Peer to Peer Lending

Where to source finance for developments and housing projects?

Sourcing finance for business is not a straightforward process as regulations and legal issues make some businesses being too risky for banks lending criteria, even if profitable. It is not only that those without assets and with variable cash flows are refused but also those with solid credit history. Every construction project is connected with variations and the construction industry is one of the most risky so businesses do not often fit with the banks' risk profiles.

Where to source finance for developments or housing projects? The answer is an alternative finance. The peer to peer lending is developing rapidly, along with the crowdfunding or invoice trading platforms. Alternative finance is a relatively new financing option. The first peer-to-peer company ZOPA was established in 2005 and most other providers are less than ten years old. However due to its rapid development, it is already providing significant amounts of capital to UK individuals and businesses.

P2P - these are debt-based transactions between individuals and existing businesses with many lenders contributing to one loan.

Invoice trading - firms sell their invoices at a discount to receive funds immediately.

Crowdfunding

- ***Reward based*** - Individuals donate for a project with the expectation to receive later a non-financial reward or product in exchange for their contribution.
- ***Equity-based*** - it is a sale of a stake of a business to some investors in return for their contribution.

Businesses seeking to borrow via P2P platforms are lending for expansion, projects or working capital. P2P funding option is interesting due to speed and ease of use in comparison to traditional lending. Moreover, cost of finance and regulations are important factors too. The trade body for P2P is the Peer-to-Peer Finance Association (P2PFA), and the P2P sector is regulated by the Financial Conduct Authority (FCA). Crowdfunding standards are set out by the UK Crowdfunding Association (UKCFA). The government has introduced regulations that will force banks to refer SMEs rejected for loan applications to the alternative finance market. There are various platforms where peer to peer finance can be obtained. The most established are Zopa, Funding Circle, RateSetter, Rebuilding society, CrowdProperty, ThinCats, Assetz Capital, FundingKnight, LendInvest, LandBay, MarketInvoice, Wellesley and Lending Works.

What is peer to peer lending?

Peer to peer lending involves those who are looking to lend and those who wish to borrow. P2P lending sites act as intermediaries by searching and risk assessing possible borrowers and lenders. By removing any financial institutions, borrowers can get slightly lower rates while lenders should get a slightly improved rate. The P2P platforms receive the fee for acting as the marketplace and intermediaries. Borrowers are credit checked and risk assessed to establish at what rate they can borrow. Moreover in case of problems with repayments of a loan, intermediaries act on behalf of lenders. However, there is no protection by the Financial Services Compensation Scheme like in the case of banks.

The P2P lending platforms act as the marketplace where the borrower can compare various loan rates, the reputation of lenders or borrowers and make investment or saving. They lend to members only and those wishing to lend need to be prepared for locking money for one to five years.

Lenders are covered by the Personal Saving Allowance (PSA) so they can earn £1000 interest without paying tax on it. Moreover from April 2016, the new 'Innovative Finance ISA' allows peer-to-peer lenders to save tax-free on their investments up to the annual allowance within an ISA wrapper.

What are benefits and risks for P2P lenders?

P2P lending platforms allow lending money directly to the interested parties and making returns on investment. The process is very straightforward, and it starts with opening an account in chosen P2P lending platform, transferring money and choosing the lending option. Then funds are matched with the borrowers and lent out in portions to different borrowers what diversify the risks. Each month borrowers pay back capital and interest on these loans. The lender can choose

SUMMARY

- ***P2P finance*** can be provided to risky customers.
- ***P2P finance*** is quicker to obtain.
- ***P2P loan application*** does not affect the credit rating (soft search).
- ***P2P finance*** is available for various purposes- stock purchase, expansion, marketing, development, debt consolidation, etc.
- ***P2P loans*** rate lower than in banks.
- No ***FSCS*** protection.
- ***P2P features low*** defaults, risk diversification, provision funds and independent contracts.
- ***P2P returns*** are included in the Personal Savings Allowance (PSA)
- Largest ***P2P loan*** so far was £4.1m for a residential housing project in Croydon, by LendInvest, on a 12% annualised rate of interest.
- ***Funding Circle*** has a maximum level of £1m for unsecured loans and £3m for loans secured on property.

when and how to access the money. The transparency and flexibility of P2P lending allow the lender to spread money and support businesses or individuals, while making a better return than in a bank or savings account.

The peer to peer lending is regulated from 1st April 2014 by the Financial Conduct Authority, but there is no protection of capital like in the case of banks, where the Government-backed Financial Services Compensation Scheme (FSCS) would pay the first £75,000 per person, per financial institution. There is no clear information what might happen in the case when the P2P platform goes bust. P2P sites have a separate emergency fund to cover bad debts and shortfalls in repayments plus all members are required to have insurance cover for third party collections. No returns are on money which is not lent and often lender's funds are not lent straight away. This form of finance is relatively young but so far has the lowest record of defaults.

What are benefits and risks for P2P borrowers?

It is a good alternative finance option not only for those who were refused credit by banks. There are various rates available with simple and quick online application process. Borrowers receive a free instant quote with no impact on credit history. There are no early repayments charges, and rates are often lower than those offered by banks. Loans can be taken for various purposes including the debt consolidation. There are almost no risks for borrowers if they stick to the loan repayment plan.

What are the most popular P2P platforms?

The P2P lending market is developing rapidly, but the most established are ZOPA, Ratesetter and FundingCircle. Zopa and Ratesetter are very similar, but Zopa is the pioneer of the P2P lending while Ratesetter is more customisable over rates. FundingCircle lends to businesses and allows the lender to assess each borrower personally but also to spread the risk. It is very popular in the construction industry, and the government is using it to fund the SMEs.

The rapidly growing sector in the P2P business financing is secured lending for real estate mortgages and developments projects. CrowdProperty is P2P platform designated for property developers and investors who are looking to borrow money from lenders to fund the property projects. Lender receives interest on the money lend to fund the project with up to 10% gross interest per annum, with the opportunity to spread the risk across numerous projects. CrowdProperty takes fees from borrowers only, and the loan is secured by a registered first legal charge against the property.

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