A sizeable market opportunity

We operate in the UK's non-bank lending sector, an under-supplied sub-segment of the market with significant unmet demand.

The market opportunity

The size of the market opportunity for the Group is based on two fundamental aspects:

1. **Too few homes being built:**
   Data from the Ministry of Housing, Communities & Local Government (formerly the Department for Communities & Local Government) on homes built from 2004 to 2016, identified a housing supply 'hole' of 1.4 million homes that were not built during this period.

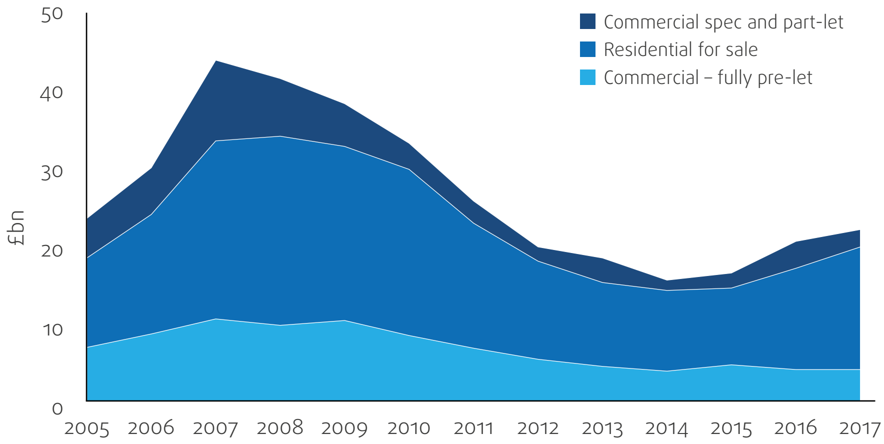
   The recent projection by the Ministry is that approximately 300,000 new homes need to be built in England per annum going forward to keep up with rising demand. This compares to the reality that only 163,250 houses were completed across England in 2017, and 163,420 to Q3 2018.

2. **A shortage of development finance:**
   Lack of availability of finance during the global financial crisis had a detrimental impact on the development finance market. Research indicates that debt outstanding and secured by residential development projects for sale has steadily declined by approximately 35% from a peak of £23.9 billion in 2008 to approximately £15.5 billion by the year end 2017.[1]

Traditional banks are constrained by regulation which has made development finance provision a less attractive activity. This includes additional Tier 1 capital requirements, conduct requirements applicable to senior directors and officers of the bank, single counterparty exposure limits, large loan constraints and higher provisioning requirements under IFRS 9.

This has meant that the financing requirements of SME housebuilders, in particular, considerably exceed the funding available in the market. Utilising government and Nationwide Building Society data, and based on the annual target for new homes, the Group estimates that there is a lending opportunity of £394 billion over the next decade across the UK. Of this, the 'funding gap' (relating to projected housing build shortfall) equates to £237 billion of development finance opportunities.

Allocation of Development Finance
(Banks, Building Societies and Insurance)[1]



1 Source: De Montfort University: Commercial Real Estate Lending Survey, Year End 2017.

Luton, Bedfordshire

Senior debt facility to fund the refinancing and development of a high profile freehold site known as 'Napier Gateway'. The 6.9 acre site is located near Luton airport and approximately one mile from the town centre. The development comprises 785 residential units, retail and leisure, a 209-bedroom hotel, a medical wellbeing centre, together with landscaping, car parking, new access and associated works.

Strawberry Star Group, established in 2007, is an international property company specialising in capital, acquisitions, development, sales, lettings, management and asset management of London property to local and international investors. It has completed a number of large mixed-use developments in London.

GDV: £124.4m

Government support

Housing is a key domestic priority for the government, with initiatives totalling some £21 billion (including the Home Building Fund, the Housing Infrastructure Fund, the Housing Growth Partnership and the Help to Buy scheme). The current government's priorities to increase housing supply are set out in the Housing White Paper, including the following which align with our business model:

- to promote SMEs over large housebuilders;
- to prioritise housing priced at a level that local residents, especially first-time buyers, can afford;
- to identify appropriate sites for development (including government land) with the right tenure mix;
- to utilise more efficient methods of construction (e.g. modular); and
- to promote higher densities in urban locations.

	Housing build number	Average housing price £[1]	Value £bn	Implied development finance @55% LTV £bn	Total development finance market over the next 10 years £bn
Average housing build figure (2008–2017)[2]	119,937	238,963	28.7	15.8	157.6
Housing shortfall to 300,000[3]	180,063	238,963	43.0	23.7	236.7
			71.7	**39.5**	**394.3**

Sources:
Data from the Ministry of Housing, Communities & Local Government (formerly the Department for Communities & Local Government); the Nationwide Building Society and government Budget announcement.

Note:
1 Average house price in England (2015-2017), per Nationwide HPI data, was £202,536. Current average is £238,963 per Nationwide Building Society HPI data (Q4 2018).
2 Private enterprise new build only.
3 Chancellor of the Exchequer, Philip Hammond, announced in his Autumn Budget 2017 the government's ambition "to put England on track to deliver 300,000 new homes a year".

Market review continued

Barriers to entry

The Group benefits from a number of barriers to entry that our sector exhibits, which make us well-placed to take advantage of the market opportunity. These include:

1. **Track record with borrowers** – it takes many years to build a reputation in the industry and a relationship of trust with quality borrowers who thoroughly vet a lender's experience and prior performance. The management team has an established track record.
2. **Track record with capital providers** – in order to attract capital, providers want to see a demonstrable track record of providing compelling returns, whilst also meeting their strenuous processes and reporting standards.
3. **Quantum of capital** – substantial capital is required to compete effectively, and new entrants would have difficulty raising substantial sums with no track record in the industry. The Group has successfully developed a number of relationships with capital providers.
4. **Cost of capital** – in order to lend profitably to experienced developers, a lender's capital must be priced efficiently or they will be unable to attract quality borrowers and maintain credit quality. The Group has negotiated advantageous terms with its capital providers to enable it to lend to these more experienced developers.
5. **Intensive management** – development finance requires intensive ongoing management compared to other real estate asset classes which new entrants may not have the operational capability to conduct.
6. **Technical expertise** – it takes time to recruit and build a technically competent team. The Group has an established team and also has a background itself as developers prior to being lenders.

> "Development finance requires intensive ongoing management compared to other real estate asset classes which new entrants may not have the operational capability to conduct."

Birmingham, B2

Senior debt facility to fund development. Timber Yard, located in Birmingham's city centre Southside district, is a mixed-use scheme. Planning permission is in place for 379 residential units and 6,257 sq ft of commercial space at ground floor level on a 1.58-acre site. The development, designed by Claridge Architects, will comprise two residential buildings and will exhibit signature designs providing premier specifications. The East Block, the first release, will feature 219 studio, 1, 2 and 3-bedroom apartments. The West Block will feature 160 studio, 1 and 2-bedroom apartments.

Galliard is a highly regarded, award-winning UK housebuilder of significant standing.

GDV: £101.3m

The housing market

Nationally, house price inflation slowed steadily during the course of 2018, in line with the previous year. Across all regions, house price inflation was running at 2–3% towards the end of 2018, lower than the post-recession average of 4% per annum, and lower than the growth rate of average earnings. In London, house prices generally drifted lower in the second half of 2018 following a prolonged period where house price growth had significantly surpassed earnings growth. Outside London and the south east, house prices rose steadily during the reporting Period.

"...real income growth will support housing market activity, and economic growth more generally."

Supported by robust employment growth, rising wages and low borrowing costs, the number of first-time buyers rose back to pre-recession levels during the Period. Reflecting a combination of factors, home mover activity levels remained well below normal. Following a lengthy period of strong growth, buy-to-let mortgage lending growth continued to soften during 2018. Overall, the number of housing transactions was close to 100,000 a month throughout 2018, as it has been since the Brexit referendum. Housebuilding continued to strengthen during the Period but remained below pre-recession levels.

Notwithstanding the uncertainties associated with the UK's exit path from the European Union, the outlook for housing market activity over the medium term remains generally favourable. As mortgage interest rates have remained low and wage growth has risen above house price inflation, housing affordability has improved. High levels of job vacancies point to sustained employment growth during 2019 and, as wage growth continues to drift upwards and inflation in the wider economy remains close to the government's 2% target, real wages can be expected to strengthen further. With borrowing costs likely to remain at historically low levels, and the supply of high loan-to-value mortgage lending showing increasing signs of returning to more normal levels, real income growth will support housing market activity, and economic growth more generally.

Rising levels of housing demand will support housebuilding over the medium term, boosting the supply of housing accordingly. The well-documented shortage of new housing in the UK provides a compelling opportunity for our developer customers to increase output. However, difficulties in the debt markets during the global financial crisis had a detrimental impact on the development finance market. Debt outstanding and secured by residential development projects for sale has steadily declined by approximately 35% from its peak, creating an opportunity for non-bank providers to enter the space.

The capital markets

Against this backdrop, the outlook for our asset management operation is also positive. Capital inflows to the sector are strong. Investors have consistently increased their exposure to the UK residential sector (including for development) over the five years since 2013.

IPF's Research Programme survey in December 2018 revealed that its participants have consistently increased their exposure to the UK residential sector (including for development) since 2013, totalling £16.6 billion (£4.9 billion in relation to development over this period) and had a continued intention to increase investment in the sector.

The report by IPF went further, stating "A total net figure of £8.3 billion is reserved for future residential investment, the majority of which is expected to be channelled through development land for investment stock (£4.7 billion)...". This was an uplift from the previous year's survey.

Market outlook

Heading into 2019, a potential headwind is Brexit. There is still no clarity as to the nature of the UK's ongoing relationship with the rest of the EU. Hence, the key mitigant to Brexit risk for the Group is to lend only on assets for which the ongoing need, and therefore value, is less likely to be adversely affected by the UK's future relationship with the EU. This translates to prudent credit policies and rigorous deal appraisal to ensure the sales risk of underlying properties is particularly low, for example through pre-sales and the financing of projects addressing under-supplied segments of the market. As a result, our current approved loan pipeline consists of developments in high demand, growing areas of the UK, such as Greater London, Manchester and Birmingham.

We remain vigilant to any sudden and sharp market movements, including salient economic indicators such as the availability of mortgage products, affordability and wage growth, and incentive schemes such as Help to Buy. It is also worth noting that over 100 lenders now offer 95% LTV mortgages, reducing the market's reliance on Help to Buy going forward. Coupled with recent wage earnings growth, the macro economic environment continues to be supportive of our lending strategy.