Brickflow **PROPERTY DEVELOPER GUIDES**

Calculating Development Finance

Background

Development finance is the most complex property-based loan to calculate. 10 different lenders will provide 10 different loans. Only speaking to a few means you're missing out on the best deals, or you're investing too much equity. To maximise profit, you need to maximise debt. Here's what you need to know to maximise yours.

Need to know

As a starter, it's key to understand the Capital Stack. This is the structure of your development finance, or the different layers that fund a scheme. The typical stack has three layers, and normally includes senior debt, mezzanine debt and equity.

Debts are repaid from the bottom up, so the higher up a lender, the bigger the risk they incur. This also means, the higher up the debt, the more expensive it is, so equity is always at the top of the stack, followed by mezzanine or 2nd charge, with senior lending (1st charge) at the bottom. Lenders will want visibility of your capital stack to see where they fit in your hierarchy of funding, and to determine potential ROI vs. level of risk.

A loan is calculated like this:

- The lender lends the lower of a percentage of the GDV and a percentage of the total costs
- The lender sets a minimum deposit, or amount of equity required, making sure it doesn't exceed their internal day one leverage cap
- The loan is broken down into two component parts; land loan and build loan
- The build loan takes priority and is allocated from the total loan first, so essentially the lender works backwards
- The lender covers the finance costs, professional fees, build costs and contingency first
- The residual (leftover) loan is the land loan, and is available to borrow against the land value, providing it respects the day one LTV cap and minimum client equity

You also need to think about:

Sweat Equity

If you've purchased the site already and enhanced the value through planning, this may be considered as part of your equity. This is called Sweat Equity because you've essentially done all the hard work. Every lender has a different way of calculating sweat equity, some are more generous than others, and some will use 100% of sweat equity, creating a 'cashless deal', so again, shop the market.

Costs

If you have met ongoing site costs (debt servicing, security, maintenance, etc.) you can legitimately assign them to the project and the lender will take them into account for their calculations, so keep a ledger.

In practice

Debt is always cheaper than equity (unless you're sitting on a big pile of cash). But due to the lack of transparency in the market, even experienced developers don't know it because they're missing out on the best debt deals. Developers are borrowing from lenders at a low LTGDV and giving away profit share to plug the equity gap. What feels like a good deal is a false economy because they're giving away 50% of their profits to secure the investment they need to mobilise the deal.

Like building a development, you need to work from the bottom up to structure your debt.

We created Brickflow to give you the power and knowledge to search the entire market, quickly, finding the best loan for you. It might be the cheapest, it might be the largest, but it will always be the loan that stretches your equity the furthest.

Brickflow is the UK's first search engine for development finance. We provide instant access to loans for ground-up developments and conversions, 24/7, from your phone or laptop.

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