Macmillan Building and Surveying Series

Series Editor: IVOR H. SEELEY

Emeritus Professor, The Nottingham Trent University

- Advanced Building Measurement, second edition* Ivor H. Seeley
Advanced Valuation Diane Butler and David Richmond
Applied Valuation Diane Butler
Asset Valuation Michael Rayner
Building Economics, third edition Ivor H. Seeley
Building Maintenance, second edition Ivor H. Seeley
Building Maintenance Technology Lee How Son and George C.S. Yuen
Building Procurement Alan E. Turner
Building Project Appraisal Keith Hutchinson
Building Quantities Explained, fourth edition Ivor H. Seeley
Building Surveys, Reports and Dilapidations Ivor H. Seeley
Building Technology, fifth edition Ivor H. Seeley
Civil Engineering Contract Administration and Control, second edition
Ivor H. Seeley
Civil Engineering Quantities, fifth edition Ivor H. Seeley
Civil Engineering Specification, second edition Ivor H. Seeley
Commercial Lease Renewals – A practical guide Philip Freedman and
Eric F. Shapiro
Computers and Quantity Surveyors A.J. Smith
Conflicts in Construction – Avoiding, Managing, Resolving Jeff Whitfield
Constructability in Building and Engineering Projects A. Griffith and A.C. Sidwell
Construction Contract Claims Reg Thomas
Construction Law Michael F. James
Contract Planning Case Studies B. Cooke
Contract Planning and Contract Procedures, third edition B. Cooke
Cost Estimation of Structures in Commercial Buildings Surinder Singh
Design-Build Explained D.E.L. Janssens
Development Site Evaluation N.P. Taylor
Environment Management in Construction Alan Griffith
Environmental Science in Building, third edition R. McMullan
European Construction – Procedures and Techniques B. Cooke and
G. Walker
Facilities Management – An Explanation Alan Park
Greener Buildings – Environmental Impact of Property Stuart Johnson
Housing Associations Helen Cope
Housing Management – Changing practice Christine Davies (Editor)

continued overleaf

Information and Technology Applications in Commercial Property

Rosemary Feenan and Tim Dixon (Editors)

Introduction to Building Services, second edition Christopher A. Howard and

Eric F. Curd

Introduction to Valuation, third edition D. Richmond

Marketing and Property Owen Bevan

Principles of Property Investment and Pricing, second edition W.D. Fraser

Project Management and Control David Day

Property Finance David Isaac

Property Valuation Techniques David Isaac and Terry Steley

Public Works Engineering Ivor H. Seeley

Resource Management for Construction M.R. Canter

Quality Assurance in Building Alan Griffith

Quantity Surveying Practice Ivor H. Seeley

Recreation Planning and Development Neil Ravenscroft

Resource and Cost Control in Building Mike Canter

Small Building Works Management Alan Griffith

Structural Detailing, second edition P. Newton

Sub-Contracting Under the JCT Standard Forms of Building Contract Jennie Price

Urban Land Economics and Public Policy, fifth edition P.N. Balchin, G.H. Bull and

J.L. Kieve

Urban Renewal – Theory and practice Chris Couch

1980 JCT Standard Form of Building Contract, second edition R.F. Fellows

Series Standing Order

If you would like to receive future titles in this series as they are published, you can make use of our standing order facility. To place a standing order please contact your bookseller or, in case of difficulty, write to us at the address below with your name and address and the name of the series. Please state with which title you wish to begin your standing order. (If you live outside the United Kingdom we may not have the rights for your area, in which case we will forward your order to the publisher concerned.)

Customer Services Department, Macmillan Distribution Ltd, Houndmills, Basingstoke, Hampshire, RG21 2XS, England.

Property Finance

David Isaac

*Professor of Real Estate Management and Associate Head
School of Land and Construction Management
University of Greenwich*

© D. W. L. Isaac 1994

All rights reserved. No reproduction, copy or transmission of this publication may be made without written permission.

No paragraph of this publication may be reproduced, copied or transmitted save with written permission or in accordance with the provisions of the Copyright, Designs and Patents Act 1988, or under the terms of any licence permitting limited copying issued by the Copyright Licensing Agency, 90 Tottenham Court Road, London W1P 9HE

Any person who does any unauthorised act in relation to this publication may be liable to criminal prosecution and civil claims for damages.

First published 1994 by
MACMILLAN PRESS LTD
Houndmills, Basingstoke, Hampshire RG21 2XS
and London
Companies and representatives
throughout the world

ISBN 978-0-333-57681-6 ISBN 978-1-349-12948-5 (eBook)
DOI 10.1007/978-1-349-12948-5

A catalogue record for this book is available
from the British Library

Typeset by
Richard Powell Editorial and Production Services
Basingstoke, Hants RG22 4TX

10 9 8 7 6 5 4 3 2 1
03 02 01 00 99 98 97 96 95 94

For Simon and Katie

Contents

<i>Foreword</i>	<i>xi</i>
<i>Preface</i>	<i>xiii</i>
<i>Acknowledgements</i>	<i>xv</i>
1 Introduction	1
1.1 Introduction	1
1.2 The structure of the investment market	2
1.3 Financial structures	3
1.4 The financing of property since the Second World War	8
1.5 Vocabulary of finance	12
1.6 Overview of the present finance market	14
1.7 The globalisation of finance	21
1.8 Summary	22
2 Theories of Finance	27
2.1 Introduction	27
2.2 Financial theory	27
2.3 The theories developed	32
2.4 The application of theory to practice	37
2.5 The comparison of property returns with other investment media	40
3 The Structure of Finance	45
3.1 Introduction	45
3.2 Categories of finance	49
3.3 The finance market	52
3.4 Glossary of financial and property terms	55
4 Property Lenders	58
4.1 Sources of finance	58
4.2 Lending criteria	60
4.3 Development and investment lending	62
4.4 Problems of security	67

viii *Contents*

4.5 Property lending survey	70
4.6 Market players	73
4.7 Loans and interest rates	75
4.8 Markets and margins	80
4.9 Interest rate management and hedging	81
4.10 Hedging instruments	83
5 Project-based Funding	93
5.1 Introduction	93
5.2 Equity partnerships	94
5.3 Forward sale	95
5.4 Sale and leaseback	96
5.5 Finance lease	98
5.6 Types of debt	100
5.7 Bridging finance	101
5.8 Loan terms and financial agreements	102
5.9 Syndicated loans	104
5.10 Mortgages	104
5.11 Non-recourse and limited-recourse loans	106
5.12 Project management fee	108
5.13 Contractor's finance	108
6 Corporate Finance	110
6.1 Introduction	110
6.2 Equity finance	113
6.3 Ordinary and preference shares	113
6.4 Issues and options	114
6.5 Warrants and convertibles	120
6.6 Debt	121
6.7 Debentures	122
6.8 Loan stock and bonds	123
6.9 Structured finance	123
6.10 Hybrids: debt with profit share	126
7 Debt Finance	128
7.1 Introduction	128
7.2 Corporate versus project-based debt	130
7.3 Long-term loans	131
7.4 Commercial mortgages	133
7.5 Convertible loans and mortgages	135
7.6 Corporate debt	135
7.7 Commercial paper	138
7.8 Multi-option facility (MOF)	140

7.9 Loan stock	143
7.10 Debentures	143
7.11 Deep-discounted bonds and junk bonds	144
7.12 Euromarket lending	148
7.13 Securitisation of debt	150
8 Equity Finance	152
8.1 Types of equity finance	152
8.2 Sources of equity	152
8.3 Equity in project-based funding	154
8.4 Equity in corporate funding	155
8.5 Authorised property unit trusts	155
8.6 Investment trusts and unit trusts	158
8.7 Mezzanine finance	159
8.8 Venture capital	161
9 Institutional Investment	163
9.1 Introduction	163
9.2 History	164
9.3 Partnership arrangements	166
9.4 Direct versus indirect development	167
9.5 Criteria for investment	168
9.6 Future for institutional investment	170
10 Property Companies	172
10.1 Introduction	172
10.2 Property shares	178
10.3 Discount on net asset value	181
10.4 Corporate finance structure	183
10.5 Gearing	187
10.6 Property trading companies and property investment companies	189
10.7 Takeovers	190
10.8 Summary	194
11 Joint Ventures	196
11.1 Introduction	196
11.2 Criteria for choice of joint venture structure	196
11.3 Types of joint venture	197
11.4 Joint venture company (limited liability company)	197
11.5 Partnerships	199
11.6 Other types of joint venture	199
11.7 Partnership arrangements	200

x *Contents*

11.8	The formal agreement	200
11.9	Example of a joint venture	202
11.10	Summary	203
12	Unitisation and Securitisation	204
12.1	Definitions	204
12.2	History	206
12.3	Problems in the development of securitisation	209
12.4	The vehicles	210
12.5	Issues in securitisation	211
12.6	Example of securitisation	213
12.7	Conclusion	215
13	Financial Accounts	217
13.1	Property accounts	217
13.2	Property accounts: issues	230
13.3	The regulation of accounts	232
13.4	Off-balance-sheet funding	233
13.5	Off-profit-and-loss-account funding	240
14	Financial Services	243
14.1	Introduction	243
14.2	Providers of financial services	244
14.3	Fees for providing financial services	247
14.4	The debt finance market	248
14.5	Presentation of loan proposals	249
14.6	Criteria of acceptance	249
14.7	Comparison of finance terms	251
14.8	Financial regulations	252
	<i>Bibliography</i>	257
	<i>Index</i>	263

Foreword

In a world of increasingly intense competition with bankers, accountants and lawyers, property professionals need to understand the dynamics of the finance world if they are not to be poor relations.

The skills of the property profession are unique, but are often seen as being narrow when compared with competitors'.

This book provides an opportunity to understand the financial world and how it relates to property. It will be invaluable to students and practitioners wishing to learn or better understand the mechanics of property finance.

Property Finance offers an overview of the theory of finance, explaining the technical jargon and removing the mystique which all industries jealously guard as the 'entry ticket'.

Corporate, debt and equity finance – the main engines of the property market – are dealt with in a practical way, using examples which will help put the theory into context.

The book also examines the property vehicles that drive the market, namely institutional investment, property companies and joint ventures, enabling the student to see in practice how finance is used to produce returns for investors.

The ability to 'add value' to any transaction is the hallmark of a true professional. In the property market, the provision of financial advice is part of the complex process of adding value. The true test will be the level of return provided by, for example, an acquisition or a development restructuring.

As a comprehensive guide to the world of property finance, this book will help those eager to learn, and will quickly become an invaluable reference point.

Michael E. Riley
Managing Director
Chesterton Financial

Preface

This book is an introduction to property finance, bringing together the professional disciplines related to finance and to property investment and development. The book intends to do three things: establish the basic concepts of finance; examine the applications of these concepts in practice; and, finally, give an overview of the market – its history and present position as of 1993. As the reader will appreciate, this is a wide field and I have tried to be as selective as possible in the text.

I believe the book will be useful for a number of different groups, including students in property-related areas, practitioners who are not specialist in the area or who have limited experience of it and those professionals involved in developing, investing in and administering property assets. For the student it provides a text at second- or third-year undergraduate level and is also useful as an introductory text at postgraduate level for those without previous knowledge in the area. Finance is an essential and arguably the paramount agreement in the process of land and construction management. Estate and land managers, surveyors, construction and project managers, architects and engineers need an understanding in this area and, at the same time, those involved in finance, commerce and business require an insight into finance as applied to the property asset. The book provides an overview for progressing to more advanced and specialised texts. For those concerned with property and construction I hope that the book will provide a view into the area of applied economics in the same way that, for those with a business background, the text will help to explain some of the peculiarities of dealing with land, property and construction.

I have endeavoured to structure the book by initially establishing the basic concepts and then looking in some detail at the main characteristics of finance, the instruments involved and the players. Where possible, I have introduced recent research and make no apologies for using and referencing this work to bring the reader up to date in a rapidly changing sector. Where possible, simple case studies have been added to assist in the understanding. I would have liked to have incorporated more extensive applications but this was beyond the scope and scale of this text.

I believe the book comes at an important time in the development of the property market; hopefully, we are now seeing the signals of partial recovery in both the residential and commercial sectors, and with recovery it is hoped that the practitioners and financiers involved in the market will

be older and wiser, and that both the lessons of the slump of 1973–4 and the false hopes of the booming late 1980s will be understood and taken on board. In fact it will be expected of professionals in the market to be older and wiser. In a previous book entitled *Property Valuation Techniques* (written with Terry Steley, Macmillan Press, 1991), we wrote about the need to clarify valuation techniques to make them more accessible and applicable; the intention here is to provide an insight into property finance that will also seek to clarify this process.

Chapter 2 is about the theory of finance; and some readers may wish to bypass this in the first instance if they find it difficult or wish to move on. Hopefully, they will come back to it at a later time when the overall picture becomes clear and they feel more suited to the material. I have endeavoured to keep the chapters self-contained and apologise for any duplication of material; the intention is to reduce cross-referencing and provide easier reading.

Finally, I would like to thank those who have assisted me in writing this book, Professor Ivor Seeley, the series editor, who has stimulated me to write what will hopefully be a number of texts for the series, and Malcolm Stewart, my publisher. I would also like to thank Mike Riley and his staff at Chesterton Financial, who over the years have provided me with valuable insights into the practice of financial services. Many colleagues and external organisations have provided me with information and assistance and these are listed in the acknowledgements. I would also like to thank Terry Steley and Maxine Davies of the University of Greenwich and Neil Woodroffe of South Bank University for their help. Finally, I am reliant on the continued support of Professor David Wills, Lewis Anderson and the staff of the School of Land and Construction Management at the University of Greenwich to develop my research and studies and I am grateful for their help.

University of Greenwich, 1994

David Isaac

Acknowledgements

The author and publisher wish to thank the following for the use of material:

Butterworth-Heinemann for the use of extracts from *Real Estate Finance*; *Estates Gazette*; the *Journals of Property Finance* and *Property Valuation and Investment*.

S. G. Warburg Securities, UBS Philips and Drew, and Paribas Capital Markets.

Chesterton Financial, Savills Research, DTZ Debenham Thorpe Research, and Richard Ellis.

Every effort has been made to trace all the copyright holders, but if any have been inadvertently overlooked, the publishers will be pleased to make the necessary arrangements at the first opportunity.