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Mortgage
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Good Practice Guide

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Bridging finance for Mortgage Professionals

This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Society of Mortgage Professionals' understanding of the regulator's rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

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Foreword

Paul Huxter
Head of Sales,
Enterprise Finance Ltd.

Bridging finance is a growth market, with some commentators reporting gross annual lending of over £5bn. Traditionally bridging was used for auction finance or to rescue a broken chain, it's now a sophisticated product used for a variety of reasons, including:

1. Broken property chains
2. Downsizing
3. Unmortgageable property
4. Renovations / conversions
5. Lease extensions
6. Planning permission
7. Auction purchases

Introduction: What is bridging finance?

A bridge is a short-term interest-only loan that usually has a term of up to 18 months. Bridging loans can be as short as one week but are usually between 1 and 12 months.

Bridging can be arranged for almost any borrower raising funds against a UK based security. This includes the ability to raise funding for foreign national clients purchasing or refinancing property in the UK. In addition we are able to raise bridging finance for individuals, UK limited companies or offshore entities.

There are many reasons your client may need a bridging loan and there are many benefits to this type of finance.

Bridging loans are secured against assets either being purchased or owned by the borrower - and can include houses, flats, commercial buildings (such as shops or industrial units), buy-to-let properties; and they can be individual assets or a portfolio of properties. For example, if your client is a property developer, they could secure a bridging loan on one or more properties depending on the amount they wanted to borrow from the lender. Clients can even borrow against a plot of land - whether it has planning permission or not.

A bridging loan can be regulated or unregulated – depending on whether it will be the borrower's main residence. See "How is bridging regulated?" for more detail.

The most important factor when taking out a bridging loan is the exit strategy. How is the bridging loan to be repaid?

Satisfying the lender that there is a sensible, achievable plan in place to redeem the loan is key. Typical methods are through sale of property, or refinance onto a longer-term form of finance. See "An untapped opportunity: When is the best time to use a bridge?" for illustrative examples.

An untapped opportunity: When is the best time to use a bridge?

Broken property chains

A bridging loan can fix a broken property chain. For example, if your client has found their perfect home and are waiting on the sale of their current property to complete, but the buyer suddenly pulls out, they can get a bridging loan to purchase their new home. That way, they have more time to sell their property and can use the proceeds of the sale to repay the bridge.

Unmortgageable property

If a property is unmortgageable, such as a house without a kitchen or bathroom, borrowers can use a bridging loan to purchase it. They can undertake the renovations required to transform it into a mortgageable property, which will allow them to change the finance to a mortgage or sell the property. They can repay the bridging loan with these funds.

Renovations / conversions

A bridging loan is an option if a borrower's goal is to renovate a property with the aim of adding value to sell at a higher price.

Lease extensions

Purchasing a property that has less than 80 years left on the lease can be challenging, as the banks may decline the mortgage. This is where a bridging loan could be convenient, as borrowers can purchase the property with a short lease, to then extend the lease so that the mortgage will be approved. Once they had secured the purchase with a lease extension, they can either sell the leasehold for a profit (it is usually a lot less to extend a lease than the increase in the value) or re-mortgage and use the funds to pay off their bridging loan. Some lenders will also fund the cost of the lease extension if needed.

Planning permission

If your client wanted to purchase land or property for the sole purpose of getting planning permission (or a use change) and then re-selling, a bridging loan could finance that transaction. Land with planning permission granted commands a higher value, so they could sell on for a profit or alternatively develop it themselves, exiting on to a development finance facility.

Auction purchases

When purchasing a property at an auction your client will usually have to pay a deposit of 10% of the full purchase price on the day of the auction - and will have up to 28 days to pay the remaining funds. A bridging loan can be very helpful when they need access to money fast, so many people use bridging loans for this purpose and then repay the loan once they have the mortgage.

The benefits of bridging

There are many benefits to bridging loans such as speedy application, quick transfer of funds and broader lending criteria – to name a few. Let's look at these and others in more detail below:

Speedy application process

The application process for a bridging loan is usually much quicker than a mortgage or second charge application. The process usually takes anywhere from 5 – 14 days with the rare case taking just 24 hours! Bridging loans are taken out by people and businesses who need money fast, for reasons such as buying a property at auction, so bridging loans need to be available quickly.

Once the application has been processed and approved, the funds are immediately released to the applicant's solicitor and ready for use.

Adaptive lending criteria

Bridging lenders look at the case scenario rather than individual affordability criteria. This leads to more 'pragmatic' underwriting; as long as the property and exit strategy are solid, a lender can agree to the deal.

Repayment options

There are two main ways lenders will charge interest; retained and rolled-up interest. With loans taken out on a retained interest basis, the borrower isn't required to make any monthly interest payments. Instead, at outset, the lender adds all the interest to the balance of the loan and effectively pays the interest itself when it falls due at the end of each month.

With loans taken out on a rolled-up interest basis, the borrower once again isn't required to make any monthly interest payments (often in bridging, you'll have noticed, borrowers want to be free of any regular payments during the term of the loan). Instead, and as with retained interest above, the lender rolls up the interest and adds that interest to the balance of the loan at outset.

Condition of security properties not a factor

The property your client uses as security against the loan does not have to be up to a certain standard. It can be in disrepair or needing major refurbishment, but as long as it has a value, it can be used as security. Be aware that bridging lenders will lend against the lower of the purchase price or the current value in the market as established by a qualified surveyor.

Bridging finance - Understand the risks

If your client reaches the end of their loan term and has not been able to repay the bridging loan they could be charged. For unregulated loans, interest rates will increase in line with the terms of the loan agreement where the loan remains unpaid after the agreed term date. This will likely add to their costs or could see them losing some or all of the profit they would have made from the deal.

This late or non-payment can occur if they are relying on the sale of a property to repay the loan. While it may be difficult to gauge the property market 12 months from the start of a bridge, the borrower needs to be certain that they will be able to realise their desired value at the term end in order to ensure that their property sells should this be the exit strategy to repay the bridging loan. Speaking to an estate agent about the current housing market would be advised.

How is bridging regulated?

There are two types of bridging loan - regulated and unregulated. A bridging loan will be ‘regulated’ if the loan is secured against a property that is (or will be) the borrower’s main residence or will be occupied by any member of their immediate family All other deals would be unregulated.

If your client was a landlord and tenants were living in their property, this would be an unregulated loan. This is because it is not your client’s own home or occupied by any of the borrower’s immediate family.

There are two types of regulated bridging loans – first charge and second charge. A first charge bridging loan is the first loan that has been secured against the property and would generally be restricted to a maximum loan-to-value of 75%.

If there is any equity after the first secured bridging loan, your client can then take out a second charge loan, restricted to 70% loan-to-value. This can be with a completely new lender and will sit behind the first charge loan.

The Financial Conduct Authority will regulate the loan on someone’s home because of the risk they may lose it if they are unable to keep up the payments. A bridging loan is regulated in the same way as a residential mortgage.

Good practice

1. Exit strategy

Each client must have a solid plan in place to pay off the loan. This is known as an 'exit route'. A viable exit route is a must on all bridging loan applications. This is as important as the client's status, property valuation and LTV.

- Refinance – this could be refinance of our security or another UK security, this would need to be evidenced based on the clients current financial position
- Sale of Property – this could be sale of the security address or another UK security
- Equity Release
- Inheritance (with evidence)
- Investments
- Pension

It's possible to have more than one exit strategy, and the more exit strategies a borrower has in place the better. For example, if they cannot sell the property, they could release equity from another property to repay the loan.

2. Repayments

It may seem obvious but make sure your clients know the date the payment is due each month and that there is nothing on the horizon that could delay that payment.

It is paramount the borrower understands the consequences of non-payment. They could lose their property to repossession if they do not keep up their payments. Ensure to stress to clients the importance of this.

3. Application process

The lender has a clear application form and detail their requirements in terms of paperwork. Sending the completed form, with the client's ID documents will allow them to get started underwriting the loan. It is good practice to have all the paperwork and documentation the lender needs kept together and sent as one, rather than it be sent gradually. There may be additional documents requested afterwards but at the start it is good to have everything in order before sending to the lender.

Conclusion

A bridge is a short-term interest-only loan that usually has a term of up to 1 year.

This type of finance is extremely flexible.

Bridging loans are secured against the assets owned by the borrower, this includes residential and commercial property, plus any type of land – with or without planning permission.

A bridging loan can be regulated or un-regulated.

Regulated bridging loans are secured against properties that are occupied by the applicant or a close family member. They are regulated by the FCA.

The exit strategy is key for a lender when deciding whether to approve the loan. The more exit strategies there are the better.