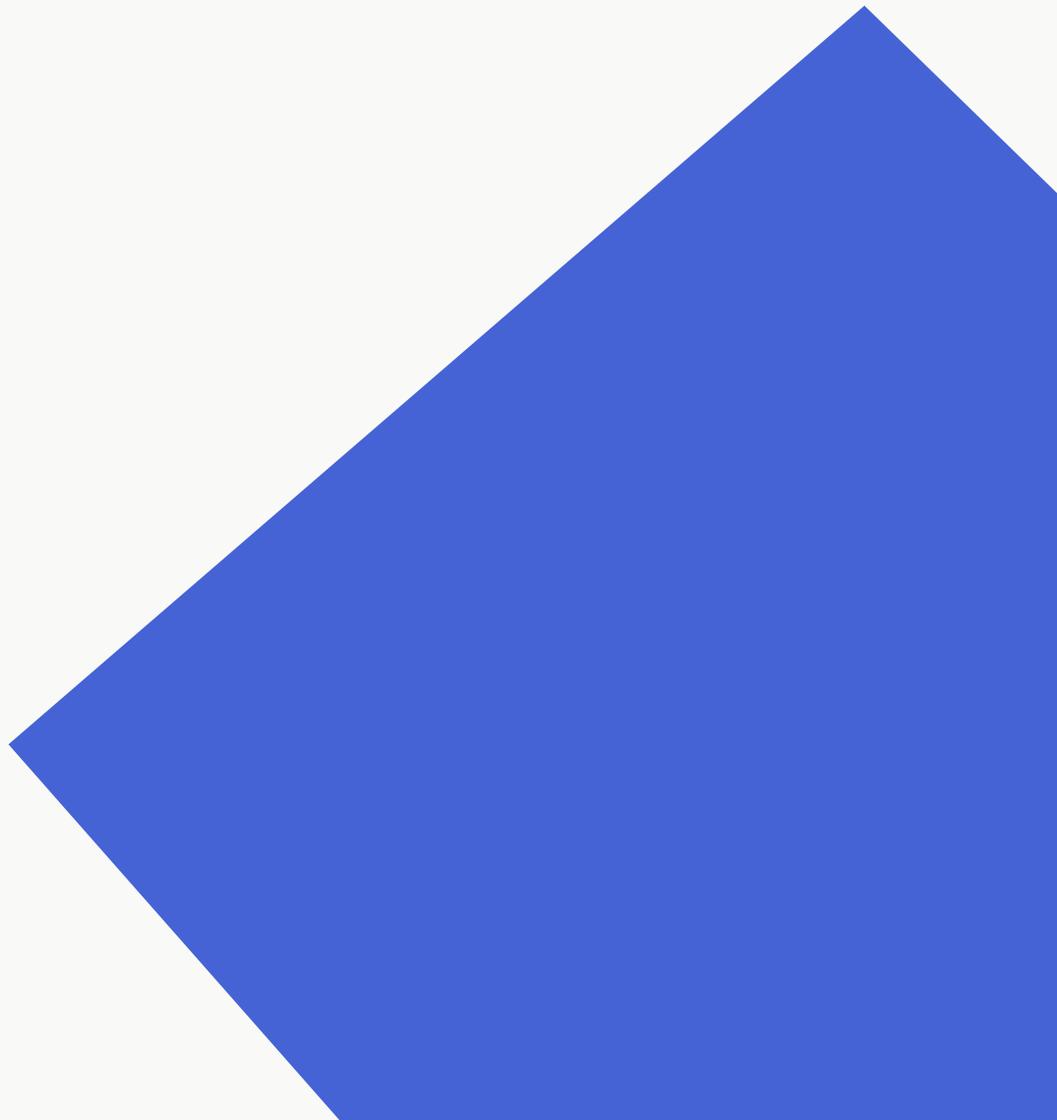


LANDBAY[®]

Stress Test

2019



Landbay Stress Test

At Landbay, we are committed to helping people understand what they are investing in and ensuring our business lends responsibly to minimise risk for our investors. As part of this commitment, we recently engaged MIAC Analytics (MIAC) to perform an industry best practice 'stress test' using Bank of England macroeconomic scenarios on Landbay's outstanding loan book to understand the impact a significant downturn in the economy could have for our investors.

We're really pleased with the results. They show that whilst, of course, there would be an impact for our investors should the economy take a significant turn for the worse, the stress test indicates that the buy-to-let mortgage portfolio should perform well throughout the economic cycle. We'll take you through the methodology and the calculations below.

Why Stress Test?

Stress tests allow investors to make an informed estimate of how their assets, in this case the Landbay mortgages that they have invested in, are likely to perform in adverse economic conditions. It is a prudent thing to do as it helps to give some indication and guidance for the impact on returns for our investors should a serious recession occur.

This is the second stress test we've undertaken, and the results show that despite significant growth in the business, we have not sacrificed credit quality to achieve that growth. We are proud of the fact that after almost 5 years of lending we have had zero defaults.



We've chosen to undertake this stress test now because there is a great deal of uncertainty in the economy; Brexit is potentially approaching, and we still don't know what Britain's future relationship with the EU will be and therefore what that may mean for the UK economy. While employment levels in the UK have remained resilient, house prices (at least in London) have been softening and interest rates have (slowly) been moving up. There are signs from across the world that economic growth is slowing down, particularly in China and the Eurozone.

As a result, people are rightly more focussed on downside risk. Transparency is important to us, so we're making the findings available to everyone. We are happy to discuss them with existing Landbay investors or anyone else who is interested to learn more about the process.

Led by experts

We engaged MIAC Analytics (MIAC) to provide an independent multi-scenario stress test of Landbay's £235 million residential buy-to-let portfolio. MIAC is a global expert in this field, with over 30 years industry experience. MIAC has performed stress tests on a wide range of UK lenders, including high street banks and are specialists in buy-to-let modelling, given their combination of analytical tools, modelling approach and relevant industry experience.

The Scenarios

The macroeconomic scenarios modelled were those designed by the Bank of England for the 2018 stress testing programme that aims to test the capital adequacy of the UK's major banks and building societies. This process supports the Financial Policy Committee (FPC) and the Prudential Regulation Authority (PRA) in meeting their statutory objectives.

Whilst Landbay is not structured the same as a bank, we want to hold ourselves up to the equivalent standards and best practices, only adapting them for our organisational context. These scenarios included a Base (what we might expect to happen) and Stress (what a severe economic downturn might look like) and these are summarised as follows;

Base Scenario

- ✓ GDP growth of 1.6-1.8% per annum for next five years (no downturn)
- ✓ Unemployment stable at between 4.1-4.2%
- ✓ House prices rise at c.3% per year
- ✓ Base rates moving up gradually to 1.55% over the five years
- ✓ Inflation (CPI) starts between 2.5-3% in year one but then steadies around 2.1% ongoing

Stress Scenario

- ✓ Recession during year one of scenario with four quarters of negative movements; GDP falls c.5% during that period
- ✓ Unemployment rises to 9.5% in 2020 and then slowly recovers to 7.5% at end of 2023
- ✓ House prices fall 33% peak to trough (Q3 2021) and then recover at c.5% per annum
- ✓ Base rate rises sharply to 4.25% at end year one and remain at those levels for three years
- ✓ Inflation (CPI) rises to 5% in 2020 and drops back to c.2% in year five

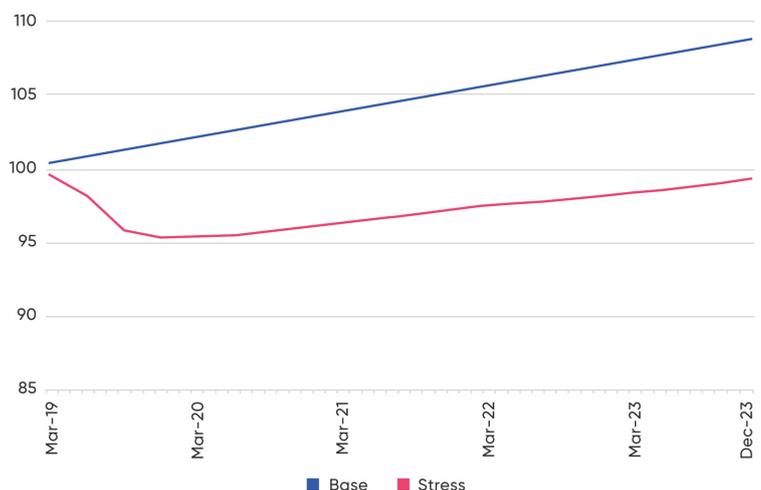
GDP Index (Jan 2019 = 100)

Base scenario

GDP growth of 1.6-1.8% per annum for next five years (no downturn)

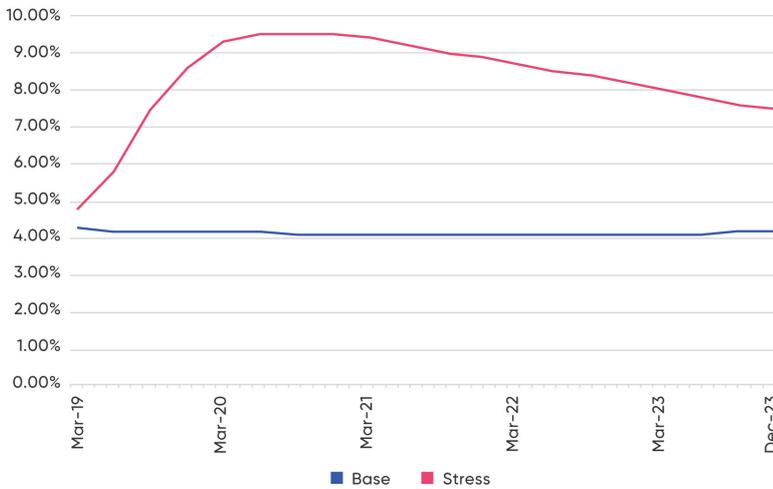
Stress scenario

Recession during year one of scenario with four quarters of negative movements; GDP falls c.5% during that period



The Scenarios

Unemployment Rate



Base scenario

Unemployment stable at between 4.1-4.2%

Stress scenario

Unemployment rises to 9.5% in 2020 and then slowly recovers to 7.5% at end of 2023

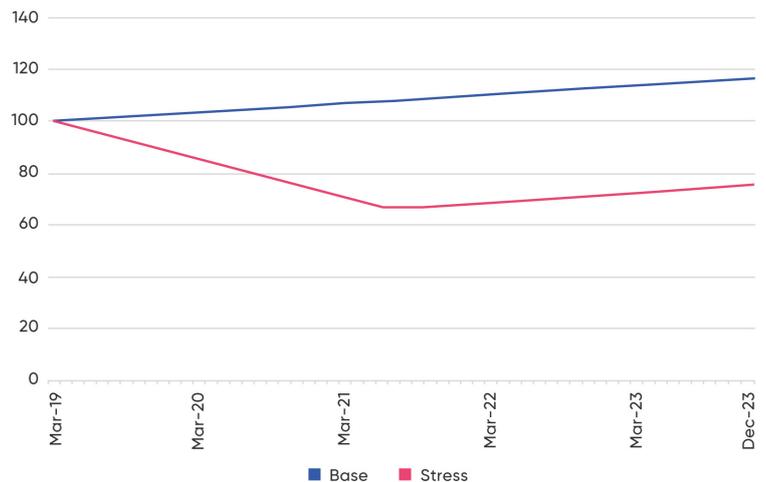
House Price Index (Jan 2019 = 100)

Base scenario

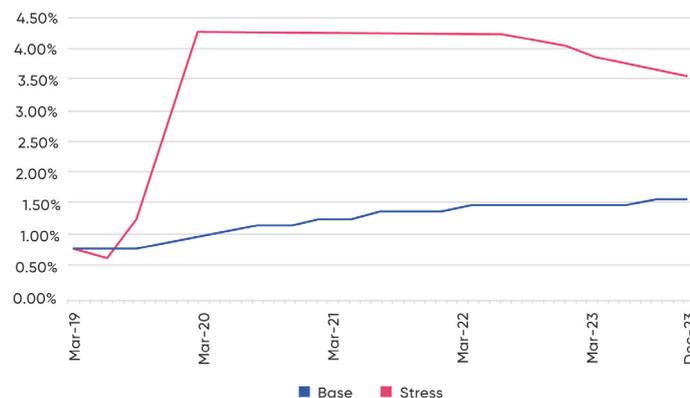
House prices rise at c.3% per year

Stress scenario

House prices fall 33% peak to trough (Q3 2021) and then recover at c.5% per annum



Bank Base Rate



Base scenario

Base rates moving up gradually to 1.55% over the five years

Stress scenario

Base rate rises sharply to 4.25% at end year one and remain at those levels for three years

The Bank of England scenarios do not specify rental projections. MIAC believes that rental income - and the resulting coverage rent provides above mortgage interest payments - is a key factor in loan performance, so they projected rental movements for the scenarios which can contribute to the modelling of default.

Methodology

All of Landbay's active portfolio loans as of the end of February 2019 were modelled. This portfolio represented £235m of UK buy-to-let mortgages.

In simple terms, the modelling assesses the chance of a default occurring on any loan under the economic conditions prescribed, and then whether such a default would result in a credit loss (the balance on a loan exceeds the value of the house). This, therefore, analyses the impact on portfolio performance in the event of a significant shift in the UK's economic conditions.

MIAC adopted a cash flow approach to projecting future credit losses. Assumptions incorporated into the cash flow process were generated through a combination of propriety models, analysis of buy-to-let industry data versus the characteristics of the Landbay portfolio, market research and experience.

MIAC believes the approach to generating key assumptions has been prudent and has therefore resulted in conservative estimates of future portfolio performance.

Every effort has been made to ensure that the modelling performed is as appropriate and product specific as possible. In order to accomplish this, MIAC made use of its large database of buy-to-let loan performance history and aligned this to the history and characteristics of the Landbay portfolio to ensure that as much specificity as possible is attributed to the lending model. This also included the future projection of interest coverage ratios (the rental amount divided by the interest on the mortgage).

Calculating Losses



Losses can occur on mortgages when borrowers stop making their payments on their obligations (defaulting) and the lender ultimately – as a last resort – has to repossess and sell the property. This can result in a loss when the balance on the loan exceeds the proceeds achieved from selling the property.

This is where lending policy and underwriting standards are important; if sufficient equity is held in the property and/or borrowers are of sufficient credit worthiness to maintain payments, then losses are less likely. However, as a demonstration of the importance of an exercise of this nature, external economic events can put unforeseen stress on individuals and housing

markets – and therefore lenders' business models – so testing how resilient those elements are to material downward shifts in the wider economy helps us understand what 'could' happen. Certain combinations of events can cause seemingly unexpected stress and that is the essence of this exercise.

Some loans that are projected to default will be 'cured' i.e. the borrower will get back up to date on the account. Non-cured defaulted loans will lead to a repossession and then a sale. It has been assumed that this process will take longer in the stressed scenario. Due to the lack of empirical data, it has not been assumed that any defaulted loans go to the receiver of rent (when the rent would get paid directly to Landbay for a loan in arrears), which would result in a reduced need to repossess and sell in a depressed market. Landbay's policy includes this option and – if exercised – could serve to reduce losses below those projected.

Loss is calculated from the balance plus accrued interest and costs, minus the proceeds of repossession sale at the time of realisation in the scenarios. Remember, house prices reduce by up to 33% during the Stress scenario, and that repossession sales typically sell for less than market value (based on real world evidence), so this can quickly erode the equity that existed in certain circumstances.

A prudent discount (Forced Sale Discount) of 40% has been assumed to the open market value for distressed repossession sales.

Results

Landbay's long loan duration, combined with the time it takes to repossess and sell properties, goes well beyond the five-year scenarios, so MIAC adjusted the timing and assumed losses were realised over a 14-year period (until 2032).

The results show that the value of all losses during the Base scenario amounts to 0.2% (of the portfolio balance of £235m). In the stressed scenario over that same period, losses would equal 1.83%.

What would this mean for investors?

In practical terms, if you invested a full ISA allowance of £20,000, (and if we assumed that the losses occur over five years under the stress scenario) your returns would average around 0.37% per year lower than expected rates.

So instead of expecting a 3.5% annual return, the figure would average 3.13%. The good news is that under this modelled scenario even with a significant downturn in the economy, returns remain above 3% and over a 10-year period, a £20,000 ISA would be worth £27,750. It is important to note that this is not a prediction or a forecast of what may happen. This is an attempt to understand what may happen in a recession and the actual performance of Landbay loans may be quite different to those that have been modelled under this stress test.

We have also looked at average results across the entire outstanding loan book. In reality, individual's investments may not perform in line with the average performance across the loan book.



Summary

We believe undertaking these stress tests and sharing the results is the responsible thing to do, and supports investors as they seek strong, sustainable returns across economic cycles.

We are very pleased with these results as they demonstrate the robustness of our loan book, and the underwriting process which determines how and when we lend. We will continue to undertake stress tests on an annual basis. You can read more about our loans, the reserve fund and other useful statistics [here](#).