

# Peer-to-Peer Commercial Property Lending

Why Commercial Real Estate Debt is the Perfect Partner for P2P Lending

LENDIT EUROPE 2015



**Peer-to-Peer Lending**, also known as Loan Based Crowdfunding, is the process of connecting investors directly to borrowers, circumventing traditional banks and financial institutions. This new asset class offers diversification and attractive yields to investors in this long term low interest rate environment.

Peer-to-Peer lending has undoubtedly revolutionised the traditional banking and lending industries. Adoption of new technology and the ability to draw and process information quickly, it has left the traditional finance sector napping.

At Proplend, we continuously apply the latest technologies adopting them alongside traditional lending models to make our offering as efficient, transparent and inclusive as possible.

The number of P2P Lending platforms continues to rise and choosing which one to invest through can be a difficult task.

Why is commercial real estate debt the perfect partner for P2P lending?

**It provides a well documented income stream plus downside capital protection from the security.**

What will your investment will be secured by? **A income producing commercial property with a Tenant on a FRI (Full Repairing and Insuring) Lease.**

How will you will be paid monthly interest? **Rental Income from the Property.**

How will your investment will be repaid at the end of the term of the loan? **A property can be sold or refinanced.**

It's simple. Commercial Property Peer-to-Peer Lending platforms are potentially one of the safest and should not to be ignored.

**Commercial Real Estate Debt** (CRE Debt) has a long history as an investment category in institutional investors portfolios, but in the UK, CRE finance has been predominantly offered to borrowers by commercial Banks who retained it on their balance sheets.

At its simplest, CRE Debt is an investment secured on a commercial property, comprising an agreement between the borrower and the lender, in which the borrower makes periodic payments to the lender and then repays the loan in full at the contractual maturity.

Since the financial crisis, banks, for a variety of reasons (regulation affecting capital ratio requirements, leverage ratio limitations & legacy asset concentration) have vacated the market they used to dominate. Most notably in the sub £5m commercial investment loan sector.

This has left many credit-worthy, successful Borrowers struggling to find suitable sources of capital in order to re-finance existing loans and this is where P2P Property lending has found its niche market.

There is approximately **£200 billion** of outstanding CRE debt in the UK. **25%** of which is in the sub £5m sector and requires re-financing within the next 2-5 years.

Lending for commercial property in the UK has traditionally been dominated by banks, which accounted for c.90% of the market. At the height of the market, in the run up to 2007, there were 55-60 banks, building societies and financial institutions actively servicing this market. Today there are only around 10 - 12. There is a clear dislocation in the supply and demand of funding available and required.

Following the financial crisis, banks have increasingly withdrawn from commercial lending due to several factors:

- Stricter capital requirements
- Deleveraging of balance sheets
- Higher funding costs

The effect of this funding shortfall is an increase in the premiums that property investors are prepared to pay for commercial property loans, which is an opportunity for cash rich, income starved investors.

By effectively crowdfunding the commercial property loan requirement, borrowers gain access to funding otherwise not currently available and investors gain access to low risk, fixed income producing opportunities.

The main benefit of P2P lending against commercial real estate debt is **Security**.

Unlike Consumer or SME Lending, every CRE loan is supported by a 1st legal charge over an income producing commercial property. The value of the property (which is determined by a professional, independent valuation) is higher than the loan amount, and the net rental income generated by the property is greater than the debt service requirement.

Tenants in a commercial property sign up to a FRI Lease which can last from between 3 to 25 years. This provides a well documented cash flow showing the level of rent being paid, how frequently it is being paid, how long it will be paid for, when and how much the rental uplifts will be and when there are any breaks, either from the tenant or the landlord.

When comparing CRE P2P Lending to more traditional investments we learn P2P offers:

- Fixed income returns are exceeding quality corporate bonds
- Better capital protection than equity and corporate bonds
- Lower volatility than equity and balanced property
- A clear legal framework in the UK offers a low probability of default along with high recovery rates
- Diversification away from traditional asset classes
- Better risk adjusted returns than offered by consumer and SME lending platforms

Proplend Investor Benefits	
	Security – 1st legal charge
	The Proplend Loan Tranche
	Transparency – loan details are listed on the platform
	Tax-free Income – via a SIPP or SSAS
	Experienced Management Team

At Proplend, we believe CRE debt is the perfect partner for P2P lending. It has allowed us to offer our investors the opportunity to construct a loan portfolio based around their specific investment parameters, such as:

1. Asset type (office, retail, industrial, leisure, residential)
2. Geographic location (city, regional, primary or secondary)
3. Tenant type (multi / single)
4. Risk parameters and Investment return
5. Loan term
6. Investment amount (subject to min £5,000)

With the introduction of the **Proplend Loan Tranche**, investors with differing risk parameters and return requirements are given the opportunity to invest in the same loan alongside one another. The Proplend Loan Tranche splits the Loan in up to three Loan-to-Value (LTV) based tranches.

In developing this model, Proplend believes that our **Tranche A** investment level is one of the **safest P2P loan investments** on the market, with **200% capital protection** (via the 1<sup>st</sup> legal charge) plus **6 months of retained interest**.

## The Proplend Loan Tranche

A £1m property is financed by a £750,000 loan at an interest rate of 6.5% p.a.

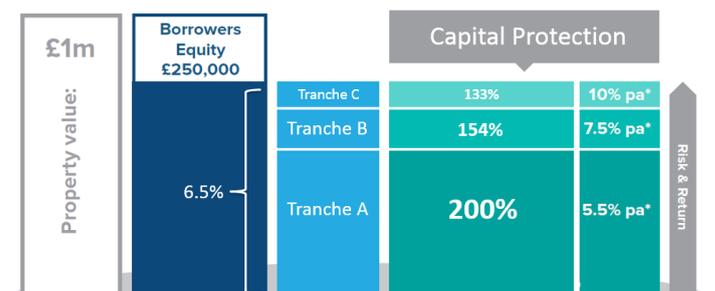
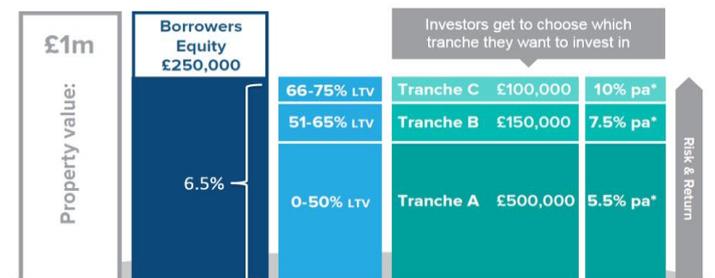
The Loan requirement is split across the fixed loan to value based tranches. The 6.5% rate paid by the borrower is split across the three tranches with Tranche C paying the most and Tranche A the least interest, investors get to choose which tranche they wish to invest into.

Tranche C offers **133% capital protection**. The property would have to fall in value by 25% before the investment is at risk.

Tranche A offers **200% capital protection**. The property would have to fall in value by over 50% before the investment is at risk.

The higher up the LTV you invest, the greater the risk but the greater the return.

By investing into Tranche A, Proplend believes that we have created the safest P2P loan investment on a risk adjusted return basis. Excellent capital protection plus an attractive return on capital.



CRE debt is not immune to market value declines, which could alter investment returns. However, the ability of commercial property debt to absorb significant property market volatility helps make this a stable, predictable and attractive investment class.

All investments come with risks, but having the security of a 1<sup>st</sup> legal charge over the property in addition to a rental income stream helps make CRE lending an attractive and sustainable P2P loan investment.

## How Proplend Mitigates Risk

### Fall in property income

- Loan amounts and terms will be determined by the quality of the tenants and occupancy terms, with resulting income protection features such as lower initial loan amounts and interest cover covenants.
- Proplend retains 6 months worth of interest to cover vacancies or borrower default.

### Fall in property value

- In a 75% LTV loan, investors in Tranche C have a minimum cushion of a 25% fall in property value. Tranches A and B offer a greater cushion.
- Post crisis drops in property values of 30-40%, without a full recovery, make a further significant drop less likely.
- Significant drops in value increase the percentage of income relative to value, this then provides attractive yield returns for distressed asset managers.

### Lack of suitable investment opportunities

- Given the size of the outstanding funding gap, especially in the sub £5m loan sector and the lack of market participants, investors should be able to benefit from current market conditions.

### Illiquidity

- Investors should expect that any loan they enter into will remain outstanding for the term of that loan.
- Investors are being paid an illiquidity premium.
- The Proplend Loan Exchange offers a secondary market for investors who wish to sell a loan part prior to the end of the loan term. It cannot, however, guarantee a buyer for that loan part will be found or the price that the loan part may sell for.

### Prepayment

- Loan terms will include prepayment protection in the form of penalties, these will be agreed on a loan by loan basis and be transparent to investors.

### Loan default

- In the case of a Loan default, Proplend Security Limited, who enters into the Security Documentation with the Borrower, will commence recovery of the debt due under that Security package.

The UK remains an attractive investment destination, with a high and stable commercial real estate risk-return profile, aided by a liquid, transparent marketplace, a creditor-friendly jurisdiction, and a well understood legal framework.

Asset prices are at sustainable levels and broad market return forecasts are favourable.

CRE Peer-to-Peer Lending provides a strategic opportunity for a medium term investment, and offers diversification benefits for a traditional investors portfolio.

Proplend's mission is to open up the institutional asset class of commercial real estate loan syndication for the sub-£5m loan sector directly to a wider range of investors in a simple and transparent way.

Brian Bartaby  
Founder & CEO Proplend Ltd

## Contact Details:

Brian Bartaby – Founder & CEO

[bb@proplend.com](mailto:bb@proplend.com)

Benjamin Butterworth – Head of Lender Relations

[bbutterworth@proplend.com](mailto:bbutterworth@proplend.com)

Office

+44 (0) 203 397 8290

Resources: Savills Property Finance Report 2014

## DISCLAIMER

Proplend operates a peer to peer lending platform specialising in commercial property loans supported by first charge mortgages. Whilst loan investments are secured against property, capital is still at risk and therefore Proplend lenders face the possibility of losing money. Investments in commercial loans are long term in nature and may not readily be realisable.

Proplend Ltd is incorporated in England and Wales registered number 08315922, registered address 145-157 St John Street, London EC1V 4PW. Proplend Ltd is authorised and regulated by the Financial Conduct Authority (firm registration no. 662661). Lenders on Proplend and other P2P platforms are not covered by the Financial Service Compensation Scheme.

If you are in any doubt as to whether lending on Proplend is suitable for you, we recommend that you seek independent financial advice.