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**HOW TO CONVINCE YOUR LENDER TO SAY YES** *plus how to finance a joint venture if they won't!*

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# CONVINCING YOUR LENDER TO SAY YES

**YOU'RE KEEN TO GET STUCK INTO YOUR PROFIT-MAKING PROJECT BUT ONE THING STANDS BETWEEN YOU AND THE DEAL – FINANCE. GETTING YOUR LENDER OVER THE LINE WILL TAKE A LITTLE MORE PLANNING THAN HOLDING OUT YOUR HAND AND WAITING FOR THE DOLLARS TO DROP.**

KIERAN CLAIR

Borrowing money for development deals is a tricky business at the best of times. What many don't realise is among the red tape and rules, there are things you can do to help smooth the process.

## WHY DID I GET KNOCKED BACK?

Small developers may have finance applications rejected for a number of reasons, not just because their project is unfeasible.

An example may be your financier's lending guidelines. Loan-to-value ratios (LVRs) are a benchmark in development lending and acceptable LVRs are linked to both your total costs and the total end value of the project, or gross realisation. For example, if you can sell your three new townhouses for $300,000 each, your gross realisation is $900,000. Shop your project finance around, according to Renato Sturma, a senior associate with Finance Advocates.

*"Not all banks at the moment are aggressively chasing development and construction deals. Some are hot and others aren't. It tends to go in cycles."*

"It used to be you could borrow 80 per cent of costs providing the amount didn't exceed 65 per cent of the gross realisation. Some banks have trimmed that back to 70 per cent."

Sturma says in these cases, they would look at an alternative lender as the marketplace has operators who will pay less attention to costs and lend on a higher percentage of gross realisation. It just depends how hungry they are for customers.

## CHOOSE YOUR LENDER

Banking is still a competitive industry. Just because one lender knocks you back, doesn't mean there isn't another waiting in the wings and salivating at the thought of landing your business.

"Not all banks at the moment are aggressively chasing development and construction deals. Some are hot and others aren't. It tends to go in cycles," Sturma says.

In some instances, it might also be best to chase second-tier lenders with a more flexible approval process and a boutique approach to clients. Sturma says this isn't a hard and fast rule

TAP TO READ A BROKER'S CHECKLIST FOR APPLYING FOR A DEVELOPMENT LOAN

though – different banking options will be suitable under different circumstances, so get advice.

"It depends on the deal. There's nothing wrong with the main banks, particularly if you tick all their boxes, because their structures and pricing are terrific."

## LANDING THE DOUGH

Don't expect to buy your site on a whim at the Saturday morning auction and then have your bank or broker issue finance approval based on a sketch plan and some guesswork about the end sale prices. You need to put your information together, prepare the pitch and hope your banker will take a swing at the deal. For some, this may mean getting a finance broker. If you find the minefield of finance a little beyond your navigation skills then having a broker in your corner might alleviate the tension, according to Sturma.

"Specialist brokers have really got their fingers on the pulse of what all the lenders are doing from LVRs to specific conditions and precedents, what levels of pre-sales are required and what levels of costs are required. I think especially for an inexperienced small developer, engaging someone is going to be a really valuable thing to do."

While the mystical 'credit department' of any financial institution has the final say, your banker is the person to impress, Sturma says.

"I'd say nine times out of 10 if your banker thinks it's a deal, generally it'll come through."

## BE PREPARED

Rule number one – be prepared.

"Have quality information to begin with to present to your lender," Sturma says.

"You can find some developers having a scrappy feasibility, or bits and pieces of it. It's all about presenting a quality application to a lender with all the information."

Sturma says developers need to put themselves in the lender's shoes and ask themselves whether they would advance money on their particular project based on incomplete or poor quality information. Lousy information makes it almost impossible for your lender to stamp the deal.

## ARE YOU EXPERIENCED?

Peter Batterson, a commercial lending manager at Queenslanders Credit Union, has been dealing with developers for some time. For Batterson, development experience is going to take you a long way when it comes to getting a 'yes' from him.

"A track record is one of the most important things in my book because on the way through the project, there are so many things that can happen. Even if it's a small project of three or four townhouses, there's still some drama that's going to happen."

Experience helps mitigate risk, and risk is what lending is often about.

"It's surprising the number of people who come in and say, 'I've got this block of land that I've got approval to build three townhouses on and I'm going to do it'. When you ask how they're going to do it, they say 'I don't know – I'm just going to get a builder to do it for me'. They'll have no idea."

***"While the mystical 'credit department' of any financial institution has the final say, your banker is the person to impress."*** **Renato Sturma**

Batterson says if you're a newbie to the game, build a team. Experience and advice can be bought and if you demonstrate to the lender there are people on your side, it will make them more comfortable.

"Get a good lawyer, a good surveyor and good consultants around you.

"If developers haven't got the experience, they should have either a really good builder who has experience in the project they're doing plus a good fixed-price contract, or a project manager or good consultants." Sturma agrees it's foolish to go forward without a gang in your corner.

"It's nearly essential if you don't have much experience unless

TAP TO READ A CASE STUDY ON HOW ONE SMALL DEVELOPER SECURED FINANCE

you're doing a simple, straightforward two-unit development. If it's anything more complex, it's good to have a team behind you. For a smallish cost, a project manager may save you a lot of headaches down the track."

If finance is looking tight on your numbers or experience, it might be time to spread the love by taking on a development partner. It's an option worth considering if things are marginal, but it's not for everyone, according to Sturma. "If I thought that was relevant, I might make that recommendation myself. It would all depend on the deal and the client."

## WHEN SIZE MATTERS

Depending on the size of your project, it might be possible to get a home loan rather than a development loan. This approach can reduce the loan complexities and may result in more generous terms. The financier will set its own guidelines on what's a development and what isn't, but it's an option worth investigating, Sturma says.

"If we can get it done under a housing loan we would go down that path because it saves the client some money and it's easier. When you get into more complex transaction and types of developments, however, it's easier to go straight down the development (loan) path and do a proper construction and development loan."

Small developers might be tempted to take this line, but ensure you know your financier's guidelines on when a property stops being a residence and starts to become something more because the rules change.

"If it's any more than four townhouses or four blocks of land we would take it as a development project. That's probably about industry standard nowadays," Batterson says.

In his organisation, Batterson says they lend no more than 70 per cent of the site value plus development costs. The only way to get more funds would be to provide additional security, but the overall exposure for the bank needs to be no more than 70 per cent.

## GET A VALUATION

Let's all avoid any nasty surprises. Everyone's a winner if you remove the guesswork and commission your own valuation up front, says Batterson. "I like to see valuations up front on all the projects we do. We send things up to our board for a decision with a valuation attached to them. We don't tend to do things subject to valuation anymore because you might spend a whole lot of time on it and then the valuation doesn't stack up."

When risk mitigation is important to the bank, they will have a preference for the person who does your valuation too.

"I prefer valuers I've used before – if it's a new valuer I'd look at it a bit more carefully." Batterson says he will often get a feel for the viability of a deal based on the valuation and other information provided to him at the initial stage of the application.

"I can normally get a feel for it. I would also go and inspect the site. If it's introduced by a broker I like to meet the client up front and get a feel for them too."

*"When risk mitigation is important to the bank, they will have a preference for the person who does your valuation too."* **Peter Batterson**

In most cases your banker or broker will be able to advise which valuation firms are acceptable. They're referred to as 'panel valuers' which simply means there's a list of valuers whose reports are accepted by the financier for lending against. Sturma says a broker can normally tell which lender you're likely to apply to early on in the process, which can help when choosing a valuer.

"Once you've had a chat to the client and have received some sort of information from them, with experience you generally know which variety of banks or lenders is going to do that transaction. With that we've got access to the bank's valuation panel."

The advantage in commissioning your own valuer is that you'll get an independent feasibility of your project upfront. In most cases this will include a comment on your cost estimates and end market value calculations as well as the site purchase value.

If the report comes in with expectations that are different to your own, you then get the opportunity to question the valuer directly – not something that will happen automatically if the bank appoints its own professional to do the job.

"It eliminates a lot of the troubles down the track, and a developer has to get one done anyway at some stage of the finance process, so why not get one upfront from a reputable valuation firm that can then be re-assigned to the lender.

"You'd be surprised how often the same valuer is on all the bank panels."

## PRE-SALES

If your project is deemed to require a commercial or development loan, this could trigger a pre-sale condition. Fronting up with ideas on how to achieve your pre-sales will smooth the process. Batterson says for anything with four or more end properties, he likes to see 50 per cent of the debt covered by pre-sales, and possibly more depending on the size of the project. Sturma says a lack of understanding about the pre-sale process can be a recipe for disaster.

***"Once you've had a chat to the client and have received some sort of information from them, with experience you generally know which variety of banks or lenders is going to do that transaction."*** **Renato Sturma**

"Some of the major banks in particular want 100 per cent of debt coverage. For example, some developers might have been with their existing bank for 20 years and just automatically thought, 'I can go into the bank and get a construction package, they'll support me because I've been with them for so long', but they haven't even thought about pre-sales and the bank has knocked them back on that basis."

Sturma says avoid overextending yourself on the initial site purchase too. You'll need funds to complete the project and there's no guarantee a development approval will give you enough capital gain to do the job.

"In quite a few instances I've had people that have basically hocked themselves up too much on the initial site purchase. They've bought a site, gone to the bank and got a home loan at 90 per cent

LVR and then have just automatically assumed because they've gone out and got an approval, that they've had a massive escalation in the value of the land," he says.

Sometimes it's not just a matter of finding some more security for the bank either, according to Sturma.

"Throwing more money at a project doesn't make a bad project that has poor profitability suddenly work. Lenders will still look at the project itself. Where is it? What is it? Is it marketable? More security may help get it over the line, but the profit and risk and the project itself is still the most important thing."

## HOW TO APPEAL THE DECISION

Say you believe the banker is destroying your golden opportunity by failing to see reason. If your arguments are sound, you may get another shot at finance, but you'd want to make sure your case was solid, says Batterson.

"If they come back with a strong enough case we will probably have a look, but generally once it's knocked back that's the end of it. They'd have to change the risk profile dramatically."

As a broker, Sturma says there's the right of appeal but you need a good argument to fight the system.

"If they say 'no' you need to understand why they said no. Is it because of sales? Is it because of the lending ratio? If you can come back with a case to counteract the 'no', we can go back in and discuss it with them."

## GET APPROVAL BEFORE YOU PAY

Purchasing subject to approval will invariably increase the purchase price. The advantage is being able to remove a lot of the guesswork on what can be done with the site, and you don't need to settle and hold the property while it's going through the local council approval process. It's another way to reduce the lender's uncertainty.

There's also the potential bonus that if you've purchased subject to one set of development guidelines and you're able to achieve something better from council, it's likely you'll make an equity gain before even settling on the site. The key is to ensure you don't pay too much initially.

"I've had clients that have been able to negotiate a sale today that will settle in six to 12 months time and they've put clauses in the contract where they've been given permission to go ahead and commence the planning process. When they settle and they've been successful in obtaining the planning permits there can be that uplift in the land value," Sturma says.

## WORST CASE SCENARIO

Sturma says it's best to work on a worst case scenario for your finances early. In some cases it means the best small developers have a back-up cash flow – they hold a regular day job while playing their developer role.

"The bank will want to have a level of comfort to say that if the end units or blocks didn't sell, will the customer still have the capacity to service the residual debt. This means things like the rental they would receive from the remaining units and if the developer is earning some sort of income."

## KEEP NO SECRETS

Don't hide anything because there's no getting around the grief that can come from keeping quiet about potential problems, Sturma says. "Full disclosure is really important because the banks will pick these things up in due course. If you do have any defaults, judgements or credit issues, let us know early so we can address them."

If you have a problem where an unpaid debt is messing with your credit rating, highlight it up front with the financier and you'll get an opportunity to explain the circumstances. Always make sure you let the broker know if you've approached another bank about doing the deal before you proceed with the application too, says Sturma.

"There's nothing worse than going to a bank your client has already approached and the banker already has an application sitting on his desk. It makes you look foolish."

By adopting a common sense approach and relying on the advice of experienced professionals, you can set yourself up for the best possible chance of landing the cash to tackle your venture.

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