
Reference:

CASE STUDY IV

From:

Advanced Development

Date, Place:

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To:

WHOM IT MAY CONCERN

CASE STUDY IV

The issue

A developer declared default on his 20 million euro office development scheme as a result of the 50 % fall in achievable rent compared to the one assumed in the initial business plan and a significant drop in demand. This has also been aggravated by the fact that the type of product developed no longer fits the current and future demand of the final customer. The project concerns the construction of two office buildings eight floors high.

Currently, banks could face a loss of up to 70 % because of the market circumstances that lead to a dramatic decrease in value of the land plot and due to the time and money consuming legal procedures.

Normal situation and normal market conditions:

- The bank would move to fire sale via an enforcement officer. This officer will organize a tender to sell the project. From the financial point of view the loan is valued usually at 70-80 % of the asset value and following the tender the bank would have obtained up to 75-85 % of the asset value. Thus the entire cost of the debt, interest and cost of enforcement would have been covered.

Current situation:

The value of the asset will cover in the best case scenario 25-30 % from the value of the loan (considering a 50 % fall in real estate value), since there is no secondary market and often the "same developer" buys its project in the tender thus causing a serious loss for the bank. Also this is a lengthy procedure requiring extra costs from the bank

The solution - project rescue

The process was structured in two parts, analysis and implementing.

Analysis

A thorough analysis of the development and all aspects of the real estate market that might have a direct impact on the success of the project (e.g. legal status, competition, market forecast (demand) etc.) has been conducted.

The present case study relies on a full cooperative investor/developer to the agreed solution with the bank.

Implementation and adding value

Projects that are currently under development and are facing financial difficulties can be difficult to be managed and, for such purpose, drastic measures need to be put in place.

The financing of the project has been stopped due to the fact that the pre-lease target has not been met. Consequently, the construction of the first office building was blocked at the fourth floor, while the construction of the second building has not even been started.

Based on architectural and business studies (demand and business plan), a solution to reshape the project was sought. To this end, one solution would be to build (i) a six floor student accommodation, instead of the first office building and, possibly, (ii) a six stores retail space to be commissioned by a retail operator, instead of the second office building.

Changing the use of the first office building may be a drastic measure required due to the fact that the location may no longer be suitable for the completion of the initial project.

This implies first an architectural redesign of the space available, especially considering that the concept for the contemplated office space could be easily redesigned for student accommodation purposes. For instance, the glass façade in the architectural design of the building could be replaced by a normal façade thus decreasing the construction cost with approximately 20 %. Such decrease will be even higher, reaching a total of roughly 35-40 %, when taking also into consideration that two extra floors will not be built anymore. The reduction in sq m would lead as well to a decrease in the construction duration, improvement of the cash flow, reduction of the financing cost and obtaining extra space available for underground parking space (it is a fact that student accommodation requires less space for parking than the previous office development).

Additionally, both a fast food restaurant and an internet café may be accommodated on the ground floor of the first office building, which may be further rented out by specialist operators.

By changing the use of the first office building and using the space that was destined for the second stage of the development, as already mentioned above, a small retail box with six stores may be developed, including, for instance, a pharmacy, a bookstore and a newspaper stand, a grocery shop. Furthermore, the underground parking spaces of the student accommodation may also benefit to the retail space.

Generally, the supply of student accommodation is very low in Romania and especially in Bucharest and, therefore, a high demand for this type of product may be expected.