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BRIDGING FINANCE

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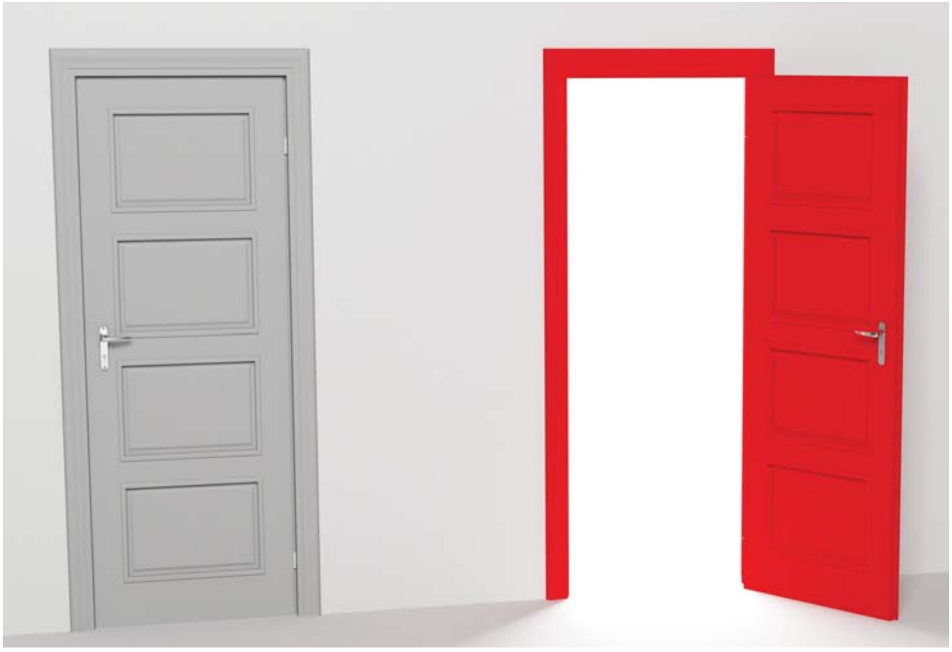
All About the Exit Strategy

Donia O'Loughlin reviews how investors can use bridging finance in today's property climate



Bridging finance can help an investor in several scenarios and it can be used for almost any type of investment, either commercial or residential.

A bridging loan is taken out on a short-term basis, typically from one day to 12 months and it is secured against a property. Rory O'Mara of Closed Bridging Finance says: "In effect, it bridges the gap between either selling the property or re-financing to a longer-term lender. A first or second charge will be taken against new or existing property or a combination of both."

There are two types of bridging - open-ended or closed bridging. Open-ended means that there is no clear exit and closed bridging means that a form of remortgage will be in place as a defined exit.

O'Mara says: "In most cases, bridging loans can be made on a non-status basis where no proof of income is required, however some lenders may ask depending on the nature of the loan and to see that the loan repayment can be serviced. Some loans are serviced monthly, others can be deducted upfront. All are treated on a case-by-case basis, for example, deducting six months payments in advance. If you redeem early, the payments would be refunded pro-rata."

Raymond Moore of the Nutcracker Clinic also believes that bridging can be used to do a little or 'no money down' purchase for a below market value property in which case the borrowing is usually only required for a short time whilst completion is taking place.

He says: "This works by firstly finding the below market value property you wish to buy. Secondly, you obtain a mortgage offer in principle preferably through the scheme's preferred broker because of their experience. Thirdly, you submit the on-line application form."

Roger Dewsbury, senior underwriter at Crystal Mortgages, adds: "An investor can buy a property with bridging finance before it's ready to be let so it can be a good method if the property is currently not mortgageable."

It is possible to get all your money back on the property when using bridging finance in this way, according to Dewsbury. He says: "If you buy a property for £100,000, borrow £60,000 using a bridging loan, spend £25,000 doing the property up and then for example, the property is then worth £175,000. Therefore you have recovered all your money and also repaid the bridge. All of the capital outlay has been recovered."

Obviously this strategy only applies if you can source deals at 30% BMV and then obtain an exit from the bridging with a good LTV mortgage.

Bridging can also be used to refurbish a property and then sell it on for a profit (flipping property). Dewsbury adds: "Bridging can also be used to buy a property before you get planning permission for it. For example, if you wish to buy a house and convert it into two properties then you can buy it cheaply, do the bridge and then get planning permission."

There is of course additional risk attached to this particular strategy if planning permission is refused or takes much longer than expected, so consider carefully any potential schemes before you present them to a bridging provider.

Laurence Goodman from Bridgebank Capital which provides bridging finance to investors says that: "Typical projects requiring bridging at the moment are single unit light refurbishments which require a spend of say £10-20,000 to bring the property up to a good standard for lettings use. The much tighter restrictions now being placed by mortgage lenders in respect of the property having to have been owned by a vendor for a minimum of six months has meant that investors have had to adapt their strategy.

"Some investors are now using bridging finance to cover costs during the interim period, often putting a tenant in for six months before they sell on or refinance to get as much of their own money back out once the property is re-valued for a BTL mortgage at around 70% LTV.

"To make this approach work, investors do need to source property to which 'value can be added' with a good yield of 7% or more and to have a clearly defined exit strategy in place before we will consider the proposition for bridging," says Goodman.

O'Mara also offers the following examples of how bridging can be used. Example 1, buying at auction and minor refurbishment, O'Mara says: "A property investor spots a three-bed investment property coming up for auction within the next four weeks. It's an ex-local authority property requiring some TLC. Cost of works would cost approximately £7,000 and the guide price of the property is £70,000 and the value after the work is completed is £100,000. In this example, we would consider lending funds of up to 85% of the purchase price, with the client putting the balance into the deal and paying for the cost of works. The client does not have to service the loan monthly. The exit route can be either to refurbish the property and refinance, typically after six months although some lenders may let you refinance in less time than this and the option is to refurbish the property and sell on to a private buyer as soon as the work is complete."

However, here is an example of an investment that was not reasonable.

Moore says: "I was asked if I could suggest a lender who would lend 100% of the purchase price plus an advance for the cost of repairing it, then wait whilst it was put on the market for sale and be repaid on completion. This person wanted someone else to take all the risk, but there was little equity and they wanted to take the profit from the deal, which is not an attractive proposition to a lender."

O'Mara believes that it is worth getting a pre-valuation in advance so that the buyer is aware of the numbers and can uncover any potential pitfalls with the property. He adds: "It is best to find these out upfront and not after you have committed to buying in the auction room."

With regards to self-build investments, O'Mara says: "A property investor found a great three-bed investment property for sale via a local estate agent that has the potential to be a good buy-to-let property. However, the added bonus was the land adjacent with full planning permission to build a three-bed house worth £250,000. The guide price was £240,000 for the house and land and the cost of works for the self-build was approximately £100,000. We agreed to lend the £100,000 in stages to cover the build. The investor would secure a buy-to-let mortgage to buy the current property. Their cash in was £80,000, after works completed and with the new-build sold, they would have all the cash back! Make sure all the numbers stack for the purchase and rental of current property and check all costs for the new-build and always have a clear exit route in place."

The lender will want to obtain a decision in principal, therefore it is worth the investor being organised to provide key information such as proof of address, copy of passport and driving license, payment of valuation and commitment fees, bank statements and asset and liability statement.

O'Mara adds: "A valuation will be required and is instructed by the bridging company, again in some cases a recent valuation can be re-typed if instructed by the client, providing the lender gives consent."

Is bridging finance difficult to obtain?

Unsurprisingly, O'Mara did see a slowdown in lending last year due to many investor clients struggling to obtain buy-to-let mortgages. He says: "The market has picked up recently with the announcement that lenders like The Mortgage Works are introducing an 80% LTV buy-to-let product with an interest rate of 4.69% on a one-year fixed-rate. We see that other lenders such as Aldermore are also now keen to lend. This provides a good exit route for our investor clients."

> **"There is now more liquidity coming back into the mortgage market and we are starting to see an upturn in demand"**

According to Moore, the credit crunch affected the two types of bridging he offers. He says: "This was because mortgages became harder to obtain but also because Mortgage Express stopped offering same-day mortgages which enabled 'no money down' deals to be done easily and then all other lenders followed. Property investors became wary and many stopped buying."

Goodman from Bridgebank Capital comments that: "There is now more liquidity coming back into the mortgage market and we are starting to see an upturn in demand for bridging finance from investors, but it is still quite marginal."

Dewsbury has also now noticed more activity and he says: "Most companies and investors would like to forget 2009. Last year, everyone felt very nervous about doing bridging as it was a falling property market and there was the possibility that if you did bridging, your property may end up being in negative equity. Therefore it was dangerous for both the borrower and the lender. This year is already getting a bit more active and we are now doing more business."

The credit crunch has of course made lenders take a much more cautious approach to lending. O'Mara adds: "The main concern for the market is how they are going to get their money back. Lenders need to be confident that if they lend you money you will be able to refinance the property for more than the bridging loan or sell the property for more than the bridging loan. If a lender can see you can do this, there should be no reason why they would not lend you short-term finance."

Moore has also started to see an improvement in the market. He says: "It started changing at the beginning of May when I received double the amount of enquiries during the first two weeks from new clients but also my existing clients are starting to add to their portfolios. There are two reasons for this - the first is that confidence has returned because of the Conservative leadership and the second is mortgages are becoming much easier to obtain with more lenders returning to the buy-to-let market."

According to O'Mara, the difficulty in obtaining this loan really depends on what you want to achieve. He says: "We work with the client to understand the numbers. What's the cost to get into the deal, cost of any refurbishment etc and what are the exit routes - flip or remortgage to rent out. If the numbers are positive and the client can see a profit, we would consider lending. The valuation is obviously key too and the client's track record."

Dewsbury believes that it is easier to obtain bridging than a standard buy-to-let mortgage. He says: "As long as you can satisfy the exit strategy, you can get a bridging loan. Call us, discuss the issue, satisfy the exit strategy, we'll email the paperwork to you, complete it and email it back and then we can go ahead. The process is a lot more straightforward then a standard buy-to-let mortgage. We are not as pedantic about the income criteria as a buy-to-let mortgage lender would be. However, ▶

income criteria may be looked at as part of the exit strategy. If you wish to get a buy-to-let mortgage as the exit strategy for the bridging loan, we will look at the prospective rent value and property value to ensure the investor will get mortgage approval."

Current rates

According to O'Mara, payment of a commitment fee and legal fees will be required once you have had initial terms agreed with the lender. Valuation fees are normally paid direct to the lender.

Bridging finance is certainly not cheap which is why it should only be used as a short-term loan. Dewsbury says: "It can cost anywhere from 1% interest a month but a typical rate is 1.25%, and this is for 70% loan-to-value (LTV)."

O'Mara adds: "Many bridging companies will lend against market value or purchase price, subject to a minimum. Typically, an investor is looking at 65-70% LTV but cannot exceed 100% of the purchase price. Some will lend on purchase price only. Each case is looked at on its own merits. Interest rates will vary but are typically from 1.25% per month plus arrangement/exit fees."

Everyone who PIN spoke to emphasised that the exit strategy is what is most important from the lender and borrower's perspective. Dewsbury adds: "We do discuss exit strategy in great detail before we give the loan as we want to get in and get out as quickly as possible, as should the borrower."

O'Mara adds: "The exit route is the key to the decision-making process. With additional security, an investor can obtain up to 100% LTV. The exit is usually a buy-to-let mortgage from a mainstream lender. A decision in principal will suffice and proof of funds may be required."

Crystal Mortgages is not interested in lending huge amounts of money to investors. Dewsbury says: "Big bridges are unattractive to us as some bridging companies were backed by big banks so they have stopped lending. Those not depending on the support from banks aren't lending large amounts. The average bridge that we do is around £200-300,000 and the max is around £600,000."

This is not the case with Closed Bridging Finance and O'Mara adds: "Loans are available from us from £30,000 up to £10m."

Crystal Mortgages rolls up the interest for the bridging loan, so an investor is not paying monthly repayment instalments. O'Mara adds: "Most loans are made on a retained interest basis making it easier for clients to borrow without having to worry about servicing the debt monthly. We are looking at offering loans based on monthly arrears and fully rolled up interest."

Benefits and drawbacks

One of the main benefits of bridging finance is that it can have a very fast completion time, according to Dewsbury. He says: "Completion can take as little as two to three days for an experienced investor with the right paperwork which means the transaction can be complete quite quickly. Another benefit is that once you have completed and negotiated a cash deal, the investor is then in the shoes of being a cash buyer and therefore in a much stronger negotiating position."

O'Mara adds: "Speed is of the essence. Some deals are completed within a few days but most bridging loans are turned around within two to three weeks. It can enable astute buyers to secure some fantastic below market value purchases."

Dewsbury feels that the biggest drawback is if the investor cannot pay back the bridge quickly as it could be incredibly pricey. He says: "That's why there is lots of emphasis on the exit strategy as it's more expensive than a normal mortgage. It's designed purely to be a short-term loan."

O'Mara agrees that it could be expensive compared to a buy-to-let mortgage. He adds: "I would agree that it is expensive but why compare apples with pears? Our view is that the deal must stack up for the client. Will he make a profit when he exits the transaction? If the numbers are green and positive, it's a great deal! If not, then look at the alternatives."

Conclusion

Whether an investor wishes to use bridging for 'no money down' deals or as a short-term loan, it is an option for those wishing to expand their portfolios. There is no doubt that the most important aspect of this type of loan is having an exit strategy. Yes bridging is more expensive than a mortgage but as O'Mara says, why compare apples with pears? If used correctly as a short-term loan, bridging can indeed be of help to those property investors who know what they are doing and understand the risks involved. PIN

Examples of how bridging finance can be used
Chain breaking mortgage
Vendor insists that you pay using cash
Property development including site purchase and self-build projects
Property conversions and refurbishments
Acquiring a property where a surveyor recommends a retention
Buying from auctions
Capital raising for business acquisitions
Acquiring property overseas
Creating a rescue package for home-owners about to be repossessed
Source: Closed Bridging Finance