

AN INTRODUCTION TO PROPERTY BONDS

PROPERTY BONDS – INSIGHT

Created by Investment Synergy, this guide offers an insight into property bonds for sophisticated, high-net-worth and professional investors; investors who are experienced with varying investment opportunities and the risk/return profiles of less traditional asset classes. Providing an opportunity to become involved in the property market, experienced investors can utilise property bonds to target more attractive returns than mainstream opportunities, whilst building a diverse portfolio in a manner that can generate returns tax-free.

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INTRODUCTION

Asset-backed property bonds are becoming an increasingly credible alternative to traditional property investment vehicles, such as buy-to-let.

Over recent years, asset-backed property bonds - the alternative investment product that provides alternative finance to property companies for the development of residential and commercial property projects - have grown in popularity. They offer investors access to the property sector, with the security of bricks and mortar, but without the hands-on nature of buy-to-let and direct property development and the downsides that often come with them. This guide will provide investors with a detailed insight into property bonds. It will illustrate what they are, how they work, and the attractive benefits - from potentially higher target returns to tax-efficiency - they can offer experienced investors.

The questions explored will include:

- Why have property bonds increased in popularity?
- What target returns can be delivered by property bonds?
- How do investors get involved with property bonds?

KEY FEATURES

Owing to their potential for higher returns, ease of access, asset-backed security and tax-efficient investment methods - with tax-free returns accessible in some cases via the IFISA - property bonds are extremely popular with experienced investors.

There are a number of key features that make asset-backed property bonds such an attractive investment consideration:

- Target returns of between 4.75% and 7.5%
- Fixed term, typically between three and five years
- Asset-backed security via a first or second legal charge
- Compounding income or regular (quarterly) income options
- Minimum investment amounts as low as £5,000
- Often no fees or charges for investors
- Allow investors easy access to the high-yielding property market, from residential property to commercial property
- Depending on an investor's personal circumstances, IFISA eligible, meaning returns are tax-free

WHAT IS A PROPERTY BOND?

Due to the attractive target returns available in the UK market, property remains one of the most popular assets for investors - and property bonds allow investors access to the sector without requiring knowledge of construction or land development, and without the hands-on nature of buy-to-let.

A property bond allows investors to loan their capital to property development companies for the purpose of purchasing land, existing properties, or for new build development finance.

Property bonds can be issued directly via a property company, or through a specialist lending company.

- A legally-binding agreement between investors and the bond issuer or property company, property bonds have the potential to provide market-leading returns for experienced investors.
- One of these is the Innovative Finance ISA (IFISA), which shields returns from income and capital gains tax.

- Investors into a property bond will receive a rate of interest over a fixed period of time, and at the end of the term, the investor's original capital is repaid in full. What is a property bond? Due to the attractive target returns available in the UK market, property remains one of the most popular assets for investors - and property bonds allow investors access to the sector without requiring knowledge of construction or land development, and without the hands-on nature of buy-to-let.
- Increasing in popularity with both investors and lenders after the 2008 global recession, their accessibility has widened. Once a niche asset, property bonds are now accessible through a variety of routes.

HOW DOES A PROPERTY BOND WORK?

Property bonds are issued in two primary ways:

- **Direct via the property company**

- **Through a specialist lending company**

Specialist lending companies will often have a team of ex-bankers at the helm. This offers an additional layer of knowledge, experience and industry understanding - allowing any such property bond to be structured in the most robust manner possible. Additionally, when issued through a specialist lending company, property bonds will often be attainable through various tax-efficient methods - including the IFISA, SIPP or SSAS. How do property bonds work? Investors Bond Issuer Specialist Lending Company Once the bonds are issued and loans are made, they are secured against the property or land. These charges offer collateral and security for investors. On occasion, an Independent Security Trustee is also appointed to provide an additional element of protection.

WHY HAVE PROPERTY BONDS INCREASED IN POPULARITY?

The alternative finance generated through property bonds is crucial in supporting SME property developers, while experienced investors are attracted to their higher target returns, easy access and the potential of tax-free returns when IFISA eligible.

- The requirement for alternative finance and non-bank lending - The issue of property bonds has become vastly more common in recent years, as the aftermath of the 2008 financial crisis left regional, SME property developers - particularly in the residential housing sector - without access to the funding they needed. Alternative finance and non-bank lending became a crucial part of the funding mix, allowing regional property developers to continue to drive innovation, create local jobs, and - for house builders - build much-needed bespoke housing.
- The UK's housing shortage: - With an estimated 345,000 new homes required each year to keep up with demand, and the government's 300,000 per year target continuously failing to be met - with only 178,800 new-builds completed in the year ending December 2019 - regional house builders play an important role in tackling the UK's chronic housing shortage, and they largely rely on the alternative finance made accessible through the issue of property bonds to do so.
- Potentially higher target returns for investors - Property bonds also offer attractive benefits to investors at a time when interest rates have hit record lows - with the Bank of England base rate sitting at 0.1% at the time of writing - and the appeal of buy-to-let property investment is in decline. High target rates of between 4.75% and 7.5% are understandably attractive to experienced investors who have, for some time, struggled to generate a healthy return on their capital due to diminishing interest rates.
- Easy access to the property sector - Investors with an interest in property can gain easy access to the sector through property bonds, as the complexities of other methods of property investment - such as direct property development and buy-to-let - also have a part to play in the increased popularity of property bonds. Many investors want to reap the benefits of investing into property - namely, the high potential returns - without having to confront the time-consuming responsibilities that come with being a landlord, or the experience needed to get involved in construction and land development.
- The diminishing popularity of buy-to-let - It's worth noting that changes to mortgage tax relief, stamp duty on second homes and the tightening of underwriting standards for buy-to-let mortgages has meant that buy-to-let has dwindled in popularity with investors. This is evidenced as landlords appear to be purchasing fewer homes than at any time in the last ten years (2010-2020).
- The introduction of the Innovative Finance ISA (IFISA) - The IFISA enables investors to hold peer-to-peer loans and debt-based securities (such as an asset-backed property bond) under the ISA tax wrapper. Investors are able to generate returns tax-free through an IFISA eligible property bond

WHAT TARGET RETURNS CAN PROPERTY BONDS DELIVER?

The returns targeted by property bonds will typically range from 4.75% to 7.5% per annum.

However, each property bond will have its own risk/return profile, and there can be a significant spread of target rates of return - all of which will vary on a provider-to-provider basis.

It is important that investors treat any investment suggesting returns in excess of 8% with particular caution, keeping in mind that the higher the return, the higher the overall risk.

Many property bonds give investors the choice of when they receive interest payments. Typically, the options are to have interest rolled-up and paid all-together with the repayment of your capital upon maturity (at the end of a fixed term), or to receive interest payments on a quarterly basis - providing a regular income.

WHY DO EXPERIENCED INVESTORS CHOOSE PROPERTY BONDS?

In a period where experienced investors are receiving low income returns on cash savings, many are looking to the alternative investment market to make their money work harder. With property bonds, investors have the potential to achieve better risk adjusted returns with higher interest rates through secured loans to the UK's residential and commercial property market. However, returns are just one aspect, and there are several other reasons why an experienced investor may choose a property bond. For example:

- Investors who are attracted to the prospect of investing into the property sector, but don't have the time for the responsibilities of buy-to-let - because, perhaps, their full-time career is already too demanding - may find the ease of a property bond particularly appealing. This is especially true when considering that most property bonds can be invested into online, often boasting a platform where investors can view the status of their investment as and when they wish.
- Investing in property bonds does not require investors to have expert knowledge of construction or land development.
- The often-low minimum investment amounts attached to property bonds mean that, when compared to the initial capital needed in the purchase of properties for the purpose of renting or refurbishment to re-sell, they're more readily accessible to a wider range of experienced investors.

- Many investors are attracted to property bonds because of the diversification they allow. With portfolio diversification a critical part of any successful investment portfolio, property bonds can provide it in various ways - such as the ability to invest in residential or commercial property, or property opportunities in various locations throughout the country.

- Diversification can be possible for investors within their ISA allowance. With property bonds accessible via an IFISA, it is possible to spread your £20,000 annual ISA allowance over a low-risk Cash ISA, the highly volatile stock market via a Stocks and Shares ISA, and the UK property market with a property-backed IFISA.

- With property bonds able to target returns that can be delivered quarterly, annually or on maturity (i.e., after a four-year period), diversification can be achieved in the way of income - choosing quarterly returns if your portfolio is based on long term gains or returns on maturity if it's the opposite.

- Whilst experienced investors are appreciative of the risk involved with investing in the property market, property bonds offer a level of security that is not possible with other similar alternative investment opportunities. Although returns are not generally guaranteed on property bonds (unless the rate of return is fixed, but such products usually offer low rates of return), the bond is secured to a physical asset - the property or the land upon which it's built.

HOW DO INVESTORS GET INVOLVED WITH PROPERTY BONDS?

Property bonds are accessible today via a range of service providers and investment platforms and can often be invested into from as little as £5,000.

- With a variety of considerations to account for, the underlying process can be detailed in three steps:

- Choosing a property bond that most closely meets your investment goals, and understanding the bond's risk/return profile
Investing into the bond via a dedicated online platform and through an appropriate investment vehicle (for example, the IFISA)
- Realising any returns as stipulated in the bond note (the agreed fixed rate or the target rate, if achieved)

CHOOSING A PROPERTY BOND

Choosing a property bond is a process, and there are several aspects an investor will need to consider - including the property bond provider, the choice between fixed term and fixed rate, and a substantial number of options in terms of who and where the actual bond will be loaned to. Understanding the targeted rates of return is one aspect - but only one. You must fully understand the risks as well as the returns, and your decision must start with your investment goals and be led by the products and investment opportunities available to help meet them. Are you targeting a payment at the end of a four-year period, or are you looking for quarterly payments to act as an income? Are you happy to introduce a level of risk into your portfolio and target higher rates of return, or do you want a notably lower rate of return, but one that's guaranteed? These are just an example of some of the questions that investors should ask themselves, and one component that should be consistent in any decision-making process is due diligence of the company the bond will loan money to. As property bonds are an investment product and do not offer guaranteed rates of return, you must be as confident as you can be that the property provider loaning your funds has the knowledge and experience required to offer the highest possibility of success.

How established is the company and the team behind it? Does their business plan appear solid? What are their plans should the developments face unprecedented challenges?

Whilst not necessarily possible if you're investing into a property bond that will loan money to property developers at the other end of the country to yourself, if it's a localised developer, you could take your due diligence a step further - how much of a demand is there for the property they're proposing to build or re-develop?

INVESTING VIA A SUITABLE VEHICLE

The process of investing into a property bond has arguably never been easier. At the time of writing this guide, there are three primary ways you can add property bonds to your investment portfolio, all having their own benefits depending on your financial circumstances and goals.

1. Innovative Finance ISA (IFISA) - The IFISA was introduced in the 2016/17 tax year to support the growth of the alternative investment industry, within which property bonds fall. Having seen over £1 billion invested into them since their inception, they are clearly proving to be a popular option for investors. Falling within the Individual Savings Account (ISA) wrapper, investors are able to invest up to the annual ISA limit - currently £20,000 - into a property bond (should the provider offer the ability to do so) via an IFISA and realise any returns completely free of income or capital gains tax.

2. Pensions - Property bonds are an accessible investment option through both Self-Invested Personal Pensions (SIPPs) and Small Self-Administered Scheme (SSAS) pensions. Whilst it is always recommended to take advice before making an investment, it becomes particularly so if you're approaching retirement and are investing with your retirement fund. However, as property bonds have a variety of investment options, there can be an opportunity to meet most requirements - from those investors looking to boost their retirement funds at the last minute, to those who are wanting to target attractive rates of return and are happy to lock their money away to achieve it. Importantly, property bonds aren't always accessible by default via SIPP and SSAS providers, so approval may have to be sought before an investment can be made.

3. **Direct** - Whilst it's always recommended to consider investing into a property bond via an IFISA, SIPP or SSAS due to the tax reliefs available, it may not always be possible to do so - you may have used all of your annual ISA contributions, for example. However, it is still possible to invest into a property bond. Although you will pay tax on any returns generated, such an opportunity provides you access to the generous target rates of return available via property bonds. What's more, this approach to investing in property bonds is not only accessible by individuals, but companies, too, giving business owners an opportunity to make any spare capital in their business work harder

REALISING RETURNS -

There are two key points to understand when looking at realising returns from your investment into a property bond:

1. When your investment (both the capital and any interest) should be delivered
2. What the amount of your target returns should be.

With fixed term bonds, the bond will mature on a specific date and this will not change. What's more, assuming the investment has achieved its goals, your capital and the targeted returns will be provided on or around said date - but as the bond does not have a fixed rate, this isn't guaranteed. There are a number of additional variables to consider when looking at when any potential returns will be realised - such as whether you have opted for returns on maturity or at another specified period (e.g., quarterly) - but all investors should be confident making a calculation of when their investment should produce a return, and of how much should be returned (on the caveat that the opportunity delivers its intended goals).

FAQs

What is asset-backed security, and how are property bonds secured? Property bonds are typically secured by way of a first or second legal charge over the underlying asset. These charges offer collateral and security for investors and are registered on the property title at the Land Registry Office. This means that in the event the borrower defaults on their loans, the bond issuer has the right to seize the asset (the development) and use it to pay back developers.

Will I pay tax on the returns I earn from a property bond? This depends on how you choose to invest. There are several tax-efficient methods of investing into a property bond, including through an IFISA - where there is no income or capital gains tax to pay on any returns realised - and a SIPP or SSAS pension.

If you decide to invest direct, returns are taxable.

Can I access my funds before the fixed term property bond matures? Property bonds are considered a long-term, illiquid investment product. With a fixed term property bond, investors will usually be unable to access their funds before the bond matures at the end of the term.

Why are property bonds necessary, why don't property developers borrow from banks? Since the 2008 recession, many smaller, regional house-builders in particular have struggled to secure the funds needed for property projects from traditional financial institutions. But the development of property remains crucial to the UK on both a societal and economic level, and the alternative method of finance offered by property bonds can facilitate the delivery of much-needed residential and commercial property developments. The finance accessible by the issue of property bonds also means developers are able to take on bigger, more ambitious projects.

Investment Synergy Limited provide experienced investors with access to information concerning fixed term property investments that generate returns from various loan structures made available to the UK & EU property sectors.

This Property Bond Guide is not intended to be a promotion of any individual investment opportunity and is not an offer to the public. The summary information provided about Property Bonds is intended solely to demonstrate a type of investment available, and any investment decision should be made on the basis of a full understanding of the structure and risks involved.

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