

Flat broke

Rachael Charmbury, Chief Executive of Drydens, examines the issues facing lenders regarding city centre new build apartments

Good news is in short supply for owners and lenders on new build city centre apartments. The glut of properties on the market is sending prices plummeting with regular reports of properties being sold at 45% less (and falling) than the original purchase price. Supply has outstripped demand by some considerable way and potential purchasers and tenants are thin on the ground. A recent report showed that in Leeds more than 5,600 flats in the city centre are empty and similar voids are reported in Manchester, Birmingham, Hull and London.

Buy-to-let has attracted a lot of press interest and comment about the role that speculators and investors have played in creating the current market situation. Such is the extent of the problem that the Government is sponsoring research to see if investors are preventing first time buyers from entering the property market.

Government planning policy encourages the development of city centre flats. Evidence of this can be seen in our region by looking at the number of new build homes in Leeds over the past 13 years. Between 1995 and 2000 only 14% of new build homes were flats. Fast forward to 2003 and in the four years to 2007 some 72% of new homes were flats.

City centre living is not suited to everyone – first time buyers may be the primary target for new

build apartments but with reducing availability of mortgages available on this type of property and a growing need to have a deposit of at least 25% it is easy to see why there is a dearth of purchasers. Such is the loss of confidence in this sector that many lenders have withdrawn altogether and those that will still lend are demanding ever higher deposits.

So has the shine gone completely from the sparkling new city centre apartment, or is it simply tarnished and in need of a little care to nurse it back to its former self?

Arrears and repossessions

This is a market sector that has been hit hard in terms of arrears and repossessions. The priority for all lenders is to avoid repossession where there are no winners – this is not always possible as some customers simply have no ability to service the mortgage. The value of shortfalls being incurred on these types of properties is increasing at an alarming rate and whilst there may be some cases of professional negligence (over valuation, undisclosed incentives) the fact remains that with falling property prices the loss in the first instance is going to be borne by the lender. Ultimately of course the customer is liable for the loss but given that many lenders are still collecting out on shortfall losses incurred in

the recession of the 1990s it's plain to see the impact on

balance sheets that large numbers of these losses could bring. So what options could be of help to lenders?

LPA Receivers

If the property was bought on a buy-to-let basis an LPA Receiver could be appointed which if paying tenants are in situ can minimise losses through the receipt of the rental income pending the sale of the property.

Historically residential customers have raised issues in relation to sales at an under value and this point has recently been tested in *Bell v Long & Others*.

In this case a lender appointed Administrative Receivers over Dimple Properties which owned four similar properties relatively close together in Bolton. Having considered whether to sell the properties individually or as a single portfolio it was decided that the best offer was based on all four properties together. One of Dimple's directors claimed that the properties had been sold at undervalue, particularly given that the portfolio was later broken up by the purchaser and the individual units sold at a profit. The Courts found that the receivers had acted within their duty to "obtain the best price reasonably obtainable". Whilst there were

no new aspects to this case, it does serve as a reminder of the

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need to ensure that documentation supporting the sale price, marketing activity and offers received is properly and extensively maintained.

Portfolio sales

Placing repossessed properties in similar locations together into an investment portfolio is an option that we have explored in the past with several lenders in order to maximise the collective value received.

In some instances this involves a single lender with multiple properties of a similar nature, in other cases several lenders with single properties but in a similar location have grouped together to create an investment portfolio and minimise their collective losses. Of course there needs to be realistic investment opportunity to make the sale appealing but benefits include:

- Large cost savings on the part of the lender (no HIP, reduced marketing and legal costs)
- Speed of sale when selling to a commercial operator with a funding line
- The lender being able to remove a volume of properties from its possession holding stock

Assisted Voluntary Sales

Increased instances of arrears and higher balance shortfall cases are leading lenders to consider the use of Assisted Voluntary Sales (AVS) in a larger number of cases. The AVS process requires customer engagement and provides assistance in selling the property whilst the customer is still in occupation.

Using the AVS route can deliver a range of benefits to both the lender and the customer including:

- Litigation cost savings
- Improved sale price and control of the sale process
- Reduced risks such as deterioration, vandalism, squatters
- Early agreement on any shortfall

Management companies

Managing a portfolio of rental properties can be a real challenge, particularly where these have come to the lender as a result of repossession. Blocks of flats are proving particularly so – often common areas have fallen into disrepair due to neglect on the part of the management companies which makes the whole block unattractive to buyers. In addition, we are increasingly witnessing several instances of unreasonable charges being levied by management companies once they realise a property has been taken by the lender and rising ground rent charges/management fees due to low occupancy in blocks of flats/apartments. All of these issues add to the burden carried by lenders seeking a solution to the city centre new build predicament.

Fraud

There have been several high profile cases involving fraud and such is the concern amongst lenders that many have either pulled out of lending in this market altogether or are demanding bigger deposits, some as high as 50%. A recent case involving a “flipping” scheme on some 60 properties racked up losses said to be in excess of £700m and police are

also investigating fraud on mortgages valued at £40m in the Thamesmead area. As losses accelerate we envisage a number of other cases will be uncovered.

What does the future hold?

There is no doubt that the city centre flat has a place in the overall housing market but there are no short term fixes. Some lenders are looking to crystallize losses as quickly as possible potentially creating further downward pressure on prices by flooding the market. Others are looking at more innovative ways of holding onto properties and releasing these for sale in a more extended timeframe to minimise short term losses. Returning to some form of equilibrium between supply and demand is crucial but given the varying commercial objectives of lenders this could take some time.

If Government plans to create a further 3 million new homes by 2020 are to be achieved then this may be an opportunity for lenders to breathe life back into this sector if they can become more comfortable lending at more affordable LTVs on flats. Perhaps this could be achieved by a move back to case by case assessments during the underwriting process as surely there are customers out there who can afford mortgages but who cannot raise substantial deposits?

The difficulties facing lenders in this market are complex making it difficult to adopt a “one size fits all” strategy. Thinking outside the box is definitely required when it comes to minimising losses in this sector.

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