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# Tax Efficient Review

**Business Opportunities with potential IHT benefit targeting capital preservation**

ESTABLISHED MANAGER - Hybrid offer combining yield producing assets and lending/ leasing

Octopus Inheritance Tax Service

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**Octopus Inheritance Tax Service**

**Business** Investing in businesses that target capital preservation aiming to provide 3% return to investors after annual management charges
**Size** Currently £1.45 bn
**Minimum investment** £25,000
**Charges** 2.0% initial charge. 1% dealing fee on purchases and disposals. 1%+VAT AMC (deferred and contingent)

**Table 1: Tax Efficient Review summary of offering Pros and Cons**

| PROS | CONS |
|---|---|
| • Well diversified offering from long established provider | • Total five years fees are high |
| • Well resourced investment teams | |
| • Good liquidity to date | |

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**Review based upon**

Documents used as part of the review process are:
Octopus ITS Product Brochure dated April 2016 (Reference Octopus-IHT-OITS-brochure-retail-CAM03409-1604)
Octopus ITS Underlying Investments Guide (Reference Octopus-IHT-OITS-Underlying-Investments-Info-Retail-CAM03681-1604)
Fern Trading Limited accounts as at 30 June 2015
Terido LLP - Accounts to 31 March 2015

**Tax Efficient Review data collection**

Tax Efficient Review has included in this review data collected from the major BPR providers covering in detail what trades are carried on in their offerings, the returns anticipated from them and the costs incurred in doing so. The net of these last two is the potential return to investors.

Different trades offer different risks and rewards and there is sometimes a perception in the market that a low return being earned by investors from a trade indicates a low level of risk. However it could be that the trade is high risk with a high rate of return but is subject to high fees and that this results in the low level of return for investors. To explore this properly, we asked providers for data on the top-level return anticipated from their trades and then details on all the costs and fees paid away before the investor return is calculated.

Costs are particularly difficult to glean and evaluate from the literature provided to investors because costs and fees are levied at various levels in the structures.

Table 2 covers the scoring methodology taken by Tax Efficient Review in scoring BPR offers.

Table 3 (sorted by provider) and Table 4 (sorted by trade) analyse the different trades carried on by the BPR offers together with the targeted returns from each trade. TER uses this data to indicate risk and to compare returns between offerings.

Table 5 shows the input data provided by the product provider for this review

Table 6 and Table 7 summarise all the relevant return and cost data for this provider and also compare these to other products. They includes a total cost over five years figure.

Table 8 shows the answers to a series of questions covering key areas.

**TER segmentation and classification of this offer**

We classify the current BPR products on offer as follows:

- those that trade through companies owning yield producing assets (such as solar or wind farms)
- those having a trade of secured lending/leasing
- hybrid offers combining both the above

Further we sub-divide each category into:

- new entrants less than two years old or having less than £20m of IHT funds under management (excluding EIS)
- established managers more than two years old and with more than £20m of IHT funds under management (excluding EIS)

This produces six categories of IHT offers (based on current expectations of managers):

| 100% Yield producing assets focus | 100% Secured lending/ leasing focus | Hybrid offers |
|---|---|---|
| **New entrants - (entrants less than two years old or having less than £20m of IHT funds under management (excluding EIS)** | | |
| Deepbridge<br>Guinness | Illium<br>ProVen<br>Seneca | |
| **Established managers - managers more than two years old and with more than £20m of IHT funds under management (excluding EIS)** | | |
| | Puma<br>Rockpool<br>Triple Point | Downing<br>Foresight<br>Ingenious<br>Octopus<br>Oxford Capital<br>Time |

The trade sub-division recognises that asset owning companies may, in our view, have less inherent liquidity to deal with large requests for withdrawals than secured lending trades (where both the interest and capital portions of the lending should be returned within quite short periods usually less than eighteen months). We accept that not all providers agree with this simplification of liquidity issues.

On this point, Octopus have asked that we carry their comment as follows:

*"We operate a blended business – our portfolio company runs a significant and established short and medium term lending business, alongside owning and operating a large portfolio of high quality energy assets. In normal circumstances, we provide liquidity through facilitating a sale of shares between exiting and incoming investors, and have done so for the last 9 years. However, being able to provide liquidity in a net outflow environment is a key part of our investment mandate when considering new transactions. Our investment managers expect to be able if necessary to sell the majority of the portfolio company's renewable energy assets within 12 months, which is faster than the loan book would be expected to mature, and has the added benefit of providing a more diversified business model. In addition, we would point out that leasing is not naturally "liquid", as the lessor is left with the asset which it will need to sell, rather than a loan that returns to cash at maturity."*

The new entrant and established manager sub division recognises that early years returns could be lower than anticipated, that investors will be offered less diversification with smaller offers, that the time taken to deploy new funds might be slower as the manager may need to await further funds before asset purchase or lending and that exit opportunities could be impacted.

Again not all providers would accept such a short period as two years as the cut-off between new entrants and established players pointing out that in such a short space of time, few or no BPR claims will have been made, few loans (if applicable) will have run to completion, valuation complexities and accuracies will not have time to resolve and liquidity will not have really been tested. Funds will also not have been started to be reinvested in new deals, which could throw up pipeline or quality issues as well.

**Hybrid offer and potential area returns**

The Octopus Inheritance Tax Service in our view competes within the same hybrid category as Downing, Foresight, Ingenious, Oxford Capital and Time.

It invests in a combination of secured lending (totalling 36% with 20% in property, 10% in Healthcare construction and 6% in solar construction) and equity holdings in companies with yield

producing assets (totalling 62% including Solar with 42%, Biomass/landfill gas with 14%, Wind 5% and Reserve Power 1%).

The offer competes as follows (in descending order of importance of the trades):

- **Solar energy equity holdings**: targets gross returns of around 7% - 8% and competes with Downing (targeting 9% from rooftop installations), Foresight (targeting 6.8%-10%), Guinness (targeting 9%) and Time (targeting 6.5%).
  We asked the providers to comment on their target returns:
  Downing said: *"Our solar investments mostly comprise a combination of residential and commercial rooftop PV systems ranging from 3kW to 200kW in size. Most of the systems are accredited under the Feed-in Tariff (FIT) scheme which guarantees RPI linked payment for the electricity generated for up to 25 years from the outset. A significant proportion of the revenue for the PV systems is derived from the FIT thereby reducing the impact on returns of energy price fluctuations."*
  Foresight said: *"Our range cover ungeared ground based solar at the bottom end of the range to geared rooftop solar at the top end."*
  Guinness said: *"We have focused on roof-mounted solar installations, which give higher returns. These have some key economic differentials to ground mount solar installations: 1) On a ground mount, electricity generated is sold to the grid. Currently the grid buys this for 3.9p/kWh. Our roof-mounted installations sell electricity to businesses for between 6p and 10p/kWh.; 2) A roof-mount installation pays no rent to landowners (the advantage to the business is lower-priced electricity); 3) A roof-mounted installation requires no expensive dedicated grid connection, no environmental permissions and no planning consent. They also have lower security costs (i.e. no dedicated security fence, personnel or CCTV required as these are usually on site anyway); 4) Size is modular, so we can invest from £50k to £5m into a single project – we can therefore match projects to inflows. You may ask why everyone does not focus on roof-mounted seeing as it is so attractive. Negatives are: 1) Leases are more complex; 2) Scale is a problem – unit size might be 500kW, so a tenth of the size of a 5MW ground mount. It is therefore more difficult to put large amounts of money to work; 3) Access can be difficult – need scaffolding; 4) Counterparty risk. If the business goes bust then you are left selling to the grid at 3.9p/kWh unless someone else occupies the building. Registering the lease ensures no-one can seize your panels."*
  Octopus said: *"We focus on owning commercial scale and institutional grade ground-mounted solar sites that feature Tier 1 technology and qualify for long-term government incentives. These sites will be financeable by mainstream banks and institutions as well as being attractive to institutional funds as an asset they would like to own. This is a testament to the quality of the equipment on the site (it is tried and tested so the energy output capacity is more predictable, equipment is more reliable and servicing the technology is better supported) and is essential for liquidity (we don't expect to sell the sites but if we needed to we expect to be able to sell the portfolio within 12 months, something that wouldn't be possible for non-Tier 1 sites). Rooftop solar tends not to appeal to this market, hence our focus on ground mounted sites. We think that our costs to run these sites benefit from the scale of our operation and also the scale of the sites that we manage. Each company in our portfolio that owns a solar site has refinanced the site with a modest level of project finance from a mainstream bank. The fact we have been able to do this is a testament to the quality of the sites and has enabled us to diversify the portfolio by acquiring more sites. It is also an essential factor for solar to be part of the portfolio as without this the returns would be too low for us to include – the market considers these sites to be too low risk for us to generate the required investor returns from them, so the debt is simply bringing the returns back in line."*
  Time said: *"The assumptions for our solar projects assume a conservative level of power price inflation and subsidy inflation, given the low inflationary environment we are currently experiencing. Furthermore, as our projects are unleveraged, and with power prices relatively*

*suppressed, it is unlikely that returns of 8%+ will be achieved, even in periods of high irradiance."*

- **Secured property lending**: Target underlying investee company return before any costs or fees is around 10%-14%. Other offerings which include property lending are Downing (targeting a gross return of 9%), Octopus (targeting a gross return of 10%-14%), Triple Point (targeting a gross return of 8.5%).
  With underlying investee company returns covering a spread from 7% to 14%, we asked the providers to comment on their target returns:
  Ingenious said: "*The Real Estate Strategy has been designed to take advantage of the much restricted supply of credit from banks to residential property developers, who may struggle to access sufficient finance on acceptable terms to fund developments which already have full planning permission. Typical transactions would follow the following criteria: London and areas within a 90 minute commute; typical loan term 12- 24 months; preferred loan size £1million to £5 million; max loan to cost 90% (including finance and costs); max loan to value 75% (including finance and costs). Bridging finance opportunities will also be considered to assist with asset-backed opportunities seeking planning permission. These would typically be short-term facilities, ideally complementary to the development finance activities and potentially leading to longer-term facilities. The Real Estate Strategy provides access for investors to a substantial market (estimated by Ingenious at £1.5 billion + per annum in respect of targeted activities), which they can currently only access through direct lending to development projects. The strategy is designed to deliver strong returns, backed by security over real property assets across a diverse portfolio of largely shorter-term loans to maximise turnover to capital, which in turn should give rise to greater liquidity. The Manager has established a strong real estate team currently consisting of five sector specialists with decades of residential development finance experience real estate finance experience. The Manager addresses investment risk by lending on a fully funded basis in each case i.e. ensuring it has sufficient cash at day 1 to fund all forecast costs plus contingency, lending in established London and South East England residential locations backed by professional valuations to management teams with a demonstrable track record in their markets. Further, Ingenious utilises an experienced in house counsel that assesses transactional legal risk alongside external legal representation engaged on each transaction.*"
  Octopus said: *"Our focus is on lending to experienced property developers and buy-to-let landlords, typically for short loan terms and at conservative loan to value ratios. The majority of our loans are secured against property on a first ranking charge basis and we favour opportunities in the south east or other regional hubs as we expect property prices to be more consistent in these areas. Our typical loan to value is 50%-60% and we never exceed 70%. We also focus on having a very large portfolio of loans at any one time, and typically have around 250 separate loans to independent counterparties, with an average loan size of just £1m. This part of our business has a very strong market presence in the property world, and we have a 30 strong dedicated property finance team in house who have lent more than £2.5bn over the last 6 years, and recovered £1.5bn with capital losses of less than 0.01%. This is a testament to the strength of our team, the types of loans that we seek, favouring conservative loan to value transactions over higher returns. Our team is very well known in the sectors that we target, and the specialist focus and dedicated expertise that we have in place enables us to appeal to borrowers based on factors such as ability to review an application quickly, ability to use our expertise to take site specific factors into consideration, rather than simply competing on price. In addition, the IRR of our loans includes arrangement and any early repayment fees which accrue to the portfolio company, combined with the short-term nature of our loans we are able to target higher IRRs."*
  Puma said: *"Puma has been lending to SMEs since 2005 and has arranged over £230 million of loans secured against real estate. We have the benefit of having lent to multiple counterparties over a long period and through full economic cycles, including downturns. Our*

*conservative approach to lending means we have never failed to fully recoup capital on a loan. We have a large, experienced team and we only ever lend on a first charge secured. We devote significant resource to the due diligence process believing each transaction and borrower is unique and requires a bespoke approach, rather than a cookie-cutter factory process. We have a conservative approach to leverage. The average weighted loan-to-value ratio in the portfolio as at the end of September 2016 was 60%, where the value considered is the anticipated end value of the project (in the case of a development). To 30 September 2016, Puma Heritage has participated in 363 loans totalling £137 million of loans with an average rate of 7.9% and has been repaid on 311 loans."*

Time said: *"We lend at a defensive LTV rates and price our debt facilities based on an assessment of the credit risk of loan. We positively favour experienced borrowers which have substantial net worth, which can provide high levels of collateralised guarantees, in addition to our first legal charge over the subject property. In addition, we positively favour loans for projects in Greater London and the South East of England where demand is high and property values are the most secure. It is our strategy to reduce risk, rather than seek high levels of return and as such, through the combination of factors set out above, we feel our typical return of c7% p.a. is attractive on a risk adjusted basis."*

Triple Point said: *"Working with one of the UK's leading property bridge lenders, we only lend on a first charge basis against UK property that benefits from a valuation report backed by PI insurance. Interest is typically paid upfront by the borrower and we predominantly focus on lending against property located in London and the South East. As at 30 September, we have completed over 70 loans, and the loan book has an average LTV of 64.7% and average deal size of £951k. We believe that, based on the first charge security and prudent LTVs, a yield of c.8.5% offers a good risk adjusted return"*

- The other five areas either are relatively small in the Octopus portfolio or are not competing with many other offers .

**Structure difference between offers**

The most common structures for a BPR product are either a Discretionary Investment Service ("DIS") or direct investment into a single company. Many of the offers are Discretionary Investment Services whereas Puma, Proven and Illium offer direct investment into a single company.

Some considerations on the two approaches are:

1. A DIS does not require the issuance and periodic updating of a UKLA approved prospectus.
2. A DIS provides an easier mechanism to facilitate regular liquidity for shareholders.
3. Both a DIS and a single company allow for the operational flexibility to add subsidiary companies.
4. For a financial adviser to recommend shares in a single company, it is our understanding that the adviser would be required to hold an FCA approved qualification to advise on 'shares' – a requirement which isn't present for advice on a DIS.
5. Both a DIS and the single company structure can invest into companies or Limited Liability Partnerships.

**Offering classification**

This offering is classified by the provider as a non-UCIS discretionary managed investment service.

This offer is a discretionary investment service that currently invests new client funds in the unquoted shares of a single private limited company (Fern Trading Limited). Fern is a significant company with more than £1.3bn of share capital and has grown to be the parent of more than 200 wholly owned subsidiary companies. Fern carries on the vast majority of its trading activity either directly or through one of its subsidiary companies. Fern carries on a small amount of its trade via its membership of a limited liability partnership, Terido LLP, in which it is a Founding Member, along with Bracken Holdings Ltd (the Octopus ITS investee company used until 2010). Fern's strategy is to operate a diversified business model, comprising around 50% owning and operating renewable energy businesses that are expected to generate predictable revenues over

the long term, and 50% short and medium term secured lending. Its turnover for the year ending 31/3/2015 was £129.7m.

Terido LLP operates one class of business, that of a money lending business. Turnover for year to 31/3/15 was £24.4m and came from arrangement fees and loan interest, net of value added tax and is recognised upon delivery of the relevant services. Members have invested £153m as at 31 March 2015. We cover more detail on Terido LLP below under the section "The Underlying Trades of Fern".

Octopus say that the pros and cons of such a structure are:

- Already trading so commencement of BPR qualifying period is instant
- Scale of current company should mean some amount of diversification, liquidity, continuity
- Not UCIS
- Taxation dealt with within the company (unlike partnership where taxation needs to be accounted for by the individual
- No complex partnership agreement

Against a company structure:

- Corporation tax is paid in the company
- Tax may also be paid by investor on any growth (unless held until death)

**Changes since last review**

Main changes since our last review in Issue 175 published in August 2014 are:

- For marketing purposes, Octopus have introduced a concept called the "Growth Shield" (covered in more detail below under performance). The concept is that the annual management charge levied by the service is deferred and only taken on exit if growth within Fern has met 3% per annum.
- Fern's trading strategy has evolved in line with its status as a much larger trading company since the last review and Fern now owns and operates more than 180 renewable energy sites in addition to continuing to run its secured lending business, which comprises more than 250 separate short and medium term loans. At the time of the last review, the initial stages of this strategy had been put in place, as Fern had acquired three commercial scale operational solar energy sites.
- At 31 March 2016, Fern's business comprised 36% secured lending and 64% owning operating assets, on a net asset basis. Octopus states that Fern's strategy is to operate at around 50% operating assets and 50% lending on an ongoing basis, so the majority of transactions in Fern's pipeline for the current year comprise loans rather than business acquisitions.
- As a result of this strategy, Fern is now the 100% parent company of around 200 wholly owned subsidiaries. Fern continues to undertake its secured lending business directly, and the ownership and operation of its renewable energy sites is undertaken by its subsidiaries. Typically, each separate site is owned and operated by a separate subsidiary company within Fern's group.
- Octopus states that the evolution of Fern's trading strategy gives investors a number of benefits. First, the sites acquired typically have a 20-25 year expected lifespan and most qualify for Renewable Obligation Certificates. This means that Octopus expect them to generate predictable income for Fern over the long term. This provides some healthy business diversification when paired with Fern's short-term lending business. Second, the sites are typically partially refinanced with project finance advanced by mainstream banks following Fern's acquisition. Octopus states that the total amount of project finance borrowed by its subsidiaries is £528m, and is secured against sites with an enterprise value of £1bn. This gives Fern an attractive level of flexibility and predictable use for the cash its sites generate- it can choose to pay down loans, including to quickly alter its business mix.
- As part of Fern's strategy to operate a diversified business model, Fern acquired 100% of a company, Melton Renewable Energy Limited, from Macquarie. Melton Renewable Energy Limited employs staff across its 5 biomass sites and 25 landfill gas sites. Melton Renewable Energy Limited comprises around 14% of Fern's business on a net asset basis, net of a

£170m bond that was in place at the time of the acquisition, and is listed in Ireland.

- Octopus says that the Fern's business strategy puts the company in a good position to deliver the target 3% growth to investors over the long term. The short-term lending book provides liquidity for Fern based on its day to day trading and the cash flows generated by the sites that Fern owns deliver an income to Fern for the life of each site. This business mix could provide some protection for Fern should part of its short-term business become unattractive, for example as the result of a change in interest rates. Octopus says that as a result of Fern's business, Fern's share price might be expected move around more as a result of changes to long-term energy price forecasts, however it expects that a good deal of protection for investors is designed to be provided by the way that their Annual Management Charge (AMC) is charged. 1% (plus VAT) AMC accrues each year within the portfolio but is not taken until an investor makes a withdrawal from their investment, and only then to the extent that it can be taken and still deliver the investor 3% growth p/a on a compound basis. This means that the longer an investor remains invested, the bigger the potential buffer against share price movement that will have built up. If Fern's share price growth exceeds 4.2% per annum on a compound basis over the period of ownership, any excess belongs to the investor once Octopus's accrued AMC has been paid.
- Octopus says that despite the fact that Fern intends to own and operate its energy sites for the duration of their life, in the event that Fern wanted to sell some or all of the sites, they would expect to be able to find a purchaser within 12-18 months. This is because the assets Fern owns are Tier 1 bankable assets, and because Fern has acquired on a scale that is attractive to pension funds, banks and family offices. Octopus has tested this point to some degree, by refinancing £250m of Fern's construction finance to date, and by securing project finance of £528m from mainstream banks against these sites.
- During the period since the last review, Octopus has reduced the flat-rate service fee that it charges Fern in return for undertaking all of Fern's managerial operations. The fee is agreed on an annual basis by the board of Fern, comprised of majority independent directors, and in respect of the current year has been set at 2.5% of shareholder capital per annum (previous year 3.8%). This significant reduction has been possible due to the scale that Fern has reached, and shows the benefit of having an independent board in place. Fern's business now comprises a significant portfolio of renewable energy assets which yield a lower headline return than Fern's short-term secured lending business, but are attractive due to the expectation that they will deliver predictable revenues over the long term. Consequently, the Octopus Inheritance Tax Service continues to target 3% growth for investors.
- The investment management team at Octopus has grown significantly to over 100 investment managers. The team now includes a dedicated portfolio team who are only responsible for overseeing the Octopus Inheritance Tax Service (Bracken, Fern and Terido).
- At the time of the last review, Fern lent money on a secured basis to a specialist car finance company called Moneybarn PLC. The borrower was sold in August 2014 and Fern's loan was repaid in full, and with the benefit of a significant early repayment. Fern no longer lends in this sector. Octopus has identified three key sectors which it thinks are capable of delivering capital preservation for investors while affording the opportunity to scale as Fern grows in size. These are property financing, financing the construction of healthcare property and renewable energy. Octopus has significant investment expertise dedicated to these sectors, and Fern's business is focused on these areas.
- In mid 2011 Octopus appointed Non-Executive Directors (NEDS) for Fern. Octopus state that they deemed it appropriate to have an independent majority on the Board to strengthen the corporate governance and deal with any potential conflicts of interest. The NEDs are Peter Barlow, Keith Willey. Paul Latham remains on the board as the only Octopus representative and is now the Chief Executive Officer of Fern.

The Octopus Inheritance Tax Service (OITS) is a discretionary investment management service.

By signing the Customer Agreement, the investor grants to Octopus Investments the right to select and manage, at their discretion, Qualifying Investments which correspond with the objectives and principles for the Octopus ITS, as set out in the Brochure. Currently new investments are made into one company (Fern Trading) whose business model is finding trades which combine appropriately mitigated downside risk with relatively predictable returns on investment.

An investment in the ordinary shares of Fern Trading should qualify for Business Property Relief (BPR), and therefore an investment in Fern Trading may be exempt from inheritance tax, following a two year holding period.

**Objectives**

OITS has the following objectives:

1. To seek to provide a capital preservation focused investment for BPR aware investors, with the aim of risk mitigation through deal structuring, asset backing or insurance.
2. To achieve a targeted growth rate of 3% per annum on a compound basis, on investments in Fern Trading (i.e. investments net of initial fees and dealing fees) after a deferred and contingent annual management charge of up to 1% (plus VAT). For the avoidance of doubt this growth rate is not guaranteed by Octopus although they do not take their deferred annual management charge if on withdrawal this return isn't met. This means that the longer an investor holds their investment for, the larger the amount of protection an investor may have built up in the form of Octopus' deferred AMC. The AMC deferral passes to the next generation, so someone who inherits an Octopus Inheritance Tax Service portfolio may benefit from a significant accrual already in place.
3. To provide liquidity to those investors that require it within as short a timeframe as possible (to date Octopus tell us that all liquidity requests have been serviced within three weeks, typically within 10 days).

At the end of March 2016, £1.45bn had been invested by more than 9,000 individuals in OITS.

In our view a product offering a business opportunity targeted at individuals seeking BPR mitigation should contain the following characteristics:

- good downside protection
- some upside potential
- a non-contentious business model
- low charges
- good liquidity

The conclusion covers how well the Octopus Inheritance Tax Service meets these characteristics.

**Insurance option**

Some providers use insurance to either offer some downside protection against losses for early death (the Downing offer has a version) or to mitigate the effects of an investor's IHT bill that might arise in the first two years (Foresight offer a version of their product which includes this for a fee).

This Service offers no insurance option. Octopus says *"We do not offer insurance as part of this investment. Investors would typically expect to be able to secure a personal policy for a lower price if insurance suits their needs. The terms of group policies often contain nasty small print that can take investors by surprise, typically don't cover those investors who might stand to benefit most and it may not always be able to secure the same terms year on year."*

**Investor choice of trades**

In some offers investors can choose between different trades or sectors.

This Service offers no such option. Octopus says *"our approach provides investors with increased diversification and liquidity. It also means that we can make sure that an investor's portfolio contains the most suitable assets at any given point in time – it is the most flexible approach."*

**Investor choice of income or growth**

Growth in an investors' portfolio will accumulate within the share price as dividends are not paid. Investors can ask at any time to take either an ad hoc withdrawal, or to set up regular withdrawals. Withdrawals will be facilitated by way of a sale of shares which is typically more tax

efficient for an investor than receiving a dividend. If distributions are set at a level that is higher than the capital growth achieved, the value of the investment will decline.

**Subscription and investment process**

The Octopus Inheritance Tax Service (OITS) has been running for more than nine years, and for the last six years new investments have been placed into Fern Trading Limited on behalf of investors.-

Diagram 1 shows the structure of the current expected investment selection.

The sequence of steps for an individual to invest in the offering is as follows (see Diagram 2):

- An individual wishing to invest in the business opportunity offered by Octopus Inheritance Tax Service decides on the amount suitable for investment.
- The investment is made in ordinary shares in an unquoted trading company with a wide remit (currently Fern Trading).
- The shares are held in an Octopus run Nominee account.
- The cash awaiting investment in Fern Trading is held in an HSBC current account.
- Fern Trading is 100% owned by investors into OITS. It is managed by Octopus Investments.

Any material transactions involving payments or receipts in any currency other than Sterling are hedged through Investec.

Octopus aim to keep cash utilisation rates within Fern and Bracken close to 100%. Like most large trading businesses, Fern has an overdraft facility to enable this level of cash utilisation. The overdraft has been in place for 2 years with Luxembourg based Letterone. Octopus are currently negotiating with a number of mainstream banks to secure a new overdraft facility for Fern to take effect when the Letterone facility expires. Fern's current overdraft facility is a maximum of £75m and a new facility is being sought at £100m. Octopus advises that at present cash utilisation rates are at about 90%.

Fern occasionally makes short-term loans to Places for People to put cash reserves to use when not required for planned near term expenditure. The term on these loans is usually in the region of 2-3 months. Places for People is one of the largest property and leisure management, development and regeneration companies in the UK. It owns or manages 140,000 homes and has assets greater than £3bn. At the time of writing Fern had a £0m loan to Places for People outstanding.

Available cash within the Fern group of companies averaged less than 10% of NAV over the 12 months to March 2016. At the time of writing, Octopus' investment pipeline shows that Fern's cash would be fully deployed within 76 days, assuming no further inflows,

In a month where there is more demand for shares in Fern than there are shares available from investors wanting to sell shares in Fern (as has been the case every month to date), then Fern will simply increase its share capital by issuing new shares. Should it occur that there is more supply than demand in a month, then Octopus will facilitate a share buyback for investors where Fern will reduce its capital using the liquidity within the company. Octopus believe that tax on growth would in that scenario could be subject to Income Tax. However investors should seek independent tax advice before investing

.

The company will not pay any dividends with all profits being reinvested for growth.

As shareholders, new investors will participate in all current deals in Fern Trading. Octopus tells us that the current inflow of funds is running at £25m to £30m per month.

Fern Trading currently deploys its funds into a number of different business lines. Each share in Fern Trading carries an equal exposure to each of the deals carried out by each of the business lines. This should provide investors with some diversification in terms of the range and number of counterparties that their investment is exposed to (more than 250 borrowers), number of operating sites (more than 180) and uncorrelated business sectors (lending secured against residential property, commercial property, healthcare and educational property, operating energy busi-

nesses).

To ensure that investors are kept informed about the performance of their investment in Fern Trading, twice yearly all clients (and their Advisers) are sent a Portfolio Valuation. Investors and advisers can also access their valuation at any time using Octopus's secure portal, or by calling their dedicated client relations team.

The share price of Fern Trading is targeted to grow at a 4.2% annual growth rate. The shares are revalued before the start of every month in order to determine the price that the Directors will set for issuing shares to new investors and that price at which exiting investors' shares will be sold to new investors. There are weekly share allotments throughout the year. The 4.2% target covers the target 3% return for investors plus the maximum 1%+VAT rolled-up Octopus annual management fee.

OITS was launched in May 2008. Between May 2008 and May 2010 investors into OITS invested into Bracken Holdings Limited. Investments into OITS since May 2010 have been made into Fern Trading Limited.

Octopus advises that the reason for the change in underlying company was due to a change in the charging structure for OITS.

Octopus receives fees at many points in the transaction chain:

2% up front (2.0% for advised investors and 5.5% for non-advised execution-only or direct investors)

1% dealing charge on investment and exit

2.5%+VAT of shareholder funds per annum to provide all the operations of Fern.

a deferred annual management charge (AMC) of up to 1%+VAT per annum. This deferred charge is rolled up interest free until the point that investors sell down their shares. The deferred and accumulated charge can only be taken at this point provided investors receive at least 3% compound growth on their original net amount invested (after initial charges and the dealing fee), net of the AMC

Octopus may also be part owners of some of the sources of deal flow

**Valuation methodology:**

The valuation methodology used for valuing Fern shares is unusual in our view (we are not aware that this future looking methodology is used by any other BPR provider at present) in that it is based upon a future discounting of potential cash flows, both in the net asset value and share price calculations. The calculation is crucial both to investor returns and Octopus receiving its rolled-up annual management fee.

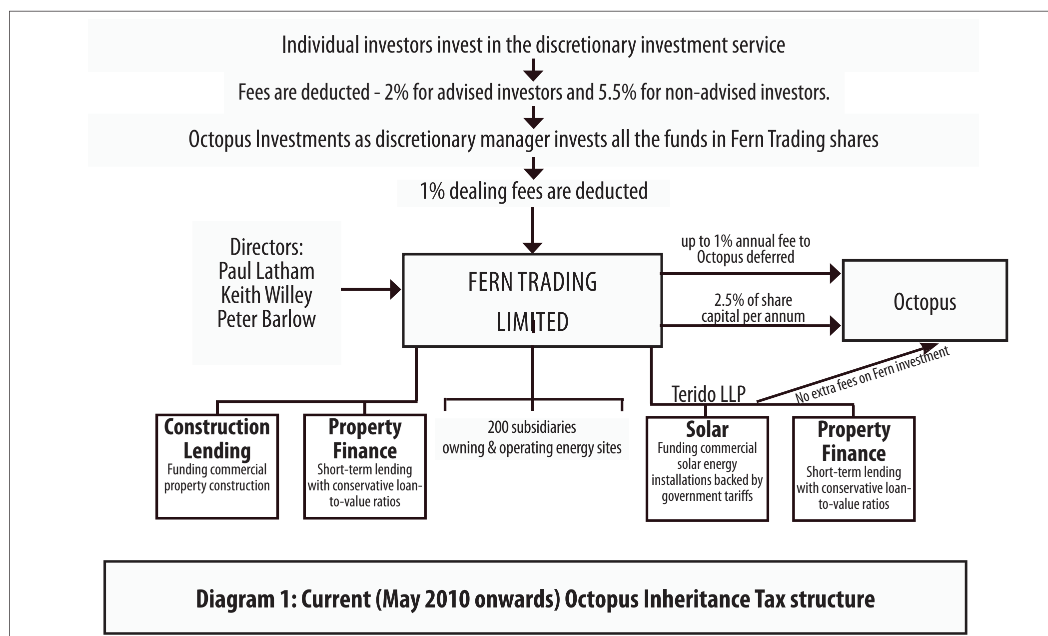


**Diagram 1: Current (May 2010 onwards) Octopus Inheritance Tax structure**

Octopus tell us:

*"Every fund with operating assets like ours would have to take a view on future cash flows when determining the NAV of their assets. The difference with Fern is that listed funds or companies have the market set a premium or discount to NAV, based on a range of things like liquidity, market sentiment, views on future performance, etc. With Fern, Octopus and the Directors have to take a view in lieu of the market being able to do so.*

*Listed companies' share prices are set by market demand which takes into account investors' views on future performance of the company compared to its break-up value today. As Fern is an unlisted company, there is no open market for its shares. Therefore, as Octopus Inheritance Tax Service investors still like to be able to purchase or dispose of shares throughout the year, the directors have to agree a fair price at which they will be willing to issue new shares or facilitate a share purchase.*

*The Specialist Finance team at Octopus carries out a valuation of Fern every month to validate the price at which shares are purchased by investors and sold by existing shareholders. These results are then checked by the Senior Management Team at Octopus as part of a formal monthly review, before being sent to the Fern Board for approval. The share price has to be agreed by the board of Fern, which comprises majority independent directors. The methodology used every month to value Fern's shares follows the principles agreed with a leading accountancy firm. This methodology is reviewed on a regular basis, typically around once a year. The last review was in December 2015"*

The steps involved for Fern are:

1. Net Asset Value:

   The first step towards setting the Fern share price is to establish the Net Asset Value (or "NAV") of the assets of Fern. The NAV essentially sums up the holding values of the loans and the operating subsidiaries, and therefore reflects the value of Fern if it were to be broken up and sold into its constituent parts.

   Fern predominantly comprises loans and fully-owned operating subsidiaries in the energy sector which are characterised by predictable long-term and government-backed income streams). We follow International Private Equity and Venture Capital Valuation Guidelines when assessing the holding value of these loans and subsidiaries.

   Loans are held at book value, less any suitable provisions in the event that their recovery may be questionable. Operating subsidiaries are typically held at a value derived from discounting the expected future cash flows of the underlying assets, using a discount rate suitable for to each asset. The subsidiaries undergo a revaluation every 6 months and are reviewed by independent experts once a year.

2. Share price

   However, Fern is a continuing business, and does not envisage being broken up and sold into its constituent parts any time soon. Like any other company therefore, consideration needs to be given on whether Fern is worth slightly more or less than its constituent parts. This is a similar exercise to the function the market performs for listed infrastructure funds, who publish their NAVs every 6 months, but then the market sets a fair price either at a small premium or discount to this NAV, reflecting views on future performance of the fund.

   Net asset values are predicted for the next few years based on the expected cashflows of the current investments/loans plus a forecast of likely cash flows that might be derived from pipeline trades that are very likely to complete during the 24 month period. This includes deals that are planned but not yet entered into, using both cash in hand at present and cash being returned in the future from current deals.

   Three reference points for the share price are predicted:

   - an 'Expected' scenario,

   - a 'Closed' scenario (that assumes no new inflows are received, and no new trades are undertaken over the forecast period, and

   - a 'Wind Down' scenario (that assumes no new trades are undertaken over the next two

years, no service fees are paid to Octopus by Fern, and all cash is returned to shareholders as the portfolio and assets are sold).

Along with the current net asset value taken from Fern's management accounts for that month, the three reference points are compared. These scenarios are designed to protect new investors, by ensuring that the price charged to incoming investors is not overstated by assuming that the company will continue to trade indefinitely, but at the same time include a realistic estimate of future performance to protect existing investors.

Based on all of this analysis, the directors (the majority of who are independent of Octopus) decide the price at which the company will issue shares in the coming month.

3. External view

   Octopus regularly engages with a leading firm of accountants, typically once a year, to conduct an independent review of the continued appropriateness of the valuation methodology used to set Fern's share price. The last such review took place in December 2015.

   In addition, the underlying NAV of Fern, comprised of the value of its loan book and operating subsidiaries, is reviewed once a year to confirm the assets are held at fair value and follow IPEV valuation guidelines.

4. Growth Target:

   The target for growth in Fern's share price is 4.2% compound. To date there has been some variation on this straight-line growth, but annualised growth has always exceeded the 3% investor target.

   Octopus say *"As part of operating a diversified trade, Fern has acquired operating businesses such as institutional grade solar sites to complement its secured lending trade. Equity income streams are inherently more variable than loans, but provide the benefit of identifiable revenue streams over the long-term. We expect this to be reflected by more short-term (month-by-month) variances in the Fern share price. However, since infrastructure assets are relatively stable in comparison to other sectors, we do not expect the ownership of these assets to materially impact the long term growth in the share price of Fern."*

In our view the share price is based upon three key assumptions that prospective investors need to consider:

1. that Fern continues as a going-concern. This is a function of Business Property Relief not being withdrawn or changed which may result in a rush to exit. Such a rush would expose the weak point of the DCF model which is that it depends on the discounting of future deals in the forecast period which are, we suspect, priced at an annual rate of return of 5%-6% and therefore show a high positive current value when discounted at the very low discount rate of either 3% in Bracken or 4.2% in Fern. Should there be a rush to exit then the locked-in deals would produce cash-flow which would not benefit from further re-investment. Octopus has responded to this point by saying that monthly valuation exercise includes assessments of the company's value assuming a 'trading as normal' scenario, as well as a more cautious scenario that contemplates the business being scaled-back in future in the event of net outflows from the OITS product. Octopus says that the outcome generated by modelling these scenarios validates the share price of Fern.
2. that the current deals will perform as predicted (with no bad debts or counterparty default) and
3. that cash flow returning from these deals can continue to be re-invested in profitable deals

**Underlying trades**

The underlying trades are managed by the Specialist Finance, Renewables, Healthcare and Property finance teams at Octopus. The investment managers seek three criteria from the trades into which they invest the money raised through OITS:

- Trades whose business activities target capital preservation with risks mitigated using deal structure, asset backing or contractual revenues with reliable customers.
- Predictable returns.

- Good visibility on cash flow (for liquidity purposes).

Octopus has a five tier investment committee process that new transactions must go through prior to investment by a portfolio company. This process is designed to ensure that each transaction is capable of meeting the above criteria, with the final stage being sign off by Fern's board (majority independent directors).

Octopus tell us that Fern's trade is currently split as follows:

| % of current portfolio | Area |
|---|---|
| 46% | in owning and operating 154 commercial scale solar energy sites (43% in the UK, 3% in France) |
| 19% | in short-term property loans managed by Octopus'"Dragonfly Property Finance" team (made up of 361 live loans, 228 loans funded directly by Fern and a further 133 funded by Terido LLP) |
| 14% | in owning and operating landfill gas and biomass sites (30 sites, of which 25 are landfill gas and 5 are biomass) |
| 10% | in loans to fund the construction of healthcare property (6 loans made directly by Fern) |
| 5% | in owning and operating wind energy sites (4 sites, of which 2 are partially owned by a major energy company) |
| 2% | in loans to fund the construction of solar energy sites (16 loans funded directly by Fern and 6 loans funded by Terido) |
| 2% | in loans to fund the construction of anaerobic digestion plants (6 loans funded directly by Fern) |
| 1% | in loans to fund the construction of reserve power plants (6 loans funded by Terido) |
| 1% | in owning and operating reserve power plants (2 sites) |

The appendices contain details on some of the trades currently being employed.

- Appendix C: Property finance trade details
- Appendix D: Renewable energy construction financing:
- Appendix E: Renewable energy ownership
- Appendix F: Terido LLP

The Octopus method of operation is to utilise investor funds to create value within a developer or associated company in which Octopus has a shareholding and a large economic interest. These funds are from a combination of tax advantaged sources controlled by Octopus (VCT, EIS and IHT) and the value is created by generating returns which exceed the low cost of funds from the tax advantaged sources. Rangeford Holdings (specialises in new villages and environments for people over 55), One Healthcare (private hospitals) and Aurora Schools (special educational needs schools) follow in the footsteps of Lightsource Renewable Energy Limited (energy) and Duncton/ Moneybarn (poor credit car finance).

We estimate that Octopus has made profits of over £100m from its 49% interest in Lightsource Renewable Energy Limited (based on our view of the developer profit level normally expected on over £1bn of solar installations transacted by Lightsource) and £34m from Duncton Group Limited (trading as Moneybarn) when Duncton was sold to Provident Financial for £120m in August 2014 (based on Octopus Capital owning 27% of the ordinary shares as disclosed in Note 9 to the accounts for year to 30 April 2014).

When we put this to Octopus they described this method of operating as:

*"The Octopus method of operation has been to closely manage some of the companies with which the portfolio companies engage. We sometimes do this by taking a stake in the counterparty, and/or a seat on the board, By doing this we can ensure that investor interests (often capital preservation) are aligned with the counterparty, and that the transaction remains BPR qualifying. For example with solar, Octopus took a shareholding in its development partner Lightsource. At the time, the UK solar market was far less developed than it is today and this was done in order to ensure that Octopus could better predict and monitor the development costs and timelines of solar sites for its EIS investors that were targeting capital preservation . It also had the benefit of enabling the developers interests to be aligned with those of Octopus capital preservation*

*investors with the developer protecting investors from downside risk in return for a greater share of any upside. As Martin has pointed out, one consequence of Octopus holding stakes in its development companies is that Octopus has managed to create value for itself from its shareholding in Lightsource , although this was not the primary reason for taking a stake in*

*the business originally."*

| Tax Efficient Review Fund Objectives Summary of key scoring factors | |
|---|---|
| **Size of Service?** | £1.57bn (at 30.6.2016) |
| **Total BPR funds under management (excluding EIS)?** | 2.2bn (at 30.6.2016) |
| **Number of investors in the Service?** | 10,087 (at 30.6.2016) |
| **Age of Service?** | 9 years |
| **BPR track record of business?** | More than 600 investors have passed away having held shares in the portfolio companies for more than 2 years. Octopus says they are not aware of any challenge having been raised by HMRC |
| **Diversification of BPR trade?** | The portfolio company invests across sectors that Octopus has selected for their ability to target capital preservation, and where they have focussed significant investment team resource. Its business is split between short and medium term secured lending, and owning and operating renewable energy assets. It has more than 450 separate assets. |
| **Diversification of investment sectors?** | As above |
| **Conflicts: Does the manager or any connected party have an interest in any other businesses that transact with the service?** | As set out in the brochure for the service, portfolio companies may transact with companies that are managed by Octopus on behalf of other retail investors, or with companies in which Octopus has an interest. |
| **Any gearing anywhere in the BPR structure?** | The portfolio company is the parent of a significant trading group. Many of its wholly owned subsidiaries own and operate renewable energy sites. Where this is the case, the subsidiary will have chosen to refinance part of the cost of the site that it owns with project financing from a mainstream bank, or may have acquired the site with such financing in place. Octopus says that borrowing levels are conservative, and therefore not usually considered to be "gearing". |
| **BPR audit conducted?** | A review of the BPR qualifying status of each portfolio company is carried out annually as part of the audit process by PWC. We think the auditors are best placed to fulfil this role, as they will be able to base their conclusions on the overall business of the companies, not just on information that is presented to them for consideration. |
| **TER overall comment** | **One of the oldest established offer and with by far the largest in terms of assets under management and asset diversification.** |

**Fund manager / Management team**

Octopus Investments was established more than fourteen years ago. Since then it has grown its customer base to over 50,000 investors and built relationships with thousands of individual advisers, resulting in over £6 billion in assets under management. Octopus employs c.450 people.

Octopus won the "Best Tax and Estate Planning Solution Provider" category at the Moneyfacts Awards in the current year and has also been awarded the Financial Adviser 5 Star Award for quality service from investment product providers for many years, including 2016.

Octopus has in excess of 100 investment professionals covering all products. The investment teams are split into two distinct areas: those that invest into externally run companies, such as the AIM team, and those that manage investments on behalf of the specialist unlisted portfolio companies.

The in house investment teams are then split into sector specialist teams, comprising healthcare, energy and property. Octopus also have separate portfolio management teams that are responsible for overseeing each product or group of products.

OITS is managed by the Unquoted Investments teams, including Specialist Finance, Renewables, Healthcare and Dragonfly Property Finance teams under this umbrella. These teams are responsible for making investments into unquoted businesses, where risks are mitigated through structure and security to deliver returns which are as predictable as possible. The team manages circa £2.5bn across five separate business lines, raised from three core products: VCTs, EISs and Octopus ITS.

In relation to the Octopus Inheritance Tax Service, the investment management resource is as follows:

- OITS Portfolio team –27 people, including 7 people responsible for overseeing the Octopus Inheritance Tax Service
- Renewable energy investment management team – 37 people, including 29 investment directors/managers
- Property investment management team – 35 people, including 15 business development managers and 17 credit/investment managers
- Healthcare investment management team – 32 people, including 15 investment directors/

managers

In addition, senior investment personnel sit on various committees within the investment process, including the head of property, head of healthcare, head of renewables and head of unquoted investments.

These teams will service all of Octopus' investments within their sector. The Octopus Inheritance Tax Service accounts for more than 60% of the FUM that is looked after by these teams, and it is estimated that approximately 60% of the team's time is allocated to the Octopus Inheritance Tax Service. The dedicated portfolio team do not spend material amounts of time working on other products.

| Tax Efficient Review Management Team Summary of key scoring factors | |
|---|---|
| **BPR assetsComposition of investment team and percentage of time spent managing the Service's BPR assets?** | Well resourced team spending the majority of their time on managing BPR assets |
| **Origination of dealflow produced in-house, outsourced or a mixture?** | In house |
| **Monitoring of investments in-house, outsourced or a mixture?** | In house |
| **Staff turnover?** | There has been no significant senior level staff turnover within the investment teams. Octopus says that they allocate 2 investment managers to each transaction in order to ensure continuity. |
| **TER COMMENT** | **Well resourced and experienced teams** |

**Track record**

Performance of IHT offers is difficult to compare as fees and charges are levied at different times (on investment, during holding period and at exit) and different places in the structure (in the service and in the underlying investee companies). The problem with performance figures is that annual figures quoted by providers do not include the initial and exit fees as this would distort the comparison. If the exit fee is 1% then loading it onto one year would not be correct.

It is important to separate out the return that Fern as a company returns to the service and the return that the service returns to investors over the total investment period. The latter must include initial fees, dealing fees and exit fees.

So how do Octopus cover performance and is it a fair way?

They cover performance in their documentation in two places - in the "Product Brochure" and in the "Details of underlying investments" document which is aimed at a sophisticated audience and goes into significant detail about Fern.

The Product Brochure says

> "*We target an annual investment return of 3% (after our annual management charge) over the period you hold the investment. This target return is based on the amount you invest, after deducting initial charges and the initial dealing fee on the investment. The performance of the Octopus Inheritance Tax Service depends on the growth in value of the company, or companies, we invest your money in".*

As we cover below in the cost section, Table 6 shows the five year costs of this offer at 29.04% which is the highest of all reviewed offers in a range going from a low for Illium of 13.25% to the Octopus high of 29.04% (excluding the Foresight offer which includes an insurance premium). Five year costs include initial fees, maximum annual management charge (which is contingent on performance and deferred) annual company running charges, dealing fees, Corporation Tax and any exit fees.

Octopus are unusual in that they defer their annual management charge (AMC) until the investor sells their investment, and then only charge it to the extent that they are able to and still deliver the investor 3% p.a growth over the life of their investment on a compound basis. This means that an investor knows the maximum amount AMC they will ever pay, but could end up paying less if the investment does not perform in line with Octopus' targets. It also means that a buffer against underperformance builds in the portfolio over time, although this clearly will not

protect against loss completely. Of the few managers who have looked to replicate this, others take their AMC each year contingent on performance, which does not help an investor year on year (high water mark).

The Product Brochure introduces a concept called "The Growth Shield: putting your returns first" and describe it as follows:

> *"Our Growth Shield works in your favour if your investment doesn't meet its target return. However, it doesn't guarantee the performance of your investment and you may not get back the amount you invested. What is the Growth Shield? It's the total annual management charge in your portfolio that builds up over time. It acts as a barrier against any potential fall in the value of your portfolio. Here's how it works. We calculate our annual management charge, but we don't take it. Instead of it being paid to us annually, it remains within your investment portfolio. We only take our annual management charge when you or your beneficiaries ask us to sell shares. Our aim is to achieve an annual target return of 3% (after our annual management charge) compounded over the time you've held the investment. The longer you are invested in the service, the bigger the available Growth Shield is likely to be. So, when you ask us to sell your shares, if we haven't delivered the expected growth in portfolio value, the annual management charge we take will be reduced or eliminated. When would the Growth Shield be called upon? If your portfolio drops in value, the Growth Shield will absorb this reduction in value first, before the value of your investment falls. If the investment hasn't achieved the 3% annual target return over its lifetime, when it's sold, our annual management charge will be reduced to help make up the shortfall. However, if your portfolio fell by more than the value of the accrued annual management charge, the Growth Shield would be used up and the investment would fall in total value. Does this mean investment returns are capped? We don't cap investment returns. But because the service targets capital preservation, we don't make investments that are likely to deliver a higher return. We invest in companies that we expect to deliver a growth in value of an average of 4.2% each year. That's the level of growth that would enable us to take our full annual management charge (1% + VAT) and still deliver the 3% annual target return to you. This means you should not expect returns significantly higher than 3%."*

The "Details of underlying investments" document shows the following 5 year performance for Fern's share price (the document covers January to January figures but we include updated figures to June):

| June 10-June11 | June 11-June12 | June 12-June 13 | June 13-June 14 | June 14-June 15 | June 15-June 16 |
|---|---|---|---|---|---|
| 4.20% | 4.11% | 3.97% | 3.72% | 3.98% | 3.82% |

Also included is the risk warning: *"The performance data shows Fern's share price only. It does not take account of initial fees, dealing fees or annual management charges associated with investing in the Octopus Inheritance Tax Service and should not be viewed as performance information for the Octopus Inheritance Tax Service".*

Actual performance therefore will be significantly lower and as can be seen the share price performance has been deteriorating over the last five years (apart from 2013/14).

In a simple 5 year example (no prediction is implied), £100,000 sent to Octopus would be invested after a 2% (no VAT) initial fee and 1% (no VAT) dealing fee so £96,428 is invested in Fern shares. If Fern performs it could deliver 3% compound per annum resulting in shares worth £112,473. On exit there is a 1% exit fee so the investor receives £111,336 which results in an annual rate of return of 2,2%.

As Octopus put it *"The Octopus Inheritance Tax Service has an annual management charge which is only taken after an investor instructs us to sell shares. And, most importantly, we will only deduct this charge from any growth of the Octopus Inheritance Tax Service above 3% a year, calculated over the investment period. Returns are not capped. However, the target of the Octopus Inheritance Tax Service is capital preservation so investors should not expect to see returns significantly higher than 3% after fees (and of course it could return less). To date, investors who have*

*sold their Octopus Inheritance Tax Service shares have all received at least the target return of 3% annualised growth per year, after our annual management charge has been deducted. Initial fees and dealing fees are excluded for this purpose."*

In summary, returns significantly in excess of 3% are unlikely, the returns have been reducing lately, the returns need to be reduced to account for the effect of initial fees, dealing fees and exit fees all of which have a greater effect the shorter the investment period

So is the return commensurate with the risk being taken in the underlying investment areas as measured by the annual gross return (before fees and costs). Our contention would be that an offer targeting higher gross returns from a similar trade to another offer seeking a lower gross return should be considered higher risk.

This approach of using gross returns as a proxy to indicate risk is open to challenge. For example, headline IRRs projected by each manager on the acquisition of a solar site can differ for a variety of very valid reasons. When a site is acquired, each manager will be using a model to estimate the revenues expected to be generated by that site over its lifetime. The model will contain a large number of assumptions, for which there is no market standard. For example, which long-term energy forecast they use, whether they take the conservative, middle or high-end forecast, macro-economic factors such as interest rates and inflation. This could lead to different headline IRRs being assumed, even for the same theoretical site. Other manager-specific factors will also impact IRR, including operating efficiencies.

The table below shows where Octopus are positioned in seeking returns.

| % of current portfolio | Area | Gross return being sought from Table 4 | |
|---|---|---|---|
| 46% | in **owning and operating** commercial scale solar energy sites | Foresight | 6.8%-10% |
| | | Guinness | 9.00% |
| | | Oxford Capital | 9.00% |
| | | Downing | 9.00% |
| | | **Octopus** | **7% - 8%** |
| | | Ingenious | 6%-7% |
| | | Time | 6.50% |
| 19% | in short-term property **loans** | **Octopus** | **10%-14%** |
| | | Ingenious | 9.5%-12% |
| | | Triple Point - 100% NAV | 8.50% |
| | | Triple Point - 50% Gens:50% NAV | 8.50% |
| | | Puma | 7.90% |
| | | Time | 7.00% |
| 14% | in **owning and operating** landfill gas and biomass sites | **Octopus** | **10% - 12%** |
| | | Ingenious | 8.00% |
| 10% | in **loans** to fund the construction of healthcare property | **11%** No other offer has this trade | |

| Tax Efficient Review Track Record Summary of key scoring factors | |
|---|---|
| **Underlying investment risk level?** | Higher than competing IHT offers in property lending |
| **Targeted net investor return?** | 3% per annum over the holding period before fees and charges on entry and exit so closer to 2% per annum after these are factored in over a five year period. There will be a lower effect over longer periods |
| **Difference from gross project level returns to investor net return (including tax)?** | Blended target portfolio company gross return 9.50% reduces after fess and costs to around 2% |
| **Actual return over the 12 periods to 30 June 2014, 2015 and 2016?** | Actual return over the 12 periods to 30 June 2014, 2015 and 2016?<br>Actual growth in the portfolio company's share price<br>June 2013 to June 2014 3.72%<br>June 2014 to June 2015 3.98%<br>June 2015 to June 2016 3.82%<br>As noted above this is before initial,dealing and exit fees. Octopus have not delivered investors this level of return, as Octopus will deduct their AMC from growth in Fern's share price. |
| **TER overall comment** | **Results have met the 3% target** |

**Withdrawals/Exit**

Liquidity to fund share buybacks will come from either working capital or through the constant recycling of the trades. The trades that Fern employs are designed to have a short duration on the basis that they should turn back into cash frequently. At this point the cash can be used to fund share buybacks if necessary. Octopus advises that the buyback process can take up to 12

weeks. Unlike some other solutions, the investor retains access to the investment. If circumstances change, the investor can dispose of all or part of the holding – although money withdrawn may not be shielded from inheritance tax. There are currently weekly share allotments for incoming/existing investors.

Octopus use PricewaterhouseCoopers (PwC) as tax advisers. As part of this remit Octopus requires PwC to provide opinion on all investments that Octopus make for BPR qualifying purposes.

Octopus advises that it has had no correspondence with HMRC regarding either Bracken or Fern and their BPR qualifying status. Octopus state that this is what it would expect as there is no reason why HMRC would need to contact Octopus in dealing with a claim for BPR for shares held in either Fern or Bracken. In the event of HMRC disputing such a claim Octopus would expect to hear from the introducing financial adviser or Executors of the relevant will. This has not happened. Over 600 investors have passed away holding investments in Octopus ITS that have been held for more than two years.

| Tax Efficient Review ReturnsDeal Flow/Exit Summary of key scoring factors | |
|---|---|
| **Liquidity aim?** | We aim to provide liquidity to investors within 1 month of a request. As this is an unlisted investment, liquidity cannot be guaranteed, and investors should be mindful that in exceptional circumstances liquidity may take significantly longer. |
| **Liquidity track record?** | We typically provide liquidity within 10 days of a request, and have provided more than £200m of liquidity to investors over the last 3 years. The longest it has taken to provide liquidity has been 3 weeks, for a £15m individual request. |
| **TER comment** | **Good liquidity track record** |

**Costs/Fees** Initial costs are fixed at 2.0% for advised investors, and 5.5% for non-advised intermediated (e.g. execution-only) or direct investors.

There is a maximum annual management charge of 1% plus VAT which is deferred and accumulated until investors sell down their shares. The deferred charge can only be collected at this time if the net investment into the underlying company has generated a return of at least 3% per annum on a cumulative basis after the annual management charge.

Octopus will apply a 1% dealing charge on investments and withdrawals by the investor (or their executors). Valuations of investment withdrawals will be made by reference to the latest valuations of investee companies.

Fees payable to Octopus by OITS investee companies

Octopus service fee. Paid by OITS investee company (Fern Trading Ltd) to Octopus is 2.5% +VAT of shareholder funds per annum. This is the only fee that Octopus makes for running Fern and is clearly set out in the Octopus Inheritance Tax brochure. Where the Fern group itself employs managerial staff, such as within its biomass and landfill gas business, the salaries of the management team are recharged to Octopus and so this cost is bourn as part of Octopus' 2.5% service fee. Directors fees paid to Octopus on behalf of Paul Latham are also recharged from the service fee.

This fee covers the work Octopus does in running Fern's business, including all deal sourcing and due diligence, deal execution, ongoing business monitoring, preparation of accounts, management and compliance.

It should be noted that on most of the lending business undertaken by Fern ( e.g. Dragonfly bridging finance for property developers) arrangement fees of up to 3% are earned on each new short-term loan. Any such fees are paid to Fern and not to Octopus.

| Tax Efficient Review Costs Summary of key scoring factors | |
|---|---|
| **Difference between the gross project level returns and the net return of the investor?** | At portfolio company level:<br>Irrecoverable VAT – lending is not a VATable trade, so VAT is not recoverable in respect of part of the portfolio company's costs<br>Cash drag – although we target retaining cash to a minimum, any cash that is not deployed in trading activities will reduce returns for the portfolio company<br>Service charge of 2.5% (plus VAT) of shareholder funds – as the portfolio company has few managerial employees of its own, the day to day management of the company is undertaken by Octopus for a fixed charge as agreed with the company's board (including independent directors). For example investment managers, finance teams for the portfolio company group<br>Direct costs incurred by the portfolio company to third parties, for example directors' fees, audit costs<br>Corporation tax – the portfolio company is expected to be profitable, so UK corporation tax will be payable<br>At portfolio level:<br>Annual management charge – up to 1% (plus VAT) charged at portfolio level. The fee accrued within an investor's portfolio but is not taken until the investor exits, and only then if the growth in the portfolio company's share price is sufficient for the investor to receive a 3% p/a return after our AMC. If not, AMC is reduced. |
| **Are any fees contingent on performance?** | Octopus says "We do not charge a performance fee as we do not think this would be appropriate with the capital preservation target of the portfolio.Octopus does not receive its full AMC for any investor portfolio where the growth in the portfolio company's share price is less than 4.2% on average each year of the investment (3% investor target return plus 1% (plus VAT) AMC). " |
| **TER comments** | **High set of fees overall (except for Foresight Accelerated offer which includes two years of insurance premiums against early death)** |

**Impact of failure of Octopus Investments**

As part of the due diligence, we asked Octopus Investments to comment on the implications of Octopus Investments no longer being able to fulfil their role in relation to OITS. For the avoidance of doubt, by asking this question we do not imply any reservations about their ability in either the short-term or long-term to fulfil their obligations nor any reservations about their financial stability or long-term commitment to this offering.

Their reply is:

"Octopus in its role as fund manager is not relevant to the security of the investment. The investor holds shares in Fern Trading Limited and the failure of Octopus would not impact on this. It is true that Octopus provides most of the infrastructure and management of Fern. Failure of Octopus would therefore probably initiate the investors (as the only shareholders) to liquidate Fern and then seek alternative investments."

**HMRC risk**

All IHT offerings face the possibility of challenge from HMRC when investors claim the 100% relief from IHT that unquoted assets can provide.

Relief will be refused if the business consists "wholly or mainly" of one or more of the following:

- dealing in securities, stocks or shares
- dealing in land or buildings,
- or making or holding investments.

HMRC will use the "Badges of Trade" concept when applying the "trade" versus "investment" rule and Appendix A sets out the concept as described in the HMRC Business Income Manual.

This is a complicated and difficult area and there is no pre-clearance that investors can request to try to settle this issue before investing.

Rates of tax, tax benefits and allowances described in the Investor Guide are based on current legislation and HMRC practice which may change from time to time and are not guaranteed.

In addition the HMRC approach to lending and what constitutes a "trade" is not tested. The HMRC website does contain detail on their view of lending within the Close Companies Manager's Manual. Although this page has recently been archived by HMRC the case law it references remains valid and as such it is reproduced as Appendix B.

Tax Efficient Review does not give tax advice.

**Conclusion**

The Octopus Inheritance Tax Service is looking to invest in unquoted companies with a capital preservation focus and is aimed at investors seeking a business opportunity to help mitigate IHT as the investment should be outside the investor's estate for inheritance tax purposes after two years. Given the lower risk nature of the investment strategy, the expected returns are low. Specifically, the company aims at returns of at least 3% per annum, net of ongoing charges, but this is not guaranteed. Unlike some other solutions, the investor retains access to the investment. If circumstances change, the investor can dispose of all or part of the holding – although money withdrawn may not be shielded from inheritance tax. The Fund Manager indicates that it will typically take less than two weeks to achieve this but could take longer in exceptional circumstances (for example if withdrawals need to be serviced by the investee companies carrying out a share buy back).

An investment in this product should therefore be viewed as a medium to long-term investment. This product carries some tax risk and rates of tax, tax benefits and allowances are based on current legislation and HM Revenue & Customs practice. These may change from time to time and are not guaranteed.

In assessing offers with business opportunities which could be attractive to investors seeking an BPR benefit, we look at the following aspects:

- Good downside protection
  OITS seeks trades whose business activities are focused on capital preservation with risks mitigated using deal structure, asset backing or contractual revenues from reliable customers and with predictable returns and good visibility on cash flow (for liquidity purposes)
- Some upside potential
  The aim is to earn a net of fees 3% for investors from the trades but there are no performance fees so all growth accrues to the investor after Octopus' AMC has been taken into account. In our view, potential upside might be favouring Octopus or its related entities
- A non-contentious business model
  None of the current businesses undertaken seem to be contentious
- Low charges
  Charges are not particularly low
- Good liquidity
  At present there is a good level of inflow to cover any required exits but this could change with the move to financing long term holdings in solar companies

In the last year there have been a number of changes to the trades and the mechanisms by which these are transacted, and these change the current offer in our view from past versions but this is still the most successful BPR product in terms of funds raised that we review.

**Tax Efficient Review rating: 87 out of 100** (for an established manager with a hybrid offer combining yield producing assets and lending/leasing)

**Risk from IM**

**Risk Factors reproduced from the Octopus Inheritance Tax Service Product Brochure**

You may lose money

The Octopus Inheritance Tax Service is a discretionary portfolio service. It invests in unquoted companies that are not listed on a stock exchange. The value of such companies can fall or rise more sharply than shares in larger, listed companies. The shares of unquoted companies can also be more difficult to sell. As with all investments, your shares could fall in value. Also, when it comes time to sell you may not get back the full amount invested.

Target returns are not guaranteed

The target returns of the Octopus Inheritance Tax Service are not guaranteed and you should not consider the past performance of the investment to be a reliable indicator of future results. The performance of the Octopus Inheritance Tax Service is based on the value of the underlying portfolio companies.

Tax rules can change

Rates of tax, tax benefits and tax allowances are based on current legislation, interpretation

based on case law, and HMRC practice. Octopus can't guarantee that tax rules won't change in the future. The value of tax reliefs depend on your own personal circumstances.

Requests to sell shares could take longer than anticipated

Selling shares in the Octopus Inheritance Tax Service is normally achieved by selling the shares you own to other investors, and there is no guarantee that a buyer will be found. If there are unusually large withdrawals, the companies you have invested in may need to carry out a share buyback, a process that could take approximately three months. In exceptional circumstances (such as a change in tax rules) where the companies do not have sufficient available funds to carry out a share buyback, the process could take much longer, as Octopus would need to sell the assets owned by the portfolio companies in order to return the proceeds of the share sale to you. You should not invest in the Octopus Inheritance Tax Service unless you understand and accept that – in exceptional circumstances – it could take a year or more to access your investment following a withdrawal request.

Your investment may be in only one company

The Octopus Inheritance Tax Service will only invest in a small number of companies conducting trades in one or more sectors. Your investment could have less diversification when compared with a portfolio of investments spread across many different sectors.

Portfolio companies may use different sources of finance

Investors in the Octopus Inheritance Tax Service are the only shareholders of the companies into which the service invests. Like any company, in order to deliver 3% growth to investors, the portfolio companies need to make higher returns to cover their running costs. In order to achieve these returns, and to undertake a wider range of activities, these companies may borrow funds from external lenders, such as banks, to fund part of their trades. However, this activity could increase the risk of your investment falling in value if interest repayments cannot be met by the portfolio companies.

BPR is assessed on a case-by-case basis

Octopus cannot guarantee that the investments Octopus make on your behalf will qualify for BPR in every case in the future. HMRC will only conduct a BPR assessment after the death of an investor, to confirm whether the companies invested in qualify for BPR at that time. If you borrow money to invest in the Octopus Inheritance Tax Service, your investment is unlikely to qualify for relief from inheritance tax.

Investment horizon

The Octopus Inheritance Tax Service is not intended to be a short-term investment, and the typical holding period for our investors is more than five years. It will normally take two years for an investment to qualify for BPR. This two-year period will begin once your money is invested in companies within the service. You need to continue holding the investment until you die if you would like your estate to benefit from inheritance tax relief.

It is important to keep your will up to date

This is particularly relevant after you've made significant changes to your investments, for example after choosing to invest in the Octopus Inheritance Tax Service. Octopus recommend that investors seek professional advice to ensure that their will is drafted to take best advantage of inheritance tax reliefs available to them, such as investments that qualify for BPR.

| Table 2: Scoring methodology<br>Tax Efficient Review scores each BPR offering in its sub-classification out of 100. There are six classifications - new entrant or established manager, lending/leasing focus or asset owning and operating focus or hybrid. The total score is made up of the four components below but no breakdown of each component score is given. No new entrant offering can score higher than the lowest established manager score in the same focus classification. | |
|---|---|
| **Areas considered within score** | **Why is this area important for investors** |
| **Fund Objectives/ Business Model rating out of 40** | |
| **Lending focus** - what criteria are set for key metrics such as Loan to Value (ie final value of development once completed) or Loan to Cost (a more conservative metric involving asset cost)<br>**Owning and operating yielding assets** - what asset class(es) are involved, what factors might affect future earnings and asset value, what yield might they produce, how easy are they to exit in stress situation | Key to understanding the underlying trade, its potential liquidity to meet withdrawal requests and its potential risk and rewards |
| Size of fund to date | Indicates potential spread of loans/assets. In early years of a new offer the acquisition of assets can be lumpy depending on their size and this could slow down deployment of funds |
| What rate of return is being targeted and what has been achieved in the last three years | How realistic are the targets. We measured return in two 12 month periods but excluded initial/set up costs and any exit costs as to deduct these from a single year return would not reflect reality where these costs would be spread over the total return earned over the length of the investment. |
| What level of risk is being taken in seeking to achieve the target rate of return | Must be accounted for to compare offers correctly |
| Diversification of counterparties to the trade(s) | The greater the number of counterparties then the greater the potential diversification and hence potentially the lower the risk, especially should a portion of the business need to be sold to produce cash for shareholders |
| How does the manager ascertain that the investments to date are BPR qualifying and how do they get comfortable that future investments will also qualify<br>Does the investee company's auditor cover this area as part of the audit process or is a firm of accountants engaged to review the BPR status of the company | This is crucial if BPR is to be maintained |
| Is there gearing anywhere in the BPR structure (i.e. In the portfolio company or in the underlying company or partnership) and if so, what percentage? | Gearing at any level in the structure will increase both the risk for investors and potentially the returns. Therefore the degree of gearing needs to be factored in to any comparison of the offerings |
| How do you check the portfolio liquidity in stressed and normal market conditions | A key risk in any investment involving BPR is the potential of future HMRC changes to the rules. Such changes may provoke a rush to exit which could seriously increase the time taken before investors are paid and may also seriously impact some asset values. Unlike VCTs and EISs there is no pre-clearance of companies by HMRC. |
| **Management Team rating out of 30** | |
| Size and composition of both the investment and management team and their background experience in the trades carried on | Does the team have adequate headcount to deploy funds in good time to avoid cash drag on returns. Do they have required skills in the areas where funds are being deployed. |
| All providers have inhouse investment professionals but are deals originated internally or outsourced | Outsourcing will involve fees being incurred and potentially divorces origination of deals from ongoing deal monitoring |
| **Deal Flow/Exit rating out of 20** | |
| For each of the underlying trades, what is the total pipeline of dealflow | This is seeking to establish the deal flow to assist deployment of new funds |
| For each of the underlying trades, what is the number of counterparties | The greater the number of counterparties then the greater the potential diversification and hence potentially the lower the risk, especially should a portion of the business need to be sold to produce cash for shareholders |
| Liquidity with emphasis on number of times per year an investor can exercise their exit option, how long is the period after exercising and funds being paid to investor and what is actual experience in last three years | Guide to ease and speed of access to the investment |
| We asked providers a number of questions to investigate the ease of access and time taken to exit the investment | 1. how much is the largest single withdrawal that they have processed and how long did it take to return the capital to the beneficiary from initial request?<br>2. What is the total £ volume of withdrawals from their BPR service that they have facilitated since the inception of their service (or the last 3 years whichever is the shorter) and what is the maximum and minimum time that the service has taken to deliver the proceeds from the day of request to actual cash withdrawal? |
| Speed of deployment | Returns will be reduced by delaying the deployment of new funds |
| **Costs rating out of 10** | |
| Fees and costs can be levied at many points in time, at many levels and in many ways. For example they may be dependent upon performance or they may be levied irrespective of performance, they may be expressed as a % of the company net asset value or the amount originally invested and they may be paid annually or deferred. | The aim of the questions we asked providers was to identify all relevant costs and to express them as a five year total. We then compared these between providers. |

**Table 3: Trade comparisons sorted by provider** Source Providers

**IMPORTANT NOTE:** these percentages are not static and change on a weekly basis. This is due to a number of factors, including income being received or repayments made on existing deals, further drawdowns being made under existing deals, and new deals being entered into. So this is just a snap-shot as at 31 August 2016.

| Provider | Trade classification (Lending/Leasing or equity holding in asset owning company) | Trade type | % of portfolio excluding cash | GrossTarget return |
|---|---|---|---|---|
| Deepbridge | Equity | Hydro | 20% | 10.00% |
| Deepbridge | Equity | Wind | 70% | 11.00% |
| Downing | Equity | AD | 3% | 9.00% |
| Downing | Equity | Asset backed | 33% | 9.00% |
| Downing | Equity | Solar | 11% | 9.00% |
| Downing | Equity | Wind | 3% | 9.00% |
| Downing | Lending | Asset backed | 48% | 9.00% |
| Foresight | Equity | Secondary PFI | 16% | 7.80% |
| Foresight | Equity | Smart Metering | 16% | 7.50% |
| Foresight | Equity | Solar | 25% | 6.8%-10% |
| Foresight | Lending | Energy Efficiency | 3% | 10.00% |
| Foresight | Lending | Solar | 40% | 6.8%-10% |
| Guinness | Equity | Solar | 100% | 9.00% |
| Illium | Lending | Media | 100% | 5.50% |
| Ingenious | Equity | Biomass/landfill gas | 6% | 8.5%-9.5% |
| Ingenious | Equity | Solar | 10% | 6%-7% |
| Ingenious | Lending | Solar | 4% | 6.5%-7.5% |
| Ingenious | Lending | Media | 19% | 4%-6% |
| Ingenious | Lending | Property | 38% | 9.5%-12% |
| Ingenious | Lending | Biomass/landfill gas | 16% | 9%-10% |
| Ingenious | Lending | Wind | 7% | 8%-8.5% |
| Octopus | Equity | Biomass/landfill gas | 14% | 10% - 12% |
| Octopus | Equity | Reserve power | 1% | 10% - 12% |
| Octopus | Equity | Solar | 42% | 7% - 8% |
| Octopus | Equity | Wind | 5% | 8% - 9% |
| Octopus | Lending | Healthcare construction | 10% | 10% - 12% |
| Octopus | Lending | Property | 20% | 10%-14% |
| Octopus | Lending | Solar | 6% | 9% - 11% |
| Oxford Capital | Equity | Solar | Investor choice | 9.00% |
| Oxford Capital | Equity | Anaerobic Digestion | Investor choice | 9.00% |
| Oxford Capital | Lending | Solar | Investor choice | 8%-12% |
| Oxford Capital | Lending | Reserve Power | Investor choice | 8%-12% |
| Oxford Capital | Lending | Anaerobic Digestion | Investor choice | 8%-12% |
| Proven | Lending | SME | 100% | 7.50% |
| Puma | Lending | Property | 100% | 7.90% |
| Rockpool | Lending | SME | 100% | 7.85% |
| Seneca | Lending | SME | 100% | 9.50% |
| Time | Equity | Self Storage | 5% | 6.50% |
| Time | Equity | Solar | 24% | 6.50% |
| Time | Equity | Wind | 31% | 7.50% |
| Time | Lending | Property | 35% | 7.00% |
| Triple Point - 100% Gens | Leasing | Corporate and SME | 22% | 6.50% |
| Triple Point - 100% Gens | Leasing | NHS and Public Sector Leasing | 66% | 3%-4% |
| Triple Point - 100% Gens | Lending | Infrastructure | 12% | 6%-7% |
| Triple Point - 100% NAV | Leasing | Corporate and SME | 24% | 8.50% |
| Triple Point - 100% NAV | Lending | Property | 43% | 8.50% |
| Triple Point - 100% NAV | Lending | SME | 33% | 9%-11% |
| Triple Point - 50% Gens:50% NAV | Leasing | Corporate and SME | 22% | 7.50% |
| Triple Point - 50% Gens:50% NAV | Leasing | NHS and Public Sector Leasing | 33% | 3%-4% |
| Triple Point - 50% Gens:50% NAV | Lending | Infrastructure | 6% | 6%-7% |
| Triple Point - 50% Gens:50% NAV | Lending | Property | 22% | 8.50% |
| Triple Point - 50% Gens:50% NAV | Lending | SME | 17% | 9%-11% |

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## Review of BPR offer ESTABLISHED MANAGER - Hybrid offer combining yield producing assets and lending/leasing

**Table 4: Trade comparisons sorted by trade** Source Providers

**IMPORTANT NOTE:** these percentages are not static and change on a weekly basis. This is due to a number of factors, including income being received or repayments made on existing deals, further drawdowns being made under existing deals, and new deals being entered into. So this is just a snap-shot as at 31 August 2016.

| Provider | Trade classification (Lending/Leasing or equity holding in asset owning company) | Trade type | % of portfolio excluding cash | GrossTarget return |
|---|---|---|---|---|
| **Downing** | Equity | AD | 3% | 9.00% |
| **Downing** | Equity | Asset backed | 33% | 9.00% |
| **Ingenious** | Equity | Biomass/landfill gas | 6% | 8.5%-9.5% |
| **Octopus** | Equity | Biomass/landfill gas | 14% | 10% - 12% |
| **Oxford Capital** | Equity | Distributed Energy | Investor choice | 9.00% |
| **Deepbridge** | Equity | Hydro | 20% | 10.00% |
| **Octopus** | Equity | Reserve power | 1% | 10% - 12% |
| **Foresight** | Equity | Secondary PFI | 16% | 7.80% |
| **Time** | Equity | Self Storage | 5% | 6.50% |
| **Foresight** | Equity | Smart Metering | 16% | 7.50% |
| **Foresight** | Equity | Solar | 25% | 6.8%-10% |
| **Guinness** | Equity | Solar | 100% | 9.00% |
| **Ingenious** | Equity | Solar | 10% | 6%-7% |
| **Octopus** | Equity | Solar | 42% | 7% - 8% |
| **Time** | Equity | Solar | 24% | 6.50% |
| **Downing** | Equity | Solar | 11% | 9.00% |
| **Downing** | Equity | Wind | 3% | 9.00% |
| **Octopus** | Equity | Wind | 5% | 8% - 9% |
| **Time** | Equity | Wind | 31% | 7.50% |
| **Deepbridge** | Equity | Wind | 70% | 11.00% |
| **Triple Point - 100% Gens** | Leasing | Corporate and SME | 22% | 6.50% |
| **Triple Point - 100% NAV** | Leasing | Corporate and SME | 24% | 8.50% |
| **Triple Point - 50% Gens:50% NAV** | Leasing | Corporate and SME | 22% | 7.50% |
| **Triple Point - 100% Gens** | Leasing | NHS and Public Sector Leasing | 66% | 3%-4% |
| **Triple Point - 50% Gens:50% NAV** | Leasing | NHS and Public Sector Leasing | 33% | 3%-4% |
| **Downing** | Lending | Asset backed | 48% | 9.00% |
| **Ingenious** | Lending | Biomass/landfill gas | 16% | 9%-10% |
| **Oxford Capital** | Lending | Distributed Energy | Investor choice | 8%-12% |
| **Foresight** | Lending | Energy Efficiency | 3% | 10.00% |
| **Octopus** | Lending | Healthcare construction | 10% | 10% - 12% |
| **Triple Point - 100% Gens** | Lending | Infrastructure | 12% | 6%-7% |
| **Triple Point - 50% Gens:50% NAV** | Lending | Infrastructure | 6% | 6%-7% |
| **Illium** | Lending | Media | 100% | 5.50% |
| **Ingenious** | Lending | Media | 19% | 4%-6% |
| **Ingenious** | Lending | Property | 38% | 9.5%-12% |
| **Octopus** | Lending | Property | 20% | 10%-14% |
| **Puma** | Lending | Property | 100% | 7.90% |
| **Time** | Lending | Property | 35% | 7.00% |
| **Triple Point - 100% NAV** | Lending | Property | 43% | 8.50% |
| **Triple Point - 50% Gens:50% NAV** | Lending | Property | 22% | 8.50% |
| **Proven** | Lending | SME | 100% | 7.50% |
| **Rockpool** | Lending | SME | 100% | 7.85% |
| **Seneca** | Lending | SME | 100% | 9.50% |
| **Triple Point - 100% NAV** | Lending | SME | 33% | 9%-11% |
| **Triple Point - 50% Gens:50% NAV** | Lending | SME | 17% | 9%-11% |
| **Foresight** | Lending | Solar | 40% | 6.8%-10% |
| **Ingenious** | Lending | Solar | 4% | 6.5%-7.5% |
| **Octopus** | Lending | Solar | 6% | 9% - 11% |
| **Ingenious** | Lending | Wind | 7% | 8%-8.5% |
| **Octopus** | Lending | Solar | 6% | 9% - 11% |
| **Oxford Capital** | Lending | Solar | Investor choice | 8%-12% |

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## Table 5: Input data for provider comparison - OCTOPUS Source - OCTOPUS September 2016

| 1 | Type of cost/fee | Fee % | | | Comment |
|---|---|---|---|---|---|
| 2 | Initial fee | -2.00% | | | no VAT is applicable |
| 3 | Initial dealing fee | -1.00% | | | This 1% charge is based on the net amount after the Octopus initial fee has been taken. |
| 4 | Arrangement fees | 0.00% | | | We don't charge any fees for running Fern other than the 2.5% service charge. |
| 5 | Other | 0.00% | | | |
| 6 | Total initial fees | -3.00% | | | |
| 7 | Underlying investee company Returns | Target % | Range % | Gearing level | % of investor subscriptions deployed as at [DATE] |
| 8 | Lending | 11.00% | 7-13% | 0.00% | 35.00% |
| 9 | Equity | 8.50% | 7%-11% | 50.00% | 60.00% |
| 10 | | | | | |
| 11 | | | | | |
| 12 | Cash | 0.50% | | 0.00% | 5.00% |
| 13 | Overall headline rate (weighted average) | 8.98% | | | Weighted average based on % allocation across investee companies as at [DATE] |
| 14 | Gross Return per annum | Target % | | Gearing level | Comment |
| 15 | Gross Annual Target Return | 8.98% | | 34.00% | On the net amount invested after initial fees, any adviser charges and dealing fee on investment |
| 16 | Administration costs | Target % | | | Comment |
| 17 | Administration | 0.00% | | | These costs are covered by the 2.5% service charge. |
| 18 | Secretarial | 0.00% | | | These costs are covered by the 2.5% service charge. |
| 19 | Custodian | 0.00% | | | These costs are covered by the 2.5% service charge. |
| 20 | Share registry | 0.00% | | | These costs are covered by the 2.5% service charge. |
| 21 | Audit & Accounting | -0.07% | | | Accountancy costs are included in the 2.5% service charge. Audit, tax and accountancy fees paid by Fern (to PwC) are expected to be approx. £1m p/a |
| 22 | Legal | 0.00% | | | These costs are covered by the 2.5% service charge. |
| 23 | Other | -0.46% | | | Irrecoverable VAT on costs in relation to the lending part of the book and £4m of direct external costs such as valuation fees and broker fees. This is not a target rate, but an estimate |
| 24 | Annual fees | Target % | | | Comment |
| 25 | Annual Management Charge | -1.20% | | | Inclusive of VAT. Octopus's AMC is deferred and contingent, so upto 1% (plus VAT) per annum will be due if compound growth over an investor's holding period exceeds 3%. The value of this buffer to an investor builds over time |
| 26 | Annual Management Charge Threshold (if applicable) | 3.00% | | | |
| 27 | Services fee for running service/investee companies | -2.50% | | | While the portfolio companies we invest in typically have employees of their own, they have few employees at a senior of managerial level. Therefore many of their day to day activities are outsourced to Octopus, which charges a fee for the services provided. Fees are currently set at 2.5% + VAT of the net assets of the companies. Salaries of managerial staff employed directl by the portfolio companies are recharged as part of the 2.5% service fee paid to Octopus |
| 28 | Transaction / Arrangement / Exit Fees charged at trade level (average p.a.) | 0.00% | | | All undertaken in house and so covered by the 2.5% service fee |
| 29 | Non Exec Directors | 0.00% | | | £70,000 (approximately 0.00006%) |
| 30 | Other | 0.00% | | | |
| 31 | Returns | Target % | | | Comment |
| 32 | Return pre-annual fees and pre-performance fee / exit charge | 8.44% | 5.17% | | |
| 33 | Annual return pre-performance fee / exit charge | 4.74% | | | Due to the structure of the product, CT will be deducted within the portfolio companies so this number is not one that can ever be achieved (ie returns pre-tax but post-AMC) |
| 34 | Corporation tax (expected) | 20.00% | | | |
| 35 | Corporation tax impact | -0.78% | | | Equity site target returns are post-CT. |
| 36 | Post Tax Annual return pre-performance fee / exit charge | 3.97% | | | Targeted portfolio company growth rate is 4.2% |
| 37 | Performance fee | 0.00% | | | |
| 38 | Net of tax & performance fee before exit charge (based on net investment) | 3.97% | | | We target 3% returns for investors, but if our portfolio performed in line with tatger performance and investment levels, it would achieve higher returns than 3%. If these are achieved, all the benefit goes to investors. We have built in extra investment buffer over and above our investors' expectations |
| 39 | Assumed investment term (years) | 5 | | | |
| 40 | Exit charge | 1% | | | Exit Dealing fee |
| 41 | Exit value in £ (after 5 years) | £117.83 | | | |
| 42 | Net return post-exit charge (based on investment term of 5 years) | £116.65 | | | After initial fee and dealing fee on investment |

## Review of BPR offer ESTABLISHED MANAGER - Hybrid offer combining yield producing assets and lending/leasing

**Table 6: Cost comparisons**

| | Deepbridge | Downing | Foresight | Foresight Accelerated | Guinness | Illium | Ingenious | Octopus | Oxford | Proven | Puma | Rockpool | Seneca | Time | Triple Pointp |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | Note 2 | | | | | | Note 1 |
| **Summary** | | | | | | | | | | | | | | | |
| Gross Return | 9.00% | 8.83% | 8.70% | 8.70% | 9.00% | 5.50% | 7.26% | 8.98% | 8.40% | 6.85% | 7.11% | 7.23% | 8.61% | 6.67% | 6.60% |
| Net Return To Investor | 4.68% | 4.28% | 4.80% | YRS 1-2 1.16% YRS 3-5 4.80% | 4.82% | 3.00% Note 3 | 4.02% | 3.97% | 4.13% | 3.42% | 3.61% | 4.34% | 4.00% | 3.50% | 3.72% |
| Difference | 4.32% | 4.55% | 3.90% | YRS 1-2 7.54% YRS 3-5 3.90% | 4.18% | 2.50% | 3.24% | 5.01% | 4.27% | 3.43% | 3.50% | 2.89% | 4.61% | 3.17% | 2.88% |
| **Difference Broken Down As** | | | | | | | | | | | | | | | |
| Non Manager Annual Running Costs | 0.50% | 0.00% | 0.70% | 0.70% | 1.15% | 1.00% | 0.19% | 0.53% | 0.87% | 0.78% | 1.05% | 0.30% | 0.01% | 0.17% | 0.28% |
| Corporation Tax | 1.17% | 1.09% | 1.20% | 1.20% | 0.82% | 0.75% | 1.01% | 0.78% | 1.28% | 0.86% | 0.90% | 1.09% | 1.00% | 0.98% | 0.96% |
| Total Annual Fees To Manager | 2.65% | 3.46% | 2.00% | YRS 1-2 5.64% YRS 3-5 2.00% | 2.21% | 0.75% Note 3 | 2.04% | 3.70% | 2.12% | 1.80% | 1.55% | 1.50% | 3.60% | 2.02% | 1.57% |
| TOTAL | 4.32% | 4.55% | 3.90% | YRS 1-2 7.54% YRS 3-5 3.90% | 4.18% | 2.50% | 3.24% | 5.01% | 4.27% | 3.43% | 3.50% | 2.89% | 4.61% | 3.17% | 2.81% |
| Five year costs & fees including initial fees and exit fees | 27.25% | 24.73% | 22.00% | 29.28% | 21.44% | 13.25% | 19.69% | 29.04% | 27.06% | 22.40% | 21.01% | 14.93% | 25.45% | 20.82% | 17.55% |

Note 1: Triple Point figures assume blended strategy of 50% Generations and 50% Navigator
Note 2: Oxford Capital figures assume Growth option
Note 3: Illium defer their AMC of 1% until investors receive 3% per annum. This shows that at the target gross return Illium do not meet this hurdle so the annual fee to manager is restricted

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## Review of BPR offer ESTABLISHED MANAGER - Hybrid offer combining yield producing assets and lending/leasing

**Table 7: Return comparison**

| | Offers based on 100% Yield producing assets focus | | Offers based on 100% Secured lending/leasing focus | | | | | | Hybrid offers combining lending/leasing focus with Yield producing assets focus | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Deepbridge | Guinness | Illium | Proven | Seneca | Puma | Rockpool | Triple Point | Downing | Foresight | Foresight Accelerated | Ingenious | Octopus | Oxford | Time |
| | | | | | | | | Note 2 | | | | | | Note 1 | |
| **Gross Return being sought from trades** | 9.00% | 9.00% | 5.50% | 6.85% | 8.61% | 7.90% | 7.23% | 6.60% | 8.83% | 8.70% | 8.70% | 7.26% | 8.98% | 8.40% | 6.67% |
| **Gross Return being sought net of stated fees, running costs, VAT & Corporation Tax (not actual results achieved)** | 4.68% | 4.82% | 3.00% | 3.42% | 4.00% | 4.24% | 4.34% | 3.81% | 4.28% | 4.80% | YRS 1-2 1.16% YRS 3-5 4.80% | 4.02% | 3.97% | 4.13% | 3.50% |
| **Stated Target Net Return in Brochure** | 6% | 5% | 3% | 3% | None stated | None stated | 5% | 3.5% Note 3 | 4.00% Note 4 | 3.5% | 3.5% | 3%-5% | 3% | 3%-5% | 3.5% |
| **Net amount returned as % of net investment (not including initial or exit fees but including any performance fees) for 12 month period shown** | JUST LAUNCHED | | JUST LAUNCHED | | 2.07% | 3.00% (2.20% before fee rebate taking it to 3%) | 4.80% | 3.81% | 3.82% | 3.54% | JUST LAUNCHED | 3.59% | 3.00% | 5.00% | 3.50% |
| | | | | | 30/06/2015 | 30/06/2015 | 30/06/2015 | 30/06/2015 | 30/06/2015 | 31/03/2015 | | 30/06/2015 | 30/06/2015 | 30/06/2015 | 31/03/2015 |
| | | | | | 3.02% | 3.00% (2.85% before fee rebate taking it to 3%) | 4.60% | 4.17% | 4.67% | 4.69% | | 3.37% | 3.00% | 5.24% | 3.50% |
| | | | | | 30/06/2016 | 30/06/2016 | 30/06/2016 | 30/06/2016 | 30/06/2016 | 31/03/2016 | | 30/06/2016 | 30/06/2016 | 30/06/2016 | 31/03/2016 |
| **Have both years actual returns without fee rebates met or exceeded target in Brochure?** | | | | | No target | No target | NO | Within range | NO | YES | | Within range | YES | YES | YES |

**Note 1: Based on Growth option**
**Note 2: Based on 50% Generations strategy/50% Navigator strategy**
**Note 3: Generations target of 1.5%-2.5% and Navigator target of 4%-6% = 2% + 5% / 2**
**Note 4: Over "medium term"**
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## Review of BPR offer ESTABLISHED MANAGER - Hybrid offer combining yield producing assets and lending/leasing

| Table 8: Additional questions - OCTOPUS | |
|---|---|
| **1. How much is the largest single withdrawals that you've processed in your BPR service and how long did it take to return the capital to the beneficiary from initial request?** | The largest single withdrawal was £15m. The investor received their funds within three weeks. |
| **2. What is the total £ volume of withdrawals from your BPR service that you have facilitated since the inception of your service (or the last 3 years whichever is the shorter) and what is the maximum and minimum time that the service has taken to deliver the proceeds from the day of request to actual cash withdrawal?** | £229,945,136 for the period 1st June 2013 - 31st May 2016 |
| **3. Is there gearing anywhere in the BPR structure (i.e. In the portfolio company or in the underlying company or partnership) and if so, what percentage?** | Yes. Fern has secured c.£700m of project finance from mainstream banks within its operating subsidiaries |
| **4. For each of your underlying trades, what are a) your total pipeline of dealflow and b) the geared and ungeared project level returns (i.e. Pre any of your fees, includes related party fees of any description, such as arrangement fees, transaction fees, dealing fees, corporate finance fees, fundraising fees, service fees) that you seek from each?** | Clear pipeline of £900m looking forward 12 months (£350m renewable energy £330m property lending £100m healthcare construction financing). Target blended returns will be in line with targets included at rows 23 and 24. Target returns include the impact of project finance where relevant (owned assets only not relevant to lending) |
| **5. What are the names of the portfolio companies and any subsidiary companies/partnerships** | Fern has over 200 subsidiary companies |
| **Third party fees** | |
| **a.What rate do borrowers pay including interest and fees** | Target 11%, all fees and interest accrue to the borrower except for a small amount of broker fees as shown as row 47, of which broker fees account for c.£4m and are paid to third party introducers of property loans |
| **b. Who benefits from these fees** | Portfolio companies (Fern Trading Ltd) |
| **c.What fees are paid to third parties involved in the investment origination and management process** | None except for the small amount of fees paid to property loan introducers (c.0.3% of the portfolio last year) |
| **Other returns from investment** | |
| **d. Does the manager or any connected party (such as a shareholder of the manager) have an interest in any other companies that transact with the investee companies** | Yes |
| **e. If so, what is that interest?** | Octopus owns equity stakes in some of the businesses to which Fern lends construction financing (currently <10% of the portfolio). It also manages some of the companies to which the portfolio companies lend on behalf of investors in different products (currently c.5% of the portfolio). All terms are agreed on an arms length basis and robust conflicts management procedures are in place, see row 93 |
| **f. Is this disclosed in the product brochure** | Yes - pages 20 and 21 |
| **g.What measures do you have in place to ensure that transactions are entered into on arms' length terms** | 5 stage investment committee process including conflicts committee, use of external due diligence by each party to the transaction, internal portfolio specific teams and most importantly majority independent Boards of Directors who have to approve any conflicted transactions as being in the best interestes of the OITS investors. |
| **Arrangement fees, transaction fees, acquisition fees, fees of any nature at a project level** | |
| **h. What such fees have been paid to the manager or another party over the last year and what do you expect to pay over the next 12 months** | None |
| **BPR** | |
| **i. How do you ascertain that the investments to date are BPR qualifying** | We visit leading IHT tax counsel annually and consult regularly, we ask PWC to approve any new types of transactions as being qualifying and most importantly PWC assess each portfolio company in the round as part of their audit review |
| **j. How do you get comfortable that future investments will also qualify** | We visit leading IHT tax counsel annually and consult regularly, we ask PWC to approve any new types of transactions as being qualifying |
| **k.Does the investee company's auditor cover this area as part of the audit process.** | Yes - they are best placed to do so as they understand each portfolio company in detail |
| **Irrecoverable VAT** | |
| **l. If your trade involves all or part lending business, how do you show irrecoverable VAT** | It is included in costs |
| **m. Do you charge VAT on your AMC** | Yes |
| **Liquidity** | |
| **o. How do you check the portfolio liquidity in stressed and normal market conditions** | We run normal, cautious and stressed valuations every month, which must be approved by the majority independent board of each portfolio company. We only acquire Tier 1 (institutional grade, commercial scale) renewable energy sites that qualify for long-term incentives because these sites are attractive to other institutional investors such as banks, pension funds and family offices. Due diligence and legal work on each site is undertaken by top tier firms, and the technology used must be provided and/or supported by a well capitalised counterparty. We also intentionally acquire significant portolios of sites as these are more attractive to purchasers than single sites. We have tested the attractiveness of the portfolio to external parties by raising c.£700m of external project finance from mainstream banks against the portfolio companies' renewable energy sites. The portfolio companies only lend against assets that we understand well, and have the expertise and experience to market if the portfolio companies had to realise their security. For example property finance where we have previously been able to sell properties for more than the borrower due to our experience and strength in the sector. We have tested demand from non-retail investors by raising institutional funds to invest in the same asset class, which validates that there is an external market for this sector of the portfolio company's business should it wish to sell to provide liquidity for investors. |

**Appendix A: HMRC Business Income Manual guidance on "badges of trade" (all wording from HMRC website)**

Source: www.hmrc.gov.uk/manuals/bimmanual/bim20200.htm

A summary of each 'badge of trade' is shown below with a brief pointer to its meaning. These 'badges' will not be present in every case and of those that are, some may point one way and some the other. The presence or absence of a particular badge is unlikely, by itself, to provide a conclusive answer to the question of whether or not there is a trade. The weight to be attached to each badge will depend on the precise circumstances. The approach by the courts has been to decide questions of trade on the basis of the overall impression gained from a review of all the badges.

| Badge | Reference | Guidance |
|---|---|---|
| **The origin of the concept** | BIM20201 | Each case where the meaning of 'trade' is an issue must be decided on its own facts. The approach of the Commissioners and the courts over the years has been to examine the facts and look for the presence or absence of common features or characteristics of trade. These are the 'badges of trade' which have been identified as case law has developed before the courts.<br>The report of the Royal Commission on the Taxation of Profits and Income in 1955 reviewed that case law and identified six 'badges'. Since then the concept has been refined and enlarged and BIM20205 provides a summary.<br>A useful modern summary of the badges of trade is contained in Marson v Morton and Others [1986] 59TC381 at page 391, although the court disclaimed any intention of the review being exhaustive. |
| **Profit-seeking motive** | BIM20210 | An intention to make a profit supports trading, but by itself is not conclusive. |
| **The number of transactions** | BIM20230 | Systematic and repeated transactions will support 'trade'. |
| **The nature of the asset** | BIM20245 | Is the asset of such a type or amount that it can only be turned to advantage by a sale? Or did it yield an income or give 'pride of possession', for example, a picture for personal enjoyment? |
| **Existence of similar trading transactions or interests** | BIM20270 | Transactions that are similar to those of an existing trade may themselves be trading. |
| **Changes to the asset** | BIM20275 | Was the asset repaired, modified or improved to make it more easily saleable or saleable at a greater profit? |
| **The way the sale was carried out** | BIM20280 | Was the asset sold in a way that was typical of trading organisations? Alternatively, did it have to be sold to raise cash for an emergency? |
| **The source of finance** | BIM20300 | Was money borrowed to buy the asset? Could the funds only be repaid by selling the asset? |
| **Interval of time between purchase and sale** | BIM20310 | Assets that are the subject of trade will normally, but not always, be sold quickly. Therefore, an intention to resell an asset shortly after purchase will support trading. However, an asset, which is to be held indefinitely, is much less likely to be a subject of trade. |
| **Method of acquisition** | BIM20315 | An asset that is acquired by inheritance, or as a gift, is less likely to be the subject of trade. |

**Appendix B Extract from HMRC Manager Manual**

**CT6650d - Close companies: loans to participators : business of lending money**

**ICTA88/S419 (1)**

The exemption in Section 419 (1) is really two separate tests - a company must carry on a business of lending money and the loan must be made in the ordinary course of that business. As regards the first test, there is judicial guidance in the case of Brennan v The Deanby Investment Company Ltd (73 TC 455).

In the Northern Ireland Court of Appeal Carswell LCJ said (at page 9 of the leaflet)

'It seems to us that the phrase in s419(1)'a business carried on by it which includes the lending of money' connotes a certain regularity of recurrence of such transactions. To carry on the business of doing something ordinarily means that it is done as a regular practice by way of a trading operation, if not with all comers, at least with a variety of customers.'

A company will only satisfy the first part of the proviso if it has a trade of lending money. Characteristics of the trade of a commercial money lender include whether the company :

- Advertises its money lending to the public or some sector of the public
- Publishes its rates of interest
- Receives applications for loans from the public or from that sector of public to which it lends
- Charges interest at a commercial rate
- Has the means (that is, a system and appropriate personnel) to enforce collection of debts
- Uses official documentation with terms of repayment of the loan clearly set out in a form which can be legally enforced.
- Has a reasonable number of loans (usually 200+) to ensure that profits on the good loans can cover the inevitable loan write offs.
- Matches borrowing and lending - a genuine trader will try and match their source of funds with loans advanced. For example, a trader would not generally borrow short-term funds repayable on demand, and lend them on a long-term basis.

A single loan made by a company to a participator, even on commercial terms, is not adequate evidence of the existence of a commercially constituted business of lending money. Since the first test fails, the second test automatically becomes redundant. Even in other cases where the first test is met, a loan to a participator still has to be made in the ordinary course of the business, and that would not be the case where the size, terms or conditions of the loan differed from those which normally applied

http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/manuals/ct123manual/ct6650d.htm

## Appendix C: Property finance trade details

Dragonfly is a trading name for a multi-award winning team of around 30 property lending specialists employed by Octopus Investments.

The team source, evaluate and manage property lending deals in specialist property sectors including bridge finance for professional developers of residential property(allowing them to undertake more projects at the same time), short term funding against commercial property that may not meet bank criteria (for example short income profile, vacant or indeed just because they need to complete quicker than a bank can move).

The loan agreements provided are transacted in the name of the lender (eg Fern) trading as Dragonfly Property Finance. Octopus identified low loan to value Property Financing as being an appropriate trade to deploy funds raised through OITS into and then proceeded to source and appoint the relevant people to start and run the business. The CEO of the business was Jonathan Samuels, however he left the team in September 2015 to start a new unconnected venture. The team is now managed by Mark Posniak, who was the head of sales for the Dragonfly Property Finance team for 6 years prior to taking up this role.

Dragonfly's website is www.dragonflyfinance.com.

The team made its first loan in April 2009. Since that time Dragonfly has grown rapidly, making in excess of 3,300 loans (as at 31 December 2015) of which more than 1,100 are currently live. Over £1.86bn has been lent since inception, with capital losses sustained on just one loan, where less than £4,000 was lost. The average loan-to-value ratio on the current book is less than 60%.

Dragonfly offers a number of products to the market, including short–term bridging loans, medium-term buy-to-let loans, development loans, loans against commercial property.

In 2011 Octopus provided TER with full details of the then current and historic loan book, average loan size since inception, total quantity of money lent, default rates etc. Octopus is not willing to publicly disclose this data as it is commercially sensitive. The default rate was less than 1% and in all but one of the 3,300+ loans made to date all capital has been recovered through the recovery procedure which typically involves the re-sale of the repossessed property at auction. In the one case where a loss was realised, it was limited to less than £4,000.

Deals are introduced to Dragonfly by mortgage intermediaries or packagers and Octopus employs 10 business development managers as part of the Dragonfly team, as well as a Head of Sales. In 2011, Octopus provided TER with a run through of a completed deal.

As a business Dragonfly is growing rapidly and adding about £9m to its loan book a month.

The Dragonfly Property Finance Team comprises 33 people.

**Key members of the team are:**

Managing Director: Mark Posniak - 17 years' experience in both the IT and Financial Services sectors across the UK and Australia. Previously Head of Sales and Marketing for the Dragonfly team for 6 years. He has also been Director of Sales & Marketing at the Cheval Group, a principal short term lender regulated by the FSA. Also worked for Linksfield Technologies, a provider of key software solutions into the financial services sector in the UK.

Director of Risk and Recoveries : Matt Smith – 20 years' experience in property lending, and 13 years of credit and underwriting experience including 3 years at Goldman Sachs (post acquisition of iGroup) and 3 years at GE Money (post acquisition of Money Partners). Promoted to Head of Credit and Servicing having spent a year as Credit Manager.

Ludo Mackenzie - Head of Commercial Property, is responsible for overseeing commercial lending. Previously, he was an Investment Partner at Melford Capital, a private equity real estate investor focused on London and the South East. He was a Director of Property at Henderson Global Investors, where he was Fund Manager of the Henderson UK Property Fund, a top-quartile, Jersey-domiciled property unit trust investing in direct property and property derivatives.

D'mitri Zaprzala - Head of Sales

D'mitri has worked for Octopus for more than 5 years. He started to work for the Dragonfly team in May 2013 as a Business Development Manager. In 2014 he become Head of the Dragonfly New Business team and, since September of last year, has been Head of Sales for the Dragonfly team. He has worked in financial services throughout his career, first as a Branch Manager and then London BDM at Chelsea Building Society.

**Typical Transaction:**

A London property developer wishes to purchase a property in order to modernise and resell it. To fund the purchase he has to release £1m from a property that he has been working on but isn't yet ready for sale. The Dragonfly team commission an independent professional valuation of the current property which comes back at £1.75m. After the establishment of full legal charge in favour of Fern (the lender) over the property, Fern advances £1m for 6 months. Within the period of the loan the modernisation is completed and the property sold repaying the loan. Fern receives all arrangement fees, interest and early repayment fees where relevant. Octopus and the Dragonfly team do not receive any remuneration in respect of the transaction – it is simply covered in the 2.5% service fee that Fern pays to Octopus per annum.

**Strategy:**

The key protection to capital is the first charge over an easily valued asset (the property) that can be realised if there is a default. Having a first charge means that the developer is unable to sell the property without repaying the loan. In reality the developer may re-finance with a longer term loan from another lender and repay Fern if there is a delay in selling the property rather than allow Fern to repossess and sell the property itself. By ensuring the loan is a relatively small percentage of the value, Fern is protected from large and unexpected movements in house prices. Fees for providing the funding, including interest, are typically deducted up front from the amount loaned. This ensures that if a borrower is late with their repayments, the maximum loan to value amount is not exceeded.

**Risk Mitigation:**

The Dragonfly team will generally seek opportunities for Fern, Bracken or Terido to lend money up to a maximum loan to value of 70% (based on independent valuations) and the lender will take a first charge over the property.

## Appendix D: Renewable energy construction financing

A small element of Fern's trade (5% of its assets as at May 2014, £46m of loans) is comprised of finance provided to commercial solar businesses.

Over the last five years Fern has provided more than £860m of construction finance loans to more than 100 companies to build commercial solar sites. The equity in these companies is owned ultimately by investors in Octopus' EIS and VCT funds. Additionally, over the same period Terido LLP (of which Fern is a Founder Member) has advanced £141m of construction finance loans to 28 such solar companies.

Fern's loans are secured with a debenture over the borrowing companies' shares, which includes charges over the assets of the companies which predominantly comprise the lease over the site on which the solar farm is built, and the equipment (the solar panels). Once the solar sites are constructed, connected to the Grid and begin receiving the government tariff payments, Fern's loans have typically been refinanced with external bank loans. Octopus has arranged and completed over £250m of refinancing of 36 of its solar installations with five primary banks. In Octopus's opinion this helps to prove not only the quality of the assets and the relevant contractual framework of contractors and advisers but also the solidity of the Octopus financial model.

The external banks (RBS, NIBC, Investec, Barclays and Santander) which provide funding are unconnected to Octopus and before lending they completed a substantial technical, legal and financial due diligence exercise including but not limited to checking the accounts, energy production levels, quality of the equipment, the site and the standard of the contractual counterparties.

The alternative to Fern refinancing its construction finance loans once sites are constructed and Grid connected is for Fern to acquire the sites outright, becoming a longer-term owner-operator. Since January 2014, Fern has completed the acquisition of 140 such sites, purchasing them either from Lightsource once their construction has been completed, or from the EIS or VCT shareholders. As this is not in our view a completely arms-length transaction (involving two Octopus related entities, see below for details on Lightsource and its relationship to Octopus) we asked for details on the purchase price paid and Octopus provided the detail but because of the commercial sensitivity they strongly preferred it not to be published in this review. Whilst it will eventually become publicly available once the accounts are published, we respect their request.

The projects that Fern will be financing will be characterised by having good visibility on both revenues and costs. Octopus will invest into proven technologies with demonstrable and measurable performance and known costs both in terms of installation and ongoing maintenance. Octopus has become the largest installer of commercial solar in the UK having deployed over £1.3bn and considers the renewable energy sector to offer trading opportunities that are capable of meeting the capital preservation target, because of the predictable revenues and costs associated.

Returns from renewable infrastructure tend to be predictable when using proven technologies because the inputs are relatively constant. Octopus say that having highly qualified financial institutions approving the quality of the assets, their earnings from energy generation and the standard of the business and financial model is a strong validation of the quality of the investments.

In addition investments into renewable energy infrastructure often benefit from government backed subsidies which are inflation linked in some cases.

The Renewable Obligation scheme was introduced by the Government in 2002 to encourage electricity suppliers to generate more electricity from renewable sources, or else effectively pay a penalty. It is the Government's primary mechanism for the support of large-scale renewable electricity generation. As the price of installing solar power generating sites has continued to fall over the last twelve months, investing into sites which benefit from ROC has become viable. Octopus will be investing primarily between 2-20MWp of generating capacity. Like the FiT scheme, ROCs carry RPI linkage. Following the most recent Government consultation on FiTs, both the FiT and ROC schemes operate for 20 years (FiTs had previously had a 25 year term). Given that ROCs are well established, there is a proven track record of banks providing finance for ROC projects, which provides comfort on the possible exit strategies for Fern. Typical Transaction:

Strategy: The following is a description of the typical construction finance loans provided by Fern to fund solar assets. Fern will be approached to provide project finance to a company owned by Octopus EIS investors to finance the company's construction of a large-scale commercial solar site. The company will be planning to construct a site valued at more than the £5m annual limit on EIS investment into any one company, and therefore requires additional finance to supplement the shareholder equity. Sites that are part-finance by Fern are typically ground-mounted PV sites, with an average operating capacity of 5.3MW. 90% of the sites constructed using finance from Fern are smaller than 10MW operating capacity. The average term of Fern's loans is 18 months, after which Fern's loan will normally be replaced with external bank finance at a lower rate (reflecting the reduced risk nature of a solar project post-construction and grid connection).

Risk Mitigation: The security package for Fern will typically involve a debenture agreement in place between the EIS solar company and Fern, giving Fern a legal charge over the shares and assets of the solar company. The average loan-to-value on Fern's construction finance loans is 51%. The maximum LTV on Fern loans to solar EIS companies is currently 80%.

## Appendix E: Renewable energy ownership

A significant element of Fern's trade (46% of its net trading assets as at March 2016) is comprised of solar energy sites that the Fern group of companies owns and operates. Sites typically qualify for long-term government incentives further to the ROC scheme.

Over the last two years, the Fern group has acquired more than 150 solar energy sites across the UK and France that it operates. The group also owns 2 wind energy sites, 25 landfill gas sites, 5 biomass sites. In addition, Fern also owns 2 reserve power plants which generate energy at peak times and in this way help to support renewable energy (although are not themselves a form of renewable energy). Fern owns 100% of the above sites, and in addition owns 50% of 2 further wind energy sites, with the other 50% owned by a major energy company.

Fern generates income from the sites both from the sale of the energy they produce and from long term government incentives that most of the sites are entitled to. The sites currently have an enterprise value of £1.25bn. Fern has secured £700m of external debt in the form of project finance and a listed bond against these sites, resulting in an equity value of £675m.

At the time of the previous review, Octopus had an exclusive relationship with its solar development partner, Lightsource Renewable Energy. The Lightsource Team comprised over 250 solar specialists.

Octopus agreed a strategic partnership with Lightsource in November 2010. Lightsource is a fully integrated developer, owner and operator of solar energy power projects. The Lightsource/Octopus partnership enabled Lightsource to fully fund projects without the need for bank debt funding, which has been a stumbling block for other fund managers looking to enter this sector.

At the time of the last review, Lightsource was a company which is controlled independently of Octopus, though in which Octopus Capital Limited (of which Octopus is a wholly owned subsidiary) held a 49% shareholding. All the Lightsource staff worked in the Octopus offices. Fern has not made any investment in Lightsource directly, however, Fern has acquired completed sites from Lightsource.

During August 2015, Octopus Capital Limited (the parent company of Octopus Investments) sold the majority of its shareholding in Lightsource to the Lightsource management team

Lightsource continue to provide ongoing project management, installation and operational services to solar companies that have either received finance from or are owned by Fern, for which it will be remunerated by the solar company.

Since the last review, Fern has acquired significant parts of its portfolio from external sources, including biomass and landfill gas sites from Macquarie, and windfarms from RES.

## Appendix F:Terido LLP:

Terido LLP operates one class of business, that of a money lending business. Turnover for year to 31/3/15 was £24.5mm and came from arrangement fees and loan interest, net of value added tax and is recognised upon delivery of the relevant services.

More than 50 members had invested £206mm as at 31 March 2015. Members include Terido DMI and Terido DM2 Limited (the Designated Members, which do not have a significant equity stake in the partnership); Bracken Holdings Limited and Fern Trading Limited, and some of their subsidiary companies (together the Founding Members); the balance of members are Trading Members. These include companies which used to qualify for relief further to the Enterprise Investment Scheme (EIS) and whose shareholders have chosen for the company to become a Trading Member of the partnership, and companies that are not managed by Octopus who have become members further to the Octopus Trading Partnership investment opportunity that Octopus offer to UK companies.

Profit sharing arrangements are complex but profit in year to 31/3/15 was £23m on turnover of £24.5mm. Octopus does not have any equity interest in the Partnership and is paid a flat fee for managing it on a day to day basis by Trading Members. Founder Members (Bracken and Fern) do not pay this fee as Octopus is paid for managing their business via the service fee paid by these portfolio companies directly to Octopus.