What You Need To Know To Deal With Lenders
By Yza Canja

Dealing with lenders for development can be an eye opening experience! To best get your deals approved and done the way you want them, you first have to understand your lenders, where they are coming from, what kind of business they like to do and what their concerns are. Whilst you are looking to push your deals through and you are focused on how profitable the deal can be for you, lenders are trained to look for the cracks in your situation to make sure that you are able to fulfil your requirements in paying them back. Don't get me wrong, most lenders do want the business and they want to get deals across the line but with the events that have unfolded during and after the GFC, lenders are very much looking to pick and choose the development deals that they fund. They are also prioritising the deals that are of the least risk to them. In this article it is my objective to assist you in getting a bit of a better understanding on the way the lenders think and what kind of deals they are more likely to entertain.

The following are a few main points that will assist you in understanding what lenders are looking for and what kind of criteria they need you to meet.

Will they lend for your deal?

When some people start researching their developments they get so caught up on how profitable the deal will be for them, they may not remember to check how they can get the finance across the line. This means they are unsure whether a lender will accept the deal and they do not know how they will fund the project, let alone repay the loan that is needed to complete the project. It is understandable that you will research the deal first before you start applying for finance, but it can also help if you are aware on a few finance basics whilst researching your development. If you know a few finance basics then it is easier for you to determine if the development is a deal or not. Here are some things that you need to be clear on before approaching your lender for finance:

- What will you use as a deposit?
- How much deposit will you need?
- How much overall funding will you need to complete the project? How much of this do you need to borrow from a lender?
- What entity (name) will be purchasing and developing the project?
- How will you prove to the lender that you will re-pay the loan?

At this point in time there is a bigger appetite for residential dwelling developments in most metro areas. Lenders like the stability that a normal residential property presents. They see this as a product/asset that is easily sellable when in metro areas as compared to more regional areas. This is not to say that they will not lend in regional areas, just that they prefer places with more active property markets. The way the lender sees it, is if you cannot make the repayments as needed, then they will need to take the property from you and sell the assets themselves, so they want to make sure that they are in the best possible position for easy sales should this occur.

You will need to make sure that there is enough profit in the deal to be acceptable to the lenders. This means that your MDC must be at least 20%.

In general lenders will lend about 65% of the end value (GRV) of the project. So for example:

- Let's say that your development of 5 townhouses will come to a Gross Realised Value (GRV) of $2M ($400k x5).
- You work out that you need to borrow a total of $1.2M to complete the project.
- The bank will actually allow you to borrow a total of 65% of GRV which means $1.3M
- This means that you could borrow more than what you need to complete the project.

The above is a general example, of course the lenders have many other factors to consider but it will give you an idea of what is possible.

Get Creative!

If 65% of the GRV is not enough for you to complete the development then you will need to be clear on how you will get the rest of the funds to complete the construction. You can get creative on how you will get these funds, either from joint venture partners, investors, perhaps some vendor finance or even a joint venture with the builder.

What to avoid

It is important to know that anything is possible when it comes to developments, this does not mean it's always easy, in fact the harsh reality is quite the opposite. The game of property development is a tough one; you have to be thorough with your research and resilient with your efforts. What does make things easier is avoiding deals that may not be as favourable to the lenders. The kind of developments most lenders are not in favour of are:

- Retirement villages
- Developments specifically for tenants over 55 yrs of age
- Student accommodation
- Holiday letting

It is not that you cannot fund these kind of deals at all, in fact there are still possibilities for this. It is just that most lenders avoid these types of property developments, thus finding funding for this could be a long and expensive process.

Put yourself in their shoes!

As mentioned earlier, lenders will look at your development deals and scrutinize it from the angle of "how easily can we get our money back?". So in other words they want to know what their risks are and how easy will it be for them to get paid back. A good thing to do is put yourself in the lenders shoes and think of all the possible issues and concerns someone lending you money could have, these could include:

- Will it be easy to sell this development?
- Are the quoted valuations realistic?
- Are the construction costs realistic?
- If the costs blow out (common occurrence) how will this developer have enough funds to complete?
- How will the developer pay me back?

These are only some of the concerns that a lender will have. You will need to address all of these. if you are able to address all of these before you apply for finance it can make your application process much smoother. Here are some example ways on how you can address these concerns:

- Will it be easy to sell this development?

  Provide a synopsis on the area, the amount of growth the area has seen in the past few years. List all the reasons why this area needs your type of development and even what the driving factors are for people to purchase property there (i.e. lots of employment opportunities, new infrastructure etc).

- Are the quoted valuations realistic?

  Provide real estate agents letters stating their assessment on the values of the proposed properties. Also provide some real comparable sales of similar properties that have sold in the last 6 months.

- Are the construction costs realistic?

  Perhaps get evidence of at least 3 different quotes from builders to show that they are all within a similar price range.

- If the costs blow out (common occurrence) how will this developer have enough funds to complete?

  Show in your feasibility that you have planned for contingency. Also be clear on all the funds that you will have to complete this project. Make sure that you have more funds available to you than what you actually need to finish the development.

- How will the developer pay me back?

  The easiest way to get rid of this concern is pre-sales. As a good rule, you should aim to have enough pre-sales to pay off the proposed loan amount. If you fail to have enough pre-sales then you will need to prove to the lender that you can personally afford to meet the repayment requirements if some or none of the properties are sold in before the bank release funds to you for construction.

Remember that if you are pre-empting all the lender concerns, it will be much easier for you to present a strong application to your lender. They will see that the deal can be profitable for you, that most of the risk has been mitigated and most importantly to them, that you have a realistic plan to pay them back!