# Investing from the ground up

If you're looking to expand your portfolio with new builds, financing those development projects might be more complicated than you think. Kevin Wright explains.

For many investors, a new build project provides an exciting addition to a property portfolio – and bridging finance can be a useful tool in some cases. But new builds aren't as straightforward as one might expect, even for experienced investors. Why? Primarily because of one key part of the process: sourcing land.

Land can be obtained in two ways: with and without planning permission. If you want to borrow for a new build on land with planning permission, you'll be looking for development finance – not bridging finance – for which you'll need to look to specialist lenders. While self-build mortgages do exist for a main residence, lenders can be sceptical. If they suspect you of borrowing for a self-build mortgage with the intention of developing and selling on, the lender can pull the funding at any point, regardless of what stage the project has reached.

Buying land without planning permission (in anticipation of getting planning approval and selling on for profit) is called "planning gain" – and it can be a successful strategy for some investors. If you're intending to buy a plot of land without planning permission, it's essential that you carry out due diligence

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– although any bridger who'd consider lending on it will be double-checking it.

Bridging lenders aren't really interested in this sort of transaction – so if they do agree to lend, they'll require a much bigger deposit than if you were to invest in developed property. The deposit they'll ask for is usually around 40–50%.

**Resourcing your funding**

Barriers to entry are high in development finance, although it wasn't always this way: in the years leading up to the credit crunch, the major high street banks were into development finance in a big way. Indeed, prior to the downturn, development finance providers would have lent up to 85% loan-to-value. Those days are gone, however, and most high street banks are no longer in the market for this type of lending.

Specific development lenders (often referred to as "challenger banks" or "challenger lenders") have come in to fill the gap left by the banks, but there aren't many of them – which has created a market that benefits the lenders rather than the borrowers. Typically, challenger banks lend against gross development value (GDV – what the development is expected to be worth when work is completed) to a maximum of around 55% these days. There are always exceptions, and a certain lender may like a particular deal and be willing to lend a bit more, but the deal would have to be exceptional for them to venture beyond 70% GDV.

**Do you tick the essential boxes?**

Development financing is set up differently from bridging loans. Specialist lenders will fund 100% of the build or conversion costs, but they would usually prefer the borrower to fund the acquisition of the site themselves. To rank as a prime deal, the borrower must either already own the site or be able to purchase it unencumbered (no mortgage or loan).

If the lender approves of the borrower and the project, they may agree to lend 50% of the purchase price AND 100% of the development cost – as long as together they don't total more than around 55% GDV, although this does mean the deal ranks slightly less favourably with them.

When it comes to experience, lenders don't see development finance as an opportunity for "on the job" learning. Almost without exception, borrowers need to have well-documented proof that they've successfully completed at least one comparable project. Development lenders don't want to be cleaning up behind inexperienced investors who screw up.

And you won't get much traction with dissimilar projects. You might've done 20 refurbs, including some structural renovations, but that's not a new build. You must have specific experience with the type and scale of development you want to finance. If your only new build experience is with a single unit, you won't get funding for a 20-unit build – because it's beyond the scope of what you've proven you can handle. However, there are rarely absolutes in this, so a great project may buck the trend and it never hurts to apply for funding.

Recently we've seen a small number of lenders entering the market that will finance 100% of both the purchase and the build, but this comes at an additional cost. The very few lenders who are in this market require a split of the profits from the development, and these deals are only viable where a profit margin of 30–40% of the GDV exists.

The barriers to entry – cash and experience – put aspiring new build investors in a catch-22 situation: If you haven't got either, how do you get started?

The practical solution is to find someone who has the cash or experience you lack, and form a joint venture (JV) with them: this will make you collectively acceptable to a development finance lender. The obvious solution is to partner with a builder, but architects and building project managers are equally valid choices.

The most common way to set up such a collaboration is to create a limited company for the precise purpose of the project, which will be wound up when the profit from the project has been shared out. This is often referred to as a special purpose vehicle (SPV), and an SPV is nothing more complex than a limited company that's set up for the purpose of one project in isolation and ceases to exist once the project is completed.

Development finance lenders typically tend to take a dim view of contractual agreements – a contractor may quit, but a co-director with equity shares won't.

**Conclusion**

While development finance isn't for the faint-hearted, it can be a valuable addition to your investment portfolio – so long as you carry out due diligence and have a careful plan in place with the right experience and funding resources to make it work.

**CONTACT POSITIVE PROPERTY FINANCE**

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