Chapter 12 – Values & Raising The Cash

Chapter Sponsors

together. Loans, mortgages & finance.

"together", formally known as Auction Finance, "together" deal with loans, mortgages & bridging finance with a specialist auction funding department. Generally accepted as market leaders, "together" start at 75% LTV with 100% available subject to additional security. You will find "together" at over 300 auctions and always well worth talking to.

ClosedBridgingFinance.com

Founded & run by Rory O'Mara, who I have known for many years, CBF is a leader in auction funding, able to make decisions at very short notice as I can attest to. CBF, AOBP Associate Member, also specialise in longer-term funding for HMO's & Social Housing. You will often find Rory at Network Meetings, if so make a point of introducing yourself, a money man well worth knowing.

Positive Property Finance

Positive Property Finance, Kevin Wright, another Bridger I have known for a long time. Kevin thinks outside the box as is evidenced by his Recycle Your Cash 1-Day Workshop, see my review on Property Investor Online. You will also find Kevin at Network Meetings across the UK, introduce yourself to an acknowledged expert with 30+ yrs experience.

The last chapter was all about number crunching and by completing that exercise in the same Analyser (IPA) you can enter the fixed-up value and monthly rent, recording the source of both pieces of information as a *comparable* for valuation purposes.

rightmove

I mainly use the 'for sale' and 'last sold' features on Rightmove or "house prices & values" on Zoopla looking for comparables within a radius of 1/4 mile (neighbourhood) and at most just 1/2 mile of your property's postcode.

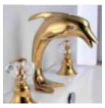
Zoopla

There are some other equally reliable, up to date websites with 'for sale' and 'last sold' data, it's just that I am very familiar with navigating my way round both Rightmove & Zoopla which saves me time and makes the exercise less stressful. Remember, time is of the essence in carrying out auction due diligence because ideally you want to be viewing the property at the first opportunity, a couple of days after catalogue release, having completed most of your due diligence.

Also in the IPA, I have included a range of non-standard features on the Area Analysis page which should have a positive effect on the valuation and may not exist in any of your comparables. It is for you to decide the percentage value of each up-lift because they will vary from one location to another.

Another point to remember about anticipated values, both fixed-up and rental, is that you may be bringing to the market a 'new' property, possibly the only property in the immediate neighbourhood (1/4 mile) which has all the features that you have built-in to your fixed-up upgraded property.

In the case of terraced houses in the immediate neighbourhood (1/4-mile), few will follow my design of having a first floor bathroom without sacrificing a bedroom and even fewer will have a cloakroom on the ground floor because to achieve that you have to move the staircase forward. Of course, you will find other features such as new windows, bathroom and kitchen in your comparables but few properties will have been rewired recently and even then the specification may not be as comprehensive as yours.



Therefore, with your new fix-up and additional features, you should be able to expect 'best' value both for the property and rent but you do need to be conscious of local/neighbourhood affordability. For example, there is no point in expecting your property value to increase by fitting gold taps or a very expensive kitchen when the norm for the area would be a good, first-class kitchen but not one from the 'top of the market'.

Last but not least, if you are able to achieve a 'B' EPC rating or even a 'C', few comparable properties in the immediate neighbourhood will reach this standard, particularly because, to do so you have to lay a new ground floor slab with insulation underneath. The same also applies to the insulated dry lining plasterboard on the walls, as few properties in your neighbourhood will have undergone this treatment. These two improvements may not directly affect values today but, I believe, will do so within a few years.

Before starting out viewing properties, my advice is to discuss your fix-up specification with a reputable local estate agent that has a valuer on their staff who also acts for lenders, a “panel valuer”. Why, because you really do need to confirm that you are being “cold-light-of-day” realistic about the fixed-up value that you intend to include in your calculations, as that value will directly impact on the amount you can borrow and if you are over-optimistic on the value then you will compromise any low or no money left in (LMLI or NMLI) strategy and that could potentially damage your long-term plans as I will show you in a minute.

When deciding on fixed-up values, you also need to be conscious of psychological price barriers and at all times be conservative in your expectations. It is better to work with a value which proves to be £10,000 below the actual value achieved for lending purposes than above. The first price barrier is £100,000, to break through this barrier you need a number of 'sold' comparables above £110,000, after that, with property values up to about £250,000, every £50,000 is a barrier. To test this search "sold" prices in your location for psychological prices 100K, 125K, etc.

Next to add into the mix, are the Stamp Duty (SDLT), thresholds. Each can have a limiting effect on values but far less so today following the major changes introduced in December 2014. Valuers are still hesitant about valuing a property even a few thousand pounds above a Stamp Duty threshold. Lenders and their valuers work on the assumption that every borrower will go pear-shaped and that they will be forced to sell, probably below market value, or let if there in any delay, and are concerned about any cost or other aspect that may deter a prospective buyer.

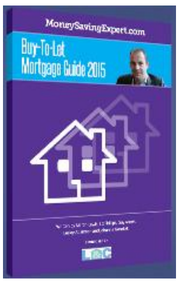
Breaking through some incremental increase barriers and SDLT thresholds can be virtually impossible, regardless of the quality of your product. If the average “good condition” price in the street is £120,000 there is virtually no chance of selling or valuing a new fixed-up property for £150,000 almost regardless of the specification.

The two principal values which limit my maximum bid calculations in most locations where I buy the majority of property are to start with, £100,000, it is far easier to achieve a fixed up value of £95,000 than £105,000. Then it's the starting point for SDLT at £125,000, and then up to £250,000. In all cases, my maximum bids are based on rainy day rather than sunny day values.

Why are these values so important? Because if you are letting, along with the rental cover, as I have said values can limit the amount that you can borrow to restock your working capital and always remember that re-mortgage values, where you already own the property, tend to be conservative.

Now let me show you the long-term effect of getting the value wrong to start with. If you include in your calculations a valuation that is too high so that your post fix-up mortgage come through at only £5,000 less than you planned, you will have reduced your future buying power by between £20,000 & £33,500, assuming that you use the £5,000 as deposit monies for mortgage purchases. The deposit multiples are 4 times at 75% LTV, 5 times at 80% & 6.7 times at 85%. To compound matters, £33,500 of property will increase in value by over £20,000 at 5% average annual growth over 10 years and that ignores the extra gross rent, possibly £2,500+ pa.

Lenders like to see that you have some of your hard earned cash sitting in the property and at risk if everything goes pear-shaped rather than just the lender carrying all the risk. If you are selling, the realistic value will limit your sale price because your buyer will want their mortgage based on the agreed sale price and not a lower figure subsequently set by a valuer. Outside of the auctions whenever a valuer doesn’t agree with my offer price, my offer is immediately withdrawn and re-submitted at the valuer’s figure, no argument.



Now we come to how to fund auction purchases. First of all, at the outset, conventional mortgages don't work because 'completion day', payment of balance due day, is generally 28 days after the auction day and there is simply not enough time to be certain of completing a conventional mortgage, even with a decision in principle (DIP), but before you write off conventional mortgages altogether, because the alternative, bridging, is considerably more expensive, read this free 36 page book from MoneySavingExpert.com.

Because of the normal auction 28-day timescale some auctioneers sell with a delayed completion, maybe 56 days, but in most cases a substantial deposit is required, which is forfeit if the buyer withdraws. In these cases the normal exchange of contracts on fall of the hammer does not take place.

Failure to complete an auction purchase, whatever the reason, no concessions, can result in very heavy penalties because, quite simply, you are in breach of contract. At the very least you will be liable for all costs associated with the resale plus any difference between your bid and the subsequent successful bid. It's most likely that the property would be resold without a reserve. The vendor will also have grounds for an action for damages if he suffered demonstrable losses because of your failure. Therefore it is imperative that you have the finance in place before you start viewing properties, yet another pre-auction action to add to your list.

Obviously you can buy with your own cash, pension, redundancy, though the auctioneers will require confirmation & evidence that your cash complies with the Money Laundering Regulations. I will explain the various payment methods in the chapter Auction Day - To Do On Arrival, later in BAP.

Bearing in mind that you will only need the purchase monies for a short time, a few months, until you have fixed-up the property and either sold or re-mortgaged it, you may be able to arrange overdraft facilities with your bankers or even buy on a credit card, yes that's not uncommon with the cheaper properties. Today you need to remember the 6-month rule where lenders generally won't re-mortgage properties until you have owned the property for at least 6 months though there are exceptions when extensive provable works are carried out. There are also specialist loans specifically designed for renovation & development but they need to be organised and agreed in advance because most of these loans come with special terms & conditions that you will have to adhere to. No point in finding out after you have bid & won your bargain that your chosen lender doesn't like flats over chip shops! To locate one these lenders first talk to one of our Sponsors who will be able to identify the lender that best suits your aims & objectives.

The most common way of borrowing to buy at auction is to use Bridging Finance from specialist lenders who offer short-term lending, generally a maximum of 12 months, following which, if the property is to be retained the Bridging Finance is repaid by taking up a conventional mortgage with another lender. Bridging lenders don't generally offer conventional buy-to-let mortgages though Bridging Finance Brokers may, and our Sponsors do.

Bridging is particularly suitable for 'flips', i.e. buy, fix-up and sell. Conventional mortgages are not designed as short-term loans and in most cases the cost of taking up a conventional mortgage and repaying after 6-12 months would be prohibitively expensive because of the early redemption fees that would be applied in most cases. Also, if you made a habit of using conventional mortgages, you could quickly damage your credit record your answer to the "purpose of loan" question would be untrue. Mortgages are generally written for years, Bridging Loans are for months.

Bridging lenders base their lending decision on your hammer price, the price you paid at auction for the property and they lend against the security of the property, not your ability to pay the monthly charges or even their money back. Generally, for this reason, they will only lend a maximum of 70% of the hammer price for a limited number of months so the Bridger knows their total exposure from the outset.

It is quite common for a decision to be made in days rather than weeks or months which can be the case with conventional mortgages. But I would always advise you to discuss your project in advance with a bridging company so that they are expecting a call from you if you are successful and know what it's all about, but don't expect a DIP, decision in principle, Bridgers don't work like that, they look at each deal on a case by case basis at the time.

If you are going to use Bridging Finance to buy an auction property, it is absolutely essential that your Bridger delivers, and some do, and some don't. Ideally only use a Bridger, who comes recommended by another investor, as we have 3 Bridger BAP Sponsors and recommended that won't be difficult. Bridgers really are middlemen often borrowing cash from private investors, lending that cash to other investors and even making the lending decision, often without need to refer to their money source, one of the reasons why fast decisions are possible.

When I use Bridging Finance I always advise the lender in advance of the property or properties that I intend to bid on. They will already be familiar with my fix-up specification, because I will have already sent it to them, shown the 'Bridger' a completed fix-up and confirmed that I always work to the same specification. I advise them of my maximum bid, you have to trust them not to play games, and they pretty well immediately confirm whether, in principle, they are prepared to lend against that property and how much. They will carry out a desktop valuation of both current and fixed-up value. I can then go to the auction confident that the means to pay for the property is agreed. At this point I have not incurred any costs though I have agreed all the costs that I will pay if I'm successful in buying the property. Failure to buy does not incur cancellation costs.

To digress for a moment, I always make a point of telling the auctioneer which lots I am interested in so that he looks out for me in a crowded room, at the same time I mention my bridging connections which increases my credibility with the auctioneers. I am now as good as any cash buyer and hopefully the auctioneer will not hang around looking for the last £50 after the bidding has reached the reserve. More on these points in later chapters.

Because auction properties are a Bridger's main source of business, they generally keep a close eye on the auction market and often specialise in one location, say South Wales, or West London, for example. The result is that they can and often will give you background information on a particular lot. It may be that a lot failed to sell in an earlier auction, maybe with a different auctioneer. Now that information is readily available from sources such as EIG if you take the time to dig, but what you can't find out is the 'why' which may be known to the Bridger.

Remember your "good" Bridger wants you to succeed and will help you in any (legal) way to secure good deals and avoid lemons because then you make him money.

There are two types of Bridging Finance, open and closed.

Open is where you do not have a mortgage arranged in principle to repay the bridge at the end of the agreed period and an open bridge is marginally more expensive than closed.

Closed is where you have arranged in principle a method to repay the bridge, such as a re-mortgage or sale of the property.

Many people, including some investors, balk at the cost of bridging finance but if a bridge makes the difference between buying a money-making deal or not, then bridging has to be considered, just include the costs in your number-crunching and IPA is set up to handle bridging.

You may be asked to pay 2% monthly interest, 24%pa, on a £50,000 bridge for six months, £6,000 plus costs, but if you're going to make £20,000 on a deal which you can't fund yourself, it's a no-brainer, £12,000+ or £0 in the bank.

Costs, which vary between lenders, are typically:

- An arrangement fee, (either fixed or a percentage of the loan).
- Legal & valuation fees, (yes, you pay both your and their legal costs).
- A monthly interest rate, (the interest can generally be rolled up into the final settlement figure easing your cash flow)
- A settlement or exit fee. Generally 1 month’s interest.
- There may also be penalties if you fail to settle, or don't agree an extension within the agreed bridging period. It’s very important to keep your Bridger up-to-date particularly about any project delaying glitches.

All these costs are negotiable and tend to become more competitive, lower, as you develop a relationship with your Bridger and he becomes more confident in your ability to deliver your side of the agreement.

Typically Bridgers will lend 70% of the hammer price, generally subject to a minimum of £25,000, sometimes stretching it to 75%, depending on the cost of the property. On auction day, the norm is for you to pay 10% of your bid as a deposit and, with the possible exception of a friendly bank, you have to find this 10% from your own cash reserves, as Bridgers will not lend the 10% deposit as they want to see that you have some of your money in the deal.

With some Bridgers, their minimum sum loaned of £25,000 or sometimes above can be reached by consolidating across 2 or more properties, lot 1 hammer @ £15,000, Lot 2 hammer @ £12,000, total bridge funding £27,000. But having bought lot 1, you now have to buy lot 2 otherwise you don’t have the funds to pay for lot 1! Another point to discuss with your Bridger before you get into the auction room.

Increasingly, post-credit crunch, everyone wants to see the investor taking some of the financial risk, certainly at the outset, so if it all goes pear shaped the investor also gets hurt. It is still possible to get all your money out of the deal, NMLI, but you need to have fixed up/improved the property and therefore its value, unless you buy a property that really is below market value and then wait six months before getting your money out. The purpose is to avoid the old ring of bent investor/solicitor/broker/valuer.

That leaves 15-20%, the difference between the hammer price less 10% and the bridging loan of 70-75%. Generally these monies come from your cash reserves, unless of course you have that very friendly bank but, again, dependent on the deal and your track record, some Bridgers will lend this percentage (15-20%) provided you have alternative unencumbered security such as another property which is mortgage free. Bridgers generally want a first charge, but don't expect every Bridger to offer this facility.

It is important to discuss your requirements and the terms available with at least two Bridgers including turnaround time, loan application and cash release. Bridgers expect to make rapid decisions when compared with the conventional mortgage market. You can expect a decision within 48 hours and cash released within 7 days.

The market leader is probably Auction Finance, now called “together” who are always competitive and generally have representatives at every major UK auction where you can discuss any bridging requirements, and often get a decision in principle, 'we will lend subject to…', but you should have sorted out your requirements before you reach the auction.

Another specialist in this field is Rory O'Mara of ClosedBridgingFinance.com. Rory provided assistance on the technical aspects of this article and has substantial funds at his disposal, can often exercise his discretion and, importantly, he makes the decisions.

Alongside Rory O'Mara and well known in the industry is another Sponsor of this chapter Kevin Wright of PositivePropertyFinance.co.uk. Out of the three, Kevin is un-usual in that he runs 1-day Workshops across the UK under the brand Recycle Your Cash.

That said, you will find all three speaking at Network Meetings, Exhibitions & Shows and all are reliable and can be trusted to deliver.

Once again the IPA will help you get the best deal from your chosen Bridger because, correctly completed, the IPA is in effect a business plan. Any lender, Bridger or conventional mortgage lender can quickly see whether you have taken everything into account. They are also able to verify your variables, be they values or multipliers, such as the cost of something or a multiplier like interest rates and management fees, the list is virtually endless. Also, within the IPA, are 5-10-15 year performance projections with critical variables that you can change to stress test and see the effect. An obvious one is the interest rate. You can start with an interest rate of X %, and then either increase or decrease it for each subsequent five-year period.

Because of the credit crunch, during which a substantial number of both amateur and professional landlords got into trouble because their investments were not properly stress tested, lenders increasingly want to make certain that your proposition will not go pear-shaped because of a change in any critical variable. With the IPA, anyone in the supply chain can change a variable, testing the effect which, if positive increases their confidence in you, your product and your strategy.

Buy to let could have been called 'borrow to let' because working with borrowed money, as against only your own, dramatically reduces the time it takes to develop a portfolio. If you use bridging at auctions, you can buy two, maybe three properties rather than one with the same cash reserves but of course the numbers do have to do stack up along with all other aspects of your due diligence.

If you intend to develop even a small portfolio (2-5) properties to let and you are going to concentrate on buying distressed property through auctions, it is best to talk to Bridgers such as together, Rory or Kevin - before you even start viewing potential bargains because there is no point in finding out after you have viewed a property, and certainly not after you have bought, that your chosen Bridger doesn't like your 'bargain deal'.

Just like conventional mortgage lenders, Bridgers also assume that your project will go pear-shaped, leaving them to pick up the pieces, so work hand in glove with them and they will be keen to work with you again and again on your auction purchases.

Take a look at the following table, repeated from the Chapter - Introduction To Bap.

The column to take note of is the 2nd last column, it lists the amount of cash need to buy a property in that region assuming that it is possible to buy very rundown property at 50% of the average hammer price, col 3rd from right.

Two regions to be careful with are the North East & Northern Ireland because their prices are on the cusp of £25,000 min loan. The minimum hammer price to bridge at 70% LTV is £35,750, loan £25,025 but in both these regions the average hammer price, right of centre col, is well above the minimum required.

This table is updated every 3 months and reprinted in the BAP Quarterly Bulletins.

Buying Auction Property
by David Humphreys
Property Auction Expert

Essential INFORMATION GROUP

Jul-Sep 2015	OFFERED	SOLD	% SOLD	% UNSOLD	UNSOLD	UNSOLD MONTHLY	Av HAM K		Cash Req @ 70% LTV K	50% of Av Ham K	Min Cash 70% Brdg K	Min Cash 75% Mtg K
EIG Regional Analysis Order	2015	2015	2015	2015	2015	2015	2015	Ch%	2015	2015	2015	2015
1 East Anglia	194	144	74%	26%	50	17	139	27%	42	69	21	17
2 East Midlands	625	451	72%	28%	174	58	109	3%	33	55	16	14
3 London	642	509	79%	21%	133	44	386	1%	116	193	58	48
4 North East	730	507	69%	31%	223	74	71	-2%	21	35	11	9
5 North West	1182	892	75%	25%	290	97	84	7%	25	42	13	10
6 North West Home Counties	265	224	85%	15%	41	14	290	19%	87	145	44	36
7 Northern Ireland	178	78	44%	56%	100	33	67	13%	20	34	10	8
8 Scotland	167	106	63%	37%	61	20	123	158%	37	62	18	15
9 South-East Home Counties	825	683	83%	17%	142	47	211	17%	63	105	32	26
10 South West	494	363	73%	27%	131	44	202	16%	60	101	30	25
11 Wales	501	384	77%	23%	117	39	81	2%	24	40	12	10
12 West Midlands	827	646	78%	22%	181	60	103	9%	31	51	15	13
13 Yorkshire & Humber	687	516	75%	25%	171	57	85	4%	26	43	13	11