Innovative lenders are leading the field when it comes to returns
GETTY IMAGES

INVESTMENT

Lending to strangers is still a good deal, despite the risks

Peer-to-peer is prospering, but there are still some concerns

Carol Lewis

Saturday January 21 2017, 12.01am, The Times

The peer-to-peer sector is booming. According to the Peer-to-Peer Finance Association, more than £800 million of new loans invested through the eight largest platforms in the last three months of 2016 brought the total invested last year to a record £3 billion.

However, storm clouds are gathering after an auditor for Wellesley, one of the fastest-growing alternative finance platforms, said it would need a cash injection to survive. The Peer-to-Peer Finance Association, a self-regulatory body for the sector, estimates that 16 peer-to-peer platforms have closed, although few investors have lost money. The Financial Conduct Authority (FCA), the market watchdog, says it will strengthen regulation this year to protect peer-to-peer investors.

The peer-to-peer industry in the UK is relatively young, but investments have been growing since 2011. More than £7 billion has been invested through the eight largest platforms in the UK.

In peer-to-peer lending — also known as debt crowdfunding — individuals lend money to other individuals or businesses at a fixed rate of interest. There is usually a formal structure to the debt repayment plan and a fixed return. Investors can often sell their debt to other investors and exit the plan. Neil Faulkner, the founder and managing director of 4thWay, a peer-to-peer analyst, says: “On average the market is in great shape; default rates, late payments and write-offs are very low. The interest rates on loans are gradually coming down, but on the whole investors are still getting some very good deals.”

4thWay has awarded six peer-to-peer lending platforms — Funding Circle, Landbay, Lending Works, Proplend, RateSetter and Zopa — a PLUS Rating, which is based on international banking stress tests and its own risk scores. Each of the platforms have shown zero or low levels of late payments and defaults, and four have provision funds, or insurance, to cover investors (Landbay, Lending Works, RateSetter and Zopa). The six offer interest rates, before bad debts, of between 3 per cent and 18 per cent.

According to 4thWay, the lowest-risk peer-to-peer lenders are Landbay, which specialises in residential buy-to-let secured mortgages, and Proplend, which specialises in commercial buy-to-let secured mortages.

Although investment via peer-to-peer platforms is not covered by the Financial Services Compensation Scheme, it is regulated by the FCA. Compensation for defaulted loans is provided through reserve funds from some lenders.

Yet, there are pitfalls. Investors were this week advised to sell their loans in Wellesley after BDO, the accountancy firm, issued a caution about funds. The auditor said Wellesley was "dependent on raising further capital to continue to operate for 12 months". Mr Faulkner believes that investors should sell their loans because of concerns about the running of the company, and its investments.

Wellesley has arranged £366 million in property loans since it was founded three years ago by Graham Wellesley, 8th Earl Cowley. It has just under 17,000 investors who have each invested about £15,000. Over the past year the default rate on its loans was 1.8 per cent, against an expected 1 per cent. However, it says it has covered all losses from its own funds with no loss of income to investors. Wellesley says investors can expect a return of about 2.25 per cent on its peer-to-peer loans.

> "
> ## In only two cases was there evidence that investors made losses

Andrew Turnbull, the co-founder of Wellesley, says: "Investors could request that their investments be made available for sale to other Wellesley customers, or bought back by Wellesley. In either situation, it is necessary for there to be either sufficient buyer demand, or adequate company liquidity. To date we have consented to all early access requests."

He added that if the company were to fail, "Peer-to-peer and listed bond investors' funds are secured by legal charge over property. Mini- bond investors [who have invested £30 million in Wellesley] have recourse to the assets of the company."

According to Wellesley's website, it has 100 loans valued at £228 million against a security of £344.68 million. It also says that Wellesley has covered all losses to date, a total of £4.3 million.

Mr Turnbull says: "Our auditor's comments were made before we had completed our strategic restructuring programme, which has resulted in our business having a higher capital base, higher profitability and a lower risk profile today. The business traded profitably through the second half of 2016 and ended the year with a positive net asset value in excess of £1 million. It has seen an 8 per cent increase in its loan book, and following its restructuring initiative, it does not need to raise capital to deliver its intended strategy for 2017-18."

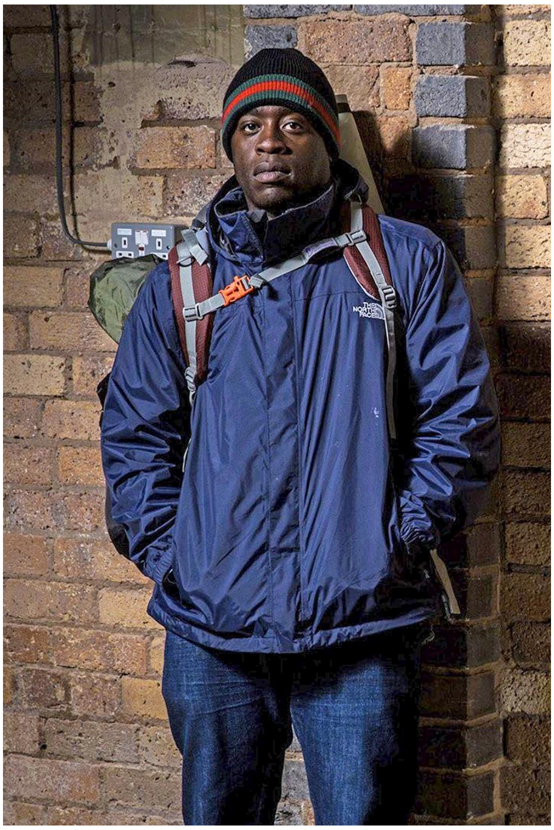
However, Mr Faulkner says: "While Wellesley might prove itself over the next year or two, its interest rates are very low and investors have knowledge gaps regarding the performance of its loans, its business and its company accounts." Wellesley is small in comparison to some of the more established peer-to-peer lenders: Zopa's total cumulative lending up until the end of 2016 is £1.9 billion; Funding Circle's is £1.8 billion, and RateSetter's is £1.6 billion.

The Peer-to-Peer Finance Association, which aims to "promote high standards of conduct and consumer protection," says Wellesley "withdrew its membership in 2014".

Robert Pettigrew, the director of the association, says: "Whilst peer-to-peer lending is a relatively new phenomenon, some less profitable platforms have ceased operations, while others have consolidated. Between 2011 and 2016, 16 platforms closed their UK operations. The reasons for exit include failing to develop effective credit risk assessments; failing to develop an effective business model for reaching the market for borrowers and investors; acquisition by a competitor; and, in one case, concerns about possible misconduct. In only two cases was there evidence that investors may have made losses on their investments."

He adds: "As platforms remain in a growth phase, operating costs recorded in recent accounts do not provide a good indicator of ongoing operating costs, due to investment in growth. However peer-to-peer lending appears to be a relatively cost-efficient form of financial intermediation."

The FCA warned last year that the industry was benefiting from regulatory loopholes and exposing investors to undue risks. This year it plans to introduce more stringent rules to protect investors. It says that it is going to consult on new rules to "strengthen wind-down plans" and "extending mortgage-lending standards" to those platforms offering mortgage loans.



Ayo Adesina, one of the winners of Hunted, invested his prize money through the lending platform Kuflink

'If anything goes wrong, we have a fallback'

Ayo Adesina clearly has an appetite for risk. The IT contractor from Romford, in Essex, dodged a team of hunters led by a trained sniper and armed with sniffer dogs to become one of the winning fugitives in the latest series of *Hunted*, a Channel 4 reality show.

Mr Adesina banked £50,000 in prize money and invested the majority in property through Kuflink, the new peer-to-peer lending platform. Mr Adesina, 33, who has also appeared on BBC 1's *Caught Red Handed* and Channel 4's *The Family*, says: "I don't know anything about shares, but knew I wanted to invest the money. Kuflink appealed because the loan is secured against property, so I knew if anything went wrong we had the asset to fall back on."

He didn't want to buy property directly. "I have a couple of properties, including a buy-to-let, but it is a fair amount of work, so I didn't want to take on more." After doing some research Mr Adesina decided to invest £30,000 in a restaurant in Richmond, southwest London. He receives monthly interest payments on the loan. His investment is for seven months with an annual return rate of 7 per cent gross.

"I was attracted by the fact that Kuflink puts 20 per cent of its own money into the investment. Also I saw that it hadn't had any defaults," he says.

Kuflink started trading in August and has invested £500,000 in residential and commercial property through 318 lenders, each with an average investment of £17,000. The company retains 20 per cent of each deal, through Kuflink Bridging, its sister company, and offers 80 per cent to investors.