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Effective property finance in a post-Covid-19 Africa requires a new approach to capital structuring

By Gerhard Zeelie

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One of the significant impacts that Covid-19 and the global lockdowns have had on the international property markets is a fundamental shift in the financing needs of property developers and investors. Before Covid-19, the priority of the vast majority of borrowers was to reduce the cost of capital. Typically, this involved maximising the debt component of the funding equation to maximise the leverage achieved through the capital structure and, at the same time, to reduce the weighted average cost of capital (WACC). In delivering on these priorities, most property finance providers targeted gearing of between 50% and 70%.

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While there were obviously some exceptions to these funding 'rules', the majority of finance agreements were built, fairly rigidly it must be said, around these basic fundamentals when the pandemic struck. And now that the dust of Covid-19 is starting to settle, albeit very gradually, property investors and developers are once again starting to look for opportunities to get back in the proverbial game. And to do that, they need finance. However, Covid-19 has significantly shifted the goalposts when it comes to viable and optimal capital structuring. Prospective funders would be well advised to rethink their response to the vastly different property environment and the significantly altered requirements of its stakeholders.

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Maximum flexibility of capital structures

For one, the intensive focus on lowering the cost of capital has given way to a new priority, which is maximum flexibility of the capital structures. This goes beyond the provision of flexible finance structure options to meet unique project needs. Developers today, and surely for some time to come, operate in a highly uncertain environment where even the most thorough plans, strategies and due diligence processes are not enough to foresee every challenge that could be encountered during the term of a project. Funders must be willing to build flexibility into their capital structures to allow possible delays in payments, or even restructure payment agreements, so as not to put pressure on the asset, should unavoidable issues or challenges arise or delays occur.

The required flexibility also extends to the conditions placed on borrowers by funders. The lack of certainty mentioned above makes it very difficult for a borrower to enter into the types and levels of covenants and conditions around their loan facilities that were largely accepted as the norm up until the end of 2019. This covenant flexibility is imperative for the sustainability of the property finance sector as a whole in an environment characterised by very high levels of uncertainty. Committing borrowers to difficult facility conditions could lead to breaches in agreements and defaults – a scenario that any property sector participant or stakeholder wants to prevent.

Higher levels of equity funding required

Obviously, in the current environment, providers of debt funding are also reshaping the property finance environment, given that they are more prudent as a result of the shift in risk. The result is that the gearing levels offered have declined to around 35% to 55%, which is well down from pre-Covid-19 gearing levels, meaning that all projects now require higher levels of equity funding.

While every property finance transaction is very different, and will require a combination of all of these elements in different weightings, the point is that financiers should be far more flexible and adaptable in the way they approach the structuring of capital, because that is one of the most effective ways in which they can help to fuel the recovery of the property sector.

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Spreading risk

Nedbank CIB Property Finance, with our focus on the provision of funding in Africa, recognises that the need for such flexibility from funders is even more acute. In addition to a willingness to accept a trade-off between lower gearing and less stringent covenants, taking a portfolio view of properties has never been more valuable. Rather than considering individual assets on their isolated merits, such a portfolio view is an effective way of spreading risk – much the same as diversification does for an investment portfolio. If a diversified property profile is possible, particularly one with a variety of projects at different risk profiles, the potential for optimal capital structuring for each of those projects or assets is increased. And at the same time, the need for demanding agreements and conditions is also reduced, given that the funding relationship extends to a number of agreements that neither party would want to compromise – either by imposing taxing conditions or failing to meet the conditions placed on any single project.

This type of portfolio approach also enables the financier to provide its borrowers with longer loan terms, thereby ensuring that they have certainty of financing; as well as interest roll-up options, if required, that allow borrowers to optimise their cashflow over time.

Agility remains key

Lastly, the lower gearing levels also allow for funders to adopt a slightly higher market risk appetite into their finance structures. For us, this has meant that we have been able to permit out borrowers to build at least a measure of speculation into the long-term asset use and value projections for their buildings.

Although it is still not possible to predict with certainty the future movements of property markets in Africa, agility remains one of the most important requirements of any property sector stakeholder. Our ability to react and adapt very quickly is vital; a new way of thinking about, and designing of capital structures has become an essential ability for lenders.

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