CONSTRUCTING EXCELLENCE
South West

Development finance

A best practice guide to lending

Contents

This guide has been produced by Constructing Excellence South West's Lean Forum led by their drafting team:

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Introduction to development finance

Constructing Excellence South West's Lean Forum identified the opportunity to bring together representatives from key organisations and disciplines within the construction sector who are involved in the pre-construction phase of commercial projects which are funded through development finance.

The aim was to understand how developers, funders and the construction teams currently work together; with a view to making the process collaborative and therefore more efficient – reducing risk and improving profitability.

It became apparent that, whilst each organisation understood their own role within a project, there does not appear to be a client guide which combines the processes of design and procurement, with finance and funding.

After recognising this, the Lean Forum has produced a 'lending map'. This is based on a hypothetical private developer-led project[1] requiring external finance[2].
The type of project envisaged is an open market housing development.

The purpose of the lending map is to show the typical key stages which need to be achieved before a lending organisation (typically a bank) is willing to provide secured funding for a speculative housing development.

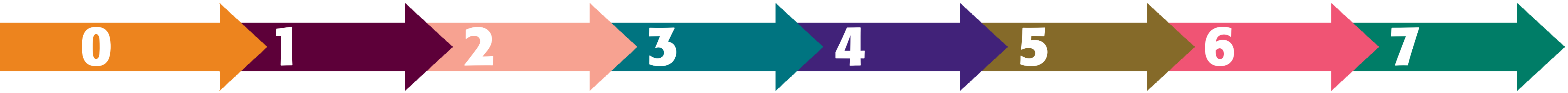
We have sought to provide an overview of the key issues at each stage. Further detailed information is provided at the back of this document which describes and identifies the key requirements of a lending bank before it provides secured development finance.

The descriptions on the following pages seek to describe the main activities to be carried out by the relevant group within each stage identified in the lending map.

[1] In England or Wales.
Separate rules apply to Scotland.

[2] Assumed project cost circa £5m.

Stages of the RIBA Plan of Work



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Commercial development – construction procurement and lending map

Constructing Excellence South West Lean Forum

Client	**Need identified**			
Lender		Initial meetings	Initial meetings	Initial meetings
Design team		RIBA Stage 0-1 strategic definition, preparation and brief	RIBA Stage 2 concept design	RIBA Stage 3 developed design
Procurement (D&B)				
Other parties			Early engagement with planning office to ascertain planning content	Statutory consents (Full planning, LBC, draft section 106 agreement etc)
Risk		Finance, land acquisition	Land acquisition	Planning. It is likely that project cannot proceed without consents, which may be subject to local decision making.
Programme		1-2 months	1-2 months	4-6 months
Approximate project spend profile		2%	2%	5%
Notes		Identify outline project budget with designer and cost advisor	Refine project cost plan	Finalise project cost plan based on developed design proposals
			Earliest point of tender (presume no planning required)	A range of statutory consents are available depending on project type
				Potential tender for contractors based on planning information and supporting specification

		Completion of agreement		Need satisfied
Project appraisal, outline approval, condition of sanction (COS), valuation and facilities letter.	Lending report, lending conditions (COS / warrantees).		Valuations to monitor spend, borrower to expend 40% of project cost before release of bank monies.	Return on investment (ROI) through sale of asset or planned repayment of loan.
	RIBA Stage 4 technical design		RIBA Stage 5 and 6 construction and handover	RIBA Stage 7 occupation
Tender and select D&B contractor. Draft construction documentation sent to the bank for approval.	Complete the construction documents – building contract, appointments, bonds and PCGs.			
	Discharge of planning conditions, and legal agreements in place.			
1-2 months	3-4 months		9-12 months	
1%	5%		85%	
				12 months defects period

STAGE 0 Identifying the need

The primary business objective of a developer is to identify the best way to maximise profit from the use of land. The developer may either own the land or have the opportunity to acquire it.

Once the land has been identified, the developer will carry out an initial feasibility assessment (or business plan) as to whether there is an opportunity to make a profit by developing the land. This will be answered by establishing whether the resultant revenue for the project will be greater than the cost to fund and produce the project.

The exact nature of the project will depend upon a number of factors. It may be that the land can only be realistically used for a specific use or the developer has a particular model which it uses to develop land. Whichever way the land is to be developed, the developer carries out its initial feasibility assessment and the decision to proceed or not is based fundamentally upon the assessment that the project will make a profit.

The developer | The lender | The professional team

STAGE 1 Strategic definition and brief

The developer

Once the developer has decided that the project should proceed, the developer will commission the key professionals and organisations to assist in the delivery of the project.

The costs involved in commissioning this stage are ordinarily borne by the developer.

The lender

The developer will start to discuss the project with one or more possible lenders. The 'appetite' of the possible lender will depend upon a number of factors. These include an assessment of the track record of the developer; the nature and projected profitability of the project; and whether the project fits the lender's business strategy. The developer will then be able to assess which lender(s) are interested in providing funding for the project. Ordinarily, a funder is unlikely to lend more than 60% of the total cost of the project and will expect the developer to fund the other 40%.

The professional team

The developer will work with the professional design team to establish the project brief to meet the developer's objectives. Details of this process are listed at Stage 1 of the RIBA Plan of Work (**www.ribaplanofwork.com**). This process is carried out within the context of the developer's feasibility assessment, the land on which the project is to be developed, the lender's requirements for funding and the projected cost and revenue of the project.

Most projects will require planning approval from a local authority. Until this has been secured it is likely to be the single greatest project risk. It is therefore recommended that the design team undertakes pre-application engagement with the local authority to ascertain the planning context and likely development constraints as early as possible.

At the end of this stage, the design team will produce a number of option studies for the land and the developer should carry out another feasibility assessment to reconfirm that the project is still projected to make a profit.

2 STAGE Concept design

The developer

The developer should continue with its dialogue with the lender to discuss the progress of the project.

The developer should commission the professional team to carry out all necessary site investigations and commission a project valuer in order that any assumptions made in the initial feasibility assessment can be checked and also any particular aspects of the proposed project which need special attention as they could affect the overall feasibility of the project. The developer should work with the professional design team to establish a preferred concept design based upon the agreed brief.

The appointments engaging the professional team will include provisions for the professional team to provide collateral warranties in favour of the lender.

It is recommended that site investigations, especially those which could adversely affect the design or project cost, are undertaken early. Consideration should be given to instructing these at this stage to avoid abortive work.

The costs involved in commissioning this stage are ordinarily borne by the developer.

The lender

The lender should be identified. The lender will indicate to the developer the information it will require at the 'application stage'. A typical list of the information required can be found on the lenders' checklist at the end of this document.

The professional team

The professional team should finalise the concept design. A full description of what a concept design consists of can be found at Stage 2 of the RIBA Plan of Work. The concept design is detailed enough to show what is being proposed on the land in order to start a more detailed dialogue with planning control and other relevant statutory bodies.

The developer | The lender | The professional team

STAGE 3 Development design

The developer

Depending on the nature of the project, the developer will need to consider any particular processes it needs to go through before a planning permission can be sought or works can be commenced.

The costs involved in commissioning this stage are ordinarily borne by the developer.

The lender

When the lender starts to consider this project as a possible business opportunity it will open further discussions with the developer on the project and the different ways in which the funding can be structured.

The professional team

Details of the design development process are listed at Stage 3 of the RIBA Plan of Work. The professional team will carry out all work necessary to submit a planning application and obtain any other consents. The professional team should also consider the construction procurement route and make proposals to the developer, if required. The project team should also update the project costs plan to reflect the design solutions. The draft construction appointments, collateral warranties and other documentation which are in a form acceptable to the lender should be issued to the professional team with a view to entering into the relevant appointments, etc.

The developer

The lender

The professional team

STAGE 4 Project appraisal

When ready, the developer produces the 'developer's appraisal' which is submitted to the lender in the form requested by the lender. This is generally known to the lenders as the 'Application Stage'. The developer's appraisal will include all aspects of the business case to support the developer's application for development funding for the project. Therefore, the developer's appraisal will explain the financial viability of the project, details of the construction process and the team, the projected cashflow, the amount and term of loan required and the nature of the security to be granted to the lender.

The costs involved in commissioning this stage are ordinarily borne by the developer.

The lender decides at this stage whether or not it is going to sanction a loan for this project.

Once the developer's appraisal has been received then the lender carries its own audit of the viability of the scheme. The lender will almost always instruct a valuation of the project from one of its own preferred panel of valuers. The lender will review all of the information received and its assessment will include the items listed in the attached checklist. This will include, for example, an evaluation of the developer's track record and the equity in the property compared to the amount to be loaned. The lender will produce a pre-drawdown terms and conditions which highlight all of its requirements before the monies will be released. A typical pre-condition would be the receipt of a satisfactory report from the lender's independent monitoring surveyor. The lender will also produce / instruct a draft valuation and facilities letter. Prior to the lender giving its credit approval, it is typical for the lender's costs in this regard to be borne by the developer.

The professional team will prepare the tender document, tender works, evaluation returns, negotiate with those who have tendered, and select a preferred contractor. All of the draft construction documentation will be sent to the lender's project monitoring surveyor and the legal team representing the lender.

STAGE 5 Technical design and lending report

The developer

The developer should provide such further information as required by the lender and its advisers. It is likely that particular points will be raised during this due diligence process and the developer needs to satisfy the lender that the particular point is resolved or a special arrangement is agreed.

The costs involved in commissioning this stage are ordinarily borne by the developer including the costs incurred by the lender's advisors.

The lender

The lender will appoint an independent monitoring surveyor. The lender will rely upon the professional expertise of the independent monitoring surveyor whose main function is to provide technical expertise to ascertain that the developer is not developing the project in a way which will put the lender's money at risk. This report will outline the developer's strategy for the construction of the project and highlight any special or abnormal matters which may affect the viability of the project and on which the lender may add special conditions to the loan offer.

The lender's professional advisers provide both technical and legal reports on both the project and the land. The lender's advisers will be aware of the lender's standard funding requirements. This will usually include the lender's requirement to take a first charge over the land and have an assignment of the benefits of the construction documentation. As such, during this process, the lender's advisers will receive draft documents such as the draft construction documentation including draft collateral warranties with step-in rights, etc. The lender receives a 'certificate of title' in respect of the land together with a report on the construction documentation. In parallel with this process, the facility letter is amended to reflect the extent and nature of the security documentation which is going to be provided by the developer and its professional team.

The professional team

The professional team will finalise the appointment documentation together with collateral warranties in a form which will be acceptable to and in favour of the lender. The professional team will also be finalising the construction information in preparation for the project to be commenced. The developer may also instruct other professional advisors on particular aspects of the due diligence process.

STAGE 6 Financial close and construction

This is the combination of all the work carried out before works start on site. This stage is often called 'completion' whereby in a meeting or remotely, the developer, the professional team and the lender conclude the legal agreements. At completion the developer and the lender complete the facility letter which has been negotiated during the process. Simultaneously, the lender then takes security over the land and the professional team's appointments and building contract. The appointment of the professional team for the construction phase and the contractor are also concluded. Sometimes, the release of some of the monies to the developer is subject to a number of other pre-conditions and as such, the developer and the professional team progress these in order that the lender releases the relevant tranche of the loan.

Sometimes, the developer will fund some pre-construction or early works to be carried out by the contractor before completion. However, once all the pre-conditions have been completed (or have been waived) then the contractor can be instructed to commence the actual construction works. During the course of the construction works the developer makes applications to the lender for interim payments based upon the work carried out and as certified by the lender's project monitoring surveyor. These valuations are often based upon pre-agreed milestones or work stages.

The amount available to be drawn down by the developer is the agreed loan irrespective of the actual cost to construct the project.

STAGE 7 Occupation and return on investment

Once the project has been constructed and the final release of development funding has been completed, the developer will then be in a position to realise the development profit. This can be by sale or lease. If the property is retained by the developer then the project is usually refinanced to take advantage of a longer term loan facility.

Once the lender receives back its loan and other costs then the developer and the project is released by the lender. It is likely that the new owner, tenant or funder will want the developer to provide a suite of security documentation from the professional team and contractor which is ordinarily by way of collateral warranties or third party rights.

Conclusions

The lending map has sought to indicate the time each stage is likely to take. From the initial identification of the opportunity until the completion date of the facility letter can take a substantial amount of time. Therefore, this lending map shows that it is in the developer's interest to either reduce these initial costs or shorten/accelerate the feasibility process.

If a project is viewed as a time line from the initial identification of the opportunity to practical completion of the project, then there is a real opportunity for all of the construction team to contribute to the saving of time and therefore, cost. The reduction of cost will increase the profitability of a project, or change a project from being unviable to viable. Or, in this context, can change a project which lenders are not willing to lend monies on, to a project where they are.

One of the purposes of this lending map is to provide a basic understanding of the commercial needs and requirements of the parties involved in a project. This is the first step in identifying and then adopting a more collaborative approach. A collaborative approach and the formation of long term alliances between the construction team and the supply chain has shown time and again that this improves quality and increases value on a project. The use of a number of initiatives and 'tools' encouraged by Constructing Excellence saves time, or the better use of time can be realised. These initiatives include the use of Building Information Modelling, early contractor involvement, supply chain engagement, off-site construction and collaborative working.

Details of these processes and exemplar projects / case studies are available on Constructing Excellence South West's website, in particular:

BIM
www.cesw.org.uk/presentations/031214

Supply Chain Management
www.cesw.org.uk/presentations/130315

Procurement
www.cesw.org.uk/docs/Outcome-Led-Procurement

Collaboration
If you would like further details of how collaborative working and alliancing can improve all construction projects then please contact Constructing Excellence South West at: **www.cesw.org.uk**

Constructing Excellence South West information checklist
to expedite the bank lending process in development finance

This checklist has been drafted by NatWest

The NatWest Real Estate team is a major force in the provision of funding to support the activities of House Building and Commercial Property Development in the UK.

Along with the supply of funding to customers who own and manage large asset portfolios in Residential and Commercial Property Investment, NatWest has a long and established track record of supporting the construction and development sectors. The 'checklist' and 'lending map' are listed as sources of information that experienced developers may reference to frame discussions, consider funders' requirements at different stages and crucially assist in early collaboration.

There is much to be gained in entering into early discussions between developers and funders. Funders (banks) are very keen to shorten the sequence between 'early discussions / underwritten approval / funds delivered to the developer's bank account' because allocation of capital and returns for the lender are, to a degree, driven by timescales of funds in use.

Equally, the developer and bank customer are keen to maximise all sources of funding and communicate with key personnel in the project as to likely timescales for release of funds.

The 'checklist' and 'lending map' will, by their nature, be subject to nuances and slightly different practices between different banks and different types of funders. The list and map are designed to be comprehensive but not exhaustive and in the spirit of all professional relationships you should continue to speak with the banking relationship managers that you know and trust.

Borrowers' checklist

Areas of consideration for the borrower	Why?	Sources / information to consider	Where can NatWest or CESW help?
Consider all forms of potential project finance	• Best fit with the strategic aims of the business / project on grounds of; – cost – risk – ease of doing business / relationship – timing	• Equity / private equity • Mezzanine • Senior debt (bank lending) • Secondary lenders • Crowd funding • Grants	
Which bank to approach?	• Existing banker where track record may exist • New banker where alternative levels of appetite / market experience may exist		Market facing lending guidance

Lenders' checklist

Areas of consideration for the lender at 'application stage'	Develop understanding with the borrower/ How and where is information used?	Sources / information to consider	Where can NatWest or CESW help?
Counterparty / sponsor	• All lenders prefer 'through the cycle experience' • Point to successful track record of schemes completed on time / on cost with good collaboration with professionals and returns model as originally envisaged • Lenders will want to understand the 'capital stack' i.e. balance of risk in equity versus borrowed money sources • Management stretch versus management capability • Key man reliance	• Sources of equity • A corporate CV of completed schemes • Sales brochures of completed schemes • Achieved sales prices versus marketing values • Clear statement of borrower's means listing all assets and liabilities • Names and details of professional team and all those with 'design input' – qualifications / experience / background – quantity surveyor – architect – structural engineer – M&E engineer – main contractor or proposed tender list	• Standard template documents • (shopping list)
Project details (non-financial)	• All banks have 'frontline relationship managers' and separate 'underwriting teams' – providing information in an easily shareable format is a great idea • All banks use postcode data to support lending appetite i.e. details of sales values and risks associated with previous problematic lending • Usually banks seek the involvement of Independent monitoring surveyors – who are selected from a small panel approved by the bank	• Site address • Anticipated purchase date for land • Procurement route • Development programme including design, procurement, construction, sales and marketing • Date to start and end construction phase • Scheme drawings and location map. Are there any site access or logistics issues to consider? • Site layout and configuration including external design, internal specification and car parking provision • Number and type of units including square feet floor sizes • Planning permission details, listed building consent, expiry of JR period and relevant conditions e.g. draft section 106 agreement and CIL • Materials to be used in construction and application of specialist services, long lead-in items, off-site materials etc.	CESW members in professional services

Areas of consideration for the lender at 'application stage'	Develop understanding with the borrower / How and where is information used?	Sources / information to consider	Where can NatWest or CESW help?
		• Environmental considerations such as – contact from the Environment Agency – ground working conditions – clearance of contamination – tree preservation orders – archaeological assessment – flood risk assessment – ecological assessment • Details of utilities already connected to the site? • Are there party wall issues to consider? • Are there any rights of light issues to consider? • Are there existing buildings on the site? If so what is planned for their continued use? If demolished consider removal of any asbestos or other contaminants	
Project details (financial)	• All banks have policy and guideline appetite statements for acceptance of risk • Sub sectors such as student accommodation, commercial property and residential development will usually carry varying degrees of 'risk appetite' • Lenders will interrogate the development appraisal to ensure all reasonable risks have been considered, including contingency and compare percentage numbers with expected norms • Early identification of the counterparty/sponsor financial risk in the scheme is required by the lender i.e. clarity on level of cash contribution available upfront • Suitably robust contingency allowance • Cost overrun protection and recourse should be discussed	• Development appraisal – land cost/value – GDV – construction costs – level of contingency – professional fees – statutory costs e.g. CIL – bank finance costs – marketing and sales costs – developer profit – holding costs/run-off post PC • Project cash flow – including a full assessment of impact of 'phasing a scheme'/development programme with key milestones • Purchase date and price of land • Amount and term of loan required	• Bank templates available • List of CESW members

Lenders' checklist continued

Areas of consideration for the lender at 'application stage'	Develop understanding with the borrower / How and where is information used?	Sources / information to consider	Where can NatWest or CESW help?
Legal considerations	• The bank will normally require independent specialist construction and contract lawyers acting for the bank – who are selected from a small panel approved by the bank • The bank, as senior debt lender, will normally require an 'unfettered' first legal mortgage over the development site • The bank, as senior debt lender, will normally require 'step in rights' on contractual positions within the project through collateral warranties or third party rights • The lender will seek a mortgage debenture and personal guarantees / cost overrun guarantees if borrowing is in the name of a limited company • Negative pledge i.e. value in the scheme not to be pledged to other lenders • Bank documentation usually includes pre draw down terms and conditions and covenants • The bank documentation will include details of the repayment arrangements / exit arrangement • Equity release to borrower can be considered • In 'joint venture' arrangements an understanding of full disclosure and 'duty of care' to all parties	• Customer legal team and bank legal team working together • Banks usually have a *de minimis* for use of independent report on title • Specialist forms of charge and terms letters may apply when borrowing say more than £10m • Legal opinion (certificate of title) on: – procurement structure – understanding of tender process – risk structure of procurement structure / relevant contracts – review of key aspects of build contract including; price, payment, retention, LADs, etc – review of terms of consultants appointments, scope of services, PII levels – in a 'commercial project' an assessment as to whether the documentation is 'institutionally acceptable', longstop dates, pre-let / pre-sale agreements etc. • Review planning permission in place, judicial review period expired • Review the certification process and the bank's reliance of the certificates • Security documentation in favour of the bank such as: – collateral warranties – step in rights – assignment rights – intellectual property rights over construction documents – performance bonds, parent company guarantees • Legal opinion on suite of collateral warranties including insurance backing needs to be in place and levels of PII • Legal opinion on the form of latent defects warranty (e.g. NHBC or similar)	

Areas of consideration for the lender at 'application stage'	Develop understanding with the borrower / How and where is information used?	Sources / information to consider	Where can NatWest or CESW help?
		• Provide legal teams with all details upfront e.g. listed building consent, draft section 106 agreement, CIL and any certificate of lawfulness • Security over the applicable performance bonds / road bonds requirement – are there 'highways issues' (S38) to consider? • Any party wall issues, details of awards etc. • Any 'rights of way' / easements / covenants on the land that need to be disclosed? • Any rights of light issues, RoL report / insurance • Details of buildings insurance in place (composite insured and first loss payee) • Health and safety and CDM regulations being followed / adopted. Name of CDM coordinator	
Valuation instruction considerations	• Banks will almost always instruct a valuation of the scheme • Banks have their own preferred 'panel' of valuers so please do not 'instruct' your own valuation ahead of speaking with your bank	• Details of any previous bank instructed valuation to hand • Original land value subject to permissions • End value / GDV (gross development value) / comparable evidence. Review of borrower's sales and marketing strategy • Overview of development appraisal • Overview details of marketing plan • Pre sales expected? Will deposits be released to developer or held by solicitor? • Anticipated sales programme • Ground rent terms (if applicable) • Pre-lets	Bank panel members
Opening a bank account	• Consider items in the bank account opening process which may add extra delays	• Business structures with overseas ownership • The need for credit reference searches early in the discussion / application process • Disclosure of politically exposed persons	

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