

Dualinvest Residential Income Unit Trust Series 1 Sub Fund Launch

1 February 2010

Series 1 Sub Fund

Initial Issue Price: 100p

Min. Subscription: £10,000

Amount to be raised: Up to £25m in separate Sub Funds of £1m or more each.

Target income yield: 6.75% cash (7.75% IRR over two year period).

Target life of Sub Fund: 2-3 years

The Series 1 Sub Fund (the Fund) is planned to be the first of a series of issues by the Dualinvest Residential Income Unit Trust (the Trust). It has strong attractions for income investors for both its targeted annualized IRR and for the degree of capital protection that it offers. Given that WYP is understood to have sourced up to £10m of property, the model appears also to appeal strongly to under-pressure property owners. We consider that this should offer good support to the concept and the launch of further Sub Funds.

The Fund offers investors the opportunity to participate in the buy-to-let residential property market at a time when owners are seen to be under pressure from their lenders. The Trust's business model includes a number of attractive and unusual features:

Downside protection: The Fund has first call on net property disposal proceeds up to a sum that equals 70% of the original purchase price of the property. The value of properties in the Fund would have to fall by 34% before investors would fail to recover their initial subscription, a figure which rises to 43% on a total return basis.

Upside potential: The Fund will participate in 15% of any uplift in value of a 100% interest in a property over the period of its ownership.

Attractive income profile: There are two elements to this. The first is the up front payment of the 13.5% coupon, a month after completion of a property acquisition. The second, which this enhances, is the targeted >7% IRR over the life of the Fund.

Rental protection: The Vendor pays the Fund 13.5% up front for the two year rental period, equivalent to 6.75% p.a. The Trust is, therefore, not at risk of any shortfall from lower sub rents or voids.

Co-ownership: The Fund proposes to acquire a 65% effective interest in properties, with the Vendor retaining the other 35%. The Vendor will, therefore, have a vested interest in the success of the scheme.

Short term investment: Leases granted to Vendors will be for an initial two-year term, with the possibility only of a one-year extension. Properties will be marketed for sale as the lease approaches its end.

No Gearing: Other than a small temporary overdraft for working capital, it is anticipated that the Fund will remain ungeared.

SIPPable: SIPP investors can subscribe directly into the Fund.

ISA qualifying: The Fund is being structured to be ISA-qualifying. The minimum investment of £10,000 is below the maximum £10,200 for the annual subscription.

Application is being made for both the Series 1 Sub Fund units, and the units to be held by ISAs, of the Dualinvest Residential Income Unit Trust to be quoted on the CISX, giving unit holders potential liquidity for their investment.

Sector: Residential property fund

Market: Channel Islands Stock Exchange (CISX)

Manager & Sponsor: JTC Fund Services Limited

Trustees: JTC Management Limited
JTC Trustees Limited

Promoter and Property Investment and Asset Manager: Wyndham York Limited (WYP)

Distributor: Smith & Williamson Investment Management Limited

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SWOT Analysis

Strengths

- Wyndham York (WYP), appointed as Property Investment and Asset Manager to the Fund, has significant experience in the residential property sector. Harvey Shulman, its managing director was also co-founder of the successful Solitaire Group plc which, managing a £4bn property portfolio between 1997 and 2006, secured 474% share price appreciation for its investors.
- The Income Units of the Fund, helped by early payment of rental income, target an attractive annualised IRR in excess of 7.75%, within a short-term (2-3 year) investment. The Fund's structure protects investors from risks from rental voids and yield volatility on sub-rents.
- Two independent valuations help protect investors from the purchase of overpriced property.
- WYP has already sourced property, in the North and North West of England, sufficient to fill several Sub Funds. The Fund also has fixed criteria as to the quality of properties it will acquire.
- The structure of the Fund protects investors against potential downside in the property, while also providing an exposure to participate in any upside in property valuations during the period of ownership.
- The payment to the Fund on a sale of the additional 5% of purchase price effectively pays investors' subscription fee, while fees paid by vendors are expected to fund property transaction costs.

Weaknesses

- The Fund may not be a pure residential play, with up to 30% of a property's value able to be in non residential, but it is unlikely that the Fund will use this provision.
- The size of the Fund limits the number of properties that can be purchased, thereby increasing the risk profile by restricting protection from greater diversification.
- An application has been made to list the units and ICC units (for investment through an ISA) on the Channel Islands Stock Exchange (CISX). However, in a narrow market, liquidity may still be limited, so that prices may not reflect the NAV.

Opportunities

- Continued tight availability of mortgage finance means that many buy-to-let property owners are coming under pressure from lenders when facilities need to be renewed. The market is, therefore, receptive to the Dualinvest proposal of providing a short-term financing solution with the option to buy back the property at the end of a lease.
- The same mortgage finance pressure, coupled with uncertainties over job security and wage/salary prospects, should result in demand for rental property remaining high. The impact of this on sub-lease rental potential will underpin the attractiveness of the offer for Vendors.

Threats

- There is considerable uncertainty over the short-term outlook for property values. However investors have downside protection for a 30% fall in value.
- Changes to government policy and tax regulations, and HMRC practice with regard to SIPP investment in property, could impact the fund, although the up front payment of income would limit any potential impact to the capital appreciation element.

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The Dualinvest Residential Income Unit Trust is a closed-end umbrella trust, established in Jersey, with a 30 year life. It proposes to issue units in a number of Sub Funds under the Trust Deed. The first of these, the Series 1 Income Class Units, is currently being launched, seeking a subscription of £1m, net of expenses, to invest in residential property in England and Wales. Application has been made for the Units, and for those of the Cell Company (ICC) through which investors can subscribe from ISAs, to be quoted on the CISX.

The Series 1 Sub Fund

Dualinvest offers investors the opportunity to take advantage of conditions in the buy-to-let market, where owners are seen to be under pressure from their lenders. The Fund looks to invest initially in residential properties in the North and North West of England, where prices are generating attractive yields.

- Properties can be either houses or flats, though most are expected to be houses.
- They can be either freehold, or leasehold with a minimum unexpired term of 75 years.
- They will either have been constructed within the last five years, or have a satisfactory surveyor's report.
- They can have up to 30% of their value in non-residential space.

Properties will be acquired at a valuation price, which will be the average of two valuations provided by two valuers from a panel list provided by WYP.

Investment in the Fund is subject to a minimum subscription of £10,000. Above this level, the amount is flexible, with no set units of investment. 5.5% of funds raised will be paid as a subscription fee to fund commission to introducing intermediaries and Smith & Williamson.

The Fund has a number of unusual, or unique, features that will be particularly attractive to investors.

Co-ownership The Vendor will normally be a corporate, from which the Fund proposes to acquire a 65% interest in each property. The Vendor, retaining a 35% interest, and therefore has a critical interest in the success of the project.

Additionally, the Vendor will:

- sign a 2-year full-repairing lease, with the option to extend for a further year,
 - pay up front a 13.5% rent, on the 100% market value of the property, for the initial 2-year period, and a further 6.75% on giving notice of renewal, and
 - be responsible for all outgoing on the property.
- This protects the Fund from risk of voids or unpaid rent or expenses.

The Vendor also pays additional sums that enhance investors' returns:

- A structuring fee of 2-3% of the acquisition price, which is expected to cover the Fund's acquisition costs, and
- 10% of sub rents received by it from tenants, of which 25% is passed on to the Fund.
- An exit fee of 1% of its share of the disposal proceeds.

Downside protection On the sale of a property, the Fund receives the first distribution of the net sale proceeds, up to a sum that represents:

- the purchase price of its 65% interest,
- an additional 5% of the value of a 100% interest at purchase, and
- any sums outstanding under the lease.

As the Fund has first call on the net sale proceeds, investors will still receive back their initial subscription if property prices fall by 34%, or by 43% if a total return yardstick is used.

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Upside potential	Additional to this distribution of the net sale proceeds, WYP will negotiate to receive 15% of any appreciation in the 100% value of a property over the period of ownership. This will be passed over in full to the Fund, and distributed to investors, giving them a potential for capital appreciation.
Early income receipt	Dualinvest will distribute net rents, interest and any exit bonus to investors quarterly, or more frequently if possible. This means that rent from is likely to start being distributed one month after closing, subject to timing of completion of acquisitions. There will be no deduction or retention for fees. To the extent that these are not covered by net rental receipts they will be funded out of the overdraft facility.
Low investment unit	The £10,000 minimum investment coincidentally falls below the £10,200 annual ceiling for investment into an ISA, opening up this investment route for individuals once the Fund has been structured to be a qualifying investment. To give investors flexibility, there are no set units of investment above the minimum figure.
Ungearred fund	There is no intention to mortgage properties to gear up the fund. The only likely debt, therefore, is the small overdraft to fund operating costs.
Liquidity	A CISX quote for both the Units and the ICC Units will give investors the potential for liquidity. There are not, in practice, expected to be any restrictions on transfer.

Exit Route

The principal exit route for investors will be the sale of properties at the end of their lease period – of either two or three years. Vendors have to give notice of extension six months before the end of the two-year lease. If they do not wish to do so, then the Trustees of the Fund and the Vendor appoint an Estate Agent to act on their behalf in the sale, and to determine the fair price for the disposal.

Properties will be sold either with vacant possession or with an existing shorthold tenancy or other permitted sublet.

The Vendor, who pays an exit fee to WYP, has the right of first refusal to acquire a property from the Fund, at the fair price determined by the Agent.

As set out above, the structure of the Fund secures for investors a share of any increase in valuation during the Fund's period of ownership, while at the same time providing protection against a downturn in value.

The Trustees have first call on the net proceeds of a sale for a sum that comprises:

- the original purchase price of the 65% interest,
- a further 5% of the 100% interest at purchase,
- any rent due up to completion if this runs beyond the second or third anniversary, and
- 15% of any increase in valuation between purchase and sale,

In addition to any amounts outstanding under the lease.

After repayment of any overdraft, which may be secured on the properties, these sums will then be used to repay investors their original subscription, the 6.75% coupon on any rent due for any period between the end date of the lease and completion, and the share of valuation uplift.

Any surplus disposal proceeds will be distributed to the Vendors.

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Expenses**Initial costs**

The initial expenses of setting up the Trust, the Series 1 Sub Fund and related Cells and securing the CISX quotes have been, or will be, paid by WYP, and will not be recouped from investors. Costs of the Series 1 fundraising will be met out of the 5.5% subscription fee.

Once properties have been acquired, and upfront rental payments received from vendors, 0.75% of gross rents received will be paid to WYP.

A distribution, at the rate of 13.5% of their subscription, is then made to investors out of net rents received, with the balance of these retained to pay annual running costs, which will, in any case, also be partly offset by receipt of a proportion of sub rents receivable.

Annual running costs

Annual running costs comprise:

- Payments to JTC entities, charged on a "time-spent" basis, as Manager – for the provision of administrative, secretarial and registrar services – and as Trustee.
- Directors' fees to each of five directors of the Fund.
- An asset management fee to WYP equal to 0.5% pa of the gross value of the property portfolio, payable quarterly in arrears.

Overall, these annual running costs of the Trust are capped at £50,000 – inflation adjusted annually for the Jersey RPI.

We understand that, given the size of the Fund, annual expenses are likely to come in well below this cap. In our calculations, on a £1m sub fund, we have allowed for annual costs of £24,000 – or £16,000 over and above the asset management fee.

So far as the offset from the receipt of a proportion of sub rents is concerned, we have allowed for a 4% annual yield. We believe that, as a result of the level of property prices, higher yields can be achieved in the North of England. Our cautious approach builds in provision for either under achievement or void periods – leaving any surprises likely to be on the upside.

Exit costs

We have assumed that costs of disposal of properties – based on 1% commission to Estate Agents and conveyancing fees of c£600 per property – will be approximately 1.5% of gross proceeds.

Property Investment and Asset Manager

WYP, which specialises in investment in the residential property sector, will be responsible for property asset management, including the selection of investment properties. Its managing director, and principal shareholder, is Harvey Shulman, who has significant experience of residential property acquisition and management. He was also the co-founder, joint managing director and principal shareholder of Solitaire Group Plc between 1997 and 2006 – during which time it managed a residential property portfolio valued at about £4 billion. WYP will be responsible for ensuring observance of lease agreements and for the managements of the properties.

Capital Appreciation

This is the key variable within the investment proposal.

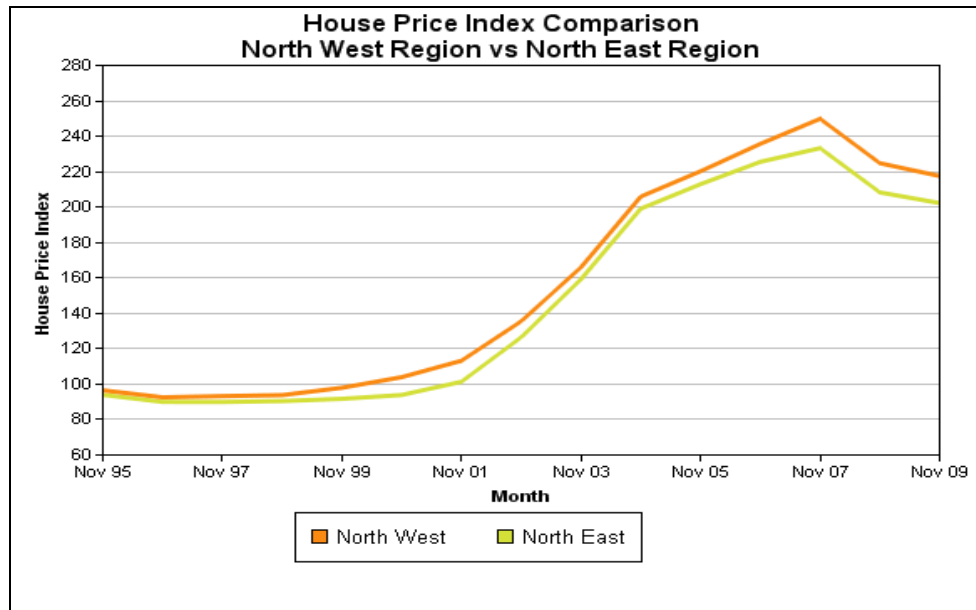
- According to recent press comment, there is a wide range of forecasts for 2010 – from -10% (Capital Economics) to +5-10% (Citigroup). The RICS holds roughly a middle view, at +2%. Few institutions publish longer term forecasts. Among those that do, Savills expect +2.7% on 2011 and +5.5% in 2011, but start from a low base in 2010.
- Then there is the degree of scepticism in forecasts engendered by both the wide range and the experience of 2009, when forecasts of a sharp downturn appeared to be borne out by figures for January-April, only to be overturned by the sharp recovery thereafter that left prices up 3-6% y-o-y, depending on the source used.

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- Finally, there is the question of regional and property-type variations, with general agreement that performance is weighted toward London and the South East.

We show below the Land Registry's chart for historic price trends in the North West and North East of England, therefore covering the principal areas in which the Series 1 Sub Fund is expected to invest. It is worth noting that, that the North of England was the one region to record a fall in prices, of 2% according to the Financial Times. This should enhance acquisition values for the Fund, while also protecting values from the risk of reversal in 2010.



Source: Land Registry

For potential investors, the key attribute of the Fund is that its structure protects subscribers from all but a particularly severe – 34% - downturn in property prices over its two year life. On the unwinding of the Fund, its trustees have first call on funds equivalent to 70% of the purchase price of its properties. From this, their only obligations are 1) the repayment of any overdraft, and 2) the return of their initial investment to subscribers. We calculate, therefore, that the value of the portfolio would have to fall by >34% before subscribers would lose any of their invested capital.

IRR Return

The Fund targets an annualised IRR return of >7%. In Table 1, below, we have set out the projected 2-year cash flow for the Fund, based on the zero capital growth. This shows that, even at this level, the annualised total IRR would be 7.75%, while confirming the full return of investment capital to subscribers. If the coupon is taken into account, then total funds paid to investors would represent a return of almost 114% on their original subscriptions.

The table shows funds of almost £1.05m available to the trustees to pay the £1.04m capital distribution to investors, which would give an annualised IRR of 7.75%. The table, though, also shows surplus cash of £18,110 within the Fund. We understand that, in the case of the Series 1 Sub Fund, it is intended to return this cash to investors, which would increase the capital payment to c£1,058,100 (or 101.7%) and increase the annualised IRR to 8.7%. After these payments, surplus cash returned to the Vendors would be c£431,200 – or 81% of the value, at acquisition by the Fund, of their 35% interest in the properties.

This, though, is before fees paid by the Vendor – the structuring fee and the exit fee – and before any imbalance between rent paid to the Fund and net sub rents received. On our assumptions, these could consume c£0.14m – but they need to be offset by the interest saving achieved by the sale and leaseback of the 65% interest.

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Table 1: Series 1 Sub Fund – two-year projected cash flow									
£	Year 1				Year 2				Winding Up
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Investor subscription	1,040,000								
Fees									
Subscription	-57,200								
Rent Collection	-1,530								
Administration	-4,000	-4,000	-4,000	-4,000	-4,000	-4,000	-4,000	-4,000	
Asset management	-1,890	-1,890	-1,890	-1,890	-1,890	-1,890	-1,890	-1,890	
Properties									
Acquisition	-982,800								
Rental receipt	204,120								
Net sub rents received	380	380	380	380	380	380	380	380	
Net disposal proceeds									1,489,320
Return to investors									
Rent Coupon	-140,400								
105% of purchase price									-1,058,400
Capital appreciation									
Balance	56,680	51,170	45,660	40,150	34,640	29,130	23,620	18,110	

Source: Hardman & Co

We understand that WYP anticipates that most properties will be sold around the second anniversary of the Fund. We have not, therefore, prepared a three-year cash flow table. For any property where the lease is extended, the Fund would receive, in Q3 of year 2, a further 6.75% rent payment, but subject to a further rent collection fee, and should benefit from a further year of capital appreciation. Offsetting this would be a further year of administration and management fees.

Table 2 sets out the potential annualised IRR and return of funds to investors at a number of points for projected capital appreciation over the two-year period.

Table 2: Summary of Expenses and Returns of the Series 1 Sub Fund							
Rate of Capital Growth		-8%	-4%	0%	+4%	+8%	+12%
Fees & expenses ¹	Initial				5.0%		
	Annual				4.3%		
	Total				9.3%		
Funds to Unit holders ¹	On winding up	101.7%	101.7%	101.7%	102.7%	103.6%	104.5%
	Including coupon	115.2%	115.2%	115.2%	116.2%	117.1%	118.0%
	Annualised IRR	8.7%	8.7%	8.7%	9.2%	9.7%	10.1%

Source: Hardman & Co

Note: ¹ Expressed as percentage of initial funds subscribed

Within this table, initial expenses include only the 5% subscription fee payable by investors, with the 0.75% rental collection fee netted off against rental income. Annual expenses are stated over the expected two-year life of the fund, and include the 0.5% of NAV payable to WYP and administration charges payable to JTC.

Conclusion

We believe that the Dualinvest model offers investors an innovative, unusual and attractive income investment opportunity, with features that are probably unique – notably the combination of its protection of capital alongside the potential to participate in any value uplift. This is backed by the use of external consultants to determine appropriate purchase and sale price levels. Then there is the income protection with the upfront payment of rent, shifting the void and yield risk onto the Vendor. And, finally, there is the target minimum annualised IRR over just a two-year period – very attractive in the current environment. As discussed above, the return of surplus cash in the Fund will give investors an element of capital appreciation even without an increase in property prices, while also raising the annualised IRR from 7.75% to 8.71 – adding to the investment’s attraction. This model should secure the successful launch of this initial tranche of investment, and pave the way for the planned launch of a number of similar Sub Funds going forward.

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