

Summary

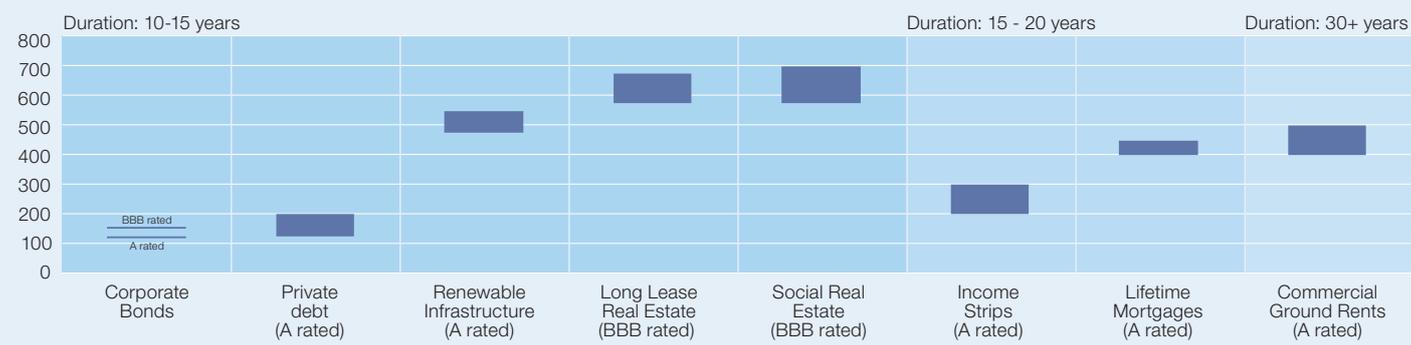
- Due to the recent Covid-19 pandemic, investors have moved towards safer assets, driving nominal gilt yields negative at the short end of the curve.
- The lowering of real gilt yields across the curve has increased the attractiveness of illiquid assets such as commercial ground rents.
- UK CPI decreased by 0.9% and RPI 1.5% in the quarter. The decreases are driven primarily by drastic price reductions in fuel and clothing.

Macro picture

10 year nominal Gilt yield	0.2%	UK RPI (y/y)	1.1%
UK BOE base rate	0.1%	UK CPI (y/y)	0.6%

Sources: ONS, Barcap, 30 June 2020 or latest published figures

Secure income market update



Spreads widen for Secure Income assets

- Over the quarter the spread over gilts for illiquid asset classes has increased. This is primarily due to the decrease in the real gilt yields of c.30 bps p.a. at the shorter end of the curve and over 40 bps p.a. at the longer end.
- However the impact of Covid-19 over the quarter has not been uniform across Secure Income with some sectors and structures so far more resilient than others.
- For instance, some long lease sector yields have been pushed further out due to recent negative market sentiment for leases and potential issues with foreclosure.
- Social long lease however, has remained broadly resilient, underpinned by demographic drivers, whilst high quality commercial ground rents and income strips have also held up well. Renewable yields also remained broadly unchanged.
- For lifetime mortgages, the spread over nominal gilts widened in the higher loan to value segment of the market as product rates remained broadly unchanged as nominal yields fell. Illiquidity premia relative to A rated corporate bonds remained broadly flat as widening corporate spreads were offset by falling gilt yields.

Asset class definitions

Renewable infrastructure: 15+ year inflation-linked cashflows from unlevered wind and solar infrastructure assets subject to Feed-in Tariff or Renewable Obligation Certificate regimes

Long lease market: 15+ year inflation-linked leases on commercial real estate. The most common structure being a Sale & Leaseback

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

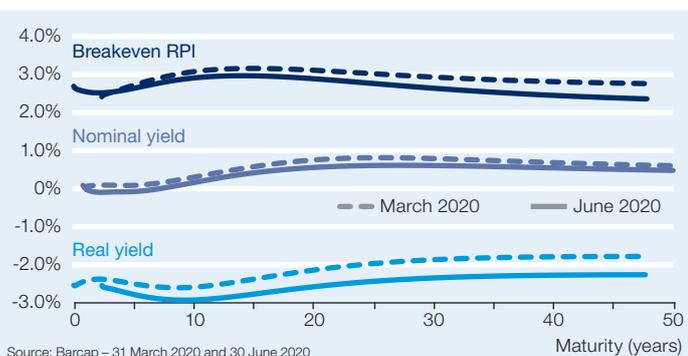
Commercial ground rent: 100+ year inflation-linked leases on commercial real estate, with a lower rental payment and greater leaseholder flexibility than a traditional Sale & Leaseback

Lifetime Mortgages: portfolio of loans from individual borrowers aged 55+ releasing equity from their property, which is repayable on death upon when entering long-term care

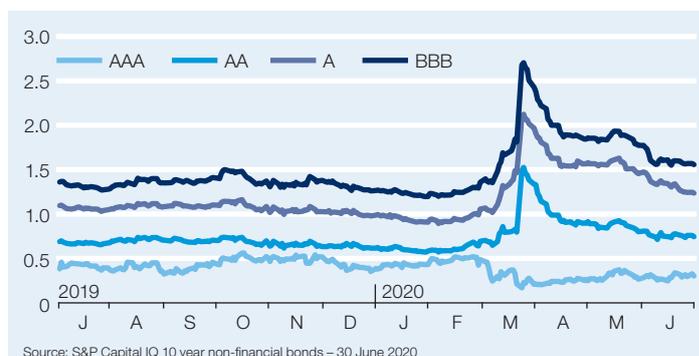
Private Debt: infrastructure debt, real estate financing and private placements (typical A-rated equivalent, fixed rate cashflows)

Source: Alpha Real Capital (for illustrative purposes only). Data as at 30 June 2020. 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 – 30 June 2020.

Liquid market update



Source: Barcap – 31 March 2020 and 30 June 2020



Source: S&P Capital IQ 10 year non-financial bonds – 30 June 2020

Inflation and bond yields

- Inflation expectations have significantly declined over the quarter driven primarily by the negative outlook due to Covid-19.
- Real gilt yields have also decreased in the quarter due to negative investor sentiment driven by Covid-19 and a move towards 'safe' assets.

UK credit spreads

- Investment grade credit spreads continued to fall over the quarter from their peak in late March, with spreads for single A rated bonds decreasing by c.70bps. This was driven by investors sentiment that the widespread support available to industries and businesses should help the majority to weather the storm.
- AAA credit spreads are lower than pre-Covid levels mainly driven by a 'flight to quality' by investors, seeking security during the pandemic.

Secure Income snapshot: Why now is an opportune time to invest in commercial ground rents?

As we begin to emerge from COVID-19 lockdown, over the next 6 to 12 months Alpha expect a significant increase in commercial ground rent deals coming to the market.

Key take-aways

- Commercial ground rents are the fastest growing¹ segment of the long-income real estate market.
- For real estate owners or acquirers', they can provide an efficient way to raise capital and for investors they can help cashflow match their longest dated liabilities rather than having to rely solely on very expensive index-linked gilts.
- Over the coming 6 to 12 months, as refinancing and M&A activity is expected to significantly increase the availability of high-quality commercial ground rents.

¹ Source: Alpha Real Capital estimate – based on 5 years period to 31 December 2019

The primary drivers are the following supply-specific factors:

Reduced liquidity: Multiple sectors are struggling for short-term liquidity, which can be achieved by releasing capital through ground rents.

Increased financing costs: Traditional financing costs have increased so ground rents will become an even more attractive funding alternative for certain acquirers and operators.

Banks looking to de-lever: Banks are looking to operators to provide new equity into existing positions to reduce leverage. Ground rents represent a low-cost option to provide this equity.

Wider opportunity set: The change in circumstances apply to many quality assets with sustainable mature income which previously saw no need for a ground rent. For example, high quality 'trophy' assets owned by family offices may need liquidity injections and this could be the first and potentially the only opportunity to access these.

Heightened M&A activity: Due to the current environment, distressed sale and consolidation M&A activity is expected to increase and require attendant financing options.

Alongside these drivers, for certain deals we expect improved terms when it comes to pricing and security.

↓ Download our latest Commercial Ground Rent CDI white paper

Other titles in our CDI series

More available to view at alpharealcapital.com/news



Commercial ground rents

Investment opportunity in a time of adversity



Commercial ground rents as a compelling fixed income alternative

With bond yields at all-time lows, where else can investors turn for contractual cashflows?



European Long Income Property

Secure real asset-backed income for pension funds and insurers



Lifetime Mortgages

A scalable, diversifying Cashflow Driven Investment for defined benefit pension schemes

Contact Alpha Real Capital

Please get in touch with your usual Alpha Real Capital representative or contact:

Hattie Walton

+44 (0)207 391 4568

hw Walton@alpharealcapital.com

Alpha Real Capital

For more information about Alpha Real Capital LLP, its funds and key personnel visit: www.alpharealcapital.com

Alpha Real Capital is authorised and regulated by the Financial Conduct Authority.

Important notice: This document has been issued by Alpha Real Capital LLP. This document and any related materials do not constitute or form part of any offer, invitation or solicitation to sell or issue or to purchase, subscribe for, underwrite or otherwise acquire any securities nor shall they or any part of them nor the fact of their distribution form the basis of, or be relied on in connection with any contract or investment decision in relation thereto. Promotion of Interests in investment funds is restricted under the Alternative Investment Fund Managers Directive 2011/61/EU (the AIFM Directive) and, consequently, this document is only directed at persons to whom interests in investment funds such as that contemplated by this document may lawfully be marketed pursuant to the AIFM Directive. In the United Kingdom, this document is intended for distribution only to persons who: (i) have professional experience in matters relating to investments, who are investment professionals, high net worth companies, high net worth unincorporated associations or partnerships or trustees of high value trusts and investment personnel of any of the foregoing (each within the meaning of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005) (FSMA); or (ii) to whom it may otherwise be lawful to communicate it (each a Relevant Person). This document is not directed at and may not be acted on by anyone other than a Relevant Person. Persons who are not Relevant Persons should not rely on this document, nor take any action upon it, but should return it immediately to Alpha Real Capital LLP. By accepting this document and not immediately returning it, by your action, you warrant, represent, acknowledge and agree that: (i) you are a Relevant Person; (ii) you have read, agree to and will comply with the contents of this Important Notice; and (iii) you will not rely on, and will conduct your own analysis and/or other verification in relation to, any data set out in this document and will bear the responsibility for all and any costs incurred in doing so. Where this document is communicated to you by an unauthorised person, this communication is exempt from the general restriction in section 21 of FSMA on the communication of invitations or inducements to engage in investment activity. The information contained herein is not to be used for any other purpose or made available to anyone not directly concerned with your evaluation of the possibility of requesting further information regarding the content of this document. The distribution of this document and other information in connection with Alpha Real Capital LLP may be restricted by law in certain jurisdictions and persons into whose possession any document or other information referred to herein comes should inform themselves about, and observe, any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. If you are in any doubt about the investment to which this communication relates, you should contact an authorised person specialising in advising on investments of the kind in question. No reliance may be placed for any purpose whatsoever on the information or opinions contained in this document or on its completeness. This document is not intended to provide, and should not be construed as or relied upon for legal, tax, financial, business, regulatory or investment advice, nor does it contain a recommendation regarding the purchase of any interests in any entity. No liability whatsoever (whether in negligence or otherwise) arising directly or indirectly from the use of this document is accepted and no representation, warranty or undertaking, express or implied, is or will be made by Alpha Real Capital LLP or any of its affiliates or any of their respective directors, officers, employees, advisers, representatives or other agents (Agents) for any information or any of the opinions contained herein or for any errors, omissions or misstatements. None of the Agents makes or has been authorised to make any representation or warranties (express or implied) or as to the truth, accuracy or completeness of this document, or any other written or oral statement provided. Some statements contained in this document, or in documents referred to in it, are or may be forward looking statements. Actual results may differ from those expressed in such statements depending on a variety of factors. Any forward looking information contained in this document has been prepared on a number of assumptions which may prove to be incorrect and accordingly, actual results may vary. Past performance is not a guide to future performance. The information contained in this document is strictly confidential and may not be released to any third party without the prior written agreement of Alpha Real Capital LLP.