LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 152 / CHRISTIAN FAES

Welcome to the Lend Academy podcast, Episode No. 152. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Peter Renton: Today on the show, I am delighted to welcome Christian Faes, he is the CEO and Co-Founder of LendInvest. Now LendInvest are based in the UK, they are really the UK's leading online property finance marketplace, they've built up the business on short-term bridge loans and they're one of the largest providers now in the UK in that space and they've done this in an online fashion. They've really brought technology to bear on the property lending and property investing process. They have a broad cross section of investors which we go into in some depth. We also talk about the technology they've brought to bear on the borrowing process. We talk about Brexit, the housing shortage in the UK and we also cover a potential LendInvest IPO. It was a fascinating interview, hope you enjoy the show!

Welcome to the podcast, Christian.

Christian Faes: Thanks Peter, it's great to be here.

Peter: Okay, so I like to get these things started by just giving a little background about yourself. I mean, you're a fellow Aussie which it's nice to have you, the second Aussie I've had on. So I'm curious to get your background and find out how someone from Queensland ends up in the UK so just give us a little bit of background on that.

Christian: Ends up in sunny London.

Peter: Yes. (laughs)

Christian: I'm a lawyer by background, studied law in Australia and did my traineeship there. I actually moved to the UK in my early 20's and was a lawyer here for a few years and I guess as entrepreneurs do I sort of jumped around a bit. I moved back to Australia, I was a lawyer there for a while and then got involved in the mortgage business there actually and actually was getting a little bit bored in Australia, was sort of keen to move back to London, I definitely like London as a city and was keen to come back here so I moved back in 2008 to set up what has now become LendInvest.

Peter: Okay, so then I know you had a business before LendInvest called Montello and so can you just explain I guess the genesis of that business and when LendInvest and how that sort of came into the picture.

Christian: Absolutely, so when I moved back to the UK in 2008, I met my now Co-Founder through a mutual friend. As I said, I was involved at a small mortgage lending business in Australia and when I moved back to the UK in 2008 it was interesting times, generally, but we saw short-term mortgages as a particularly interesting opportunity, certainly we thought it was.

The operators in the space at the time typically had one bank that they relied upon and coming into the crisis that bank sort of pulled their funding lines and their businesses disappeared, but not necessarily due to the credit quality of their loan books. If I compare that to the short-term mortgage market in Australia, it was quite common for there to be small funds that sort of backed lenders in the industry, but in the UK that didn't really exist. So saw it as an opportunity essentially to sort of try to create an investment asset class around short-term mortgages and allow investors to invest in the loans that we would originate as an originator.

So we really set up as a funds management and loan origination business back then, got off to a very slow start; like I said, it was interesting times. But really, in many respects, the foundation for what is now a very scalable business, but we were very much an offline short-term...I guess, certainly, some would perceive as quite a niche player at that time. It was only in the last four or five years that we've become very tech-enabled and really tech-driven as a business and that was sort of a journey I guess that we went on initially in using technology to try and raise capital so we set up our online investment platform which allowed investors to pick loans and that was quite transformative for us as a business.

So I think as an untried fund manager it was very difficult to raise capital as fintech was becoming really a big thing here in the UK, peer-to-peer platforms taking off and so on and when we set up our platform it was very sort of elementary in the early days, but we started to raise more capital within a matter of months online than we had in the fund management business that we had spent four or five years trying to build.

So I guess technology really captured our imagination initially just to raise capital and then sort of beyond that, we essentially pivoted what was Montello into LendInvest and became very tech orientated.

Peter: Okay, so then I'm curious about...I just want to go back, I mean, you started this business in 2008, I mean, real estate was the cause of the crisis particularly in the US...

Christian: Yeah.

Peter: ...and globally for that matter in most countries it seemed. You said this bank pulled back funding, what were the other options apart from the bank back then? I'm just trying to get a sense of what the competitive landscape was for short-term bridge loans in the UK and how has that evolved over time,.

Christian: Yeah, it was amazing. It literally was a blank canvas in many respects so one or two sort of smaller-ish players had survived through that period and they're still in business today, but generally speaking, all of them went out of business.

Peter: Wow.

Christian: So there's a number now...it's become a much more institutionalized space in the last ten years, I guess, and it is dominated by sort of a big five or six players which we are a part of, but most of those were fairly new players post the crisis.

Peter: So it was a while there that people really struggled, like these developers really struggled to get short-term bridge loans, I take it.

Christian: Yeah, they really did. It was quite interesting to be operating in that period because I think in many respects there were better opportunities for property investors in terms of the discounts they could get in the market in the sort of distressed situations that perhaps investors could capitalize on, but the funding wasn't there.

I guess that was probably one of the things that we underestimated. I think on paper the business was a great opportunity for us as well, but we probably didn't calculate quite as accurately how difficult it would be to get investors. Like you say, mortgages were kind of the eye of the storm of the crisis and so to try to get investors to be confident enough to originate deal flow that was of a quality that they would want to invest in was a real struggle in the early days. But I think it was a good start for the business.

Peter: Right, right. Obviously the short-term bridge loans weren't really the cause of the crisis, it was more of the longer term ones. So I wanted to talk about the actual loans themselves for a little bit. I was just on your website this morning and it said you've done over 1.1 billion pounds worth of loans. I presume the vast majority of those are these short-term bridge loans. Can you tell us what are the typical...you know, what's the loan size, how long, interest rate, that sort of thing?

Christian: Yeah sure. So we've got three products now. The heritage of the business was in short-term mortgages, we're still very dominant in that sector of the mortgage market, we've got about 10% to 15% market share in the UK so that's a core product for us. Interest rates on that to the borrowers vary anywhere from 7 to 12% per annum, but it's a monthly charge and they can pay it back anytime, early without penalty.

So it's a fairly flexible facility, average duration is six to seven months so again quite short-dated and usually the vast majority of the book is secured by first registered charge against the property and we go to a maximum loan to value of 75%, but across the book it's sort of 60 to 65 percent so it's pretty conservative in terms of the lending profile.

The other product which we've been active most recently in the last two to three years is development finance which is more ground up, literally building a house on a block of land, more sort of extensive work being done to a property than what a bridge typically entails and that can lend out to three years in duration and sort of similar sort of LTVs and similar sort of interest rates as well, actually.

Our most recent product which we launched late last year is buy-to-let. What is commonly referred to here in the UK is buy-to-let, is essentially just an investment mortgage where the borrower is not going to live in the property, they're going to tenant it out and earn a return on it.

Peter: Right.

Christian: And that product goes out to 30 years and is a much lower interest rate of sort of between 3 and 5% per annum. So we lend from one month through to 30 years in duration now.

Peter: Wow, so I want to talk a bit about the borrowers. You talked about the development loans, but these short-term bridge loans..I mean, obviously the fix & flip sector is pretty hot in the US, there's lots of different players and these are sort of developers that...they buy a property, they spend $30 or 40 or 50 grand doing it up then sell it pretty quickly for a profit. Is that the sector...are these sort of small business people that are doing these? Who are the borrowers?

Christian: Yeah, we describe our borrowers as property entrepreneurs, So those three products fit quite neatly as catering as a one stop shop to that property entrepreneur customer. So they're professionals, they're doing this on a full-time basis, they usually will be active in a certain geographical patch so they know the agents, they know the market quite well, they know who the end buyer is going to be for the product.

On the bridge product, like you said, it's similar to the fix & flip or hard money product in the US and it's typically someone buying at auction where they've got a 28-day completion period and they really just need quick capital. Or, they're going to buy and change the bathroom, kitchen, whatever it may be; fairly cosmetic work, not necessarily structural work, and then like you said, look to sell it. Or, in many instances, they're portfolio landlords so they'll buy distressed properties or properties that need work, they'll do them and then they'll roll them into sort of a long-term portfolio.

So for us, the bridge product allows them to move quickly if they need that quick capital, development finance if it's a more extensive project that they're working on and now buy-to-let if they want to hold it for a long period of time. And really, the buy-to-let product was a natural evolution for us in the sense that half of our business before was actually fix & flip, some of it gets sold and the other half pretty much sat across borrowers that we're doing the refurbishing work and then intended to hold for a long period of time so they were refinancing with another buy-to-let lender. So for us, we've got a full complement of products that they want.

Peter: Right. I'm curious, you started off talking about technology and you brought technology to bear on the investor side of the business. We'll talk a bit more about that in a little bit, but I'm curious about the technology in the borrowing process because property…there is a lot of offline stuff, a lot of offline records. Obviously, it's by definition an offline product, it's a piece of physical property so how have you brought technology to bear in the borrowing process?

Christian: Yeah, I think the mortgage space is hard and I think that in some respects that's the attraction to it for us, longer term, but it's very difficult to try and automate a lot of it, like you say. So we still have an independent value, we'll go and visit the property, they'll go inside and take photos and so on and so there's kind of pain points along the process that I think the capital markets kind of demand of us in their underwriting processes to just adhere to for the time being and that does necessarily slow it down. But the technology is extremely useful in really speeding up the process so that it really can land on an underwriter's screen.

So we literally...all the decisions are still made by experienced underwriters, but all the information can land on their screen in a much quicker way. Actually, they can make a more informed decision by taking from more data sources and presenting them with a much fuller picture to make that decision that they need to make. Some of that is as simple as just not having someone at a traditional financial institution that types the borrower's name into various different search platforms on a borrower or inspecting the property, to have that come through APIs and done in a much quicker way through to the experience of the borrower.

Here in the UK, the market is very intermediated so a lot of our technology is created to sort of cater to the borrower, but also with the broker in mind as well so really allowing them to transact with us in an easy as possible way, you know, DocuSigning contracts and things like that. In many respects, I guess from your perspective, being very much in touch with what's happening in online lending, we think that's not all that revolutionary, but when you come from the mortgage world, that really is quite interesting and certainly gets to allow us to transact very quickly.

So on average, we're lending within 14 days of first point of contact from the borrower which is still slow, but the average mortgage in the UK takes three months so it's definitely the quickest in the market.

Peter: Right, and yeah, it's still slow in the US for the most part and that's what a lot of the entrepreneurs here are trying to speed up that process. So you mentioned brokers, I'm just thinking about your channels for finding these people...I mean obviously now you're a major player so you probably get a lot of word of mouth, but how are you finding...like there's obviously new property entrepreneurs starting up every month and they say, I'm going to give this a go. How do you find them and how do you find the good ones?

Christian: Yeah, sure. I think it's something as a business that is still very much a work in progress and the reality is a lot of it is still done in traditional ways. So mortgage brokers are very key to our business and are a large source of deal flow for us and so, like you said, it's creating calculators and all sorts of tools that they like and don't get from other lenders that makes coming to us a much stickier proposition through to the same as we see with the hard money lenders in the US using land registry systems to try and profile types of borrowers that are most likely to want bridging finance or undertaking a development project to identify who they are and to reach out to them and start forming a relationship, many times most usefully through a real human picking up the phone or meeting with them.

So there are some sort of friction points I guess in that process, but again, if you get a good intermediary or you get a good borrower, the profile of that property entrepreneur I described before will transact on average five or six times a year. So it's good business once you form that relationship with them and it can be particularly sticky as well with the platform where essentially you just go online and they keep providing new details for the new property they want to lend against and it can be done in a very streamlined way.

Peter: Yeah, that's one of the great advantages you as a property....Zopa or RateSetter don't get five or six consumer loans coming in every year, or Funding Circle for small business. You have that natural advantage that these are people that just...you know, their business is trying to find financing that's sort of a core piece of it.

Christian: Yeah, exactly.

Peter: So I want to touch on the investor side for a bit. I know you said you started out with peer to peer, you've moved away from that now; what was the reasoning behind moving away from sort of the pure peer to peer model?

Christian: Sure, so we've been on a bit of a journey, I guess, on the investor side. As we are at the moment, we have essentially four channels, we describe them as four for investors to invest in the loans that we originate and the ultimate sort of idea was to have as wide a universe of investors as possible coming into the loans.

So we still have our funds management business which is kind of where we started so we run a fund out of Luxembourg which is open-ended, continues to raise capital. We have our online investment platform so investors can go on and select loans, but it's only open to sophisticated and high net worth investors which I think is kind of equivalent to your accredited investor in the US. We have traditional institutional lines so banks like Citibank and so on essentially buy our loans through warehouse facilities and then we have a retail bond which we listed on the London Stock Exchange.

But coming back to your question about the online investment platform and peer to peer specifically, probably about 2015, we raised equity and got quite excited about the concept of going after retail investors to fuel our loan book. I think we kind of came to the quick realization that it was commercially just very expensive to acquire these retail investors. It sounds like I'm stating the obvious and everyone said it was going to be expensive and it just is expensive.

So we certainly acquired more investors, but we started paying a lot more to acquire them and also when we went pure retail, we did fairly mainstream advertising on London Underground, rail, cinema, direct mail, all that sort of stuff, we just found that the type of investor we were attracting, we weren't entirely sure that they perhaps really understood what they were investing in. I think there was a bit of a change of mood music coming from the regulator in terms of a lot of excitement around fintech generally and peer to peer, but I think the regulator were starting to...they were giving signals that they were looking at this a lot more closely.

I think for us, we just felt that it was so expensive to acquire these customers that we could probably do without them. And so all of them investing online was not the most appropriate way for them to be investing which is why we transitioned retail away on the online platform so we only put the sophisticated and high net worth investors and then we launched the retail bond which is a London Stock Exchange listed bond program and we just thought it was a more robust regulatory structure for retail investors to be investing in. It's a liquid bond, pays a fixed coupon and gives investors a portfolio spread across many loans. So I guess that's the kind of the journey we've been on and I think those four channels we now have are pretty sound for what we're doing.

Peter: I'm curious about...I imagine you would have got some pushback from the retail investors who were enjoying your platform, enjoying the returns or whatever. So this bond, did you get much uptick from retail investors on this bond?

Christian: Yeah, we did, so it was targeted specifically for retail investors. It was a 500 million pound program when it launched and we do it in tranches so we did 50 million last year, we did 40 million just before Easter, targeted towards retail investors so the big sort of brokerage platforms here like Hargreaves Lansdown and so on. People could go online and buy into it and they can still post the issue. I think the surprising thing for us is actually how much institutional take up we had for it so we did have a large number of institutional investors, you know, like pension funds buying into our retail bond.

So I think it allowed us to engage in an initial discussion with those sorts of investors that we hadn't had interactions with before and they were coming in because they were comforted by the fact that it was listed on the stock exchange and we were also able to satisfy retail investors, like you say, they liked the platform, they were certainly getting more comfortable with us as a brand and the returns we were able to provide. They are able to still get it now, but just in a less sort of granular way so they're not selecting the loans.

Peter: Right, is your goal...you've got at least four channels and I imagine some of them are bigger than others, but it sounds like what you've got now, you're really focused on diversity of different types of investors. Are you trying to grow all these equally or how do you think about it when you have these four kinds of buckets?

Christian: Yeah, it doesn't quite work out as perfectly as them being equal…

Peter: Sure.

Christian: …but certainly we have an emphasis on ensuring that we maintain a certain quantum through each of the channels. Definitely as the business scales, the focus has been towards the institutional investor. I think you'll see that across all sorts of platforms that have gone through a period of scaling and for us that tends to be the cheapest capital so if we look at our buy-to-let loan, the 30-year mortgage where the borrower is paying 3%.You know, there's not that many investors that want to lock up, go online and invest in that type of mortgage so it's necessary to get institutional investors into it.

I think for us, we want to continue to widen the universe so we look at the pension funds and insurance companies as being particularly interesting for us as funding further products with the view in the future of getting into the home loan space where those types of investors are happy to take a 30 year exposure at a certain cost. We think that can be quite interesting from a borrower product perspective as well, but sovereign wealth funds, geographically and as wide as possible of network of investors is what we're after.

Peter: Right, right. So I read an article the other day, there's a housing shortage in the US and I've also heard that there's even a bigger housing shortage in the UK. Obviously you've got less land there than we have here. So what is being done in the UK to kind of address the housing shortage there?

Christian: The UK press refer to it as the UK housing crisis and the reality is population growth has surpassed the number of houses that are being built and that's something that's been going on for the last couple of decades actually so there is a big shortage of housing. So I think from an investment perspective, it's a sound asset class to be lending into because you've got this sort of imbalance where there's presumably a safety net on the pricing side. But the government is very actively trying to get house builders building more houses and there has been a focus now on realizing that the small house builders are the ones that are going to be able to really make that difference in the shortfall.

So post the crisis, a lot of those players left the market and haven't come back and so access to finance for small house builders is a key issue and it's something that we've actually been getting a lot of traction in engaging with government in terms of trying to foster and support that market. So it's really just build more houses is the simple answer, but it's something that will take a long time to sort of get to the levels that they need to.

Peter: Right, right. And so then I have to ask you about Brexit. We're a couple of years now removed from the Brexit decision and I'm curious to see...obviously there's still deadlines that are coming up here fairly soon, but I'm curious to know how has Brexit affected your business over the last two years, if at all?

Christian: Yeah, so I think in many respects we don't see a huge impact on our business. We're a UK only lender at the moment, we have a lot of international investors, but they're sort of comfortable with getting UK exposure as part of their sort of investment portfolio they're doing so, that side of it is fine. I think more on the ground is the fact that it has been a huge distraction so I think...yeah, you can't get through a discussion or a meeting these days without talking about Brexit and what impact it is going to have.

For us the difficulty has been in some respects around employees and attracting staff so the free movement of people has been something across Europe that's been really useful for us and a lot of our engineering team are from Europe. Before we've relocated people from Spain, Italy and wherever across Europe and it's just not a problem. They can be here next week sort of thing, you don't have to worry about visas and all the rest of it. Where now there is a bit of anxiety around whether those conditions will remain and whether those people will be able to remain on the same terms and certainly to try to attract people from across Europe to join the business has become more difficult.

But again, I think we will work through it…it is just going to continue to be a bit of uncertainty for the next year or so, but on the medium term I'm very optimistic. I think a lot of the rules and regulations that come out of Europe just get applied here in the UK and that has caused a lot of frustration for us as a business over the last ten years, and I think there'll be an opportunity to try and create a more competitive commercial environment in the UK, actually post Brexit.

Peter: Right.

Christian: We're going to have to go through the next few years to get there.

Peter: Yeah, it's going to be interesting to see.

Christian: Yeah.

Peter: So who are the people...you said you raised equity capital in 2015, who are the equity investors backing LendInvest?

Christian: Yeah, we actually have only one external investor in the business at the moment. That's Atomico, which is a European VC, backed by Niklas Zennström who was one of the founders of Skype, so a very technology focused VC investor and they've been a great partner for us in the business. My Co-Founder and I are not from a technology background so we've definitely leaned on them to assist with that side of things and I guess you can stay tuned, Peter, things may evolve. (laughs)

Peter: (laughs) I know you also had a Chinese investor at one stage. Is that Chinese investor no longer part of the scene?

Christian: Yeah, no longer around. We did have a Chinese investor for a period of time. We subsequently bought them out of the business and now it's just Atomico.

Peter: Right, right. So obviously I have to ask this, you did win the extremely prestigious LendIt Award for Real Estate Platform of the Year recently and you beat a bunch of really pretty impressive companies in the US so I've just got to ask you. You've also been to many, many LendIt conferences in the US, do you have plans of coming to the US market anytime soon?

Christian: Not really. I think when we….well no, just to be categorically about it. (Peter laughs). When we first raised equity, we spent a lot of time looking at the US, we looked at different markets, Australia, Ireland and others where we thought legal jurisdictions sort of fit with what we're doing, but I think it's been really interesting to go to the LendIt conferences and see the market evolve, the whole online lending space, particularly around property actually where it feels like a few years ago there was almost more excitement than there is now. I think people are realizing that it's pretty hard and it's difficult to automate and all those sorts of things.

For us, we look at the UK mortgage market as a huge opportunity, it's 280 billion pounds a year in annual originations and there's not that many players. There's banks talking about digitizing mortgages and so on, but there's not that many that are really actively making the progress that we are as a business. So I think for us, its really just a focus on what's right in front of us. We'd love to be a global company, but I think we've got the next few years in front of us here in the UK.

Peter: Okay, so final question I've got to ask...there's been talk in the press about an IPO for LendInvest I think going back a couple of years now the talks sort of started. You've got Funding Circle, it seems like they're getting closer, obviously no confirmation from them at all, but I'm curious about what your attitude is to the public markets and if we'll see a LendInvest IPO in the next 12 months?

Christian: Well I'm not going to put a timing on it (Peter laughs). We definitely aspire to be a publicly listed company. I think for us a key part of achieving out our true ambitions as a business is trying to drive down our cost of capital. We think that being a listed business just naturally walks us to that direction. It also puts a big stamp of credibility on the business and allows investors to participate in the equity upside as we go on that journey. So I think an IPO is just part of the journey that we're on and like I said I won't put a time on it, but in the next year or two, that's something that we'd like to achieve.

Peter: Right, I'm sure you're sort of supporting Funding Circle and watching them very closely, I imagine, as this process unfolds.

Christian: Yeah, we are and they've done an exceptional job in terms of building a really big brand here in the UK or certainly in the online lending space and taking it international and so on and really forging this marketplace concept. So we'll watch that closely, it's a great management team over there and we wish them well and we look forward to seeing how it all unfolds.

Peter: Right, I think certainly LendInvest has...you're not directly competing with them, but I know people do sort of paint you as you're in the same fintech bucket, so a successful go there…an there are others, Zopa and others have talked about it as well, but we certainly will be following it very closely and wish you all the best, Christian.

Christian: Thanks very much, Peter.

Peter: Okay, thanks for coming on the show. See you.

Christian: Cheers.

Peter: Bye.

It's going to be very interesting to me to see how the IPO landscape develops this year. Obviously, we talked about Funding Circle, there's GreenSky here in the US, there's many, many others waiting in the wings that are sort of watching to see how these new IPOs perform. I think fintech, as a whole, has not really had that many successful IPOs. There's been some challenges with some of the companies that have gone public already, but I sense that the environment is about to change and I think we will see several successful IPOs this year and I think that's going to be a great thing for the industry.

Anyway on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

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