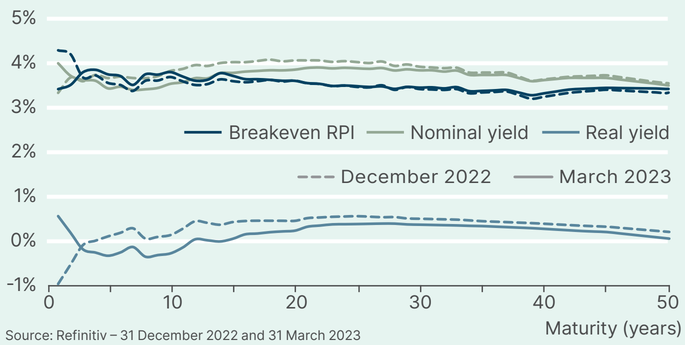
Market Monitor Q1 2023

AlphaReal
Real assets. Real security.

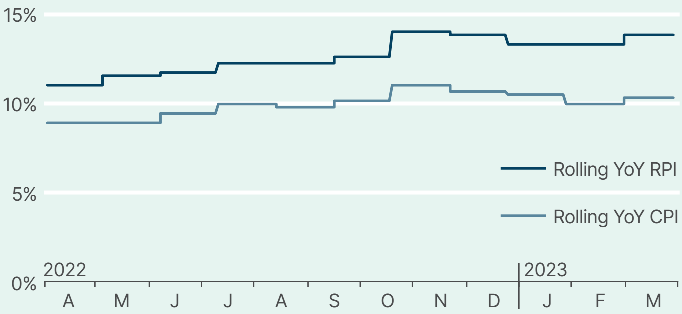
Rates, inflation and credit spreads

Gilt yield curves



Source: Refinitiv – 31 December 2022 and 31 March 2023

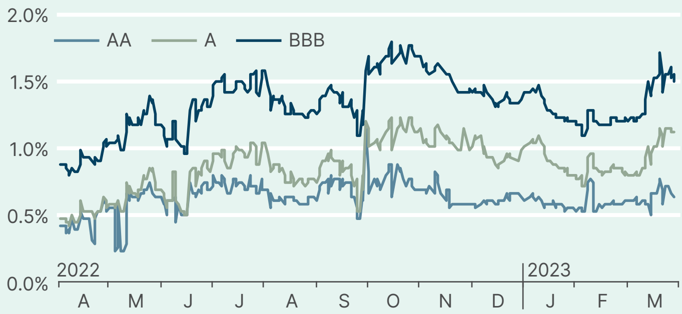
12 month rolling inflation



Source: ONS – 31 March 2023

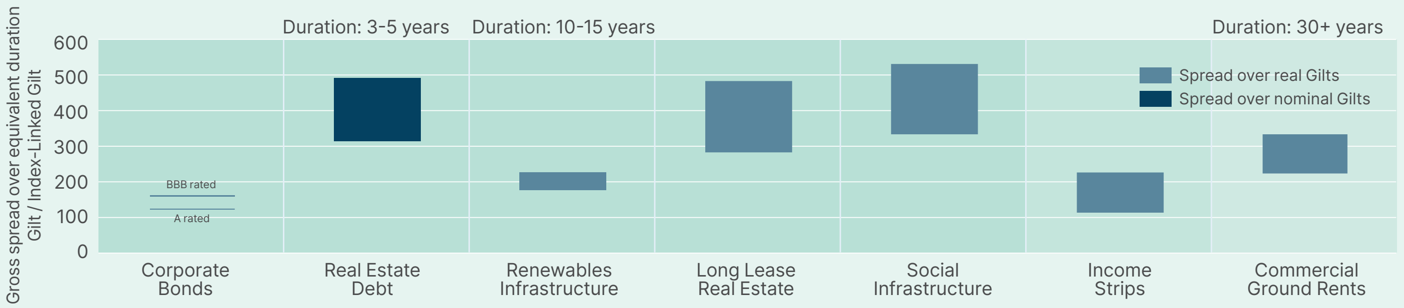
- Real Gilt yields decreased c.26bps across the curve. The change in Nominal Gilts yields was more varied across maturities. The short end (3Y) remained broadly unchanged. However, the 5Y, 12Y and 20Y fell by 24bps, 30bps and 21bps, respectively. At the longer end, the 30Y nominal yield only fell by 8bps.
- CPI inflation remained elevated through the quarter, with February CPI at 10.4%. Despite the falls in utility and fuel prices inflation is expected to feel “sticky” for much of the year. Given resilient economic conditions, there is a possibility of bank rates rising further in the near term to 4.50% from the 4.25%.
- Spreads on non-financial corporates have increased since the beginning of the year. Spreads were particularly volatile toward the end of the quarter, mainly a fallout during the banking sector turmoil seen in both the US and Europe.

Credit spreads



Source: S&P Capital IQ 10 year non-financial GBP bonds – 31 March 2023

Secure income market update



Spreads remain compelling for secured long income assets

- Spreads over risk-free yields for Commercial Ground Rents remain unchanged. For income strips the spread extended down to 110bps in line with recent market assessments of the highest quality income strips.
- Spreads for Renewables over the equivalent duration gilt increased by 50bps at the bottom end reflecting further upwards movement on project discount rates in addition to changing gilt yields over the quarter. At the top end of the range there was an upward movement of 25bps, the resulting narrower range in spread reflects a reduction in uncertainty versus H2 22, noting that there have been acquisitions within this range over the quarter.
- There were no changes in the spreads for Social Infrastructure and Long Lease Real estate.
- As the higher-than-expected inflation period lasts, the inflation linked nature of the assets (albeit typically capped) has acted to maintain values and spreads.

Asset class definitions

Senior Investment Debt: 5-year interest and fees cashflow from senior investment term-loan secured against core real estate where interest is comprised of a margin over either SONIA or BoE base rate.

Renewables Infrastructure: 15+ year inflation-linked cashflows from unlevered wind and solar infrastructure assets subject to Feed-in Tariff (FIT) or Renewable Obligation Certificate (ROC) regimes.

Long Leases: 15+ year inflation-linked leases on commercial real estate. Traditional sale & leasebacks fall within this market.

Social Infrastructure: 15-20+ year inflation-linked leases on operational real estate across the housing, healthcare and education sectors.

Income Strips: 30+ year inflation-linked leases on commercial real estate where the lessee has an option to purchase the real estate back at the end of the lease for a nominal amount (e.g. £1).

Commercial Ground Rents: 100+ year inflation-linked leases on commercial real estate, with a higher degree of rental and value cover than a traditional sale & leaseback.

Sources: Alpha Real Capital (for illustrative purposes only and for typical transactions available to pension schemes in these asset classes). Data as at 31 March 2023. The future returns and opinions expressed are based on Alpha Real Capital internal forecasts and should not be relied upon as indicating any guarantee of return from an investment managed by Alpha Real Capital nor as advice of any nature. Source of corporate bond spreads: S&P Capital IQ 10 year non-financial bonds – 31 March 2023.

It’s time to focus on the health sector

The availability of suitable affordable housing is essential for a functioning society. Yet interestingly, new AlphaReal commissioned research with UK Local Government Pension Scheme (LGPS) fund professionals reveals that three quarters of respondents cite the health sector as suitable for a social impact infrastructure allocation.

However, survey respondents said that knowledge of the investment and impact characteristics is the biggest barrier to investing in social impact infrastructure. We summarise the opportunity and how we invest with societal impact in mind.

The opportunity – real impact

At AlphaReal, we believe the health sector is a £20 billion market opportunity for institutional investors.

(see Social Real Estate: A £50 billion secure income opportunity?)

Long-term structural demand
due to an expanding and ageing population

Declining & inadequate supply
across essential public services

Significant funding shortage
due to constrained public finances

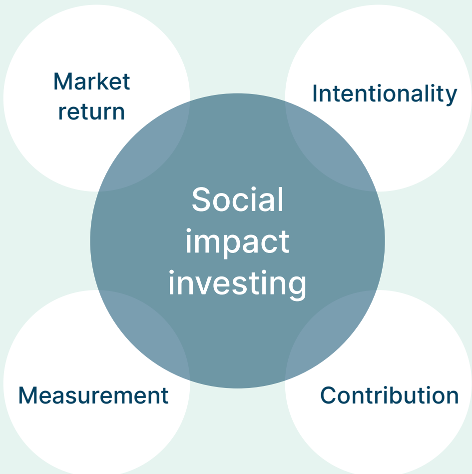
We see investment opportunities in health from the growth in elective procedures and diagnostic provision, in-community facilities such as renal dialysis freeing up capacity in NHS hospitals, to mental health admissions alongside those more traditional segments such as elderly care. Importantly, investment in these areas can achieve real impact for the underserved in our communities alongside attractive long-term returns for investors.

Framing investment and impact characteristics

At the underwriting stage for each asset whether it is health, housing or education, AlphaReal focuses on four key features which when combined, define impact.

Creating and investing in long leases of 20+ years, with rent reviews linked to RPI/CPI. This creates a predictable and robust cash flow providing inflation linked long income.

Deliberately screening physical assets to focus solely on those which support the long-term delivery of essential services in health, housing and education.



Third-party assessment of the value of the Social, Environmental and Governance contributions made. Positively challenging the assessment tools and methodologies used.

Asset level analysis of the benefit to those receiving the service, those delivering the service and to wider society. Including tenant engagement re ESG

Contact us

Client Solutions
clientsolutions@alphareal.com
www.alphareal.com

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