Bridging loans can stir up troubled waters

Borrowing Customers in financial difficulties can make their plight worse, writes **Leah Milner**

Borrowers have been urged to be wary of using costly short-term "bridging loans" if they are struggling to remortgage or they could be left stranded on a high rate and at risk of repossession.

The City watchdog this week fined Fastmoney, a bridging lender, £28,000 and banned its director and chief executive for not treating customers fairly.

The Financial Services Authority (FSA) is concerned that some brokers are misusing these loans, which were originally designed to help borrowers get access to money quickly when trapped in a property chain. On a bridging loan, brokers can earn double or treble the commission they might receive from a conventional mortgage, but as they are intended to be a short-term solution, the annual cost can be four times higher than a normal residential mortgage. The FSA fears that some brokers are using bridging for borrowers in payment difficulties, which could make their problems worse. It says that some brokers may be offering these loans as a short-term option for borrowers who cannot remortgage because they do not have enough equity in their homes, have a history of missed payments or no longer meet their lender's stricter new requirements. But these borrowers could end up stuck on a sky-high rate as they may still not qualify for a conventional mortgage when their bridging loan comes to an end, usually after 6 or 12 months.

The interest on a £150,000 home loan at 3.5 per cent — a typical rate from an ordinary high street mortgage lender — would be £5,250 over a year. A typical rate for a bridging lender is about 1.5 per cent a month, meaning that the total cost over a year for this example would be £27,000.

The cost of being trapped in a cycle of short-term finance can quickly mount because of the interest rate, but also because the loans usually come with a high arrangement fee, which can be as much as 2 per cent of the mortgage value — equivalent to £3,000 on a £150,000 mortgage. These lenders often charge an exit fee at the end of the bridging term, which can be up to 1 per cent — or £1,500 based on the same example. When the bridging term is up, the lender calls in the loan. It may be possible to arrange for the term to be extended or remortgage with another bridging lender, but this normally means paying another arrangement fee. The borrower in the above example would have paid £4,500 in arrangement and exit fees on the first loan, £27,000 in interest and, if he or she was unable to remortgage with a conventional lender, another £3,000 to arrange a new loan, which would also be at a high rate. This equates to a total spend of nearly £35,000 in just over a year.

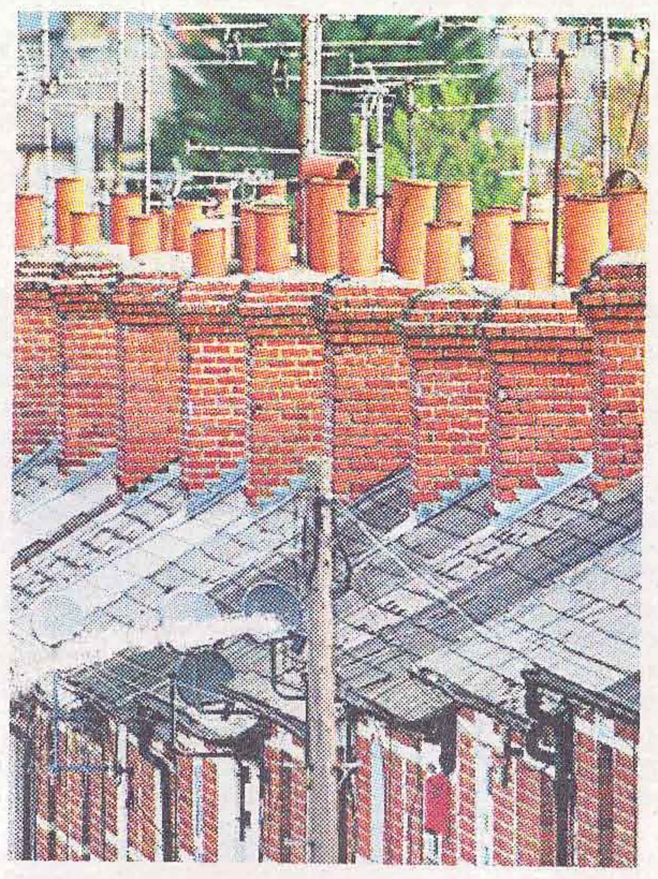
> **The pressure might cause some to create 'imaginative' solutions**

Often the interest payments are rolled up and taken off the value of the property at the end of the bridging deal, meaning that borrowers who already have little equity in their homes could be left much worse off — with debts higher than the value of their property.

Bridging loans have been booming at a time when other parts of the mortgage market have been subdued. One bridging lender, West One Loans, has forecast that the market will grow from £700 million last year to £1 billion by 2013. It says the growth is down to demand from property investors and lack of alternative funding on the high street, but the FSA has concerns that other factors could be driving this boom.

Speaking to brokers at a recent trade show, Sheila Nicoll, director of Conduct Policy at the FSA, said: "One repeated concern is that the current pressure might cause some to create solutions that might best be called 'imaginative'. To give an example, bridging loans have clear consumer benefits in unlocking property chains. But they are a far less likely answer for borrowers in payment difficulties and may simply put off the inevitable without any clear evidence that this is in the consumer's best interest."

Another reason the FSA is concerned about bridging is that some brokers may be doing deals in such a way as to avoid regulatory oversight. Bridging loans on properties that a borrower intends to live in themselves are covered by FSA regulations, but loans to companies or to buy-to-let landlords are not. The FSA says it suspects some brokers may be trying to arrange bridging loans for customers on their own homes by pretending that it is buy-to-let property.



Bridging loans can cost four times more than conventional mortgages

Fastmoney, based in Staffordshire, is the second bridging lender fined by the FSA for not treating customers fairly. In November last year Glasgow-based Bridging Loans Ltd was fined £42,000 for irresponsible lending and poor treatment of borrowers in arrears. The regulator said some of the borrowers already had a poor credit history when they took out the costly loans. The lender charged some customers the incorrect amount of interest and hit them with excessive fees.

Aaron Strutt, of Trinity Financial Group, the mortgage broker, says: "If you take out a bridging loan, it is important that you have a solid exit plan and you know how the bridge will be repaid." Mr Strutt says that he knows of one borrower — who was not a client of his company — who ran into difficulties after taking out a bridging loan on a buy-to-let property. The tenants stopped paying rent, leaving him unable to cover the interest on the bridging loan. The lender moved quickly to repossess the property and get their money back.

Ian Gray, of Largemortgageloans.com, says that even wealthy clients can get into difficulties with bridging loans.

Mr Gray says his company recently helped a self-employed TV producer earning £400,000 a year who was advised to take out a bridging loan by another broker. She bought a property in London worth £2 million from a relative at a discount, so that she paid only £1.3 million. The client was unable to find a high street mortgage lender willing to provide a loan for 100 per cent of the purchase price, so her broker arranged a bridging loan. The loan was charged at 1.5 per cent a month — or £19,500 — plus there was a £32,500 arrangement fee, but there was no clear exit strategy for the borrower. The bridging lender was threatening to charge a further £32,500 if the borrower did not repay the loan within a few weeks, but the original broker referred the case to largemortgageloans.com, which managed to arrange a much cheaper deal with a private bank in time to avoid this penalty.

> **With bridging loans it is important that you have a solid exit plan**

The Association of Mortgage Intermediaries, which represents brokers, says that advisers must recommend the most suitable product for clients and avoid "quick wins" which could put their customers at risk.

The Association of Short Term Lenders condemns anyone offering bridging loans in inappropriate circumstances, but does not believe the problem is widespread.