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Mezzanine finance back in favour as residential presales surge

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MAXCAP is backing the third stage of Geocon's $156 million Canberra project Republic Precinct behind a global investment bank, as the resurging housing market brings mezzanine financing firmly into focus.

According to commercial finance intermediary Stamford Capital, mezzanine and traditional bank financing arrangements are emerging as key trends in real estate debt capital in the commercial property sector, as developers return to trading bank lenders and incorporate mezzanine finance in their development finance stack.

"Residential is back with a vengeance and particularly over the last six months, off-the-plan developers are able to show the strong pre-sales needed to secure mezzanine finance through the main trading banks," said Michael Hynes, joint managing director at Stamford Capital.

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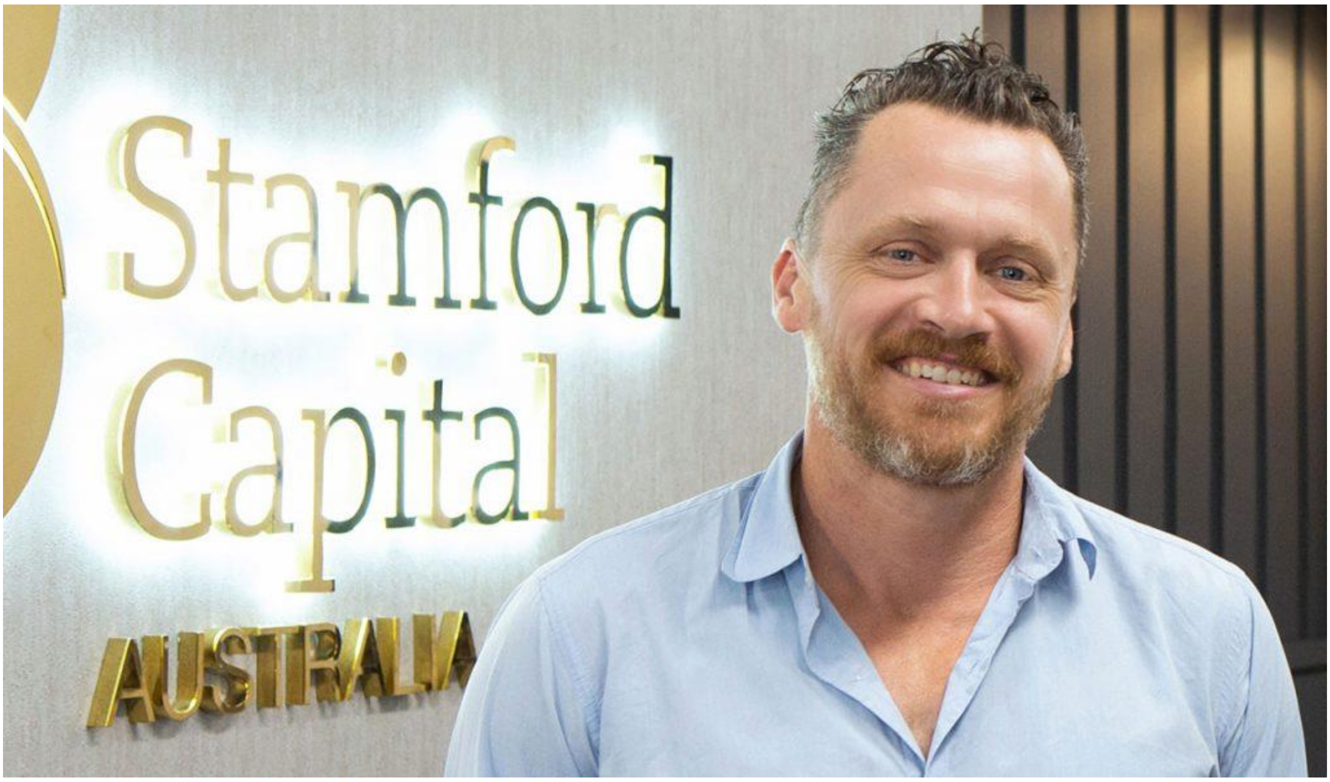

The combination of trading bank senior and junior debt in a development finance stack remains more price competitive than non-bank senior only alternatives, according to Stamford Capital, whose modelling indicates savings of about 15% to 20% of borrowing costs.

“We closed a $20 million capital stack recently using bank and mezzanine, which proved $250,000 cheaper than the alternative non-bank senior only solution.”

He said that bank appetite for mezzanine hasn’t changed, yet over the last few years many developers struggled to meet pre-sales criteria in the wake of the GFC and stricter lending rules resulting from the banking royal commission.

“But that landscape is completely transforming with a surge in residential pre-sales, making mezzanine finance more attainable.”

Banks have been seen closing mezzanine loans over existing investment assets, where traditionally they have favoured pre-sold developments for their lower risk profile.

"Mezzanine on existing investment assets is a new trend, no doubt helped by lower debt costs post-COVID relieving ICR covenant pressure. These stacks are presenting as a cheaper cocktail relative to the non-bank enior only alternative," Hynes said.

MaxCap's commitment to Canberra largest-ever residential development constitutes the fourth it has funded for Geocon, having reached financial close of Aspen and Establishment projects in September and City 7 in February last year.

The Republic development is located at 2 Grazier Lane in Belconnen. Its first stage was completed in the first half of 2020 and completion of stage two is expected by the middle of this year.

The third stage of the project Nightfall will accommodate 334 residential apartments over 22 levels, with 17 commercial and retail units on the ground and lower ground floors, and two levels of basement car parking which will join the basement already constructed for the first stages.

Stages one and two comprise 1,250 apartments, a 185-room hotel, over 500 public car spaces and commercial and retail accommodation.

Some 92% of 390 apartments sold in stage have been sold.

Stamford Capital recently closed a mezzanine facility up to 78% LVR behind a second-tier bank, effectively equating to a blended rate of 4.16% per annum.

"This was secured against a portfolio of quality income-generating assets, allowing the client to achieve terms more competitive than a stretched-senior facility from a single non-bank lender," Hynes said.

"Further to the above, investor appetite was strong for a mezzanine facility secured against a portfolio of fully leased residential apartments. Also behind a well-known bank, the blended rate amounted to 4.28% per annum and was structured up to 80% of the in-one-line value."