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A CRITICAL ANALYSIS OF A LARGE SOUTH AFRICAN BANK'S COMMERCIAL DEVELOPMENT PROPERTY LOAN PRE-DISBURSEMENT CONDITIONS.

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A research report submitted to the Faculty of Engineering, University of the Witwatersrand, Johannesburg, in partial fulfilment for the degree of Master of Science (Building)

Johannesburg
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ABSTRACT

The research question was to determine whether commercial property development loan pre-disbursement conditions protect the bank's interests, or whether certain conditions hinder the pre-disbursement compliance process.

The research showed that the majority of pre-disbursement conditions are of high importance in protecting the bank's interests.

However, findings were that not all conditions are important or even relevant for every project. Lack of understanding of the content and importance of the pre-disbursement conditions by the front-line consultant can lead to repetition and consequently an excessive number of conditions.

The most important reason for delay in compliance with pre-disbursement conditions was identified as a lack of understanding by the client of the bank's requirements and processes.

Ignorance on the part of the developer of the bank's procedures and requirements was also identified as the most common instance where relationships between the bank and the borrower were negatively affected by the pre-disbursement compliance process.

DECLARATION

I, Chloë Louise Joubert, declare that this research report is my own, unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Science in Building in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

_____ _____

Chloë Louise Joubert **Date**

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1 INTRODUCTION

1.1 Background

This research report deals with the pre-disbursement loan conditions pertinent to a commercial development property loan. A Commercial Development Property Loan is a short term bridging loan to finance the construction of commercial property, industrial property, sectional title developments, cluster housing, etc. or the infrastructure for construction projects and township development, which is granted to coincide with the construction and sale period of the development. ABSA (1998)

Development loan pre-registration and pre-disbursement conditions are imposed to compensate for the identified risk of the Borrower and, specific to commercial development property loans, the identified risk of the subject property acting as security for the loan.

Compliance with all of the pre-disbursement conditions will safeguard the lender in that any disbursements made under the loan agreement will be legally recoverable from the borrower. Compliance with all loan pre-disbursement conditions is compulsory in order for payment to be made to a developer against the development loan.

The United Nations Institute for Training and Research (UNITAR's) advice to developing country borrowers is "The fewer pre-disbursement conditions, the better" based on the statement that "these conditions tend to be excessive and occasionally irrelevant. These conditions keep a borrower from drawing down on the loan by distracting it with compliance rules. Numerous and irrelevant pre-disbursement conditions unduly delay disbursement of the loan while borrowers are already committed in financial payments, such as commitment fees. It is important for borrowers to negotiate fewer pre-disbursement conditions."

1.2 Introduction to the Research Problem

The author is a professional quantity surveyor who is currently employed in the financial sector as a valuations consultant. An important aspect of her role is the checking of compliance of the construction-related pre-disbursement conditions contained in a development loan facility letter. In her experience, where borrowers are unfamiliar with the bank's conditions, compliance with the pre-disbursement conditions can be a long and cumbersome process and may delay payment to the developer for weeks.

Should the developer be unfamiliar with the bank's pre-disbursement requirements, it may take time to obtain the compulsory documentation from various sources. Further to this, delays in the pre-disbursement compliance process are often as a result of the misunderstanding of the content and implications of certain pre-disbursement conditions, both by the bank and the developer.

In most instances, construction begins prior to the final approval of a development loan. A developer will have obligations to pay contractors and consultants at regular intervals. Delays in disbursement of the development loan will result in the developer having to make alternative arrangements to finance the early project payments. Should the developer not have access to cash, bridging finance may need to be arranged. All alternative financing options will have a cost which may affect the profitability of the project.

Delays in the approval of pre-registration and pre-disbursement conditions can have a negative effect on the relationship between the developer and the bank. Should a developer perceive that conditions are less onerous or that service is more efficient at another financial institution, they will likely move their business to the bank where conditions are more favourable.

1.3 The Research Question and Objectives

Against this background, research was conducted into the content of a large South African bank's commercial property development loan pre-disbursement conditions, and as to how these conditions limit protect the bank's interests against risks inherent in the lending process.

The research question was to determine whether commercial property development loan pre-disbursement conditions protect the bank's interests, or whether certain conditions hinder the pre-disbursement compliance process.

This report focuses on the pre-disbursement conditions imposed by the subject bank with respect to commercial development property loans, and the role of each condition in protecting the bank's interests.

Through her research, the author intends to understand whether UNITAR's advice to developing country borrowers of "the fewer pre-disbursement conditions, the better" is equally relevant to the subject bank, and property developers wishing to utilise this method of finance.

The author anticipates that this Research Report will identify certain pre-disbursement conditions that, relevant to specific types of developments, may be redundant or inapplicable, conditions that may need to be reworded, and perhaps new conditions that may need to be added to the Pre-disbursement Conditions. It is also intended that this report, or extracts of it, will assist in the education of all relevant parties within the bank as to what the content and importance of each pre-disbursement conditions is.

1.4 The Research Hypothesis

The research hypothesis is as follows:

> A large South African Bank's Commercial Property Development Loan Pre-disbursement Conditions protect the Bank's interests.

2 LITERATURE REVIEW

The theory relating to risk with respect to commercial property development loans is briefly discussed. Next, the content of each pre-disbursement condition of the subject bank is examined. Literature relating to the marketing implications of numerous pre-disbursement conditions is briefly cited.

2.1 Risk

The risk to the investor in commercial and industrial properties is of major importance to the bank. The different risks associated with these properties may stem from: the intrinsic value of the property itself; and the potential of the property to earn revenue. ABSA (1998)

The extension of credit, without regard for the ability of prospective customers to meet their commitments, leads to bad debt losses. This in turn leads to higher prices as these losses are unavoidably built into the costing structure and thus the selling price. It is the consumers who meet their obligations who pay the price for poor consumers' credit standards and the payment failure of defaulting consumers. Legal City (2001)

Isaac (2003) describes four 'Cs' as the aspects that lenders consider in a lending proposal, as follows:

- Character: the trading experience or development history of the borrower and their credit history;
- Cashstake: the amount and source of equity (borrower's own funds) to be contributed towards the transaction;
- Capability: the borrower's ability to service the loan;
- Collateral: the security offered for the loan.

Strischek (2000) maintains that for bankers, the ideal loan should have three alternative sources of repayment, i.e. cash flow, collateral and guarantees. Although repayment is expected out of the cash flow from operations first,

collateral and guarantees offer lenders secondary and tertiary sources of repayment. Therefore, loans that lack one or more of these attributes are considered more risky than loans with all three attributes. The primary source of repayment is enough cash flow from operations to repay the loan principal and periodic interest on time, in full and as agreed. At a minimum, cash flow from operations should cover 100% of the principal plus interest, i.e. the debt coverage ratio should ideally remain above 1.0. Pre-disbursement conditions improving the odds of obtaining sufficient cash flow from operations include pre-leasing or presales requirements (refer to Sections 2.2.6 and 4.6 below). If cash flow is insufficient to repay debt, then the lender must look to collateral to satisfy the unpaid obligation. When cash flow is insufficient to repay a loan and collateral liquidation is unlikely to cover the shortfall, the other source of repayment is the guarantee of individuals and entities related to the borrower (alternative loan security is discussed in Section 2.2.1 below).

ABSA (1998) maintains that the break-even point of the loan and the development costs is crucial in determining the risk of financing a development. Archer, Elmer, Harrison & Ling (2002) propose that the central measure of default risk is the loan-to-value (LTV) ratio, but argue that there is no empirical relationship between default and LTV ratios, i.e. mortgages with low and moderate LTV ratios may be as likely to default as those with high LTV ratios. Their research has identified that the strongest predictors of default are property characteristics and initial cash flow as reflected in the debt coverage ratio. They found a strong inverse relationship between incidence of default and the debt coverage ratio. Their research found that property characteristics such as location, number of units, year built, etc. have the strongest predictive content for default, which is significant in that property characteristics are observable at the outset of the loan and are relevantly permanent features of a property.

According to Ralston & Wright (2003), sound lending practice has three key elements:

- The systematic identification of the risk of individual loan applicants;

- The adjustment of lending conditions to compensate for this risk prior to loan approval;
- And the implementation of timely arrears procedures when payments are missed.

Credit risk-ratings allow banks to estimate the risk of loss from a borrower's failure to pay as promised. Antonov (2000) argues that, because of intensified competition in the traditional market for bank commercial lending, risk-adjusted pricing, an efficient framework for analysing risk in a consistent manner, and the need for proper allocation of economic capital are necessary tools for competing effectively, increasing profitability and ultimately creating value for shareholders. As a result of sustained economic growth, high-risk companies that are smaller, have relatively short track records, and are often involved in risky businesses have entered the lending market making it more difficult for banks to control risk exposures. Antonov states that only those banks with sound credit risk management, efficient decision support and management tools will survive in an increasingly globalised banking market.

BMO Financial Group, a Canadian financial services company ranked second in the world for delivering risk-adjusted returns to shareholders, has had the lowest provisions for credit losses as a percentage of net loans and acceptances in their Canadian peer group for fourteen of the past fifteen years. Tony Comper, Financial Group President and Chief Executive Officer for BMO attributes their success in assessing and managing credit risk to the following five factors:

- Regional credit centres with large discretionary lending limits as opposed to centralised credit decision-making;
- BMO's 'know your customer' approach to relationship management, i.e. the bank does not loosen or tighten its credit criteria as conditions change, which sets it apart from the competition in the eyes of its competitors and is contrary to Ralston & Wright's key elements listed above;
- Consistent decision-making;

- Compensation policies that reward lenders based on the profitability or overall quality of a transaction, not simply the revenue generated;
- Identifying deteriorating accounts early and working closely with the client to turn things around. Comtex (2006)

2.2 Pre-disbursement Conditions

The United Nations Institute for Training and Research (UNITAR) defines pre-disbursement conditions as "…a number of conditions that the borrower must meet or comply with before the loan is disbursed or before the proceeds are available."

The Development Property Loan Pre-disbursement Conditions of the subject bank are numerous. For the purposes of this report, these conditions will be categorised as follows:

2.2.1 General Conditions

These conditions relate to standard conditions of contracting in terms of South African law, including proof of the identity of the Borrower, the Borrower's capacity to contract, and FICA requirements. Also included in this category are conditions relating to security. These conditions are usually imposed prior to registration of the mortgage bond.

In terms of the Financial Intelligence Centre Act 38 of 2001 (FICA), banks are required to identify all new and existing customers by obtaining prescribed information, verify the correctness of the documentation supplied, and keep records of prescribed details of customers and their transactions.

Further to their obligations with respect to the prevention of money laundering, banks also need to correctly identify individuals in order to assess their financial risk profile. Credit reports about the potential borrower are procured from a credit bureau, and together with the internal banking history, the credit

assessment is made. This assessment forms part of the Property Report submitted to the Credit Committee for consideration prior to granting finance.

ABSA (2002) defines “Security” as something that is “in a monetary sense valuable to the lender” and “ceded or pledged by the borrower to the lender to support their intention of repaying the loan. If the loan is not repaid, the lender has the right to recover the amount of the loan, any interest due and his expenses, by selling the security for cash.”

Development loan pre-registration and pre-disbursement conditions are imposed to ensure that the Borrower provides adequate security for the debt.

According to ABSA (2002), types of security typically taken by the Bank in respect of Commercial Development Property Loans are the following:

- **Cessions** – a cession is a transfer of a collection of rights from one person to another. Cessions of rentals, leases, sales proceeds or subsidies are often taken in respect of commercial property to support the borrower’s ability to repay the loan. Cession of comprehensive insurance over the subject property is required for all development property loans. The financial institution’s interest is to be noted on the policy so that, in the event that the whole or part of the property taken as security for the loan is destroyed, the financial institution can recover losses from the insurance policy.
- **Suretyships** – a suretyship is created when a third party signs an undertaking to repay the obligations of a principle debtor (the bank’s client) should the principle debtor not fulfil his/her obligations. Directors / members / trustees of companies / close corporations / trusts with limited assets, which are commonly set up for the sole purpose of developing one or a few properties, are often required to act as surety for the total of all loan amounts offered to the entity by the bank.
- **Mortgage Bond** – a mortgage is a right registered in the Deeds Office by the bank over the fixed property (land and/or buildings) of the client.

- **Continuing Covering Mortgage Bond (CCMB)** – a bank registers a CCMB over fixed property to provide security for any existing or future indebtedness of the mortgagor, i.e. it is not specific to any particular facility offered to a client.
- **Liens** – in South African common law, a contractor has a lien over the property belonging to the developer, i.e. the contractor can retain possession of the property until payment is made for the works. A contractor who has waived his lien will have surrendered an important means of enforcing payment for his work, and as a quid pro quo the employer is obliged to provide a payment guarantee in favour of the contractor. JBCC (2005). A financial institution providing finance for a building project under a mortgage bond will normally require the contractor to waive his lien. Finsen (1999 pg. 73)

Without exception, where the subject bank grants a commercial development property loan to a client, a first continuing covering mortgage bond is taken over the subject property. This gives the bank the right to sell the property to recover any debt incurred should the borrower be unable to meet their obligations with respect to the loan.

2.2.2 Borrower's Equity

Typically commercial development loans do not exceed 75% of the property valuation. ABSA (1998). According to Isaac (2003), banks generally consider any loan in excess of 70% of value to be riskier and would expect to be compensated by a greater return.

The difference between the loan amount and the total cost of the development is the Borrower's Equity. The Borrower's Equity is to be financed by the borrower, usually prior to any monies being disbursed by the financial institution.

2.2.3 Plans and Diagrams

These pre-disbursement conditions serve the purpose of identification of the subject property, providing a visual scope of the development, and confirming that the proposed development has been approved by the relevant authorities.

According to Cloete (1998 pp. 177 – 179) the factors determining the design of a development include:

- Land uses and density in accordance with the town planning scheme;
- Government planning, e.g. a proposed railway or road;
- Soil research;
- Dolomite research (where applicable);
- Conditions of Title Deed.

The objective of the National Building Regulations and Building Standards Act No. 103 of 1977 is to protect the public interest with respect to health and safety. The Act provides guidelines for building site operations, design and construction. Cloete (1998 pg. 35)

Section 7 of the National Building Regulations and Building Standards Act provides that the local authority give approval in respect of the erection of buildings if it is satisfied that the application complies with the requirements of the Act and any other applicable law. Approval will not be granted should the area where the building be erected be disfigured by the building, should the building derogate from the value of adjoining or neighbouring properties, or should the building be dangerous to life or property. When approval of the plans is granted, at least one of the copies of the plans, specifications and any other related documents is to be endorsed with the approval and is returned to the applicant. Approval will lapse within 12 months of being granted unless the erection of the subject building is commenced, or the local authority has granted an extension of the period in writing.

Cloete (1998 pg. 71) defines a Site Development Plan as a plan which shows the proposed development of a property on any salient features thereof. The Site Development Plan must take into account all the requirements of the town planning scheme and conditions of the title deed. The local authority's Department of Housing, City Planning and Environmental Planning will consider the Site Development Plan, together with other interested internal and external bodies, e.g. emergency services, Telkom, traffic department, etc. Section 8 of the Act provides that a court may order the local authority to grant or refuse its approval should it not have been made timeously. Section 7 (1) of the Act states that the local authority is to refuse or accept an application within 30 days if the architectural area of the building is less than 500m^2, and within 60 days where the area of the building is 500m^2 or larger. Delays, however, are frequently experienced as many local authorities' planning departments are experiencing large backlogs in approvals and / or shortages of skilled staff. According to the front-line consultants interviewed, property developers are often reluctant to apply for court orders to expedite approval as they feel that these would prejudice any future plan approval applications.

2.2.4 Township and Development

These pre-disbursement conditions serve the purpose of confirming that the subject property is correct, that all planned development is in terms of the conditions pertaining to the property, and that the proposed development has been approved by the relevant authorities.

The broad goal of planning is to optimise the utilisation of scarce economic and biophysical resources, to improve the general welfare of society and to ensure the sustainability of the environment. Cloete (1998 pg. 24)

2.2.4.1 Town Planning Legislation

Three distinct levels of legislation affecting land and land use currently exist in South Africa:

- Acts introduced by parliament and passed into law at a national level;
- Ordinances affecting activities at a provincial level;
- Town planning schemes and by-laws which generally operate on a local level.

More than 130 Acts, 50 ordinances and numerous local authority by-laws directly or indirectly control or affect land use or town planning matters. Prescribed application procedures must be followed where applications are lodged. The procedures of importance to the property developer are as follows:

- Township establishment
- Rezoning
- Consent use
- Removal of restrictive conditions
- Subdivision of land. Cloete (1998 pg. 40)

2.2.4.2 Township Establishment

Township establishment is required if farm land or an agricultural holding is converted into urban land.

The application for township establishment is submitted to the provincial Department of Development Planning, Environment and Works and the local authority jointly, together with a memorandum motivating the reasons for township establishment, the deed of transfer, layout plan, power of attorney, any relevant bondholders' consents, mineral rights and deeds report. The Town Planning Hub CC (2004)

The provincial government or authorised local authority advertises the application in the Provincial Gazette for 2 consecutive weeks, and may require the application to be displayed on the site. Simultaneously, the local authority consults its internal departments and other interested external bodies, e.g. Eskom, Transnet, etc. for comments. Interested parties are given 60 days in which to comment on the application. Should objections be received, a

hearing will be held by the Town Planning Committee to hear both the objections and the applicant's motivation on the application, after which the Planning Committee will either approve or refuse the application. Hugo Olivier and Associates (2003)

Once the provincial government's Townships Board has made a recommendation approving the township establishment in principle, a set of detailed conditions to the establishment of the township is issued. Upon acceptance of these by the owner, they become final conditions, which embody a number of pre-proclamation conditions which the applicant has to comply with. Service agreements and financial arrangements regarding the installation of engineering services are also made with the local authority by the applicant. Cloete (1998 pp. 40 – 41)

On issue of the final Conditions of Establishment, together with the approved stamped Layout Plan of the township, the property can be marketed as the rights would have been formally entrenched in the property. In order to exercise the approved rights the Surveyor general will allocate final erf numbers and the Layout Plan will be amended to reflect these. Hugo Olivier and Associates (2003)

At this stage of the application, it will be necessary to appoint certain professionals to assist the Town Planner in attaining township proclamation, as follows:

- A Land Surveyor to survey and lodge the General Plan of the township for approval by the Surveyor General;
- An Environmental Consultant to apply for exemption (see Section 2.2.4.7)
- An Engineer to prepare the Outline Scheme report for approval by the local authority, i.e. design of essential services within the township being water, sewerage, roads, stormwater and electrical reticulation;
- Attorneys to assist with all the legal matters pertaining to the proclamation of the township, including applying to the Registrar of Deeds for the opening of the Township Register, cancellation of Conditions of Title and

possible registration and cancellation of servitudes, surface right permits, etc. Hugo Olivier and Associates (2003)

The Services Agreement addresses the provision of electricity, water, sewage, roads and stormwater should these not be available on the site prior to township establishment. Engineering standards of services are usually in line with those included in the Guidelines for Engineering Services and Amenities, also known as the Red Book. Cloete (1998 pp. 183 – 185). As the local authority and various external bodies, e.g. Eskom, Johannesburg Water, will ultimately take ownership of the services to the edge of each site in the new township, they have a vested interest in the quality of their design and construction and will therefore provide input into the Services Agreement. The Service Agreement will also state what financial contributions will be made by the developer and the local authority. It is common for the developer to pay for the installation of new services, and for the connections to existing services. The local authority will usually contribute towards the cost of enlargement of existing services to accommodate existing and future townships. According to Cloete (1998 pg. 184), it does not make sense to try and design services too early as the land surveyor's measurements are essential in getting the levels and locations correct. Also, should the developer not have extensive experience with the relevant local authority, it is expedient to first conclude the services agreement with the local authority before starting the design of the services as the conclusion of the service agreement "is generally known as the most time-consuming step in the whole township establishment process".

On approval of the General Plan, a Section 125 Amendment Scheme application is prepared by the town planner to incorporate the new zoning of the property into the prevailing Town Planning Scheme. Once all the pre-proclamation conditions have been complied with, the attorneys will be in a position to make application to the Registrar of Deeds for the opening of the Township Register.

The Conditions of Establishment must be complied with within 12 months of the date of approval by the Municipality, failing which the approval of the

proposed township will be deemed to have lapsed. When all conditions are complied with, the township will be declared an approved township in the Provincial Gazette in terms of section 103 of the Town-planning and Township Ordinance, 1986 (Ordinance 15 of 1986).

An average township application takes approximately 12 months from submission to proclamation. Cloete (1998 pg. 41)

2.2.4.3 Rezoning

The Town Planning Scheme applicable to an erf dictates the land use, boundary building line, coverage, bulk, building height, parking requirements, etc. Should a developer wish to change the land use rights pertaining to a site, it will be necessary to lodge an application to rezone the property in terms of the Town Planning and Townships Ordinance, 1986.

Cloete (1998), Hugo Olivier and Associates (2003), and the Town Planning Hub (2004) summarise the rezoning process as follows: The applicant prepares a motivating memorandum, supporting documents, various maps, plans and annexures and lodges these with the local authority (in Gauteng) or the provincial government.

The application is then advertised in the press, the Provincial Gazette and on the site. The objection period is 28 days. The application is also submitted to the various internal council departments and relevant external authorities, which have 60 days to comment. Once all comments have been received, and provided there are no objections, the matter will be submitted to the Head of Department for approval. If objections have been received, there will be an inspection and a Committee hearing at which the application will be considered.

If the decision is favourable, the final documents are prepared amending the town planning scheme and the application is promulgated in the Provincial Gazette. The average time taken for a rezoning application is 6 months. Where objections are received, the application can take from 12 to 15 months.

2.2.4.4 Consent use

Consent use applications are limited to certain uses such as the use of a residential property for a place of worship, crèche or doctor's consulting rooms, i.e. the land rights are not being altered on the title deed but consent is given to use the property for a specific purpose.
The applicant advertises the application on the site and in the newspapers for a period of a month, calling for any objections. After expiry of this period, the application is submitted to the local authority, which can consider and grant the application without referring it to a higher authority. A consent use usually will have a specified time limit, i.e. further application will need to be made when the consent expires.

A consent use application normally takes 4 to 6 months.

2.2.4.5 Removal of restrictive conditions

Where a restrictive condition is contained in the Title Deed of the property an application for the removal of the restrictive condition(s) needs to be made in terms of the Removal of Restrictions Act No. 84 of 1967 or the Gauteng Removal of Restrictions Act No. 3 of 1996 in Gauteng. This essentially follows the same procedure as a rezoning. If successful, the Title Deeds are endorsed removing the restrictive conditions. The process takes 6 months on average, and 12 to 15 months if objections are received, and commonly runs parallel with an application for rezoning. Cloete (1998 pg. 43)

2.2.4.6 Subdivision

Where it is required that a site be divided into two or more portions, application must be made to the Department of Agriculture in terms of the Agricultural Land Act No. 70 of 1970 for agricultural land, or to the province or local authority in terms of the relevant Town Planning and Townships Ordinance for the subdivision of an erf in an established township. Cloete (1998 pp. 44 – 45)

Together with the application and supporting documents, a Land Surveyor is instructed to prepare a base plan of the property on which the subdivision lines are indicated.

The application is advertised on site, and contiguous property owners are notified of the proposed subdivision. There is a 35-day objection period. The application is also circulated within council for comment.

Should the application be approved, with the approved subdivision plan, the Land Surveyor will be instructed to survey and peg the subdivided portions. Surveyor General (SG) Diagrams will be prepared and submitted to the Surveyor General's office for approval. Once the SG Diagrams have been approved and the applicant has complied with all the conditions of subdivision stipulated by the council in the letter of consent to subdivide, transfer of the subdivided portion can be affected by the appointed attorney. Hugo Olivier and Associates (2003)

2.2.4.7 Environmental Matters

The purpose of the Environment Conservation Act 73 of 1989 is for the preservation of ecological processes and natural systems, natural beauty, indigenous wildlife and biotic diversity. Provision is made for the protection of two categories of natural environment areas: 'protected natural environment areas' and 'special nature reserves'. Once an area has been declared a protected natural environment, directions are issued to all affected land owners and holders of real rights over the affected land in respect of any land or water usage. Every land owner and every holder of a real right in land situated in a protected natural environment (including their successors in title) will be subject to the provisions of these directions and the title deed of the property may be endorsed accordingly. Section 21 of the Act creates a mechanism whereby the Minister of Environment Affairs, in consultation with the Council of the Environment and the Administrator of each province, may identify activities which have a substantial detrimental effect on the

environment. Examples of these activities may be land use and transformation, water use and disposal, resource removal, agricultural or industrial processes, transportation, recreation, etc. Once an activity has been identified in terms of Section 21 as having a detrimental effect, no person may undertake that activity except by virtue of written authorisation issued by the Minister or local authority. Delport (1997, pp. 158-3 - 158-8)

Should the land earmarked for development be a protected natural environment, or should the proposed type of development normally require an Environmental Impact Assessment, e.g. change of land use from 'Agricultural', the developer will need to appoint an environmental consultant to apply to the provincial Agricultural, Conservation, Environment and Land Affairs department for Exemption from compliance with the Environmental Impact Assessment Regulations. Application for Exemption usually takes 6 months.

It is important to note that Exemption is always granted subject to Specific Conditions. These Specific Conditions usually refer to the land usage on the site and usually require the submission of an Environmental Management Plan (EMP) for approval, which addresses the management of noise, dust pollution and disposal of solid waste during construction and the landscaping of the proposed development.

Should an exemption not be granted, the developer will need to have an Environmental Impact Assessment (EIA) done of the site, which can take up to 18 months and, depending on the findings, may result in the development being rejected.

2.2.5 Architect's Confirmation

The South African Council for the Architectural Profession defines "Architectural work" as comprising "the business and management of the process of investigating, assessing, defining, conceptualising and designing a physical intervention in the environment, and processing the design through

technological development and co-ordination of the input of professionals from other disciplines, to produce documentation which can be utilized for the tendering and construction of the project and which the architectural professional will use for the administration, cost and quality control of the construction process, with the ultimate purpose of delivering an architectural product which responds to the client's requirements in a manner which exemplifies design excellence, enhancement of the environment, social responsibility, appropriate technology and quality of construction and the whole executed in an ethical, competent and professional manner."

The architect is the member of the professional team normally responsible for preparing the Site Development Plan and building plans, based on the approved rights in terms of the title deed and town planning scheme. This includes a responsibility to position the building correctly, on the specified erf, and within the allowed site boundary lines. The architect is responsible for designing the buildings and specifying the materials and methods of construction, taking into account the requirements of the National Building Regulations and Standards Acts any by-laws.

2.2.6 Pre-sales

Pre-sales are a good indication of demand for the development. Pre-sales conditions are imposed by the financial institution to ensure that the development will generate the required sales in order for the borrower to be able to pay back the loan amount, fees and interest charges. A developer will need to acquire proof of a prescribed number of sales, totalling a given value. The bank also prescribes how the pre-sales are to be proven, i.e. mortgage bond approval in principle or deposit values of at least a certain value or percentage of the property selling price.

A growing economy with falling inflation and interest rates has influenced people to invest in property. The percentage of South African property buyers who are buying to let out property rose to 21% in the fourth quarter of 2005,

according to the First National Bank (FNB) Residential Property Barometer in January 2006. Property investors have tended to buy numerous properties, often with borrowed funds.

According to the Absa House Price Index released in January 2006, South Africa recorded average house price growth of 21.9% in 2005, down from 32.3% in 2004. Absa senior economist Jacques du Toit has commented that "With CPIX inflation (headline consumer inflation less mortgage rate changes) currently well under control and a much stronger rand exchange rate since late last year, interest rates are expected to remain at current levels throughout 2006. Against this background, lower house price growth of between 10% and 12% is projected in 2006, mainly driven by the combined effect of the affordability of housing and interest rates remaining low over the next twelve months." Property24.com (2006/01/13) Rudi Botha, CEO of mortgage originator BetterBond, commented that meeting lower end market needs will be a huge challenge in the face of growing raw land shortages and the surge in building costs. "Obviously, developers must look toward cheaper raw land, such as that on the periphery of towns or less popular areas, but even then the cost savings could be limited and offset by purchasers not wanting to relocate too far from work." Property24.com (2006/01/23)

Because of rises in property prices causing finance and operating costs to exceed rentals, banks are currently exercising caution, especially with respect to high-end residential apartments, i.e. sectional title flats selling for over R1million in areas like Sandton (Johannesburg), Musgrave (Durban), Claremont and the Cape Town CBD. Financial Times (2005/02/06) When investors cannot find tenants for their properties, or cannot meet the shortfall between the rental and property operating and finance costs, there is a risk that they will be unable to service their debt and may ultimately lose their properties. Property24.com (08/10/2004)

While the outlook for the South African property market for the first quarter of 2006 remained upbeat, real estate professionals believe that unrealistic expectations by sellers are the most significant contributor to the slowing

down of the overall market. Property24.com (2006/01/23) In the face of a slowing market where developers' costs are increasing, and the increase in selling prices is slowing, developers' profit margins are set to decrease.

2.2.7 Housing Consumers Protection Measures Act

The purpose of the Housing Consumers Protection Measures Act, 1988 (Act No. 95 of 1998) is "to make provision for the protection of housing consumers; and to provide for the establishment and functions of the National Home Builders Registration Council; and to provide for matters connected therewith." (www.acts.co.za)

The National Home Builders Registration Council was established in terms of the Housing Consumer Protection Measures Act, 1998 (Act No. 95 of 1998), with the following mandate (www.nhbrc.co.za):

- To protect housing consumers by monitoring quality standards in the home building industry;
- To provide assistance to housing consumers where under circumstances where major structural defects occur and where home builders fail to meet their obligations in terms of the Act;
- To build the capacity of the home builders through a national training programme, with specific emphasis on the historically disadvantaged;
- To provide technical and management support to Provincial Housing Departments and Local Authorities;
- To grow and sustain the warranty reserve;
- To educate the housing consumers and home builders about their rights and obligations.

To achieve their mandate, all contractors constructing residential units are to be registered with the NHBRC. Further to this, all new homes under construction are to be enrolled with the NHBRC three weeks prior to construction. A fee of 1.3% of the selling price (construction cost plus land

value) is payable on registration of a new home, which entitles the homeowner to the following:

- Inspections by NHBRC personnel to check the structural integrity of the construction;
- Handling of housing consumers' complaints;
- Conciliation of disputes between housing consumers and home builders, covering all relevant structural concerns of the housing consumer and clarifying the home builder's responsibility and the housing consumer's obligations;
- Undertaking remedial works in respect of structural defects found in enrolled homes.

2.2.8 Certificate to Commence Construction

Section 7 (6) of the National Building Regulations and Building Standards Act No. 103 of 1977 allows the local authority to give provisional authorisation to an applicant to commence construction relative to the application before granting or refusing the application, upon written application from the applicant.

2.2.9 Geotechnical Report

Wikipedia defines geotechnical engineers as engineers who "investigate the soil and bedrock below a site to confirm their engineering properties as they will relate to the proposed construction." Fairfax County, Virginia, USA defines a geotechnical review as "an engineering study of the geology and soils of a site which is submitted to determine the suitability of a site for development and recommends construction techniques designed to overcome development on problem soils, e.g., marine clay soils."

It is vital that the geotechnical report be considered and recommendations made by the geotechnical engineer be adhered to by the structural and civil engineers in designing the foundations, superstructure and buried services, as

ground conditions will dictate certain constraints on the structural design. Problematic soil conditions will also have a cost impact on the development, e.g. requirement for piling, and must be taken into account in the financial feasibility of the project.

2.2.10 Demographics Study

Ontario Equity defines Demographics as “characteristics of the population that influence consumption of products and services. They include age, sex, race, family size, level of education, occupation, income and location of residence.”

When choosing the location and designing a shopping centre, a developer will use area-specific information such as demographics, businesses, consumer spending, purchase potential, other shopping centres, traffic volumes, projections and more. Certain demographic information is available from the local authority, and information relating to consumer spending, purchase potential, etc. is usually purchased from vendors who specialise in compiling this type of information, e.g. Eighty20 Consumer Information Portal.

2.2.11 Professionals

The subject bank’s standard loan agreement states that “The construction (including, but not limited to, all excavations, casting of foundations and footings, structural and steelworks, concrete works and civil services) must be supervised by one or more of the professionals and they must on request report to the bank in writing, if so required, on any aspect of the construction. “

Clause 5.1 of the JBCC Contract requires the employer to appoint a principal agent and such other agents as are stated in the contract. Clause 5.2 allows for further agents to be appointed during the currency of the contract.

The financial institution will rely on the professional team to effectively manage the cost, time and quality aspects of the development. For this

reason it needs to be satisfied that the professional team is suitably qualified and experienced to manage the specific development.

The subject bank's standard requirements are for the following information from the professional team:

- Proof of qualifications and experience acceptable to the bank;
- Professional Indemnity cover and an undertaking to keep cover in force for the duration of the project;
- Letter of appointment.

The bank uses the above information to ascertain whether the professionals employed by the borrower are capable of effectively managing the construction. The bank further imposes that the final appointment of the members of the professional team shall be subject to its approval. The bank has exercised its right to refuse the appointment of certain professionals with which it has previously experienced gross incompetence.

In accordance with recommendations from property industry clients, the Association of Consulting Engineers, Glenrand MIB and a quantity surveyor surveyed by Fatima Wadiwalla, a Senior Project Manager at Absa's Commercial Property Finance division, guidelines to the required level of professional indemnity (PI) cover are summarised as follows:

- Insurance cover should be at least twice the professional's fees for a particular project;
- The Association of Consulting Engineers insists of PI cover of no less than R2million on all projects;
- PI Cover is valid for a calendar year and must be renewed if it expires during the project.

A good indication of a professional's capacity, reputation and claims history is its level of professional indemnity cover. Should an underwriter be unwilling to provide a professional with professional indemnity cover, it may do so based on the number and severity of previous claims against their professional

indemnity insurance, or on the professional's history of payment of insurance premiums. In an instance where an underwriter is unwilling to provide indemnity cover to a professional, the bank may consequently insist that the borrower appoint another professional with suitable credentials and sufficient professional indemnity cover.

A further safeguard in assessing a professional's capacity to act is by requesting proof of their registration with various South African construction professional bodies. The JBCC Agreement does not stipulate, as it did in the previous 1991 edition, that the Architect be registered in terms of the Architectural Profession Act No. 44 of 2000 (which replaces the Architects' Act No. 35 of 1970). The South African Council for the Architectural Profession established under the Architects Act is a statutory body which registers architects, supervises their training, prescribes rules for professional conduct and prosecutes those who breach these rules, and prescribes a scale of fees. Section 22(1) of the Architects Act provides that no person who is not registered as an architect in terms of the Act may hold himself out as an architect, nor do the work of an architect, except in respect of small simple projects. Similarly if an architect's registration has been suspended or even cancelled by the South African Council for the Architectural Profession as a punishment for a serious transgression of the prescribed rules of professional conduct, or for the disability such as insolvency or even failure to pay his dues, he will not be permitted to undertake work reserved for architects, and would be in breach of the act if he did so. The same holds good for quantity surveyors, whose conduct is governed by the South African Council of Quantity Surveyors, and consulting engineers, who are governed by the South African Council of Consulting Engineers. Finsen (1999 pp. 46, 69 – 70)

It is common for an employer to appoint the architect, quantity surveyor or consulting engineer as principal agent. The employer surrenders many of his contractual rights to the principal agent, for example:

- the right to approve work;
- the right to order additional work;
- the right to determine the value of variations;

- the right to extend the construction period in appropriate circumstances;
- The right to determine the amounts of payments to be made under the interim or final payment certificates.

In doing so, the principal agent binds the employer. The principal agent is expected to act even-handedly, without bias to any party, and the employer may not influence him in the execution of his duties. Finsen (1999 pp. 69 – 70)

Therefore, as the principal agent holds the majority of the administrative powers with respect to the construction contract, it is in the bank's interest to obtain sufficient professional indemnity cover from the principal agent to safeguard the employer (borrower) and the bank against any misconduct or negligence of the principal agent.

The subject bank insists that each professional consultant acknowledges receipt of the bank's notification that it will act as financier, that the bank will rely on the professional consultant's payment certificates, recommendations, or other documentation, and that such professional consultant is deemed to owe a duty of care to the bank in the exercise of all duties in terms of his/it's appointment. A standard "Duty of Care" letter is issued to each professional consultant.

The intention of the acknowledgement that the bank is financier is described by Lourens Labuschagne, a Legal Advisor at Absa's Commercial Property Finance Division, as follows: "In order to establish negligence on the part of a professional it must be shown that he / she / it owed a duty of care to the bank. Negligence does not exist in the air. Whether or not in particular circumstances a professional owed a duty of care to a financial institution is a factual issue that is only investigated when there is loss or damage. The question is: would / should another professional with similar skills etc. in the same position and acting reasonably have foreseen the loss or damage and taken the reasonable steps to avoid / mitigate such damages? Sometimes professionals would argue that they did not foresee the possibility that a party as remote as the bank may suffer damages as a result of their conduct. We

(the bank) no longer require, as was the case in the past that professionals provide a duty of care undertaking. We merely require the acknowledgement of a notice advising the professional that we have an interest as financier and that we deem him / her / it to owe the bank a duty of care. That would not create a duty of care. Such a duty either exists or it does not. A court would have to decide that. The professional may even disagree with the contents of the notice. However, proving that we have informed the professional of our interest, takes away the possibility of the argument that the professional had no reason to believe that the bank could suffer damages as the financier and establishes one of the facts that the court will consider when assessing whether the damages were foreseeable or not, and whether the professional could reasonably have been expected to take steps to prevent it."

2.2.12 Building Contract, Drawings, etc.

The principal building agreement identifies the employer, the contractor, the principal agent and the professional team. The building contract describes the obligations of the contractor, employer and employer's agents (or professional team). The building contract also sets out the contract period, contract sum, escalation method, insurances, guarantees, contract documents and dispute resolution and is an important source of reference for the monitoring of the construction.

The building contract refers to drawings which visually describe the scope of the project. Specifications are incorporated to provide the standards and details of construction and materials required by the designers and the financial institution. Finsen (1999) states that "In most building contracts, the bills of quantities takes the place of the specification. In the absence of a bills of quantities, a specification is usually necessary to define the quality of materials and workmanship to be employed, the manner in which the contractor is to proceed with the works, and other requirements for the works that cannot readily be shown on the drawings.'

The prime obligations of the employer under the principal building agreement are to appoint agents, to hand over the site to the contractor, to make payments in accordance with the agreement and to provide a payment guarantee if required. Finsen (1999 pg. 69)

The JBCC contract provides that, on being given possession of the site the contractor shall commence the works within the period stated and proceed with due skill, diligence, regularity and expedition and bring the works to completion. JBCC (2005). As the development forms the security for the loan, the choice of contractor is important as sub-standard work on the part of the contractor may result in a building of unacceptable quality. ABSA (1998). As an expert in building the contractor warrants by a term implied by law, that the materials used will be fit for purpose and, if they should be unsuitable he is obliged to replace them with suitable materials or be liable for damages. The contractor is responsible for producing a satisfactory standard of workmanship. In the absence of a contractual stipulation, the common-law position would be that the contractor has undertaken to produce workmanship that is of a similar standard to that produced by other competent contractors working in similar circumstances. Finsen (1999 pp. 83 - 84)

Maintaining the construction programme is vital to meet the obligations of the Borrower to future owners or tenants, and also limits cost overruns. The construction programme determines the term of the development loan and the estimate of the interim interest relative to the loan.

The intention of the performance guarantee or retention monies is for the fulfilment of the contractor's liabilities in terms of the agreement. JBCC (2005). The contractor is required to produce a Performance Guarantee for the construction of the development. If using the JBCC 2000 contract, the contractor has the choice of providing a variable construction guarantee or fixed construction guarantee in favour of the employer. Each guarantee type has cost and cash flow implications and a financial institution will only issue a performance guarantee if the contractor is of good standing with the financial institution. Should no performance guarantee be provided by the contractor, in

terms of the JBCC contract the employer is entitled to withhold 10% retention from payments to the contractor, the percentage reducing as project milestones are attained.

It is vitally important that the employer (borrower) and contractor perform their obligations regardless of the status of the development loan, i.e. the contractor is to construct the works and the employer is to pay the contractor according to progress. This is problematic where the construction has commenced prior to all pre-disbursement conditions being met, i.e. the employer is liable for payment to the contractor in accordance with works certified by the principal agent, but is not yet entitled to receive draws against the development loan. It is important for the front-line consultant to advise the borrower accordingly when preparing the deal, and the front-line consultant should further assess whether the borrower has the ability to pay the contractor, professional team and any other project-related costs should there be any delays in the borrower complying with all pre-registration and pre-disbursement conditions.

In terms of Clause 3.1 of the JBCC Contract, where the contractor has been required to waive their lien over the site (refer to Section 2.2.1 for further discussion of the waiver of lien), the employer is obliged to provide a payment guarantee to the contractor using the JBCC Guarantee Form. It should be noted that the subject bank does not issue payment guarantees on the JBCC Guarantee Form unless security, separate to that taken for the development loan, is provided for at least the value of the payment guarantee. Instead the bank offers a reducing payment guarantee that is linked directly to the development loan grant, and effectively protects the bank against any cost overruns and VAT not paid to the contractor should the borrower default. The bank takes further precautions when granting a payment guarantee in that, where the development loan is granted by the same bank, payments due to the contractor are made directly by the bank to the contractor. The reluctance of the bank to issue JBCC Guarantees is a cause of delay in concluding the pre-disbursement conditions as, in terms of the loan agreement, a waiver of

lien and resolution from the construction company must be signed on the bank's standard forms prior to approving payment against the loan.

2.2.13 Certificates

The subject bank may require submission of the following certificates:

- Certificate from the Town Council that rates, taxes, water and electricity in respect of the property are paid up to date;
- Certificate from the Body Corporate of a Sectional Title Scheme or any other applicable governing body that levies and rates and taxes are not in arrears.

In terms of the Amended Local Government: Municipal Systems Act, 2000, the lodgement of a rates clearance certificate (a document stating that all rates and taxes for the current rates year have been paid) is required on transfer of property unless exemption in terms of Section 118 (4) is obtained. Delay in receiving rates figures from the municipality and/or the clearance certificate can delay registration of the bond and transfer of the property. Mortgage SA (2006)

The subject bank may also require submission of the following:

- Certificate as required in terms of regulations of the Occupational Health and Safety Act, No. 85 of 1993 in respect of electrical installations as well as confirmation that the Safety Standards contained in the Construction Regulations to this Act have been complied with.

The Electrical Certificate is a requirement in terms of the Occupational Health and Safety Act. Electrical installations are inspected and tested according to the code or standards that prevailed at the time the property in question was built. When a Compliance Certificate is issued for a completely new building requiring a new installation it has to be signed by four parties, namely: the designer of the installation; the purchaser of the electrical components and equipment; the contractor in charge of the installation; and the tester.

It is not necessary that the Electrical Certificate be lodged with the Registrar of Deeds for transfer purposes. The absence of an Electrical Certificate will therefore not affect the transfer of your property. However, when a property is sold the new owner will require an Electrical Certificate of Compliance before the Local Authority will connect the electricity supply. It is common practice for the Seller to be required to furnish such a Compliance Certificate to the Purchaser. The Seller may have to instruct an electrician to effect repairs to the installation before the Electrical Certificate can be issued. The certificate should be retained by the Purchaser to hand to the next Purchaser when the property is again sold. A new Electrical Certificate will only be required if there has been any addition or alteration to any electrical installation subsequent to issue of the existing Electrical Certificate of Compliance. Huis-Huis Properties

2.3 Marketing Implications

The author has consulted literature relating to the marketing implications of numerous and cumbersome loan conditions.

Attracting and retaining profitable customers, and increasing revenue from those customers, is a priority of the managers of all firms in today's globalised marketplace. Ralston and Wright (2003)

Research on customers' perception of service quality in banks in India has also identified that the focus of marketing has shifted to managing relationships with customers. Sureshchandar, Rajendran and Anantharaman (2003)

Joubert (1993) concluded that responsiveness was the most important factor in determining the property financing decisions of commercial and industrial property developers.

Research of the marketing implications of the pre-disbursement conditions is not included in the scope of this report.

3 RESEARCH METHODOLOGY

3.1 Introduction

In order to respond to the Research Question, investigative research was conducted in two stages, as follows:

- Firstly, it was necessary to research the content of each pre-disbursement condition to understand their meaning;
- Having established the meaning of each pre-disbursement condition, a sample was tested to discover the relative importance of each condition in protecting the bank's interests.

3.2 Sample

Pre-disbursement conditions are imposed by the bank's Credit and Risk departments. The front-line consultant from Large Business, Medium Business, Residential or Affordable Housing selects the conditions relevant to the development from the bank's standard conditions and negotiates these with the property developer (the borrower). Compliance and Valuations (building-related conditions) consultants are responsible for inspecting documents submitted by the borrower to assess whether they conform to the pre-disbursement conditions. In situations where non-compliance or partial compliance is achieved, compliance consultants are often asked to comment on any motivations by frontline consultants to have pre-disbursement conditions waived or deferred.

The sample contains General Mangers, Regional Managers and Consultants of the subject bank involved in initiating and administrating commercial property development loans. Respondents were also selected in order to achieve representation across small, medium and large value commercial, industrial and residential projects.

3.3 Examination of the Content of the Pre-disbursement Conditions

3.3.1 Literature Review

The author conducted a literature review of material relevant to each pre-disbursement condition (refer to Chapter 2 above). Sources of information included the following: books; research reports; journal articles and published papers; websites; government legislation; and Absa Learning and Development study guides.

3.3.2 Interviews

In-depth and informal interviews were conducted with various key individuals including Credit, Risk, Legal and front-line consultants to relate the information obtained from the literature review to the processes and requirements of the subject bank. The interviews were structured, consisting of questions relating to specific pre-disbursement conditions.

Front-line consultants responsible for facilitating small, medium and large value commercial, industrial and residential projects were interviewed to provide a broad overview.

3.4 Critical Assessment of Pre-disbursement Conditions

3.4.1 Questionnaire

A self-administered questionnaire was emailed to the sample (see Section 3.2 above). The author intended to test the research hypothesis in Section 2.4 above, and the propositions in Section 1.3 above across different departments of the subject bank.

Fifty questionnaires were distributed to the respondents via email. Seventeen completed questionnaires were received, i.e. 34% of the total respondents.

Contents included a demographics section, to ascertain the respondents' position and department. Responses were received from every department approached, and from persons at all levels. The designation and department of respondents from which complete questionnaires were received are graphed below.

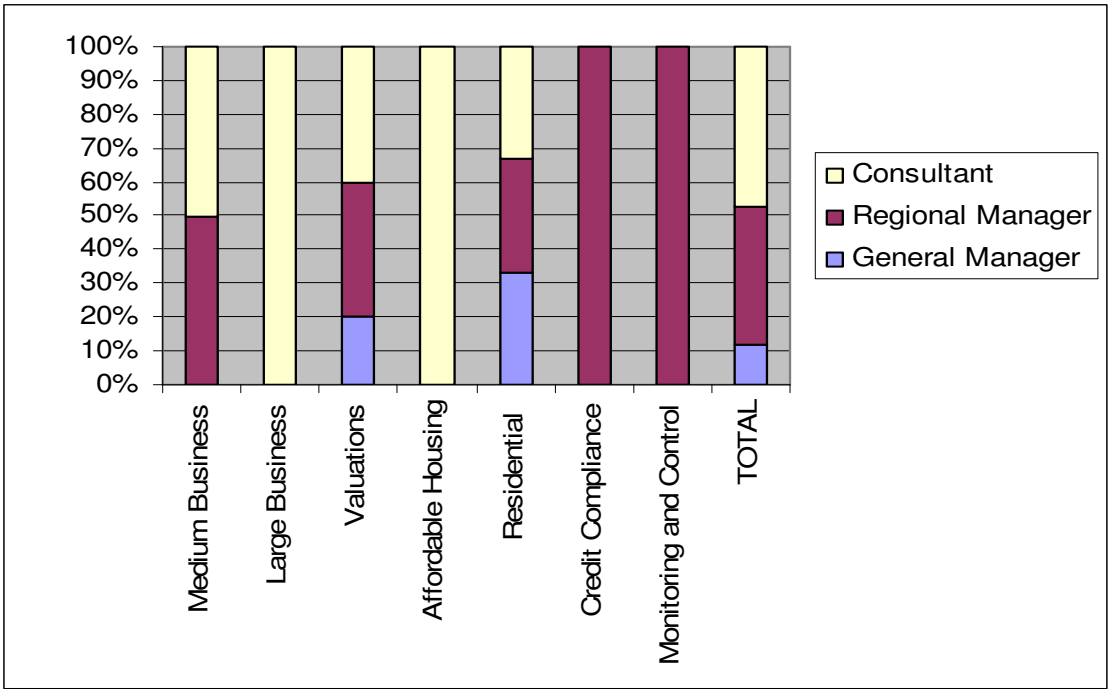


Figure 1 : Demographics of Questionnaire Respondents

For the purposes of this research, the sample of seventeen respondents was expected to be representative of the population, owing to the sample being representative of all seven departments approached, and because the sample representing persons at all levels considered.

The subject bank has forty-five standard pre-disbursement conditions. Respondents were asked to rate the importance of each development loan pre-disbursement conditions in protecting the bank's interests, as follows:

- High Importance
- Medium Importance

- Low Importance

Respondents were encouraged to provide comments to elaborate on the reasons for their choices.

Questionnaire responses were recorded by the author according to the respondent's designation and department. Responses are represented graphically in Section 4 for each pre-disbursement condition surveyed, consistent with each department.

3.4.2 Survey of compliance times

An email survey was conducted of 45 front-line consultants and sales support personnel, i.e. persons responsible for collecting compliance documentation of behalf of the front-line consultants. The purpose of the survey was to collect and data from a broad range of current development loans to determine the shortest, average and longest times taken by borrowers to comply with the pre-disbursement conditions. The following questions were proposed:

- In your experience, what are the shortest, average and longest times taken by borrowers to comply with the pre-disbursement conditions?
- Is the time taken for compliance relative to the type or size of development?
- In your opinion, what are the common delays in the compliance process?

This data is intended for use as a key indicator in determining the efficiency of the loan disbursement process.

Responses were received from only 8 people, i.e. 18% of the sample. Although few responses were received, respondents represented all departments approached. Therefore, for the purposes of this research, the sample of eight respondents was expected to be representative of the population. Responses received are discussed in Section 5 below.

3.4.3 In-depth Interviews

Further to the survey discussed in Section 3.4.2, compliance consultants were interviewed to ascertain which pre-disbursement conditions most frequently delay the compliance process.

The author interviewed front-line consultants representing different types of developments and clients to ascertain the following:

- How the pre-disbursement compliance process affects their relationship with borrowers?
- What are the fundamental reasons for delays in the pre-disbursement compliance process?

4 CRITICAL REVIEW OF PRE-DISBURSEMENT CONDITIONS

This chapter presents the results of the questionnaire (refer to Section 3.4.1 above) and the interpretation of their applicability in protecting the bank's interests. Each pre-disbursement condition is considered separately in the relevant sub-sections below.

In summary, 61% of all responses were that pre-disbursement conditions were of "high importance", 31% were of "medium importance" and 8% were of "low importance" in protecting the bank's interest.

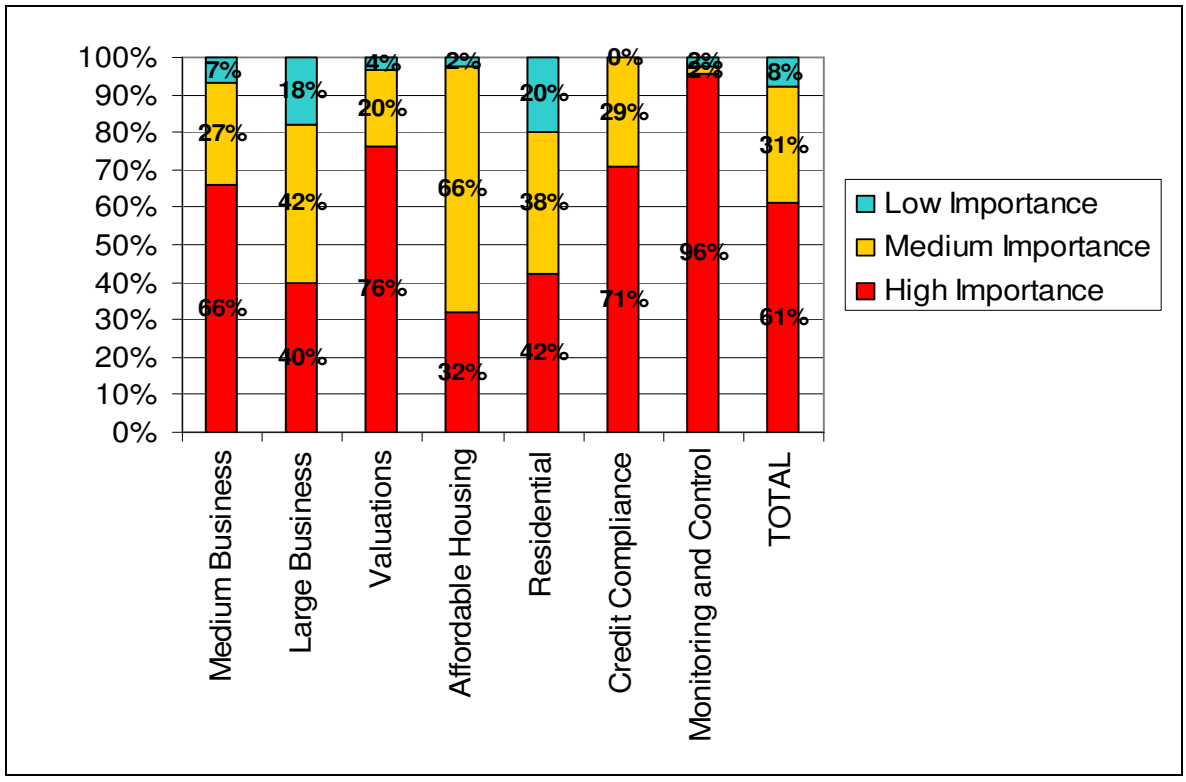


Figure 2: Summary of Questionnaire Responses

4.1 General Conditions

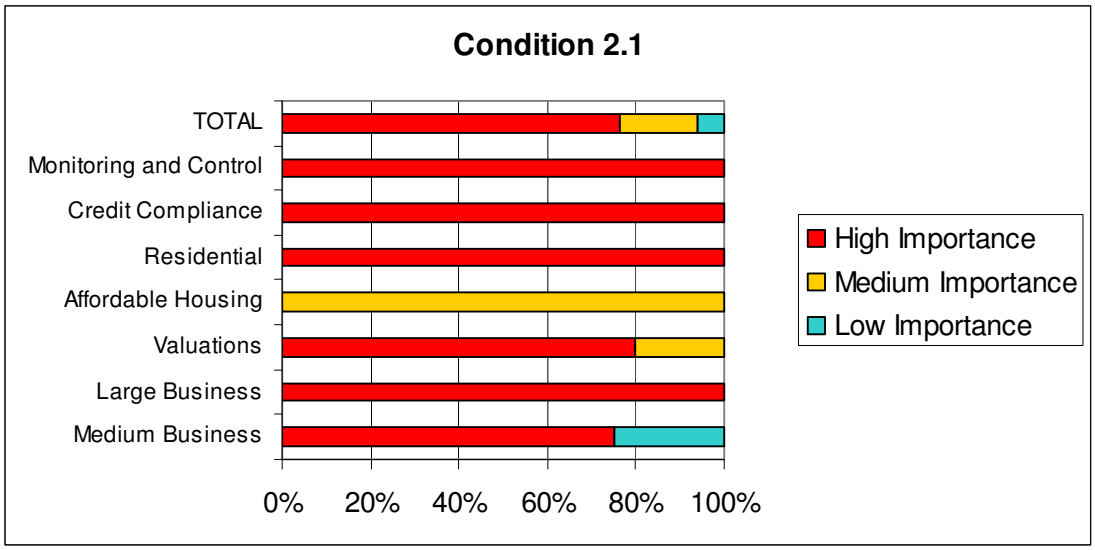
4.1.1 "Registration of the Mortgage Bond and all security documents listed as Pre-registration conditions to be duly signed and legally in order."

In practice, fulfilment of pre-registration conditions and registration of the mortgage bond often precede the fulfilment of pre-disbursement conditions. Therefore, in order for any disbursements to be made against a development loan, all pre-registration and pre-disbursement conditions must be fulfilled. Exceptions to this rule require the authority of the Risk and / or Credit Managers.

All respondents answered that this condition is of high importance in protecting the bank's interests. In the light of respondents' comments and Section 2.2.1 above, if all identification and security documentation is not in order, the bank is at risk of non-payment should it disburse any monies against the loan.

4.2 Borrower's Equity

4.2.1 The Bank requires "Proof that the Borrower has contributed in cash towards the property and / or the development."



The vast majority of respondents, with the exception of Affordable Housing, rated this condition of “high importance” in protecting the bank’s interests.

If the borrower does not make a contribution to the subject development then only the bank will incur risk with respect to the loan. This condition makes provision for adequate funds being retained by the bank to complete the project. By deducting the amount of any cost overruns from loan disbursements, the bank also ensures that it is not responsible for funding any cost overruns, i.e. that the bank finances the original scope of works approved by Credit.

The reasons for Affordable Housing consultants rating this condition as of “medium importance” are as follows:

- Department of Housing subsidies are normally ceded to the bank as security for loans to construct affordable housing, and borrower’s equity is therefore often not required.
- Disbursements are made by the bank based on approvals of the progress and quality of the works by the Department of Housing and National Home Builders Registration Council.

Therefore, besides the risk of slow payment from the Department of Housing, there is minimal risk to the bank of non-payment.

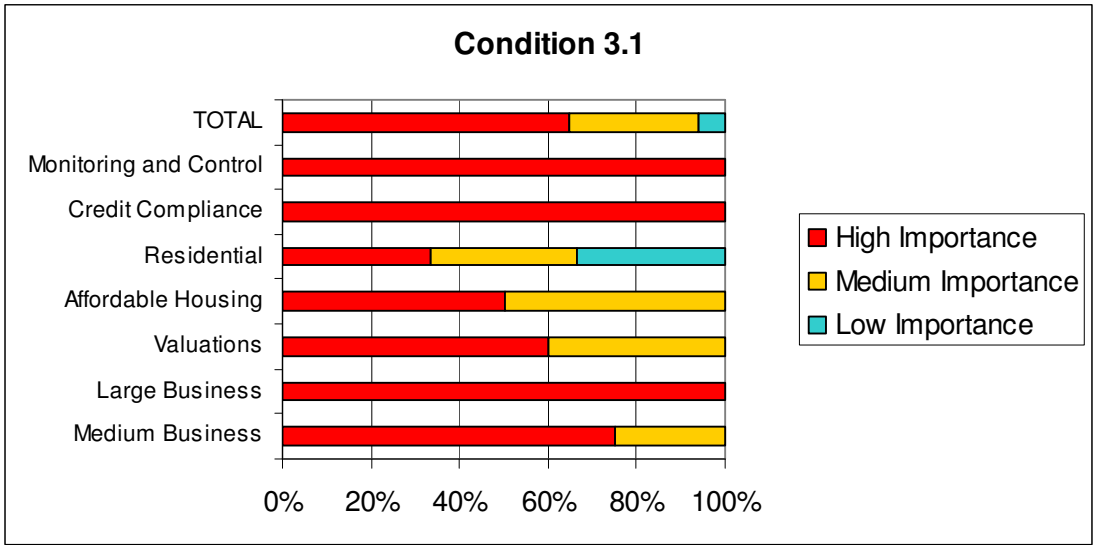
In conclusion, this condition is of high importance in protecting the bank’s interests, except for Affordable Housing projects.

4.3 Plans and Diagrams

4.3.1 “General plan of proposed township approved by the Surveyor General.”

A consequence of township establishment (see Section 2.2.4.2) is the creation and approval of a General Plan of the township by the Surveyor General, showing street names and erf numbers. This marks the creation of

the subject property and is effectively when the rights applicable to that property become formally entrenched.



It is of high importance that the township establishment process be completed prior to the property forming security for the development loan.

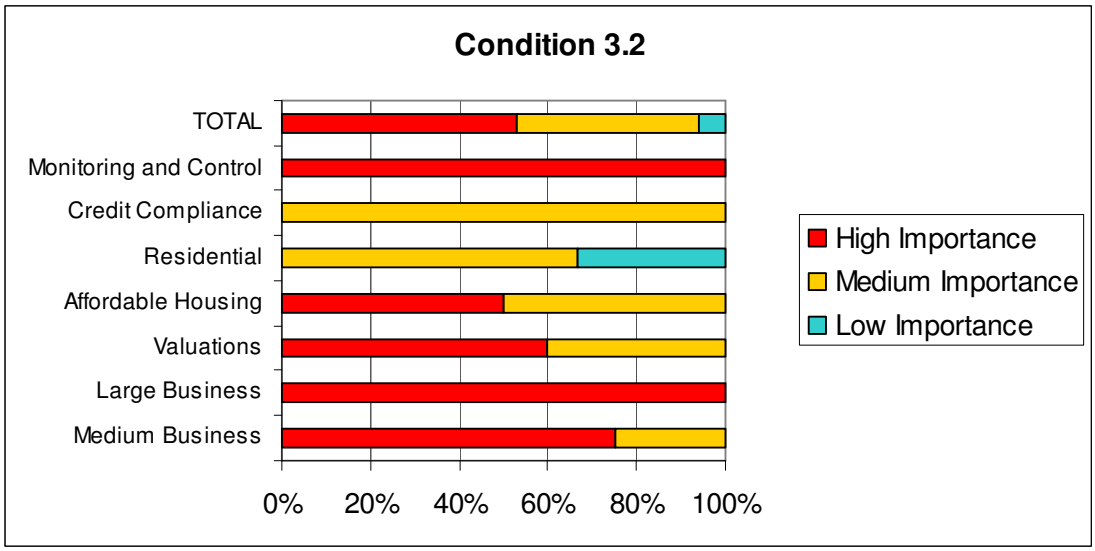
However, as township establishment usually takes at least 12 months to complete, it is common practice for the installation of infrastructure for residential developments to commence concurrently with the application for township establishment. Where this occurs, the bank will rely on receiving acceptable proof that the subject township establishment has been approved in principle, i.e. that the final Conditions of Establishment have been issued and accepted by the developer, and certificates from the town planner stating that these conditions have been complied with, or compliance is a formality (refer to Section 4.4). This is why a respondent from Residential rated this condition as of low importance.

In conclusion, this condition is of high importance in protecting the bank's interests but may be deferred to subsequent disbursements should satisfactory information identifying the property and confirming the status of township approval be received.

4.3.2 "Subdivision diagram in respect of the property approved by the Surveyor General."

Should the development be dependent on subdivision of a property, it is important that proof of the subdivision is obtained prior to completion of the project as this approval implies the following (refer to Section 2.2.4.6 above):

- The subdivided portions are pegged and therefore identifiable;
- An approved Surveyor General (SG Diagram) will be prepared;
- Transfer of the subdivided portion can be affected by the appointed attorney;
- A mortgage bond can be registered over the relevant portion.



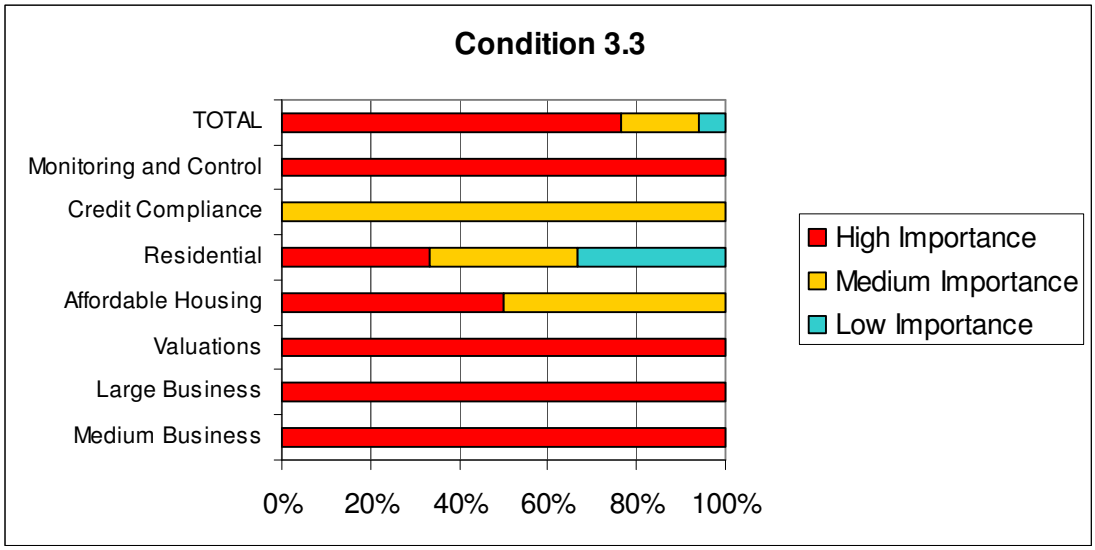
The status of the subdivision and rights of subdivision of a property will also influence the valuation of the property, as a property with the potential of subdivision will have more utilisation to a developer.

The importance of this condition is dependant on whether the bank has taken a mortgage bond over the entire property subject to subdivision, or only a portion resulting from the subdivision. Should the security of the loan only be the portion of property resulting from the subdivision, i.e. not the entire property subject to subdivision, it is important that this security can be sold should the bank require it to meet the obligations of the loan, i.e. the subject property must be transferable. Where the mortgage bond is over the entire

property the bank's risk is greatly reduced as, when the subdivision of the property is finally approved, the bank will effectively have the security of more than one property and it is very likely that, because of greater utility, the sum of values of all properties is greater than the value of the original erf.

In conclusion, this condition is of high importance in protecting the bank's interests where only the portion resulting from the subdivision is taken as security by the bank.

4.3.3 "Site development plan in respect of the proposed development approved by the local authority".



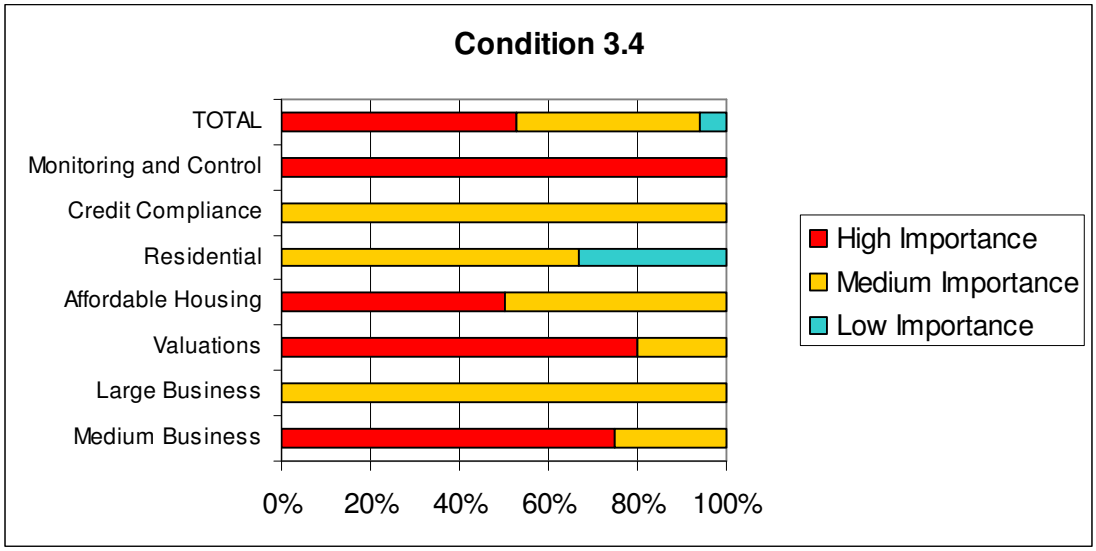
The approval of the Site Development Plan should imply that the proposed development is in accordance with the town planning scheme (refer to Section 2.2.3 above). This is of high importance to the bank as, should the development not comply with the town planning scheme or conditions of the title deed, there is a risk that additional time and costs may be incurred to rectify the construction to meet council's requirements.

A respondent noted that, should the Site Development Plan (SDP) be approved, the local authority would have taken the requirement for approval of the general plan and subdivision (if applicable) being in order prior to approving the SDP.

Should the finance required from the bank be solely for the development of infrastructure, as is common in residential loans, this could be done prior to the approval of the Site Development Plan as, if it is intended that the erven be sold prior to construction of the top structure, the end-user will require control over where their dwelling is situated on the site. In this instance, an approved Layout Plan and approved Service Agreement could be allowed instead of the approved Site Development Plan.

In conclusion, this condition is of high importance in protecting the bank's interests. Exceptions can occur where only infrastructure is being financed by the bank.

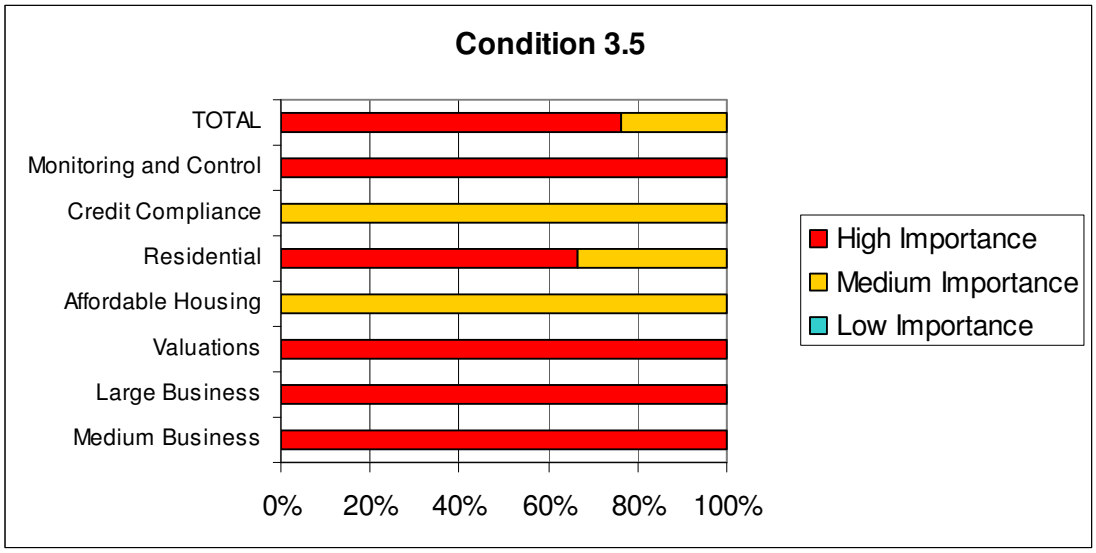
4.3.4 "Consolidation diagram reflecting the consolidated erven approved by the Surveyor General."



Proof of Consolidation of more than one erf, if applicable to the development, is important when determining whether the mortgage bond is to be registered over both the properties or whether the property to be sold as one. However, both options are possible.

In conclusion, this condition is generally rated as of medium to high importance in protecting the bank's interests, and in practice is often deferred as a requirement prior to the final draw.

4.3.5 "Building plans approved by the local authority."

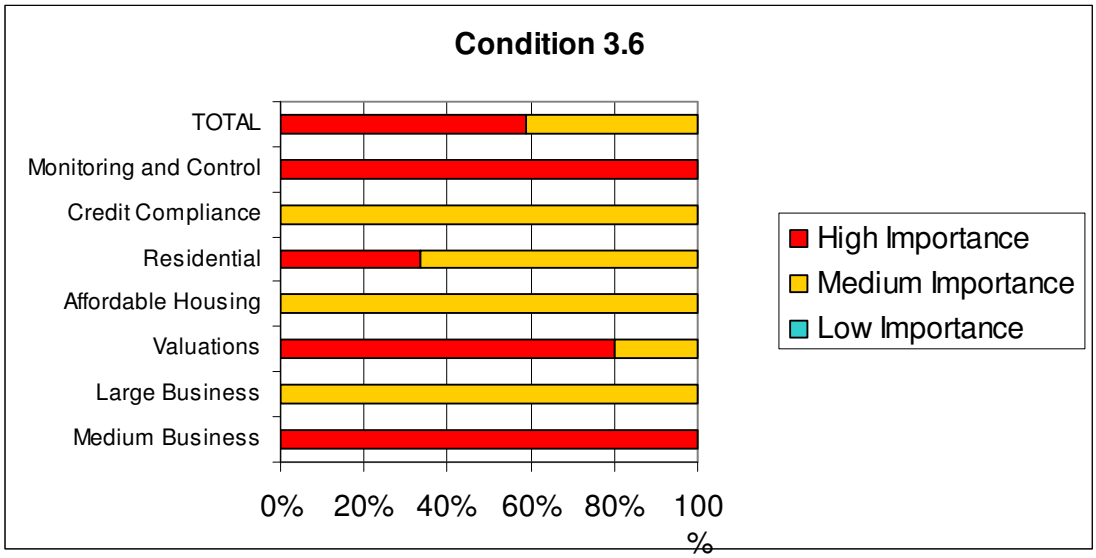


Questionnaire respondents noted that the approval of building plans implies that township establishment, subdivision, consolidation and the approval of the Site Development Plan have been obtained. Therefore, this condition is of high importance.

However, the approval of the building plans is often delayed by the backlog experienced by various councils (refer to Section 2.2.3 above). Therefore, in practice this condition can be deferred to prior to the final disbursement, provided that satisfactory proof is provided that the town planning requirements prior to the submission of the building plans have been addressed, and that there is no reason that the building plans will not be approved (refer to sections 4.4 and 4.5 below). When construction is completed, should the Occupation Certificate be issued by the local authority, this may also be considered as tacit approval that the building plans have been approved and all town planning requirements have been complied with.

In conclusion, this condition is of high importance in protecting the bank's interests but, in practice, is sometimes deferred to subsequent payments to account for delays in approval by the local authority.

4.3.6 Engineering designs approved by the local authority."



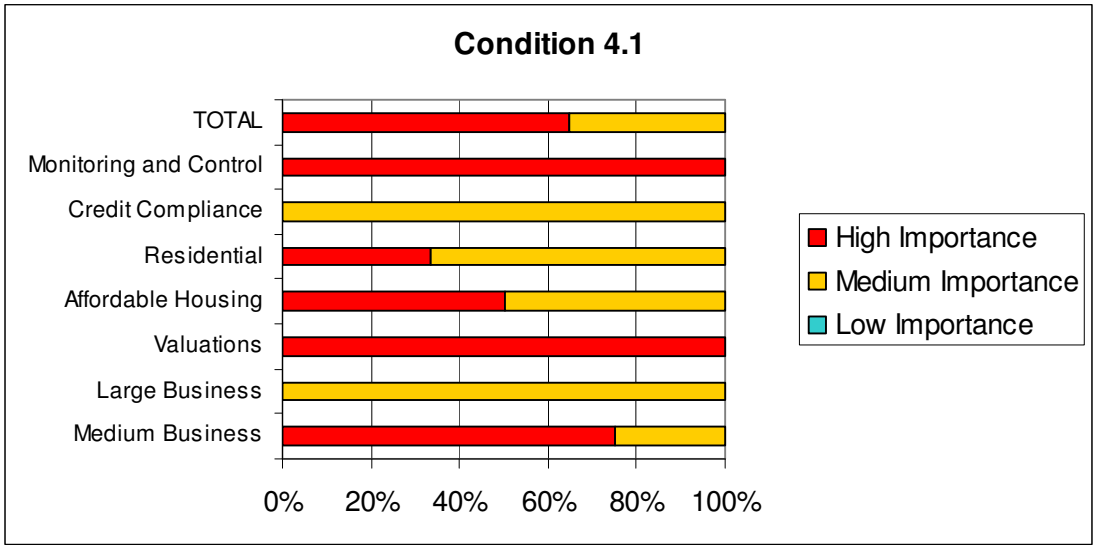
Approval of engineering designs are a requirement of the township establishment application (refer to Section 2.2.4.2 above). Therefore, once approval of the township is declared in the Provincial Gazette, it is implied that the engineering designs are approved.

Other applications may attract conditions relating to the engineering services. However, as all interested internal and external parties are approached for comment prior to approval of an application. Therefore, should the Site Development Plan and building plans be approved by all relevant authorities, it is fair to assume that the engineering designs have been approved.

In conclusion, this condition is of high importance to the bank with respect to developments where only infrastructure is being financed by the bank, and township establishment is not yet proclaimed (see Section 4.3.3 above). Otherwise, this condition can be substituted by conditions 4.3.3 and 4.3.5 above.

4.4 Township and Development

4.4.1 "The signed Services Agreement with the local authority."

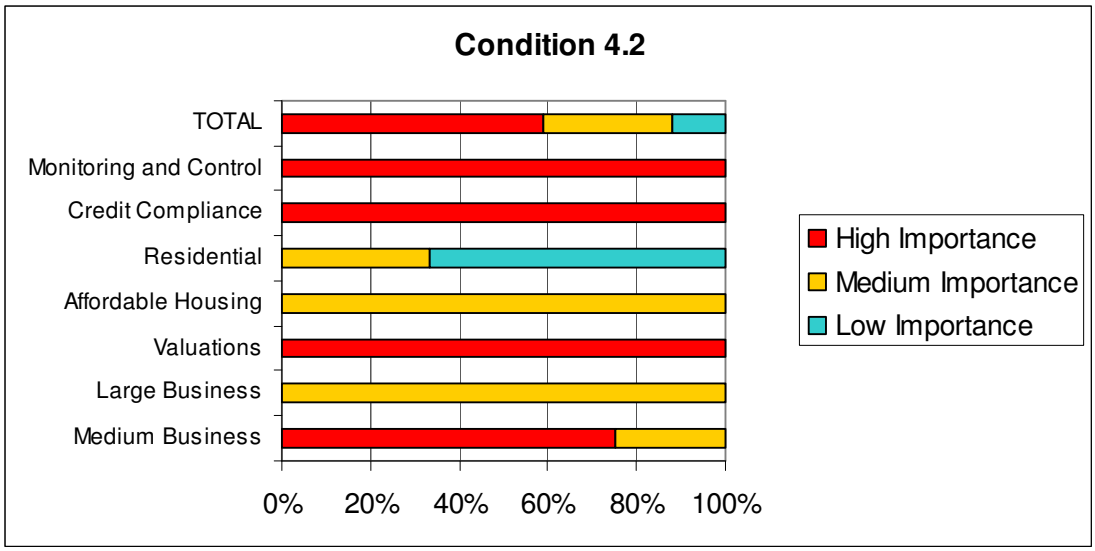


The signing of the agreed Services Agreement by the developer and the local authority is a requirement of the township establishment application (refer to Section 2.2.4.2). Therefore, once approval of the township is declared in the Provincial Gazette, it is implied that the Services Agreement has been approved, i.e. proof of township approval can be submitted to the bank in lieu of the signed Service Agreement. This is why certain respondents rated this condition as of medium importance.

This condition is of high importance should the developer wish to commence construction prior to approval of the township. In this instance the bank should insist that the signed Service Agreement be submitted. The approval of the Service Agreement is a time-consuming process and could potentially delay the township approval. Also, should the contractor commence construction of the services without approvals, if amendments to the installation are required in terms of the Service Agreement, this could cause delays and additional costs.

In conclusion, this condition is of high importance in protecting the bank's interests where a developer commences with installation of the services prior to township proclamation.

4.4.2 "Written evidence to our satisfaction that the development contribution has been paid to the local authority or acceptable provision has been made for payment thereof."

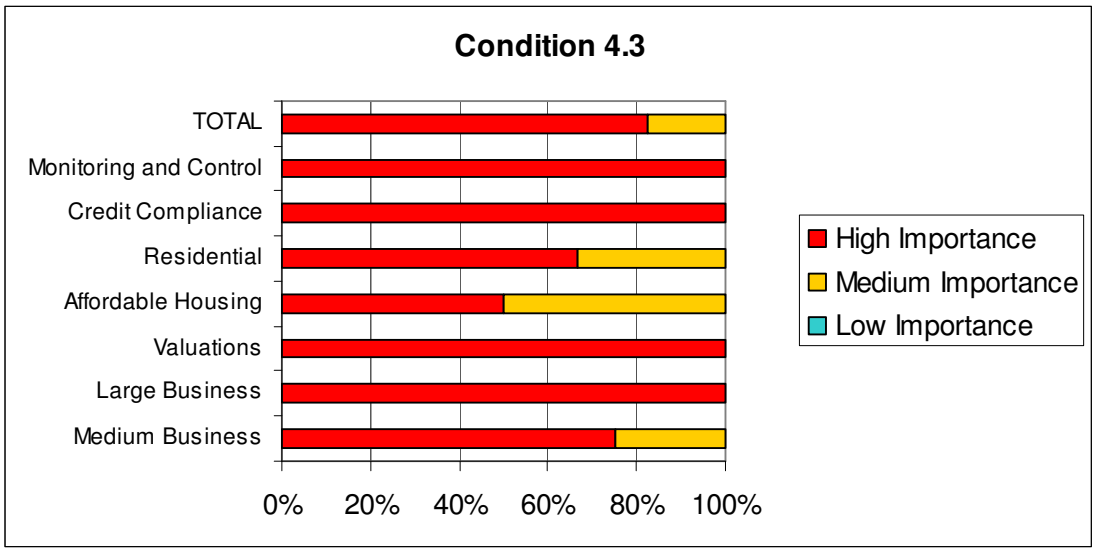


It is usual for provision for the payment of development contributions to be made in the development loan amount. From a Valuations perspective, it is important for proof of payment to be submitted prior to approval of disbursement from the loan being made for this purpose. The correct disbursement of monies against the loan is verified by Credit Compliance and Monitoring and Control.

In conclusion, this condition is of high importance in protecting the bank's interests where the bank is financing the development contributions.

4.4.3 "Conditions of Establishment approved by the local authority."

The issue of the final Conditions of Establishment signals that the Township Board has approved the township establishment in principle. At this stage, together with the approved stamped Layout Plan of the township, the property can be marketed as the rights would have been formally entrenched on the property (refer to Section 2.2.4.2).

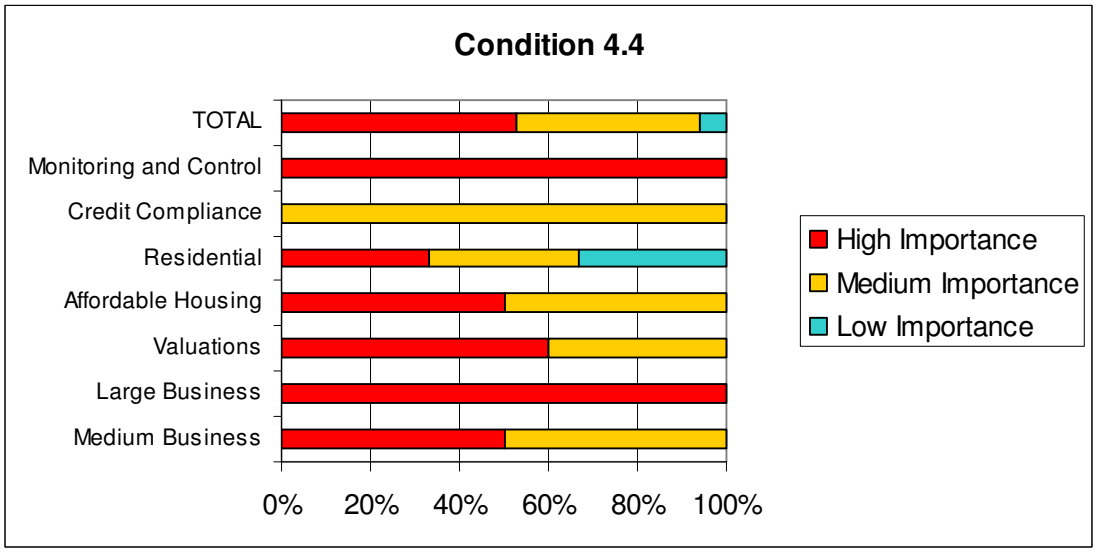


The final Conditions of Establishment provides the bank proof that the township establishment has been granted approval subject to pre-proclamation conditions and alerts the bank as to what these conditions are.

In conclusion, this condition is of high importance in protecting the bank's interests should the developer wish to commence construction prior to approval of the township. Should the township be proclaimed, this condition is irrelevant.

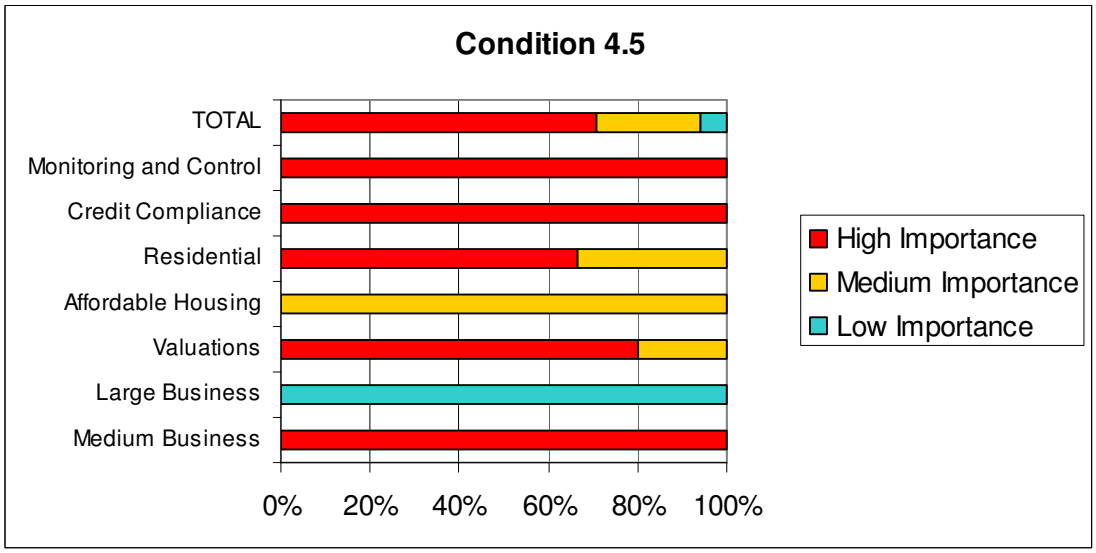
4.4.4 "Written evidence to our satisfaction that you are not precluded by Section 67 or 97 of the Town Planning and Townships Ordinance, No. 15 of 1986 (Gauteng), or any other law or by-law applicable in other provinces, from entering into contracts for the alienation or disposal of erven in the township."

Section 67 of the abovementioned Town Planning Ordinance prohibits contracts of sale, exchange or alienation or disposal or any options to purchase of erven prior to a township being declared an approved township. In this instance, the effect of non-compliance is that sales are not valid. This condition is only relevant where a developer wishes to sell or enter into options to purchase on erven prior to township proclamation, and will affect the timing of the developer meeting pre-sales requirements.



In conclusion, where the bank imposes pre-sales requirements (see Section 2.2.6 above) relating to a development that has not yet achieved township proclamation, this condition is of high importance in protecting the bank's interests.

4.4.5 "Written evidence to our satisfaction that external services including inter alia roads, water reticulation, waterborne sewerage and electricity have been installed to the boundary of the township and are available to all erven in the township or that acceptable provision for installation has been made."



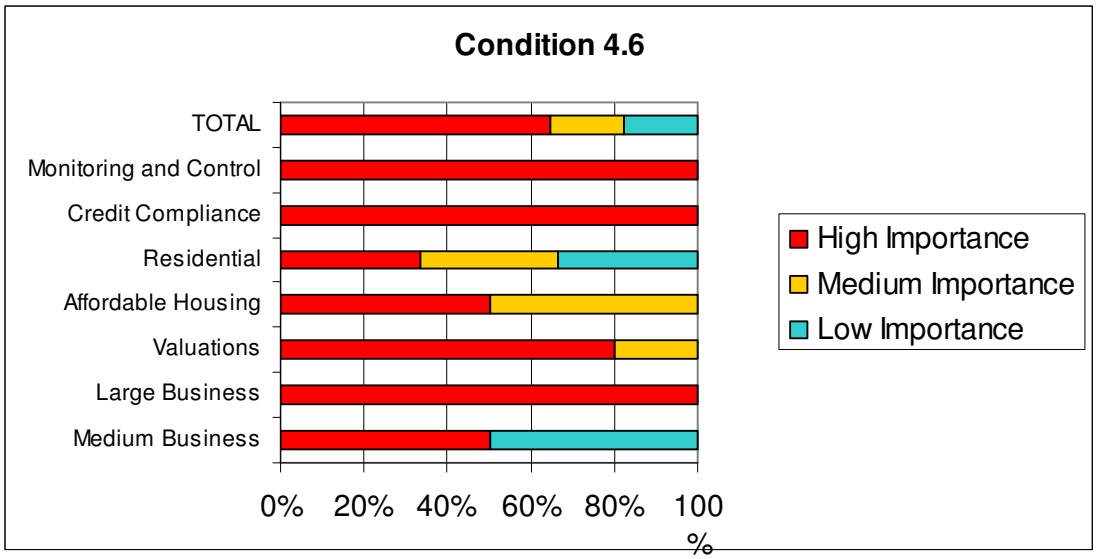
In May 2005, five construction projects in Bryanston, Johannesburg worth R460-million were ground to a halt because City Power could not supply them with electricity as the grid did not have the capacity to cater for the new applications that City Power was receiving. This resulted in more than 350 job losses and losses to developers who had to abandon their unfinished projects. City Power did not alert developers, some of whom had already begun work in the area, to the crisis until as recently as March 2005. Sunday Times (22 May 2005 **-** City Power pulls plug on R460m project)

Similarly, rolling blackouts or selective power cuts are expected within the Western Cape and Eastern Cape for several years until a R1,1billion project to upgrade power lines from Mpumalanga to Koeberg is expected to finish in May 2007. Business Day (28 November 2005 - Cape to suffer cuts until power-line upgrade over)

The lack of service capacity has a detrimental effect on planned development. In some municipalities in the recent past, building plans have been approved by the local authorities without taking cognisance of the additional infrastructure required. In the current environment where economic growth has lead to large-scale development and, in turn, backlogs in the upgrading of infrastructure, it is important that the developer ensures that adequate infrastructure is available at the time of construction. This is the reason for the bank imposing the condition that the developer obtains proof that all the required services have been installed to the boundary of the site.

In conclusion, this condition is currently of high importance in protecting the bank's interests. This condition would be of low importance if reliance could be placed on the local authority assessing the adequacy of infrastructure prior to approving a development, which is what the respondent from Large Business assumed. This condition is of medium importance in the case of social and RDP housing initiatives where the Department of Housing, and not the developer, is normally responsible for the provision of infrastructure to the site boundary.

4.4.6 "A certificate by the town planner confirming that the proposed development has been approved by all the relevant authorities."



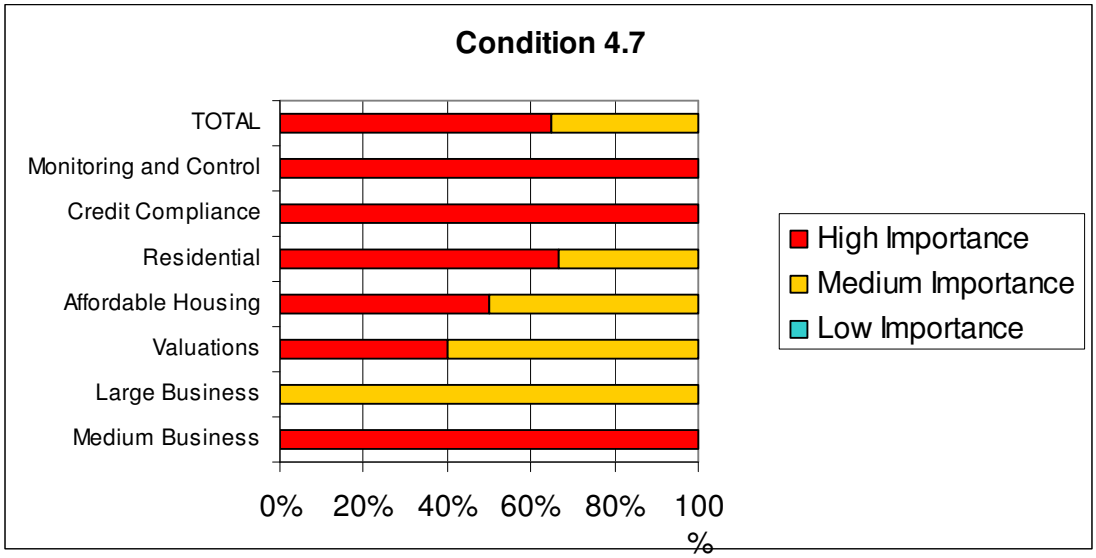
Every local authority has a method of stating that the proposed development has been approved. For this reason, it may be difficult for compliance officers of the bank to ascertain whether all relevant parties have approved the development. The town planner will have the necessary expertise to ascertain that all required town planning procedures have been completed and that the proposed development is approved. Together with this certificate, the bank will require acceptable professional indemnity insurance (refer to Section 2.2.11 above) and an acknowledgement that the bank is financier (see Section 4.11 below) to safeguard its interests.

In conclusion, this condition is of medium to high importance in protecting the bank's interests.

4.4.7 "A certificate by the town planner confirming that the conditions to be complied with prior to the declaration of the township as an approved township as contained in the approved conditions of establishment have been complied with or should they not have been complied with yet, compliance thereof is a formality."

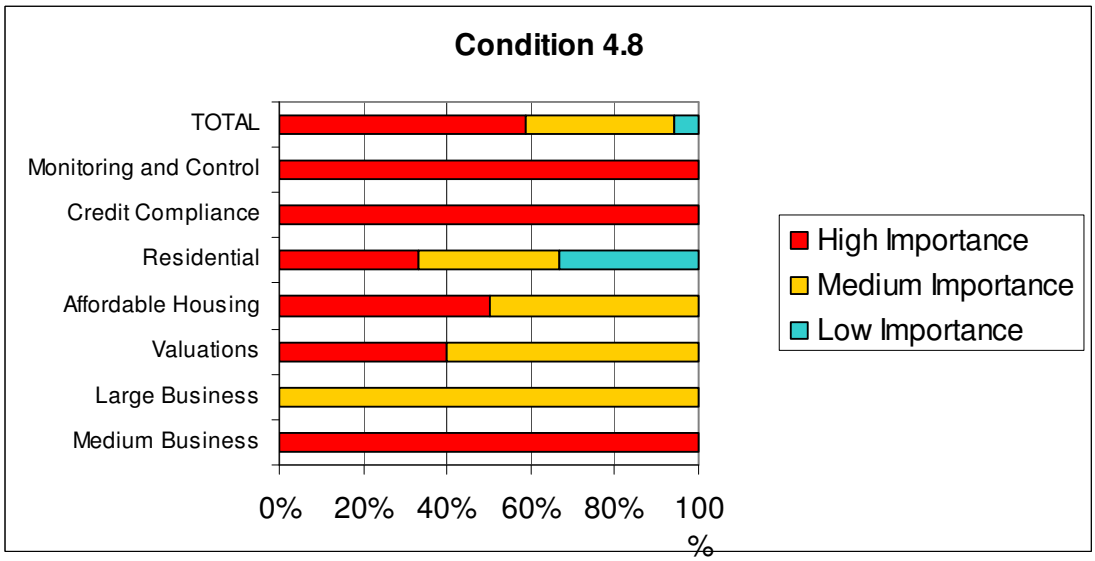
Should the township not yet be proclaimed, certain pre-proclamation conditions may be outstanding. Together with condition 4.4.3 above, this

certificate will provide reassurance to the bank that the developer is in the process of complying with the pre-proclamation conditions and proclamation is imminent.



In conclusion, it is of high importance that the township eventually be proclaimed to protect the bank's interests (see Section 2.2.4.2 above), therefore it is vital that the developer comply with the pre-proclamation conditions in a timely manner. Should the township be proclaimed, however, this condition is irrelevant.

4.4.8 "A certificate by the town planner confirming that all laws in respect of environmental matters have been complied with."



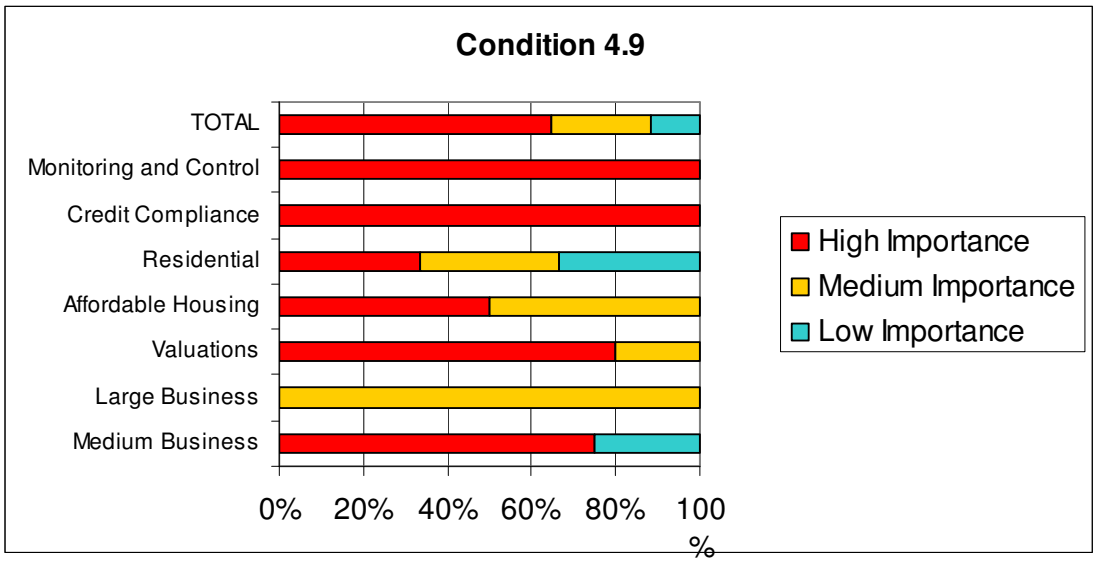
When the site on which the proposed development is planned is subject to an Environmental Impact Assessment (EIA) (refer to Section 2.2.4.7 above), the town planner is a professional in a position to monitor the status of the EIA approval / exemption. It is therefore important that the bank ascertain: firstly whether the site is subject to an EIA, and secondly the status of approval of the EIA.

In conclusion, as this condition has a cost and time impact on the development and, if not complied with, can potentially prevent the development from proceeding; it is of high importance in protecting the interests of the bank.

4.4.9 "A certificate by the town planner confirming that the development complies with the applicable town planning scheme."

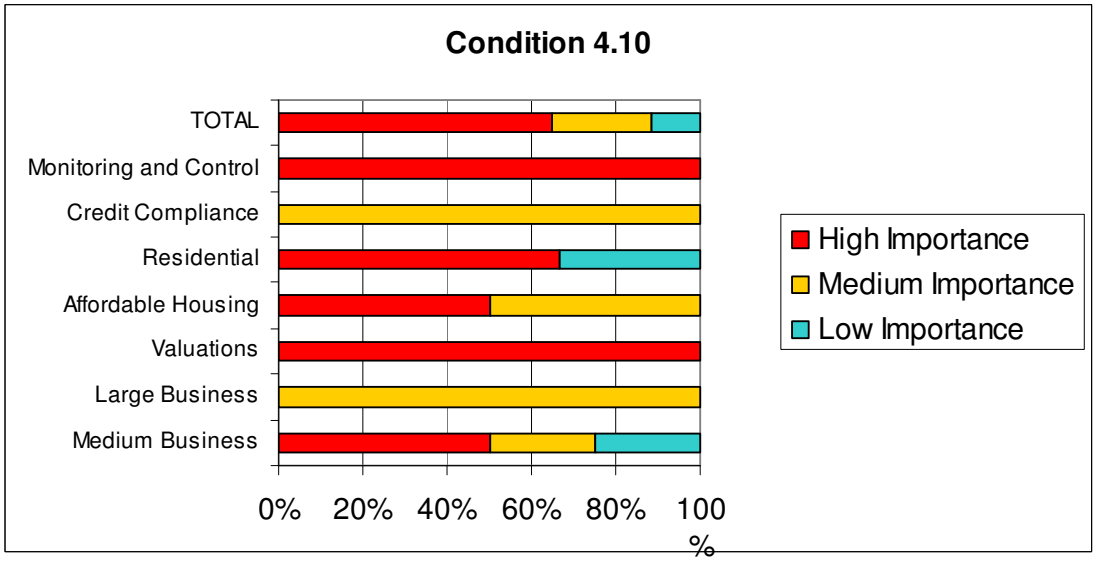
As with condition 4.4.6 above, the bank may not be able to ascertain that the development complies with the town planning scheme from the documentation submitted. Further to this, recently the bank has financed a project where the local authority approved the site development plan and later rejected it as the parking allowed was not as per the town planning scheme. The local authority has taken no responsibility for this error and, in order to comply with the scheme, buildings had to be demolished at the expense of the developer.

Most questionnaire respondents commented that, should the site development plan and building plans be approved, this implies that the proposed development complies with the town planning scheme. However, in the light of the project mentioned above, it is prudent for the bank to obtain a certificate, normally from the principal agent, confirming that the development has been designed in accordance with the town planning scheme. Further to this, the principal agent has the power to instruct variations to the design which may affect compliance with the town planning scheme (see Section 2.2.11 above).



In conclusion, it is of high importance in protecting the bank's interests that the bank obtains an undertaking from the principal agent that the development and any future variations will be undertaken in accordance with the town planning scheme.

4.4.10 "A certificate by the town planner confirming that the proposed development will be undertaken in accordance with the record of decision issued by the Department of Agriculture, Environment and Land Affairs."

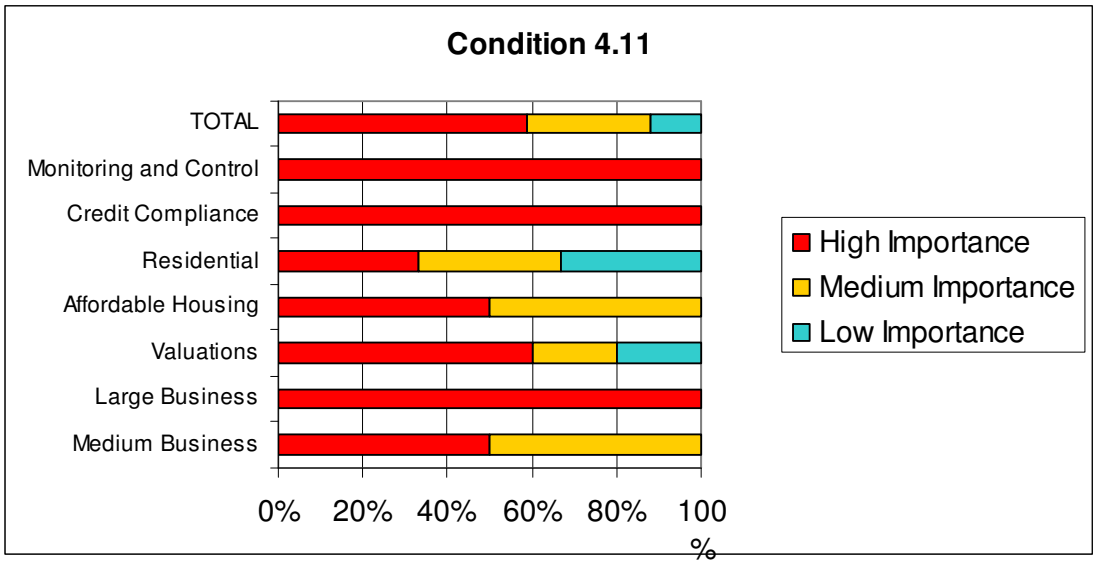


Further to condition 4.4.8, when the Environmental Impact Assessment (EIA) is approved or if exemption from the EIA is granted, an approved Environmental Management Plan (EMP) is issued imposing methods of

construction and usage of the site (refer to Section 2.2.4.7 above). The town planner is a professional in a position to monitor the status of the adherence of the contractor to the EMP.

In conclusion, non-adherence to the EMP could have a cost and time impact on the development. Therefore, this condition is of medium to high importance in protecting the interests of the bank.

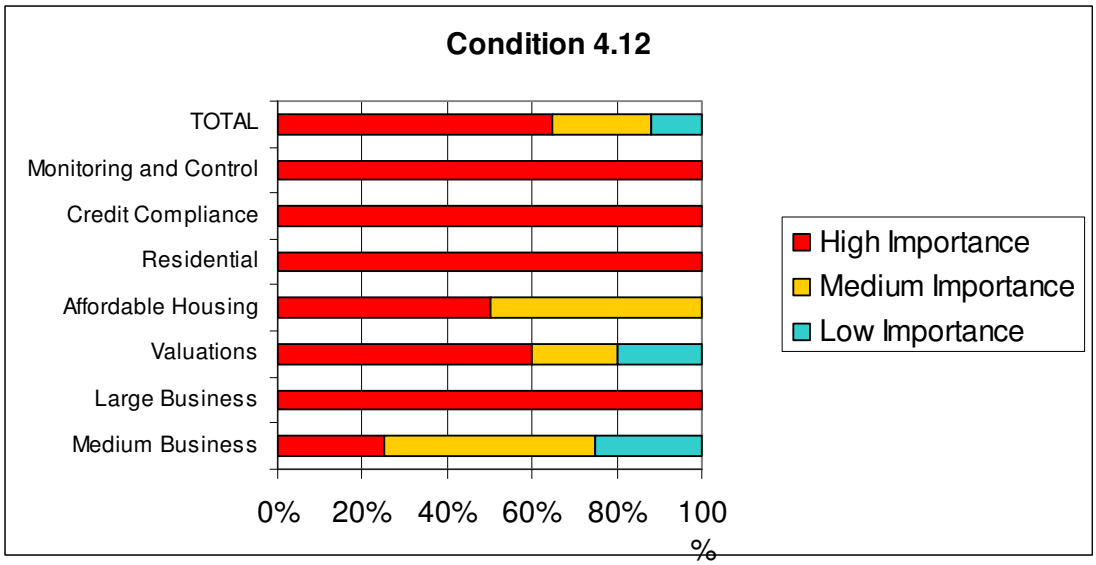
4.4.11 "A certificate by the town planner confirming that there are no further legal procedures which may prevent the township from being declared an approved township."



Legal matters pertaining to the proclamation of the township include: applying to the Registrar of Deeds for the opening of the Township Register; cancellation of Conditions of Title; and possible registration and cancellation of servitudes, surface right permits, etc. As with conditions 4.4.1, 4.4.3 and 4.4.7 above, this is an indication of the progress of the township establishment process.

In conclusion, this condition is of high importance in protecting the bank's interests should the developer proceed with construction prior to township establishment.

4.4.12 "A certificate by the town planner confirming that he is satisfied that proclamation of the township is a formality and won't be unduly delayed."

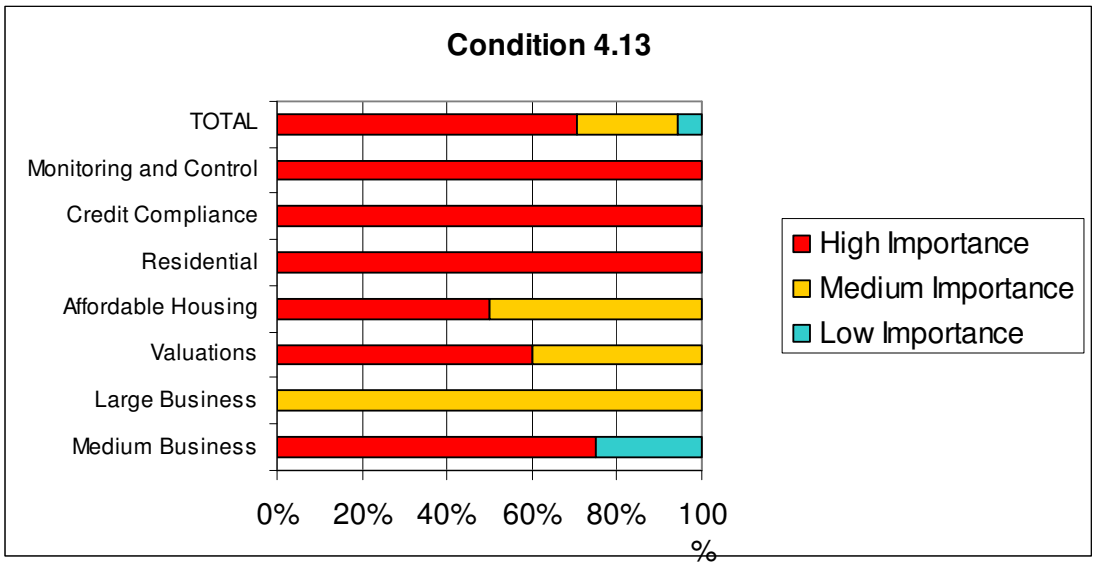


Again, as with conditions 4.4.1, 4.4.3, 4.4.7 and 4.4.11 above this condition serves the purpose of alerting the bank to the status of the township establishment application. A questionnaire respondent commented that the town planner's statement that he is "satisfied that the proclamation of the township is a formality and won't be unduly delayed" is speculative.

In conclusion, in consideration of the wording of clauses 4.4.7 and 4.4.11, and the contents of clauses 4.4.1, 4.4.3, 4.4.7 and 4.4.11, this clause may not be necessary, i.e. by including other clauses relative to the status of township approval, this clause becomes redundant and is of low importance in protecting the bank's interests..

4.4.13 "A certified copy of the current zoning certificate from the local authority certifying that the property may be used for the following purposes."

The terms of the development loan agreement are based on an intended land use, to be created by the proposed development. Should the town planning scheme relating to the site not permit the land use anticipated by the developer, the property is not adequate security for the loan.



Should the site development plan and building plans yet not be approved, it is important to ascertain whether the proposed development is in accordance with the zoning rights.

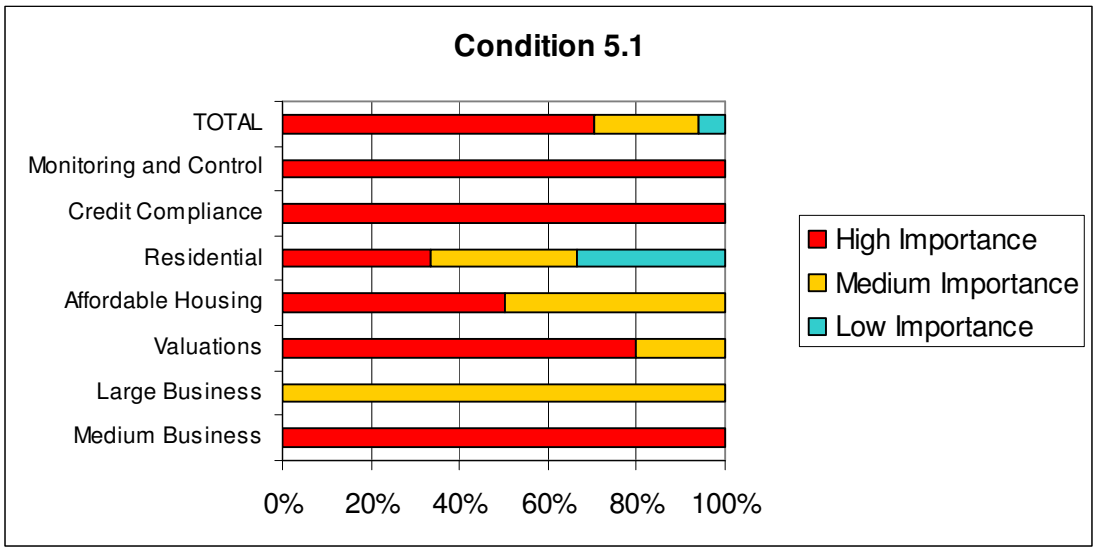
In conclusion, this condition, together with the principal agent's confirmation that the development complies with the applicable town planning scheme (refer to condition 4.4.9 above) is of high importance in protecting the bank's interests.

4.5 Architect's Confirmation

4.5.1 "The Site Development Plan has been prepared in accordance with the approved rights."

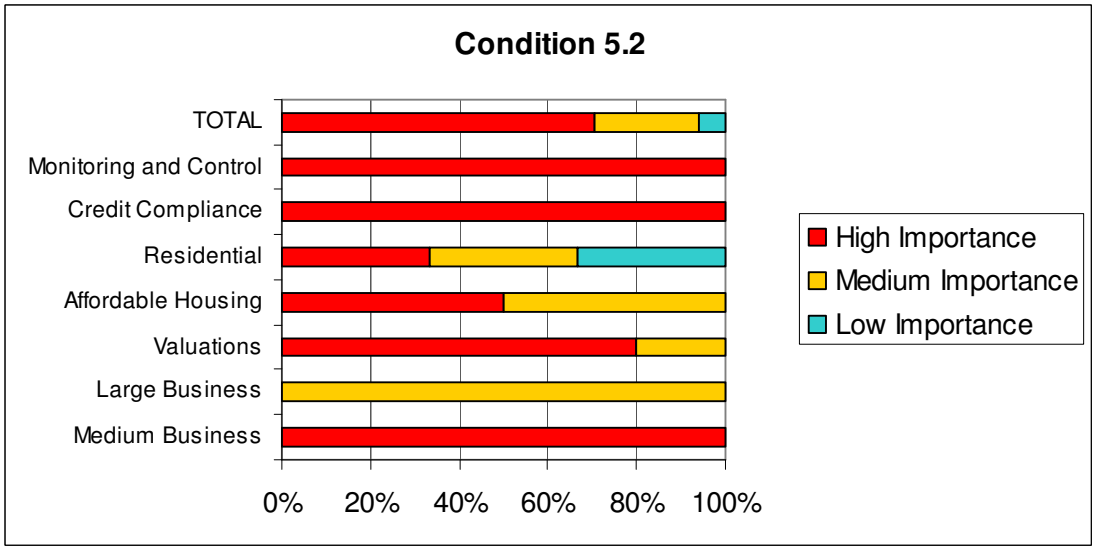
This condition is interchangeable with condition 4.4.9 above.

In conclusion, it is of high importance in protecting the bank's interests that the bank obtains an undertaking from the principal agent that the development and any future variations will be undertaken in accordance with the approved rights of the Title Deed and town planning scheme.



4.5.2 "The building plans have been prepared in accordance with the National Building Regulations Act and relevant municipal by-laws."

The architect is responsible for the design of the development (see Sections 2.2.5 and 2.2.11) and, by virtue of his profession, is required to design in accordance within the guidelines of relevant legislation and local authority by-laws.

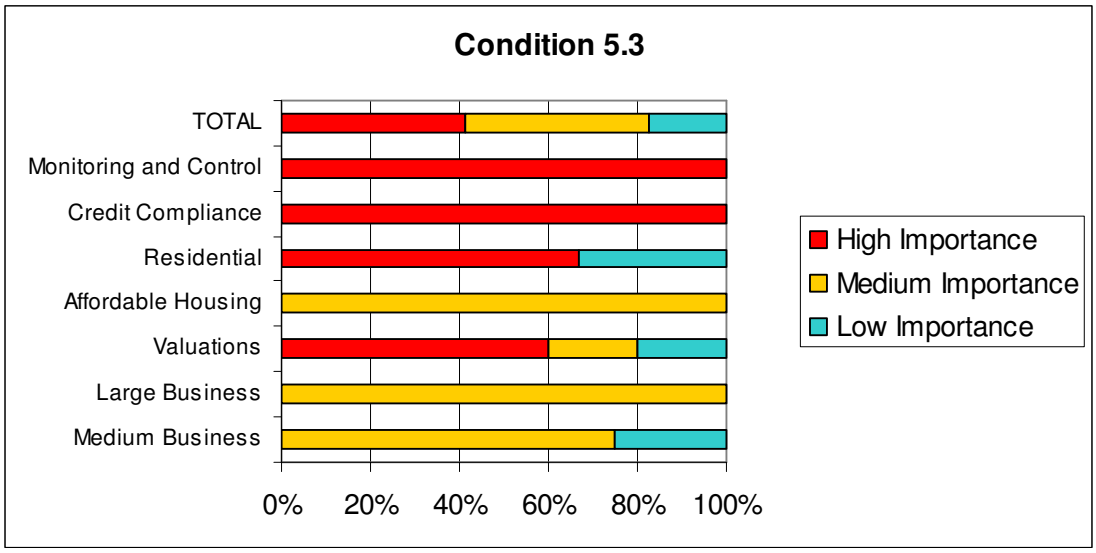


However, where building plans are prepared by persons not registered with the South African Council for the Architectural Profession, i.e. a draughtsman, for assurance that the quality of the building will be acceptable and that the

local authority will issue a Certificate of Occupancy on completion of the project, it is prudent of the bank to obtain an undertaking from the person designing the building that the plans are prepared in accordance with the National Building Regulations Act and relevant municipal by-laws. This is commonly the case in small-value construction projects financed by Medium Business.

In conclusion, this condition is of medium importance in protecting the bank's interests and is applicable to buildings designed by persons not registered with the Council for the Architectural Profession.

4.5.3 "Approval of the building plans is a formality and will not be unduly delayed."

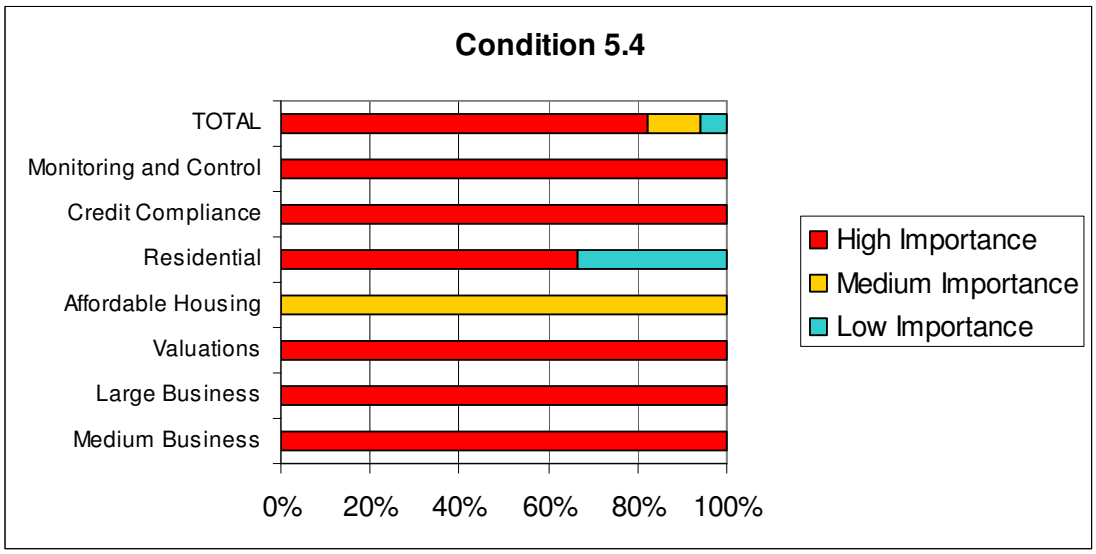


If condition 4.3.5 has not been met, this condition is applicable. However, besides being responsible for the submission of plans in accordance with the town planning scheme and the requirements of the National Building Regulations and Standards Act (see Section 2.2.3), the architect has no control over the approval process. Therefore, unless supporting documentation from local authority is submitted with this statement from the Architect, it cannot hold any substance.

In conclusion, this condition is of low importance in protecting the bank's interests.

4.5.4 "Prior to the pouring of concrete, that the foundations are correctly positioned, do not encroach on any other property / building line and are adequate."

As with conditions 4.4.9 and 4.5.1 above, a member of the professional team needs to take responsibility that the building is constructed in accordance with the town planning scheme and rights. The correct positioning of the building with respect to the approved site development plan and the applicable building lines is very important as, should this be incorrect; the local authority has the right to have the building demolished and relocated, and may not issue an Occupancy Certificate. Therefore, this assurance must be given by the principal agent or architect (if different) with acceptable professional indemnity insurance should this statement turn out to be false.

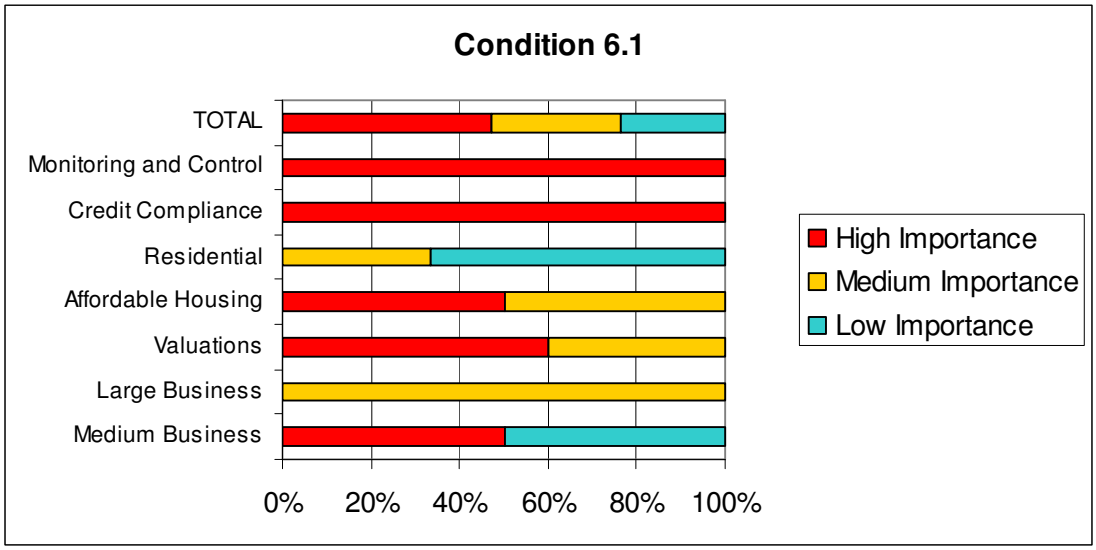


In the construction of affordable housing, the Department of Housing is usually responsible for approving progress on all elements of the house. It may sub-contract the overseeing of the foundations to a specialist consultant and, in this case, it is the onus of the Department to check either the site or supporting documentation to confirm that the foundations are correctly positioned and of a suitable quality.

In conclusion, this condition is of high importance in protecting the bank's interests.

4.6 Pre-sales

4.6.1 "A schedule of selling prices approved by the Bank, net of VAT, estate agent's commission and transfer fees for release purposes."



The loan agreement conditions should state that the proceeds of sales are ceded to the bank. Therefore, the checking of the schedule of selling prices is purely an administrative function and need not be a condition of the loan.

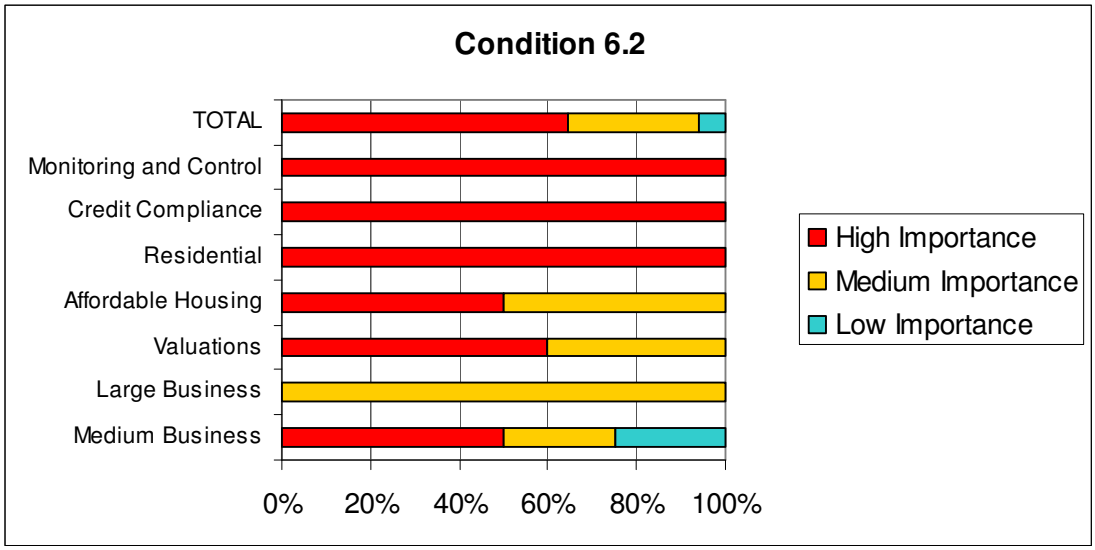
In conclusion, this condition is of medium importance in protecting the bank's interests. Condition 4.6.2 below is, however, of high importance in protecting the bank's interests.

4.6.2 "Proof has been provided to us to our satisfaction that pre-sales have been entered into."

Pre-sales conditions are normally imposed on residential development loans and sectional title retail / warehouse / office developments, typically administered by the Residential and Medium Business departments (refer to Section 2.2.6 above).

Developers often lament the pre-sales requirement, if onerous, on the basis that, once the development is near completion, normally the developer can charge higher prices. This is normally as a consequence of two factors:

- Over the construction period, selling prices will normally increase (residential property prices grew by 21.9% in 2005);
- Buyers have more confidence in the development when they can see construction progressing.

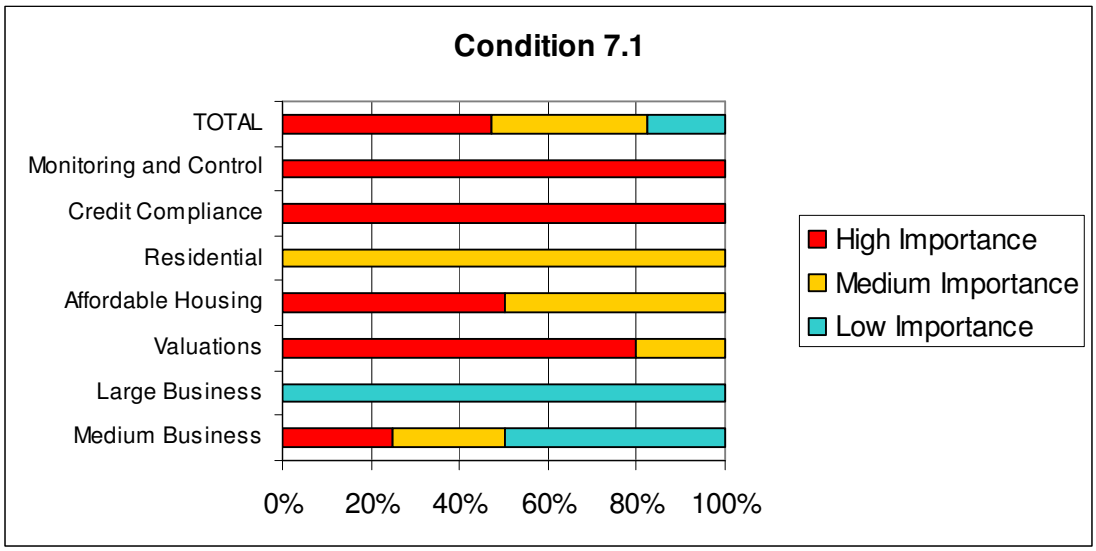


In conclusion, as pre-sales are an important indicator of the demand for the development, and therefore the potential of the developer to repay their loan, this condition is of high importance in protecting the bank's interests. A questionnaire respondent did comment that the wording should be that pre-sales have been "achieved" not just simply "entered into".

4.7 Housing Consumers Protection Measures Act

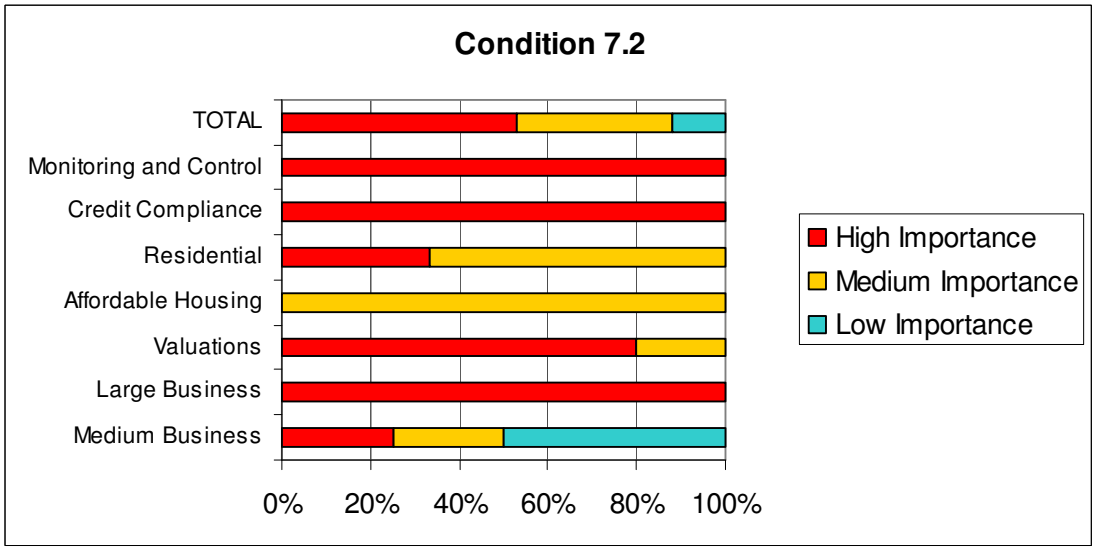
4.7.1 "Proof that the proposed development has been approved by the NHBRC and the Department of Geoscience."

This condition is specific to residential developments in areas where dolomite is prevalent. In dolomitic regions, the Department of Geoscience will scrutinise the building plans and may impose conditions on the development relative to the soil conditions. For residential developments, the NHBRC official, when inspecting the development, will check that these conditions are being adhered to.



In conclusion, as this condition reflects a requirement in terms of Housing Consumers Protection Measures Act (refer to Section 2.2.7 above), it is of high importance in protecting the bank's interests with respect to loans granted for residential developments.

4.7.2 "Proof to our satisfaction that the contractor is registered, and the development / units are enrolled, with the NHBRC under the Housing Consumer Protection Measures Act, No. 95 of 1998, and the prescribed fees have been paid."



The National Home Builders Registration Council (NHBRC), established in terms of the Housing Consumer Protection Measures Act requires that all contractors constructing residential units are registered with the NHBRC, and

that all new homes under construction are enrolled with the NHBRC three weeks prior to construction. A fee of 1.3% of the selling price (construction cost plus land value) is payable on registration of a new home (refer to Section 2.2.7 above).

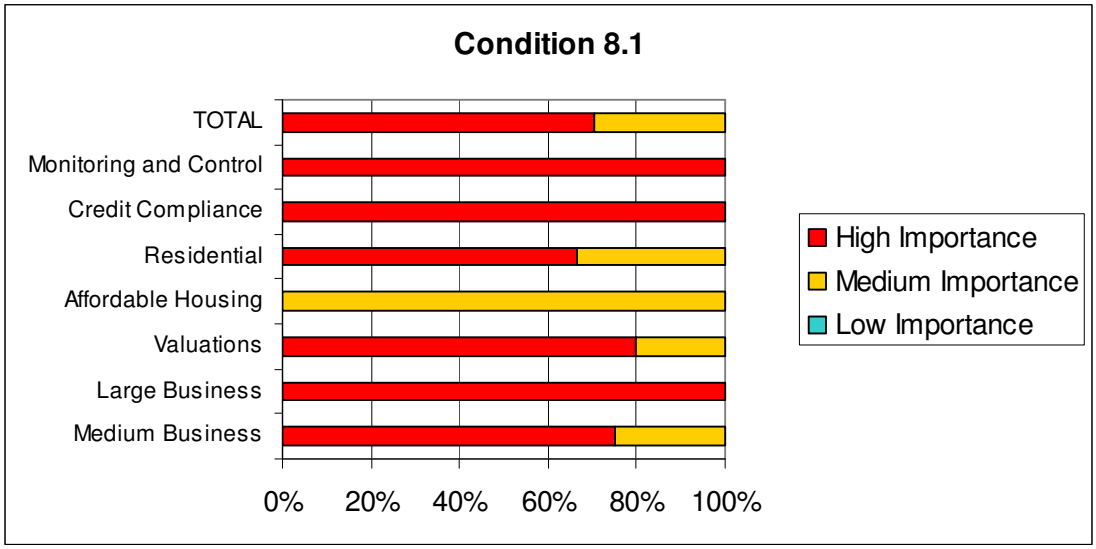
The subject bank usually includes provision in the development loan for the payment of NHBRC enrolment fees. Therefore, it is in its interests to have proof that these fees have been duly paid.

If a developer is late in registering the residential units, they are liable for a fine of R25,000 per unit. This fine will most probably affect the feasibility of the development, especially development consisting of a large number of units.

In conclusion, and contrary to the questionnaire responses received, the registration of residential units and builder with the NHBRC prior to construction is of high importance in protecting the bank's interests.

4.8 Certificate to Commence Construction

4.8.1 "Certificate to Commence Construction in terms of Section 7(6) of the National Building Regulations Act, no. 103 of 1997."



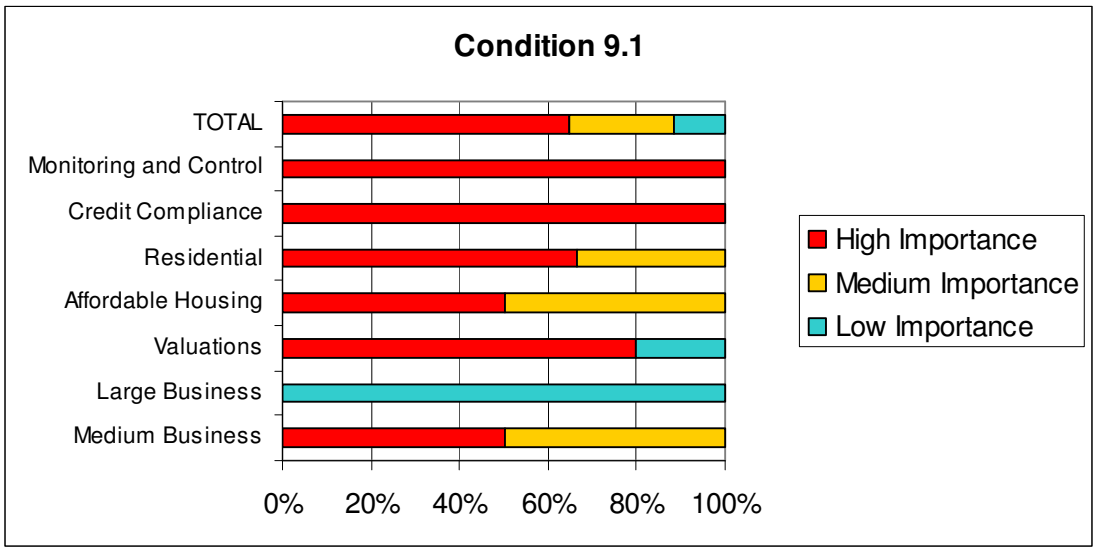
Where the approval of building plans is delayed, the bank may allow the submission of a Section 7 (6) certificate (refer to Section 2.2.8 above) as sufficient to comply with the pre-disbursement condition requiring approval of building plans providing the approved building plans are produced prior to the final draw against the loan.

In conclusion, the approval of building plans is of high importance in protecting the bank's interests (see conditions 4.3.3 and 4.3.5 above).

4.9 Geotechnical Report

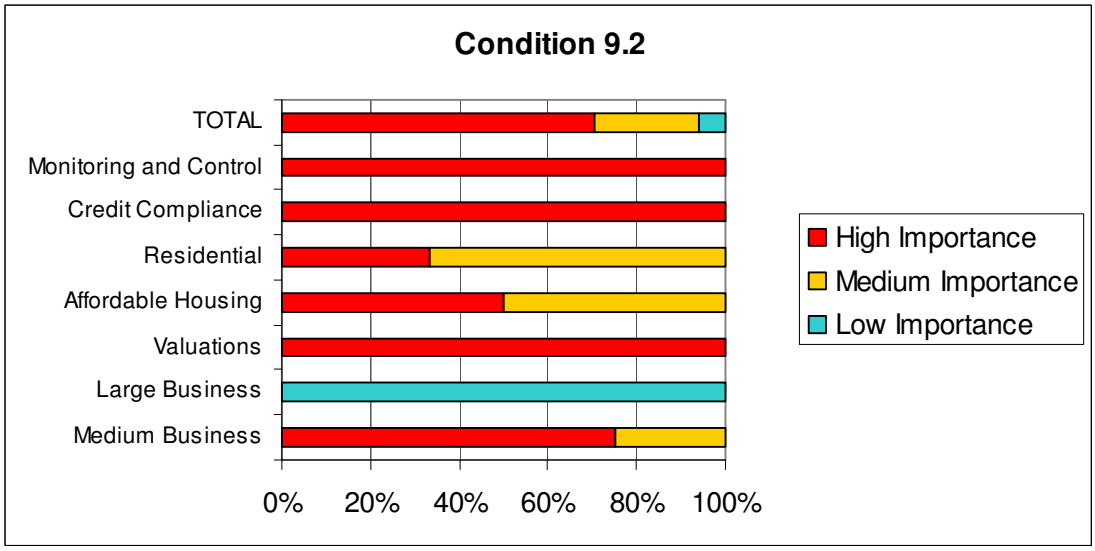
4.9.1 "An acceptable geotechnical report."

The importance of the geotechnical report is discussed in Section 2.2.9 above. The bank is conscious that it does not have the in-house ability to interpret the findings in the geotechnical report in relation to the structural design of the building. It is therefore sufficient that a letter be submitted by the structural engineer stating that the findings of the geotechnical report have been considered in the design of the foundations and structure, and that the ground conditions are suitable for the proposed development (see condition 4.9.2 below).



In conclusion, as structural integrity of the building is of high importance, this condition is of high importance in protecting the bank's interests.

4.9.2 "A certificate from a structural engineer or other suitable qualified professional that the ground conditions are stable and that the foundations and structural design are suitable for development."



Despite the front-line consultant's responses graphed below, Credit Compliance, Monitoring and Control, Valuations all concur that the submission of the geotechnical report (see condition 4.9.1 above), together with a certificate from the structural engineer, are of high importance in protecting the bank's interests.

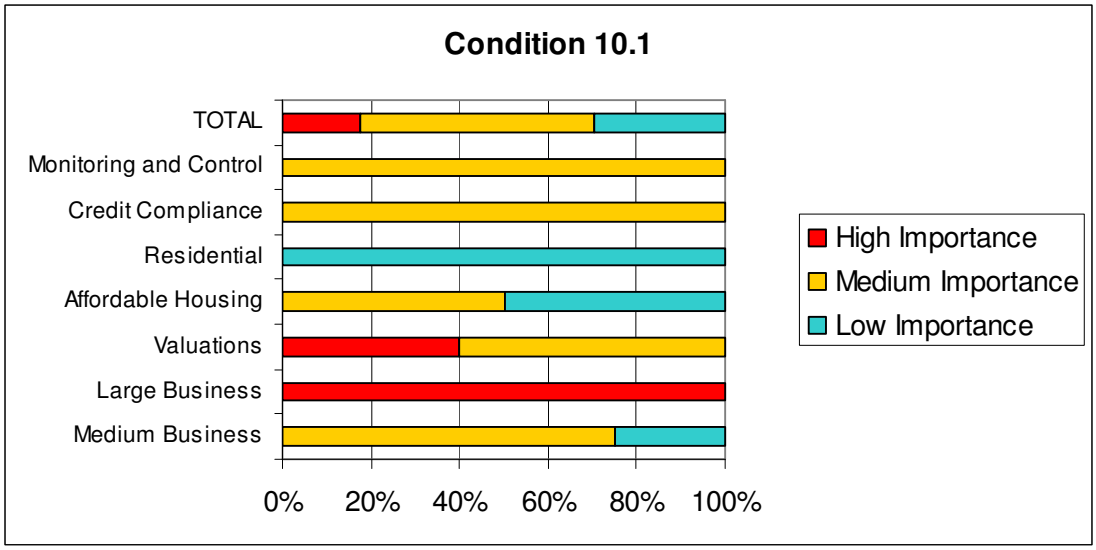
In conclusion, this condition is of high importance in protecting the bank's interests.

4.10 Demographics Study

4.10.1 "An acceptable demographic study."

This condition is specific to retail developments, normally administered by Large Business (see Section 2.2.10 above). As with the geotechnical report, compliance officers in the bank's Credit Compliance and Valuations departments do not have the relevant skills to assess whether the results of the demographic study are "acceptable" to the bank. Further to this, for retail developments, a pre-registration condition of the bank is that "Certified copies must be provided of duly stamped and signed leases acceptable to us (the

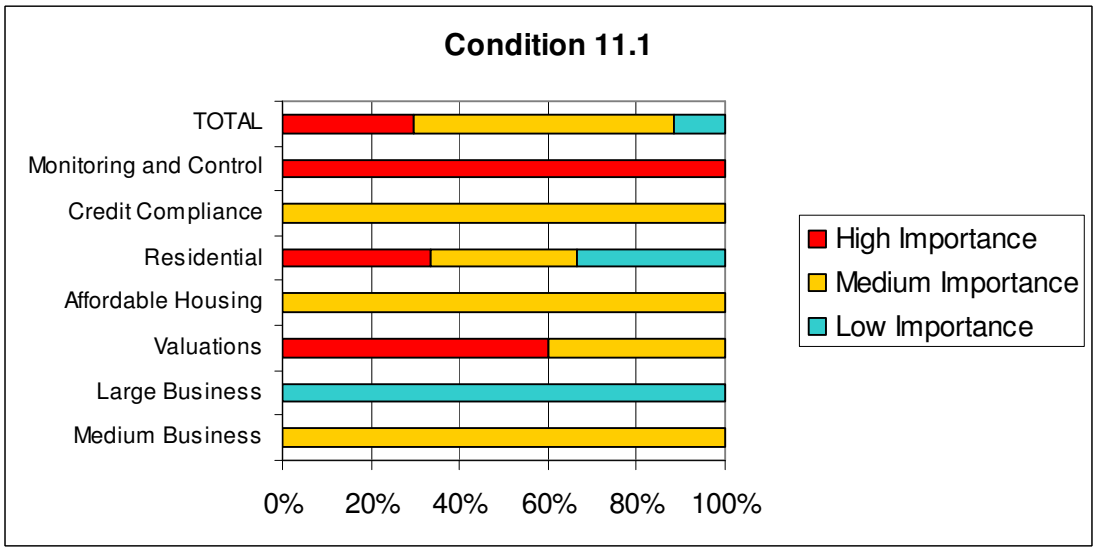
bank) entered into for __% of the gross lettable area of the property or a minimum value of R__ per month." It could be assumed that the tenants of the retail development have taken cognisance of any demographic data relevant to the area prior to concluding their lease. Therefore, should the lease requirements of the bank be met, the bank's interests are protected.



In conclusion, this condition is of medium importance in protecting the bank's interests with respect to retail developments.

4.11 Professionals

4.11.1 "Record of the members of the professional team."



Although a definitive list of the professional team is a good source of reference, the bank can ascertain who the professional team are based on the documents submitted for conditions 4.11.3 – 4.11.7 below.

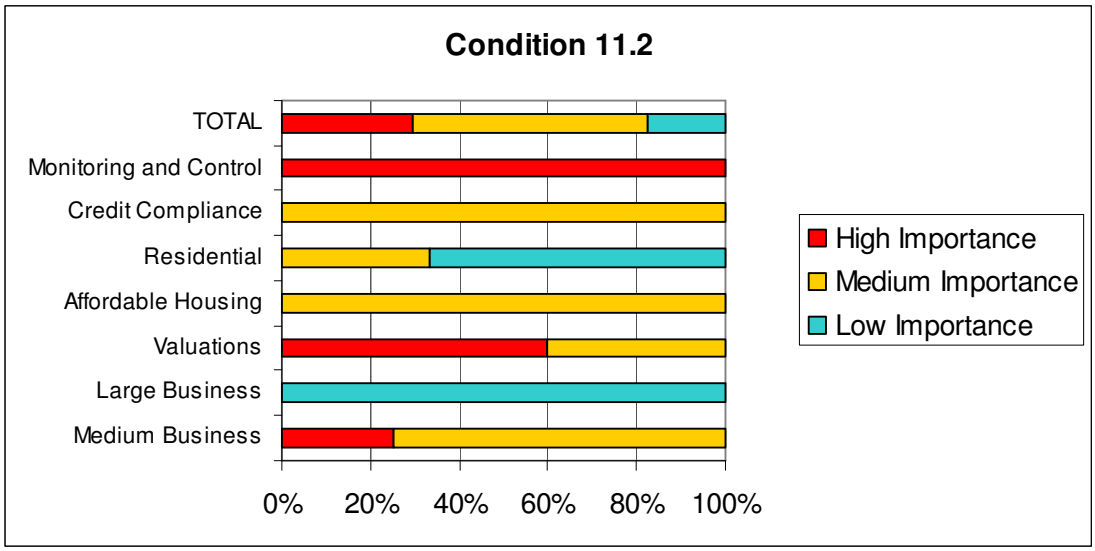
Should the bank be of the opinion that additional consultants are required, it will discuss this with the borrower and agree the necessary action. The following clause is included in the Loan Agreement supporting this right: "The Bank is entitled to appoint a watching brief by a suitably qualified professional at the Borrower's cost." A clause included in the loan agreement is "The Bank may instruct an independent quantity surveyor or valuer at the Borrower's cost to provide an independent payment certificate, which will be binding on the Borrower." On a number of smaller projects, the developer will perform the cost control of the project in-house. The bank has internal quantity surveyors who interpret the principal agents' payment certificates and cost reports when assessing claims for draws against the development loan. In instances where the information produced by the developer is insufficient to determine the value of works complete, and more importantly the anticipated cost to completion, the bank will appoint an independent quantity surveyor or valuer to determine this, at the borrower's cost.

In conclusion, this condition is of low to medium importance in protecting the bank's interests. Conditions 4.11.2 – 4.11.5 should provide the same information to the bank.

4.11.2 "The final appointment of the members of the professional team, including any joint venture arrangement with any other contractor, shall be subject to the Bank's approval upon such conditions as it may deem fit in order to satisfy itself that each professional consultant is suitably qualified, experienced and indemnified."

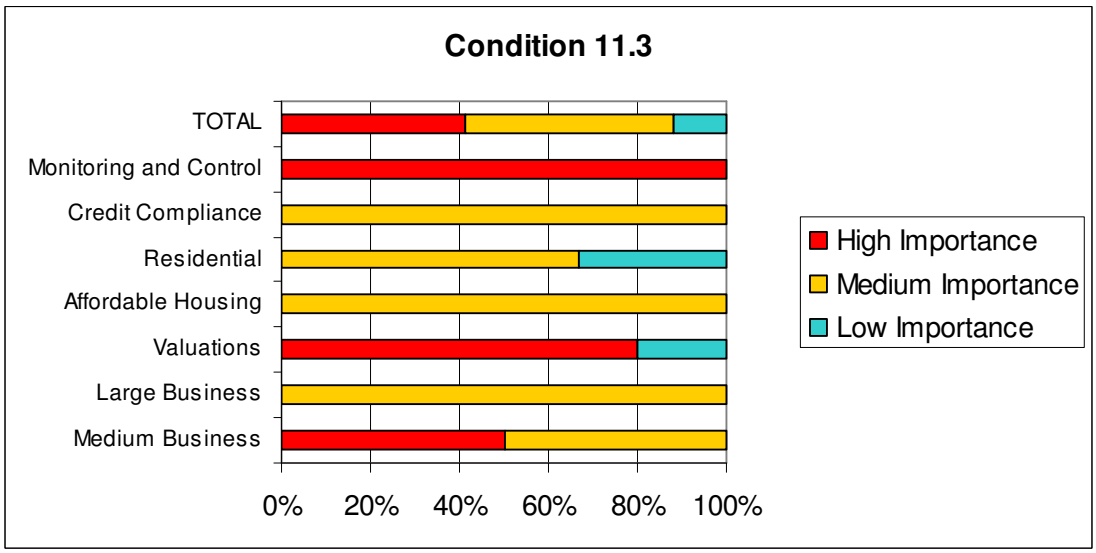
In practice, this condition is signed off after compliance with the following three conditions is obtained, i.e. it is completely reliant on satisfactory

qualifications and experience, and professional indemnity insurance cover being proven.



In conclusion, the approval of conditions 4.11.3 – 4.11.7 replaces this condition, i.e. it is of low importance in protecting the bank's interests.

4.11.3 "Proof of professional qualifications and experience acceptable to the Bank."



The bank will scrutinise professionals' *curriculum vitae* to assess whether the professional has experience of previous construction projects of a similar

nature. The professional's registration with relevant Councils governing professional conduct is preferred and the bank will usually insist on registration of at least the structural engineer and the principal agent (refer to Section 2.2.11 above).

This condition is of high importance to Valuations who rely on the professionals to manage quality, time and cost, and base payments against the development loan on information submitted by the professionals.

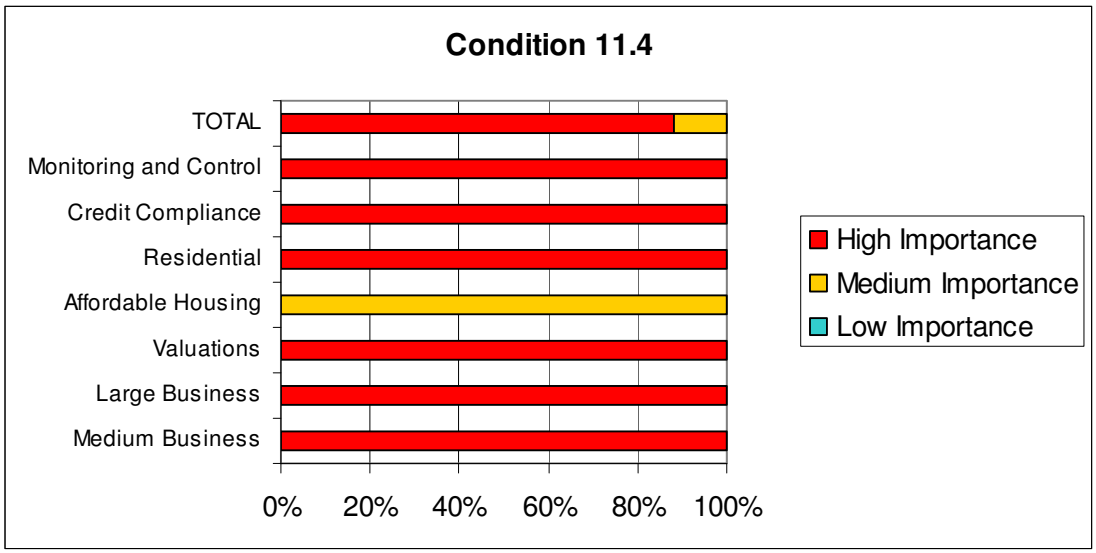
Professional consultants may work on numerous projects financed by the same bank. The bank keeps record of any gross misconduct by a professional on the projects it finances and will usually exclude these consultants on future projects.

In conclusion, where a professional is not familiar to the bank, this condition is of medium importance in protecting the bank's interests.

4.11.4 "Professional Indemnity cover and an undertaking to keep cover in force for the duration of the project."

Should the professional indemnity cover not meet the following criteria, it will be unacceptable to the bank and will need to be rectified:

- Compulsory for all professionals responsible for determining the design, cost and quality of the project, e.g. principal agent, architect, structural engineer, civil engineer, quantity surveyor.
- At least twice the value of the professional's fee.
- At least R2million or twice the professional fee payable (whichever is greater) for civil and structural engineers.
- Valid and in force for the current period.

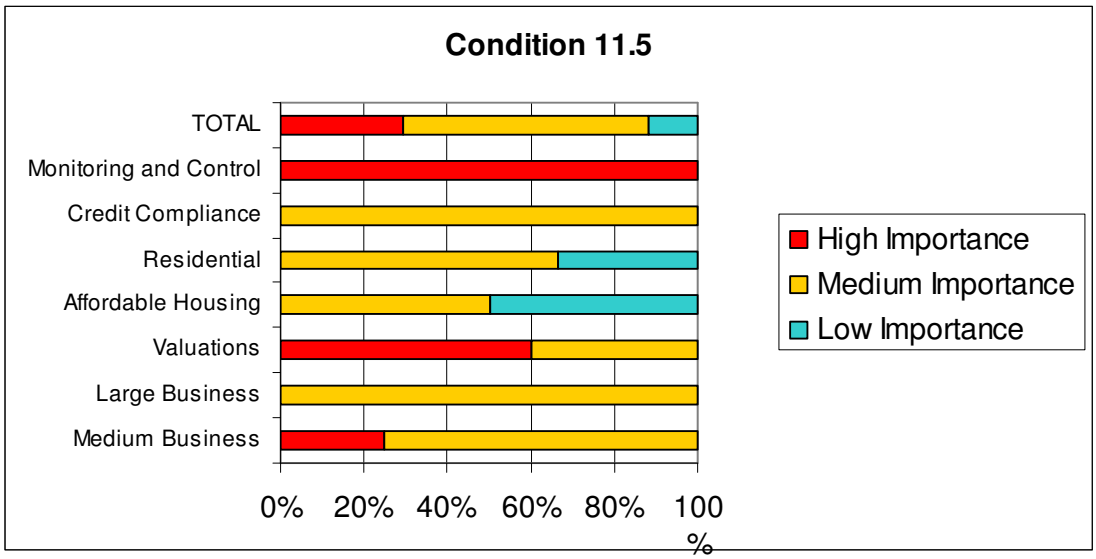


In conclusion, as the bank places reliance on the professionals to manage quality, time and cost, should loss or damages be suffered be suffered by the bank as a result of negligence by a professional, the provision of sufficient professional indemnity insurance by all professionals involved in the project is of high importance in protecting the interests of the bank.

4.11.5 "A copy of the relevant agreement or letter of appointment."

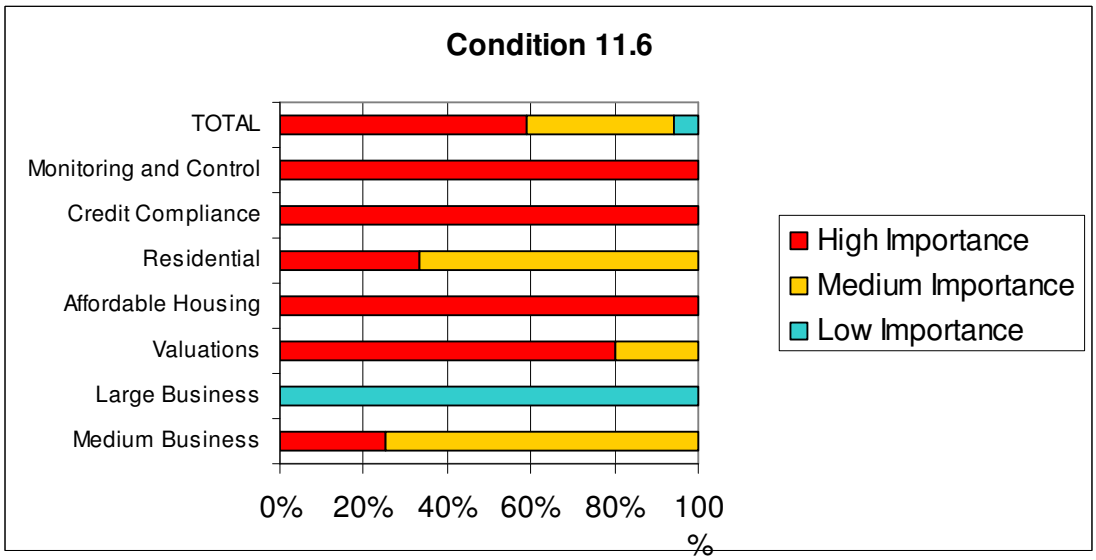
The bank needs to satisfy itself that the professional team proposed by the developer is the same team managing the subject development. Further to this, by assessing the scope of appointment for each professional, the bank can determine whether it is satisfied that the appointments are adequate to effectively manage the type and size of development.

In practice, the requirement for the submission of the letters of appointment is often waived should the duty of care letters be submitted. The reason for this is that, it is unlikely that a professional would sign a duty of care letter should it not be employed on that development. Also, upon receipt of the signed duty of care letters, the bank can ascertain the number and roles of the pertinent professionals.



In conclusion, this condition as of medium to low importance in protecting the bank's interests.

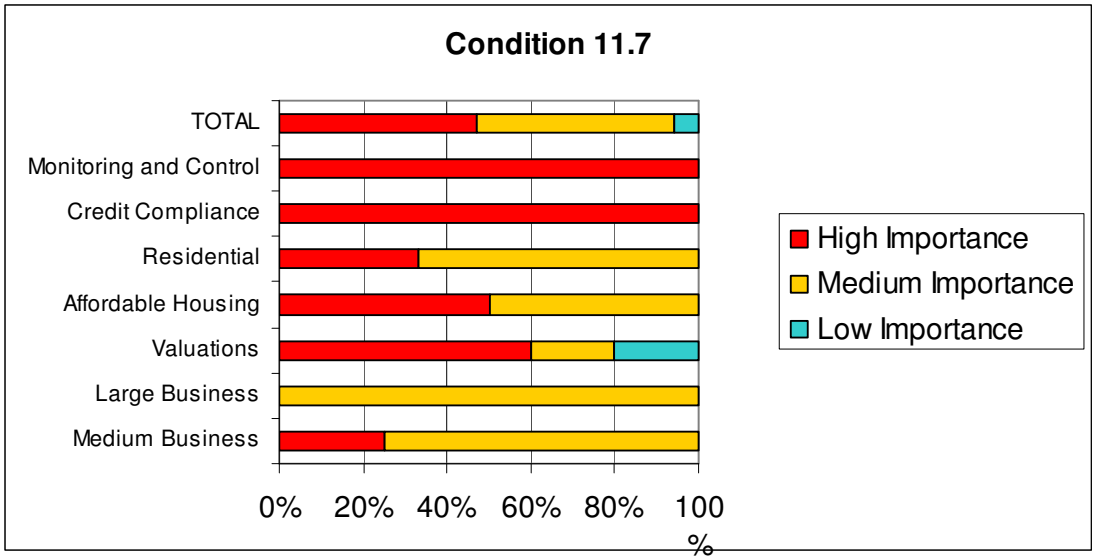
4.11.6 "Approval by the Bank of the professional team shall further be subject to each professional consultant acknowledging receipt of the Bank's notification that it will act as financier, that the Bank will rely on the professional consultant's payment certificates, recommendations, or other documentation, and that such professional consultant is deemed to owe a duty of care to the Bank in the exercise of all duties in terms of his/it's appointment."



Some Residential, Large Business and Medium Business rated this condition of medium and low importance, as the bank no longer requires a duty of care

undertaking from the professionals. However, in respect to the requirement of the acknowledgement that the bank is financier, from a legal perspective, this clause is of high importance in protecting the bank's interests. Therefore, in order to emphasise the true intention of this clause, it may be necessary for the subject bank to change the wording.

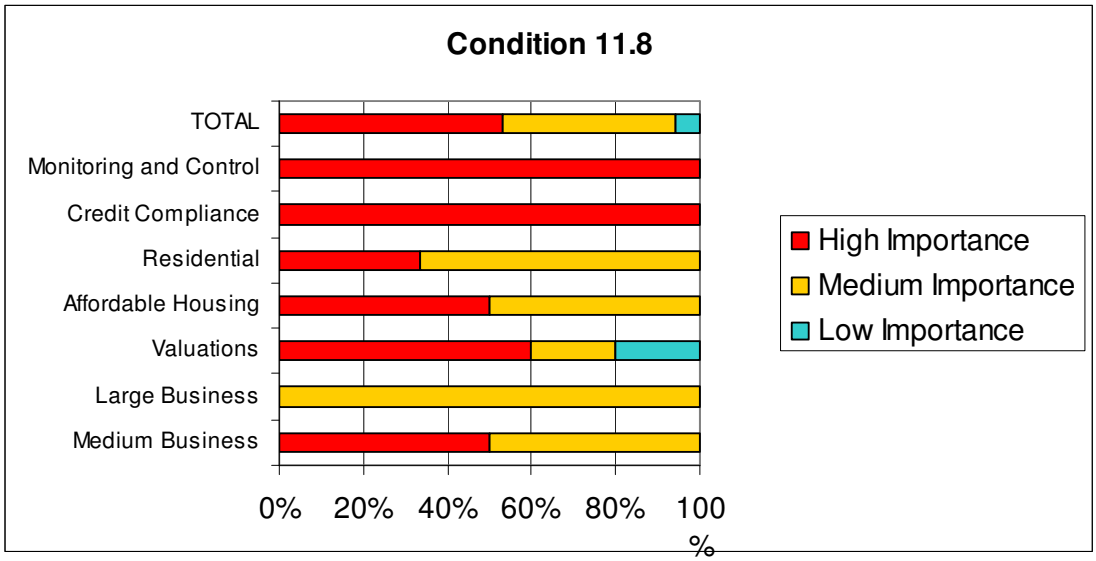
4.11.7 "Should any professional consultant fail or refuse to acknowledge receipt of the notification referred to in 4.11.6 above, the Bank reserves the right to call for a cession in security of all of your/the developer's/subcontractor's rights in and to any agreements/contracts vis-à-vis such professional consultant, provided that such rights have in the opinion of the Bank not been limited to an acceptable extent, and that cession of such rights is not prohibited in terms of the relevant agreement/contract."



As discussed in Section 4.11.6 above, this condition intends that the bank has a right to take legal action against a professional should it incur loss or damages due to the professional's negligence, even though the bank has no contract with that professional. Although condition 4.11.7 proposes a more time-consuming and complicated method of obtaining these rights (the acknowledgment discussed in Section 4.11.6 above merely entails the signing of a standard letter format), it has the same effect of protecting the bank's interests in the event of loss or damages.

In conclusion, this condition is of high importance in protecting the bank's interests.

4.11.8 "Based on the assessment of the abovementioned information and documents, the Bank reserves the right to impose such further conditions as it may deem fit."



This condition is a catch-all clause inserted in case the bank has omitted a relevant condition in error or, on scrutinising the information submitted, the bank becomes aware that additional information is required.

In conclusion, this condition is of high to medium importance in protecting the bank's interests, if required.

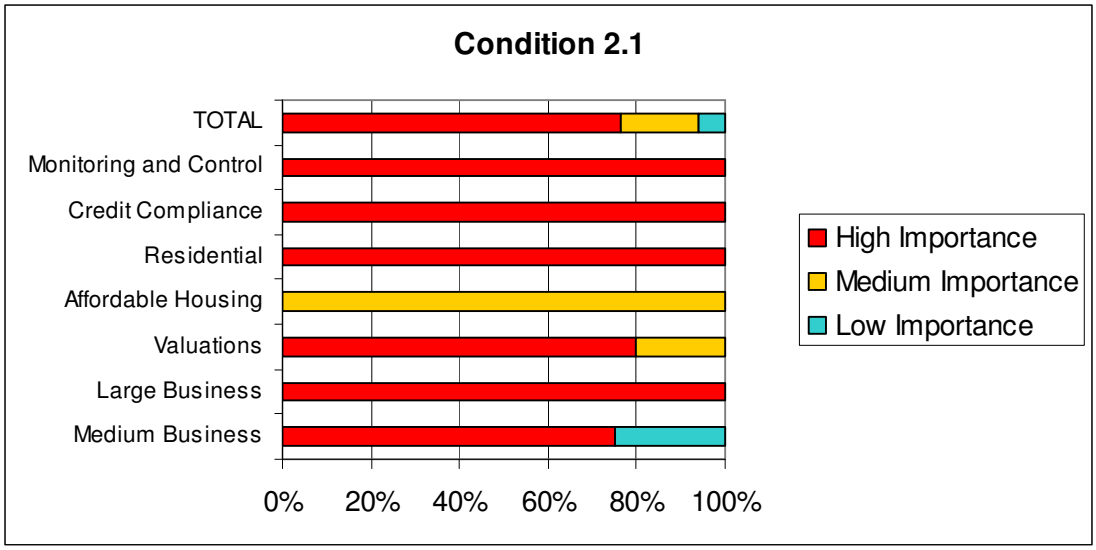
4.12 Building Contract, Drawings, etc.

4.12.1 "The contractor, construction contract, development cost, site development plan, architectural drawings, specification and schedule of finishes together with any change or cancellation thereof, must be approved by the Bank in writing and, where required, by the competent authorities."

The construction contract, bills of quantities and drawings all provide important information to the bank as to the scope of the project and how it will

be controlled. Valuations will use this information when assessing what amounts can be disbursed from the loan with respect to progress claims.

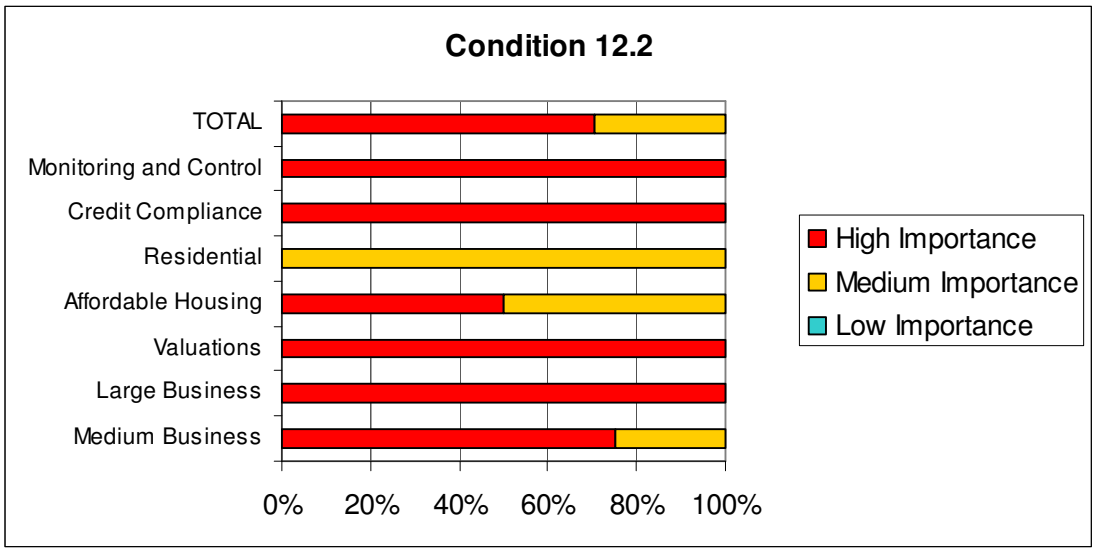
Normally on affordable housing projects, the approval of contractor, contract, plans, etc. are controlled by the Department of Housing.



In conclusion, on projects other than affordable housing developments, the approval of the contractor by the bank is of high importance in protecting the bank's interests (see Section 2.2.12 above).

4.12.2 "A certified copy, acceptable to the Bank, of a Bank, Contractor's or Insurance Company Performance Guarantee for the construction of the development. Alternatively, a retention on each draw down will be retained and will only be released on fulfilment of the conditions relating to the final disbursement."

The performance guarantee is discussed in Section 2.2.12 above. Although the employer is meant to hold any retention monies in an interest bearing joint account at a financial institution (Finsen (1999 pg. 101)), it is normal practice for the subject bank to retain control of the retention monies by not disbursing these to the borrower / contractor until the final draw.



It is common in residential developments that the agreement between the developer and the contractor is not on a standard format, i.e. the provision of performance guarantees or retention is not addressed. However, even if the developer does not wish to impose this condition on the contractor, the Risk Manager may insist that the bank withhold retention, usually in accordance with that of a standard contract normally used on that type of project.

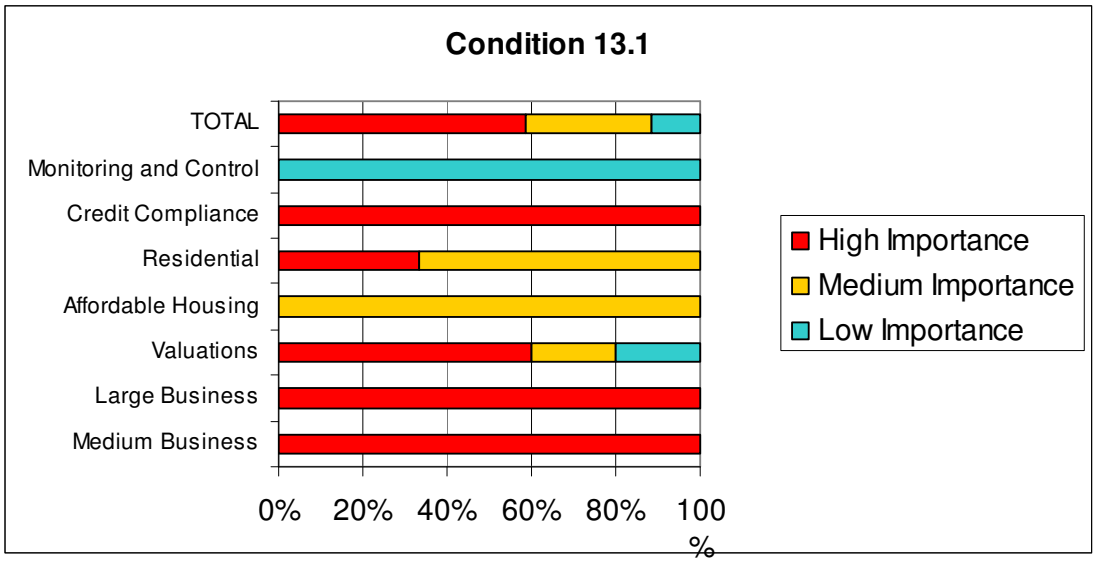
In conclusion, this condition is of high importance in protecting the bank's interests should it need to step into the shoes of the developer to complete the project to a satisfactory state that is fit for purpose.

4.13 Certificates

4.13.1 "The Town Council, that the rates and taxes & water and electricity in respect of the property are paid up to date or from the Body Corporate of a Sectional Title Scheme or any other applicable governing body that levies and rates and taxes are not in arrears."

Should the developer be in the process of purchasing a property for the purposes of the development, and the rates clearance certificate has not been obtained, this could cause delays in the transfer of the property to the developer (see Section 2.2.13 above). In this instance, this condition is of high importance in protecting the bank's interests. The requirement that the

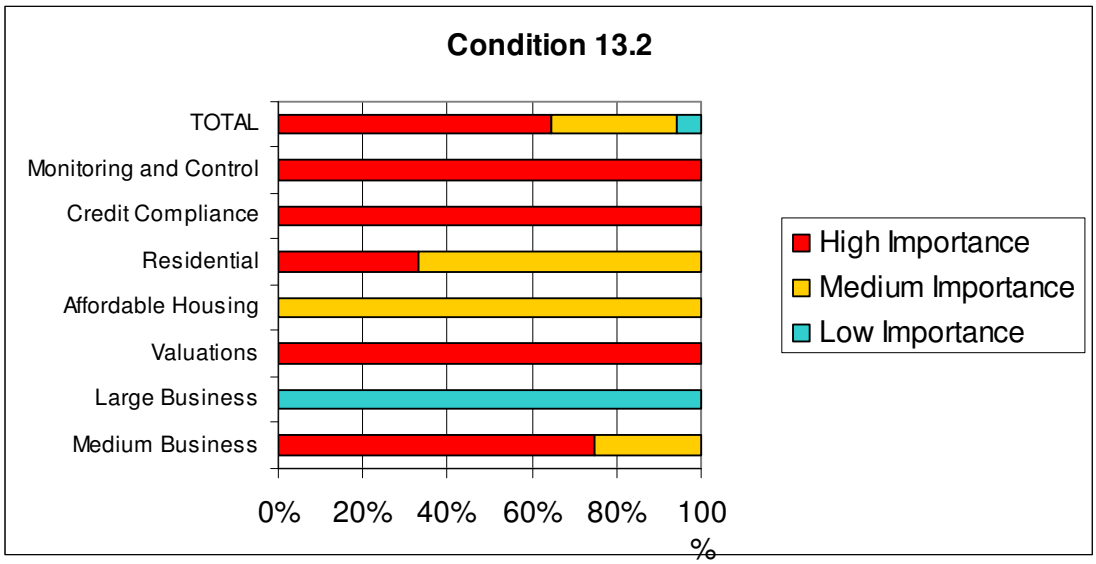
developer owns the land relating to the proposed development is normally addressed in the pre-registration conditions of the development loan.



Also, where a development is complete and is being transferred to a new owner(s), a rates clearance certificate is important to allow transfer to proceed. In this instance, this condition is irrelevant with respect to the subject bank's pre-disbursement conditions specific to commercial development loans.

4.13.2 "A certificate as required in terms of regulations of the Occupational Health and Safety Act, No. 85 of 1993 in respect of electrical installations as well as confirmation that the Safety Standards contained in the Construction Regulations to this Act have been complied with."

This condition is applicable when a developer amends an existing electrical installation through alterations to an existing building (see Section 2.2.13 above), which is common to developments administered by Medium Business. Although compliance is the responsibility of the seller, delays may occur should the seller need to upgrade the electrical installation.



With new development, an electrical compliance certificate must be produced when the installation is complete (see Section 2.2.13 above). Therefore, it is premature to request an electrical compliance certificate at pre-disbursement stage. If required, this certificate should be submitted when construction is complete and prior to the final draw on the loan. It could be implied that the electrical compliance certificate has been submitted prior issue of the Occupation Certificate by the local authority, as the electrical compliance certificate is normally a condition stated on issue of building plan approval.

In conclusion, this condition is of medium to high importance in protecting the bank's interests with respect to alterations to existing buildings, and could be deferred to prior to final disbursement to allow time for the installation to be completed and tested.

5 SURVEY OF COMPLIANCE TIMES

This chapter presents the results of the survey of compliance times (refer to Section 3.4.2 above).

Front-line consultants and sales support personnel were asked to answer three questions relating to the time that developers take to comply with pre-disbursement conditions. Survey respondents represented Credit Compliance, Valuations, Medium Business, Large Business, Residential and Listed Debt departments. The survey results are discussed below.

5.1 Pre-disbursement Condition Compliance Times

Respondents were asked, in their experience, what the shortest, average and longest times were for developers to comply with the pre-disbursement conditions. Responses are measured in weeks, and are scheduled according to department below:

Department	Shortest (weeks)	Average (weeks)	Longest (weeks)	
Credit Compliance	2	3	4	
Large Business	2	3	6	
Listed Debt	1	2	3	
Medium Business	1	2	6	
Medium Business	4	10	16	
Residential	3	4	6	
Residential	8	12	16	
Valuations	2	3	4	
				TOTAL
Mean (average)	2.88	4.88	7.63	**5.13**
Median (middle)	2	3	6	**3.5**
Mode (most frequent)	2	3	6	**2**
Maximum	8	12	16	**16**
Minimum	1	2	3	**1**
Standard Deviation	2.30	3.87	5.29	**4.32**
Variance	5.27	14.98	27.98	**18.64**

Figure 3 : Results of Survey of Compliance Times

The average time for compliance with pre-disbursement conditions was 5 weeks, the minimum compliance time being less than a week and the longest time taken being 4 months. The most frequent response was 2 weeks.

Respondents were consistent in their comments that compliance times were reduced where the developer had previous experience with the bank, and where the front-line consultant spent time with the developer preparing them for the compliance process. Very experienced clients could obtain compliance with pre-disbursement conditions within as little as 2 to 3 days.

The longest compliance times were attributed to borrowers being unfamiliar with the bank's conditions and processes, delays in town planning approvals, obtaining sufficient professional indemnity cover for all professionals, and insufficient pre-sales or lease agreements. In these instances, compliance could take up to 4 months. The longest compliance times were reported by consultants in Residential and Medium Business, who often deal with first-time developers and developers who have never used a development loan before.

5.2 Project Type or Size

Respondents were asked whether the time taken for compliance with pre-disbursement conditions was relative to the size or type of development.

Respondents were unanimous in stating that the type and size of development have no relation on the length of time to comply with pre-disbursement conditions. However, one respondent commented that on larger projects often the professional team is more comprehensive and more experienced, i.e. information produced for compliance is of a higher standard and may reduce the time for compliance.

Two respondents commented that structured, specialised or securitized lending may have longer compliance times because of the complicity of the

deals, especially where the compliance officer, client and / or attorney are not familiar with this type of transaction.

5.3 Effect on Relationship with Borrowers

All respondents agreed that delays in the pre-disbursement compliance process had a negative effect on their relationship with borrowers.

Respondents identified the following instances where relationships were negatively affected by the pre-disbursement compliance process:

- Ignorance by the developer of the bank's procedures and requirements;
- Lack of consistency in communication of the bank's requirements;
- Poor communication when documents submitted were not acceptable to the bank;
- Duplication of requirements;
- Based on the large amount of documentation required, the borrower believing that the bank wants to take full control of their project.

Some methods of remedying the problems listed above were provided, as follows:

- The front-line consultant spending time with developer in preparing them for the compliance process;
- The front-line consultant driving the process within the bank, and being the single source of communication with the client;
- Care taken by the front-line consultant when preparing the term sheet to ensure that no superfluous conditions are incorporated in the loan agreement.

6 CONCLUSIONS

This chapter discusses the scope, importance and limitations of the research. Then it summarises the main findings of the research, relating the finding to the original hypothesis proposed by the researcher. Finally recommendations for future research in this field are presented.

6.1 Scope of the Research

The scope of the research was to examine the content of each pre-disbursement condition of the subject bank. The research further sought to establish the importance of each pre-disbursement condition in protecting the bank's interests.

6.2 Importance of the Research

As there is little literature, and no known prior research on commercial property development loan pre-disbursement conditions in South Africa, it is intended that this report, or extracts of it, will assist in the education of all relevant parties within the bank as to what the content and importance of each pre-disbursement conditions is. In understanding the meaning of each pre-disbursement condition and knowing which conditions are important in protecting the bank's interests for a specific development, front-line consultants and property developers (borrowers) will be able to focus on the conditions of high importance and not waste time and resources to obtain unnecessary approvals and information.

6.3 Limitations

There were a number of limitations of the research, notably:

- There is limited literature, and no known prior research on property development loans in South Africa;

- Owing to issues of confidentiality, the pre-disbursement conditions, questionnaire respondents, survey respondents and persons interviewed are all representatives of one bank;
- The author was a part-time student, and constraints of both time and money existed in conducting the research.

Without the above limitations, a comprehensive listing of pre-disbursement conditions from all financial institutions in South Africa offering commercial property development loans could be researched. Also, a much larger sampling of persons responsible for administrating the pre-disbursement compliance process in all South African financial institutions could be undertaken. In addition, the opinions of borrowers utilising commercial property development loans at all financial institutions within South Africa could be researched.

6.4 Conclusions

6.4.1 Protection of the Bank's Interests

The purpose of the pre-disbursement conditions are to determine the borrower's experience in similar developments, the borrower's equity, the borrower's ability to service the loan, and the quality of the security offered for the loan. Isaac (2003) Research by Archer, Elmer, Harrison & Ling (2002) found that property characteristics such as location, number of units, year built, etc. have the strongest predictive content for default, which is significant in that property characteristics are observable at the outset of the loan and are relevantly permanent features of a property.

It was proposed that a large South African bank's commercial property development loan pre-disbursement conditions protect the bank's interests.

Based on the literature review, questionnaires and interviews, the research showed that the majority of pre-disbursement conditions are of high importance in protecting the bank's interests.

However, findings were that not all conditions are important or even relevant for every project. Lack of understanding of the content and importance of the pre-disbursement conditions by the front-line consultant can lead to repetition and consequently an excessive number of conditions. In having a full understanding of a specific project, and in taking cognisance of the relevant local authority's town planning conditions specific to the project, the number of pre-disbursement conditions can be limited to those that are important in protecting the bank's interests.

It is therefore evident that UNITAR's advice to developing country borrowers of "the fewer pre-disbursement conditions, the better" is equally relevant to the subject bank.

6.4.2 Hindrances to the Pre-disbursement Compliance Process

The research question was to determine whether commercial property development loan pre-disbursement conditions protect the bank's interests, or whether certain conditions hinder the pre-disbursement compliance process.

According to the results of a survey, the average time for compliance with pre-disbursement conditions was 5 weeks, the minimum compliance time being less than a week and the longest time taken being 4 months. The most frequent response was 2 weeks.

Pre-disbursement compliance times are not dependant on the size or type of development. Structured, specialised or securitized lending may have longer compliance times because of the complicity of the deals.

The most important reason for delay in compliance with pre-disbursement conditions was identified as a lack of understanding by the client of the bank's requirements and processes.

Ignorance on the part of the developer of the bank's procedures and requirements was also identified as the most common instance where relationships between the bank and the borrower were negatively affected by the pre-disbursement compliance process.

In order to address delays and their negative effect on the relationship between the bank and the borrower, a requirement was identified for banks to educate inexperienced borrowers on the contents and importance of the pre-disbursement conditions.

6.5 Further Research Related to this Topic

6.5.1 Broader-based Sampling

It is recommended that a broader sample of commercial property finance consultants be approached from a number of financial institutions, to eliminate any bias caused by the respondents being consultants of a particular institution.

6.5.2 Perception of Borrowers

Developers using development property loans could be surveyed about the speed of the pre-disbursement condition compliance process and how it affects their perception of the quality of the financial institution's service.

6.5.3 Marketing Implications

Research into the marketing implications of numerous and cumbersome loan conditions imposed by certain banks could also be conducted.

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APPENDIX A – QUALITATIVE QUESTIONNAIRE

APPENDIX B – RESULTS OF QUALITATIVE QUESTIONNAIRE