Assetline Capital

MAKING PRIVATE LENDING SIMPLE: A GUIDE

Considering private lending, and not sure where to start or whether it's right for you? This guide helps you understand the ins and outs of private lending, so that you can make an informed decision.

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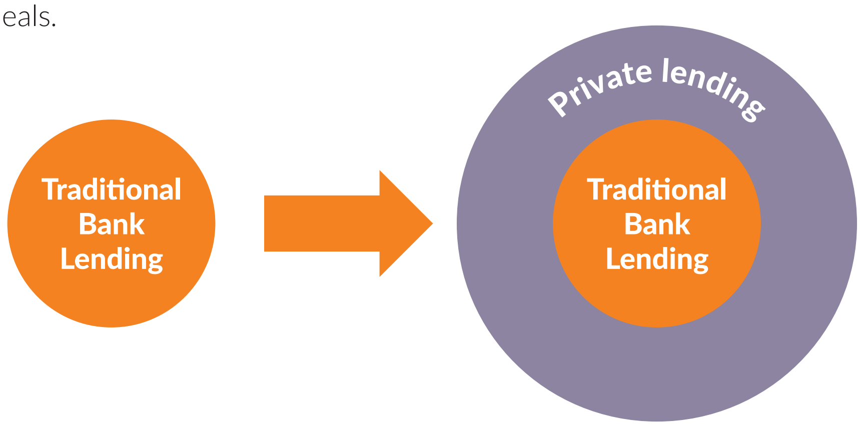
WHAT IS PRIVATE LENDING?

Private lending is lending provided by private finance or lending companies. While banks (mainly the ‘big four’) are the biggest secured lenders in Australia, there are many transactions that don’t fit the big bank’s criteria, but are still solid, creditworthy deals.

THE CHANGING LANDSCAPE



Private loans are normally for shorter periods than bank loans (for example, from 3-24 months) and provide funds to borrowers for specific situations that traditional banks usually won’t fund.

What are the different reasons why I might opt for private lending?

BRIDGING FINANCE/ URGENT SETTLEMENT

To fund an urgent settlement

To manage a mismatch in settlement timing

BUSINESS LOANS

To utilise ‘lazy’ equity in property to assist with cash flow or working capital requirements

FUND CREDITORS

To pay ATO/OSR arrears

To make payments to suppliers

INVESTMENT OPPORTUNITIES

To fund time-sensitive business opportunities

CASE STUDY

NOTICE TO COMPLETE

“Notice to Complete” on a commercial property settlement

A property developer who had already delayed settlement on a Melbourne commercial property was issued with a 'Notice to Complete' from the vendor. He risked losing a $350,00 deposit if he couldn’t settle the transaction within seven days. His broker had led him to believe that finance from a 'major' was imminent, but it wasn’t approved because his tax returns were not up to date.

THE PRIVATE LENDING SOLUTION

The lender advanced first mortgage funding (70% LVR) on a 6-month term, enabling the client to settle on the property. Due diligence was completed and the funds were advanced within five days of application.

Where to next:

The client refinanced the private lender's loan with construction funding.

WHAT SECURITY DO I NEED?

Private loans all require a form of property security. It can be:

Lower LVR ⟷ Higher LVR

- Residential Security
- Commercial / Industrial Security
- Land Security

Private lenders apply different loan-to-value ratios (LVRs) to different security types. For example, the highest LVR might be applied to residential security in a metro area, whereas raw land in a rural area will attract a much lower LVR.

WHO IS ELIGIBLE?

Private lending is generally only available to company borrowers, not individuals. That's because loans to companies fall outside the National Consumer Credit Protection (NCCP) Act, so different regulations apply.

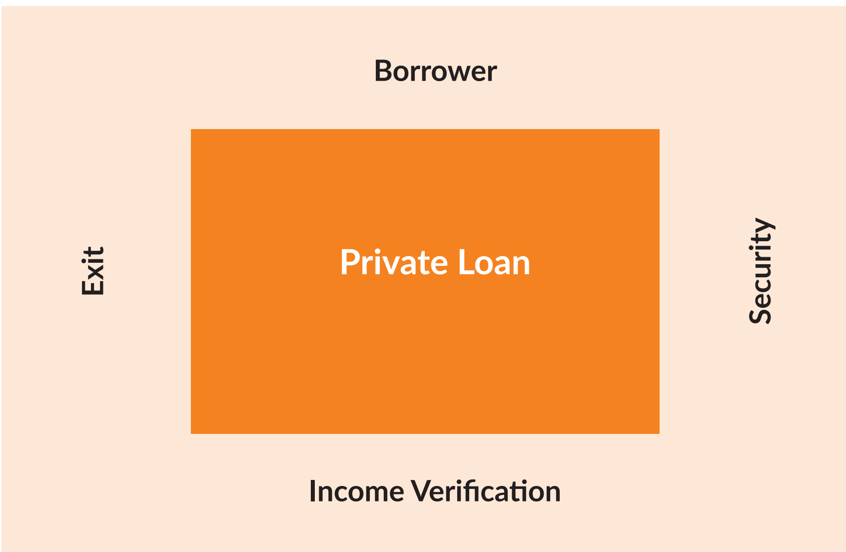
HOW CAN I QUALIFY?

Qualifying for a private loan is simpler than going to a bank.

Lenders will have slightly different requirements but, in general, all private deals must tick four boxes:

- ✓ **THE BORROWER**
  must be a company (or, if not a company, the loan must be primarily for business purposes)
- ✓ **THE SECURITY**
  the loan must be backed by property security. This can be residential, commercial, industrial or land
- ✓ **INCOME VERIFICATION**
  establishing that the Borrower has income to pay the interest
- ✓ **THE EXIT**
  you must be able to show how you will pay back the loan. This is normally done by refinance, sale or other cash injection.

PRIVATE LOAN ASSESSMENT



HOW CAN I FIND THE RIGHT PRIVATE LENDER?

The private lending market is very fragmented and there is no central database to source lenders.

If you find a private lender on the internet, it also important to get references as many lenders might deliver a very different proposition to what they advertise on their website. Make sure to ask around before you commit.

Some of the key questions to ask are:

- How long have they been in business?
- How big is their loan book – i.e. how many loans have they lent in the past and do they currently have on their books?
- Do they run the business out of an office?
- Are the Directors / Principals available and accessible to answer questions?
- What is their reputation in the market?
- Do they belong to any industry bodies (e.g. MFAA, FBAA)?
- Do they hold any licences (e.g. Australian Financial Services Licence, Australian Credit License)?
- Which service providers (e.g. law firms) do they use?
- Have they ever been sanctioned by the regulators?

Different lenders have different focus areas, for example;

- First mortgage versus second mortgage,
- Short term versus medium term;
- Commercial versus residential security; or
- Smaller loans versus a larger loan

There are also some mortgage brokers who focus on setting loans with private lenders. You might like to refer transactions to them if you are not able to set them yourself.

DOES IT MAKE SENSE TO PAY MORE?

Yes, sometimes it does. Where speed, certainty and flexibility matter, it usually makes sense to use a private lender.

In many areas of daily life, people pay a premium for convenience (you might choose to take a taxi over catching a bus or order take-away for dinner rather that cooking at home). It's similar with loans. Sometimes the financial trade-off also makes sense, where there is an urgency to getting the money quickly and with certainty.

Here are some examples where it might make sense to pay more:

- You might **risk losing a deposit** if you can't come up with the funds to settle a property (under a 'Notice to Complete')
- You might **miss out on a compelling business opportunity** where you can't access the equity from your property on short notice
- You might have to **pay a tax debt to the ATO** before you can refinance with a mainstream lender
- You might need to **settle on a property you are buying** before you have sold one you already own
- Your bank loan may have come to the end of its term and **the bank may be putting pressure on you to refinance**

In all these cases, there is a compelling case to pay more for a shorter-term loan.

CASE STUDY

LOOMING TAX DEBT

Private lender refinances borrower who had fallen behind on his business tax debts

A borrower was being pressured by his bank to refinance his commercial facility. The borrower had tax arrears, so the bank decided not to renew his existing facility.

THE PRIVATE LENDER SOLUTION

The lender advanced $1,350,000 against the client's commercial property. He was able to pay out his tax debt and the outgoing lender in full.

Where to next:

The borrower sold several pieces of equipment, and subsequently refinanced the property, to repay the private lender's loan.

HOW MUCH SHOULD I EXPECT TO PAY?

All banks and finance companies follow a similar model. They raise money at a certain rate and then lend it out to you at a higher rate. They also take each individual case, circumstance and potential risk into consideration – so there isn't a standard cost that applies across the board.

Here are some key things that you should know about the interest and fee structures of your loan:

- Banks raise their funds from deposits and in the wholesale money market. The cost of their funds is the lowest in the industry, and that's why they can lend money out at the lowest rate. Also, they operate at a large scale, which plays in their favour.
- Private lenders, by contrast, raise their money from private investors. They have to pay more for their capital and so need to lend it out at higher rates. Private lenders are also usually able to advance money quickly, and so will charge a premium for this. But remember, if they are lending our money on short notice, they probably have to access it on short notice too. This costs them more.
- Rates are always higher for loans that are secured by second mortgages than first mortgages; a reflection of the increased risk. Loans secured using raw land and commercial / industrial property security are also charged at higher rates than residential security, because there are fewer buyers for these assets should the property need to be sold.

Your lender should provide a clear outline of your interest payments and all fees, as well as talk you through the terms of your loan.

5 REASONS TO USE PRIVATE LENDERS

1. SPEED

Private lending works when you need access to funds quickly.

2. FLEXIBILITY

You get to customise the loan to your requirements. For example, if you need a minimum term or no penalty for early repayment, this can be negotiated with the lender.

3. SIMPLE PAPERWORK

Private lending works because the paperwork is much simpler than applying for a loan from a bank.

4. STREAMLINED DUE DILIGENCE

Private lenders focus on what's important to the deal. That's mainly the strength of the properties being provided as security and the exit strategy (to repay the loan).

5. ACCESS

Because private lenders are smaller and more nimble than large banks, you will usually deal directly with the decision makers.

CASE STUDY

RESCUE REFINANCE

Private lender provides 'rescue' refinance to borrower when a loan with major lender came to the end of term

The borrower had been a long-standing client of a 'major' bank, but his commercial property loan had come to the end of term and the bank was strategically pulling back from the client's sector. The borrower was given a short period of time to seek refinance or sell.

THE PRIVATE LENDER SOLUTION

The lender advanced $1.2m secured by a first mortgage over the commercial premises, enabling the borrower to repay the loan.

Where to next:

The borrower refinanced with another 'major' lender after 6 months.

PRIVATE LENDERS VS BANKS

LOAN CRITERIA	TRADITIONAL BANK CREDIT	PRIVATE LENDERS
Fast approval process	X	✓
Flexible loan amount	X	✓
Streamlined due diligence	X	✓
Transaction certainty	X	✓

CASE STUDY

URGENT FUNDING

Developer needed immediate funds to secure an outstanding metro site

The borrower had an opportunity to buy a 2,000m^2 development site in the Brisbane CBD. He held four unencumbered units from a previous development that he was in the process of selling down to raise further liquidity.

THE PRIVATE LENDER SOLUTION

The lender advanced $4.25m, taking the four unencumbered titles as security. The deal was settled within three days of the initial application.

Where to next:

The lender was progressively repaid as each underlying property was sold.

The private lending process – how does it work?

The private lending process is designed to be streamlined and efficient.

AVOIDING THE PITFALLS – WHAT TO WATCH OUT FOR WHEN PICKING A PRIVATE LENDER

When choosing a private lender, watch out for the following:

- **Fees too low** – this may sound counter-intuitive, but 'low-balling' is a deceptive tactic used to get borrowers committed when, in reality, the private lender has no intention to fund the loan. Remember, if something seems too good to be true, it probably is!

- **Large upfront fees** – be wary of lenders who charge large up-front fees before getting started on due diligence. The more reputable private lenders will charge only a nominal up-front fee (to make sure that the borrower is serious and is not shopping the deal).

- **Brokers who front as Private Lenders** – brokers sometimes portray themselves as lenders and charge large upfront fees. In reality, they are just brokers and don't have money to lend. Once they have taken a hefty upfront fee, they may find excuses not to write the deal.

- **Receivers / Administrators who run lending businesses** – Receivers / Administrators are appointed as part of the enforcement process when the Borrower has defaulted and the loan is in 'work-out'. Where a Receiver / Administrator is also the Lender (or is a related entity to the Lender), they may be looking to trip the Borrower up based on a minor technical default and deliver them from one side of the business to the other.

- **Punitive penalty clauses** – watch out for clauses in Offer Letters or Loan Agreements that impose heavy penalties for breaches of loan terms.

- **Long minimum interest periods** – be careful of loans which commit you to pay interest for a minimum number of months, as this can be restrictive if you want to get out of the loan early. For example, you may enter into a 12-month loan and want to repay after 3 months but instead, you are locked in to paying 9 months of interest – effectively penalising you for paying down debt early.

THE PRIVATE LENDING PROCESS – HOW DOES IT WORK?

The private lending process is designed to be streamlined and efficient.

		TIMING	WHAT IS THIS?
1	**Indicative Loan Summary**	Issued same day as inquiry	A high level summary of loan terms for the broker to present to you
2	**Application Form**	At the client's convenience	This is the formal application – it provides key information about you, so that the lender can issue an Indicative Offer Letter
3	**Indicative Offer Letter**	Within 24 hours of receiving Application Form	This is your formal offer from the lender which sets out the terms of advance for you
4	**Valuation**	Instructed as soon as you pay the Valuation Fees. Usually, this takes 2-3 days	The lender values the security which is collateral for your loan
5	**Due Diligence**	Starts as soon as you sign the Indicative Offer Letter	The lender performs due diligence (all the background checks) on the borrower (you) and the transaction
6	**Loan Documents**	Instructed as soon as valuation and due diligence are completed. Generally issued to you within 24 hours of instruction.	The lender instructs the solicitor to prepare and issue loan documents to you
7	**Settlement**	Within 48 hours of loan documents returned	The funds are advanced to you

Assetline Capital

ABOUT ASSETLINE

We are Australia's leading 1st mortgage short-term secured asset lender. As entrepreneurs ourselves, we take pride in our ability to 'think outside the square' in assessing loan applications to maximise the loans advanced.

Our loans range from 3 to 24 months and we are able to fund up to $20,000,000 per transaction.

www.assetline.com.au

info@assetline.com.au

1300 370 821

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