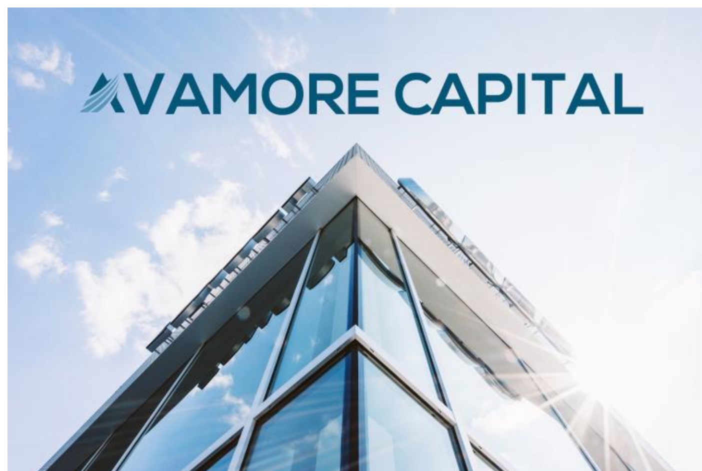
Why You Should Invest in Property Bridging Loans

Investment in private debt is on the rise.

Institutions and family offices are increasingly turning to private debt as a means to generate alpha for their portfolios. Predominately, these loans are made by specialist debt funds to back large PE fund acquisitions of corporate targets. However, increasingly investment in these types of loans are made into the smaller-cap property bridging loans, especially in the US and UK.



We at Avamore Capital are in discussions with multiple parties regarding selling exposure to elements of some of our UK bridge and development loans (or even whole loans) to institutional investors. Why? Because they rightly see that the risk/reward profile is quite frankly fantastic. In our loan book (past and present) our average gross IRR is over 11%, whereas our average LTV is 61%. Honestly as risk-adjusted returns go, it doesn't get much better than that.

So why now? Given that total forecast 2017 IPD returns on property in the UK (commercial and residential) are likely to be flat at best or even negative in certain markets, having exposure to real estate, albeit exposure that generates yield regardless of whether the underlying market goes up or down, must be highly attractive in the current post-Brexit climate. Particularly as the yields are substantially in excess of rates of inflation.

Granted, good developers/asset managers will be able to achieve 20%+ IRRs whether markets go up, down or sideways and forthrightly these are exactly the types of counterparts lenders should want exposure to. However, there can be a lot of concentration risk from an investor backing a handful of

developers on the equity side. Additionally, a well-balanced investor portfolio should only have a very small (sub 5%) exposure to real estate development equity, based on our experience.

Investing in bridge and development property loans is ultimately transient. That means that if you invest in a 6 or 9-month bridge or development loan, at the end of the term you get your money back and if another asset class looked more interesting at the time of repayment to invest in, then you can naturally do that. Alternatively, if nothing looks attractive, you can recycle your cash into another bridge loan.

Businesses (any, not just property or investment businesses) can also find investing into development loans a useful cash management tool. For businesses that throw off a regular cashflow each month, they can invest in a development loan that can be the aggregate of that monthly cashflow over the term of the development loan. A bit like investing in a loan in instalments. Compared to the cash sitting in the bank earning nothing, making 5-8% annualised on a property development loan sounds like a much better deal.

So how do you get access to private real estate debt opportunities?

Let's break this down based on the type of investor you are:

- **Small Investor** – as a retail investor your options are a bit more limited. Your IFA will be able to advise you of the potential options, but you are really limited to crowdfunding platforms (Crowdrise, Landlordinvest, Proplend etc) or one of the few listed bond products. Lendinvest has just launched a bond at just over 5% p.a. – although your counterparty is the lending vehicle, the bond is funding as opposed to having direct exposure to a loan. It is absolutely essential that as a small investor you are investing through a FCA (or equivalent internationally) authorised and regulated platform. Otherwise you can't have any certainty

the people you're handing your money over to will give it back. Some crowdfunding platforms also offer secondary markets, which means that if you want to sell your position to another investor before a loan is repaid, this can be achieved (although the liquidity of secondary markets can be unpredictable).

- **High Net Worth (HNW) Investor** – in addition to crowdfunding platforms, high net worth investors have more options and can potentially obtain higher returns than their small investor counterparts. Additionally, HNW savers with SIPPs (and even those drawing pensions) can even invest in bridge loans potentially tax-free.

  The key opportunity for HNW investors (vs retail investors) is investing directly into bridge and development loans originated by specialist platforms, either as lender of record (meaning you as funder are listed on companies house and land registry) or via a security agent/trustee vehicle (where the lender's anonymity is maintained). HNW investors don't have to fund the entire loan, but can part-fund the loans and the platforms will fund the balance themselves, or pull together other investors to lend alongside each other.

  Other alternatives for HNW investors is to invest into private debt funds, albeit the HNW investor probably won't have the option to withdraw principal from those funds if they are closed-ended in structure. There are also the options of buying mortgage-backed securities, although the returns on offer for the better-quality tranches are not that high.

- **Institutional investor** – whether you manage a pension fund, private equity investor or you are an opportunistic hedge fund (or something in between), all options are available to you. In addition to the options mentioned above, the following can be considered as well:
  - Appointing a bridge/development lender as an asset manager to lend your money on a managed account basis, or with a discretionary mandate, with a degree of exclusivity.
  - Buying closed whole loans, with the originator retaining responsibility for management of the loans.
  - Providing a revolving credit facility directly to the loan originator for a fixed period of time (generally 3 years) of a set amount for the originator to lend on.

- Loan-on-loan investment – i.e. lending the lender a proportion of the loan quantum for each loan (up to 80% of the loan advance) where the remaining 20% funding comes from the originator, whose funds are at risk before yours.

Unquestionably, institutional investors should have a material degree of exposure to private debt investment.

Although returns have come under a lot of pressure over the past few years, this is as much a consequence of the levels of interest being shown by the investment community in the private debt space.

On the flip side, the market has never been broader or deeper, with a particularly rich pool of potential managers/originators. There are some signs that rates charged to borrowers are starting to creep up and investment returns in the short-to-medium term could increase, which should provide an incentive for you to start to invest in the space now.

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If you have any questions relating to this article or wish to discuss anything, please direct them to md@avamorecapital.com.