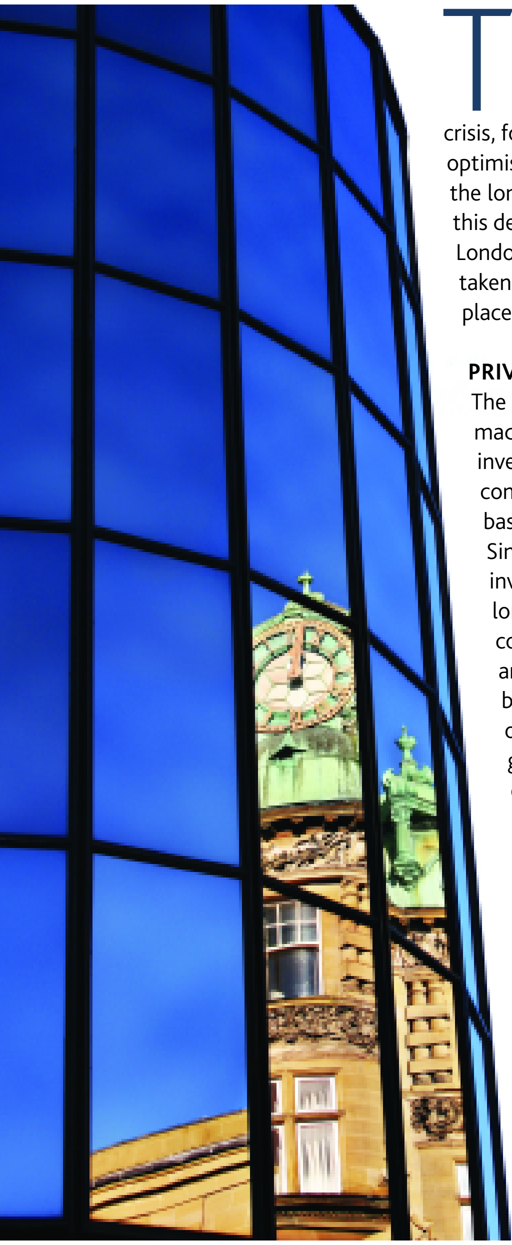
Private property

STUART HITCHCOCK AND **PAUL COATES**, ALONG WITH ISSUERS CADOGAN, GROSVENOR AND HOWARD DE WALDEN, DISCUSS THEIR RECENT FINANCING SUCCESSES IN THE PRIVATE PLACEMENT MARKET.



The funding environment for the real estate sector has continued to evolve following the financial crisis, focusing organisations on optimising their debt structure for the long term. At the forefront of this development has been the London estate sector, which has taken advantage of the private placement market.

PRIVATE PLACEMENT BASICS
The private placement market is made up of institutional investors (such as insurance companies and pension funds) based in the US and London. Since they are buying an investment to hold for the longer term they are naturally conservative, value-stable and cash-generative businesses, typically focusing on "implied" investment-grade issuers. The real estate sector naturally lends itself to this form of financing – the sector is asset-strong, with long-term assets and cashflows. Consequently, investors are able to lend over the very long term, anything from three years to 50 years, enabling issuers to better match their long-term assets with long-term finance.

WHY ACCESS THE MARKET? Since Lehman's collapse, there has been a pronounced focus by businesses on optimising their financing structure, specifically by diversifying their lender base and minimising refinancing risk through extending and smoothing their debt maturity profile. Over this period, the private placement market has provided a large number of corporates with committed, long-term finance from a non-bank source.

A private placement is complementary to other types of finance, such as shorter-term bank lending. The importance of diversification cannot be overemphasised. In the wake of more limited bank liquidity generally, issuers have sought to reduce their reliance on one form of financing, and to reduce refinancing maturity humps. Following much more closely the US funding model, there has been a real trend towards financing structures where banks provide businesses with short-term day-to-day working capital funding needs, and institutional investors provide core long-term capital that will remain on balance sheet for a period of time.

This development is welcomed by bank lenders – an issuer's ability to demonstrate access to alternative forms of finance has helped improve the banks' assessment of an issuer's credit strength, which has flowed through to improved bank facility appetite and pricing.

Paul Coates, managing director, UK real estate finance, corporate banking, at RBS, says: "The financial crisis showed that even the largest business can be caught out by sudden illiquidity in their mainstay markets. During this time RBS continued to support its clients and the UK real estate sector and we will continue to do so. Part of that support is to help clients explore new pools of liquidity that complement their existing funding structures and business plans. It's all about what's best for the client, and the private placement market has provided an attractive source of liquidity for a number of clients."

The private placement market is a deep one, and often a surprise to potential issuers – over £1bn equivalent for quality credits over time. Issuers can come back to (or "tap") the market on an ongoing basis. Both Cadogan and Grosvenor have accessed the private placement investor base on numerous occasions, Grosvenor having done so over a decade ago when the market for European issuers was in its infancy. Since that point the market has grown significantly, with over £15bn raised by non-US issuers each year.

Private placements are typically structured on similar terms to an issuer's existing banking agreement. The key for investors is that they remain pari passu with other senior lenders, meaning that the majority of financings are also unsecured. Toby Shannon, chief executive of Howard de Walden, says that the key to structuring a financing was to "make certain it worked alongside the bank loan documentation and that, given the long tenor of the notes, the covenant architecture and levels were flexible enough and operated with enough sensitivity in the financial model".

PRIVATE PLACEMENTS AND THE PROPERTY SECTOR In 2010, RBS reopened the private placement market to the real estate sector with the debut private placement financing for Howard de Walden Estate, which owns a significant portion of the Marylebone area of London. Howard de Walden received a hugely positive reception in the market with over £500m (equivalent) of interest in maturities of up to 40 years. Shannon says: "The decision to access the market was driven by our desire to diversify our funding base away from the conventional bank market, given the balance sheet constraints all banks are experiencing at present, and the fact that Basel III is likely to further impact on both the availability and cost of bank credit."

Howard de Walden's success has been followed in 2011 with financings (all through RBS) in the London estate sector for Cadogan (third time to market since 2006) and Grosvenor, as well as for both a Dutch and a UK-based real estate investment trust (REIT). The trend looks set to continue.

Richard Grant, finance director of Cadogan Estates, explains his decision for approaching the market again: "We knew the private placement market well, having issued twice previously, in 2006 and 2008. We had good relationships with a number of the larger investors and were particularly attracted to the long maturities available and the buy and hold approach of the majority of investors in the private placement market."

PREPARING FOR MARKET: POSITIONING THE CREDIT STORY For a debut issuer, a private placement typically takes seven to 10 weeks to complete, although in the current environment, delayed drawdown of up to six months has been achievable. The key thing is that pricing/documentation is typically crystallised by week four, meaning that an issuer has committed funds at a set price by that point. For repeat issuers, a financing can be completed in a matter of days, depending on the investors' familiarity with a credit.

Roger Blundell, finance director of Grosvenor Great Britain and Ireland, says: "We regularly report to the board on the strategic vision of the business, which includes the finance strategy. Part of this vision was the desire to add further long-term financing when we felt it was the right time. We have a treasury team which monitors all the markets and constantly assesses each market in terms of underlying pricing and terms to identify when is the right time to access a market."

In the private placement market one size does not fit all, which can be hugely advantageous. Investors make their investment decisions based on an issuer's unique credit story; they do not rely on a public rating. Positioning this credit story properly is the key to achieving the tightest possible pricing. The result can often be surprising, with a number of recent financings pricing inside the levels of short-term bank facilities or comparable publicly traded bonds. This window of opportunity has been apparent over the past couple of years, as investor demand for private placement assets has continued to rise, leading to massive competition for well-presented financings.

The three key marketing materials for a private placement are the information memorandum, the investor presentation and the note purchase agreement.

The preparation of these materials will typically take between two to four weeks. An information memorandum may not always be required, particularly for repeat issuers, but is often created to ensure that a credit story is positioned correctly, to give investors the best possible information to help put their money to work. There is, of course, upfront work in producing these materials and for this reason Shannon highlights that "for a couple of weeks the issuer will be committed to this process and need to have a strong deal team around them". Blundell recommends that an issuer "utilises their agent effectively as they have the market experience and know the process backwards".

All three estates decided to produce an information memorandum, which paid significant dividends in the result achieved. As a debut issuer, Shannon felt these materials were key to communicating the credit story successfully. The message is reiterated by Blundell: "Although not absolutely necessary, we spent time producing a comprehensive information memorandum to ensure we minimised the questions from the investors and helped them understand our business." Grant, as an existing issuer in the market and with relatively recent documentation (2008) in place, says: "Having been through the process twice previously, the workload was very much as expected. It helped significantly that we had precedent documentation which could be updated without undue effort."

ENSURING THE RIGHT RESULT: THE CORRECT MARKETING STRATEGY An issuer's financing requirement will determine the appropriate marketing strategy. Different strategies will be employed depending on the client and the requirement. Working with a trusted and experienced agent/adviser helps issuers to achieve this. Only a detailed knowledge of the investor universe on both sides of the Atlantic will ensure that the correct marketing strategy is employed

for the benefit of the issuer. Therefore, it is essential to have an up-to-date understanding of such things as which investors are actively investing in a sector, together with their currency, maturity and documentation preferences.

Investors are able to provide a range of currencies. The attractiveness of the US investor base, together with the potential arbitrage of raising dollars and converting to sterling or an issuer's other desired currency (which either the issuer or the investor might do), has confirmed that issuers should take advantage of this part of the investor base. In a number of sectors, including real estate, US investors have been able to provide the tightest-priced bids because US publicly traded comparables have been trading tighter (relatively) than European comparables. Consequently, issuers wishing to offer a financing to US investors have been able to generate the largest books of demand, often multiple times oversubscribed, and create the kind of competitive tension that has driven pricing down to the tightest possible level.

All three estates decided to undertake a single group investor meeting in London together with a group meeting in New York. Investor meetings typically last two hours and enable management to meet with key institutional investors. In the case of the London estates, the New York meetings also included investors who had flown in from further afield to meet management, such was their interest in the businesses.

Grosvenor needed RBS to help facilitate an innovative funding solution where it could issue in sterling but price in dollars, taking advantage of a pricing arbitrage through the cross-currency swap while avoiding any swap counterparty risk, maintaining its banking covenants and have a small number of core long-term relationship partners. Blundell says: "We wanted to issue in sterling while being able to take advantage of the deep dollar market, and consequently targeted a small group of US and UK institutions that like the prime London property market. RBS's knowledge of who could provide direct sterling was essential as this can change. We visited New York for three main reasons: first, investors showing a keen desire to invest in other core London estates and seemingly pricing more aggressively than the UK investors; second, to take advantage of the pricing arbitrage through the cross-currency swap in the maturities we desired; and third to build new core long-term relationships to help access further financing in the future. We ended up with four investors, exactly the number we had targeted at the beginning of the process, with half of the investors (and more than half the volume) coming from the US."

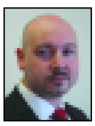
Grant says: "Cadogan's strategy was to achieve a mix of existing investors and a couple of additional investors. We were particularly keen to ensure meaningful lot sizes and not have a large number of small investors. We approached a total of approximately 15 institutions, ending up with six existing investors and two new investors, very much in line with our original ambitions."

Shannon says: "We decided very early on in the process that as a first-time issuer we should go to New York and make the case for Howard de Walden Estate. We saw it as our making a statement about the value we placed on relationships. The investor strategy was developed very much in partnership with RBS, and focused on those investors that the bank knew would have interest in the estate. The experience was a very positive one, with the group of US investors showing real interest in our credit, how the estate works and its business philosophy. The scale and competitiveness of the bidding certainly surprised us. We did not expect to be eight times oversubscribed, with all our financing requirements (maturity and currency) satisfied, and pricing below expectations by quite some way. In the end, five of our seven investors were US-based."

THE RIGHT PARTNER When it comes to undertaking a private placement, using an experienced agent/adviser will ensure the best possible result. An agent can utilise its market expertise to determine the appropriate investor group to approach, manage pricing and demand expectations, help to construct marketing materials, advise on documentation and structuring, provide market-based pricing comparables, negotiate pricing and terms directly with the investors, manage the bid process, help to drive down pricing using the book of demand, and ensure the smooth closing and funding of a financing. Banks have set up dedicated private placement teams to help take issuers through the financing process. RBS has successfully taken over 200 European issuers to the private placement market since 2000.

"We would like our clients to see RBS both as a funder and a trusted partner," adds Coates. "We have enjoyed relationships with Cadogan, Grosvenor and Howard de Walden over many years, and were delighted to work with them in their recent approaches to the private placement market. The success of these transactions is a testimony to the quality of their businesses and management teams, which gave the investors a strong degree of confidence."

See Atlantic Crossing, The Treasurer, February 2011, p32



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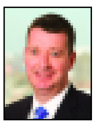

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