INSIGHT · FIRST-TIME BORROWERS

From Cash to Leverage

A first-timer's guide to funding property projects

By Kiran Patel ACA, Co-founder, Venture Finance

> *Plenty of builders and investors have done well using their own cash. Borrowing for the first time can double what that cash achieves, or double the damage if it is done badly. Chartered Accountant and property investor Kiran Patel ACA explains how to make the move from cash to leverage safely.*

Some of the most capable people I meet in property have never borrowed a penny against it. Builders who have funded every small scheme from their own pocket. Landlords who bought their first few houses outright. Investors who have done well with standard buy-to-lets and now want to try an HMO, a refurbishment or their first small development.

Their caution is understandable. Debt brings fees, deadlines, paperwork and someone else with a say in the project. But staying cash-only has a cost too: it limits how many projects you can do and how fast your money grows.

The move from cash to leverage is one of the biggest steps an investor makes. Done well, it multiplies what your capital can achieve. Done badly, it multiplies the problems. This article is about doing it well.

Why leverage changes the numbers

Take an illustrative builder with £400,000 of cash. A typical scheme for them is four houses: £120,000 for the site, £250,000 to build and £30,000 of fees and other costs. That is £400,000 in total, and the houses sell for £520,000.

Paid for in cash, the builder does one scheme and makes £120,000, a 30% return on their money.

With development finance covering about 65% of costs, each scheme needs around £140,000 of the builder's own cash. Finance costs of about £30,000 per scheme cut the profit on each to £90,000. But the same £400,000 now funds two schemes at once, with £120,000 held back as a contingency.

	Cash only	With development finance
Schemes funded	1	2
Builder's cash used	£400,000	£280,000 (plus £120,000 reserve)
Profit if sales go to plan	**£120,000 (30%)**	**£180,000 (45%)**
Profit if sale prices fall 20%	£16,000 (4%)	A loss of about £28,000 (–7%)

Illustrative figures for a fictitious builder, before tax. Returns are on the £400,000 of cash.

That last row matters as much as the first. Leverage magnifies results in both directions. Used well, it lets good builders and investors grow faster. Used carelessly, it turns a disappointing project into a loss. The rest of this article is about getting the first part without the second.

Matching the finance to the strategy

The first rule of borrowing is to use the right type of loan for the job. A standard buy-to-let mortgage is designed for a finished, lettable house. Most other strategies need something different, at least at first.

Strategy	Typical finance	How it works	The exit
Small development	Development finance	Part of the land funded on day one, build costs released in stages as a surveyor signs off the work	Sale of the units, or a refinance onto term debt if you keep them
First HMO	HMO mortgage, or a bridging loan if the conversion is substantial	A specialist mortgage once the property is licensed and let as an HMO	Long-term HMO mortgage
Buy, refurbish, refinance (BRRR)	Bridging or refurbishment loan	Funds the purchase and works over 6–18 months	Refinance at the new, higher value onto a buy-to-let or HMO mortgage
Light refurbishment	Light refurbishment bridge	Short-term loan for cosmetic works with no planning or structural change	Sale or refinance

Most of these start as short-term money with a planned exit. The question a lender asks first is not "can you pay the interest?" but "how will you repay the loan, and when?" Have that answer ready before you apply.

What lenders ask first-timers

Lenders are not against first-time borrowers, but they price and size the risk differently. Expect questions on five things:

- **Experience.** Have you done this kind of project before, even with your own money? A builder with ten cash-funded schemes behind them is not a first-timer in a lender's eyes, as long as the track record is written down.
- **Your contribution.** How much of your own money is going in, and where has it come from?
- **The numbers.** A realistic appraisal or refurbishment schedule, with costs a lender can check and a contingency of at least 10%.
- **Permissions.** Planning, building regulations and, for HMOs, licensing and any Article 4 restrictions in the area.
- **The exit.** Evidence that the end values or rents are achievable, from local comparables, not hope.

If you are genuinely new to a strategy, you can close the gap. Start with a smaller first project. Bring in an experienced partner or contractor and show their track record alongside yours. Use a professional team (an architect, a QS or a good project manager) whose CVs a lender can see. And expect to give a personal guarantee: for most first-time borrowers through a limited company, lenders will ask for one.

The costs first-time borrowers forget

Cash buyers are used to two costs: the purchase and the works. Borrowing adds a layer that is easy to underestimate. As an accountant, this is the part of a first appraisal I check most closely.

Cost	What it is	When it hits
Arrangement fee	Usually 1–2% of the loan	Taken from the loan at completion
Exit fee	Charged by some lenders, often around 1%	When the loan is repaid
Interest	Often rolled up and added to the loan, so it compounds	Every month, paid at the end
Valuation	The lender's valuer, paid by you, sometimes twice (at purchase and again at refinance)	Before the offer
Legal fees	Your solicitor and the lender's, both paid by you	At completion
Monitoring surveyor	Checks the works before each stage of a development loan is released	At every drawdown
Broker or adviser fee	For arranging and structuring the finance	Usually at completion
Refinance costs	A second set of valuation, legal and arrangement fees on the exit loan	At the end of the project

None of these is unusual, but together they add a meaningful share to the cost of a short project, and more if it overruns. Put every one into your appraisal before you commit, and keep your contingency separate from them.

Common first-time mistakes

Each strategy has its own traps. These are the ones I see most often.

Small developments

- Pricing the build at what it cost last time, with no allowance for rising materials or labour.
- Assuming the lender pays for everything. Development lenders usually release money after the work is done and certified, so you need cash to keep the site moving between drawdowns.
- Leaving the exit until the houses are finished. If sales are slow, you need a refinance option ready before the loan term runs out.

First HMO

- Buying before checking whether the area has an Article 4 direction, which can mean planning permission is needed to convert a house to an HMO.
- Forgetting that most HMO lenders want the property licensed (where required) and set up as an HMO before they lend on the long-term mortgage.
- Budgeting for a standard let. HMOs carry higher running costs: bills, furnishing, management and more frequent voids.

Buy, refurbish, refinance

- Assuming the refinance valuation will match your own estimate. If it comes in lower, more of your cash stays in the deal.
- Not checking how long you must own the property before a lender will refinance at the new value. Many lenders have a minimum period, often around six months.
- Overspending on finishes the valuer will not pay for.

The common thread is the exit. Almost every first-time problem traces back to an exit that was assumed rather than tested.

A first-timer's checklist

Before you borrow for your first project, make sure you can answer yes to each of these:

1. **I know my exit,** and I have a fallback if the first one fails.
2. **My appraisal includes every finance cost,** from arrangement fees to the refinance at the end.
3. **I have a contingency of at least 10%,** separate from the finance costs.
4. **I have the permissions I need,** or a clear route to them: planning, building regulations, HMO licensing.
5. **I can show a lender my track record,** even if it was all funded with cash.
6. **I understand what I am guaranteeing personally,** and I am comfortable with it.
7. **I have stress-tested the numbers:** what happens if values fall 10–20%, costs rise or the project runs six months late?

Borrow like a professional from the first deal

Leverage is not just for large developers and portfolio landlords. Used with care, it lets a good builder or investor do more with the capital they have built up. The investors who make the move successfully are not the ones who borrow the most. They are the ones who plan the exit first, count every cost, and keep enough in reserve to absorb the surprises.

> *If you have done well with your own money, you already have the hardest part: the ability to deliver a project. Good finance simply lets you do it more often.*

About the author

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