



First Property Group plc

Leverage: An amoral tool

26 April 2016

First Property Group plc is a property fund manager and investor with operations in the United Kingdom and Central Europe. Its earnings are derived from:

- **Fund management** – via its FCA regulated and AIFMD approved subsidiary, First Property Asset Management Ltd (FPAM), which earns fees from investing for third parties in property in the UK and Poland;
- **Group Properties** – principal investments by the Group, currently comprising:
 - Six directly owned properties in Poland and Romania;
 - Five properties in Poland held by Fprop Opportunities plc (FOP), an FPAM managed fund in which the Group is a 76.2% shareholder;
 - Non-controlling interests in four other funds managed by FPAM.



FPAM funds rank No.1 versus MSCI's Investment Property Databank (IPD) Central & Eastern European (CEE) Benchmark for the ten years from the commencement of its operations in Poland in 2005 to 31 December 2015, and for the annualised periods from 2005 to the end of each of the years between 31 December 2008 and 31 December 2015.





Chief Executive, First Property Group plc — Ben Habib, MA (Cantab)

Ben founded First Property Group plc (Fprop), the award winning niche property fund manager and investor, in 2000. Fprop operates in the United Kingdom and Central Europe (principally Poland). The performance of its funds ranked No.1 vs the IPD CEE universe for the annualised periods from the commencement of its operations in Poland in 2005 to the end of each of the years between 31 December 2008 and 31 December 2014.

Prior to setting up Fprop, Ben was Managing Director of a private property development company, JKL Property Ltd, from 1994 - 2000.

He started his career in corporate finance in 1987 at Shearson Lehman Brothers. He moved in 1989 to PWS Holdings plc, a FTSE 350 Lloyds reinsurance broker, to be its Finance Director.

He was educated at Rugby School and Cambridge University.

- Leverage is neither good nor bad.
 - Enables returns to be boosted.
 - Enables cash flows to pay for themselves.
 - The need for yield.
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1. Quantum of debt applied to a property should depend upon:
 1. Sustainability of income that property generates – must be sufficient to cover interest and debt amortisation payments;
 2. The longevity of that income -
 2. Policy driven investing is flawed:
 1. 30% LTV can be too high if the yield is too low to support leverage
 2. Fixed loan-to-value LTV policy not sensible - income profile of property crucial
 3. Long term investors - CV movements only relevant with regards to LTV loan covenant breach
 4. Property is illiquid – short term funding a disaster
 5. Interest rates need to be hedged – IR caps are better than fixed rates as cost is certain.
 6. Institutions should use leverage to acquire property – helps maintains total returns
 7. Great time for leverage – key is to pick target assets carefully and treat leverage with respect and structure it carefully.
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Trip wires

1. LTV covenants – low enough to provide sufficient headroom to protect against adverse movements in market value of a property
 2. DSCR covenants – the need for yield
 3. Other covenants
 4. Duration – long enough to enable early refinancing
 5. Interest rates – the use of caps, collars and fixes protects against adverse movements
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➤ **Loan Covenants:**

- LTV covenant $>$ LTV at purchase.
 - DSCR at purchase and based on hedge $>$ DSCR covenant.
 - Managing consequences of breaches: hard / soft breach.
 - Guarantees; cross collateralisation; additional security rights.
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- QE and central bank policies have suppressed interest rates to lowest levels EVER!
 - Asset values in bubble territory? So where is the yield?
 - Applying low cost, carefully structured leverage to high yielding property = RECIPE TO MAKE MONEY!
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Leverage: An amoral tool

“The Gherkin” – 30 St.Mary’s Axe, EC3



2006 - sold by Swiss Re (main tenant) for £600 million to 2x buyers in JV, financed by £396 million of senior debt (c66% LTV) from a consortium of German banks. 1x JV partner opted to denominate its debt in CHF, saving it c100bp vs GBP interest costs. Swiss Re agreed to pay part of its rent in CHF BUT the hedge did not cover the CHF loan in full.

2009 - Credit crunch:

- CHF appreciated by c60% causing CHF loan to increase by c£100m;
- Interest rates fell pushing the mark to market value of the borrower’s interest rate swap contracts c£140m out of the money;
- Valuation dropped to £480 million leading to breach of borrower’s LTV covenant – but technical default, not cash default, so banks did not foreclose.

2014 - still fully let (17 years unexpired), now valued at £650 million but senior lenders want cash injection of c£100m to remedy ongoing defaults (borrower lack of equity considered misaligned with lenders). Not forthcoming so Receiver appointed.

- 1x JV partner willing to inject additional equity but consent from other not forthcoming. Willing JV partner tried but failed to buy out the clients (retail investors) of other JV partner.
- Complication - the 4 lending banks in syndicate launched legal battle against lead bank to ensure the loan debt is treated as senior to the swaps, which involve the lead bank alone. Source: FT 1 Aug 2014
- Sold for £700 million to Safra Group



Purchase price	Aug-2007	€41.5m	
Valuation	Mar-2015	€49.3m	+19%
NOI	2007	€2.6m	
	2015	€4.7m	+81%
Equity invested		€3.35m	
Pre-tax income return on equity invested (p.a.)		€2.7m	55.9% ROE
IRR (implied – at valuation)			66.6%

Holding for:

- High ROE;
- Additional capital gain from development of second tower on large podium in due course.