

An easy beginner's guide to development finance

Education

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Are you looking to fund a small property development project? Development finance could be the solution you seek. If you have never used this finance option before, then it can be a tricky concept to navigate.

We have prepared this guide to help you understand development finance, what it can be used for, and its benefits over a high street lender – such as a bank.

How does property development finance work?

Development finance can be used to fund a variety of different property projects. Think of development finance as a loan. You are the borrower, and a lender provides you with the funds.

Obviously, it's not as simple as a lender handing you cash. The lender needs to undertake their due diligence. As such, you will be required to complete several forms, in some cases, provide bank statements, a full project appraisal, and a detailed breakdown of your plans, costs, and timelines.

If planning permission is required, the lender will need to see these documents, as well as building regulations consent and any warranties for the project. You will then need to agree on an exit strategy – for example, this could be selling the property or refinancing it.

If your lender approves the funding you will receive an offer letter that details the full terms, always make sure to read this thoroughly before progressing.

You may be thinking that this sounds like a good deal, but what is the lender getting out of this? Understandably a lender will not hand you the money without a financial incentive for themselves. You will be charged interest on the money you borrow, typically on a monthly basis. Usually, interest is only charged on monies actually drawn. You should also be aware that exit fees are common too and are often a percentage of the total loan.

However, interest and fees are not to put you off. [Property development finance](#) has some flexibility, and most lenders will work with borrowers to agree on a plan that suits all parties involved. Furthermore, you will not have to worry about paying the money back immediately, most lenders offer repayment terms between 12 and 24 months.

What can development finance be used for?

If your project involves adapting property on any level, chances are you can use development finance to fund it. Development finance can be used for residential and commercial projects, as well as building on undeveloped land, renovating properties, or converting derelict buildings into usable spaces.

Furthermore, you do not have to be a property developer to utilise development finance. You could be a self-build enthusiast, an individual undertaking a project or even part of a company. Development finance can be a funding option for countless people and countless projects.

Some of the most common projects fuelled by development finance include:

- Self-build homes for residential use
- Houses and apartments for profit
- Converting commercial properties into residential (and vice versa)
- Creating shops, salons, restaurants and other commercial spaces
- Mixed-use developments
- Extensions and loft conversions
- Renovating or refurbishing offices
- Converting unique structures such as barns or churches

Why would I choose to use development finance over a bank loan?

Since banks offer loans, you may be wondering why development finance even exists. Banks and building societies, especially the main high street names, are trusted and part of our everyday lives, so why wouldn't you secure finance from them?

Well, sometimes banks are constrained to box ticking when it comes to lending and it can be extremely difficult to source development finance from the high street banks. Why? Simply, development finance is a bespoke product and has specialist teams working behind the scenes to understand all of the risks and parameters that need to be considered when lending. It's essential for lenders to have complete oversight of the project and often these high street banks do not have the time, nor expertise to understand property development and the nuances between projects.

Development finance is offered by specialist alternative lenders, like us here at TAB. We live and breathe finance solutions including development finance. You can give us a call on 0208 057 9070 or email enquiries@tabhq.com to learn more regarding development finance.

Wait, is development finance the same as bridging finance?

Both are forms of alternative finance, but it is better to look at development finance and bridging finance separately.

Bridging loans are commonly used to 'bridge' a gap, such as purchasing a property when the previous hadn't sold. You can release the equity on your current property, allowing you the finance to secure another. Click to read more on [what are bridging loans](#) and how bridging finance can be used.

So, where bridging finance is used to purchase a property, development finance is better suited to adding value to property, whether that's building from scratch, renovating or carrying out a change of use.

How do I repay the money I have borrowed?

Development finance is a flexible form of alternative finance. This means repayment can be on your terms, provided the lender agrees. The way in which you pay the money borrowed back will depend on the size of the project you undertake. For example, if you renovate three apartments it is highly unlikely they will all sell on the same day. Therefore, the lender will allow you to pay in stages (known as part redemptions). In contrast, if you built a house from scratch to live in yourself you will need to refinance and begin paying back in this way. Each lender is different and you can liaise with them to create a repayment plan that suits both parties.

Are there any risks to development finance?

Property development tends to have more risks associated with it than other areas of the property market which can impact the cost of development finance. This is because there are several elements to a property development project and they can change throughout the course of the loan. Since development loans are longer than a standard bridge in some instances, the end game can even change. For example, end values can go up or down, costs can increase or even the refinance market and regulations can change. It is important to be aware of the risks that property development has before you take out any development finance as any property used as security is at risk of repossession if you do not keep up with your payments.

Don't forget, the TAB team is on hand to help you with your development project. Simply get in touch on 0208 057 9070 or email enquiries@tabhq.com to find out more about development finance and how we can help. Please note that TAB is not authorised by the Financial Conduct Authority and TAB loans are unregulated. You will have no access to the Financial Ombudsman Service (FOS). Any property used as security is at risk of repossession if you do not keep up with your payments.

If you are unsure of the risks, you are advised to obtain appropriate professional advice.

Development finance terminology

To better help you understand development finance, we have also provided a list of key terms and commonly used acronyms that you might come across when acquiring development finance, you can access them all in our [glossary](#) as well!

Gross development value (GDV)

GDV is the expected market value, all circumstances being normal and once works have been completed, of what the property development should be worth on the open market.

Loan to value (LTV) day 1 and during the project

LTV is the ratio of how much a borrower has requested for a loan against the asset being used as the security, which can be property or land. Day one LTV is the ration loan against the value of the asset at the very beginning of the project. LTV can change as the project progresses. For example, on day one, if a security being used is just land and as the project progresses gains planning permission, then the value of the land might increase, therefore LTV would change.

Loan to gross development value (LTGDV)

The LTGDV is the ratio between the amount of money we lend against a property development project and the expected market value, all circumstances being normal and once works have been completed, of what the property development should be worth on the open market.

Loan to cost (LTC)

LTC is the ratio used to compare the financing of a project (development loan) against the cost of the development, refurbishment, or build of the property.

Rolled up interest

Often interest is served on a monthly basis or in some bridging loans, deducted from the gross loan in advance. These methods can be draining on cashflow which is imperative when undertaking developments. Funders understand and appreciate this, and therefore offer a part of the overall loan that is reserved for interest. The expected interest on the loan is estimated ahead of time, and then deducted from the total loan available but only paid at the time of the redemption.

Drawdowns

When undertaking a development, a developer will have to pay the principal contractor at preset agreed dates, usually monthly. These funds can then be approved by the funder and advanced to the developer to ensure they have funds to pay for the next set of works on site. This process of claiming funds spent on site is called a drawdown. The borrower is drawing down on funds pre-agreed with the lender.

Redemption

Redemption is the act of the repayment of a loan from the borrower. Once a borrower has repaid all of the loan and interest then the loan is considered fully redeemed.

Capital is at risk. Property values can go down as well as up. Borrowers may default and investments may not perform as expected. Interest and income are not guaranteed. Returns may vary. You should not invest more than you can afford to lose. TAB is not authorised by the Financial Conduct Authority. Investments are not regulated and you will have no access to the Financial Services Compensation Scheme (FSCS) or the Financial Ombudsman Service (FOS). Past performance and forecasts are not reliable indicators of future results and should not be relied on. Forecasts are based on TAB's own internal calculations and opinions and may change. Investments are illiquid. Once invested, you are committed for the full term. Tax treatment depends on individual circumstances and may change.

You are advised to obtain appropriate tax or investment advice where necessary. Understand more about the key risks [here](#).

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