Property finance loans

Key features and risks

By helping experienced property professionals build new residential homes, refurbish existing properties or access short-term finance, you can support small housebuilders in bridging the housing shortage facing the UK.

If you are using Autobid, you will automatically lend to both small business and property loans, allowing you to build a well-diversified portfolio. Property loans work slightly differently to small business loans, so this document covers all of the key features and risks involved with lending to experienced property professionals. Information specific to each individual property loan request can be found in the investor report downloadable from the financial summary tab.

All property finance loans are secured against an asset, which means if the borrower is unable to pay their loan, Funding Circle can enforce the security to repay investors. Unlike unsecured small business loans, investors will typically receive monthly instalments of interest, with the principal repaid at the end of the loan term when properties are sold.

By lending to businesses, your capital is at risk.

How are property loans assessed?

Property loans will be assessed by our experienced property credit assessment team. Some of the key considerations when deciding whether a loan should be listed on the marketplace are:

- **Funding ratios** – We ensure that the value of the property that is used as security is higher than the value of the loan that is requested by the borrower (i.e. an appropriate loan-to-value ratio). The borrower also needs to commit an appropriate amount of equity to the project, in case market conditions change.
- **Property fundamentals** – We assess whether the proposed property is the right fit for its location, has an appropriate sale price and the building costs/timings are suitable for the term of the loan.
- Borrower track record – We want to be comfortable that the borrower has successfully delivered similar projects in the past.

Like unsecured small business loans, property finance loans will be assigned a risk band, however the interest rate will be set individually for each loan.

Property development loan

Development loans are provided to experienced borrowers who typically wish to undertake construction of new residential homes, refurbish existing properties or convert existing buildings into flats.

Key features

1. **Interest funded up-front** – The total amount of interest payable by the borrower over the term of the loan is typically funded by investors alongside the principal when the loan is first originated. This interest 'up-front' is held by Funding Circle in a designated bank account and is distributed to investors as regular, monthly interest payments. It can also be used by the borrower to repay the loan early. The 'up-front' approach permits reliable, monthly distribution of interest to investors even though borrowers receive income much less frequently, namely when the completed property is sold.
2. **Principal repayment** – The principal is repaid at the end of the loan term when completed properties are sold. The final scheduled interest payment is paid alongside the principal repayment (even if the principal payment is late).
3. **Late payments** – If the principal repayment for a development loan falls late,

interest at a rate 2% (per annum) higher than set out in the loan agreement will accrue on a daily basis from the date the principal repayment was due. This additional interest will typically be paid by the borrower along with the outstanding principal and the final regular interest payment.

4. **Borrower** – Borrowers will typically have a demonstrable track record in successfully delivering a number of projects similar to the one proposed. You can see details of previous developments completed by the borrower in the investor report.

5. **Security** – In nearly all cases, property development loans are secured with a first ranking legal charge against the subject site. In some instances, we may take a second ranking legal charge. You can view the legal charge ranking for each development in the investor report. In most cases, we will take either a personal guarantee from the shareholders/directors of the company or a debenture against the company in favour of Funding Circle. An explanation of different types of security can be found in our FAQs.

6. **Valuation** – For all development projects, we will instruct an independent RICS (Royal Institution of Chartered Surveyors) valuer to undertake a full valuation of the proposed site. The valuation will typically provide details of the expected Gross Development Value (the estimated value of a property once completed) and market demand of the completed development, residual land value and an estimation of the timeframe for completion. Funding Circle also reserve the right to re-value the development at any time.

7. **Monitoring Surveyor** – We will also instruct a RICS appointed monitoring surveyor to report on all aspects of the proposed development. This will typically include a review of the planning consent, construction agreements, budgets and any risks associated with the proposed development. The monitoring surveyor will be required to monitor the development until it is complete.

8. **Legal documentation** – We will appoint an external firm of lawyers to undertake due diligence on all legal aspects of the proposed development and they will distribute money to the borrower following completion of their assessment. The appointed law firm will be registered with The Law Society.

9. **Planning consent** – All proposed developments are required to have a full and valid planning consent before any loan is agreed.

10. **Borrower equity** – Typically borrowers must commit their equity into the development before any funds are advanced. You can see details of the borrower's equity commitment in the investor report.

11. **Drawdowns** – The loan term for the overall development will typically range

between 18 and 24 months. The entire funding for the development will typically be drawn in individual loan requests to the same borrower (“tranches”) to meet the cashflow requirements of the project. Each tranche is treated as an individual loan contract held between investors and the borrower.

Loan tranches will be repaid from the sale of properties in the order they were funded, however all tranches will rank pari passu (on equal footing) in terms of recourse and security. This means that if a property loan is defaulted, any recovery payments made will be distributed evenly between all outstanding loan tranches.

Risks

As with all lending, some businesses including property professionals will not be able to pay their loan back in full, or there may be delays with repayment. When this happens, we will pursue recovery of the outstanding amount through legal action or enforcement of security. This may cause significant delays to repayment, and there is a possibility that investors will not receive back all of their investment. Diversification, where you spread your lending across many businesses, helps you manage this risk and earn a more stable return. Autobid is a great way to do this automatically.

The following list details the key risks that could lead to late repayment or default of a loan:

1. **Construction risk** – With development loans, there may be delays caused by unforeseen events, which may increase the costs and timeframe needed to complete the project. Usually a contingency is included within the loan amount to account for any increase in costs. Construction risk is typically reduced on later tranches once the foundation and structural works are completed. If costs increase beyond the contingency, Funding Circle may agree to support this by increasing the overall loan amount, which will affect subsequent tranches. This may also result in those tranches reflecting different total costs and LTV (loan-to-value) figures. Where this happens, we will make this very clear to you in the investor report on those tranches.
2. **Main contractor default** – Delays to a project may be caused by the failure of the appointed main contractor, as the borrower will need to find a contractor to continue the works. However, most borrowers perform this function themselves, reducing the risk of delays.
3. **Market/sales risk** – An estimated period for marketing and sale of the properties is included within the loan term, however, sales may take longer than expected due to changes in market conditions.
4. **Breach of loan agreement** – If the borrower breaches the conditions set out in

the loan agreement (e.g. the borrower provided false information), Funding Circle may choose to default the loan.

5. **Borrower default** – If the borrower enters insolvency or liquidation and is unable to complete the project, there is a risk that investors will not receive back all of their investment.
6. **Platform failure** – In the unlikely event that Funding Circle stops trading, there is a risk that there may be a shortfall in the money held on behalf of Funding Circle's investors and borrowers (e.g. the part of the borrower's loan commitment used to make interest payments to investors).

Short-term property loan

Borrowers may require short-term finance (typically up to 12 months) to extend an existing loan agreement, to submit an application for improved planning consent, or to cover the period between refinancing their project with another lender. With the exception that a monitoring surveyor will typically not be appointed, and full planning consent may not be required, key features for this type of loan are equivalent to those of property development loans.

Risks (in addition to the risks described for property development loans)

1. **Refinance risk** - There may be delays in the borrower's ability to secure refinance facilities during the agreed term of the facility.
2. **Planning risk** - If the loan agreement was for the borrower to either obtain or improve planning consent, then there is the risk of that consent not being achieved within the term of the loan agreement. This can cause delays with repayment of the loan.