Association of
Bridging Professionals

A Professional Approach to Short Term Lending Secured against Land or Property

2012 Edition

A Professional Approach to Short Term Lending Secured against Land or Property

Introduction

The members of the Association of Bridging Professionals (AOBP) want to ensure that you have as much information as possible about how short term lending secured against land or property works in order that you can make an informed decision.

This booklet is designed to provide you with this information and, in particular, draw your attention to the risks associated with this type of lending.

Since being formed in 2010, the AOBP has, through its members and executive committee, worked to promote industry standards to provide consumers with a fair, open and transparent service. As part of their membership criteria, members of the AOBP have signed up to the Association's code of ethics and professional conduct and agree to abide by the professional standards set.

Look out for the AOBP logo to be sure the firm has signed up to the Code:

Despite the fact that firms try to use plain English as much as possible, it is still possible that there will be some terms or industry jargon that you may not be familiar with.

This booklet seeks to provide you with information to assist your understanding. Inevitably, it may not cover everything you are not familiar with. If there is something you are unsure about ask your intermediary to explain it to you.

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Land or Property

Whilst land may not need defining, property in the context of this booklet refers to commercial, residential or mixed-use property - i.e. a building. It does not refer to property such as cars, works of art, jewellery etc. which may be used as security for a loan from pawn brokers or other specialist 'asset' finance lenders.

Equity

Equity is the amount of value left in a property after deducting the amount due under any mortgage secured against it. For example, if a property is valued at £250,000 and there is a mortgage of £150,000 secured against it then the equity in the property would be £100,000 (£250,000 - £150,000).

You should bear in mind that lenders will generally only lend against a percentage of the available equity and not the full amount. You should also be aware that the 'value' of the property will be based on the figures provided by the lender's surveyor. See the section on Survey and Loan to Value for further information.

What defines a short term loan?

A short term loan, sometimes referred to as a bridging loan, is generally for a term of 12 months or less. In some cases the term may be longer, e.g. 18 months. It is usually secured against land or property – i.e. it is a mortgage.

What is a secured loan?

A secured loan means that you, the borrower, provide some form of security to the lender, which is for the lender's benefit and not yours. This is in addition to your promise to pay. For the purposes of the loans covered in this booklet, the security offered will be a legal charge, i.e. a mortgage, against your land or property.

This means that although the land or property remains in your possession, and you continue to enjoy the use of it, the lender can take steps to repossess it if you do not pay the interest due at the agreed times, or you fail to repay the loan by the end of the term or indeed breach your agreement with the lender in some other way e.g. you let your property without consent. Most short term loans secured on property also contain powers for the lender to appoint a Receiver over the property. Receivers also have powers, including the right to sell or receive the income from the property.

Receivers are also known as LPA (Law of Property Act) Receivers. Although appointed by the lender, they will be considered to be your agent.

If you do default on payments, fail to repay the loan at the end of the agreed term, or breach your loan agreement in some other way, then the lender can seek to repossess the property and sell it in order to recover the amount owed. See Arrears and Repossessions for more information.

What if I already have a mortgage on my property?

It is possible to have more than one mortgage on a property; the later, second mortgage is often referred to as second 'charge' or secured loan lending.

The 'charge' is still a mortgage, i.e. you are giving the security for the loan, and it is identical in nature to your first mortgage. It should not be treated differently. A charge will be referred to as a first charge (your first mortgage), second charge (your additional mortgage), third charge (a third mortgage) etc. The 'number' (first, second etc.) of the charge generally determines the order in which the lenders have the rights to any money from the sale of the property. There may be circumstances where this is changed due to deeds of postponement where one lender agrees to postpone the priority of their charge in favour of a 'later' charge by another lender. This does not change the fact that you will still owe the lender the money and they can still seek repossession or hold you personally accountable for any shortfall if the property is sold for less than you owe.

We will generally refer to second charge lending as covering all loans that are secured after a first charge mortgage for ease of reference.

Some lenders restrict the right of a borrower to have a further mortgage and so it may not be possible to

obtain a second or third charge mortgage even where there is sufficient equity in the property without your first mortgagee's consent.

Survey and Loan to Value

The lender will require a survey to be carried out to value the property and will generally wish to instruct their own surveyors to carry out the valuation. In some cases a lender may consider accepting a very recent survey that has already been carried out, providing the surveyor is acceptable to them and the surveyor is willing to re-address the survey to them. The surveyor will usually charge a fee for this but it will be less than the cost of a new survey. You will be required to pay for the cost of the survey.

The survey is for the lender's benefit, not yours. It is not a structural survey and is used only to assist the lender to determine whether or not to lend money and, if so, how much.

Lenders differ in the amount of loan they are willing to provide against the value of the property. This is known as the 'Loan to Value'. We referred earlier to loans being made against the 'equity' available in the property – i.e. the difference between the value placed on the property by the surveyor and any existing debt.

Generally, lenders will either use an 'open market valuation' or a '90 day sale' (sometimes known as forced sale) value.

The 'open market valuation' is based on the price the surveyor believes the property can achieve if marketed and sold in the normal manner. The surveyor will generally comment on the demand for the type of property and likely selling time. This may be lower than the estate agent's and your view of the value of the property.

The '90 day sale' value is based on the price the surveyor believes could be achieved if the property had to be sold within 90 days. This is often, but not always lower than the 'open market' value.

You should bear in mind that the value that the lender puts on the property and the type of valuation used by the lender will affect the amount of money the lender will be willing to provide.

For example, if the lender will offer 70% of Loan to Value against the open market value and the property is valued at £100,000 this means the maximum loan you can get would be £70,000. If you have a mortgage already this would need to be deducted from the amount. In this example, if you already had a first mortgage of £30,000 you would only be able to borrow another £40,000.

If, using the above example, the lender only offered 70% of the 90 day value and this was £90,000 rather than the £100,000 open market value, then you would only be offered £63,000 as a first charge or £33,000 on a second charge basis.

You should also note that some lenders offer a lower maximum loan to value when the loan is secured on a second charge basis.

What is APR?

There are a number of factors you may consider when comparing one loan with another, such as speed, lending criteria, availability of the funds, affordability, etc.

Fees and charges may be important considerations. The Annual Percentage Rate (APR) is one method of comparison.

The APR reflects the true cost of the loan and includes all of the interest together with any other charges. This may make it easier for you to compare the true cost of borrowing between different lenders for the same loan amount and term.

If the loan is regulated by the Financial Services Authority (generally first charge mortgages on your own home) then you must receive a Key Facts Illustration (KFI) which all lenders have to provide in a standardised format. In section 5 of the KFI you will find the APR as well as the total amount you will have to pay back, including the loan amount and the cost per £1 lent to you.

Generally speaking, the shorter the term of the loan the higher the APR is likely to be because there is less

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of a period to spread the cost of charges and fees.

If you are unsure about this or any of the costs, contact your intermediary.

Fixed or Variable

Most short term loans are written on a fixed rate basis – i.e. the interest that you are charged each month is fixed throughout the term of the loan.

It is possible that the loan may be on a variable rate basis, in which case the amount charged each month can rise and fall. The information provided to you should state which basis the loan is written on and, if it is variable rate, what basis is used to set it. This could, for example, be the Bank of England Base Rate, but it does not have to be.

Some fixed rate loans can have the rate changed if you do not repay on time and both fixed and variable rate loans can have interest rate changes if you fail to make payments on the due date or breach some other term of your agreement.

You should make sure you know what basis your loan is offered on and what the impact of any change might be.

Term of the loan

It is important to ensure you request the right length of term at the outset. Failure to repay the loan on time may incur additional costs (see Extending the term below).

Short term lenders do not generally charge extra for having a longer term at the outset, but you will need to check if there are any charges for repaying the loan before the end of the term.

Selling a property and refinancing arrangements often take longer than you think to happen, so it is usually best to build in some lee-way into the term. Consider where you are in the sale or re-mortgage process. Ask your intermediary for further information or advice on the right term for you. The length of the term which is appropriate for you will depend on your anticipated route for repaying your bridging loan, e.g. whether you intend to sell the property or refinance the loan.

Extending the term

Sometimes things do not go according to plan and you may find yourself in a position of not being able to repay your loan at the agreed time.

The important thing is to *contact your mortgage lender as soon as possible* to discuss your position. Affiliate lenders will look to reach sensible arrangements with you unless there are specific reasons why they cannot extend on your particular circumstances. Failure to make contact may reduce the willingness of the lender to try to assist you.

You should be aware that there may be additional costs and charges incurred if you do not repay on time. Many short term lenders charge fees for extending the term or for failure to repay on time. Short term lenders made their own commercial arrangements based upon you settling your loan at the end of its agreed original term. It is therefore possible that the lender may also increase the interest rate when this occurs.

Make sure you know what will happen if you fail to repay on time and consider the risk of this happening.

Paying Monthly, Retained Interest and Rolling up

There are three basic methods which short term lenders use for borrowers to pay the interest due on the loan.

Paying monthly is, as it suggests, where you pay the interest due each month either by standing order, direct debit or other method agreed with the lender. Borrowers who cannot afford to make the monthly payment on the loan will need to choose a loan with one of the other methods.

Retained interest is where you borrow the interest payments due on the loan in addition to the loan

amount you require. The extra amount is held by the lender (retained) and used to meet your monthly payments as they fall due. You may be required to pay interest on the amount of interest payments retained.

Rolled up interest works by adding the interest due each month to the loan balance. Interest is calculated each month based on the balance then outstanding.

There are various combinations of these approaches available in the market, e.g. part monthly pay part retained/rolled up where you pay only a fixed percentage of the interest due and borrow the rest or roll up the rest. Some lenders also offer the opportunity to retain interest for only part of the loan, e.g. six months of a nine month loan. This approach is sometimes used when a borrower believes he will definitely be able to repay the loan within, say, six months but wants the flexibility of having a bit longer if need be. The borrower will, however, need to make sure they can make the payments for the other three months if they cannot repay after the retained period ends.

The interest rate on short term loans is generally higher than that of long term loans. This is because short term finance is provided to meet a particular short term need, and a short term lender does not enjoy the benefit of receiving interest for long term use of its money The short term lender is offering a bespoke service and has to operate at speeds and levels of service which the longer term lenders cannot match. The costs incurred by short term lenders therefore tend to be higher than those of long term lenders in order to provide the service required. They tend to be smaller and more personable than mainstream lenders such as Banks and Building Societies.

It is important, therefore, that you make any payments due to avoid eroding the equity in your property.

Arrears and Repossessions

You may, despite your best intentions, find that you are unable to make your payments due under the loan agreement. It is important that you *contact your lender as quickly as possible* to advise them of your circumstances and agree a course of action. Avoiding contact will make matters worse, where there is no dialogue; lenders have no real alternative but court action

You are likely to incur fees and charges if you fall into arrears (whether or not there is court action). These should be explained to you and will be set out in writing as part of the loan agreement. Some lenders issue a separate tariff of charges document which covers all of these fees. Do ensure that you familiarise yourself with these charges.

If the loan is regulated either by the FSA or the Consumer Credit Act then the lender has to follow the rules laid down by the regulator. Ask your lender for information on this. If you feel you are being unfairly treated you can make a complaint to the lender who has to consider your complaint and

respond. If you are dissatisfied with the response you take your complaint to the Financial Ombudsman. Your lender should provide you with details or you can look at the website: **www.fos.org.uk**

Some people incorrectly believe that if they keep up their payments on their first mortgage they can miss payments on a second charge mortgage. In fact, the second charge mortgage company has the same rights as the first mortgage company and can repossess your property. They will, of course, be obliged to deal with the first mortgage lender's interests and ensure that they are paid off first from any sale proceeds.

If you fail to keep up your payments, repay your loan on time or breach a condition of your loan, the lender can commence legal proceedings to repossess the security property. Once the lender gains a possession order from the courts the lender can then seek to obtain an eviction order to make you leave the property. The lender can then sell the property in order to recover the money you borrowed plus any additional costs incurred in recovering the money and any accumulated interest and charges.

It does not matter what type of lender you have dealt with, e.g. a high street bank, building society or short term lender, if you borrow money using a mortgage as security you are agreeing that the lender can take the property away from you if you fail to keep to the agreement.

The property does not become the lender's, but the lender acquires the right to sell it. If you have more than one mortgage the lender will use the sale proceeds to pay off all or as much as possible of the mortgage debts owed to all the lenders involved. Any surplus left over will be passed to you.

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It is also worth remembering that if the sale proceeds of the property are not enough to repay all of the amounts owed, the lender can pursue you through the courts for the shortfall. This is particularly important to bear in mind when you have other assets, e.g. your own home, that have not been used as security for the mortgage, as a charging order can be placed against these by the courts.

Affiliate lenders will seek to enter into sensible agreements with you first so that the costs and expense of litigation can be avoided.

Affiliate lenders of the AOBP subscribe to the principle of TCF (treating customers fairly).

Incorporated within that principle is a commitment to treat repossession and enforcement as a last resort. If you run into repayment difficulties, AOBP affiliate lenders will first seek to reach a satisfactory arrangement with you, which is designed to lead to the repayment of the debt before taking you to court or other action.

Regulated Loans

The precise description of regulated loans can be quite complex. As a rule of thumb the following will apply:

A mortgage will be regulated by the Financial Services Authority if it is secured as a first charge on a residential or part residential property in the UK which is at least 40% occupied or intended to be occupied at some time in the future by the borrower or a 'related person'. A related person means the borrower's spouse, parents, grandparents, siblings, children and grandchildren. An unmarried partner of the borrower whose relationship with the borrower has the characteristics of the relationship between a husband and wife is also included. This can include a person of the same sex as the borrower.

A loan will be regulated by the Consumer Credit Act if it is not 'exempt'. Loans which are exempt and thus not regulated include those covered by the FSA, loans to limited companies or partnerships of 4 or more people, loans predominantly for business purposes or to high net worth people and loans secured on investment properties not at least 40% occupied by the borrower or related person. If you are unsure if your loan will be regulated ask your intermediary to clarify this for you.

Fees and charges

Your loan may be subject to a variety of fees and charges and you should ask your intermediary to explain them to you.

The most common fees are:

Fees charged by the lender:

- **Arrangement Fee** - A fee for providing the loan – which is often described as an arrangement fee, application fee or completion fee. Some loans have both an application/arrangement fee and a completion fee. The fee(s) may be payable at the time of the application or at the time the loan is advanced. A completion fee, and sometimes the arrangement fee, is generally payable when the loan is advanced. Sometimes the fee is added to the loan required and then deducted from the money advanced when the loan completes.

- **Valuation Fee** -You will normally have to pay for a survey to be carried out on the property that is to be mortgaged. Your intermediary will advise you of the cost and this will have to be paid at the outset. Some lenders require you to pay the surveyor direct.

- **Legal Fees** - The lender's legal costs are usually payable by you. These are normally on a set scale according to the value of the property. If more than one property or title is being used as security then the costs will increase. You may be required to cover the costs at the outset – this is often done by giving funds to your solicitor who will undertake to pay them to the lender's solicitor as required. Some lenders arrange for their legal costs to be deducted from the loan amount when the loan completes. You will also have your own solicitor's costs to pay (see below). Short term lenders generally require borrowers to use their own solicitors to ensure they have independent legal advice on the nature and risks of the transaction.

  You may be able to add the lender's legal costs to the amount you borrow.

- **Telegraphic Transfer Fee** - Some lenders charge a fee for transmitting the loan electronically to

your solicitor's bank account.

- **Mortgage Administration Repayment Charge** - This can also be known as a redemption fee or deeds release fee. This is to cover the lender's cost in dealing with the repayment of your loan.

- **Exit Fee** - Sometimes called a loan repayment fee or redemption charge. This is a fee charged to the lender as part of the cost of the loan. It is often expressed as a percentage of the loan amount borrowed or a number of months' interest payments. It is payable when the loan is repaid.

- **Arrears Fees** - These are payable if you fail to make payments due under the loan on time. This may be a set monthly charge, an amount per missed payment or an amount for each month the loan is in arrears. Another basis of charging is for each action on your account – e.g. a telephone call to chase payment, writing a letter, bounced debits etc.

  As stated previously, you may also find that the interest rate on your loan increases if you fail to make payments on time.

  Interest will still be added to your account and you may be charged interest on the missed payments as well as any fees or charges incurred.

  If the lender has to instruct solicitors, take you to court or repossess your property all the costs incurred will be added to your loan.

- Some lenders charge fees for providing additional statements, dealing with requests for redemptions, providing information to other lenders on your request etc.

- If you are having your loan advanced in stages to cover a building project you may be liable to pay additional re-inspection fees to check on the work completed so far and current value of the property. These are generally lower than the initial valuation fee.

- **Facility Fee** - Some lenders have a facility fee included in their product terms.

  This is usually set at a rate of interest per month. This fee is generally waived by the lender if the account is maintained in good order throughout the term of the loan. If your loan has a facility fee you should ask your intermediary for information about how much it is and the circumstances in which the lender would be prepared to waive the fee.

Fees payable to other people:

- Intermediary Fee - Your intermediary may charge you a fee. This may be payable at the outset to cover the cost of the work they will have to do, or may be payable only when an offer is made by the lender, or when the loan completes. In some cases there may be a fee payable at more than one time.

  Some lenders allow the intermediary's fee to be added to the loan and pay it to the intermediary when the loan starts.

- Indemnity Insurance - Many lenders require insurance to be effected to protect them from a defect in the title to the property (title indemnity) or other specific risks. This also helps to speed up the process. The cost of this is often passed on to you via the legal costs you incur and is deducted from the loan at completion, but the cover is for the lender only. You have no interest in such a policy.

- Valuation Insurance - Some lenders insist on valuation insurance cover. This covers the lender and any difference between sale price (in repossession) and original valuation. This is cover for the lender only. You have no interest in such a policy.

- Legal fees on redemption - You will generally be responsible for paying the lender's legal fees for redeeming the loan. This is usually based on a set scale.

- Your own legal fees - Your solicitor will charge you for the legal work which they carry out. They should provide you with information on the cost and how it is worked out when you instruct them.

- You may have other fees or charges that are not listed here. Your intermediary should be able to

advise you of any that he is aware of that are specific to the loan.

How is my intermediary paid?

Your intermediary may get paid in a variety of ways and they should tell you how much and how they will be paid.

The most common methods are:

- A fee, often calculated as a percentage of the loan, which you pay direct to your intermediary or which is added to the loan.
- A commission, or procuration fee, paid to the intermediary by the lender.

Sometimes there is another firm, often referred to as a network or packager, who sits in between your intermediary and the lender. If any fee is payable to them you should be advised of this fact.

The amount of commission/fee will be disclosed to you. It is a common practice for such commissions to be paid.

Though the intermediary may be receiving commission from the lender, they are independent of the lender and therefore you should be fully satisfied as to this independence. The lender will provide to you a complete list of deductions from the mortgage money.

Repaying the loan

Generally the loan will need to be repaid by a set date (the term). This is often referred to as redemption.

It is your responsibility to make sure you can repay the loan on or before the end of the term. The lender is not responsible for making this happen. You will have provided the lender with details of how you intend to repay this borrowing before the end of its short term and you should only enter into the transaction if you are confident that you will be able to achieve this. Remember failure to do so can result in action being taken against you, further costs and fees being added to your loan and, as a last resort, repossession of the property.

Generally loans are repaid either by the sale of the property the loan is secured against (or another property) or refinancing the loan with another lender, often a mainstream bank or building society. In some cases the loan is repaid from other personal resources such as an inheritance.

It is important to consider the risk that you may not be able to achieve your planned exit (redemption) in the required timescale. What alternative could you put in place if the planned refinancing was declined or if the property market dropped?

Although short term lenders have the same rights as other mainstream lenders such as banks and building societies, they are more likely to seek repossession of your property in a shorter timescale. This is because the lender has made commercial arrangements based on the loan facilities being regularly serviced and repaid in full on expiry and because interest rates on short term loans are typically higher than long term finance rates, meaning that equity of the property is more quickly eroded.

Uses of short term loans

Short term loans are used for a number of reasons. These range from conventional bridging, which is described as providing finance on one home when a new home has been bought but the original one has not yet been sold, to auction finance, business loans etc.

They are generally suited to borrowers who want money quicker than can be obtained from mainstream lenders such as banks and building societies, or where they will not lend due to the current state of the property, for example, where it needs a kitchen or bathroom installed to make it habitable, or due to their underwriting criteria.

As the name implies, the loans are only suited to those who need the money for a short time. They are not suitable as a replacement for long term finance.

The most important aspect of taking out a short term loan is making sure you can repay it by the due date, i.e. the exit strategy.

If you do not have a viable exit strategy, or think that there is a strong risk the planned exit will not work, you should consider very carefully whether to proceed. You will be at considerable risk of losing the property if you fail to repay the loan at end of term.

What if your partner wants the loan and you do not?

Sometimes a person may want a loan but their partner does not. One person may pressurise the other to take the loan. This pressure, which does not have to include violence, is known as 'undue influence'. Lending companies do not want to lend when this happens. If you inform the lender or your solicitor the loan will not go ahead.

Can I change my mind and cancel the loan?

You have the right to cancel you loan application up until the time your solicitor requests the funds from the lenders, although if your solicitor has already given an undertaking to meet the lender's solicitor's fees, these will still be payable whether or not completion takes place. Likewise, some lenders do include facility fees, which in some cases are payable whether or not you proceed with finance. Check the terms of your facility very carefully before signing and returning it. At this stage you are committed. Cancelling before this may mean that you are liable for fees that have not yet been paid such as solicitor's fees and any other fees you have agreed to.

Many lenders will allow you to repay the loan immediately after completion but you may have to pay an early repayment charge. This may be a number of months' interest or some other set fee. This should be advised to you as part of the loan documentation.

AOBP Affiliate Lenders

A list of affiliate lenders of the AOBP can be found on the website:

http://www.aobp.org.uk

Our affiliate lenders insist on you being separately and independently represented so that you have professional advice about the nature, content and effect of the documents on the transaction generally.

Notes

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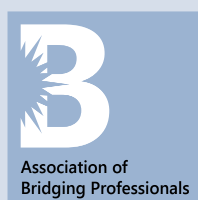

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