P2P RESIDENTIAL

RISK PACK / 2018

SPECIFIC / UNSYSTEMATIC RISKS

These are risks specific to individual projects, which we can and do control.

BUSINESS RISK

Risk that the project in question does not represent a good business case.

Mitigation

We ensure that only projects that meet our minimum profit-on-cost (POC) criterion of 25% are taken on with planning permission already in place. As the market recovers and opportunities diminish in quality, deals that meet this criterion are increasingly rare. Despite this, we do not compromise on it!

LAND VALUE RISK

Risk that the value of the acquired land changes due to market or any other circumstances.

Mitigation

In addition to add value, we always aim to buy assets below market value but more importantly, we carry out thorough research which is essential in assessing all risks. The important research areas that we cover include:

1) Forecast of development;
2) Optimal strategy;
3) Investor demand;
4) Occupiers and consumer demand;
5) Regeneration;
6) Transport and amenities.

In order to avoid acquiring sites with nasty surprises such as obstructing pipes, WWII unexploded bombs and other archaeological remains, we ensure that we carry out the maximum due diligence on the sites before acquisition.

PLANNING RISK

Risk that no usable planning permission is granted or that this process takes longer than expected. This risk also applies to other municipal approvals or change of use.

Mitigation

For development projects where we acquire the site upfront, we only select sites that would have some form of planning already in place, unless agreed otherwise with our investors. The deal has to stack up on its own, i.e. achieve 25% POC without further planning approval.

If there is room for further enhancing the deal with regards to planning, we carefully consider the risk-reward aspects before proceeding. In the event that we decide to obtain new or improved planning, we would do the following:

- Work with experienced planning consultants in the local area whom are familiar with the council's planning and development strategies;
- Speak directly to the council's planning department;
- Look for comparable developments and planning precedents in the local areas;
- Foresee any potential conditions that may prevent planning from being granted.

CONSTRUCTION RISK

Risk of construction cost spiralling, inferior design, substandard quality and extension in construction duration.

Mitigation

Before selecting a project, our Chief Risk Officer and Development Director will produce an initial development appraisal consisting of calculated estimates based on their prior experience. At this stage, the development costs would be based on the floor area multiplied by the cost per square foot.

Once a project has been selected, we mitigate the construction risk by having our Development Director perform meticulous costs calculations. Only projects that satisfies the strict risk-reward criteria will progress past this stage.

Cost calculations continue to be refined throughout the development process as the design evolves towards final specifications, and as project costs are ascertained. Our appraisals also take into account costs associated with potential delays and their impact on the overall project.

Before going to tender and choosing a contractor to carry out the works, we inspect the quality of their past projects and check their financial health. We only proceed with those who are capable of developing properties to our high standards and finish the work.

We also ensure that we have controlled pricing mechanisms when entering into construction contracts. Therefore, we prefer to have a watertight fixed price contract provided by the Joint Contracts Tribunal (JCT), specifically JCT 2011. We insure the construction works with performance bonds as well as self-insure via retentions.

The quality, cost, and the timeframe of the building works are constantly monitored externally by a Quantity Surveyor (QS) as well as internally by our Development Director and our own QS.

As part of our business in the long term, we monitor inflation levels, potential labour and material price increases to ensure that we stay up-to-date with construction costs.

OPERATIONAL RISK

Risk arising from failure of internal processes, people and systems, dominance of single individuals, reliance on third party and failure of plans to recover from external events.

Mitigation

Our Chief Operating Officer is responsible for ensuring that the internal processes are solid, only the right people are working with or for P2P, and that systems are put in place to keep things running smoothly.

Constant communication is maintained between members of P2P to reduce complete reliance on single individuals so that should something untoward happen to one of them, some other members can take over his or her roles.

We work with various third parties over the course of the project, such as contractors, agents, solicitors etc. We vet them before proceeding to do any business as we must ensure that they are the right fit for P2P.

We seek to obtain appropriate insurance to cover the risk of external events damaging the project.

REVENUE RISK

Risk that we do not achieve the desired revenue levels determined when the project was first appraised.

Mitigation

In order to ensure as much as possible that we sell the properties for at least as much as what we intended to sell at outset, we are prudent with our estimates of sale prices. We only consider properties that have already been sold or sold subject-to-contract as suitable comparable properties. We try as much as possible to only use similar properties in close proximity to the project property to compare against. Crucially, future house price increases are not factored into the expected sale prices.

We occasionally seek estate agents' opinion on potential sale prices but they serve more as confirmation of potential sale prices rather than being the basis of our expected sale prices.

LIQUIDITY RISK

Risk that we run into cash flow problems during the project.

Mitigation

We ring-fence our projects in Special Purpose Vehicles (SPVs) to ensure that the projects are ring fenced and their respective cash flows are protected.

We make sure that our Lenders are in a good position to fund the project. For private investors, this means vetting them to make sure that they are financially and emotionally comfortable with parting with their money for the duration of the project. For institutional lenders, this means checking that they are reputable and are in a strong financial position to continue to release development finance when required by the project.

LEGAL RISK

Risk of financial or reputational loss arising from regulatory or legal action, disputes for or against the company, failure to correctly document, enforce or adhere to contractual arrangements, inadequate management of non-contractual rights, or failure to meet non-contractual obligations. It also concerns the risk of not obtaining the required permits and the risks involved with buying existing companies to acquire land positions.

Mitigation

First and foremost, we undertake thorough document reviews and researches at the early stages of a deal.

Most of the relationships in a property deal are defined by contracts. Therefore, as part of our business dealings, we use watertight contracts which are drafted especially for P2P. We adhere to industry guidelines and involve our solicitors in various stages of the process.

More importantly, we try to avoid legal risk altogether by developing and maintaining a good relationship with the various parties we deal with during the course of the project. We keep communication lines open and communicate frequently.

EXTERNAL RISK

Risk from external factors, such as natural disasters.

Mitigation

We ensure that we are properly covered with the appropriate insurance. Just as we do for choosing lenders, we only select reputable insurers who are capable of honouring our claims should the need arise.

SYSTEMATIC RISKS

These are risks that affect the entire market as well as other investment markets that are generally out of our control.

MARKET RISK

Risks related to changes in the investment market values or other features correlated with investment markets, such as interest and inflation rates.

Mitigation

In order to mitigate interest rate risks, we only involve ourselves in short-term projects, usually between 12 and 24 months so that we do not have to worry about long-term changes to the interest rates. Where longer-term funding is required, we would opt for fixed interest payments if we feel that an interest rate rise is likely.

Perhaps the biggest concern in the property industry today is the turning of the market. Our mitigation lies in our strategy, which is to only undertake projects with a minimum of 25% POC. This implies that we can take a hit of roughly 20% before the project enters the loss territory.

We keep an eye on the market so that if needed, we may choose to exit the project earlier than originally intended to prevent further reduction in profits.

For all of our projects, our Chief Risk Officer carry out scenario tests where two variables are stress-tested simultaneously - project duration and price drop, as follows:

Scenario	Project duration	Price drop
1	+1	0%
2	+2	3%
3	+3	6%
4	+4	9%
5	+5	12%
6	+6	15%
7	+7	18%
8	+8	21%
9	+9	24%
10	+10	27%
11	+11	30%
12	+12	33%
13	+13	36%

The logic for such scenario tests is such that when the construction completes, we see what the market value is relative to our original estimate (which is the current market value without taking into account any future house price inflation) and drop the price accordingly. The stress tests are double whammies because in addition to the price drop, the time taken to sell the properties are also extended, thus increasing the amount of interest that needs to be paid.

Based on historical experience, by referring to the Nationwide House Price Index that goes back to 1973 when it was first recorded, the data shows that over 18 months, the largest ever fall in the Outer Met area was -20.23% (during the 1990 economic crisis) and for London it was -20.10% (during the 2008 credit crunch). If we assume that the market will bottom out as badly as the historical worst, then targeting a POC of 25% would provide us with a sufficiently high cushion for price falls.

POLITICAL RISK

Risk arising due to a change in government, regulations and zoning (Unitary Development Plan).

Mitigation

We constantly monitor regulatory amendments and follow up on the latest policies. For example, we thoroughly analyse each budget announcement from the government. We then work very closely with our planning consultants to interpret these changes and react in the most effective manner.

TAX RISK

Risks arising due to a change in tax laws.

Mitigation

With tax laws constantly changing, we speak to tax experts before the start of each project to choose the best structure for the project. As the project progresses, tax risks become less of an issue.

Please not that we do not offer tax advice to our investors but we can always recommend trusted professionals we work closely with.