Exploring the evolving landscape of alternative finance in 2023 and beyond

Opinions

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Specialist property finance has evolved rapidly in the past few years. And, as base rates began to rise in early 2022, the landscape of lending changed even further. Lenders' margins were squeezed, leading to increased costs and stricter stress testing. Lenders have had to adapt and innovate which has culminated in the launch of new products. In this article, we will explore the evolution of specialist finance and its future direction, including the importance of environmental, social, and governance (ESG) considerations.

Historically low interest rates contributed to a period of sustained growth in the property market. However, the current base rate, which stands at 4.00% (at the time of writing this article), is the highest it has been in 15 years, and with the majority of lenders' institutional funding lines linked to base rate and/or SONIA, this has introduced a new risk for lenders. As the base rate rises, lenders face the challenge of squeezed profits. This made it increasingly more difficult for lenders to offer competitive rates to borrowers.

All the while, the higher interest rates meant it has become less affordable to service bridging loans. Where some borrowers pay the interest owed on a monthly basis, with rates tracked against the base rate, when the base rate changes, this changes the interest owed by the borrower. Therefore lenders need to stress test affordability more stringently, and borrowers need to be assessed in the long term and to several base rate scenarios.

Lenders had to find the perfect balance to protect their business in the short, medium and long term but also continue to support borrowers. One solution lenders took was to move products onto a tracker rate, which was adopted early by some lenders, such as TAB. This approach protected the business and enabled it to continue to be liquid and support its borrowers and brokers alike.

More recently, we have also seen bridging become a solution to short-term stability to allow borrowers to realise their assets. With the cost of borrowing and long-term debt being more expensive than it has been for 15 years, by taking a slightly longer term on bridging, particularly when interest is deducted, borrowers can improve their short-term cash flow, and asset manage their properties. Many can buy time to allow for market stabilisation.

Furthermore, as lenders are adapting to market changes, some have reintroduced fixed rate products back into the market at lower LTV’s to mitigate risk. Sitting alongside tracker products, the two are designed to find that perfect balance for borrowers.

Looking forward to the rest of 2023, I expect to see that as base rates stabilise and property prices reach a reasonable level, yields will rebase themselves, and the market will have a greater understanding of where borrowing will max out and the capital requirement for borrowers will bottom out.

From a new product perspective, ESG considerations are becoming increasingly important in the specialist property finance sector and property in general. Coupled with the Government introducing new regulations to landlords and releasing more incentives to make ESG improvements to properties, I expect to see products designed to support this coming onto the market.

For example, borrowers will be able to borrow money to refurbish a property with a bridging loan which can then be refinanced with longer-term debt that is ESG-focused with interest rates that are more palatable for the borrower. This incentivises borrowers to invest in ESG changes and take cheaper money at the same time.

In conclusion, the evolution of specialist property finance is ongoing, and lenders must continue to adapt to changes in the market. With no crystal ball on what interest rates might do next, and with ESG considerations becoming more important, lenders must find innovative solutions to protect their business while continuing to support their borrowers. Bridging loans offer a short-term solution for borrowers to realise their assets and manage their properties, while longer-term debt can be ESG-focused to incentivise borrowers to invest in property sustainability. By embracing these changes, lenders can continue to support the growth of the property market and contribute to a more sustainable future and navigate the next challenge that might be around the corner.

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