Pending insolvency? Secure future viability now

Introduce liquidity preserving measures to secure your company's existence

Many project developers and real estate holders are facing financial difficulties in the real estate market. The current state of the real estate sector is concerning. Daily news reports highlight the need to halt various major construction projects. It's about time for developers to take action by implementing measures to preserve liquidity and ensure their survival, while also establishing structural reforms to stabilize and secure capital serviceability.

In the current landscape, it's evident that it's not just individual projects feeling the impact, but the entire spectrum of projects managed by developers. High construction costs and rising interest rates emerge as the predominant factors behind project halts. According to research from the Munich-based ifo Institute, a notable 11,9 percent of residential construction companies surveyed are currently grappling with financing challenges, marking the highest figure in 30 years[1]. The situation is getting worse as the industry's optimism in recent years has exposed shortcomings in financial planning, failing to account for either rising interest rates or growing material costs. Declining prices also imply that the development projects cannot be sold at construction costs.

Stakeholders, particularly capital providers like banks and shareholders, need a realistic foundation for decision making, to assess whether it makes sense to provide project developers and real estate holders with the required liquidity or not. This liquidity is crucial as it is vital to proceed with ongoing projects as well as for the future viability.

Given the current overall economic situation, the future doesn't promise clarity and stability. On the contrary, there's significant uncertainty regarding the trajectory of interest rates and construction costs. Moreover, pricing dynamics within the current market environment preclude the passing on of increased costs. Consequently, a fundamental assessment of economic viability is crucial when determining the next steps. The following approaches provide the foundation for informed decisionmaking, creating transparency for all stakeholders, and ultimately, critically evaluating existing business models.

1 Stornierungswelle im Wohnungsbau markiert neuen Höchststand

Transparency and scenario based financial planning

Making decisions involves weighing alternatives in terms of their respective meaningfulness and economic viability. In the current economic climate, creating transparency is more critical than ever. An independent assessment of a company in the form of an Independent Business Review provides one way to achieve this.

Specifically, this entails establishing an understanding of the initial circumstances, identifying deviations in past planning from the current reality, and attaining clarity on the primary anticipated market trends. Following this, it becomes crucial to evaluate the upcoming challenges. Utilizing insights into the company's current economic position and its underlying drivers enables proactive planning for the company's future trajectory. Since future economic advancement depends on multiple interconnected factors, it's imperative not only to depend on a single financial projection but also to create varying scenario-based planning assessments.

In practical terms, making informed decisions, particularly for stakeholders, requires financial projections that incorporate various scenarios and assumptions. These projections account for diverse risk profiles and capture market uncertainty through different premises, thereby determining the required capital needs. As part of this process, the necessary liquidity level is often evaluated across three distinct scenarios in financial projections – Best Case, Base Case, and Worst Case. By outlining the different risk profiles in these scenarios, banks, for instance, can gain a credible understanding of capital requirements for each scenario. Moreover, these projections transparently outline the underlying assumptions in each scenario. While stress testing is a routine practice for banks, project developers are still acclimating to this approach. Historically, their planning has been shaped by a secure market environment, lacking the comprehensive detail now demanded by financiers.

Adjustment of the strategical focus

Currently, 61,4 percent of surveyed companies report dissatisfaction with their business conditions, as per a survey conducted by IW and ZIA[2]. Furthermore, the prevailing sentiment is pessimistic, with the majority of businesses anticipating a significant downturn in the next twelve months. Adjusting their strategic focus could empower companies to diversify more effectively, thereby mitigating risks. For project developers, the adaptation of existing business models offers a pathway, where developers may need to temporarily assume property ownership to prevent forced sales. Using property holders as an example, there exists potential for future space repurposing to enhance profitability and ensure liquidity, in collaboration with financiers.

Securing future viability through investment in sustainability

In the coming years, businesses will face mounting pressure to meet ESG requirements, impacting both their current property holdings and future development projects. Within this framework, it is imperative to strategize specific measures aimed at achieving sustainability compliance. Integrating ESG principles into the real estate sector commences with a thorough understanding of the present situation and the formulation of tailored ESG objectives. Building upon this groundwork, the necessary investment to implement sustainable practices can be accurately determined. Given the enduring nature of real estate investments, the planning process should be initiated as early as possible. Sustainable buildings are increasingly demanded not only by tenants but also by investors, highlighting the importance of investing in sustainability to ensure future market attractiveness and maintain creditworthiness.

Complying with sustainability standards involves making investments that require additional liquidity. Within the framework of evolving strategic direction, it is imperative to systematically assess future capital requirements, which may be partially neglected in current financing arrangements due to ESG factors. Early recognition of forthcoming megatrends (such as ESG, declining demand, demographic shifts) and their implications provides an opportunity to promptly identify actionable steps and capitalize on strategic opportunities.

In combination with the current market conditions, ESG requirements typically entail additional financing needs. Amid regulatory and financial challenges, planning and scenario analysis may lead to prioritizing and/or extending the timeline for certain measures. This, in turn, carries implications for the profitability and marketability of individual projects.

2 Projektentwickler erleiden Stimmungseinbruch (iwkoeln.de)

Summary

The current landscape of challenges calls for a proactive and timely examination of both present circumstances and future prospects to secure a company's survival. Transparency regarding both the current state and future outlook of the company is fundamental to initiating any course of action. Subsequently, potential future scenarios are outlined through scenario-based financial projections. Depending on the existing business model, it may be advisable to explore a new strategic direction by aligning the business model accordingly. Concurrently, ensuring future sustainability should consistently prioritize investments in sustainability.

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