W P Property Finance
East Bridge House, East Street Colchester,
Essex. CO1 2TX t: 01206 586 580
e: contactus@wpfinanceme.com
w: www.wpfinanceme.com

UNDERSTANDING BRIDGING FINANCE

My name is Tony Pomphrett, Managing Director of W P Property Finance Ltd. I have been advising my clients and brokering all types of property finance for over 30 years and have lost count of the conversations and emails I have taken part in answering the same questions about mortgages, bridging loans and short-term finance. The internet can provide lots of information on just about everything but unfortunately, not all that information is correct or being sought from the right place.

A guide to Bridging Finance *(based on my experience)*

Bridging finance is a short-term loan that is typically secured against property or land. From a broker perspective, bridging is all about helping you get your loan processed as quickly as possible, and our lenders bridging products are designed to deliver this providing you meet their lending criteria. Their Fast Track options utilise AVMs and enhanced title indemnity insurance to save time during the underwriting process. With Fast Track, full valuations aren't required, and many key legal issues are indemnified. When your enquiry doesn't qualify for Fast Track, lenders standard bridging options offer all of the same care and due diligence but require a full valuation to be carried out and for solicitors to conduct full enquiries, much like a traditional mortgage which could result in longer processing times.

The term of a bridging loan is typically up to 12 months, it can be shorter or longer depending on your requirements and can be offered for up to 5 years although, this is rare.

Bridging loans are sought for a number of reasons but in the main it's to deal with a requirement not met by the more traditional route, i.e. short term need rather than long term, unmortgageable property and speed.

In the past, these loans were provided for what were known as chain breaks, where a seller lost their buyer and didn't want to lose out on the property they were buying, so they would take out a short-term loan until a new buyer could be found and their property sold. Although this could potentially solve the problem it was usually, an expensive exercise.

These days, as well as chain breaks, the rise of the professional property investor market has seen a huge increase in the demand for bridging which has led to many more lenders and financing solutions on offer. People are looking at old run-down unmortgageable property in need of refurbishment which they can improve, uplift the value, and either sell or refinance on to a longer financing solution.

Are bridging loans actually mortgages, and what is the difference?

Put simply, they can be deemed mortgages or loans, mainly dependent on whether they are regulated or not. If you want a more detailed explanation, refer to the Financial Conduct Authority handbook. The short version, if you and/or your family have in the past lived in, or intend in the future, to live in the property being used as security for the loan, it would most likely be deemed a short term regulated mortgage contract. If this is not the case and the property is a purely business transaction, then the loan is likely to be treated as unregulated.

Unlike a traditional residential, buy to let or commercial mortgage, a bridging loan offers the following features:

- short term borrowing, usually 3-12 months
- can be secured against unmortgageable, uninhabitable property.
- fast track loans, AVMs, and title indemnity
- 1st and 2nd charge loans could be available and combined into one facility.
- interest can be paid monthly or rolled into the loan and paid back when the total loan is repaid.
- part interest, part rolled/retained interest during the term of the loan to suit your financial needs.
- you can pay back the loan early, usually with no redemption penalties [see note 1 below.]
- you may be able to secure the loan against a number of properties, both residential and commercial.
- you may be able to secure 100% funding against the purchase using additional security.
- If you are improving the property, you may be able to secure an additional facility to cover 100% of the work costs.
- If you are buying below market value, you may be able to borrow against the open market value.
- you may be able to secure a rolling credit facility, borrow and pay back as required using existing equity.

[Note1] *Some lenders may apply exit fees to certain types of loan, usually structural development loans or ground up building projects.*

How much can you potentially borrow against a property?

Loans granted on a property will vary from lender to lender and case to case. A typical bridging loan would be offered up to 70% of the value or purchase price of the property usually, whichever is the lower. Some may offer to lend against the value if this is higher than the purchase price, but this may be capped dependent on the difference. Lenders will advertise loans to 75% but you should expect the interest rates to be higher. Loans above 75%, if offered, may be granted if you are providing additional security or adding value to the property at your own cost. These loans may provide some of or all of the funds you need to refurbish the property on day 1 and could prove a more cost-effective option. If you furnish us or your broker with the right information at the start, then the right solution to meet your particular circumstances can be sought.

How interest and charges might impact the loan

Usually, when a lender advertises a loan to value offering of say, 70% this may be referred to as the **gross loan**. This means, this is the maximum they will lend against the property with the interest and charges included. If this is the case then the amount you actually receive in your bank account day 1 of the loan commencement will be 70% less the charges and interest applied, On the terms issued to you this amount will be referred to as the **net loan**. If the lender allows, and you elect to pay the interest monthly then charges are deducted from the gross loan, not the interest.

If interest is held back and applied to the gross loan this is usually referred to as **retained interest**. If intertest is retained but applied to the net loan, this is referred to as **rolled interest**. If you pay the interest monthly, this is commonly referred to as **serviced interest**. Each will impact the amount you receive in your bank account so it's important you understand the differences and don't judge the overall competitiveness of the loan purely on the interest rate alone as some may mislead you into believing they are offering a better deal. The same applies to charges so make sure you understand what you are actually paying.

How much of your own funds do you need?

You would need to consider all the charges and fees you may have to pay as well as the deposit required to meet the difference between the price you are paying for the property or any amounts to settle any existing mortgage, and the amount you receive in your bank account from the lender on completion of your loan application. The list below shows some chargeable events, the list is not exhaustive so other fees may apply, these should be shown in your offer letter and other documentation provided by the lender.

You should check you have sufficient funds available to meet all costs involved.

Chargeable events not usually included in the loan.

- Your own deposit funds.
- Auction costs, if purchasing through this route
- Valuation of the property – you would normally need to fund this upfront.
- Re-valuation costs (if applicable)
- Your own legal costs – you may have to pay some of these upfront to cover searches.
- Lenders legal costs – your solicitor may have to provide an undertaking and may request funds from you.
- Local authority and/or planning application costs.
- Licences or application fees
- Broker administration fees
- Stamp duty
- Works funding
- contingency

Charges which can be included in the loan.

- Lender's arrangement fee – typically around 2% of the loan
- Lender's administration fee
- Lender's legal fees (not all lenders include their legal fees in the loan)
- Retained interest.
- Bank transfer fee
- General insurance fee
- Title insurance

Below Market Value Property

BMV as it is often referred to, could be an option but while most people would like to purchase a property below its real value it is sometimes more difficult to achieve than some may have you believe. Make sure you do your research and check the real prices property is being sold for, rather than the price they are offered at. You need to ask yourself why anyone would want to sell a property way below its true value. A lender may ask questions and delve into the reasons for such a decision.

Information taken from a lender's legal tips document: -

Common legal issues - Transfers at less than the market value

Why would the lender be concerned?

- The transfer of a property to the borrower at an apparent under-value could be at risk of being unravelled by a future insolvency practitioner if the transferor becomes bankrupt or goes into liquidation.
- An unravelling of the transfer to the borrower could result in the lenders legal charge being unravelled.
- A transaction is easier to unravel if the transfer is between connected parties e.g., husband/wife, parent/child, company/director, company/director's wife.

However, is it really a transfer at below the market value?

- It is important for the lender to gain a full understanding of the case. The lender will ask questions. Does the deal make sense? Why would anybody sell an asset for less than it's worth?
- There may be a plausible explanation for an "apparent under-value".

An example scenario:

- Transfer of equity case – one owner transfers its interest to the other owner for what appears to be less than its market value. The lender would require evidence that the outgoing owner is getting value for its actual interest in the property.

Evidence could include:

- A declaration of trust at the time of the original purchase confirming the outgoing owner's true share.
- Documentation showing the out-going owner did not pay a deposit for the purchase or made little or no contribution to the mortgage payments.
- Documentation showing the out-going owner did not contribute to any redevelopment of the property which enhanced its value e.g., all costs were met by the borrower e.g., receipts, contract for works etc.

- The lender may be able to establish that the transaction is not one at an under-value after all. This is because the outgoing owner is receiving the true value of its actual interest in the property.

Further protection would include:

- A bankruptcy search against the out-going owner
- A declaration of solvency
- An indemnity insurance policy
- Insisting the out-going owner separately represented
- [1]Works/refurb/development costs (allow for a contingency, usually around 10%)
- Other, sourcing agents, local authority, licences, contracts etc.

[1]You may be able to fund some of these.

Current interest rates *(at the time of writing which could change in the future)*

Although you should expect bridging loan interest rates to be higher than traditional mortgages, they are more competitive these days than they were in the past, driven mainly by competition in the market.

The interest rates the lender will charge will depend on a number of factors:

- The size of the loan
- The type of the loan or its complexity
- The loan to value representing a higher risk to the lender.
- Their own internal policies or funding lines

Currently, we are seeing rates starting at around 0.55% per month. Some may advertise lower rates, but these are rarely delivered. For a typical fast track loan to 70% LTV, rates start at around 0.75% per month to around 0.85% for standard loans. As the deal becomes more complex or, if you are seeking higher LTVs, rates will rise to around 1% per month or even higher, to 1.5% per month.

Minimum & Maximum loans

You may be able to secure a loan as low as £5,000, and maximum loans vary from lender to lender, some into the tens of millions. Most lenders will set a minimum loan according to the type of business they are looking for, typically expect this to be around £100,000 - £150,000, some lenders will offer competitive loans from around £50,000.

Refurbishment bridging, what is it and what does the term funded and unfunded mean?

You are purchasing a property with the intention making improvements and adding value. Due to the condition of the property or your particular requirements, you need bridging finance and need to understand the options available with a refurbishment bridging loan.

If you have the funds available and will pay for the works yourself, this is referred to as an **"unfunded"** loan. You could apply for a loan with a lender who may offer to lend around 70% of the gross development or, done up value (future value) of the property and provide some of these funds to you on day 1 (usually around 10% of the purchase price). This will not be allowed to exceed the purchase price of the property but could result in a net loan of around 80% of the purchase price. Of course, you will need to meet the lender's criteria and underwriting requirements.

If you do not have the funds to pay for the works and need to borrow these from the lender, this will commonly be referred to as a **"funded"** loan. A lender in this marketplace may offer to fund 100% of the works in arrears. You will need to agree a schedule of works with the lender and draw down the funds required in stages. You will need to fund the first stage then draw funds and repeat the process with the remaining stages until all works are completed. The lender may charge additional fees for each drawdown you take and may need to instruct further inspections of the property at each stage. There may be additional charges to pay for these inspections.

When trying to calculate how much a lender may offer for a loan of this nature, they may use a number of measures and apply percentages to these to meet their lending criteria and attitude to risk, e.g. they will apply a maximum percentage against the loan to gross development value (LTGDV) usually around 65% to 70%. Works cost, usually up to 100%, loan to current value, usually around 70% and loan to cost, usually up to 80% to 85%. These will usually represent the maximums and will not be exceeded. Some lenders may use different guidelines, I have provided the most common.

Experience

Before a lender will agree to funding this type of project, they will want to know about the customers experience and you may need to provide evidence, qualifications, pictures, explanations, profit & loss accounts. If you do not have the relevant experience and are contracting this work out, they may ask for the same evidence from your contractors.

Property types

Bridging loans are available on most property types, for some lenders there are no go areas such as pubs, care homes, schools, places of worship, to name a few. If the property is non-standard, make sure you provide as much detail as possible to your broker up front.

Property values & valuations

Most lenders will want their own valuations carried out by an independent valuer instructed by them, not the customer. You will be responsible for the cost of this valuation, but the report produced will belong to the lender and they are under no obligation to release this to you however, some lenders are happy to provide these. You are free to instruct your own valuation for your own purposes, but this is unlikely to be acceptable to the lender. If you disagree with the valuation or conditions imposed by the lender following the valuers report, you can try and make an appeal to get a revised decision. This will delay the loan application and is unlikely to be successful.

Valuation reports may offer up a number of different values and figures for the property dependent on its type. The lender will want to know the marketability of the property in the current market as well as the valuer's opinion of events effecting the market. As well as the current open market value, the report may list a 180-day value, 90-day value, vacant procession value, rental assessment, expected works costs and gross development value.

Valuations instructed for refurbishment loans and complex arrangements tend to be more detailed and will come at a higher cost. Lenders may provide a number of different companies and quotes which you may be able to choose from.

Cross collateral loans, what are they and how do they work?

A cross collateral loan is where you offer up additional property to raise further funds to meet the costs of your project. These can be on a 1st charge basis if the additional property is unencumbered, or 2nd charge basis if the property already has a mortgage. The 1st charge lenders permission may be required. Loans can be offered up to 75% on unencumbered property and up to 70% on 2nd charge, (minus the existing mortgage amount outstanding). You could use the equity in your investment property or, your own main residence for this purpose. You should carefully consider the profitability of the project and whether you are going to be able to pull enough funds out of the deal to repay your cross-collateral loan. If you can't then you may have to consider re-mortgaging your cross-collateral property to repay the bridging loan.

Short leases

Bridging loans are available for properties with short leases where the customer wants to extend the lease. The remaining term on the lease allowable by the lenders will vary. Typically, 70 years or above is fine, some will accept 50 years or more and some will go lower but expect your choice of lender to reduce. If you want to borrow additional funds to pay for the lease extension then either use additional property as security or you will need to complete the lease extension on, or before completion of the loan, to borrow against the uprated value. Under current rules, you cannot extend the lease on a property until you have owned it for a minimum of two years, if you are buying a short lease property the current owner needs to extend the lease (provided they have owned for two years or more) or start the process and assign a section 42 notice to you.

Planning

If you are building ground up, extending, converting, or completing major structural works that require planning, most lenders would want to see this in place prior to commencement of the loan. Some will lend without planning; we or your broker would need to know the full details of the proposition. If you are completing works under permitted development (PD) make sure you have completed your research as lenders may question evidence of this from a local authority.

Credit

A less than perfect credit record will not automatically prevent you from obtaining credit. Bridging lenders may take a different view from that of a high street lender but, they will carry out their own checks and investigations and if they feel you reflect a greater risk to them, either decline to lend or alter the terms of the loan. Make sure you provide honest and accurate information to your broker prior to applying for the loan.

Exit strategy.

If you are buying property and using bridging finance to fund the project, you need to consider how you are going to repay the loan. Are you going to sell or refinance. If selling you need to consider, how long it's going to take to sell, what it will cost to market and sell, and when should you start the process. Thanks he longer you remain on the bridging loan, the more it's going to cost. If you are refinancing, when do you start the remortgage process, what costs are involved, and how much of your money can you pull out of the deal for your next project. An all-in-one solution may be the answer, a lender who could offer the bridging loan and the commercial or residential buy to let loan. If this is right for you it could save time and costs.

Summary

Property has proved to be a good investment over the years, and many believe it to be the best investment you can make. The economy in the UK would collapse if we stopped buying property or lending institutions ceased to lend. If you took out a mortgage to invest in the stock market the financial regulator would take a dim view of such action but borrowing to invest in property is viewed differently but, that doesn't mean there are no risks involved. You need to understand the risks because it doesn't always work out for everyone. It's crucial to seek professional advice from qualified individuals who have the integrity and honesty to genuinely want to do the right thing for their clients and prospective clients.

Our business has been helping our clients achieve financial independence and realise their dreams of owning their own property for over 30 years. We know we go the extra mile, and we know we approach property financing very differently to other brokers. How do we know this? because our lenders, our long-standing clients, and our lending partners tell us we do.

We don't use gimmicks or fancy marketing techniques we just tell it straight. If the deal doesn't work, we will tell you. It's probably not what you want to hear so, unfortunately, we won't be to everyone's taste, however, we think, our lenders think, our lending partners think, and our long-standing clients think, we do it right. I am happy with that.