How to buy like a cash buyer (without the cash)

Funding expert Kevin Wright explains why less cash doesn't have to mean less property.

By Neil Cumins

One thing above all else is likely to put the brakes on a property investor's ability to do more deals: lack of fluid cash. Most investors need time to put together the healthy deposit required by lenders, which means that the path towards property empiredom can be slow and frustrating.

Fortunately, there's a way to grow property investments more quickly, and with less cash. It's a method used by a client of Kevin Wright – our resident development finance broker – and it involves something that many investors seem fearful of: bridging finance.

Kevin's client Nassir had found a disused care home in Cleethorpes that had been on the market for a year, with no takers. As a family-owned home, it had failed to meet the new Care Quality Commission standards, and the cost of compliance was so prohibitive that the owners had no choice but to sell.

Kevin takes up the story: "Nassir spotted the opportunity for a win-win. Not only could he make an outrageous offer for a property that nobody wanted, but he could complete the sale quickly to help the vendors keep their remaining savings, instead of continuing with a mortgage that would bankrupt them."

The building had originally been a row of six terraced houses, knocked through into a single entity. Nassir planned to turn it into an 18-unit HMO, but the asking price was £350,000 and he needed another £50,000 or more to carry out the conversion. No traditional buy-to-let mortgage company would lend on it, and he didn't have anywhere near the 25% deposit a commercial lender would require either. Unable to refinance his existing properties to pull out the cash required, he was stuck.

Quick fix

"It was really cash-buyer-only territory," says Kevin, "and Nassir didn't have enough in the piggy bank. Fortunately, someone put us in touch with each other, and we had a chat about his options. He'd heard of bridging finance, but thought it was very expensive. My response was that it's higher than standard mortgage rates, but you can also use it to facilitate projects that generate a very high return. Because bridging loans are so quick to arrange, they can allow a developer to effectively work as a cash buyer. As a result, they can often negotiate a better purchase price – especially if everyone else who's eyeing up the property is struggling to get mortgage finance."

Nassir did just that: with a little coaching, he managed to get the the asking price of £350,000 down to £250,000. "The expense of arranging bridging finance seems like far less of a concern when you've just used it as a tool to negotiate £100,000 off the purchase price!" Kevin points out.

"Another useful feature of bridging is that it's based on the property value, not the purchase price. When the bridging company surveyor came to take a look at the property, he said it was definitely worth £350,000, even in its run-down condition."

That allowed Nassir to put together all the cash required to buy. "We arranged finance at 70% of the full value of £350,000, which is £245,000. Minus set-up costs of £7,375, Nassir now had £237,625 to finance the purchase. This meant he only needed to put £12,375 of his own cash into the pot to make the full purchase price. That's a great deal less than the £87,500 deposit that would have been required to secure a commercial mortgage – if one had even been available.

Just one final problem: "Nassir was left with about £25,000 in his bank account for the conversion, which was only half what he needed. However, I had another little strategy planned to sort that out..."

How it worked

The original bridging loan was for six months. That gave Nassir plenty of time to carry out the conversion, and turn what was perceived to be a problem property into a des res. His original plan to transform the care home into an 18-bed HMO met resistance when he applied for planning permission, so he reverted to Plan B and turned it back into six terraced properties.

"To complete the conversion, we negotiated a further advance from the bridging lender of £25,000, along with an agreement that Nassir could pay the interest in monthly instalments of £3,308 per month. Since he could show a healthy cash flow from his existing properties, the bridging lender was happy to oblige in both regards.

"Turning the terrace back to the original six individual homes was less complex than the original plan to create HMOs, which meant that Nassir's team had the conversion completed within the finance period. A depressing, deserted and dilapidated building had taken on a new lease of life, and become six attractive homes."

THE RESULT

With the conversion complete, it was time to get the property (now properties) revalued – and the independent valuation was now £450,000! If Nassir had chosen to sell them on, he would have immediately made a gross profit of £200,000 on the purchase price. Out of that £450,000, he would have had to pay back the original £245,000 plus the additional £25,000 to the bridging finance company, as well as his monthly bridging interest and fees totalling £19,848.

These are how the sums break down:

Loan repayment	£245,000
Additional loan	£25,000
Interest	£19,848
Nassir's original deposit	£12,375
Nassir's costs of refurb (part)	£25,000
Total	£327,223
Profit	**£122,777**

But there was a twist in the tale, as Kevin concludes: "As it happens, Nassir didn't sell the development. He simply remortgaged it, getting a commercial mortgage from one of his existing lenders based on its new value of £450,000. A £300,000 mortgage means less than £30,000 has been left in – and it now generates a healthy income for Nassir each month. Not bad for an up-front personal investment of just £37,375..."

CONTACT POSITIVE PROPERTY FINANCE

Kevin Wright advises investors how to buy property intelligently using non-standard funding models, through his through his brokerage.
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