Episode 120

What is a self build mortgage? – with Thomas Honour of BuildStore

The show notes: www.houseplanninghelp.com/120

Intro: Perhaps you're someone who loves all the design part of building a house and thinking about what you could have, but maybe you haven't yet addressed your finances. Well, actually this is something we should investigate very early on!

Self build and traditional mortgages do have differences, so we're back at the National Self Build and Renovation Centre for this podcast, and talking to Thomas Honour from BuildStore.

I started by asking Thomas to explain a little bit about what he does.

Thomas: Yes, so my name's Tom. I work for BuildStore mortgage services. I'm one of the mortgage advisers there. We arrange all sorts of finance, ranging from new build homes, re-mortgages, buy to lets purchases.

We specialise in finance for projects, so self build, custom build, renovations, conversions. So my day job is to speak to people about how we can finance their projects.

Ben: I am in this position at the moment that it feels like my budget can float a bit, until I've found that plot of land and got a more detailed idea of what I'm building. So where do we start with knowing what we should access in terms of finances?

Thomas: Yeah, there's always this conundrum with self build finance in the fact that you don't know how much you need to borrow until you've found the plot, or what you're going to build on the plot. But you don't know what plot you can buy or what you can build until you know how much you can borrow. So there is a bit of to-ing and fro-ing.

But we would recommend that you come and speak to an expert within self build finance to ascertain your borrowing capacity and budgets that are available to you. We will look at things like your income and outgoings, and be able to give you a rough idea on the amount you could borrow, so you'd know that you're looking for plots and builds that are going to be plausible for you.

Ben: Let's go through an example then. Let's say I'm on the average salary in the UK, which I think was roughly about £25,000 a year, I've saved up £100,000 for my build and I want to know how much more am I going to be able to borrow, is sensible to borrow. Does that give you enough detail? What else would you like to know about me?

Thomas: Yes, so salary is probably the single most important thing because that's going to drive the amount of money that you can borrow.

There are other things that we need to put into the equation, such as your outgoings, so have you got any ongoing credit commitments, things like credit cards, bank loans, car finance and other things as well such as child care costs or any other significant outgoings. They'll be deducted along the way and then generally speaking most lenders apply an income multiplier, of somewhere between 4 and 4.25 times your joint household income.

Each lender is obviously very different. Some are a bit more generous than others and some treat income and outgoings in different ways. So for example, if you're someone that's in receipt of bonus or overtime or non-guaranteed allowances, some lenders are willing to consider all of that, other lenders may only take a percentage of it towards your affordability.

Ben: Can I ask the fundamental difference between a self build mortgage and a normal mortgage?

Thomas: Yes, so the main differences between a self build mortgage and a conventional mortgage are the way in which the funds are released.

So on a conventional mortgage, if you're purchasing a second hand property or a new build property, you'll get all of the money in one lump sum. Along with your deposit, you use that to purchase the property.

With self build mortgages the money is released in stages. There's two phases. The first phase is money released to help you purchase the plot. And the second is to help you fund the build of that. Typically you'd be looking at four to five stage release payments, which are released as the build progresses.

Ben: When we talk about stage payments, are there ever any difficulties because you get your money at a certain point and I'm sure it doesn't always work that that's the exact right amount of money, or is there a way of approaching this?

Thomas: Yes, it's a good question. There are two different types of self build products. The first one is a traditional self build product which provides the money in arrears of the stage being completed. So this is particularly useful for people that have got larger deposits or may own the land outright, because it keeps their cash flow positive. Basically it means that the client puts in their own money up front, and the lender gives the money in arrears once the work's been completed.

It can cause some cash flow difficulties, particularly with more modern types of construction – things like timber frame, structurally insulated panels, and insulated concrete forms, because quite often the manufacturer will want a larger chunk of money earlier on in the project, so the cost is borne quite early on.

So the second type of product which was designed by BuildStore to mitigate these cash flow difficulties is the accelerator product which gives the money in advance of each stage. So this gives the client the money upfront, payable to the builder before the works are completed to ensure that cash flow remains positive throughout and there's no negativity throughout the whole project and it can run smoothly.

Ben: What happens if our financial circumstances change? Do we still have access to this agreed amount?

Thomas: So once the application has been fully underwritten you'll be in receipt of a mortgage offer. And once that's signed and agreed, essentially that's the lender committing to giving you the funds.

Leading up to that point as part of the underwriting checks, we as your broker and a lender have got a duty of care to ensure that that mortgage is going to be affordable for you. So if we're aware of any pending changes then yeah, that might influence the lender's willingness to give you the money, and that's really just to protect the client from over-borrowing or over-stretching themselves.

Ben: When you see people come in and ask you questions, are they generally surprised about the amounts that they can and can't borrow, in terms of getting to the actual build?

Thomas: It's a bit of a mixed bag. Obviously some people have been through, we would speak to people that are first time buyers right through to people that may have mortgaged three or four times previously. So it just depends on how au fait they are with the process.

On the whole, I mean there are lenders that will lend similar amounts to lenders that lend more conventional mortgages. On the whole, again there are a number of lenders that might not lend quite as much as those conventional mortgages.

So, we do get a bit of a mixed bag, but that's why it's important to establish a budget, so early on to know exactly what your borrowing capacity is, so that you've not got your heart set on a particular plot or particular build to find out when you're quite heavily committed on that, that actually you can't afford it.

Ben: In the introduction you were saying that you also do re-mortgages. So is that when you're on a build and perhaps you've got to a stage where the money has got tighter again? What are your options then?

Thomas: Yes. So as your mortgage broker and the lender, both of us work together to ensure that your build costs are reasonable and they're going to be plausible for the type of project that you're doing.

We're not going to necessarily lend you £100,000 if you're planning on building a ten bedroom mansion. We do police those quite closely to make sure that your budget is realistic, that you can build what you say you're going to build to prevent the need for anyone to come back and have to borrow money mid-project, because if you do that you do need to reapply. Your application will need to be re-assessed and there's no guarantee that you'll get any further funds. Most importantly it's likely to include delays and those delays inevitably will be quite expensive for you.

So we do a lot of work upfront to make sure the amount you borrow upfront is going to be enough, including things such as contingencies and other costs that you may not have looked at. Of course there are times when we do our best to make sure that doesn't happen and there are some rare occasions when people do need to come back and borrow further funds, and that's what we'd normally call a further advance, or an additional advance where you can apply for further money, subject to underwriting from the lender to make sure that build can be completed. So it's not quite a re-mortgage, it's an additional loan.

Ben: What do we need to know about these mortgages in terms of setting it up, or is it again you've got to go through each one individually?

Thomas: Yeah, it varies from lender to lender. Like with most mortgages there will be costs to set up. Typically you'd be looking at an arrangement fee which most lenders will charge as standard on any type of mortgage these days.

Also a valuation fee. The valuation fee is a little bit different on a self build than it is to a conventional mortgage because they're not just going to value a house that's already built. On a self build instance they'll be valuing the plot, based on its value now and what you're paying for it. They'll also give an end value based on what you're planning on building and what they think it will be worth when it's completed.

And also a reinstatement value for site insurance purposes.

So, so far you've got an arrangement fee, a valuation fee, some lenders may charge other additional fees, things like booking fees, they're all quite similar but they name them differently. Our job as your broker is to make sure that you're aware of all those fees upfront so that you know what they are, what they cover, what you're paying for them and when they're due.

Ben: If we're someone who has say got a lot of investments or has money tied up, what can we do in terms of bridging the finance situation, and perhaps how can we get ourselves better prepared?

Thomas: Yeah, okay. I mean there is options for people to use a bridging facility which is often suitable for people that own an asset but may have a low income. They've got a house worth, I don't know, £500,000 but they might be on a pension income of just £10,000 and they want to borrow more than that £10,000 would allow them to do on a typical mortgage. So what we can potentially look at is bridging that finance, securing that against their existing home. That enables them to build their house. They can then move into that house, sell the old one and use that money to pay off the bridging facility.

Ben: What am I not thinking of in this conversation? You're the expert, what else do we need to be considering?

Thomas: One of the other contributory factors is construction types. So not all lenders will lend on all different types of construction. All of them will lend on your more traditional type, so masonry, sort of brick and block.

Ben: Why? Why is that?

Thomas: A lot of it is due to re-saleability. So being able to have, if you've got quite a weird and wonderful construction type, it might not be to everyone else's taste. So the lender's always thinking about are they going to get their money back, and if they had to take possession of that property, how easy is that property going to be to sell. So if you've got a property that's quite an acquired taste, the lender needs to take possession of that, they may struggle to get their money back. Whereas a more traditional looking building is not going to have too many issues in being sold on again, because obviously there's so many in the market already and typically if the buyer of that needed to obtain their own mortgage most lenders would lend on a masonry construction opposed to something that was non-standard.

Ben: If we have got something that's unusual, what are our options? How can we make this a nice easy run?

Thomas: The most important thing is that we can fund non-standard constructions. But non-standard means different things to different lenders. So it's just important that we can place it with a lender that can also lend you the amount that you want, in the area of the country that you're building, on top of the plot that you're building on.

So, some lenders will deem timber frame non-standard, a lot of them will deem that standard. Other more modern types of construction, things like steel frames, insulated concrete forms, structurally insulated panels. The good news is that more and more lenders are deeming that traditional now and are happy to lend against those construction types, but again not all lenders, so it's important that you check that with your mortgage broker to make sure that we can fund your project.

Ben: A lot of us are wanting to build energy efficient homes, Passivhaus homes, and I know there are certain mortgages that offer some benefits. So why is that, how do we get them? Is it exactly the same process?

Thomas: Yeah. There are lenders out there that will offer discounts for building energy efficient homes and there are other lenders that it doesn't matter how energy efficient it is, it's the same product that's out there all the time. So it's just down to the lender's preference and their outlook on what type of mortgage book they're trying to keep. And they're few and far between. There are one or two lenders that offer those discounts, but on the whole it's more down to if the client wants it to be eco-friendly and energy efficient rather than because the lender wants you to do it.

Ben: Let's go back a bit here and talk about those early stages of deposit. So let's say we come to you, we have our chat and we don't know when we're going to build our house. So how can we clarify this in our mind that maybe we need to go away and keep working on our deposit. How does this work?

Thomas: So with every mortgage you will need to put down and contribute a deposit from your own funds. So typically with most self build mortgages you can put down a minimum deposit of around about 10% of the overall project costs. Now that project cost is derived by the combined land cost and the build costs. So if you've got a land cost and you want £100,000 and build costs of £100,000, 10% of that, you know £200,000 altogether, you'd need to put down £20,000 of your own savings to meet the minimum requirements for that. The more deposit you can put down, the more favourable interest rates that would be available to you, and possibly more lenders.

There are also options for people that already own the land to use that as their contribution as a deposit. So if they own the land outright already, say a garden plot that's worth £50,000 as an example, that would be their £50,000 contribution as a deposit.

Ben: Do you find that many people actually are stopped in their tracks because of this deposit? Because you don't want to get into a nasty situation – you must have seen a few?

Thomas: Yeah, I think with all types of mortgages there are some people that aren't going to have the sufficient levels of deposit to buy the plot at that time.

There's lots of people that will come to us and they've found their dream plot and they know what they want to build on it. But at that moment in time they've just not got the required deposit to put down. But it's important that we would go through that process with a client because what we don't want then is them stretching themselves to just scrape together the deposit. But then there might be other unexpected costs they hadn't considered – things like stamp duty on the land, maybe architect's costs for design of the property, insuring the site. So site insurance and structural warranties are all costs they need to consider and we would rather decline someone up front and say we can't help you, than put them in a position where they've got a project they can't complete because there's not enough money.

Ben: Is there any advantage of almost having a gap, a pause between getting the land and moving onto the next stage? Because once you've started building, that's the risky bit again isn't it?

Thomas: Yeah. The lenders will underwrite the project up from day one. So they'll want to make sure that you've got enough deposit from day one from when you're applying for the mortgage. They won't rely on sort of money coming in to your bank account throughout the project, so they know the moment they release their funds to help you buy the land, you can simultaneously start the project and complete the project without any cash flow difficulties, so that's protecting the client and the lender from any risk there.

Most lenders will put in some sort of caveat that you must complete the build inside two years, which is quite a broad timescale. Most projects that we, people that we speak with are completing their projects within six to twelve months. So it does allow the option to potentially take a bit longer to complete the build and even have a small break in there if need be.

Ben: What else do we need to think about when we're financing a self build?

Thomas: It's important that the budgets are broken down in detail. So again we've talked about deposit, you need to have a minimum 10% deposit put towards the build and land costs, but there are other costs that you're going to need to consider. I touched on site insurance, structural warranties, things like contingencies as well.

It's important that every person we speak with sets out with the best interest to go out and bring the project in on budget and on time. The reality is that doesn't always happen. I'm sure we've all seen the TV programmes. It makes great telly when someone runs over budget, but it's not so good if it happens to yourself. So it's important that there is a buffer in there for any unexpected or hidden costs. Should they arise they can be covered - it doesn't bring the project to a halt.

Ben: Is that effectively what you're doing – working very closely with a budget? If I come to you, you're not going to be interested in speaking to me unless we can put together a budget?

Thomas: Yes, and the people will be at different stages of their planning, so we have some people that are coming to us very early on. They haven't found land, they don't know exactly what they want to build. They might have an idea on where they want to build and what sort of property, but at that early stage we can help the client, put our arm round them and say look this is the sort of budget that's plausible for you. These are the sorts of land costs that you can be looking at and what you can build based on your budget. So it gives them an idea on what they can build. They can go out to the market, search for plots. If they then find a plot that they like they can come back to us and we can put together a more detailed budget specific to that project and that plot to make sure that it's going to be plausible.

Ben: Can you talk a little bit about the services that you provide, and also we know Harvey we spoke to last time told us about the store, but we can also learn here too.

Thomas: Yes. So we are a mortgage broker. We specialise in finance for projects which is quite a complex, niche market. There aren't as many lenders that lend for self build as there is for a conventional mortgage.

And the lending criteria is quite complex. So it's important that you do speak with an industry expert to make sure that we get the application right for you and the budgets right and we can get the money that you need.

So we provide a fully advised service. Once we've assessed the client's need we'll be able to make a recommendation on the best way to fund the project for them.

We will also manage things like their stage release payments, so we're not just going to give them the mortgage and then send them off on their way. We hold their hand right through the process to make sure that not only does the builder get the money when they need it so that the project can run smoothly, they get the right amount, so the cash flow remains positive throughout the project as well.

Ben: And the courses here, is that some of the things they touch on?

Thomas: Yes. Yes, again so obviously there's courses here at the National Self Build and Renovation Centre. We do a session on the course about finance where we give people a kind of mini seminar on things they need to be considering at the early stages when financing. We touch on budgeting, we touch on cash flow, we touch on the products that are available and also some of the other costs, things like contingencies and insurances. By going with a broker like ourselves you have got that reassurance and peace of mind that we're going to be with you every step of the way and we're not just going to leave you out there on your own.

Ben: It's interesting that a lot of people that I speak to, they start their journey here, so it's clearly a good service that you're providing.

Thomas: Yes, BuildStore have had a base here since the centre opened. We've got advisers based permanently here in Swindon that are happy to speak to people that are just either early stages or are ready to pursue finance straight away. We also have coverage across the UK as well in other areas. So we've got people in most places across the UK to be able to speak to people locally.

Ben: And finally, just looking at self build in general, what do you think the biggest barriers are within finance?

Thomas: The biggest barriers are probably things like affordability at this moment in time. Since the mortgage market review which happened by the regulator a couple of years ago now, there's more of a burden on lenders to ensure they're lending responsibly.

So there are lots of rules and regulations in place to ensure that they are doing that which is right, they should be lending responsibly and we completely back that. But also some of their affordability criteria does limit the amount that people can borrow and they might not quite be able to borrow the amounts that they want, which means they need to put more deposit down and things like that.

Other things, like construction types. Again it's important just to make sure early on that we can lend against the construction types. The good news is that we can lend against every construction. We do also have particular products that complement certain construction types. The more modern types of construction where the cost is borne earlier on in the project – things like timber frame, insulated concrete forms, structurally insulated panels. The manufacturer quite often wants the money quite early which can cause cash flow difficulties for your project. So we have products, we've designed a specific product – the accelerator product – which provides money in advance, upfront to make sure the manufacturer can be paid and keeps the cash flow positive throughout the project.

Ben: Well Tom, thank you very much for this today. I hope I haven't been too rough around the edges. As you can see, finance is perhaps not a strength! I appreciate your time!

Thomas: No problem at all. It's a pleasure. Thank you.