# Increased diversity of funding will support growth in Irish residential development

*The quantum of development finance necessary to support the supply side of the home building sector has been a limiting factor to housing supply in the recent past. But the general recovery in the Irish economy since 2013, coupled with sustainable levels of house price inflation, means the economic fundamentals are now in place to facilitate significant growth in home building, says EMMET O'REILLY. He adds, however, that significant levels of debt funding will be essential to support this growth and that the availability of development finance from banks will undoubtedly need to be supplemented by a range of specialist lenders.*

The Government has recently launched a four year plan to ensure that 'everyone can access a home, either on their own or with State support.' Significant State resources will be required to achieve this, with the recently published Action Plan for Housing and Homelessness (www.rebuildingireland.ie) setting out the ambitious goal of delivering a 'social housing programme of 47,000 units to 2021 ... with funding of €5.35 billion'.

While the private sector may well have a role to play in delivering at least part of this social housing programme, it is clear that its involvement will be essential to delivering housing for those citizens with the financial capacity to buy their own homes. Since the onset of the economic crash in 2007/08 there has been a dearth of new homes completed, resulting in a significant housing shortage throughout the country which has driven rents to near record levels nationwide (www.daft.ie/report/q1-2016-daft-rental-report.pdf).

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That is why the completion of up to 25,000 new private dwellings a year over the next four years is an important part of the Government's Action Plan. In responding to this challenge, measures such as the streamlining of the planning process and the continued focus by the National Asset Management Agency (NAMA) on the rollout of residential developments are most welcome. From a financing perspective, however, significant funding will be needed to facilitate this supply of new homes.

Emmet O'Reilly

Private sector equity will be required to fund at least 25 per cent of the costs and sales proceeds from initial phases of developments will be available to fund subsequent phases. But even allowing for this, the debt funding requirement to deliver these 100,000 homes will probably still exceed €5 billion.

This significant level of debt funding represents a significant barrier to supply and is an issue which cannot be addressed by any one party alone.

**Funding sources**

The availability of construction finance from a broad spectrum of lenders is important to the development of a healthy and efficient home building sector, preventing over-reliance on bank financing. This diversity of sources is now apparent in the Irish new housing marketplace.

NAMA, for example, has a stated objective of supplying '20,000 new residential properties…over the next five years' and has a funding model in place to achieve this. It has also said it is 'actively open to joint venture and other partnership arrangements which could involve other parties meeting at least some of that funding requirement.'

The three largest banks are also now actively back lending to the residential building sector – a welcome development. Operating within overall development finance portfolio limits, the banks will provide about 50 per cent to 60 per cent leverage on fully planned sites. However, the banks' appetite for development finance is most unlikely to meet in full the €5 billion rolling funding requirement.

**"The recent broadening of the capital pool in Ireland mirrors what has occurred in other developed economies and is a prerequisite to the emergence of a more normalised, stable and healthy financing environment."**

Since 2012/13 institutional equity investors, including Lone Star, Apollo, Avenue Capital, Oaktree, Deutsche Bank and Centerbridge, have acquired significant tranches of residentially zoned land. These entities have the financial resources to fund the build-out of developments and, on a case by case basis, they will seek some leverage from banks and specialist development lenders.

**Cost of building 25,000 homes p.a. 2017-2020**

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| Number of private new homes: | 100,000 |
| Average size (typical 3-bed semi): | 1,214 sq. ft. |
| Site & build cost* (per sq. ft.): | €193 |
| Total site & build cost*: | €23 billion |

**Site and build costs exclude finance costs, VAT and profit margin*
*Source: Society of Chartered Surveyors Ireland Research Paper: The Real Cost of New House Delivery*

Cairn Homes plc, which successfully floated on the London Stock Exchange in 2015, has acquired a significant portfolio of residentially zoned land across the State. Using a blend of equity and debt finance, Cairn is poised to increase completions up to its stated target of 1,200 homes per annum by 2019. In addition to Cairn, there may be scope for one or more new or existing publicly listed home builders to enter the Irish market. Multi-family residential product offered by investment/development groups, including IRES and Kennedy Wilson, is a new feature of the market which is also likely to continue over the coming years.

**Specialist development lending**

Specialist development lenders, including senior and mezzanine debt providers, are another important new source of funding. Although relatively new to the Irish development finance market, they are already well established in other jurisdictions. These lenders provide builders with pools of committed and flexible capital to finance residential developments. It has been estimated, for example, that at least 25 per cent of all new lending in the UK real estate market now comes from specialist non-bank lenders, which are supported by pension funds, insurance companies and sovereign funds. These specialist lenders have committed long-term capital dedicated to specific markets and seek to be nimble in response to market demand.

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It is noteworthy that the home building sector is playing its own role in facilitating improved access to funding. Thankfully there is evidence here, too, of increased professionalism - as there is in the property sector generally in Ireland over recent years. Home builders and their capital providers have taken appropriate steps in response to the increased regulatory environment and to the need to manage development exposure. These include the preparation of more robust development appraisals, in consultation with planning advisors, quantity surveyors and sales agents, as part of the initial investment decision; agreeing appropriate phasing of multi-year housing developments; ensuring financing documentation has the right balance between control and operational flexibility; and facilitating the necessary third party oversight of construction.

**Conclusion**

The recent broadening of the capital pool in Ireland mirrors what has occurred in other developed economies and is a prerequisite to the emergence of a more normalised, stable and healthy financing environment. This welcome development, together with anticipated measures from Government on the demand side, should help bring the demand and supply sides of the housing market into equilibrium.

*Emmet O'Reilly is CFO of specialist lender Activate Capital (www.activatecapital.ie), a joint venture between global investment firm KKR and the Ireland Strategic Investment Fund, with €500 million of committed long term capital.*