



Secrets of Property

Funding



Funding

Introduction

These notes, although generally relevant to all development works, apply in particular to “Gardener’s Questions” “Two into One” “On the Edge” and “Looking Up”. They should also be read in conjunction with “10 Golden Rules”.

The Bank

Until recently the banks were usually happy to lend 70% of the site or building value on condition that they were given a Standard Security against the property. Since the recent credit crunch, that figure has dropped to 60-65%, although experienced developers with a well-established track record may do a little better. Best to work on 65% maximum however.

External investors

The remainder should be sourced from 3rd party private investors, who are never that hard to find. You will be surrounded by individuals, and sometimes companies, who need to find a home for their money and who will be delighted to get offered returns that are well above what they would obtain from leaving their money on deposit. £100 000 in the bank for a year at present might bring them at most a couple of thousand, depending upon how highly-prized a customer they are, whereas the same money invested with you might bring in 15k to 20k per annum.

It makes sense to run a newspaper advert locally or even nationally, asking for investors. You’ll be surprised at how strong the results are. But be wary of other speculators who will respond just to try and find out what your ideas are. Don’t give too much information away until you’ve met up with someone and are convinced that they’re genuine.

The reason for using external investors is simple. If you use your own money for the 35-40% contribution then you will soon run out of money and will have to halt further activities until the first deal matures and pays out. If your resources are limited that might mean doing only one deal initially. Hardly the route to serious wealth. If however, you use external finance, you can run a number of projects concurrently, so that within a year or two you would hope to have generated a substantial war chest. At that point you could indeed dispense with the external investors if you so wish, although in our view it makes sense to keep the system rolling. Once you become familiar with particular investors and they with you, things can run very smoothly.



Investor Security

As we said, the bank will want first charge [security] against the property, be that a building or just land. You can then offer the external investors a second charge ranking behind the bank, so that they also have a high level of security. Bear in mind that you will have purchased at or below valuation as advised in the 10 Golden Rules, so if the added value deal falls through and you have to sell the original asset in the same form, you should be able to get your money back. Of course you will lose something because of the incidental costs, unless you manage to increase the sale price a little, but these costs are not serious enough to cause large losses for your investors. A minor hit would be considered fair enough given the high rewards to be made on other deals.

Repayment

You need to give some thought to how and when the investors get their money back, because they will probably insist upon this being tied down in advance. If for example the sales comes back in 2 amounts, which is almost guaranteed if you have more than one item to sell, you may have a small surplus from the first payment after the bank has received their money. Does that go to the investor or is it shared equally? Does it all go towards your running costs? Frankly it doesn't matter so long as everyone knows beforehand, but you must deal with it upfront to avoid disputes and bad feeling. Take nothing for granted and you'll avoid a lot of disharmony.

Interest

The investor will want to be paid interest on their loan, but will probably wait until the final payday. The bank however, will insist upon interest being met each quarter, or possibly even each month. Don't overlook this at the outset because per project it could be a grand or two each month. You can ask the investor to cover it, but they may prefer to see you carry that yourself. If they do pay the bank interest, expect them to want additional profit-share in return.

Legal Fees

Agree straight away who is to pay the investor's legal fees in connection with possibly preparing but certainly scrutinising and advising on the legal documents. In addition to the security document there will be one covering the repayment of monies, possibly another one called a Ranking Agreement that determines where the investor stands in a share-out if things go badly wrong. The investor for example may wish to ensure that his loan does not rank behind other debts or obligations that you may have to the bank in connection with other projects that he or she is not involved with.

If you are to be responsible for their legal fees, do make sure that the amount is capped to a reasonable level, because at this stage you may not know what law firm is being used or how extravagant their fees will be. Your own lawyer can advise on this.

Monitoring

Do keep a disciplined eye on all your project finances, and if that isn't your forte or if you are likely to be spending all your time finding sites, pay someone to do it. Even one project can spiral out of control if you don't



check it regularly and intelligently, but with 3 or 4 the potential for getting into unnecessary difficulties is considerable. Most people get into trouble simply because they don't know what's going on in their own business.

Updates

Keep the bank and your investors informed of what's going on, even if nothing is going on. They have a right to know, but more importantly they'll be happy if they're updated and unhappy if they're not. You need your investors on your side, so treat them as you would want to be treated in their position.