cannot meet the cost the lender is likely going to have to do so to ensure the project is completed and they recover their debt.

COST TO COMPLETE
Refers to the requirement by Lenders that they will only advance funding on a project after the developer has contributed their equity contribution in full. In essence, the Lender wants certainty that their undrawn funds will always be sufficient to complete the project in order to fully repay the debt. To ensure this, they require a QS to certify the "cost to complete" at each drawdown and in the event there is a shortfall against the undrawn loan amount, the borrower will be required to inject the additional equity required prior to the lander advancing against the claim.

DEVELOPMENT MANAGER
A qualified individual or company authorized by the developer to be responsible for coordinating completion of the Project in accordance with the Developer's directions. This role places full responsibility for the control and management of all components of the transaction including Town Planning Approvals, Construction, Marketing, Sales and in some cases Finance with the Development Manager. Refer also 'Project Manager'.

FEASIBILITY
Refers to the mathematical process used to determine the profitability or otherwise of a proposed project. Simplistically it is expressed as:
Gross Income less: selling costs = Net Income less: TDC = Net Profit
where TDC includes the land and associated acquisition costs, construction and associated consultant costs and the cost of finance including associated legal costs etc. (refer TDC).

DEVELOPER FEASIBILITY
Typically a developer will prepare this assessment based on the known costs and those that can be reasonably estimated using known market derived averages/estimates such as realisation values based on recent market sales prices and construction cost using known $psm to build similar product. Subject to the quality of the inputs, this provides the developer with a level of confidence as to the viability of a given project and the likely return on equity invested based on assumed funding levels and the projected net profit.

REVERSE FEASIBILITY

This is the approach used by a valuer and accepted by most banks and which differs from the Developer's method by using the market "knowns" and an appropriate "profit and risk" factor to solve for the market value of the site "as is".

Gross Income less: selling costs
= Net Income
less: Profit and Risk factor
= Total Capital Outlay
less: Development, Finance, Interest and Acquisition costs
= "as is" Value of Land.

This is then crosschecked against the site value as assessed by reference to comparable site sales over the past 6 months (Direct Comparison method), to ensure that the value determined is accurate.

FF&E

An abbreviation for furniture, fixtures and equipment, generally associated with interior design and planning of retail stores, office facilities, holiday apartments or hotels.

GANTT CHART

Is a bar flow chart recording the actual flow as compared with the projected flow of the schedule of activities for a project. It records the start and finish dates, critical and non-critical activities, down time and assists with plotting the likely completion date as well as identifying road blocks impacting the construction progress.

HOUSE CONSTRUCTION PROGRESS DRAWS

For the construction of detached dwellings the progress draws will typically follow the HIA stipulated draw-down milestones rather than being made monthly on the following or similar basis:

	HIA Standard Payments	
1	Deposit	5%
2	Base (Slab)	10%
3	Frame Complete	15%
4	Brickwork Complete	35%
5	Fixing (Lockup)	25%
6	Practical Completion	10%
	Total	100%

MILESTONE

Is an arbitrary goal agreed between the parties, usually as a trigger for some form of action and payment when the party with the underlying obligation fails to perform. It is common in Facility Agreements where the lender requires the borrower to meet agreed undertakings such as completion of the project, presales hurdles etc. It is also a common mechanism in construction contracts where the builder undertakes to meet agreed time frames in order to receive bonus payments or incur penalties.

MILESTONE PAYMENTS

Sometimes fees are paid upon achieving certain events, this can happen with Development Management Fees where, rather than the developer being paid a flat rate of $15,000 per month, they might receive a reduced sum with bullet payments at key milestones dates subject to the level of works completed, thereby keeping the development manager motivated to achieve each milestone.

OWNER BUILDER

A term used to describe an Owner who takes on the responsibilities of the general contractor to build a specific project. Lenders typically reduce their lending ratios to owner builders as there is an increased risk associated with getting the costing's right and the associated sub-contractor negotiations.

PERFORMANCE BONDS

Typically a developer is required by council to provide a Bank Guarantee or similar security in support of a Performance Bond to secure works that will either be completed in the future or maintained for a period of time after they are built. An example is in a land subdivision where the kerb and channelling, and landscaping can sometimes get damaged from the builders and contractors undertaking construction on the individual allotments. This can occur long after the developer thinks his job is done and therefore council require security from the developer to ensure any damage is rectified

PROJECT MANAGER

A qualified individual or company authorized by the developer to be responsible for coordinating tasks relating to the construction of the project. Their role typically relates to the control and management of the builder, architect, engineer, town planner and liaising with the quantity surveyor and other relevant consultants. The role includes obtaining BA/OPW approvals, ensuring headwork's are paid and titles can be issued efficiently and that all defects are corrected by the builder and/or sub-contractors.

QUANTITY SURVEYOR

An independent consultant who assesses the costs associated with producing a project in accord with the architectural plans in concert with the DA and having regard to the prevailing market conditions impacting labour costs and material suppliers. Usually retained by a developer as a means of assessing the profitability prior to commencement and then controlling costs once

development commences. They are also retained by lenders to ensure that the project is correctly costed, and as a means of having the "cost to complete" risk assessed (refer Cost to Complete). Civil Engineers are retained to undertake a similar role in respect to land subdivisions involving civil works.

RETENTIONS

Under most forms of contract, a builder agrees to have a portion of their progress payments held back or "retained" as surety that:
(i) they complete the contract works,
(ii) the quality of the works are satisfactory; and
(iii) any faults requiring rectification are completed in a timely manner.

Typically the level of retention is set at around 5% of the total contract sum but this can vary according to the risks involved as agreed by the parties, including the financier. Similarly, retentions are usually accrued at the rate of 10% of each progress payment until they equate to the agreed limit however, this can also be adjusted by agreement between the parties. Retentions are usually released to the builder on the basis of 50% on the satisfactory completion of the works and the balance at the end of the warranty period agreed under the contract (typically anywhere between 3-6 months), with the clients/ financier's QS usually responsible for assessing the quality issue and determining the level of retentions to be expended on issues requiring rectification.

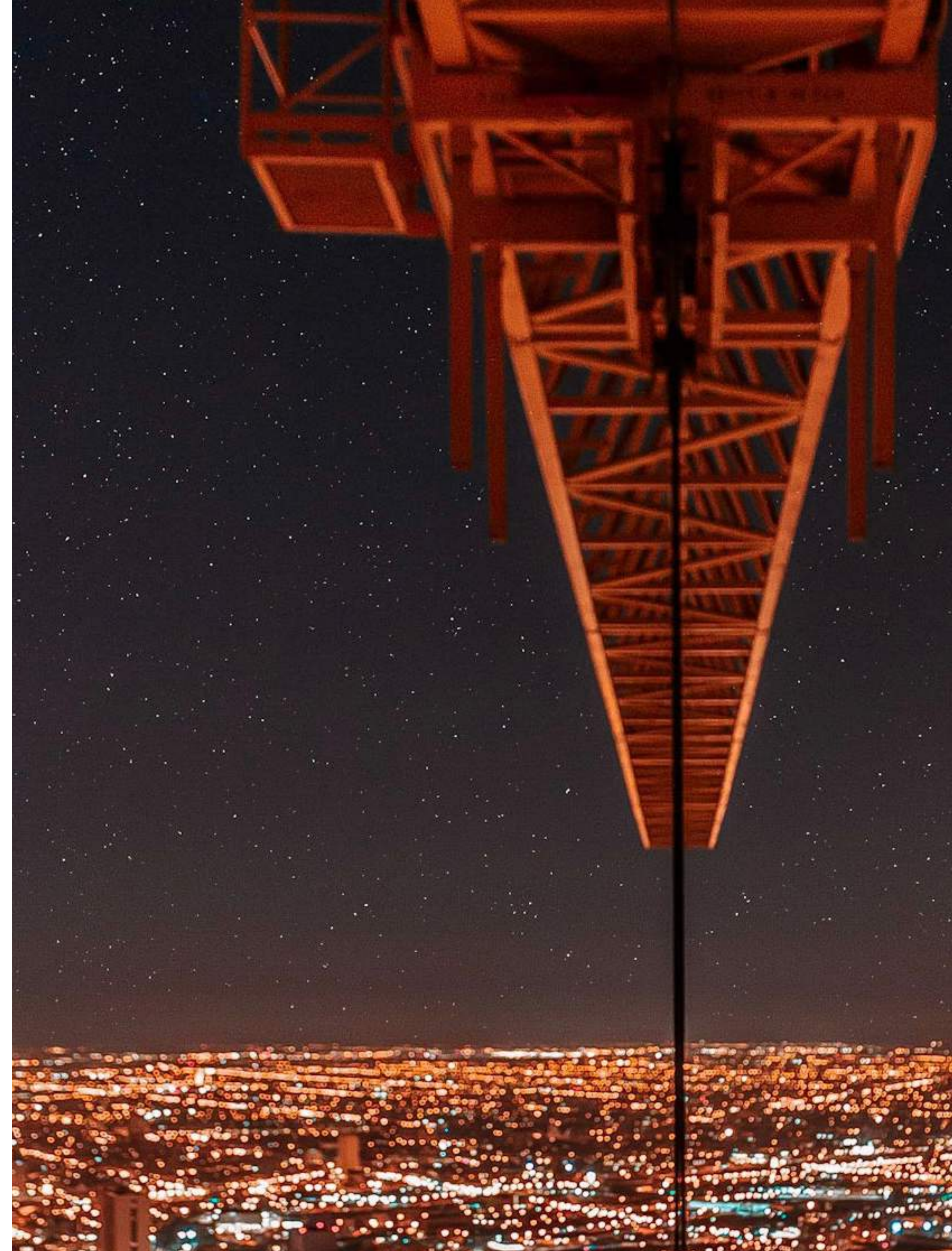
As an alternative to the retention process a builder can provide Bank Guarantees however, this requires the provision of appropriate security to the issuing bank and in most cases, small builders opt for the retention process and then apply a similar process to their sub-contractors, effectively reducing the impact on their own cashflow.

SHOVEL READY

A term indicating that a project is ready to commence development having achieved the required town planning and building approvals and is ready to commence; subject only to the Developer having the necessary resources including financial capacity to do so.

VARIATIONS

Provide the builder with the ability to claim an increase to the contract sum to take account of design changes instigated by the Customer or increased costs/ specifications agreed under the terms of the contract at the outset.



Valuation Terminology

"AS IS" VALUE

The collective value applied to a property based on its current town
planning status. This reflects the market value a willing purchaser would pay for the property having regard to its existing status including its potential for redevelopment.

IN ONE LINE

The value applied to a cluster of apartments or product which can be sold individually. Typically the collective value assess them on the basis of their individual value as well as their valuer to a 'single buyer' who would then take the market risk at some future date of selling them individually. There is generally a discount rate applied to reflect this risk which can very dependent on the circumstances surrounding the property and the market conditions prevailing. However, a typical range for residential and retail projects of this nature would be 20-25%.

NPV

Net Present Value, derived by working out the overall value of all incoming and outgoing cash flows derived from the property over a period of time, usually projected at 10+ years as a minimum. This approach is usually applied when valuing a property which is subject to lease(s) or a component of a property which those attributes.

"ON COMPLETION" VALUE

Reflects the value of a property having regard to any current DA and/or BA approvals on the assumption that it is constructed to meet those terms and conditions. This value can be assessed via a number of methods including "direct comparison", "reverse feasibility" etc.

Town Planning

DEVELOPMENT APPROVAL (DA)

Refers to the written approval provided by the local council's town planning authority which authorises the development of a specific project in accord with a written town planning, typically lodged by the developer/land owner's consultants. Approvals are typically granted on the basis that they are either "Code Assessable" or "Impact Assessable".

Code Assessable: submissions means that the proposed development meets all the existing town planning code requirements as published by the local authority and can be processed and approved without public notification. This results in relatively prompt approvals.

Impact Assessable: submissions, indicates that the submission has elements that fall outside of the standard requirements of the published planning codes and will require some level of relaxation/approval. It will also require to be given public display, which provides opportunity for parties with legitimate objections to submit them to council for consideration. Prospect of approval will be largely dependant on how much diversion from the planning code is being sought.

ZONING

Local government authorities typically provide guidelines as to the
permitted uses of land and buildings within designated zones shown on town planning maps which are published to assist developers assessing the development potential for their sites.

ROL

Refers to a reconfiguration of Lot, for example separating stage 1 of a project onto its own title would be classified as an ROL.

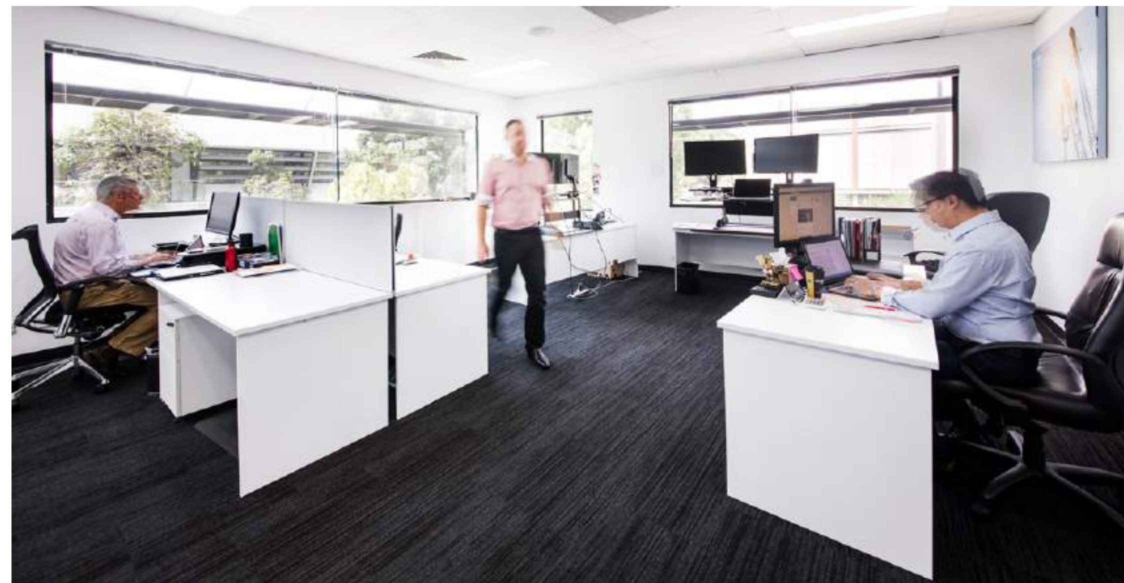
MCU

Material Change of Use of a property, for example changing a rural residential lot which might allow only 1-2 dwellings per hectare, into an urban residential zoning to allow say 12-15 would be considered a material change of use.

RFI

A request for Information usually occurs once council have received and assessed the application and deem that they need more information on particular aspects before they can process the approval.

About HoldenCAPITAL



HoldenCAPITAL is a multi-award winning specialist construction finance group, recognised as a market leader for their success in deal structuring and sourcing of debt and equity solutions. The goal of the group is to leverage their resources, relationships, skills and knowledge to structure project finance solutions which minimise the risks and maximise the returns for all stakeholders.

The majority of our client's projects are funded by the major banks, where we use our daily participation in the finance markets and first-hand knowledge and real-time data from similar transactions to facilitate the best terms.

Another strength of HoldenCAPITAL is our ability to source and negotiate more flexible terms from our extensive network of non-bank institutions, mortgage funds and our trusted relationships with private lenders. HoldenCAPITAL also has a successful track record of sourcing and negotiating Joint Venture Partnerships for medium to large sized projects. This includes sourcing, structuring and negotiating passive joint venture/preferred equity and subordinated/mezzanine debt solutions as well as the introduction of Group sourced projects to our experienced and proven property development groups.

Meet Our Team HoldenCAPITAL

Steve Wiltshire
Executive Chairman
Steve spent 26 years with Macquarie Bank doing project finance and joint ventures and recently 3 years as Executive Director of ANZ Property.

Dan Holden
Director
Daniel brings over 15 years of development and finance experience which includes over 10 years in finance consultancy and funds management.

Brett Cottam
Finance Consultant
Brett has over 16 years of corporate banking experience with NAB and BOSI, specializing in property investment & development including residential, commercial, retail, industrial & mixed use assets.

Eric Trieu
Director
Eric has over 20 years experience in project marketing. He was CEO of two international marketing firms, The Aldy Group and Empire Property Investors.

Daniel Hounsell
Finance Consultant
Daniel has over 13 years of experience structuring joint venture opportunities within a range of industries and over 10 years experience with Property Finance.

Gary Connolly
Head of Investments
Gary has over 12 years of experience in financial services, specifically in banking and funds management. Gary most recently spent 8 years with Trilogy Funds Management as their Business Development Manager and prior to that was in key account management roles at Citigroup and Deutsche Bank.

Adam Hartard
Finance Consultant - Sydney
Adam has over 13 years of experience in property finance and development including Commercial, Industrial and Residential property.

Matt Mattson
Director - Melbourne
Matt is a highly experienced corporate finance and accounting professional with over 18 years working at Nab, PwC and EY. Specialising in property finance, Matt has worked with a wide range of customers to provide effective capital solutions.

"An investment in knowledge pays the best interest."

- Benjamin Franklin

3 Years in a Row!
#1 Commercial Broker in Australia

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CONSTRUCTIVE FINANCE

I'm investing in knowledge. You can too! Learn from leading industry experts.

EP29: RON BAKIR

EP25: ADAM DIMARCO

EP9: DON O'RORKE

THE CONSTRUCTIVE FINANCE PODCAST

LISTEN NOW

HoldenCAPITAL

Our Services HoldenCAPITAL

CONSTRUCTION LOANS
- From $2 – 50+ million
- Facility limits up to 70% LVR
- Maximum Loan to Cost Ratio's up to 80%
- Bank margins commencing at 1.50% with line fees from 1.50%
- Non bank funds from 9.75% with a 1% Loan Management Fee;
- No pre-sales requirements for approved projects;
- Responses within 1-2 days of all information being received

STRETCH SENIOR DEBT
- Typically $2 – 20 million
- Maximum Loan to Cost Ratio's up to 90%+
- Margins ranging from 9%+ upwards
- Lower and No pre-sales solutions for suitable projects;
- Responses within 3-5 days of all information being received

MEZZANINE DEBT
- Typically $2 – 10 million
- Maximum Loan to Cost Ratio's up to 90%
- Margins ranging from 13%+ upwards
- Est Fees of 5% reducing for larger transactions
- Responses within 3-5 days of all information being received

PREFERRED EQUITY & JOINT VENTURE
- Typically $2 – 20+ million
- Est Fees of 5% reducing for larger transactions
- $15K up front work fee with balance of the fee capitalised to the Facility

DEVELOPMENT SITE FUNDING
- Typically $1 – 10 million
- Facility limits generally 65% LVR however we have provided up to 80%LVR in some cases
- If suited for a bank then margins commencing at 1.50% with line fees from 1.50%
- If solution chosen is a private lender than cost of funds is typically 15%pa, some cases 12%pa is available.
- Responses within 1-2 days of all information being received.

1

WIDE RANGE OF SOLUTIONS TO MEET YOUR FUNDING NEEDS

HoldenCAPITAL have over 60 active debt and equity providers, including major and minor banks, mortgage trusts and trusted relationships with numerous private investors, as well as our own Equity Fund in HoldenINVEST.

2

INFLUENTIAL RELATIONSHIPS ENSURE YOU GET THE BEST TERMS

It is not just knowing which lenders have an appetite for a particular loan type but also having a trusted relationship with their decision makers to ensure you get the best possible terms and conditions.

3

BESPOKE SOLUTIONS TO MAXIMISE YOUR RETURN ON EQUITY

There are many variables in every project that make it unique for you as the developer. A major factor in getting the right finance structure is understanding your capital requirements and ensuring that the deal is tailored to suit your needs

4

EXCEPTIONAL REPUTATION FOR DELIVERING RESULTS

Our business has grown and matured out of the tough times of the GFC aftermath of 2012 and flourished in the increased market activity of 2014/5. This is because we have a stable of developer clients who trust us with their projects and happily ask us to secure funding for all their new projects and they do this because WE DELIVER

5

THERE ARE MANY WAYS TO PARTNER WITH HOLDENCAPITAL

We see our role is to work hard on your behalf to create competitive tension between the lenders to get you best outcome. We can also provide a loan from one of our white-label loan products, or invest in your project through our Equity Fund, Queen Street Invest.

Index

Assets 10
Asset and Liabilities Statement 10
Balance Sheet 10
Balance Sheet Strength 11
Bank Guarantees 29
Banks Treasury Margin 18
BBSY 21
BBSW 21
Building Approval (BA) 29
Cap and Collar 11
Capitalised Interest 12
Cash Flow 11
Compound Interest 12
Conditions Precedent 15
Conditions Subsequent 16
Contingency 26
Cost to Compete 11,31
Cost Plus Contract 30
Construction Management Contract 30
Cost Over-Runs 30
Credit Record 11
Design and Construct Build Contract 29
Development Costs 13
Development Feasibility 31
Development Manager 31
Early Repayment Fee 14
Equity Redraw 25
FF&E 32
Fixed Price Construction Contract 30
Fixed Variable Interest Rate 13
Gantt Chart 32
Gross Revenue 26
GSA (General Security Agreement) 14
GST Applying the Margin Scheme 26
GST Fully Taxable 26
Hard and Soft Costs 13
House Construction Progress Draws 32
ICR 12
In One-Line 36
Inter Bank Reference Rate 21
Interest 12
Interest Only Loan 12
Joint & Several Liability 16
Joint Venture 25
Land Bank Loans 14
LCR 14
Liabilities 16
Limited Liability 16
Line Fee 18
Loan Conditions 15
Loan Margin 18
Loan Term 18
Low-Doc Loan 15
LVR 16
Margins 18
Margin on Development Cost 27
MCU 37
Mezzanine Debt 24
Milestone 33
Milestone Payments 33
Minimum Interest Period 13
Mortgage Documentation 19
Net Revenue 27
Non-conforming loans 19
NPV 36
"On Completion" Valuation 36
Origination 19
Owner-Builder 33
Performance Bond for Builder 33
Performance Bond for Council 33
Personal Property & Security Act 19
Preferred Equity 24
Presales Under-writing 20
Principal and Interest Loan 13
Progress Payment 20
Project Manager 33
Project Valuation 27
QPS – Qualifying Pre Sale 20
Renounceable Presales Contract 22
RFI 37
ROC 27
ROL 37
Soft Costs 13
Statement of Position 22
Statement of Performance 22
Unencumbered 22
Variable Interest Rate 13
Veda Advantage 11
TDC 27
Zoning 37
90 Day BBSY 21

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