SCALING UP THE INNOVATIVE FINANCE ISA

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How the Innovative Finance ISA can take off

by Andy Davis

As the alternative finance industry gears up for growth, exclusive research commissioned by AltFi demonstrates a remarkable lack of awareness for the IFISA.

It is clear 2018 is the crunch year for the Innovative Finance ISA. Announced in March 2015, launched without any of the P2P world's biggest names on the ticket in April 2016, and held back ever since as they kicked their heels awaiting authorisation, the moment has finally arrived when the stars are aligned.

The leading platforms are finally able to start promoting it in earnest – so what happens next? AltFi's market-leading research has found clear appetite among P2P investors to use the new, tax-free wrapper – but almost no one else has even heard of it. The IFISA faces a major challenge to break through with investors and prove its worth.

A wall of public ignorance stands between the Innovative Finance ISA and mainstream adoption, however, with more than three quarters of people recently surveyed by saying they have never heard of the government-backed tax-free alternative investment wrapper.

Public awareness of the IFISA – announced by former Chancellor George Osborne in the 2015 Budget and formally launched in April 2016 – lags far behind P2P lending, which 60% of people told AltFi's researchers they were familiar with.

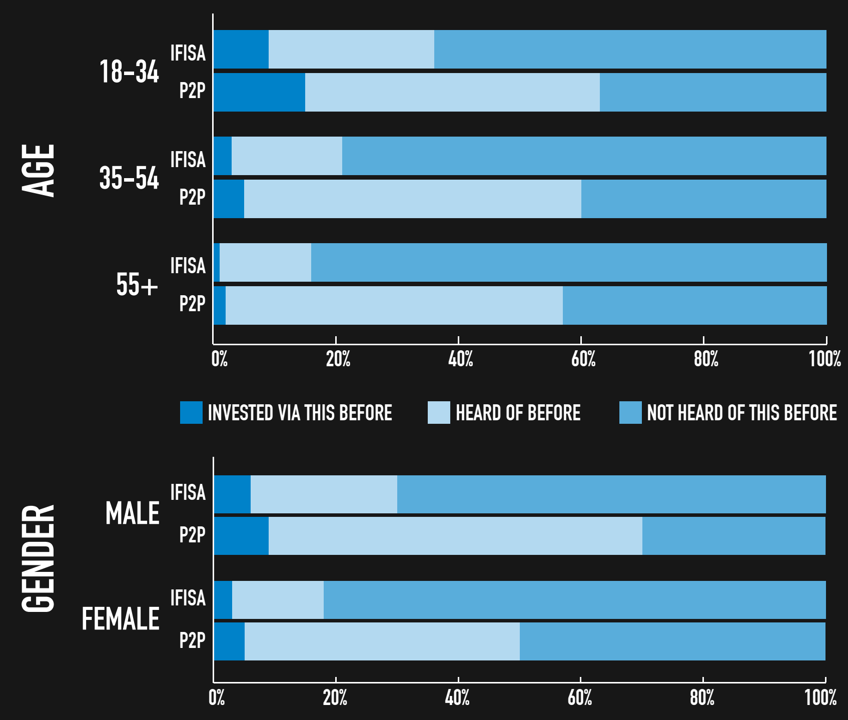
The survey, which questioned just over 2000 adults leading up to Christmas, found that of those who had heard of the IFISA, about one in six had already put money into one (23% aware vs 4% who have invested). By comparison, roughly one in eight of the larger group who have heard of P2P lending say they have invested in it (53% aware vs 7% invested).

The higher conversion rate from awareness to adoption among IFISA users could represent early evidence that the opportunity to invest tax-free will encourage more people to put money into P2P loans and debt-based securities. But at this stage in the IFISA's evolution, it might simply represent a rush among better-informed early adopters that will not necessarily spread into the wider market.

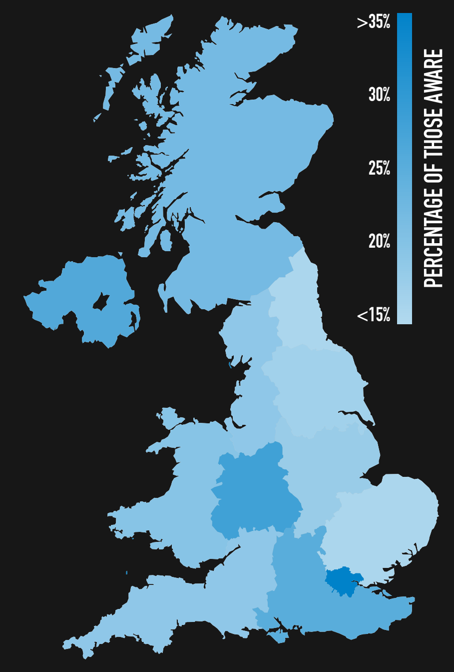
Age is a key factor in awareness of the IFISA and in people's willingness to use it. Familiarity with the IFISA is significantly greater among younger people and they are at least three times more likely to invest in P2P and use an IFISA, according to the survey results. Some 15% of 18-34s say they already invest in P2P and 9% are using an IFISA: the equivalent figures for 35-54s are 5% and 3% respectively.

Very sharp regional and demographic divides also emerged from the survey. Awareness of the IFISA is strongly metropolitan, reaching 17% in Greater London, 12% around Birmingham and 10% in Edinburgh. But in Wales and the South-West almost no one has heard of it, and the picture is little better across most of northern England, Scotland and Northern Ireland.

COMPARATIVE BAR CHART OF P2P/IFISA AWARENESS



HEAT MAP SHOWING REGIONAL DISPARITIES IN AWARENESS OF THE IFISA



Perhaps not surprisingly, people in the top socio-economic groups are most likely to be familiar with the IFISA. Some 18% of survey respondents in group A were aware, and about 10% of Bs, while among the C1, C2, D and E groups, the figure never climbs above 7%. In fact, the level of IFISA awareness is so low that the more detailed demographic and regional findings from the AltFi survey are based on sample sizes that are too small to be statistically robust – these figures should therefore be treated simply as a guide to the state of the market.

Do these results suggest that the IFISA is in danger of proving a damp squib? On the face of it, very low levels of awareness among the general public would seem to indicate a financial product struggling to gain traction, especially among the older age groups that have the most money to invest.

But in interviews with industry leaders and individual investors to delve into the snapshot provided by the survey, a picture emerges of a market that is in the earliest stages of development but is evolving gradually towards wider public adoption.

The IFISA's roll-out so far

Since April 2016 almost 30 alternative lending platforms have launched IFISAs, offering P2P loans and debt-based securities, and targeting a mix of consumer, small business and property lending opportunities. At least three further platforms, RateSetter, ArchOver, and Thincats, have announced plans to launch IFISAs of their own in the coming months.

According to the most recent HMRC figures – disputed by some in the industry – about 2,000 IFISA accounts were opened during the 2016-17 tax year, attracting total "new money" subscriptions of £17m, or £8,500 per IFISA on average.

Over the same period, almost 2.6m Stocks & Shares ISAs received a total of just over £22.3bn in subscriptions – giving an average subscription of £8,623, very much in line with the average sum put into IFISAs. Our research found that about 13% of people say they have a Stocks & Shares ISA, while another 13% say they own shares or funds outside an ISA wrapper (although there is very likely to be some overlap between these two groups).

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AltFi's survey results, which are not directly comparable to the HMRC figures due to timing differences, found that among those who had opened an IFISA, the average investment was around £4,450. People who had concentrated on P2P lending via their IFISA reported an average investment balance of almost £5,900. It is not clear why this discrepancy in the averages reported might arise. Could it result from a growing number of IFISA account openings since end of the 2016-17 tax year by younger people with less money to invest?

> **"Among those who had opened an IFISA, the average investment was around £4,450"**

During 2016-17, almost 8.5m Cash ISAs received total subscriptions of £39.19bn, a drop of nearly a third on the previous tax year, as a combination of rock-bottom interest rates and the introduction of the new personal savings tax allowance largely cancelled out the benefits of saving via Cash ISAs.

Another big influence on the scale of the early flows into IFISAs is regulation: platforms must achieve full authorization before they can register as ISA managers with HMRC. The three market-leading P2P platforms, Zopa, Funding Circle and Ratesetter, took longer to gain their FCA clearance than many small operators and were therefore late into this market.

Consumer lending platform Zopa was the first of the big three to be authorised, in May 2017, and launched its IFISA the following month. Funding Circle started offering its IFISA in November 2017 and Ratesetter is planning to launch in February 2018.

Timing issues largely explain the IFISA's low profile in its early stages. Given that platforms themselves are the providers of IFISAs, they will necessarily be the product's main advocates. And taking into account the overwhelming share of retail investment flows into P2P lending claimed by the three biggest platforms, it is not surprising that in the period before the market leaders were able to launch their offers early take-up of the IFISA was slow and awareness of it extremely limited. By their nature, the smaller platforms have small pools of investors, modest revenues and therefore limited marketing budgets. Equally, the supply of opportunities to invest in P2P assets that they can offer represents only a very small slice of the overall market.

To give an idea of the potential change the arrival of the largest players could have on the IFISA market, the £17m subscribed into all IFISAs during the 2016-17 tax year should be set against the average of £36m per month invested in Funding Circle's Classic account over the past six months. If Funding Circle's investors follow the pattern already observed at Zopa and Abundance Generation, about half of that £36m per month can be expected to flow into IFISA accounts.

Does this therefore mean that now the leading P2P players are starting to roll out IFISAs, we can expect to see awareness and take-up surge? The signs are that take-up will rise, but conversations with leading industry figures suggest this will happen in carefully managed stages to ensure existing investors are not disadvantaged and that supply and demand for funds remain broadly in balance.

As Andrew Lawson, Chief Product Officer at Zopa, notes: "We have very much prioritised our existing customers when it comes to our IFISA, to ensure a balance between supply and demand [of funds]." Like Zopa, Funding Circle is so far promoting its IFISA only to existing investors. This staged approach will determine the way the IFISA market evolves over the coming year.

The key message is that this will continue to be a market sharply divided between a fairly small group of informed insiders and a much larger group of "P2P outsiders" who are likely to see relatively little mass marketing of the IFISA and among whom, therefore, awareness of it is likely to remain low.

Baby steps towards mass-market adoption

The largest IFISA providers, Zopa and Funding Circle, are both taking an incremental approach towards the roll-out of tax-free P2P investing.

Zopa started last June by allowing its existing investors to open an IFISA and subscribe new money up to their annual allowance of £20,000 (a big increase from the £15,240 allowance in 2016-17, the first year the IFISA was available). In November, Funding Circle launched its Isa offering in a similar way, opening it first to new subscriptions from its most longstanding active investors (those who have made an investment in the previous six months), and also allowing them to sell existing portfolios of loans in its secondary market and move the funds into their IFISA account so they can re-invest tax-free. Once this group has had the chance to fund their IFISAs, Funding Circle will progressively open access for more of its retail investor base.

"Our hope is that we will be able to open up the ISA to all existing customers by the end of this tax year, and make it available to new customers next tax year," the platform says.

Just before Christmas, Zopa took its next steps. First, it too started allowing existing IFISA holders to sell loans held outside their ISA and move the proceeds into the tax-free wrapper (up to the £20,000 ceiling) to invest in fresh loans. At the same time, the platform also began allowing investors to transfer funds from old Cash and Stocks & Shares ISAs into their IFISA, which Funding Circle does not currently permit.

Between them, these two developments are likely to be the crucial factors driving the next phase of growth in Zopa's IFISA balances, and in all likelihood the growth of IFISA funds held by the other major platforms. Andrew Lawson says: "We've already seen really strong uptake and demand from people to transfer in old ISAs and we have to ensure that we focus on the quality of loans and supply to our current customers."

The scale of the funds that could potentially flow on to P2P platforms as their existing investors transfer in old ISAs is very significant, and helps to explain the platforms' caution.

Bruce Davis, Founder of Abundance Generation, which specialises in bonds backing renewable energy projects, says his platform sees its target market as about 8m UK adults with existing investments inside or outside ISA wrappers. This group holds historic ISAs containing about £100bn, he says.

To date, just over £20m has been put into the 2,337 IFISA accounts opened with Abundance since April 2016, of which £4.8m came via transfers-in of funds from existing ISAs held elsewhere.

For the moment, the big unknown, especially for the largest platforms looking to roll out the IFISA, is how keen their existing investors will be to transfer money over from old ISAs. "The scale of the transfer market then determines when we would start going out to new customers and promoting the IFISA," says Andrew Lawson. "It's somewhat dependent on how quickly we can serve all that transfer-in demand from our existing customers."

Why the IFISA market will get deeper before it gets wider

The importance of ISA transfers highlights two major issues for P2P platforms as the tax-protected investment universe expands to take in the direct lending assets they specialise in.

The first is obvious, but worth spelling out. Now that P2P loans and debt-based securities can be held in an ISA wrapper, from the individual investor's perspective they have effectively moved into a different "investment pot", as Bruce Davis puts it. Before the IFISA, the money most investors put on to direct landing platforms would effectively have represented the amount left over after they had made their ISA commitments for that tax year. Now people can consider crowd bonds and P2P loans as part of their core ISA holdings, rather than just add-ons once the ISA money is committed.

Since opening its IFISA, Davis says Abundance's average investment has gone from £7,500 to just over £10,000, and its typical fundraisings have grown from £1m-£2m to £4m-£5m. But this is not simply a result of ISA availability encouraging people to commit more money, he argues. "It's a different pot of money and it's about the size of the pot you're talking to."

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Risks and rewards for P2P platforms to scale up their operations via the IFISA

by Jonathan Rogers and Peter Wilson

With the Innovative Finance ISA poised for greater uptake among UK investors the industry is at a crossroads.

The 2018 UK ISA season is almost upon us, and with the UK's big peer-to-peer (P2P) industry players now in the Innovative Finance ISA (IFISA) market, we expect there will be significant inflows into IFISAs. This burgeoned by the government's continued promotion of technological innovation in UK financial services, and its support for the P2P sector, which provides an alternative source of finance to bank lending for SMEs.

Despite the absence of an anticipated FCA review of the UK P2P sector, the bellwether for the IFISA looks good as it matures and makes its way into mainstream public consciousness. Increased inflows will not be without risks for P2P platforms, and as operations are scaled-up to meet demand, firms would be wise to review and enhance their risk governance models.

As with any business in growth mode, new customer acquisition is always a priority. However, this needs to be balanced with a prudent and forward-looking approach to risk management that accounts for expected and/or forthcoming regulatory change. Senior management in P2P firm should be ever mindful of this, particularly given the FCA's drive towards greater personal accountability. In the FCA's December 2016 Feedback Statement containing its interim feedback following a call for input on its post-implementation review of its crowdfunding rules (FS16/13), P2P firms received clear sign-posts on how the FCA is likely to develop its regulation of the sector. In particular, it may:

- Require firms to maintain an enhanced control environment, especially as regards retail protections, such as due diligence, disclosure, transparency, and creditworthiness;
- Mandate appropriate planning for wind-down/ insolvency scenarios, related controls on client asset and client money/safeguarding and potential enhanced capital requirements; and
- Impose additional restrictions around complex business models (e.g. cross-investment) or those where regulatory arbitrage is possible.

FS16/13 indicated that the FCA's next step would be to publish a consultation on proposals for new rules and its final new rules during 2017. We understand from media commentary that the November 2017 update of the FCA's policy development webpage removed reference to this consultation and that the FCA has since said that there is no timetable available for the document's release. While this is potentially indicative that the FCA is now comfortable with the status quo, we still expect that a consultation or consultations will follow.

> **"The potential upsurge in P2P platform usage driven by the IFISA will no doubt garner FCA attention"**

Regulation and collaboration

The potential upsurge in P2P platform usage driven by the IFISA will no doubt garner FCA attention, particularly if there is significant change in the demographic of the current crowd investor population. While it will certainly offer savers more choice as to how they invest their money, the FCA has previously expressed concern that unsophisticated investors lack sufficient understanding of the risks associated with investments into P2P.

Aside from the regulation, there are at least two other commercial trends in the P2P sector and the UK FinTech sector at large, which will continue into 2018. First, as firms scale up their propositions for the IFISA, we are increasingly seeing collaboration in service and product offerings between both new and old industry players. Second, firms are enhancing their service proposition, for example in the P2P sector we see a movement towards the challenger banking space. P2P platforms not shackled by the legacy systems and creaking infrastructure of their more established cousins are well placed to capitalise on these trends. Provided the core brand is protected and not diluted, clear commercial benefits can be recognised by P2P platforms via well managed collaboration and business model enhancement, leading to increased market profile and greater access to both investors and borrowers, the two sides of the P2P coin.

There also remains a need for P2P firms to ensure vigilance to macroeconomic risk. Critics of P2P lending are keen to point to the fact that the majority of UK P2P businesses have not been exposed to an economic downturn. A combination of unmanageable amounts of unsecured personal debt, increasing inflation, poor wage growth and a gradual increase in interest rates, could see a rise in UK borrower defaults. How P2P platforms loan books will fare remains to be seen. And of course, there is Brexit, which poses a threat to the UK economy at large but may also frustrate any plans that UK P2P platforms have to expand their businesses cross-EU border. With crowdfunding in the future sights of the EU Capital Markets Union, UK firms looking to achieve scale across Europe may in time have to establish group presences in other EU territories.

With the FCA positioned to consult on enhancements to its regulatory framework of the P2P sector in 2018, firms should be actively monitoring FCA announcements and be ready to respond. A strategic customer-focused approach to the roll out of the IFISA product will in the long-term lead to competitive commercial advantage, and see the leading P2P firms move from being perceived as FinTech 'start-ups' to trusted 'household names'.

Jonathan Rogers is a partner at Taylor Wessing and heads up the firm's Financial Services Regulatory group.

Peter Wilson is a solicitor at Taylor Wessing specialising in the provision of advice to financial services.

Is this the beginning of the end of Cash ISAs?

by Julia Groves

It seems the penny has finally dropped - the amount invested in Cash ISAs last year is down 33% from 2015-6 saving levels.

With interest rates so low, I am bemused by investors who use their increasingly generous annual ISA allowance - now £20,000 p.a. - on their savings rather than investments (for those comfortable with the risks).

Does it make sense to use all your tax-free allowance on a lower return if you are both a saver and investor?

The introduction of the personal savings allowance may be a contributing factor to last year's lower Cash ISA volumes - a higher rate taxpayer earning today's average 1% p.a. on his or her savings can stash away £50,000 before having to pay tax on the interest.

But if interest rates start to increase and that money is outside an ISA wrapper, you will start to be taxed.

An alternative is, of course, a Stocks and Shares ISA – subscription amounts are up from £21.1bn in 2015-6 to a record high of £22.3bn in 2016-71 but that still leaves some £18bn that is no longer being invested in Cash ISAs, without a home.

As a P2P investor, you may well already have an answer with the Innovative Finance ISA (IFISA).

> "For those investors that are happy to take on the higher risk that comes with debt-based securities, the IFISA could prove an attractive option in today's low interest rate environment"

Is cash still king?

The alternative finance sector has seen major growth over the last ten years with more than £10bn of loans made to people and businesses. The opportunity to also earn these potential returns tax-free may be a no-brainer for early adopters, but I believe it could also play a major role in bringing P2P lending and Crowd Bonds (a form of debt-based security) to the mainstream.

Let me be clear that this is not about taking all your savings and ploughing them into alternative finance – Crowd Bonds and P2P lending put your capital at risk, and do not have FSCS deposit protection (you can lose some or all your money). But if you are investing AND saving, surely your ISA allowance works harder for you to protect the higher potential returns than those currently on offer on your savings?

Take Alison from the adjacent table for example. Alison is a higher rate (40%) taxpayer and has £20,000 that she would like to invest in an ISA in the 2017/2018 tax year. She wants to make the most efficient use of her ISA tax benefits and decides to take a closer look at three different options: investing in a Cash ISA, investing in a Stocks and Shares ISA and investing through the IFISA.

After considering her options and the additional risks relating to Stocks and Shares ISAs and IFISAs, Alison decides the most efficient use of her ISA allowance is by investing in a Crowd Bond through an IFISA.

Crowd Bonds offer the potential for significantly higher returns than currently available through cash ISAs – typically between 4 – 7% p.a. over a short to medium term. And since they are generally illiquid and held for a fixed term they are not exposed to the short-term volatility that comes with investing through a Stocks and Shares ISA. So, for those investors that are happy to take on the higher risk that comes with debt-based securities, the IFISA could prove an attractive option in today's low interest rate environment.

Amount invested	£20,000 in a Cash ISA	£20,000 in a Stocks and Shares ISA	£20,000 in an Innovative Finance ISA
Example return	1.00% p.a. interest	3% p.a. dividend rate 5% p.a. capital gains	6% p.a. interest
Amount of income not subject to tax	£200	£1,600	£1,200
Other allowances that could be used	£500 personal savings allowance	£5,000 dividend allowance £11,300 CGT allowance	£500 personal savings allowance
	Alison wouldn't be taxed on £200 through a Cash ISA offering an interest rate of 1.00% p.a. The return could be saved as part of Alison's £500 personal savings allowance.	Alison wouldn't be taxed on a total return of £1,600 (dividends and capital gains) through a Stocks and Shares ISA. However, she could invest her money directly into stocks and shares, and protect the same amount through the dividend and CGT allowances available.	If Alison were to invest outside the IFISA wrapper, she would have a tax liability on any interest earned above her personal savings allowance. Instead, she can earn interest tax-free using an IFISA.
Disclaimer	Capital is not at risk. Money is protected by the FSCS deposit scheme up to £85,000 per person per firm.	Capital is at risk. Money is not protected by the FSCS deposit scheme.	Capital is at risk. Money is not protected by the FSCS deposit scheme.

This table is for illustration purposes only and as such should not be relied upon as the basis for an investment decision. Tax treatment is dependent on the circumstances of each individual investor.

With the annual ISA allowance at £20,000 and as there is no investment limit on transfers of existing ISAs from previous years, those looking to diversify their ISA portfolios and invest in assets uncorrelated to the stock market, the IFISA may be worth a look. (It's always important to check with your current ISA providers whether there are penalties fees to pay on exit.)

We launched our online investment platform in March 2016, raising more than £46 million across 21 bonds to support UK businesses in a variety of sectors including renewable energy, care homes, property development and community pubs. In doing so, we have offered members a weighted average interest rate of 5.9% p.a.

Since we launched the Downing IFISA 10 months ago, nearly a third of our members have opened an IFISA account, accounting for approximately 30% of total bond orders, and we expect this to continue growing.

And with the tax year end fast approaching, maybe it's time to ask: you are making the most of your ISA tax benefits, aren't you?

Julia Groves is head of crowdfunding at Downing and has been instrumental in reforming regulation for crowd investors, and in the creation of the Innovative Finance ISA. She can be contacted at Julia@downing.co.uk

ISA Innovation: What do investors think?

by Karteek Patel

Crowdstacker's CEO Karteek Patel reveals why investors have opted for the Innovative Finance ISA over the past two years.

When the first types of ISA launched in 1999 the country was still in the first flush of a much feted Blair Government, the economy was buoyant, and the outlook rosy.

It was the end of a decade that saw average base rates of around 8%. Inflation meanwhile may have started at 9.5% in 1990, but it rapidly fell to a more manageable 1.5% by 1999.

In this environment investors looking to expand their portfolios could be forgiven for assuming a steady rate of return would be par for the course, even if they simply put their money in a standard cash ISA. And the temptation to dabble with a Stocks and Shares ISA was equally strong.

But eighteen years on with a Global Financial Crisis and uncertain political and economic environments in most major markets, the original types of ISA are arguably losing popularity. Rates of return on cash ISAs in particular have been woeful for the last few years.

Enter the new Innovative Finance ISA which launched in April 2016 with the aim of enabling retail investors to take a tax efficient stake in the increasingly popular and potentially more lucrative (with some double figure returns offered) alternative finance sector.

Some IFISAs, such as our own, also came with the added bonus they were helping to boost funding for British businesses. In fact, recent data from the British Banking Association implies the P2P business lending industry now supplies about 6.56% of all new loans to SMEs across a wide range of industries – a small but increasingly important source of funding for home grown businesses.

Things can only get better

Alongside our colleagues at Crowd2Fund, Crowdstacker was one of two platforms to offer the Innovative Finance ISA from the very start. Gradually over the past two years other platforms have secured the correct permissions from the FCA and license from HMRC to also offer an ISA. So today there are several Innovative Finance ISA products on the market for retail investors to choose from.

However, over this time questions have been asked by the media and analysts, as well as inside the industry, about the performance of this new type of ISA, and the potential it has. If you take a look at data from nearly two full tax years of offering the new investment, some interesting patterns and insights emerge which show just how much potential it has.

A welcome addition to a balanced portfolio

Not only is the IFISA an important source of income for British businesses, it also provides exposure to a range of industries for investors.

The 4th Alternative Investing Industry report is hot off the press, and this indicates peer-to- peer business lending is the largest alternative finance segment, at a value of over £1.23bn in 2016.

This is a huge achievement in a short period of time, but is still dwarfed by the value of the mainstream British banking industry.

To compare IFISA subscriptions with stocks and shares ISAs or cash ISAs must be done so in this context.

Despite the disparity in size, the same report reveals IFISA investors have been given the opportunity through P2P business lending to invest in sectors as diverse as construction and real estate, as well as leisure and manufacturing.

Male investors are a key target market

We can also see some interesting differences between male and female investment patterns.

The difference between the numbers of male and female IFISA investors on our platform has remained steady with something in the region of three men to every one woman investor. Across the industry this data is similar with more than twice as many men as women engaging in peer-to-peer business lending.

> "The difference between the numbers of male and female IFISA investors on our platform has remained steady with something in the region of three men to every one woman investor"

This compares, however, to overall figures for all types of ISAs where slightly more women than men invest.

This is possibly because P2P lending is considered in a similar risk category to stocks and shares investing, compared to low-risk products such as cash ISAs or cash savings accounts. The latter are clearly preferred by women with more than twice as many men as women telling us in our most recent research they intend to invest in stocks and shares, either as part of their ISA or other investments.

IFISA investors happy to invest more, and get more

Take a look at the amounts being invested however and Innovative Finance ISAs are clearly considered worth this slightly increased risk.

2016-17 average ISA subscriptions were £5,558. Average subscriptions for our Innovative Finance ISA were above £11,000 – probably indicating early adopters of the IFISA are more seasoned investors, who are investing larger sums. Of course, as we know from other innovations such as smartphones and social media, where early adopters lead, the masses will follow, as long as the proposition is attractive.

And the overall proposition of the IFISA is very attractive. Our own investments over the past two years which are eligible to be held in an ISA have offered up to 7% returns. That's still nearly four times even the best rates on offer from cash ISAs at the time of writing.

We took some time to understand what investors are looking for from their investments, and the three key responses were tax efficiency, the ability to understand where and how the money is being used, and a fixed income. The Innovative Finance ISA offers all three of these key investment traits.

What will it take to go mainstream?

More work needs to be done by the whole industry to educate businesses and retail investors about the possibilities and opportunities presented by alternative finance, as well as the tax-free Innovative Finance ISA options. Average returns from our own platform have remained steady around 4-6% beating inflation and consistently beating many better known, but less risky investment products such as cash ISAs. Investors need to be educated to not only create better awareness of this type of investment, but also a better understanding of how they can be used as part of a well-balanced investment portfolio.

Once this greater momentum of understanding is achieved the Innovative Finance ISA could easily command its fair share of the entire ISA market.

Karteek Patel is CEO of Crowdstacker, one of the first P2P platforms to offer the IFISA. He can be contacted at karteek.patel@crowdstacker.com

The Housing Crisis: A New Year Res–Solution

by Michael Lynn

Alternative finance may prove a valuable force in tackling the UK's housing deficit.

It's the Government's stated aim to build 300,000 homes each year to solve the ever-increasing housing crisis. What resources will it take to do that? Land with planning permission, willing developers and necessary funding. The Government has already committed to releasing more land, particularly to smaller developers and is consulting with Local Authorities and developers on how to speed up the planning process. As to willing developers; there are plenty of great SME developers across the country with years' of experience and schemes under their belt, ready and willing to take up the challenge provided that the other two elements are in place. The largest 16 housebuilders built 90,668 in the year to October 2017. Even assuming a dramatic increase in their activity they are unlikely to build more than 150,000 new homes between them. This would leave a further 150,000 homes to be built by the smaller SME developers.

The House Builders Federation (HBF) has estimated that in 2015 fewer than 1 in 8 new homes were built by SMEs and that returning to the amount built in 2007 could boost housing supply by 25,000 homes per year. It is an aim and an endeavour of Relendex to accelerate the supply of new homes.

We have seen at first hand the demand from SME builders to fund the building of new homes and the refurbishment/ change of use of existing properties. We also know from lenders that there is appetite out there for investment loans on income-producing property.

UK Government efforts to boost the housing supply are being choked by a squeeze on funding for small housebuilders, according to a recent Federation of Master Builders (FMB) industry study. It showed that 54% of small and medium-sized developers said accessing finance is a major barrier to building more homes.

SMEs built 12 per cent of homes last year, according to the Housebuilders Federation, equating to 20,000 properties. This is a pitifully low number. There has been a long-term decline in the amount of SME housebuilders, falling 80 per cent over the last 25 years, according to HBF. During the financial crisis there was a steep decline with one-third of them folding between 2007 and 2009, often as a result of banks removing funding lines at critical stages in the development cycle.

> **"We have seen at first hand the demand from SME builders to fund the building of new homes and the refurbishment/change of use of existing properties. We also know from lenders that there is appetite out there for investment loans on income-producing property"**

The Government says that it will make available more funding but its conundrum is how to raise the necessary funding without raising the Government borrowing limits. We understand that Local Authorities may be given permission to borrow in their own name but does that really take the problem off the National Balance Sheet?

Alternative finance to the rescue?

If SME developers are required to build 150,000 new homes, then assuming an average new build selling price of £329,000 across the country and a 70% cost of sales (land and construction) would mean a cost of £230,000 per home. The SME developer would need to fund 30% from his own resources and the remainder would require debt funding or £24bn. Of course a proportion of this funding requirement would be provided from existing sources. Many of these new homes could be acquired by Local Authorities, Housing Associations, other Government agencies and private buyers. So how could this funding be made available from a source other than Government borrowing?

Imagine if you will, that just like in the old days, mutual Building Societies took in funds from savers and lent it to provide homes. The many-to-many model worked well for generations. What if there was a bit more joined up thinking out there that brought together Government, housebuilders and capital in a more constructive way? If we could unlock a small proportion of ISA cash and some SIPP cash, this could benefit all parties. The Government has already recognised that SME lending through Peer to Peer Innovative Finance ISAs (IFISA), is a way of bringing more funding into the nation's small to medium-sized businesses, which includes SME housebuilders.

> **"SMEs built 12 per cent of homes last year, according to the Housebuilders Federation, equating to 20,000 properties. This is a pitifully low number"**

Is this risk free? No, it's not but it represents lower volatility that Stock and Share ISAs and in areas where there is proven demand (and scarcity in many cases) for housing, the failure rate should be fairly low. A project that gets into difficulties would unlikely represent a total loss to investors. There would be a minimum of 30% cushion against any loss and investors could potentially be well diversified across multiple projects across the whole country, using managed IFISA products.

Once the completed homes had been delivered to a Local Authority or Housing Association, IFISAs could be used to provide long term funding of some of those homes, provided that the Government or Local Authority offered a suitable rental guarantee. Such a guarantee would protect investors but would not materially impact the Government's/Local Authority's overall commitments. And it would provide a low-risk, tax-free yield of say 4 or 5% to investors.

I'm not suggesting that any investor group should put the whole of their savings pot into SME House Builder lending but 3% of the accumulated wealth of both pots would represent over £20bn of new tax-free lending capital to support this national endeavour and this capital could be recycled year on year. It seems to me to be a win-win for the nation, Government, housebuilders and savers. It doesn't put new debt on the national Balance Sheet. It doesn't unduly burden Local Authorities or reduce the tax take to the Exchequer. It creates the new homes the country urgently needs to avoid a threatening social catastrophe and brings new employment to all the industries associated with construction, equipment, materials, interiors, furnishings, professional services and design.

Michael Lynn is founder and CEO of Relendex, a peer-to-peer company specialising in UK property loans. He can be contacted at michael.lynn@relendex.com

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This shift has the potential to change fundamentally the way investors think about their P2P holdings and it opens up platforms' access to a separate and much larger part of their existing investors' portfolios – Davis believes Abundance's "addressable pot" contains about £100bn that its owners would not previously have considered investing in P2P loans or crowd bonds.

The second major issue flows from the first, and is well illustrated by Zopa's experience.

Between March 2017 and late January 2018, Zopa was closed to new investors, a move the platform took in order to ensure it could satisfy demand from its existing customers for P2P consumer loans, without having to take on more risk or drive down loan pricing. By the time it reopened to new investors, Zopa had a waiting list of about 26,000 people alongside its existing customer base of 60,000 investors.

"We're seeing a lot of demand from existing customers to invest more in Peer-to-Peer," says Lawson. The desire among Zopa's investors to increase their P2P allocations means that the platform's loan book is growing at nearly 50% year-on-year simply through the increasing commitments of its existing investors. As they start to transfer old ISA holdings into the platform's IFISA, it is possible that Zopa will need to reinstate waiting lists from time to time to balance supply and demand on its platform.

> "We're seeing a lot of demand from existing customers to invest more in Peer-to-Peer"
>
> ANDREW LAWSON
> CHIEF PRODUCT OFFICER ZOPA

The trend, therefore, that will shape the next phase of the IFISA's roll-out is that the market is likely to get deeper – as existing P2P investors increase their allocation the asset class, both through new money and through ISA transfers – before it gets very much wider, with large numbers of new P2P investors joining the party.

Paul Sonabend, a VC investor who took out an IFISA with property platform Relendex in 2016, typifies this trend. He says that once the IFISA became available, a combination of growing confidence in P2P and the ability to invest tax-free encouraged him to channel his family's money as well as his own into P2P. He has opened IFISA accounts for his wife and children, greatly expanding the overall sums he is prepared to commit.

Today, he has about 5% of his personal portfolio in P2P loans but as other investments mature and run off, he's shifting funds over from other parts of his portfolio. "If you asked me again in 12 months, I would be very surprised if that proportion hadn't doubled, and if all goes well in 10 years it could easily be 20% or 25%," he says. It is this deepening of the P2P platforms' relationships with their existing investors that will determine how quickly the IFISA can be extended to include the "P2P outsiders".

Against this background, it is hardly surprising that for now awareness of IFISAs among the general public is so low. It is entirely possible that this will not change very much for some time to come.

Of course, the overall speed of the P2P market's growth will determine how long it takes for the major platforms to absorb the pent-up demand from its existing investors with funds in other types of ISA. The faster the market grows the sooner these platforms will be able to market their IFISAs more widely to new customers. For smaller platforms that may find it harder to attract investor funds, particularly to back larger loans, the ability to receive ISA transfers could offer quicker access to a larger share of their investors' overall assets, and therefore speed the growth of their loan books.

Who are the IFISA adopters and how much are they allocating?

Although AltFi's research suggests that younger investors are slightly more likely to have heard of the IFISA than older consumers, and are significantly more likely to use it, interviews with several of the largest platforms do not suggest a major influx of younger investors into P2P since its launch. Andrew Lawson says Zopa's investors are evenly distributed across the various age brackets, while Funding Circle's investors are on average aged 50-plus.

Abundance Generation provides a useful insight into the profile of IFISA adopters that reinforces the impression of a product dominated so far by older, more experienced investors.

Bruce Davis, Abundance's Founder, says the platform differs from others because rather than promoting its IFISA exclusively to existing investors, it advertised it to the mass market from launch in April 2016. "We're probably the only one who's gone out into the wider market and attracted new IFISA investors." The result has been "quite a marked shift in the profile of investors who've come on to our platform," he says. "We've still got our millennial audience putting in hundreds of pounds, but that just doesn't move the needle in terms of the amounts of money. The people who move the needle put in £5,000, £10,000 and £20,000 investments and that's a different group."

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> CO-FOUNDER, ABUNDANCE

The new arrivals have been better-off mainstream Stocks & Shares and Cash Isa investors predominantly in their fifties. These are not necessarily people primarily motivated by commitment to environmentally friendly investment – although they value the opportunity to support renewable energy projects. Instead, he says Abundance's IFISA offers them a way to diversify their overall ISA portfolio and generate additional yield.

In terms of flows, both Zopa and Abundance say that about 50% of the new money placed on their platform is now going through IFISA accounts.

As far as allocations to P2P are concerned, Abundance says that 60% of its investors do not use any other platform, and the median portfolio allocation to Abundance is 10%, with a smaller group allocating up to twice that.

Bruce Davis believes this illustrates the role that direct lending platforms will come to play in mainstream retail investment portfolios, now that these assets can be included in ISAs. "The IFISA means the sector is now able to access larger pots of money, but we're taking a similar share of those pots so we're still a diversification play. I don't think we're stealing anyone's lunch but it's easier now to diversify your investments within the tax-free wrapper."

The gulf that divides the IFISA market

For compelling practical reasons rooted in the need to balance supply and demand, the IFISA market is dominated by longstanding P2P investors who are using the new tax-free wrapper to increase their allocations to this asset class, often by transferring funds from other parts of their ISA portfolio and their existing P2P holdings. This process is likely to represent a significant proportion of IFISA inflows for at least the next few months and possibly longer. How ready are the "P2P outsiders" that form the great majority of our survey panel to take their initial steps into this market, and how many of them might eventually do so?

Some 26% of those who took part in the research own shares or funds either inside or outside an ISA, while 40% have a Cash Isa. Assuming the IFISA follows a similar trajectory over the next few years, perhaps 10%-20% of the population might eventually become P2P investors, inside or outside the IFISA wrapper. However, the rate of take-up will depend on numerous factors including how quickly alternative lending volumes expand and the outlook for interest rates on Cash ISAs, which could start to attract more money again if they began to rise.

But, as Karteek Patel, Chief Executive of Crowdstacker, argues, the major drag on wider adoption is likely to be the pervasive levels of ignorance about P2P. "Knowledge of alternative investing is still low and, by virtue of that fact, knowledge of the IFISA is still low," he says. "But the people who are using the IFISA are reaping the benefits of it."

The basic problem confirmed by the AltFi research is the continuing lack of basic awareness of P2P and the IFISA. This in turn feeds uncertainty and misconceptions about how these investments work – in many cases, the biggest group among respondents are the "don't knows".

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Most people are not sure whether the availability of an ISA wrapper makes P2P investing more attractive: 18% of people agree or strongly agree that it does; 14% disagree or strongly disagree; 27% neither agree nor disagree; 41% don't know. It is noticeable here, though, that the 18-34 age group is more likely to agree with this statement than older respondents.

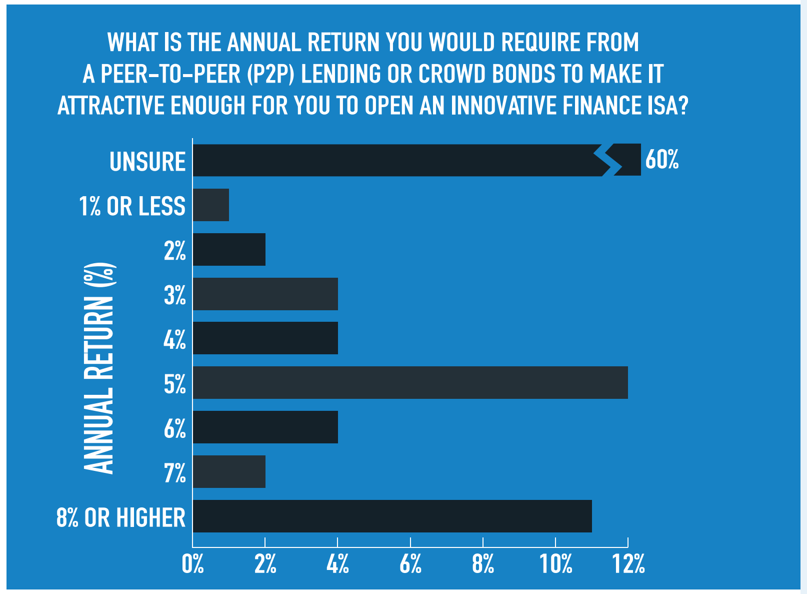
There is little evidence that people would prefer to spread their risks by investing across more than one alternative lending platform: again, 16% agree, 17% disagree, 26% are on the fence and 40% don't know.

And in some cases, the survey responses directly contradict the attitudes of "P2P insiders" who are already familiar and comfortable with the asset class. Just 11% of people would consider transferring a Cash or Stocks & Shares ISA into an IFISA, while 33% of women and 43% of men regard lending their money directly to consumers and small companies as riskier than investing in shares. Just 12% in both cases regard it as a safer proposition. This finding, in particular, stands in direct contrast to the most recent UK market report from the Cambridge Centre for Alternative Finance, published in December. The CCAF conducted its research among active P2P investors and found that they consistently place alternative lending of various kinds below equities on the risk spectrum.

"We're still a long way from the mass-adoption, mass-trust phase, where retail investors understand where alternative lending sits in a balanced portfolio," says Karteek Patel of Crowdstacker.

One possible takeaway from these findings is that there is currently a group comprising about 10%-15% of the survey respondents, who have a reasonable understanding of the attractions and risks of alternative lending. Those in this group that are not currently using lending platforms are most likely to form the next wave of P2P adopters. This impression is reinforced by the evidence the survey reveals that people are keen to know more about alternative lending investments and are looking for information and advice: about 15% of respondents had seen a financial adviser in the past year and within that group, just over a quarter had discussed P2P lending with their adviser. Among 18-34-year-old respondents, 56% of those who had seen a financial adviser had discussed P2P.

The survey findings suggest that IFISA providers need to offer returns of at least 5% in order to get investors interested, and that a second hurdle exists at 8%, where another sizeable group of people indicate this level of return would encourage them to invest.



Whether they will actually do so, however, remains a moot point. When asked whether they plan to invest more in 2018 than last year, the net balance in almost every age group is negative. The only exception to this comes among the 18-34s, among whom a net balance of 17% indicate that they do.

Overall, the research clearly demonstrates the widespread lack of knowledge about alternative investments that persists. There are some obvious bright spots in the findings for the long-term, notably the evidence that among younger people, P2P and alternative lending is well on the way to being regarded as a mainstream investment option. As they move through their peak earning years, those that choose to invest are likely to allocate a meaningful proportion of their capital to alternative lending assets.

But in the meantime there remains an unmistakable "wall of ignorance" that the IFISA must overcome before it can take its place alongside better known types of ISA in the portfolios of the wider investing public.

Andy Davis is a writer concentrating on finance and business and a former editor of FT Weekend. He can be contacted at andy.davis.ft@googlemail.com

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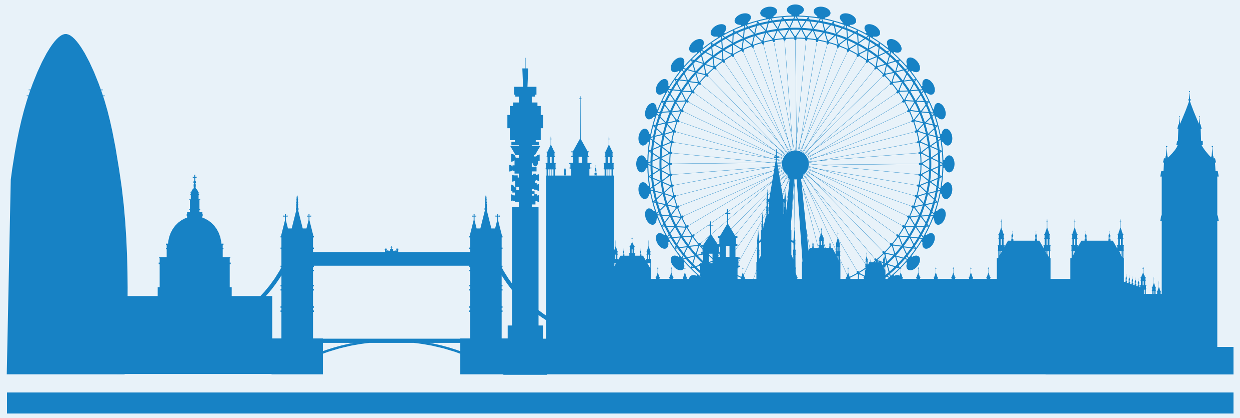
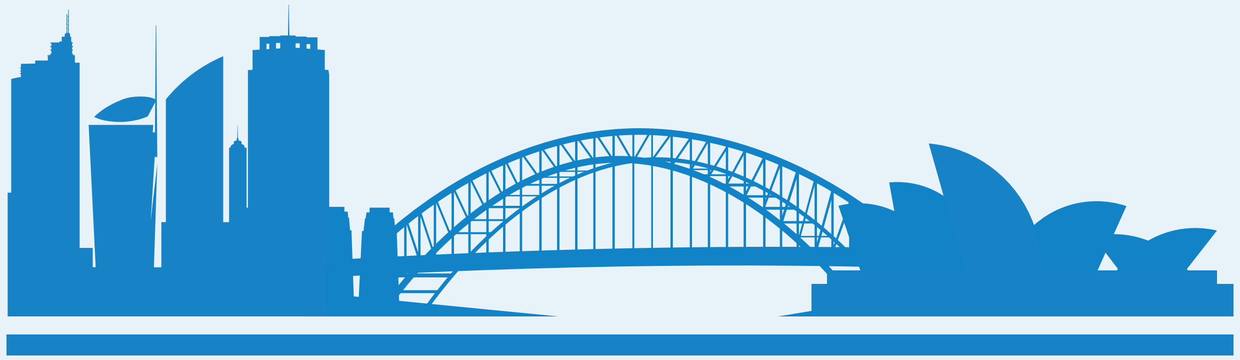


LONDON SUMMIT 2018

The AltFi Summit London returns for the fifth time, in a new venue, with new topics to explore and brand new audience segments. Open Banking and PSD2, each set to go live in early 2018, will form an important part of the discussion, as will the ongoing maturation of the online lending sector.

26th March 2018



AUSTRALASIA SUMMIT 2018

We are excited to announce that AltFi Australasia Summit is coming back to Sydney for its third edition.

16th April 2018

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When investing it is important to remember that past performance is not a guide to future performance. Capital is at risk and returns are not guaranteed. Tax reliefs depend on the individual circumstances of each investor and may be subject to change in the future.

Notes