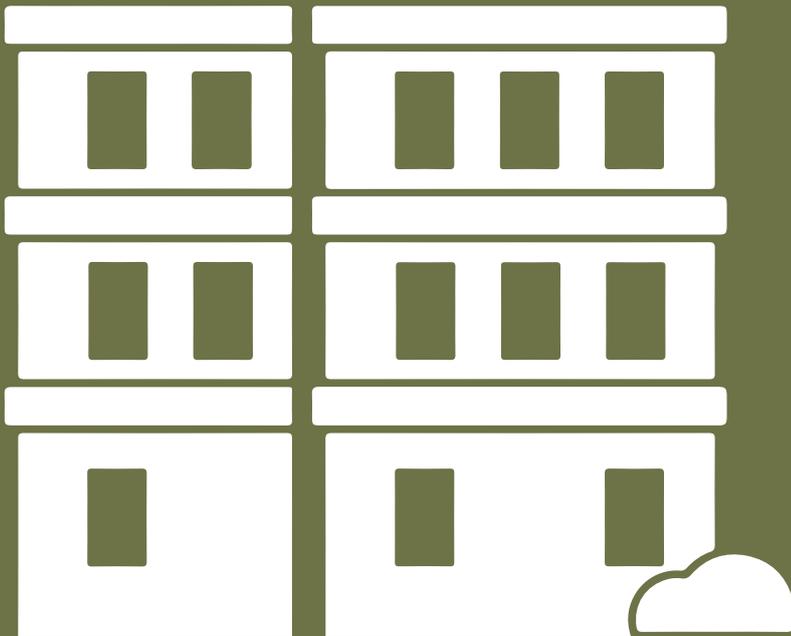


lateral partners®

Buidling a Feasability - A Guide.



September 2023

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Property development. Let's make it easy.



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Contents.

Intro to Lateral Partners	4
Building a Feasibility	8
Project Costs	9
Finance Costs	11
About the Team	13
Glossary	14

Intro to Lateral Partners.

Lateral Partners were founded in 2020 off the back of more than 20 years lending experience with leading banks and mortgage broker businesses. We are a firm who specialise in sourcing capital for clients across residential, commercial and property development. Because of this we have an in-depth knowledge of the buying, selling and construction process and access to relationships that can help make your development journey as simple as possible.

At Lateral Partners, we value integrity. To us that means at all times, being honest, upfront, and transparent with our clients and our business partners. This is a non-negotiable and it's through this that we empower you as our client to make more informed decisions.

We have dedicated property development specialists that can guide you through the entire process, introducing experts where required, giving balanced advice at all stages and ensuring you obtain the finance for the project.

You can read more about our process and what working with us could look like in "Finance Cost" section of this guide.

We're here to help, so please don't hesitate to [get in touch](#)

Building a feasibility is an important early-stage task when planning any development project. A feasibility study can be complex, or 'back of the envelope'. Either way, the process is designed to show both the developer and any potential financier and stakeholders that the project is commercially viable.

An initial feasibility study should be undertaken before acquiring a site to ensure that the purchase price of the land allows for a satisfactory profit margin for risk. The exception might be if you have owned the property for a period of time and want to explore its development potential down the track.

The below is not exhaustive, however, is designed to be an initial guide to building a feasibility and outlines some common costs that should be included. Every project is different, and costs will vary on a case-to-case basis e.g. a steep site will have higher costs relating to retaining and engineering than a perfectly flat site.

To illustrate the typical layout, we have included our Lateral Partners feasibility template which you are welcome to download and make your own!

Let's start from the top.

Revenue

What can you develop on your site? A bulk and location will identify the highest and best use of the site. Once this has been confirmed you can estimate the market value of each individual unit or lot (I'm assuming these values are GST-inclusive for the purpose of this exercise). There are 4 primary types of lenders that operate in the property finance market. These consist of Banks, Non-Banks (otherwise known as finance companies), Private Lenders and Mezzanine Financiers.

Most financiers will require a registered valuation ("RV") that they will rely upon to support values. Some non-banks will finance projects without a valuation and rely on their own estimates. If your estimate is higher than that of the RV (or the lender's estimate), then the lender will rely on the RV (the exception might be if there are qualifying presales above the RV/lender estimate).

The sum of the collective values is the gross realisation e.g. 6 townhouses at \$900,000 each = \$5,400,000 gross realisation.

Before an RV is held, the best way to assess market value is to look at comparable sales in the area. What is a product of similar build specification selling for in the same suburb (or neighboring suburbs)?

GST

What is your treatment of GST throughout the project? A simple rule of thumb is that if you are building and plan to hold the completed stock as an investment, then you likely won't claim GST on the site acquisition or project costs. If you are developing to sell, then you will likely claim the GST on the project costs and remit GST upon the sale of each completed lot or unit.

GST Facility

Most lenders will provide a GST facility as part of their offering that will typically sit separately from the development loan.

A GST facility works like a project overdraft that can be used to fund the GST component on invoices payable. It works like this:

1. The lender receives the monthly progress claim from either the developer or the QS (let's say it totals \$50,000 including GST).
2. The lender will make a payment of \$43,478 from the loan facility, and a payment of \$6,522 from the GST facility. The balance of the GST facility will go to -\$6,522.
3. The developer will claim the GST from the IRD which will be refunded in line with their GST cycle.
4. The IRD will refund the GST, usually directly to the lender whose bank account will be nominated. The balance of the GST facility returns to zero.

Treatment of GST throughout a project can be complex so it is worth getting expert advice prior to commencement.

Sales Commissions

These are the costs associated with selling the completed stock.

It's important to review the agent's agreement in detail – will these costs be due (in full or in part) upon an unconditional contract, or on settlement?

Whether due upfront or on settlement, these remain a project cost and need to be factored into the project's feasibility.

From here, we can calculate the net realisation of the project using the following simple formula.

Gross realisation - GST - Sales Commissions = Net Realisable Value (“NRV”).

The NRV is the revenue figure that you're going to use to calculate your project profit and risk margin.

What are the project costs?

The below items relate to some typical project costs, we are going to assume that all costs referred to are ex-GST.

Land

Initially, the land value should be input into the feasibility at the purchase price. This way, the true margin can be calculated.

If the land valuation shows an increase in value relative to the purchase price, then the uplifted land value can be put into the feasibility and count towards equity. An uplift in a site value can be the result of a range of factors including prudent market timing, purchasing off-market or the granting of resource consent and building consent.

Note that whilst this will have a positive effect on your equity into a project it will be detrimental to the profit margin (as your cost center increases) and so at times there can be a fine balance to tread. It can, however, prompt a conversation around the margin you stand to gain from selling the site alone as opposed to developing and the consideration of risk for this.

Demolition / Site Clearance Budget

What is currently on the site? Most likely, the site improvements that are in place when the site is acquired will need to be either relocated or demolished as part of the proposed development. You need to ensure that these costs are accounted for either separately or as part of the construction/civil contract.

Civil Construction Budget

The civil construction budget encompasses all work on site relating to the infrastructure and groundwork. This includes site levelling, excavation, trenching, drain laying, driveways and slabs. This work might be subcontracted out by the main construction contractor, or the developer might engage their own civil operator to complete this work.

Construction Budget

The construction budget is broad, and the items included in this will vary. We usually refer to construction costs as any build costs incurred from the slab up. This budget should include all costs required to take the project from the slab stage to practical completion. Items such as materials, fixtures and fittings, painting, plumbing, electrical and builders' labour should all be included.

A simple rule to work out if your construction budget is in line with the market is to calculate the rate per square meter of internal build area. For a townhouse development of medium quality, you would expect a rate of between \$2,750 – \$3,500 per square meter (ex GST). Square meter rates that fall materially outside market parameters (relative to what's being built) will raise questions with lenders and project stakeholders.

Professional Fees Budget

Which consultants are going to be helping bring your project to life? There is a wide-ranging group of consultants that are typically engaged in a development project. Think of this budget as one that includes all those that will assist you outside of construction on-site.

Usually included are valuers, architects, planners, quantity surveyors, geotech, engineers and many more. Ensuring these costs are accurately budgeted and funded will help to mitigate project risk. Throughout our time in the industry, we see a lot of common errors made when looking for property development finance. To help you avoid these, we've listed the top common pitfalls below:

Local Authority Fee Budget

Developing land intensifies the area surrounding the development site, placing added pressure on existing services and infrastructure.

Those entities that provide local services will require payment to use their services or install updated ones to accommodate the higher density. This budget should encompass all these items.

Some common fees that developers are charged are outlined here. Resource Consent and Building Consent – The costs payable to the local council to get your project consented.

Note, under this budget, we are factoring in only the costs paid to the council and not to the consultants who assisted the RC/BC (which are included in the professional fees budget).

Watercare ICG - The Watercare infrastructure growth charge is a contribution towards the capital investment Watercare has made in bulk infrastructure to provide services to new or existing customers who increase demand for their services.

223c and 224c – These are the costs remitted to the council for the sign-off of the survey plan and subdivision consent approval, respectively.

Chorus & Vector – The major providers of Fibre Optics and Electricity in NZ. Your costs for these items will vary depending on your site specifics. You can check out the following links to get more info: [develop-with-chorus](#) or www.vector.co.nz/developers.

Development contributions – These are costs payable to the Council that pay for the impact that new developments have on services and infrastructure.

These costs are typically due prior to the local council issuing a code of compliance for the subject development. A contribution is made on a per-lot basis i.e. a four-lot subdivision would require development contributions to be made for the three new lots being created.

A simple way to estimate these costs for your Auckland-based project is via this [link](#).

Project Management

We typically see two types of project management budgets.

The first is when a third-party firm is engaged to monitor progress on-site and acts as an agent for the developer. This arrangement is usually in place on larger projects or where it is a requirement from a lender.

The second is when the developer seeks to manage the project themselves and invoices a monthly project management fee to the borrowing entity (ultimately themselves). This structure provides the developer with a monthly income for the duration of the project and is approved by a lender at their discretion. It is worth noting that the developer's own project management budget is typically the first budget to be cut by the lender if the profit and risk margin is tight, or the equity is short.

Legal Fees Budget

The depth of this budget is going to change depending on the size and scope of the project. Typical legal costs to be included are finance legal costs (lender and borrower solicitors costs) and selling legal costs (think conveyancing costs). Any costs that might become due within the legal scope should be included in the legal budget.

Contingency Budget

A common omission we see when reviewing a client's feasibility is the lack of a sufficient contingency budget.

The project contingency should be as important to the developer as it is to the lender. Not only does it provide a cushion to absorb any cost overruns, but it demonstrates to stakeholders that the project margin can withstand cost overruns.

A rule of thumb when calculating the contingency is to get it as close as possible to 10% of the construction budget.

Profit and risk margin (pre-finance)

Net revenue less all project costs will give you the project margin in a dollar figure. This dollar figure divided by total project costs will give the pre-finance margin as a percentage. Ideally, this figure sits on or above 20% (noting that this margin is less important than the post-finance margin).

Finance Costs

Development Finance costs are typically broken down into three segments.

Interest costs – Usually capitalized to the facility monthly in arrears and charged on the balance of the loan i.e. what you have actually drawn down from the lender.

The Lateral Partners model will calculate an estimate of these for you, assuming an average 70% utilization rate.

Line Fee – a fee charged on the facility limit and capitalised monthly in arrears. This figure will be constant each month and typically works out to be c. 1.00 – 3.00% per annum depending on the lender.

Establishment Fee – The upfront cost charged by the lender expressed as a percentage of the loan. This might sit somewhere between 1.50% – 3.00%+.

Lenders can be ambiguous with the way they communicate interest and fees in their offerings. Always ensure that you do the percentage calculations yourself to check what amounts they are using to calculate dollar figures, or better yet, get Lateral Partners to do it for you.

Post finance margin

This is the prefinance margin minus the finance costs. This margin, expressed as a percentage of total project costs, is usually the quickest way to get an indication of the viability of the project, all costs and revenue considered.

In a slower market, such as now (September 2023) a post-finance margin in the double figures (10%+) is generally acceptable to lenders when it comes to having funding approved. A 15% - 20%+ post-finance margin is what you might consider ideal provided all costs and revenue are correct.

LVR and LTDC

Once revenue and costs have been accounted for, you can calculate the project ratios. The key ratios lenders will review are the loan-to-value ratio and loan-to-total development cost ratio.

The LVR is typically more important, as this is the position that the lender will be left with at the completion of the project. A development LVR should be calculated by dividing the sum of the principal and finance costs by the net realizable value.

For projects without presales, an LVR of up to 60% is typically acceptable. This increases to c. 65% for projects with a material level of qualifying presales.

The loan-to-cost ratio shows the debt facility limit relative to the project costs, expressed as a percentage. LTDC ultimately shows a stakeholder what level of equity a borrower has in the project as a percentage of the cost (skin in the game as it's often described).

The Lateral Partners' Model

We developed a model we typically use when doing initial analysis on a client's project. The model is straightforward and can be tweaked to add or subtract various budgets and other line items and was included in the Development Finance Basics Guide email. You are welcome to tweak it and make it your own!

Lateral Partners is happy to walk you through the feasibility process or discuss development finance for your project anytime!

About the team



Ben Pauley

Director, Commercial & Development Adviser

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Ben has over 10 years experience in the finance industry spending 9 years with ASB Bank as a Commercial Manager as well as 2 years running the commercial and development division of Squirrel Mortgages. As Director of Lateral Partners, Ben specialises in working with developers, businesses and large investors to provide financial advice, lending, equity and transactional solutions.



James Meehan

Commercial & Development Adviser

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James has 10 years of finance experience the majority of which has been within the commercial lending and property finance space. He spent 8 years in Australia holding roles at National Australia Bank, Investec and four years as a commercial broker in Sydney. Upon his return to New Zealand in 2019 he spent 3 years at a prominent non-bank lender helping manage their loan book.

James is passionate about property, design and urban development. He leans on his experience as both a lender and a broker to provide tailored debt and equity solutions to property developers and commercial property owners.

Glossary.

Building Consent – This is written approval provided from the council to carry out the building work specified and the site specified.

Capitalised Interest and Fees – In simple terms this means that the interest and fees associated with a loan are included in the loan limit.

Collateral Security – any assets used as security against your loan additional to the property being developed. For example, if you utilise an investment property as additional security that would form Collateral Security.

Contingency – This is an amount surplus to the costs of the project (normally limited to build and civils) that is in place to cover any unforeseen cost overruns.

Code of Compliance (CCC) – This is a formal statement that confirms that the building work carried out on site has been completed per the building consent issued, and complies with that consent. It is required to close out a building consent and move to title and settlement.

Cost to Complete Basis – Funding is normally provided based on a cost to complete basis. What this generally means is that a funder will release funds only when their facility is equal to or greater than the cost to complete for the project. It ensures the client's equity is in the project first and that the lenders risk is adequately managed.

Deed of Priority – A legal document that stipulates the amount a mortgagee can claim up to before any subsequent charge can exercise their rights to any sale proceeds.

Drawdown – This is the release of funds under an agreed limit with the lender. For example, if the limit on the loan is \$1,000,000.00 and only \$200,000.00 is drawn, then you may process drawdowns for a further \$800,000.00.

Engineers Planning Approval (EPA) – This gives permission for the civil engineering works for the infrastructure (stormwater & wastewater connections) that will be vested to the council.

Establishment Fee – This is a fee charged by the lender for establishing the development loan.

Feasibility – This is a measure of how financially feasible a project is. It normally forms a full budget, including expected revenues, total costs and expected profitability.

General Security Agreement (GSA) – This grants the lender a security interest over all the assets of a development entity.

Gross Realisable Value – This is the total pre-tax sales value of all the finished units in a development.

In One Line Valuation – A value provided for multiple units as if they were sold in a single transaction as opposed to individual buyers.

Interest Cover – This is a servicing metric used for large residential investment or commercial property holdings. It is calculated as the Net Rent (Gross Rent less OPEX) / Interest Expense.

Line Fee – A lender fee charged as a percentage against the limit of the loan. This fee is charged monthly throughout the entire period of the loan and is measured against the limit (not drawn or available balance).

Liquidated Damages (LD's) – Liquidated Damages is an amount of money agreed up front at the time of signing the build contract that establishes the amount of damages that can be recovered in the event a party breaches the contract. These normally apply to the failure to complete work on time.

Glossary. Continued.

Loan to Total Development Cost Ratio

(LTDCR) – This is a ratio of the total loan relative to the total development cost. It reflects the level of equity in the project and is calculated as the Total Loan / Total Development Cost.

Loan to Value Ratio (LVR) – This is a ratio of the total loan relative to the total on-complete value of the properties. It reflects the equity in the project on completion and is calculated as Total Loan / Total Value on Completion

Mortgage – A document that registers the security interest of a lender against your property.

Mezzanine Finance – A loan subordinated to the senior debt that is provided to complete the project when equity is insufficient. Because it ranks behind the senior debt, it is significantly more costly.

Pari Passu – Pari Passu is latin for equal footing. This normally occurs on large loans where there are two lenders who lend to a project with equal priority amounts / rights.

Performance Bond – this is a guarantee normally provided from the builder's bank in favour of the lender or developer. It is paid out in the event of the contract being breached and is irrevocable (i.e. must be paid no matter what). It is a form of insurance and normally represents 5% of the total contract value.

Power of Attorney (POA) – This is a document appointing someone to make decisions on your behalf or sign documents for you. This is normally relevant in pre-sale contracts where the vendor will have the right to remove caveats.

Preferential Equity – This is a loan that is a combination of debt and equity. It is a loan that grants the lender the right to take a share of ownership in the project under certain circumstances.

Pre-sales – these are sales made 'off-plan' or prior to the construction commencing. These are normally required by the lender to provide some certainty to the loan repayment on completion.

Quantity Surveyor (QS) – A professional who calculates or estimates what labour and materials are required to complete a build and how much they will cost. They also provide a report prior to construction that comprehensively covers many aspects of the development including the budget, programme, consents etc.

Resource Consent – This is written permission from the council for an activity (construction) that isn't allowed for 'as a right' under the district or regional plan.

Return on Equity (ROE) – This is a representation of the profit of the project relative to the equity utilised. It is calculated as Profit / Equity.

Senior Debt – This is the first ranking loan taken out to fund the development. It is normally up to 65% LVR or 80% of cost.

Stretched Senior Debt – this is a senior debt facility that is normally beyond the standard 65% LVR or 80% of cost. Because it is beyond the standard lending criteria it is normally priced as a blend of senior and mezzanine debt.

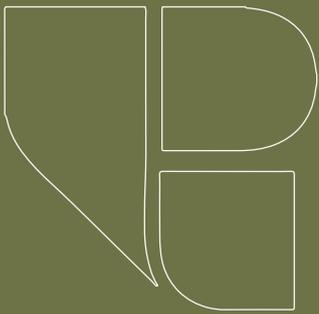
Sunset Date – this is a date set in a pre-sale agreement for certain milestones (normally completion of the property,) where if not met, one or both parties can cancel the contract.

Total Development Cost (TDC) – This is the total cost of a project and includes land, civil works, construction, professional fees, local authority fees and finance.

Glossary. Continued.

Tranche – a portion of the loan, normally describing each lump of money released by the lender in order.

Underwrite – These are prevalent for large development projects, where a party will provide an option to purchase an amount or all of the properties in the development in lieu of pre-sales. It normally attracts a fee of 3 – 5% and the price for the properties is normally at a deep discount to market value. The option can be triggered on completion of the project in the event the developer does not manage to sell the properties during the development. These are normally put in place for large projects (apartment blocks etc.) where waiting on sales can be prohibitive to starting a project.



Got questions?

We hope that you found this guide helpful as an introduction to the world of property development finance. It's a long and exciting journey, and we are here to help you through every stage of it. If you have questions on any part of this guide, we'd love to hear from you.

[Contact us](#) and our experienced team will be able to help.