Market monitor – Q3 2018

Alpha Real Capital

Summary

Inflation

- Annual UK CPI remained at 2.4% over the quarter, despite significant volatility which saw annual CPI rise to 2.7% in August only to fall back down to 2.4%. The volatility was caused by unexpected increases in sea fares and theatre tickets
- Annual UK RPI was also volatile but ended the quarter 10bps lower, partly driven by a 6bps fall in mortgage interest payments
- UK inflation expectations have increased significantly across the curve (see chart). Changes to inflation expectations are likely to be particularly sensitive to the ongoing Brexit negotiations during Q4 2018

Bond yields

- Long dated real yields marginally increased (c.7bps) over the quarter whilst shorter dated bonds slightly fell
- Nominal yields increased across the curve (c.20bps), largely driven by the rise in inflation expectations

Credit spreads

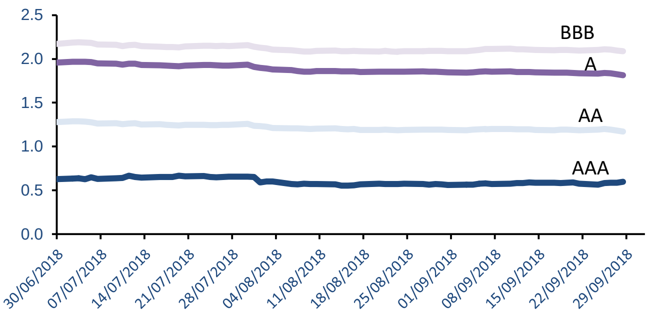
- Investment grade credit spreads have slightly narrowed over the quarter, with A, AA spreads compressing by over 10bps. The decrease was largely a reversal of last quarters widening, however AAA and BBB have yet to fully recover

Macro picture

UK GDP (y/y)	1.2%	**UK RPI (y/y)**	3.3%
UK BOE base rate	0.75%	**UK CPI (y/y)**	2.4%
March 2024 real gilt yield	-1.9%	**March 2040 real gilt yield**	-1.5%

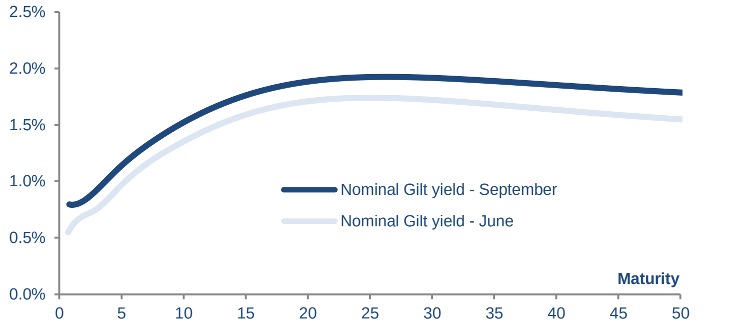
Sources: ONS, Barcap, Reuters, FT.com, 30 September 2018 or latest published figures

UK credit spreads



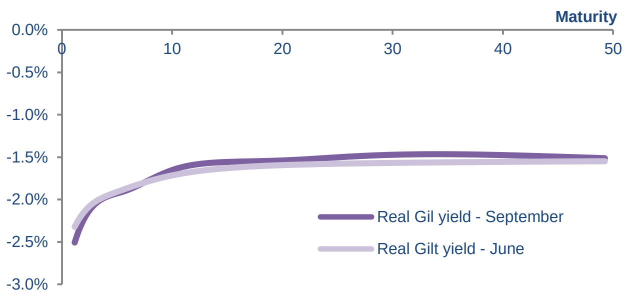
Source: Thompson Reuters, IBOXX non-financials +15 year indices

Nominal Gilt yield forward curve



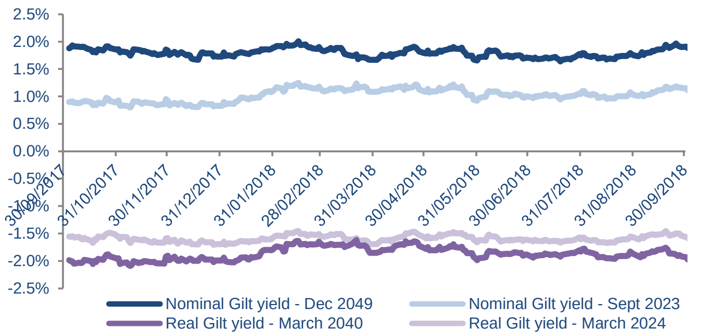
Source: Barcap – 30 June and 30 September 2018

Real Gilt yield forward curve



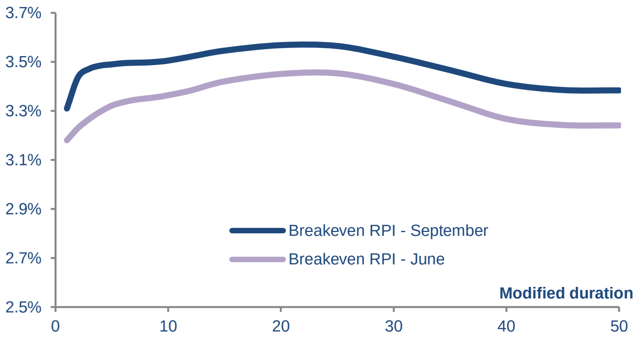
Source: Barcap – 30 June and 30 September 2018

Historical nominal and real yields



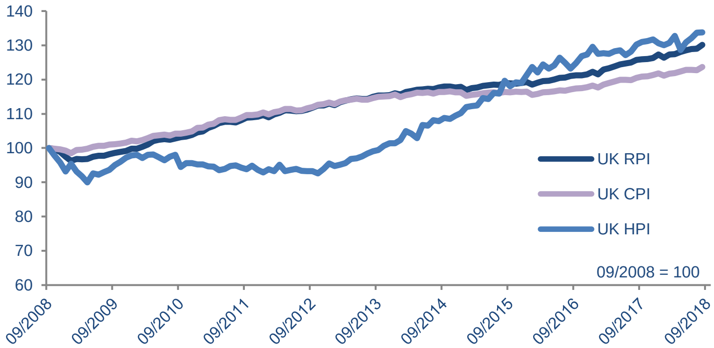
Source: Barcap – 30 September 2018

RPI swap rate



Source: Barcap – 30 June and 30 September 2018

RPI, CPI and HPI historical returns



Source: Thomson Reuters, ONS

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Alpha Real Capital LLP (Alpha) is developing a new fund (the Fund) to invest in Lifetime Mortgages, an equity release product regulated by the FCA. The Fund's objective will be to purchase the beneficial interest in mortgages, yielding circa 200-300bps (net of fees and fund costs) above long-dated fixed interest gilts, while the originator, as legal title holder, retains the on-going regulatory responsibility of managing/servicing the loan.

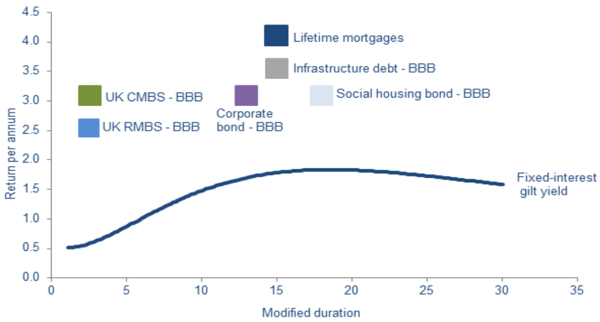
Background

Lifetime Mortgages allow homeowners aged 55 years and older to realise a portion of the equity in their property while still retaining 100% ownership and the right to reside there, rent free, for the rest of their lives. There are no required monthly payments with interest typically fixed and rolled-up/accrued into the mortgage balance, full repayment only becomes due when the last borrower either dies or moves into long-term care.

With historical reputational issues addressed by much tighter regulation and improved product structures, large insurers Aviva and Legal & General have become the major suppliers of Lifetime Mortgages, together originating £1.7bn[3] (56% of the market) in 2017, and both Santander and Nationwide Building Society are marketing Lifetime Mortgages to their customer base through distribution partnerships.

Lifetime Mortgage stats[2]	Lump sum[4]	Drawdown[4]
Average interest rate	5.3%	4.2%
Average age	68.6	71.7
Average initial advance	£101,203	£63,569
Average LTV	31.5%	27.4% (17.5% initial + 9.9% future drawdowns)

Lifetime mortgage's return as compared to other asset classes[1]



Attraction for investors

- Attractive risk-adjusted return as compared to other long-dated secure assets
- Provides portfolio diversification with risk and return drivers linked to house price inflation and longevity
- Investment secured by borrower's primary residence (at a low loan-to-value) which is unencumbered by any other mortgage or loan
- Provides a secure source of contractual income to meet long-dated liabilities
- Mitigates longevity risk by typically generating additional returns if borrowers live longer than expected
- Portfolio valued on a gilt + spread approach, providing direct balance sheet hedge against changes in interest rates
- Positive social impact as Lifetime Mortgages allows borrowers to finance their retirement, ongoing expenses and/or refinance expiring interest only loans

[1]Fixed interest gilt yield, UK CMBS AND RMBS – BARCAP, Social housing bond - JRCA – Social Housing News – December 2017, Corporate bond – IBOXX corporates BBB non financials, Infrastructure –Schroders, Infrastructure financing - an overview
[2]Equity Release Council Spring 2018 Market Report
[3]Legal & General's and Aviva's Annual Reports and Accounts 2017
[4]Lump sum - provides customers a single, payment upfront (typically at the maximum loan-to-value ("LTV") available). Drawdown - provides customers an initial cash lump sum and an additional facility which can be drawn if/when needed and charged at the prevailing market interest rate up to a maximum LTV

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