Uptick in SA commercial property sellers now turning to vendor loans

Fairly well known internationally, vendor loans (or vendor finance) are now growing in popularity in South Africa's commercial property markets, according to Gary Palmer, CEO of Paragon Lending Solutions.

Palmer says his team has seen an uptick in the number of companies and individuals who want to take advantage of property deals at the moment. However, not many have readily available cash and banks are still being very conservative, with many reducing their loan to values. This has resulted in many sellers choosing to finance a portion of the purchase price themselves, referred to as vendor loans.

Gary Palmer, CEO of Paragon Lending Solutions

Palmer says for property owners who need to access liquidity quickly, but don't want to sacrifice the full price - which would almost certainly be the case in the current climate - these vendor loans make excellent sense.

"We saw a great example of this recently," explains Palmer. "A client of ours wanted to sell a shopping centre, and were looking for R30m. But, they were prepared to leave R9m in the deal, which they offered to finance, almost interest-free, over two to three years. Paragon assisted the buyer with the bond finance for the balance and then the buyer contracted with the seller to make up the full asking price. This worked well for the seller as they sold the property for asking price and the buyer was able to secure finance they would otherwise not have access to."

Check the fine print

Anything that is new can elicit concern in the minds of buyers. Palmer says, as with all deals, buyers should look carefully at the terms of the deal. This is especially the case when it comes to what security is required, bearing in mind they would have had to already put up security for the initial bank bond.

He advises that banks should be made aware of the vendor loan, warning, however, that some may resist the notion of a second bond. From the vendors' side, some are choosing to protect their interests by taking equity in the new venture.

Buyers should be aware that interest rates may also change over time, so they must analyse the structure of the deal and be sure they are satisfied. Buyers should concentrate on the value of the property, not the deal offered by the vendor. The decision must be made on the fundamentals. Buyers should ask if it's a good property deal, not if it's a good finance deal.

Vendor loans are enabling property transactions which is good for the market. These loans suit the vendor because they are getting the price they are looking for. It suits buyers because the vendor is leaving money in the deal.

However, should the markets not show adequate recovery, some buyers could be left unable to repay their vendor loans when it becomes due and payable. This could end up in litigation between vendor and buyer and the banks could see themselves dragged into litigation, making them less inclined to support these deals. Palmer warns that buyers should be certain they can service the deal and suggests running cash flow models to be sure both the bank and the vendor can be serviced and settled on due date.

Invest sufficient equity into the deal

It’s also important for buyers to invest sufficient equity into the deal or they risk being unable to refinance the property in order to settle the loan at the end of the term.

The problem with this structure is that if the buyer doesn't put in sufficient equity into the transaction themselves, there is a risk that at the end of two years or three years, when the vendor loan is due, that the refinancing of the property won't be enough to settle the loan.

Palmer also cautions that choosing the best means to finance property at the moment takes some insight.

“The local property market now consists of upwards of 25 sectors and sub-sectors, each behaving differently, during different parts of the property cycle. Trends specific to each sector, like the co-working office space, for example, influence what financial product is best. Even residential property is divided into four classes. So, if you want to get into the property market, you must be clear about what it is you want. The sensible course is to speak to an independent lending specialist to help you understand your options as well connect you to the best products and partners,” Palmer advises.