Armchair Development

Why Would They Do It?

Since looking at the information we've shared with you on our Armchair Development concept you've probably asked yourself the #1 most asked question I hear each day:

"Why on earth would a developer pay investors a higher return than the interest rate they could get from a bank?"

I get it! At first glance it might not seem to make sense, however the reasons become a lot clearer when you understand the bigger picture that lays ***below the surface.***

On the surface borrowing funds for a development project at lower bank rates may seem logical and more profitable, however, what is not obvious are the conditions and obligations imposed by the banks when they lend for a development project.

- Banks will tend to only lend a maximum of 50-60% for development projects and in most cases, **only for construction costs**. As the amount a developer can borrow is tied to the valuation of the property (LVR) a fluctuation in market values at any point in time can mean the bank will require the developer to tip in more money to keep the LVR at the agreed rate otherwise the banks has the power to step in and liquidate the development

- When a developer gets the majority of their funding from a bank, in a sense it can actually increase the risk of the project as they place so many conditions and ***restrictions on a developer*** as well as tie the whole endeavour up with red tape. Just think of the paperwork, process and amount of time it took you (or a friend or family member) to get a home loan – now multiply this 1000 times and you can begin to appreciate what a developer has to do to obtain project funding.

- Compounding Interest: Interest is calculated daily and compounds on itself each month which creates a ***significant holding cost*** for the development project.

- There are also a multitude of other costs that a ***developer has to fund themselves*** and this is where private funding becomes a key element in the profitability of a development.

- Private funding doesn't come with same extensive ***pre-sale requirements*** set by banks. First tier lenders require the developer to employ a first tier builder from their panel of builders, ***forcing the developer to pay full retail construction prices*** rather than delivering a wholesale priced project themselves with far less red tape. Basically, the developer can construct their project with a **greater profit margin** which they can in turn **share with investors** who have made it possible.

This doesn't mean that projects have no bank lending at all, it just means they borrow a lot less from the banks.

It's actually a good thing to have a mix of private funding and bank lending – the best of both worlds so to speak as when a bank is funding part of a development project, this offers another level of risk mitigation for private lenders as they can be assured that the bank has conducted a ***stringent level of due diligence*** before agreeing to the funding.

I hope this helps to answer this very common question - if you have any others then please just call my team on 1800 600 890 and they will set up a time for us to discuss - obligation free.

Kind regards
Paul

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