Sink or swim as schemes head underwater

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The new year is finally upon us. We have a substantial majority for the Conservatives, which is great news for the economy, and a Brexit deal will be forthcoming, which means we can all get back to business as usual. But what exactly does this mean for developers and lenders?

For new schemes the number one issue is planning and we have numerous clients who have been attempting to gain consents for more than two years. While we have a system in place when it comes to affordable housing, viability is still a major issue. With Labour councils still running the vast majority of London boroughs, this is unlikely to be resolved in the near future.

But what of those existing schemes with planning, under construction or completed? Unless you have pre-sold, the stark reality is that anyone who has bought anything in the past two years probably has issues.

Lost profits

Most developers work on a 20% profit on cost and in most cases sales are down and build costs are up, so your profit has evaporated. We have valued a number of schemes in the past six months for developers and lenders, all of which are pretty much underwater. Many will be lucky to get their money back.

The vast majority of the schemes we have looked at are failing for one of two reasons: the developer or contractor runs out of money or goes bust; or the finished units are not fit for purpose due to poor specification, being overpriced or both.

Bank valuations, with their pages and pages of waffle, have not actually looked at schemes in enough detail. This means layouts, surroundings, competition and proximity to transport. There are hundreds of units being created at completely unrealistic values.

The other side of the coin is the amount of money available for development. Most first charge debt costs somewhere between 5% and 8% per annum, including fees. In most cases there is at least one slug of equity, bridging, mezzanine, stretch senior, or whatever silly name they give to this, generally charging 6-15% per annum.

This cost will kill your profit if your scheme is delayed because of planning, build, or not selling in the requisite timeframe.

What next?

A large number of new developers formed during or after the bull market of 2013-16. Their profile tends to be one partner who is an ex-agent, banker, surveyor, contractor or interior designer, with the other having access to capital. I suspect a large number of these will not be around in two years' time. We are also aware of a large number of lenders employing or transferring staff into new departments to deal with these forthcoming issues.

Many private lenders will bite the bullet and keep the schemes they have lent on as there is still nowhere else for them to invest their money. High-net-worth individuals have this insatiable appetite for investing money, no matter the risk, as they can't face the thought of zero returns in the bank. For the banks this is not an option as loans need to be repaid within a fixed timeframe.

While the general public don't know much about property, they do believe what they read in the papers. Headlines tend to focus generally on a weak market and the opportunity to do deals. Over the past six years the large majority of new homes in London have sold to investors. They are now sitting back and waiting for new opportunities to buy at discounts.

The good news for bulk sellers is that professional property companies are being outbid by high-net-worth individuals or funds looking for yield or discount to vacant possession value, or in some cases both.

So while the last quarter of 2019 was basically a waste of time for most in the business, due to Brexit and then the election, this comfort blanket of not wanting to make decisions has now been lifted and it is finally time to get down to business.

Whether developers or lenders like it or not, assets are only worth what someone is prepared to pay for them at a point in time. It's just a question of whether you are willing or able to face the music.

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