

The **Property Loan Note**

Updated for Off Plan Investments



An Outline from the Head of The Route – Property

The UK's housing stock is now worth over £6 trillion, with the rental sector alone worth over £1 trillion (Savills, 2016). My view is that Buy-to-let property, which remains one of the most stable generators of income in UK, coupled with the potential for capital appreciation, will enjoy continued growth as the economy stabilises, and due to the chronic lack of new housing supply across the country. Accumulating sufficient money for a deposit to purchase a property, particularly for first-time buyers, is driving demand to the private rented sector, with around 1.1 million renters expected to add to the market between 2016 and 2020.

Whilst the political and economic landscape has been unstable, following Britain's exit from the European Union, as well as, more recently, the Trump victory in the US, there has been a sustained and strong purchase appetite for well sourced northern properties, as it continues to provide the highest yields nationally, with rental demand outstripping supply. Since the launch of The Route – Property's Property Portfolio Service (PPS) in August 2014, there has been a strong demand for investment properties from its Members – over 250 individual units were purchased in the first two years, with an aggregate purchase value of over £15m. Demand for northern property is expected to increase significantly, as institutional investors, particularly from Asia, are beginning to enter this market in a bid to secure stock.

I believe that The Route – Property has amongst the strongest deal flow available, for competitively priced and high yielding UK property stock. With the pipeline expected to remain healthy for some time yet, it will continue to deliver its market leading investment proposition with the aim, in the very near term, to provide a facility that will allow investments from tax efficient wrappers, such as ISAs, Junior ISAs, offshore bonds and other mainstream fund structures.

Up until 2017, it was only possible to access PPS using cash, despite the considerable demand from Members to use money that is held in their pensions. The Route – Property has now developed a simple, SIPP approved, solution – The Property Loan Note – which allows Members to utilise these monies to invest in this asset class, using the same proven research methods, due diligence process, expertise and investment approach. We successfully launched 2 issues in 2017, investing £4mm for Members.

The Route – Property

About The Route – Property

The Route – Property, which is a trading style of Route Mortgages Limited (established in 2002), originally focused on advising on UK and international property acquisitions, financing and Stamp Duty tax planning. Since 2014, due to the demand from its Members for stable yield, coupled with the potential for capital appreciation, it has specialised in the sourcing, acquisition and management of residential properties, targeting an aggregate total annual return of 15%. Its objectives are to:

- Provide a well constructed property investment opportunity that significantly reduces the risk, time and hassle involved with traditional Buy-to-Let purchasing; and
- Produce reliable returns based on a combination of a robust investment strategy and a proven track record.

In order to allow Members to utilise their pensions, via a SIPP, to access this strategy, The Route – Property has established The Property Loan, which is a Loan Note that is made to a Special Purpose Vehicle (SPV), a UK Limited Company called The Property Loan Company Limited (“The Company”). Quite simply, the loan note has been created to replicate this proven model, in order to take advantage of the property sourcing connections and strong deal flow, primarily in the North of England



Summary of the strategy

The Route – **Property** and its joint venture partners review the market place for ‘**Distressed sale**’ and ‘**Off Plan**’ purchases in the UK, normally in the North of England, via an agreement with a major UK High Street banking group.

The strategy is to:

- ① Initially, buy, then renovate or develop, followed by renting and finally, sell the properties within a two year period; and
- ② Repeat this process, whilst sound investment opportunities continue to be available.

The properties are purchased in areas with strong rental demand and anticipated ease of sale.

The targeted aggregate total return for lenders is 50%, net of all costs, over the five year term, which equates to 10% per annum (pa). This is made up of a:

- 7% pa coupon from the rental; plus
- A 3% bonus coupon from each of five property sales during the term.

If two sales are achieved within the five year term, which The Route – Property considers as being a conservative expectation, the aggregate total return will be 41%, which is 8.2% pa. If eight sales are achieved, which is towards the top end of the expectation, the aggregate total return will be 59%, which is 11.8% pa. The table on page 5 provides a breakdown of the expected range of returns.

Whilst the intended term is five years, there may be a secondary market for these loans. If a buyer can be sourced to purchase your loan, The Company will assist to facilitate this transaction.

An assumption of both 1) Nil house price growth; and 2) Nil rental inflation, for the term of the investment has been used – the actual growth in these regions averages around 3% and 5% each year, respectively.

The fee structure is aligned with the lenders’ interests, in that all parties involved are incentivised to produce the highest possible return on the initial investment. Also, once each property is sold, the Lenders will receive their bonus coupons before The Route – Property receives any residual profits from The Company.

Expectations

A strong pipeline of properties exists as:

- Property repossession continues to occur at a reasonably high rate in the regions identified;
- Banks that previously retained the larger scale repossessed blocks, following the financial crisis of 2007, are now releasing these onto the market; and
- Property demand continues to outstrip supply and so developers are supplying 'New build' properties to the market to satisfy this shortfall.
- Various new 'Exit' opportunities will become available, as the post-Brexit depreciation of sterling has made the relative purchase cost of UK assets, for foreign buyers, noticeably lower. There is a very strong demand from, in particular, Asian investors.
- Demand for high yielding, discounted properties will continue as the low interest rate environment continues to support and encourage investors
- Off Plan developments provide an alternative opportunity to invest in entire blocks with freeholds which are in demand from institutional buyers. A guaranteed yield is paid by the developer during the build phase, before a 'Corporate Let' commences at build completion.

Expectation	Number of sales achieved	Total of the 7% pa regular coupons	Total of the 3% bonus coupons	Aggregate total return	Annualised return	Total return if £100k invested	Total return if £250k invested	Total return if £500k invested
Low	0	35%	0%	35%	7.0%	£135,000	£337,500	£675,000
	1	35%	3%	38%	7.6%	£138,000	£345,000	£690,000
	2	35%	6%	41%	8.2%	£141,000	£352,500	£705,000
	3	35%	9%	44%	8.8%	£144,000	£360,000	£720,000
Mid	4	35%	12%	47%	9.4%	£147,000	£367,500	£735,000
	5	35%	15%	50%	10.0%	£150,000	£375,000	£750,000
	6	35%	18%	53%	10.6%	£153,000	£382,500	£765,000
High	7	35%	21%	56%	11.2%	£156,000	£390,000	£780,000
	8	35%	24%	59%	11.8%	£159,000	£397,500	£795,000
	9	35%	27%	62%	12.4%	£162,000	£405,000	£810,000
	10	35%	30%	65%	13.0%	£165,000	£412,500	£825,000

The Investment Process

Step 1 – Property sourcing

Banks will typically look to recoup the equity tied up in repossessed properties through one of the three channels outlined below:

Channel to sale	Percentage of all repossessed stock sold*	Typical purchase price relative to market value	Typical purchaser	Completion restrictions
Estate agent	33.33%	90%	Retail investors	Properties are usually sold within three months and there is some flexibility around the speed of sale
Auction house	33.33%	80%	Retail and professional investors	Completion must occur within 28 days of the auction date
Wholesale agent	33.33%	65%	Professional investors	The wholesale agent must commit to purchase the required property stock within three days of its release by the bank

*This split varies depending on the prevailing market conditions

- ① Having researched the market, and eliminated all unsuitable property introducers, The Route – Property has a contract in place with a wholesale agent based in the North of England, as the level of discount sought is simply not available in the south of the country.
- ② Once the agent has legally exchanged on the purchase of a property, it will typically carry out any necessary refurbishment work before The Company will acquire it.
- ③ The properties sought are one and two bedroom flats, within selected regions, with the criteria of strong rental demand and expected ease of sale being paramount.
- ④ A list of 200 to 300 properties becomes available each month from the bank and other sources, which, after thorough due diligence, the agent reduces to a shortlist of between six to ten individual flats, plus one to three larger scale, part developed and/or new build opportunities, usually made up of 20 to 50 units each. Therefore, there can be up to 160 units available in any single month containing good rounds of sourcing, but more commonly 50 to 100 per month.
- ⑤ The agent typically purchases 1 bedroom flats for around £46,000 and 2 bedroom flats for around £50,000, excluding costs. These prices can vary from property to property.
- ⑥ An ‘Acquisitions team’, on behalf of the agent, conducts an initial desktop appraisal of all of the properties on the list. Once a shortlist has been agreed, viewings and basic surveys are conducted in order to assess:-
 - The potential to both re-sell and rent;
 - The quality of the surrounding area;
 - The credibility of the company managing the buildings & communal areas; and finally
 - The typical demographics of tenants residing in the development.
- ⑦ After the properties have been appraised, the acquisitions manager confirms with the agent which properties are to be purchased. If there is any uncertainty, a property can be re-visited with the agent and a more detailed review conducted. Due to the time constraints involved, the agent must purchase all properties and developments with cash i.e. no mortgage finance can be used. Upon selection of the properties, all legal documentation is reviewed by a solicitor to ensure there are no abnormalities within both the legal titles and leases, before the purchase can proceed.

The Company’s strategy is to purchase an entire block, or a part of it as funds allow, in order to minimise the administration and costs involved with a more fragmented portfolio. The ‘sale’ of a property therefore also refers to other properties purchased in the same block and/or on the same day.

Step 2 - Renovation

Upon completion of the purchase, the agent will instruct a maintenance company to complete a basic renovation of each property. Typically, work undertaken includes re-decoration, re-carpeting, installing new white goods and ensuring the water tanks and boilers are operational and serviced, and that the respective compliance certificates are available. Finally, any remaining snagging issues are dealt with and a maintenance warranty is provided to cover all internal maintenance works.

The typical turnaround time for each renovation is 7 to 10 days, with two men working on each flat. The cost is usually in the region of £4k, with up to a 50% variance between properties.

The agent's typical cost base

	1 BEDROOM FLAT	2 BEDROOM FLAT
Bank's sale price	£46,000	£50,000
Legal fees to purchase	£1,000	£1,000
Stamp duty	£1,380	£1,500
Bank fee	£1,200	£1,200
Renovation costs	£3,600	£4,500
Legal fees to sell	£800	£800
Fee charged*	£6,000	£6,000
TOTAL	£59,980	£65,000

*50% of this is paid to The Route – Property

Step 3 – The Property Loan Company Limited purchases the properties

Upon completion of the renovation, the agent is instructed to re-sell the properties promptly in order to ensure that capital is available to purchase the next round of properties during the following month. For cash flow purposes, it is therefore not in the agent's interest to retain the properties. The goal is to sell promptly, at a discount, in order to retain the pipeline exclusivity with the bank and other sources. For this reason, as well as the restrictions imposed by most lenders for 'Back-to-back' transactions, all purchases must be made with cash i.e. no mortgage finance can be used for these purchases.

Each month The Route – Property receives a list of properties that meet its investment criteria of:

Purchase price +/- 10%:

1 Bed - £60,000

2 Bed - £65,000

Estimated rental per calendar month (pcm) +/- 10%:

1 Bed - £500

2 Bed - £550

Rental yield per annum +/- 10%:

Gross - 10.0%

Net - 8.5%

Estimated discount to market value of at least 15%

Remaining lease terms of at least 70 years

Comparisons showing:

- Prior sale price at higher level than current price; and
- Similar properties either in the same development and/or within a one mile radius.

The Company will then select the properties that meet the specific criteria, instruct the solicitors and arrange for completion for each purchase, usually all within fifteen days.

Step 4 - Lettings

Upon completion of each purchase, the properties will be managed by the agent's lettings business, which is a member of TPO and manages several thousand properties. The agent will undertake a corporate let from the day of completion i.e. the agent will become the tenant for all properties purchased, and will then re-let the property, to a paying tenant.

The agent will conduct all of the necessary checks on the prospective tenants in order to ensure that the properties are promptly let. It typically takes between one to six weeks to find a tenant and for that tenant to move in, if the property is not already let.

All rental agreements for tenants are set up on a minimum six months 'Assured Shorthold Tenancy' (AST) basis with the majority being placed on a twelve months AST. A tenant must provide two months' notice to vacate the property and, upon receiving this notice, the property will be promptly re-marketed in order to minimise any void periods for the agent. A property will typically be vacant for four to six weeks during a rental period of two years.

The Rental Guarantee

- The letting agent will, upon completion, undertake a 'Corporate let' and then sub-let the property to a paying tenant.
- The agent will continue to pay the rent to The Company, on an open-ended basis, regardless of whether the property is let or empty.

Therefore:

- Council tax bills will be the responsibility of the letting agent if/when the property is empty; and
- If the property is let for a lower, or higher, amount than anticipated, the letting agent will absorb any loss or gain that occurs.
- The agent will pay all maintenance costs and will often reclaim these costs from the tenant.

Step 5 – Re-marketing the property

Upon the completion of the purchase, The Company will arrange for the property to be marketed for an onward sale. Whilst an 'Open market' sale, using local agents, Rightmove and Zoopla, would generate a 'Market value' price, this route to market can often take up to 24 months, and sometimes longer, to complete. Therefore, only a handful of units are re-sold in this way, and only where a prompt sale is expected to occur.

The Route – Property has relationships in place with a network of property clubs and investment intermediaries, through which it anticipates providing a more efficient exit route. These affiliations provide access to tens of thousands of active property investors, both UK and non-UK, who wish to purchase UK properties and, when packaged correctly, will often buy the same

property at a higher price with a corresponding lower level of yield – thereby generating the profit though the sale of the property.

Net of the sales agent's fees, which can vary from agent to agent, The Company anticipates achieving a profit of around £12,500 on the purchase price, with a targeted completion time of around twelve months. On the open market, one would expect to achieve an onward sale with a profit of £15,000 to £17,500 above the purchase price, but this would typically take nearer two years to accomplish.

Once a bona fide offer has been obtained, The Company will arrange for the re-sale process to begin.

What will you pay in fees?

Your coupons will be calculated based on your gross investment and any fees paid will not reduce your allocation.

The Company will receive:

- A fee equal to 3% of the monies raised, to cover marketing expenses;
- Approximately £3k per property purchased, to cover the sourcing and due diligence of stock. This varies from property to property, as outlined above; and
- Any residual monies within The Company, after coupons and all costs have been accounted for. This will be settled after the completion of each property sale, or if a sale of multiple units, once the final unit has been sold.

What are the Risks?

Product specific

As with all investments, there are risks associated with this product. It is your responsibility to ensure that the product meets with your requirements. Please note that the list below is not necessarily an exhaustive list:

The value of the properties could fall, as well as rise, and so you may not obtain your investment capital back in full.

It may not be possible to sell the properties at a later date, and so you may not obtain your investment capital back during the five year term.

Although there is a guaranteed rental agreement in place, this is a corporate guarantee which is only effective if the letting agent is solvent and would be an unsecured claim against the letting agent, if insolvent, and so is subject to any prior ranking claims against the letting agent, in that event.

The service charges are estimates, based on the previous year's management accounts. These may be higher or lower than the estimate. On occasion there can be a considerable variance depending on the work that the management company conducts in order to maintain the standard of the property and keep the property compliant with the regulations in place at that time. It may therefore be possible that the costs may inhibit the payment of the coupons, in which case you may receive a lower return than expected.

Coupons paid other than to a tax-advantaged structure (e.g. a SIPP or a SSAS) will be paid to you net of Basic Rate Tax. It is your responsibility that you correctly report the coupons via your Self Assessment Tax Return, where applicable.

Particular company related

This investment does NOT have the protection of the Financial Services Compensation Scheme, and as with any investment activity, this investment may expose the investor to a significant risk of losing all of the monies invested in the event that the value of the underlying properties deteriorates significantly.

The Company may not be able to dispose of the properties at a sufficient consideration to enable the repayment of all the investments.

General

Macro-economic risks and changes in the general economic outlook, both in the UK and globally, may impact the performance of The Company and the property market. Such changes may include (but are not limited to):

- Contractions in the UK economy, or increases in the rate of inflation, resulting from domestic or international conditions (including movements in domestic interest rates and reduced economic activity);
- Property market fluctuations that will affect market prices for properties;
- The impact on the UK economy of Brexit;
- New or increased government taxes, duties or changes in taxation laws; and
- A prolonged and significant downturn in general economic conditions that may have a material adverse impact on The Company's trading and financial performance.

Security

The loan provided by each investor will be secured over each of the properties acquired by the Company. This will mean that the investor will rank ahead of other unsecured creditors of the company. The security granted will be a debenture over all the assets of the Company, and a legal charge over each property.

The security will be held by The Route – Property in its capacity as a security trustee, 'Security Trustee', for all investors, and this appointment will be governed by the terms of a security trustee appointment document, which will provide that the Security Trustee can only act in connection with the security for the benefit of all the investors.

Security documents

To ensure full security cover, to satisfy SIPP regulations and trustee requirements, further security will be provided on 'off plan' developments; for example a first ranking legal charge over the site's freehold. This additional security will expire as the build progresses and value of the properties increases.

How do you invest?

The Route – Property will meet with you to explain The Property Loan in detail.

You may invest using one, or any combination, of:

- Cash;
- A Self-Invested Personal Pension ('SIPP');
- A Small Self-Administered Scheme ('SSAS');
- Company deposits; and
- Trust funds.

Once the details of your source of funds has been established, The Route – Property will process almost everything on your behalf.

The minimum investment is £100k, with multiples of £5k thereafter.

Two Minute FAQs:

The Company is happy to answer any questions you may have. If your question is not covered by the FAQs below, please email it to Katanya.west@therouteclub.com.

Q: What return can I expect?

A: You will receive a 7% gross return per annum on your capital, plus bonus coupons of 3%, once each property is sold.

Q: How often will interest be paid?

A: Your 7% coupons will be paid half yearly i.e. 3.5% every six months. The bonus coupons will be paid upon completion of each property sale.

Q: How often will I receive investment performance updates?

A: Every six months you will be emailed a performance summary, providing details of the investment activity and performance of the property portfolio that has been purchased, together with an estimate of when the next sale is expected to occur.

Q: How much can I lend?

A: The minimum amount you can lend is £100k. The Company may accept lower initial amounts at its discretion.

Q: When does the loan mature?

A: The loan is for a five year term. On maturity, you are entitled to the return of the original loan in full, together with any interest outstanding. If a secondary market is available you may sell your loan during the term. No exit penalty will be applied by The Company but you will be required to contribute to any costs of the transaction.

Q: Can I invest using my pension?

A: You can hold the loans within a Self-Invested Personal Pension (SIPP) and/or a Small Self-Administered Scheme (SSAS).

Q: Can I invest using my ISA?

A: This loan is not yet available for ISA monies, but this option is in development and is expected to be available shortly, via the new Innovative Finance ISA.

Q: What is the fundraising target?

A: There is no fixed target, as there is a very strong pipeline of properties available and so additional stock can be readily sourced if there is higher than forecasted demand. The minimum raise amount is £1,000,000.

Q: What security do I have if The Company becomes insolvent?

A: You will have the benefit of a 'First and only' legal charge over each property and a debenture by the Company over all of its assets. The security will be held by the Security Trustee for the benefit of all of the investors. The security is only worth as much as the underlying properties that are being secured, and so if the properties fall in value, they may not be sufficient to cover the amount of the loans.

Summary

CLOSING DATE

Each SPV will have a different closing date, which will be communicated to you prior to commencing each raise.

COMMENCEMENT DATE

The loan will commence, and interest will accrue, from the day after receipt by The Company, of the total aggregate amount raised.

TERM OF LOAN

Five years, albeit the loan can be repaid early, at the discretion of The Company. As explained above, the loan may also be repaid after the five year term has expired, if the property has not been sold.

REPAYMENT DATE

Five years from the relevant Commencement Date. The Company reserves the right to repay the loan early, which is at its discretion. If the loan is repaid early, it will be accompanied by any pro rated interest that has accrued up to that point.

EARLY REPAYMENT TERMS

There is no 'Early Repayment' charge levied by The Company or The Route – Property. You will be invoiced for any professional fees incurred to facilitate an early repayment of your loan capital. You will also forfeit all future coupon payments.

MINIMUM AMOUNT

£100,000, The Company may accept lower amounts at its discretion.

MINIMUM LOAN RAISE

£1,000,000

INTEREST RATE & PAYMENT

Coupons paid other than to a tax-advantaged structure (e.g. a SIPP or a SSAS) will first have Basic Rate Tax deducted and paid to HMRC on the loan note holder's behalf.

The regular 7% coupons will be paid six monthly, i.e. 3.5% every six months. The first payment will be six months from the Commencement Date, then every six months thereafter. The payment may be made up to 15 working days after the Interest Payment Date.

The 3% bonus coupon will be paid up to 15 working days after the property has been sold. Since the Company's strategy is to purchase an entire block, or a part of it as funds allow, the 'sale' of a property therefore also refers to other properties purchased in the same block and/or on the same day.

The Route – **Property**, which is a trading style of Route Mortgages Limited (established in 2002), originally focused on advising on UK and international property acquisitions, financing and Stamp Duty tax planning. Since 2014, due to the demand from its Members for stable yield, coupled with the potential for capital appreciation, it has specialised in the sourcing, acquisition and management of residential properties, targeting an aggregate total annual return of 15%. It believes it has amongst the strongest deal flow available, for competitively priced and high yielding UK property stock, and with the pipeline of properties expected to remain healthy for some time yet, it is excited to continue to deliver its market leading investment proposition to its Members.

The Route – Property is a trading style of Route Mortgages Limited, which is authorised and regulated by the Financial Conduct Authority (Financial Services Register number 310129).
The Buy-to-Let Property Portfolio Service (PPS) is not a regulated product and a recommendation will not be made about its suitability for you, therefore you should seek advice if you are unsure about whether or not to invest. For this reason, PPS is only marketed to certified High Net Worth individuals.

Contact us

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www.therouteclub.com/services/property/

