Brickflow **Property Developer Guides**

Capital Stack

Defined

The Capital Stack is the structure of your development finance, or the different layers that fund a scheme. The typical stack has three layers, and normally includes senior debt, mezzanine debt and equity. Strategically determining the best capital stack for your project allows you to minimise your equity investment and maximise your profits.

Need to know

- Debts are repaid from the bottom up, so the higher up the lender, the bigger the risk they incur and the more expensive the debt
- Equity is always at the top of the stack, followed by mezzanine or 2nd charge, with senior lending (1st charge) at the bottom
- Lenders will want visibility of your capital stack to see where they fit in your hierarchy of funding
- This lets them determine the potential ROI vs. level of risk.

In practice

- Not all lenders require a big deposit, so don't always default to your trusted lender, and shop the market to keep your equity longer
- Deposit requirements range from 10-20%, so for a development with costs of £10m, a deposit could vary by £100k, creating a huge opportunity cost from lost equity if your loan deposit is at the higher end
- When a lender requests a large deposit, an obvious route is to secure an investor on a profit share basis, but this can prove a false economy
- Experiment with different loan structures to avoid hefty profit share payments. Here's an example:
  - Developer X borrows at 5%, but needs to put down £800k of equity
  - Developer X only has £400k, so secures £400k from an investor
  - 12 months later, the scheme completes and he pays the 5% interest and gives the investor 40% profit
  - On the same project, Developer Y finds an alternative lender and borrows at 7.5%. The rate is higher, but he can borrow £400K more
  - Developer Y pockets all the profit and still has £400K to invest in his next scheme
- Within 18 months, Developer Y uses his retained equity and additional profit to complete on a second scheme

brickflow.com | 0203 488 1674 | @brickflow