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February 2011

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Bridging Finance Update

Peter Hemple asks industry experts about the current state of bridging finance

Bridging finance has been around for a long time now and became a favourite finance option for many property investors that were buying property at auctions at below market value, refurbishing the unit and then either selling at a profit or refinancing and recouping their entire investment but with the added bonus of a buy-to-let property in their name.

However, when some buy-to-let lenders withdrew from the market in 2008 the latter option became a lot harder and the bridging finance industry suffered as a result. But what is the situation like now and how can property investors still use bridging finance to their advantage?

Market Comment

Laurence Goodman, managing director at Bridgebank Capital, explains how the industry has changed since 2008: "The most significant changes in the sector concern the quality of borrower and the repayment profile. We are seeing applications from borrowers that are relatively high-net-worth or better, and with proven property experience. Pre credit crunch, this type of wealthy borrower didn't need to use bridging finance as they could access funding for their property project directly through their high street banking relationships. Overall therefore, we are certainly lending to a much better quality borrower that can deliver the bridging loan exit without difficulty.

"Throughout 2008 and 2009, there were a number of withdrawals (of bridging finance companies) from the sector. However, as confidence has slowly returned we have seen a number of new entrants enter the market in the latter half of 2010, coupled with those established lenders that have survived the fall out of the recession. Overall, we are currently in a position where the number of established quality lenders is not far short from where the sector was at pre-credit crunch."

> **"Property purchase opportunities are still strong, but purchase prices have probably bottomed out and experienced investors have recognised this"**

However, with regards to how much the bridging finance industry suffered after the credit crunch, Goodman says: "It's difficult to assess how far the overall demand for bridging has fallen over the last four years. Our statistics suggest that application levels in 2009 were probably 50% down on the 2007/8 levels. However, there has been a steady growth in lending throughout 2010 and we expect that to improve steadily in 2011. Landlord and investor confidence has returned. Property purchase opportunities are still strong but purchase prices have probably bottomed out and experienced investors recognise this, so they are buying. Rental demand is strong and yields are slowly improving. Overall, the residential buy-to-let market is a good place to be if property has been bought at the right price to facilitate sensible and worthwhile yield returns.

"Our bridging loan products are for anything from one day to 12 months; and we will be introducing a short term loan product usable for a period of 12-36 months in the spring of 2011. Certainly bridging loans are being taken for longer terms now as investors recognise that a re-mortgage to repay the bridging loan probably can't be delivered inside three months anymore. On average most bridging loans are being taken for five to six months."

However, Goodman warns that bridging finance should never be used by a property investor that does not have a clear exit plan. He says: "Bridging should NEVER be ▶

used as simply as a form of finance; it is a 'facilitator' product that supports a specific need in advance of or in preparation for a remortgage or quick onward sale of a property. The length of the loan must be designed to match the time it will take for the borrower to deliver the exit on the loan."

How is closed bridging finance to other bridging finance? "Closed Bridging is effectively a situation where there is 100% absolute certainty on the date and source of the loan repayment. For example there is an unconditional exchange of contracts on a property sale or completed remortgage offer, which is fully signed off, valued, approved etc and all that needs to be done is the solicitors have to conclude the required legal work to draw the funds", says Goodman.

Lastly, he gives his advice on what an investor landlord should be aware of with regards to both the risks and rewards of using bridging finance, concluding: "Only use bridging finance if you are very certain as to your exit strategy to repay the loan; make sure that your financial circumstances and credit profile will be adequate to secure the long term remortgage to repay the loan. Do NOT use the funds as a long term financing solution - it is too expensive. Deliver the project and don't take your eye off the ball and exit the loan in the time frames you allowed for on taking the advance.

"Only use a reputable lender; preferably a member of the Association of Short Term Lenders like ourselves. Fully understand the terms and costs of the loan. Most property entrepreneurs are 'asset rich but cash poor' so take a loan from a lender that will deduct the debt finance costs from the gross advance rather than enduring the pressure and stress of having to find the cash to meet the monthly debt service costs - defaulting on monthly interest payments could prove expensive.

"Finally, factor the bridging loan costs into the overall project costs to assess the viability of the project overall, and if viable assess if the project could proceed without the bridging loan. If it cannot, then use bridging for the right reasons."

Rory O'Mara, director at Closed Bridging Finance, says: "Business has picked up significantly in the past 14 months and 2010 was our best year ever for bridging. I would say there are the same players in the market; however we hear that there are more planning to enter in 2011. As far as the investor is concerned, do they deliver beyond their promise of the 'marketing blurb' on the web site? Are loans based on value or purchase price? Can the lender act quickly? We hear that lenders are picky on the deals and locations. London is favourable, more remote areas are less.

"Mortgage approvals have been at an all time low over the past two years which is driving investors to look elsewhere for funding. The number of loan approvals for house purchase (42,563) fell in December 2010 and was lower than the previous six-month average (47,433).

"Fees are generally the same; we have a typical rate based from 1.5% per month, all subject to understanding the nature of the deal and the all important exit route(s) to repay the bridge. I believe that demand for bridging is up significantly and traditional buy to let lenders are really dragging their feet on lending to investor clients, and this was highlighted by an announcement by Lloyds Banking Group last year that as from 25 Sept 2010 all BTL property portfolios will be limited to a maximum of three properties or £2m worth of lending, (whichever is exceeded first).

“If you fail to plan and have a poor exit strategy, then you could end up being repossessed”

"Bridging fills this gap in the short term and gives investors the ability to move quickly. We are seeing commercial lenders come into the market and they are open to lending to professional property investors, which is our type of customer. Strategies based around sound business principals like funding an HMO for example are areas that we are very busy in now compared to 12 months ago."

"I don't believe that the way investors use bridging finance has changed significantly in the past few years unless you include the Mortgage Express factor! In 2006-2007 a savvy investor could use bridging finance to buy a Below Market Value (BMV) property for cash, say £70k using bridging finance and then remortgage the same day for a higher amount say £100k, thus pocketing the £15k difference, assuming an 85% loan to value mortgage was offered all with the blessing of the lender. Many bridging companies built their businesses on this strategy. Those days are over and the market has changed in so much as the investor today can't really use that type of transaction.

"Today we see our investor clients focusing strategies that will enable them to make a profit and cash-flow if they retain the property. Loans are usually from three to nine months. The six month rule as imposed by CML Lenders will dictate that a property cannot be refinanced until the investor has owned it for more than six months. The exception is commercial lenders who are not so focused on this rule, which is impacting the volume of deals an investor can complete on a year."

O'Mara concludes: "Bridging offers professional experienced investors access to short term funds enabling them to acquire property quickly thus giving them a competitive edge. Decisions are usually made on the same day subject to valuation and an understanding of the proposed strategy and exit plan(s). We would expect a 1st legal charge over the property with a minimum loan of £30,000.

"If you have a very clear plan for your project with sufficient profit then bridging is a great way to leverage money. If you fail to plan and have a poor exit strategy then you could end up being repossessed. A good underwriter would explain this in advance prior to lending. Our clients are experienced professionals who work on projects that allow enough of a margin for this not to be a worry."

Nigel M Alexander, director at Finance and Credit Corporation (Fincorp), says: "Since 2008 bridging finance has taken on a new persona and importance in the property funding market. Prior to 2008, bridging finance was primarily utilised by property buyers who were novices, had no demonstrable property track record, had credit problems and as a consequence, had little or no access to traditional forms of finance.

"The bridging finance business has taken a massive rationalisation as a result of the recession but in general the established firms survived, the firms who had meteorically entered the market have meteorically exited it, but a number of new players have been attracted to the market in view of the demand for bridging loans and the attractive returns. Consequently, the pricing of bridging loans has remained relatively stable as a result of a competitive market place. The demand for bridging finance post the end ▶

of 2009 has risen dramatically as other more traditional sources of funding have completely dried up.

"Traditionally, landlords did not utilise bridging finance as the professional investors all had access to more traditional sources of funding. They utilised bridging finance on an irregular, somewhat 'ad hoc' basis as and when circumstances demanded an especially rapid completion where their existing sources of funding would struggle to have the funds ready in time.

However, the whole market place has changed beyond recognition because the clearers and traditional buy to let funders have suffered the ravages of recession and as a consequence there is a complete lack of liquidity in the market place. This illiquidity is being increasingly made easier by active bridging lenders. Hence, traditional landlords are now utilising bridging finance to fund acquisitions as their existing sources have either dried up or are taking considerably longer to process funding applications. Indeed, it seems to be our experience, that buy to let applications can take in excess of three or four months to complete whereas purchasers at auction have only one month to do so.

"Property investors are aware that bargains are available, either at public auction or through private sales, and this is what they are utilising bridging finance for. They take a bridging loan on the basis that they can either immediately sell on the property or alternatively arrange funding from a more traditional source but obviously more slowly than previously."

Alexander concludes: "Investor landlords should use bridging finance cautiously for short term usage only. In addition, investor landlords should be aware that in assessing quotations from bridging finance companies, they look at the small print so that they may be fully apprised of the 'all in costs' and should not be seduced by competitive headline rates."

"Investor landlords should use bridging finance cautiously for short term usage only"

Case Studies / Examples of how bridging is being used in today's market

O'Mara at Closed Bridging Finance gives an example of how one of his customers benefited from taking out a bridging loan. He says: "The investor, a Neil Chapman Blench, purchased a block of three flats on the South Coast for £430,000. The cost of works is approximately £15,000 to refurbish one flat. The goal is to split the title, so each flat can be sold for circa £195-205,000. The garage will sell at auction for £15,000; it's close to the railway station. The freehold will sell for £12,000 and the three flats for £600,000. Gross value is approx £627,000, gross profit circa £197,000. We lent £318,000 to the client on a 1st legal charge basis for a maximum period of four months. The cost of the bridge for the full period inclusive of all fees will be £38,000, still leaving the client with a profit of £159,000 less his legal fees."

Another example is given by O'Mara: "An investor purchases a block of eight repossessed flats in the North West for £130,000. The cost of works is approximately £51,000 to refurbish the property. An after works value of £320,000 has been agreed with the commercial lender who will take out the bridge. We lent £150,000 to the client on a 1st legal charge basis for a maximum period of 3-4 months. The net advance from the commercial lender would be approx £224,000 and the cost of the bridge for the full period inclusive of all fees was £16,111.

"The client ends up with eight flats which have high rental demand, financially he has spent approx £197,000 (purchase, refurb and bridging loan costs) and has a drawdown of £224,000 leaving him with cash back of £27,000 to invest in his next property deal. This deal worked well for the investor as the exit route supplied by the commercial lender was not subject to the usual CML six-month rule and the valuation was based on rental income and improvement to the property. Bridging gave the client the opportunity to secure the property very quickly; we were highly geared at 115% of the purchase price and our fee reflected this."

Lastly, O'Mara gives an example of how a bridging loan can also assist an HMO landlord. He says: "The investor purchases a property in the North East for £90,000 and the property requires approx £10,000 to cover the cost of works to meet HMO standards as requested by the local authority and lender. The exit route is commercial finance based on the income of the property.

"The lender agrees to value at £155,000 after works completed thus providing the investor with a net draw down of circa £100,750 (65% LTV commercial finance). In just over a month the investor has acquired a property requiring minimal works and has refinanced. We lent £71,250, total bridging fees including our legal fees were £5,250, so the client ends up with a small amount of cash £5,500 to cover his legals and leaving no money in the deal." PIN