Liquidity of property investors in times of crisis

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The effects of the coronavirus (Covid-19) have led to a marked change in the economic situation within a short period of time and to a re-evaluation on stock and capital markets. The long-term effects cannot be estimated at this time. Although unique, the current situation is nevertheless in line with a number of other crises that have emerged in recent decades (financial market crisis 2008/09, 11 September 2001, Swiss real estate crisis 1989/90, oil crisis 1973). In this respect, the current crisis is by no means unique. In each of these crises, large assets have been destroyed, but values have also been created.

«Buy when the guns are fired, sell when the violins play» Baron Rothschild (1788-1855).

Who will benefit from the crisis: liquidity ensures survival, risk creates value

Crises lead to drying up investment abilities and to unstable cash flows in all asset classes. This also applies to real estate, especially in the Commercial, Industrial & Retail categories. Typically, there is also a reduction in potential investors for illiquid assets, incl. real estate, and thus an extended marketing period. The drying up of refinancing sources also makes debt financing more challenging: financing transactions take longer or are even impossible as a result. However, compared to investors in company shares, for example, real estate investors are in a good position, as assets continue to generate cash flows in a crisis.

At the same time, opportunities arise for liquid investors with expertise and a willingness to take risks to acquire attractive properties or invest in subordinated or mezzanine financing. However, this requires liquidity, short-term liquidity. In the current situation, how can liquidity be obtained beyond the operating cash flow?

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Hyrock is an independent mortgage expert for sophisticated private and institutional clients in Switzerland. Hyrock focuses on more complex and larger financings and serves its clients from Zurich and Geneva. Hyrock also enables investors to invest directly or indirectly in mortgages.

Early renewals

Despite slightly rising interest rates at the long end of the yield curve due to rising risk premiums, SWAP rates remain very low (27 March 2020: 10 yrs.: -0.19%). An investor who holds a mortgage that is due to expire in two to three years (the period of current uncertainty may well continue for that long) should consider an early renewal - even accepting early repayment penalties in some cases. Better cash flow planning increases the risk capacity and is strategically worth the one-off insurance premium for early repayment.

Switch LIBOR-/SARON-mortgages into fixed mortgages

Some investors have positioned their refinancing at the short end of the yield curve. In our view, this increases uncertainty in the current situation, without any significant prospect of profit. In contrast, an extension of liabilities increases stability. With the exception of special situations (e.g. new construction and conversion projects), financing should therefore currently have a minimum term of five years.

Additional financing on real estate portfolio

Due to the value increase in recent years, most real estate investors have properties that offer room for higher loan-to-value ratios. At present, there is still the possibility of tapping into these reserves and actively increasing the financing level to strengthen liquidity.

In particular, if the health and social crisis worsens, the processing times for mortgage loans could increase significantly (also partially dictated by more pressing matters on the government's agenda, e.g. Covid-19 bridging loans), making debt financing transactions almost impossible. In such a situation, investors who have obtained additional liquidity early on through financing can gain an invaluable advantage in transactions.

Change and diversification of refinancing partners

In a crisis it is advantageous to maintain relationships with several banks and alternative financing partners. This is despite the fact that the banking system in Switzerland currently appears solvent and liquid. At present, we recommend asking several providers for each maturing mortgage and specifically considering alternative refinancing sources (e.g. pension funds, insurance companies, smaller banks). Such a change may possibly also be associated with an increase in financing, which can help to build up liquidity.

«When the wind of change blows, some build walls and some build windmills.» Chinese saying

Mezzanine financing for liquidity shortgages

In addition to traditional financing, it is also possible to raise subordinated or mezzanine financing from alternative financing partners (such as liquid private individuals or family offices). Although the interest rates on these instruments are significantly higher, typically between 5-10% p.a. plus one-off fees. Nevertheless, they offer a discreet and, above all, fast way of bridging a liquidity bottleneck. These are financing options, typically used as a „bridge loan", to finance a transaction in the short term. At a later stage, the financing can be replaced by a more cost-effective, longer-term, traditional financing without time pressure.

However, there is a possibility that delays may occur in the event of a deterioration in the overall situation. In individual cases it may therefore be worthwhile to arrange liquidity early on through such a transaction - or at least to prepare the first steps for it, Hyrock for example has carried out quite a few such transactions in the last two weeks.

Proactive negotiation with banks for interest deferral and reduction of repayments

In some European countries, especially in the UK and Italy, government offers to defer interest payments (on residential and commercial property types) have been or are being launched. We do not currently see any such solutions in Switzerland. However, we believe it is possible that, in a specific liquidity situation, banks will currently offer to defer interest and repayments. We recommend an early, proactive communication - based on a long-term positive operating cash flow of the portfolio.

Negotiation with tax offices / tax deferral

The current situation is also leading to a greater willingness on the part of public authorities to defer taxes. Taxes are an important cost item for real estate investors. There is no reason not to take advantage of this opportunity to ease liquidity pressures. Of course, the funds thus gained should only be used as a „safety cushion“, not to take on additional risks.

Lending on other assets

In addition to real estate, other assets can also be lent against to generate liquidity, in particular securities via a Lombard loan. However, due to the current uncertainty and lower share prices, such transactions are currently more difficult. This applies even more so to alternative assets such as art or ships. Nevertheless, this can be an option for obtaining additional liquidity.

Conclusion

Real estate portfolios will continue to generate positive operating cash flows even during the crisis. In addition, we recommend proactively building up excess liquidity from financing activities. Increased liquidity helps in overcoming any crisis and especially in the targeted exploitation of opportunities.
For most real estate investors, a mixed strategy consisting of an extension of the financing term to stabilise cash flow in combination with the - as far as possible - early raising of additional liquidity via additional financing of properties is recommended.

For real estate investors with a liquidity shortage, for example due to recent transactions or a concentration of assets in assets with negative cash flows (construction promotions, certain commercial areas, properties under renovation or construction), the current situation is a challenge. However, there are opportunities here too, whether with mezzanine financing or other alternative sources of finance.