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Modern options for financing real estate investments

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Abstract

The realities of the period we live in with limited resources, uncertainties, speculations, radical upheavals, put their mark on the entities in many respects. The situation requires a rethinking of the business so that it can remain viable, to meet the needs of customers and to obtain a maximum profit. The decision-making process is one that thus outlines the major importance it has for each entity. The options that the entity can use to finance its investments are the objective of this material, our analysis aims to present the main characteristics of these options.

Keywords: investments, leasing, financial leasing, lease-back.

1 Introduction

The society of the third millennium is characterized by limited resources, uncertainties, speculation, radical upheavals. These situations have an impact on the entities in all the aspects that these processes involve. Therefore, the new era may, more than ever, require a process of rethinking the business so that it can withstand the new conditions while meeting the needs of customers and making the most of it. Therefore, more and more participants in economic life often end up rethinking their business. In this context, the performance capacity of an entity increasingly depends on the ability to make decisions, the decision-making process being very important. In contemporary economic theory, concepts such as: real estate investment, real estate or investment valuation are frequently used. These concepts have different meanings and characteristics for some professionals. The definition of these concepts, the classification and the methodology of valuing real estate investments are processes that raise some difficulties caused by the novelty of these concepts.

2 Real estate financing options

2.1 *Mortgage loan for real estate investments*

A mortgage loan is a loan granted exclusively by authorized institutions, in compliance with the legal regulations in force in that country, for the acquisition or construction of real estate. Thus, in countries such as the USA, Germany, the United Kingdom and others, mortgage banks are those institutions that grant long-term loans for real estate investments and the loans granted are secured by mortgages on real estate (Căpraru et al., 2013:47). Mortgage banks obtain financial resources by issuing specific securities, respectively, mortgage bonds that are sold on the secondary market of mortgage financing, being forbidden to attract deposits, obtaining income from commissions and interest charged on loans. But in countries like France or Spain, mortgage banks are not the only institutions that issue mortgage bonds, they can also be issued by commercial banks (Căpraru et al., 2013:47).

In Romania, Law no. 32/2006, regulates the mortgage loan for real estate investments (Căpraru et al., 2013:47).

The real estate market knows two main categories of real estate loans (Căpraru et al., 2013:65):

-fixed interest mortgages which are those loans whose interest rate does not vary over the repayment period, and remains fixed. Thus, the loan rates are also fixed, and the debtor will know before how much he will pay to the bank during the repayment period;

- variable-rate mortgages are characterized by the fact that the interest rate may vary over the repayment period. It may increase or decrease, depending on the default benchmark (EURIBOR, LIBOR, ROBOR). Variable interest loans are disadvantageous to the client in that a possible increase in the level of the index could lead to an increase in the level of the loan rate. The higher the growth and the longer it lasts, the lower the likelihood that it will pay off credit rates. Of course, for the bank, the variability of the interest rate is favorable and the rate on loans is adjusted to the market interest rate, but to the extent that the client will be able to keep up with the payment of monthly loan installments. Otherwise, the loan may become non-performing, which is why the bank will perform a stress test for each client and will corroborate its results with the degree of indebtedness and repayment capacity after which the client will qualify or not as eligible.

2.2 *Development of a real estate project through a bank*

In the opinion of the authors Căpraru and Onofreis (Căpraru et al., 2013:72), in the context of the development of a project financed through a bank, which would contribute to ensuring the success of obtaining this financing, the following general principles are considered:

-establishing a new company for the purpose of independent project development;

- attracting investors to partially support the project and to participate in the establishment of the new project company;

- guaranteeing the financing of the project with the assets of the established project, and not with the assets of another business;

-consider as a primary source of repayment the financing the cash flow generated by the financed project, in no case other sources obtained from other older businesses carried out.

Usually, in the context of developing a project proposed for financing (such as, for example, a commercial real estate), the newly established project company with the contribution of already selected investors who will partially contribute to the financing of the project has to establish first collaboration relations. with a number of partners involved in the project, before proposing the project for financing to the bank (Căpraru et al., 2013:73). These would be: a general contractor for construction, a works supervisor, who will represent his interests in the relationship with the general contractor and who will monitor the costs and quality of works, an insurer (insurance company) to insure the project in case of events that could disrupt the progress of the work. In the case of the development of residential complexes, the bank can participate through financing offers for the clients of the future project, offering them real estate loans.

2.3 *Non-reimbursable financing for investment projects*

One of the recent external financing options available to entities is that relating to accessing European funds to finance real estate investments. European funds, according to GEO no. 63/1999 on the management of non-reimbursable funds allocated to Romania by the European Community, as well as their co-financing funds, are defined as the financial contribution of the European Union, represented by amounts transferred to the Government of Romania by the Commission of the European Union with the title of non-reimbursable financial assistance. The Structural Funds are post-accession funds funded by the European Union budget, which aim to support Member States in areas of interest such as: education, research, agriculture, SME development, etc (CECCAR, 2011:54).

Real estate investments that are eligible for funding from European funds mainly aim at the regeneration of disadvantaged areas, investments in the real estate infrastructure of SMEs and the various investments materialized in: rehabilitation of buildings, ensemble of buildings, modernizations, restorations, etc.

2.4 *Real estate leasing*

Leasing, as a complex concept, has encountered over time several types of formulations, each trying to emphasize the common aspects of this phenomenon. The difference between the concepts can be seen concretely when the perspectives by which the lease is defined are different.

The economic outlook approaches leasing as a financing activity concluded on the basis of a leasing contract, whereby the funds necessary for the investment are guaranteed by the financier. Basically, the one who rents the property (owner) allows the user (tenant) to use a certain property provided that he pays a series of payments (leasing rate) for the entire duration of the lease. The financial benefits related to the lease do not arise from the ownership of the good but from its use. The user is the one who establishes the good and the related specifications (brand, model, manufacturer, installation, warranty, service, delivery, etc.), negotiates the price with the owner and then concludes the lease, specifying the duration of the contract, leasing rates and other optional considerations.

The legal perspective defines leasing as a complex contract that allows the user to purchase a good without immediately paying its price. The Romanian legislative framework does not provide a concrete approach to the lease term but defines the leasing operation as that operation by which a party, called the lessor, undertakes at the request of another party, called the lessee (user), to buy or take over to a third party, called a supplier, a certain movable or immovable property, and then to transfer to the user the right to use it in exchange for a monthly payment called royalty, for the purpose of using, or, as the case may be, purchasing the property (Ordonanța 51/97).

From the beneficiary's point of view, leasing is a form of lending according to which the value necessary for the purchase of the good is achieved through its use, its repayment is made in installments, in the form of leasing rates and, finally, the residual value. In this case, the lease appears as a sale in installments, in which the ownership is transferred with the payment of the residual value.

From the point of view of the leasing company, the lease determines the purchase of a good in order to be rented, aiming at transforming the lease into a sale. buy at the end of the contract, after the related rent and the residual value have been paid. The purpose of the leasing operation (with the transfer of the property to the user) is similar to that of the sale-purchase with payment in installments, but the difference appears from the perspective of the transfer as follows: money, while leasing assigns the right to use the property.

The first attempts for definition attributed to leasing are found in French literature, but the definition addresses the concept of real estate leasing (credit-bail), and refers to the fact that an economic unit can lease real estate, built on its own or bought, having as an objective its use by the lessee and implicitly the possibility of the purchase of the good by him.

The German tax circulars of 1971 and 1972 complete the concept of leasing, but not entirely, what appears new compared to existing concepts is the determined duration of the contract and the inclusion in the royalty paid by the user, in addition to the acquisition cost, of all additional expenses financing unit.

Leasing has its origins in Antiquity in this way: around 210 BC, the owners of agricultural tools in the Samaritan town of Ur rented the goods of the farmers who needed them and recorded their records on clay plates. Thus, people have noticed that the benefits generated by a good do not arise from ownership of the good, but from its use.

The first forms of leasing took place in the United States, in the late nineteenth century, when telephones were rented to customers under a contract called a "lease." In 1936 the owner of "Safe Stores Inc." bought a land on which he built a huge store, but needed capital to continue, so he sold his store to a group of investors, who later re-leased it to the former owner on a "lease" basis. This type of operation is called sale and lease-back. The United States strongly encouraged this type of activity, offering multiple tax advantages that led in 1950 to the employment of more than 150 higher education institutions in lease-back transactions. At the time, the backers were the insurance companies.

Financial leasing appeared in the middle of the 20th century, due to the need for a manager to place an important order for food but without the necessary equipment. The person in question, D. P. Bootle, decided to rent the equipment he needed in order to honor his order. This moment of Bootle's brilliance would lead to the emergence of an entire leasing industry. This experience led Bootle to set up his own leasing company, US Leasing Corporation, and then, together with his partner Schoenfeld, set up the first company specializing in furniture leasing operations, which is still active in the leasing market today. The two have historically been known as the "founders" of leasing. Banks were the ones who centrally encouraged and supported the leasing of industrial equipment, and in 1963 the banks also received authorization to carry out leasing operations. The first banking network to operate on the leasing market was National Banks, followed by Bank Holding Companies, and by 1975 they had been authorized to conduct leasing operations directly in 41 US states.

The rapid expansion of leasing in the US was mainly due to the fiscal facilities granted but also to a growing economy. This trend was also taken over in Continental Europe, the United Kingdom being the first country to adopt this activity, being strongly supported by credit institutions. Western countries have also adopted the phenomenon, each imposing its own legal regulations. LEASEUROPE was established in 1972, the European Federation of Leasing Companies, which came to include 25 affiliated countries and 1054 member institutions in 1993. Today the federation has expanded to 32 countries and controls about 80% of the European leasing industry.

In Romania, the first leasing company was established in 1994, and the first leasing regulations appeared in 1995, and in the following year the National Union of Leasing Companies-UNSLR was established. The year 1997 marks the adoption of the first law specific to leasing operations - OG 51/1997.

Financial leasing is a strong starting point for financing companies that want to buy goods but do not have the necessary financial resources to purchase them. This financing activity helps economic agents who do not have the possibility to attract loans from banks, or do not want to encumber their assets, whether movable or immovable, by setting up mortgages or pledges.

Leasing, as a way of financing, primarily aims at economic agents that seek to expand the activity and improve economic performance, and in general aims at technical optimization. The user's decision on the purchase of a good must take into account, in addition to the net cost of purchase, a number of elements that influence its size: the discount factor, additional costs specific to each type of purchase, taxation and compulsory insurance required.

A sale and leaseback transaction involves the sale of an asset owned by an economic operator to a specialist company and the leasing of the same asset to the original seller. Sales price and leasing rates are interdependent variables because they are negotiated together. The accounting treatment of these transactions differs depending on the lease that is concluded.

If the sale and leaseback transaction has as its purpose a financial leasing, it is a means by which the lessor grants financing to the lessee, the negotiated property having the role of guarantee. The difference between the sale price and the carrying amount of the good must not be recognized immediately as income in the lessee's financial statements, it is deferred and amortized over the term of the finance lease.

On the other hand, if the result of the transaction is an operating lease, the asset is sold at fair value, and the difference between fair value and carrying amount will be recognized immediately as profit or loss, as the case may be. If the price at which the good is sold is less than the fair value, the loss will be recognized immediately, unless the loss is offset by lower future leasing rates (below market price), it will also be deferred and amortized in proportion to leasing rate, for the entire duration of the contract. A price higher than fair value involves the same deferral and amortization mechanism as loss.

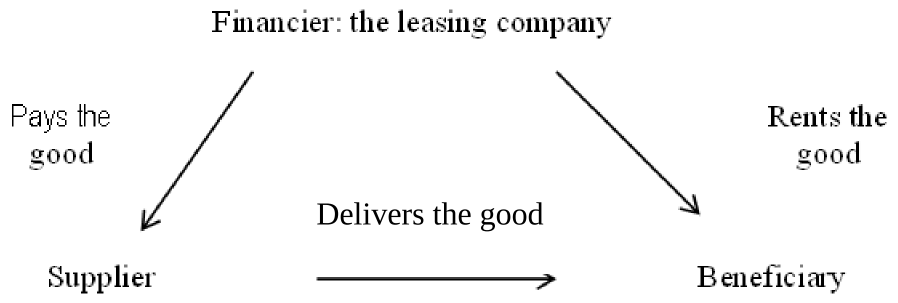
If at the time of the transaction, as a result of an operating lease, the fair value is less than the carrying amount, the difference will be recorded as an adjustment for impairment. In the case of financial leasing, the book value will be reduced only if there are signs of depreciation of the asset, but up to its recoverable amount.

In practice, there are different ways of carrying out and financing financial leasing operations, in the following lines we have presented the main types encountered.

The classic financing operation

This assumes that the lender has sufficient liquidity to purchase the asset that will be the subject of the lease, and the leasing rate will also include interest, which will cover the risk of the amounts involved. The interest will be set in a way that is attractive to the user, but proportionate to the interest on a loan if the user purchases the good through a loan. Schematically this operation can be presented as follows:

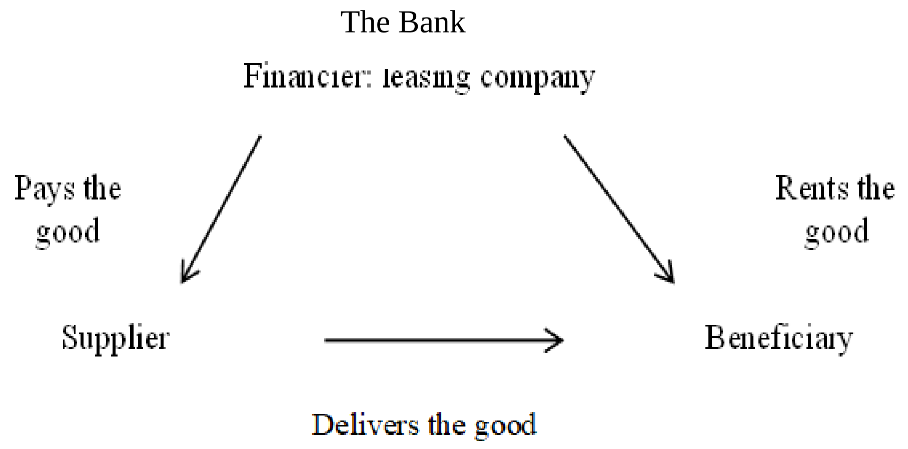
Figure 1. The classic financing scheme of the leasing operation



External credit financing

This type of financing is the most widely used in practice and is due to the fact that the leasing company does not have the necessary liquidity to cover the entire volume of leasing operations. Financing is based on sources attracted, generally from banks, where the interest charged by the bank is transferred within the leasing rates that the user has to pay.

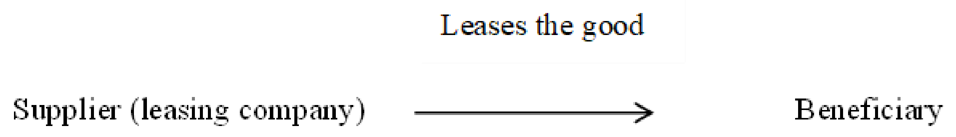
Figure 2. External credit financing scheme



Direct financing operation from the supplier

This type of operation presupposes that the supplier is the producer of the good, at the same time being the leasing company that concludes the leasing operation. It is the simplest way to finance.

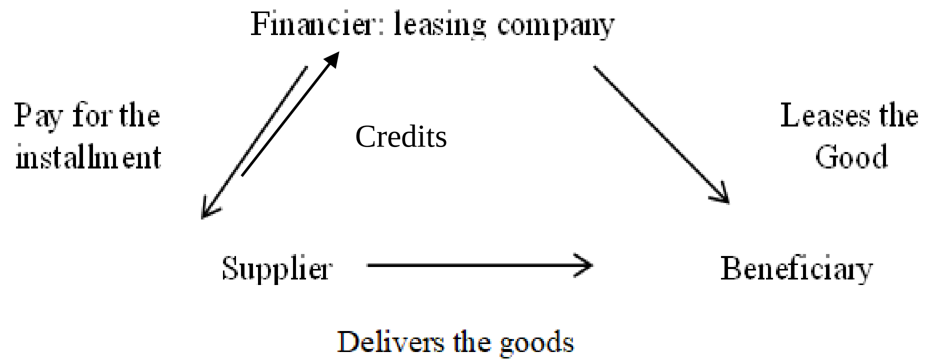
Figure 3. Scheme of direct financing from the supplier



Supplier credit financing operation

In this situation, the supplier sells the leasing company's assets on credit, and will recover the value of the investment as the user pays the leasing rates.

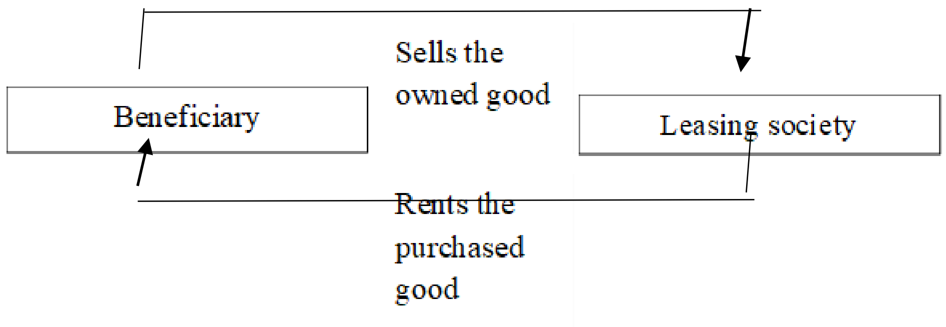
Figure 4. Supplier credit financing scheme



Leaseback financing operation

In this financing operation intervene only two parties, the beneficiary-seller and the leasing company, that are involved in this type of financing. The operation involves the sale of the property that will be the object of the leasing contract by the beneficiary to the leasing company, then moistening its lease to the owner who initiated the sale. At the end of the contract, the good is returned to the beneficiary's possession after the payment of the residual value.

Figure 5. Leasing financing scheme

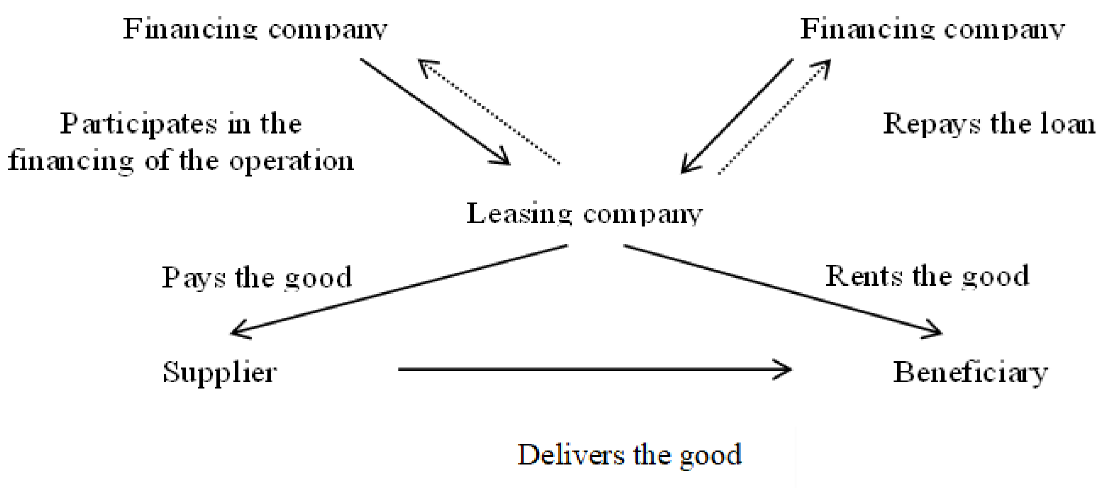


Similar to financial leasing is the shareholder leasing, the difference is that the beneficiary does not sell goods but own shares of his company to an investment fund. These will be leased through a lease set out in the lease, and the shares will be redeemed at the end of the lease.

The "leasing leverage" financing operation

This operation is specific to high-value assets, such as air transport, and refers to the fact that the leasing company cannot fully cover the cost of financing, the difference in financing being obtained from various creditors, which they will recover their investment through a certain perceived interest as well as from the advance and the leasing rates. The guarantee offered to the creditors is the good that is the object of the leasing contract.

Figure 6. "Leasing leverage" financing scheme



3 Conclusions

A mortgage loan is a loan granted exclusively by institutions authorized for the acquisition or construction of real estate. Mortgage banks obtain financial resources by issuing specific securities, respectively, mortgage bonds that are sold on the secondary market of mortgage financing, being forbidden to attract deposits, obtaining income from commissions and interest charged on loans. The real estate market has two main categories of real estate loans: fixed rate mortgages and variable rate mortgages.

Development of real estate project financed through a bank, general principles regarding the establishment of a new company for the development of the project, attracting investors, guaranteeing the financing of the project with the assets of the established project and considering as a primary source of financing the flow of cash generated by the funded project. One of the recent external financing options available to entities is that of accessing European funds to finance real estate investments. Investments in real estate that can use this form of financing are mainly aimed at regenerating disadvantaged areas, investments in real estate infrastructure of SMEs and various investments materialized in: rehabilitation of buildings, or set of buildings, modernizations, restorations, etc.

Leasing is a strong starting point in financing entities that want to purchase goods but do not have the necessary financial resources to purchase them. This financing activity is offered to entities that do not have the possibility to attract loans from banks, or do not want to encumber their assets, whether movable or immovable, by setting up mortgages or pledges.

Leasing, as a way of financing, primarily targets entities that seek to expand the business and improve economic performance, and generally aims at technical optimization. The user's decision on the purchase of a good must take into account in addition to the net cost of purchase and a number of elements that influence its size: the discount factor, additional costs specific to each type of purchase, taxation and mandatory insurance required. It can be seen that leasing is similar to investment credit, even if the user does not immediately become the owner of the property. The financier regards leasing as a loan for a certain period, guaranteed by the property right, and the user as a form of credit through which the good generates the purchase value through its use, thus the credit obtained is material and not monetary.

Cash payment can be considered the ideal form of acquiring a good, but as opposed to financial leasing, it coins the full existence of the liquidity needed for the purchase. The advantage that appears in this way of purchase is that the user becomes the owner of the purchased good at the time of delivery. It is true that cash acquisition leads to a lower financial effort compared to leasing.

It is true that the purchase of cash leads to a lower financial effort compared to leasing, but it presupposes the existence of own funds made from previous actions and not those resulting from the exploitation of the good. It is noted that the only advantage offered by the lease is the non-existence of the time gap between the time of payment and the deduction of expenses, and the fact that it does not require the full existence of liquidity for the purchase of the good. Summarizing the above, we can see that the advantages and disadvantages of leasing are different for each of the three participants in the leasing operation, giving different importance depending on their needs and requirements.

The beneficiary will choose the financing through leasing according to how much he can negotiate the payment of the lease installments or if he has the possibility to use the good even after concluding the lease contract, based on lower rents (if he does not want to buy the good, paying the residual value). At the same time, the fact that he may have access to more advanced technologies through which he can develop his activity, or the lack of guarantees should be important considerations in the leasing decision.

The leasing company, the one that finances, first of all pursues the additional gains that may arise from the re-leasing or resale of the goods that were the subject of a leasing contract. Thus we can say that the leasing company tends to keep the property right over the good, in order to exploit it later.

The supplier will always try to attract new customers and beneficiaries through leasing operations, in order to increase its sales, it will also try to overcome the possible difficulties related to the import legislation, if they opt for an import good. Promoting high quality goods and high prices that will lead to higher profitability is another way to show the importance of leasing to the supplier.

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