Property Development Finance Guide Q1 2017

How The Lending Marketplace Really Looks

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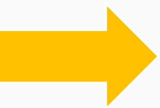

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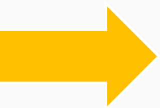

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Introduction

Who This Guide Is For And What You Will Learn

This guide is produced on a Quarterly basis, and has been put together to help UK based property developers who:

1. Want to understand how the post-2008 development finance marketplace now works, including a real-time update on the impact of Brexit
2. Want to stay up to date on recent, significant changes in lending credit policies that may affect their projects
3. Want to remain fully informed and prepared about which funders to use, before they embark on their next round of funding, and
4. Want to have a useful, free-to-use "compare the market" tool, which allows developers to analyse the top 35 funders, instantly.

In this guide you will learn:

- How competing lenders' appetite and products **vary wildly, and why**
- Why **selecting funders based on APR is a hugely inaccurate practice**
- How interest can form as little as 50% of your total finance costs
- Why you could be ruling out the more cost effective funders as a result
- Why selecting funders by including and assessing Loan to Cost % Ratios and Fee Structures is much more accurate
- What's currently happening in the development finance marketplace, and finally..
- How to quickly compare **over 40 of the top non-bank funders in the UK**

Before we begin, I'll briefly explain why are we qualified to tell you about this…

Discover & Invest Ltd.

A Little About Us

Discover & Invest is a specialist property development finance consultancy. We are unique in that we do not charge broker fees for introducing developers to lenders.

Set up in 2008 by Chris Davidson, our deep research on a monthly basis, based on regular conversations with credit teams at multiple lenders, means we remain on top of the marketplace at all times.

Due to the vast difference between finance products in just the development finance marketplace alone, we believe in specialising in this field of commercial finance and understanding each option as thoroughly as possible.

As a result of our deep research, we are able to come up with a number of unique insights, which allows developers to quickly access and select the most cost effective marketplace lenders.

We work non-exclusively with over 40 funders in property development, and 50 funders in property refurbishment, and this financial year are on target to complete over £50m of funding transactions nationwide.

You can find more at **www.discoverandinvest.com**

The Current UK Marketplace

A Summary

Since 2008, which heralded the retreat of the banking sector, the property development lender marketplace has fragmented and expanded substantially.

Whereas previously there were banks and some expensive-looking, short-term bridgers, an increasing number of new entrants have emerged to fill the gap between the two extremes in rates.

What type of debt funders are there today?

Aside from the banks, there are as many as 40 established funders specifically for property developments, and a good number more if you include smaller, local or regional offerings.

On the debt finance side, there are specialist development "banks" in their own right, there are a number of Private Equity backed but debt providing specialist lenders, and there are Real Estate focused Family Offices looking to deploy capital in both an equity and debt manner. The rest are short-term bridging finance houses, many of which are far less expensive than you may think.

There is also the equity space, where funding can be found for two different scenarios. Firstly, there is private individual equity investment. For developers who otherwise would get approved for debt lending but do not have the deposit or cash position, a third party equity investment allows them to get approved. Secondly, larger chunks of private equity for up to 100% of the project costs can be provided in a Joint Venture capacity, where a profit share is agreed at the end. Both of these equity plays we will cover later.

Our **free-to-use Development Finance Marketplace Comparison Tool**, which you have downloaded with this guide, will cover the top 40 senior debt development funders, giving you immediate sight of the current marketplace.

Post Brexit Update: It's not all doom and gloom!

Post-Brexit, and at the time of writing (January 2017), liquidity has remained strong and the funding marketplace has continued to be a stable environment.

To sum up:

- Brexit is not a 2008 situation: liquidity remains intact.
- Lending has restricted a little in some quarters
- For most lenders, lending appetite and criteria has remained the same
- The major issue was the uncertainty over valuations
- Most surveyors have regained confidence in the market

Clearly the situation is going to need regular monitoring, as Brexit unfolds in full. Our quarterly data updates will be useful from this point of view.

So far, so good though.

Top 10 Insights into UK Residential Property Development Finance Today

1. Brexit has not stopped nor severely restricted Lending

Over 6 months have now passed since the Vote, and all lenders have reported to us that lending volume and confidence remains as high as before the Vote.

Whilst the ongoing uncertainty is in the back of everyone's minds, it has not had a strong impact, and many lenders are still lending on the same terms, or only slightly lower pre-Brexit.

A few points to note:

We've a confidence problem, not a liquidity problem

In 2008 we were suffering from a severe shortage of liquidity, and a resulting steep drop in confidence.

This time we have plenty of liquidity, and at the moment only a slight drop in confidence. Lenders are mostly financed privately, and the funding lines they have in place are still there, virtually to a man. The key is getting confidence to return to the political landscape.

Uncertainty = A little tightening

Uncertainty in any economy leads to two issues with regards development finance. Lenders restrict what they are willing to lend, and surveyors downplaying the land or property they value, resulting in deal completion becoming much harder.

The good news is lenders are not restricting their lending as much as one might think, nor are vast waves of lenders calling a halt to lending.

Many had already slightly restricted their criteria in late 2015/early 2016 on the back of London residential oversupply concerns. Coupled with strong liquidity ratios, many lenders don't see any immediate need to re-assess any further.

Lending has not changed greatly

Property developers will be delighted to hear that with the vast majority of lenders, it is business as usual.

Valuation uncertainty has lifted

During the first couple of months, there were issues surrounding valuations, and what surveyors considered the true value of property post Brexit.

Valuations were being downgraded by up to 20%, or having “uncertain markets” clauses entered into surveys, at the request of the governing bodies.

However, lenders can confirm that the vast majority of valuations are coming in at very close to pre-Brexit levels, with most surveyors having had a renewed surge in confidence in the marketplace.

2. Selecting Lenders by the best Interest Rate is costing you money

One truth about the marketplace is this:

The cheapest looking lender is rarely the cheapest in practice.

Most will understand that the lender's headline interest rate is designed to get your attention but comes with some form of caveat.

Lenders do it because they know one thing works: most prospective borrowers select their lenders, at least initially, according to who has the cheapest looking interest rate.

The bad news is **it's probably costing you a lot of money**. The good news is we have a free tool that compares lenders correctly for you (which we will introduce later).

The lender selection problem arises because borrowers don't have full sight of the marketplace. Unlike the Residential mortgage space, where products are fully visible and fixed, there is no decent equivalent service for businesses and in particular property developers.

A few lenders are usually found randomly, and in a bid to narrow options down quickly, borrowers start going with the one or two that seem to be the cheapest i.e. have the lowest advertised interest rate.

There are two main pieces of knowledge to pass on here:

1. **Interest rates can be applied using 3 different calculations,** and
2. **Interest can make up as little as 50% of your overall finance costs!**

In more detail:

1. We can show you 3 different lenders with a 7% per annum interest rate. They all calculate and apply their rate differently, which will give you 3 very different amounts of interest ranging from £430k to £700k on a £10million loan (before we even look into fee structures)!
2. Most funders have arrangement and exit fees, but some now have exit fees as a % of the GDV not the loan, which adds at least 50% on the exit fee. Some 7% per annum funders come out as expensive at 15% annualised in the end.

Both of these points are covered in detail in our Key Lender Comparison Criteria Section.

With this changing marketplace, and in order to make sure you're accessing the most cost effective lenders with appetite for your project, developers now require a real-time research tool with which they can accurately filter and compare up to 40 lenders. You may already have downloaded this but if not, we will show how that is possible later.

3. How the appearance of cheap finance can be deceptive

There is a great deal of “smoke and mirrors” when it comes to how lenders advertise their interest rates. It may be surprising to hear that many cheap looking lenders are actually very expensive, as well as the opposite: some expensive looking lenders are actually much cheaper.

It is common for a borrower to look at a monthly “bridging” interest rate of 1% per month and decide it’s 12% per annum and too expensive.

But is it 12% per annum?

***NO: it is MUCH LOWER if the rate is calculated on the drawn balance*.**

If the rate is calculated on the drawn balance not the facility, the annualised rate is **nearer 7.5%** (based on a 12-month loan and 9 equal drawdowns).

Some lenders also have very low or zero exit fees, and so what happens quite frequently is that the initially cheap looking lender at 7% (but with a 2% arrangement and 1-2% of GDV exit fee), is the same overall cost as the more expensive looking lender at 1% per month with a 1% of loan exit fee or zero exit fee.

For those that don’t like paying exit fees, and don’t like the idea of a GDV based exit fee as a variable, the lower exit fee lender sometimes becomes the preferred route, at least for up to 12-14 months.

If the loan is likely to be over 12-14 months, the higher interest lender will become increasingly expensive as their monthly rate is essentially double that of the development lender pro-rata.

If the loan is under 12 months though, for deals like Permitted Development Schemes, it is well worth comparing both ends of the cost scale; you may be surprised!

4. Assess Lenders by % Loan to GDV and % Loan to Cost first

There is more to assessing the true cost of lenders properly than just the rate, and the GDV and LTC ratios are two such components.

For example, some developers are more interested in how much cash they need to put in over the rate, either because they have low cash levels, or because they wish to deploy the cash they have across multiple projects simultaneously.

Lenders with a higher maximum Loan to GDV %, and those with a higher maximum Loan to Cost %, will typically allow developers to borrow more money and put less down.

They are NOT though, always the cheapest rate lenders.

The cheapest rate lenders usually want more cash levels going in, so it is a balancing act between how much interest you will pay and how cash you have to put down on Day 1.

Lenders also have a Day 1 LTV restriction regardless of other criteria, which can range from the developer putting down anywhere between 20% of the site price and 50% of the site price.

Some lenders can fund 100% of the site price if other assets are available, so there are several options. Again you may find the preferred lender is not the one you thought when comparing properly.

If you are yet to buy a site, it is worth going through this process first, so you know how much you need to put down, what the maximum site price is that you can aim for, and what loan you require as a % of the GDV so you can rule in or out a number of lenders.

We cover this in more detail in the Key Lender Comparison Criteria Section.

5. How to get funding without your own deposit/equity stake

You may be a developer without any cash, and wondering if you can get a project off the ground at all. There are a number of ways to do this:

- Some lenders will allow you to put down zero cash if you have a strong asset position behind you. If you have a substantial property portfolio, some lenders will take charges over various properties to the amount they deem secure enough for them to lend.
- You can bring an equity investor on board who will provide the cash cover and asset position for you. There are now many angel investor and crowd funding websites, where property is not only the most popular form of investment, but also some sites are specifically for property investing. Type “property crowdfunding” or “equity crowdfunding” into Google and you should get most of the right websites quickly.
- Pre-sell units to off-plan investors. A model that works with some lenders is to partner up with an investment company who will sell units for you. They take non-refundable, exchanged deposits, and some lenders allow you to use it as at least part of your cash stake.
- Pre-sell part or the whole site to a Housing Association or Fund, which if the deal is right, can negate the need for funding at all (to be covered shortly).
- Partner with Funds or Asset Managers that will bring 100% of the funding on a Joint Venture basis, with profits split at the end. There are a good number of these companies around with multi-million Pound budgets looking to partner with developers.

We have relationships with a number of firms who could help if required.

6. Pre-selling units to Housing Associations, Investors or Funds: why it's important

With global economic concerns lurking as we write in January 2017, speculative residential development projects, based on selling units locally on completion backed up by local comparables, have the potential to become more difficult to fund, if the number of units is high, or the location remote.

It can be hard to find good comparables in some locations, either because the site is remote, there have not been many recent local sales, or when an area has an awkward mix of expensive modern property backing on to 50's style bungalow estates for example.

Lenders are all about risk; specifically the risk of a project not completing or units not selling. They assess the project's viability based on the developers' experience, the shape of the economy, and the ability to sell in the local area. One way to greatly reduce the risk for a lender in uncertain times is to pre-sell a site if possible to a company like a Housing Association, Investment House, Family Office, Asset Manager, a Pension Fund, or a firm representing internal bulk buyers.

Building relationships with these groups, or engaging with someone who has relationships with these groups, is a useful early action in today's development world. By thinking with the end in mind before you start, you greatly reduce the perceived risks for lenders, and for some the project may go from 50-50 to a "no-brainer lend" as a result.

7. Been bankrupt or in a CVA? It is not impossible to get finance..

If you have, or have had credit issues, it does not mean you cannot qualify for lending.

In the development world more than any other, firms can be deeply affected by economic turbulence. Lenders understand this; 2008 for example was a time where developers could not be at fault for the economic downturn.

Lenders increasingly take the view that CVAs, bankruptcies and other credit issues are not deal breakers as long as the client is a) honest and upfront and b) the causes were down to bad fortune rather than bad business skill. With so many developers going under at the time, if lenders did not take this view, they would do a lot less lending!

It is always a case-by-case basis, but we have experience of helping previously bankrupt developers from 2008 who are able to get decent levels of cost effective finance today, subject to the whole picture stacking up.

Be honest about any issues, because if you're not, they will be discovered in searches, and lenders will lose all trust and confidence in you, resulting in the loan being declined.

8. Why your project scheme selection is now crucial (particularly in London)

Aside from Brexit, most developers and property professionals will be aware of the Prime Central London price falls, and the impending mass over-supply of Central London luxury apartments, particularly in the Battersea area.

Numerous experts have commented on the lack of demand to cover this supply, and the likely market correction in the coming 1 to 2 years. With an uncertain global economy lenders have adjusted their scheme type appetite, at least in the short-term.

Most lenders, whether in London or beyond, want to see schemes with mass appeal aimed at the mid market i.e. the largest and most likely financially to be able to buy.

So build projects aimed at young professionals or families where couples are upwardly mobile, in areas where they can a) buy and b) areas where property prices have the forecasted potential to rise.

Do not try to build luxury upmarket single unit properties unless there is some form of pre-sell in place, the equity position is enormous, or your net asset position is extremely strong. We cover lender appetite in more detail shortly.

9. Personal Guarantees: what you must know.

All funders in today's market want Directors to provide some form of Personal Guarantee. This will be on top of a 1st charge, equity stake and debenture over the SPV the site sits in.

Most lenders look for a PG in the region of 20% of the loan given, as a fixed sum PG (i.e. restricted to that amount). The PG acts to cover any cost overruns, over and above any contingency you've built in to your development appraisal. Some lenders look for more, and can be anywhere from 50-100% of the loan depending on who you go to.

PGs are calculated based on the equity in property assets the Directors hold i.e. if there was a cash problem over and above the loan, a Director could sell or re-finance a property asset to continue the project.

If you're struggling to cover the PG, consider bringing on board either equity investors, or other directors that can act as guarantors for the facility.

10. Planning Permission: what to do if you don't have full planning

The reality is very few funders will lend prior to full planning, unless it's a Permitted Development opportunity, or you have other assets that can be offered up as security.

There are some who will lend on outline planning, but the rates are higher to reflect the risk, and they will typically be short-term loans requiring a strong Plan B exit strategy should planning not materialise.

The clever method is to agree a conditional upon planning sale i.e. put down a deposit and take an option on the site, with a view to completing the purchase once full planning is in place. You can go to a lender on this basis, as you would not need funds until completion.

Recent Changes In Credit Policies

What's Changed

There have been a number of issues that caused lenders to change their credit policies. Whilst some of this may be concerning, knowing what lenders now like should help developers know what types of projects to source.

There are 3 major factors affecting lender confidence:

1. Brexit – Some lenders, in the short-term at least, have slightly restricted what they are willing to approve. Some though have not changed their stance at all.
2. Prime Central London house prices have reduced by as much as 20-40% in the last year, depending on which surveyor you engage with, and has been commented on by many news outlets.
3. There is substantial concern over the anticipated chronic over-supply of luxury £1m+ apartments in Prime Central London, and in particular the Battersea area.

Bought by overseas off-plan investors, the fear is 1000's of units will be for sale on completion in the next 12-24 months with the level of demand projected to be far lower than the level of supply. Developers, having sold off-plan, have little control in drip-feeding the market to slow supply.

What lenders don't currently like – luxury apartments

It won't be a surprise to hear then that lenders to a tee won't fund prime central London development schemes where the units are £1m+ each. There is no confidence that there is anywhere near enough demand to service the current supply, let alone any new developments.

Similarly, speculative schemes with large numbers of units, even in London, will struggle to get funded for the foreseeable, due to the lack of confidence in selling out. (The exception to this is pre-sold schemes, which present no risk to a lender).

Also, any single unit, high-end developments, not only in London, but nationwide, are also off the radar for most lenders as well. Lenders have a number of these properties on their books that are not selling, and don't wish to add any more. Even Private Equity Real Estate Funds are shying away. Sales from international buyers, however, should pick up with the weak Sterling post-Brexit, so there may be a turn around before too long. There is the odd lender willing to consider subject to a good deal on paper, so it's worth knowing who those lenders are.

What lenders do currently like - mid-market, mass appeal and/or pre-sold

If we are talking purely London, virtually all lenders are in agreement regardless of their differing products:

They like residential apartment schemes with units valued from £300k to £800k each. This will be preferably in urban re-generation locations where values will hold and likely rise, regardless of the concerning indicators already mentioned.

Micro-location is likely to be the main factor for lending approval, so if you're looking at where to source your projects, think mass-market, urban regeneration. Lenders are also looking for smaller schemes now in order to guarantee sales, so large schemes will struggle for funding unless part of the site is pre-sold.

In general terms then, mid-market, mass appeal schemes, either apartments or houses, with strong local comparables will be fundable. Pre-sold, de-risked projects where lenders are not relying heavily on the local market for sales will always attract funding options.

Developing relationships with Housing Associations, Funds, Asset Managers with budgets, and investment companies with databases of off-plan BTL investors will help get your funding application approved by decent sources.

The 5 Ways Funders Assess Your Application

Knowing how a funder analyses your application is important because approaching funders in the wrong manner can have a damaging effect on your application. By understanding the major factors upfront, you can greatly improve your chances of getting approved, and also save yourself a lot of time for projects that might not stack up.

1. Experience

Any lender in any commercial finance space, looks at experience before anything else i.e. is the borrower "a safe pair of hands"? Funders will then split into those that want to see you've completed similar projects to the current application (usually the more conservative), and those that will consider growth projects that are larger than you've done before.

A word to newbies or site owners: it is possible to get funding by employing strong contractors, but the more conservative funders won't be available until you have a couple of projects under your belt.

2. The Numbers

Covered extensively in the Key Lender Comparison Criteria section to follow, lenders will look at whether the loan amount is within their range, their preferred geography, and whether the amount is within their Maximum Loan to GDV %, Maximum Loan to Cost % and Day 1 LTV % ratios if applicable.

3. Location & Comparables

Geography will be taken into account, and then critically what the comparables look like in the local radius i.e. is the stated GDV accurate and demonstrable?

Ask yourself this: if you were a buyer with the budget available for your unit, what other options exist in the local market at that price, and how do you compare? Opinions from local letting agents, as well as online referencing is usually required, and looks good if presented at the first approach.

4. Wealth/Net Asset Position/Equity Investment

Virtually all lenders want someone involved showing they have a solid wealth/net asset position, and all will require Personal Guarantees. In the main they require fixed sum PGs at around 20% of the loan, but some lenders want 50-100% guarantees, or corporate guarantees from established developers.

PGs are generally covering cost overruns, with lenders looking for coverage through the Directors equity positions against property assets only. If the Directors do not have any property, or equity positions are low, there may be the need to bring anther Director on board who can cover the PG, or inject extra funds through an equity investor.

Not all funders allow this though, so it's important to know who does and who doesn't, and in general which funders you can realistically approach.

5. Employ intelligent exit strategies like pre-selling

The usual exit strategies are by sale or re-finance if you're holding on to the units. However, there are a number of sales based techniques to help you get funding. One of the best ways to de-risk a project for a lender is to pre-sell part, or all, of the site to one of a number of entities.

A developer can pre-sell all or part of the site to Housing Associations, Pension Funds, or Off-Plan Buy-to-Let Investors, before construction begins. In some cases, an agreement of this nature negates any need for funding if payment is upfront or staged. Most of the time, though a deposit is paid and the rest on completion, thus some funding is needed.

Pre-selling provides a funder with a very strong reason to lend because the risk of not selling units on completion to the local market is either partially or totally negated. The term of the facility is close ended, and from a lender's point of view, de-risked from the start. It's a solid strategy if other aspects of the funding proposal might cause lenders concern.

Preparing for project funding – what you need to consider…

- Are you looking for the lowest % finance costs or the minimum you need to put in to a project?
- What size of project can you aim for based on how much cash stake and PG position you have available
- Do the local comparables provide solid evidence of your projected GDV?
- Do you need to enlist equity investors for cash cover, or Housing Associations, Funds and Asset Managers to pre-sell your site?
- Have you got together all the documentation needed to apply?

The 8 Areas to Compare Lenders By

And why they are important

Having looked at how lenders assess your application, let's now look at how you can assess and compare the lenders instead!

This is an important starting point because contrary to popular opinion you're unlikely to qualify for all funders. This is because many work within narrow parameters, and are only interested in certain types of projects.

Below is a look at the main comparison components (and insights into each), so you have a structure with which to evaluate lenders that you approach:

1. Lending Range

All funders have a minimum and a maximum lend. Many of the more cost effective lenders, for example, start at a £1million lend, but not all do.

Some of the more conservative lenders have a minimum lend of £5m, so it's important to understand whom you should, and should not initially approach so as not to waste your time.

Our Marketplace Comparison Tool gives you immediate sight of this.

2. Geography

It is equally important to know if the better lenders cover your geography, particularly if your project is outside London & the South East. Encouragingly, for those projects outside of the South East and into Wales/Scotland, more and more London based funding is looking further afield.

This is because a number of London projects are becoming unviable as London's land prices sky rocket, and also because the imminent over-supply of luxury apartments means once attractive apartment schemes no longer hold any interest (as covered in credit policy changes)

3. Sector Appetite

Not all lenders like the same type of project. Appetite can vary according to the number of apartments, whether it is the refurbishment of an existing property or a land buy and build from the ground up. Some will look at planning risk, like permitted developments and some won't. Some like specific sectors like student accommodation, and some stay away from it.

4. Ratio Number 1: Maximum Loan to GDV %

There are three main ratios a lender uses to assess the numbers behind the project.

Firstly is the loan to GDV ratio i.e. what percentage of the final sales value of the site, (otherwise known as the Gross Development Value), will the funder lend up to? Lenders are anywhere between 50% of GDV up to 75% of GDV in a couple of cases. Most lenders are in the 55-65% of GDV bracket, in a bid to stay alongside the traditional 30-30-30 model of construction.

So if a project has a reduced margin due to high land or construction costs, and therefore needs a larger loan than usual, a developer will need to source a funder with a higher Loan to GDV ratio, and maybe some mezzanine top-up funding too. Usually the rate is slightly higher to reflect the extra risk.

5. Ratio Number 2: Maximum Loan to Cost %

The second ratio is the Loan to Cost (LTC) ratio, which is the % of total project costs the funder is willing to lend up to. To reverse the ratio, it is essentially the cash or equity stake the lender wants the developer to put in. (This is mainly focused on site purchase & build. For sites already owned, often but not always there is enough built in equity to cover this amount).

LTC ratios vary from 50% up to 90%. So if a lenders maximum Loan to Cost is 90%, and the total costs are £2m, the lender wants the borrower to put £200k in.

Important to Note - It can be more cost effective to go with a higher LTC ratio lender with a higher interest rate, than sourcing the cheapest interest rate lender with a lower LTC ratio, who requires you to put in much more on Day 1.

Whilst more conservative lenders tend to charge lower interest rates, they also tend to require the borrower to put in more cash upfront. Sometimes it can be more efficient to pay say £50,000 more in interest, knowing that the extra interest is significantly offset because £200,000 less is going in on Day 1, which can then be recycled into other projects or provide increased levels of contingency.

6. Ratio Number 3: Day 1 Loan To Value %

If a site is being purchased, lenders will have a Day 1 LTV restriction to how much they can lend. Many lenders LTV% is similar to their GDV%, but it can be as high as 75% or 80%.

Lenders will use all three ratios to work out what they are prepared to lend, so it’s important to understand how these ratios work, particularly if you are yet to source a project and want to understand what each funder requires from you.

7. Interest Rate (and why it can be misleading...)

Firstly, all funders now roll up interest i.e. you do not need to service the debt on a monthly basis like you do a bank (although many allow you that option).

Secondly, the advertised rate can be extremely misleading, not by the lenders, but if it used as the number one criteria for selecting the cheapest lenders. This is for 2 reasons:

1. The same interest rate can be calculated in 3 different ways, resulting in 3 different interest amounts
2. Interest can form as little as 50% of the total finance costs, and therefore does not come close to providing the real cost of funding on its own

Calculating Rate:

You may be surprised to hear that there are three different ways an interest rate can be calculated:

1. Applied to the total facility amount
2. Applied to the drawn balance, like a credit card rate
3. As a % of the rate based on a mid-term drawdown projection

If we take an example headline interest rate of 7% per annum for a £10m loan from 3 funders using the models above, we indicatively get the following:

7% per annum applied to the facility

The rate is a true annual rate, and can be calculated on the total facility.

The interest is £700k and the rate remains at 7%.

7% per annum applied to the monthly drawn balance, pro-rata

7% is divided by 12 months, giving 0.583% per month.

If those funds are drawn down equally over 9 months, of a 12-month term, ***the total interest is £430,930, or an annualised rate of 4.39%!***

So a significant change in interest and rate, although both headline rates look the same.

7% per annum using 60% of the rate as a mid-term draw down projection:

60% of the rate becomes 4.55%, so a total interest element of £455,000.

So 3 funders with the same rate, but with varying levels of actual interest from £700,000 down to as low as £430,930. ***That's a potential saving, on interest at least, of £250k to £270k!***

(A note on drawdowns: it is vitally important to understand when you plan to drawdown what and when. With many lenders applying the interest rate to the drawn balance, the only effective way to compare them is with a good drawdown calculator.)

8. The True Cost of Finance (including fees...)

The second reason the headline interest rate is misleading is because it can form **as little as 50% of the total finance costs**.

Many lenders, due to the loss of bank funding lines, have had to go to private equity firms to raise cash. There are also new, PE backed funders that have entered the marketplace to exploit the gap left. The requirements for returns in Private Equity are much higher than banks, and as a result, the costs of finance have gone up.

A little has been added to the interest rate, but most has been factored into exit fees, where some exit fees are now a % of the GDV instead of the more standard exit fee as a % of the loan, or no exit fee at all.

Not only is this much more expensive than a loan based exit fee (1.5% of GDV is roughly 2% of the loan), but it is a variable, not a fixed cost, as it's based on the final sale prices. So if the properties sell for more than originally forecast, the total cost of finance is even higher. Of course the opposite is true if the properties sell for lower than forecast.

(The good news is whilst PE firms are more expensive, they do take more risk, hence some of the more flexible products in the marketplace).

So when calculating the true cost of finance ensure you know the following:

- What is the cash stake on Day 1 if purchasing?
- How is the interest rate calculated?
- What is the arrangement fee (typically a % of the gross loan)?
- What is the exit fee, and how is it calculated (% of the loan or % of GDV)?
- Any additional fees, and when are those fees due (upfront admin, broker, etc.)?

Usually we don't include the two standard costs, which are the legals and valuation, as they vary depending on the size of the deal, who is on the lender's panel, and who the borrower wishes to use.

Early questions to ask yourself:

Understand which lenders you qualify for

- Sort lenders by % GDV, % Loan to Cost, Rate, and Fees
- Is the cheapest looking interest rate really the most important driver, or is it how much you have to put in on Day 1?
- Is the interest rate and fee structure fully understood?
- Have you worked out the true cost of finance, including all fees, as a % of the loan?

How to Compare the Marketplace Instantly

Having read the guide, hopefully you now have an advanced understanding of the marketplace, how products differ, how lenders assess you, what the recent lending policy changes are, and a number of insights to help you plan for your next project, or get in shape to for funding applications.

You can also compare funders across a range of criteria, which will hopefully give you a better understanding of how they compare in reality.

One issue remains, and that is your time, and your ability to know all the lenders operating at any one time, and how they compare on a deep level.

Do you have the time to deeply and regularly research a constantly expanding and increasingly fragmented marketplace, with criteria that regularly changes?

Can you realistically stay on top of this marketplace in real time in order to know you've really found the best options for your project?

We can, because this is what we do, full-time.

Next Steps

Now, would it be helpful if you had a free-to-use tool that could give you sight of the top 40 non-bank funders, how they compare in real-time, so you knew exactly where to go to for funding?

Download our Free Development Finance Marketplace Comparison Tool

Well such a tool does exist.

Use our Funding Comparison Tool to compare lenders instantly: Instant Access to free marketplace data to help you make informed finance partner decisions, fast.

This free tool shows you how to filter and compare today's funders in the quickest and most efficient manner, so you can move forward with confidence.

Our information sorts lenders by:

discover and invest

Illustration purposes only

DEVELOPMENT FINANCE MARKETPLACE COMPARISON TOOL Q2 2016 (FUNDING BUILD COSTS ONLY)

SORTED BY MAX LOAN TO GDV % (COLUMN F in red)

YOUR PROJECT INFO (ENTER IN PINK CELLS)	
GDV	£3,000,000
Lending needed	£2,000,000
% GDV	67%

Step 1 - See which lenders you qualify for based on their application criteria
Step 2 - Analyse lenders by their headline rate and annualised (*based on £2m loan & 9 equal drawdowns over a 12 month term)
Step 3 - Understand each lenders fee structure
Step 4 - Understand each lenders total finance costs (Interest + Fees) as a % of the loan
Step 5 - View illustrative worked examples (cash deposit based on % of loan, not total cost, as unknown)

Next Steps
For bespoke data/queries, contact Chris Davidson at Discover & Invest
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Email: chris@discoverandinvest.com

STEP 1 - LENDER APPLICATION CRITERIA

						Site Purchase Only	
Lender	Min Lend	Max Lend	Geography Covered	Max Loan to GDV %	Max Loan to Total Cost %	Developer Cash Stake %	% Build Cost Funded
1	£1,000,000	£10,000,000	L,SE	75	90	10	100%
2	£1,000,000	£20,000,000	L,SE,E,W	75	90	10	100%
3	£50,000	£5,000,000	L,SE,E,W,S	70	70	30	100%
4	£100,000	£2,000,000	L,SE,E,W,S	70	70	30	100%
5	£5,000,000	£100,000,000	L,SE	70	90	10	100%
6	£3,000,000	£50,000,000	L,SE,E,W,S	70	90	10	100%

STEP 2 - RATE INFORMATION

				Build Costs Only	Site Purchase & Build Costs
Lender	Headline Interest Rate %	Rate Calculated Monthly (M) OR Annualised (A)	Rate a % of Total Facility or % of Current Drawn Funds	Annualised Rate %	Annualised Rate %
1	0.8	M	Drawn Funds	5.76%	7.89%
2	12	A	Drawn Funds	7.50%	10.21%
3	1.1	M	Drawn Funds	8.28%	11.28%
4	1.2	M	Drawn Funds	9.07%	12.37%
5	8	A	Facility	8.00%	8.00%
6	8.25	A	Facility	8.25%	8.25%

STEP 3 - FEE STRUCTURE / **STEP 4 - TOTAL COSTS AS % OF THE LOAN**

					Build Costs only	Site Purchase & Build Costs
Lender	In Fees % of loan	Exit fees %	Exit Fee a % of Loan or GDV	Total Fees as % of loan	Total Finance Costs as % of Loan (Fees + Interest)	*See SP & Build Ssheet*
1	0.0	0.0	Loan	0.0%	5.76%	
2	2.0	0.0	Loan	2.0%	9.50%	
3	2.0	0.0	Loan	2.0%	10.28%	
4	2.0	0.0	Loan	2.0%	11.07%	
5	1.5	1.5	GDV	3.8%	11.75%	
6	1.5	2.0	GDV	4.5%	12.75%	

STEP 5 - ILLUSTRATIVE EXAMPLE (BUILD COSTS ONLY)

			Site Purchase Only	Fees & Interest Breakdown for Total Cost (Column AC)					
Lender	Max Loan (Max GDV%)	Loan needed	Cash Deposit needed	In Fee	Exit Fee	Total Fees	Interest	Total Finance Costs (Fees & Interest)	Total Loan+ Costs
1	£2,250,000	£2,000,000	£200,000	£0	£0	£0	£115,200	£115,200	£2,115,200
2	£2,250,000	£2,000,000	£200,000	£40,000	£0	£40,000	£150,000	£190,000	£2,190,000
3	£2,100,000	£2,000,000	£600,000	£40,000	£0	£40,000	£165,600	£205,600	£2,205,600
4	£2,100,000	£2,000,000	£600,000	£40,000	£0	£40,000	£181,400	£221,400	£2,221,400
5	£2,100,000	£2,000,000	£200,000	£30,000	£45,000	£75,000	£160,000	£235,000	£2,235,000
6	£2,100,000	£2,000,000	£200,000	£30,000	£60,000	£90,000	£165,000	£255,000	£2,255,000

Lending Criteria

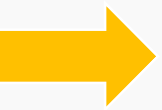
- Min/Max Lend
- Geography
- Maximum Loan to GDV Ratio
- Maximum Loan to Cost Ratio

Interest Rate Information:

- Annual or Monthly
- Rate calculated on the Facility or Drawn Balance
- Actual annualised Rates

Fee Structures:

- Arrangement Fees
- Exit Fees
- Total Fees as % of the Loan



Total Cost of Finance:

- Interest + Fees

If you have already downloaded the spreadsheet, please open the instructions document.

If you are yet to download, **click here for free, instant access**

Testimonials

Here's what a few of our clients say:

"Discover & Invest were extremely professional to work with, and their network of potential funders proved to be extremely valuable as we sought to secure funding for residential development coming out of the well documented financial crisis, when most of our own contacts had either disappeared or closed for business. We have since returned to Chris for further requirements and look forward to working with him and the team in the future"

- Keith Punler, MD, Kapital Assets Ltd.

"We were all very impressed by the amount of research Discover & Invest had obviously carried out on our behalf and in particular the range of knowledge and understanding of the finance market in the sector."

- Paul Cohen MD, Warrens Holdings Ltd.

"Discover & Invest have been great to work with, Chris has been looking at projects for us for some time now and even though I own a Chartered Architectural Practice, finance companies have previously considered me to have no relevant experience for developments. Discover & Invest has been creative with the finance process and we have now managed to get terms on a large development. I would highly recommend Discover & Invest to assist anyone with these matters."

- Carl Collins, MD, CC Property Group

Contact Details

If you wish to contact Discover & Invest with any queries, please contact our MD, Chris Davidson, using the following methods:

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Email: chris@discoverandinvest.com