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October 2022

WHY NOW FOR REAL ESTATE DEBT

The opportunity today

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The real estate market today

Fundamental shift in the cost of capital changes the market dynamic in European Real Estate

Cost of capital ↑

Significant re-pricing of debt capital in Europe in 2022

Real estate valuations ↓

Valuations are falling and expected to fall 15-20% by end 2023

Lenders step back

Fewer lenders. Falling values meets with lower leverage availability

Schroders, 2022.

The opportunity for investors today

Market conditions are driving a pipeline of attractive transactions to alternative lenders

Increased margins

Opportunity to achieve additional returns

Lower leverage

Higher returns now available from lower leverage and with enhanced downside protections

Senior secured

Senior secured loans now generating 6-10% gross IRR with full covenant packages

Schroders, 2022. Gross IRR is a projected figure at time of execution, based on expected cash flows and arrangement and/or exit fees. Projected gross IRR's are not guaranteed.

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THE MARKET CHANGE IN 2022

The opportunity today

Lending markets dislocated in H2 2022

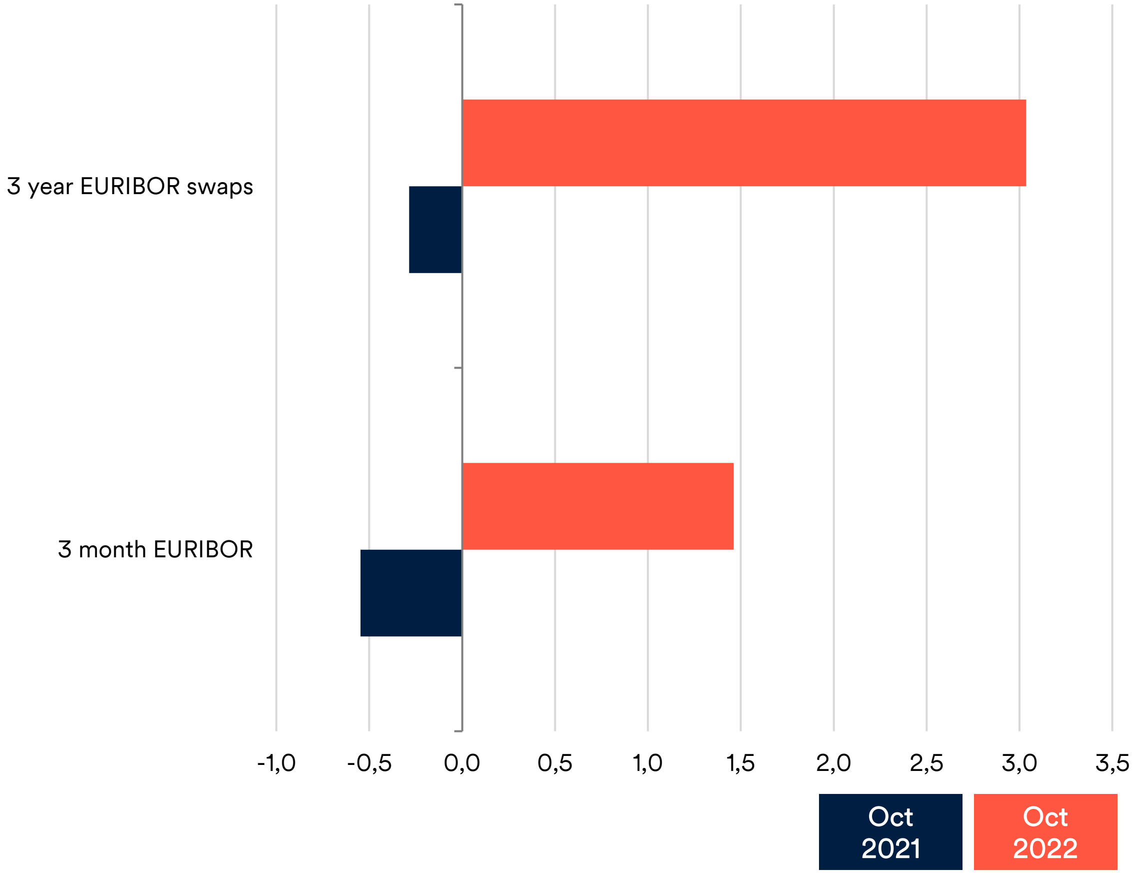
We observe	Opportunity set
Above target inflation, central bank rate rises and a challenging macro environment	Attractiveness of inflation linked assets. Real assets provide downside protection
Significant increase in the cost of capital results in falling asset values	Market repricing results in conservative capital value basis and strong yield on debt
Lenders increasingly cautious, making fewer loans and lending at lower LTV's	Refinancing opportunity for Whole Loan and Mezzanine capital structures
In summary, a dislocated lending market	Senior secure loans on value add assets, often requiring ESG related capex, which delever through the life of the loan (office)

Schroders, 2022.

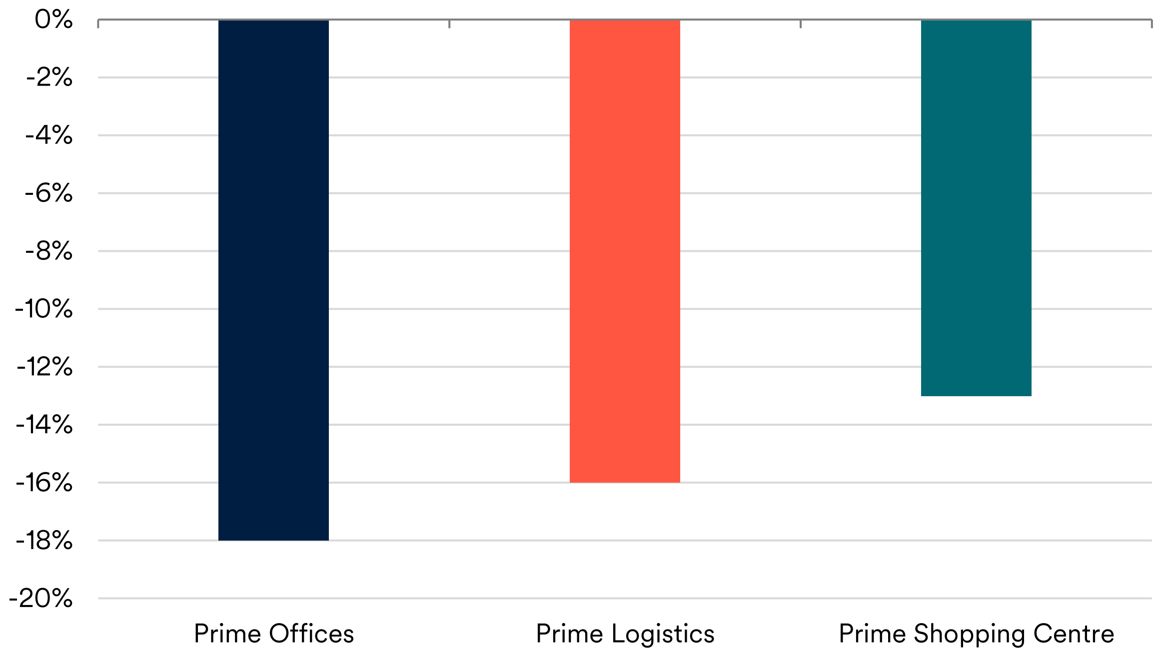
What a difference a year makes

Increase in cost of capital impacts real estate valuations

EURIBOR rates, 20th October 2021 to 2022



Schroders Capital Real Estate research – expectations for capital values to fall 15–20% between 2022–2023



Schroders research, Chatham Financial, October 2022.

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IMPACT ON REAL ESTATE LENDING MARKET

What is the impact on the real estate lending market?

Appetite for new loans has reduced, leverage has reduced and return hurdles have increased

Banks and alternative lenders are operating *very* cautiously


Real Estate Capital Europe

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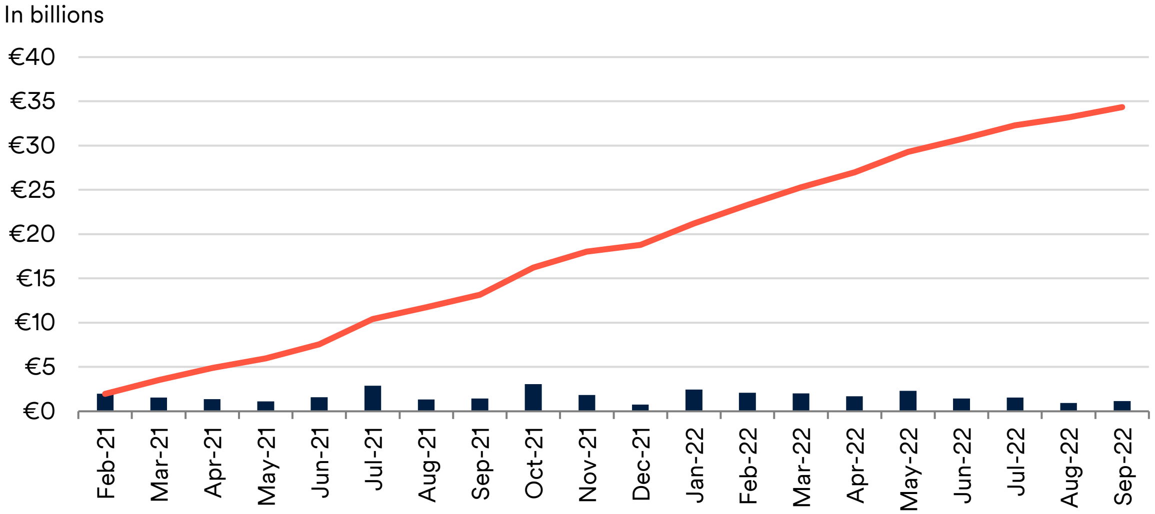
REFINANCING

AEW: Key markets face €24bn refinancing gap to end of 2025

Fewer lenders likely to result in higher deal flow



Those who will lend are doing so at lower LTV's

- Finding debt capital will be a challenge for borrowers – both as loans mature (typically every 5 years) and for new acquisitions
- Lower asset values will make re-financing challenging – borrowers will in some cases need to inject fresh equity, but in others will need to find new financing arrangements or look for a junior lender given values have fallen
- Appetite which does exist from lenders (banks, alt. lenders) will be at lower leverage (LTV's)

Regulatory changes are impacting banks re-financing capability

- Basel IV (coming January 23) will make it more difficult for banks to re-finance loans by simple 'extend and pretend'
- The capital charge of holding loans with 'forbearance' will increase
- We expect the outcome here to be further deal flow and a desire for banks to offload these liabilities

Schroders, 2022. AEW. Deal flow shown is Schroders proprietary deal flow since 1st January 2021.

Lending appetite across market participants is low

Regulations and small number of players constrains the market

Banks

Very limited appetite for new loans in the current market

Focus only on large, existing relationships

Reduction in risk appetite resulting in lower LTV's for those transactions which do complete

Basel IV regulations reducing ability to re-finance some loans

Maximum leverage typically up to 60% - punitive risk capital charges thereafter

Insurers

Focus is on a specific market segment which is attractive from a risk weighting perspective

Typically look for low risk, low leverage investment grade deals with long tenor and specific clauses (7+ years)

Small part of the market and limited appetite to broaden lending scope

Debt funds

Limited appetite for lending in the current market environment - focus will be on ensuring performance of existing loan book

LTV's will have come down and required rate of return will have increased as capital markets re-price across asset classes

High fixed costs to create a debt business deters new market participants

Conclusion

The 3 key market participants have each;

- Reduced their lending appetite
- Reduced their LTV's on loans they are prepared to provide
- Banks and insurers are constrained by regulations and are therefore unable to extend their loan franchise
- Debt funds are small in number and AUM vs the size of the EUR1tn market

Schroders, 2022.

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THE OPPORTUNITY FOR INVESTORS TODAY IN SENIOR SECURED LENDING

The opportunity for investors

Senior secured lending targeting 6-7% gross IRR

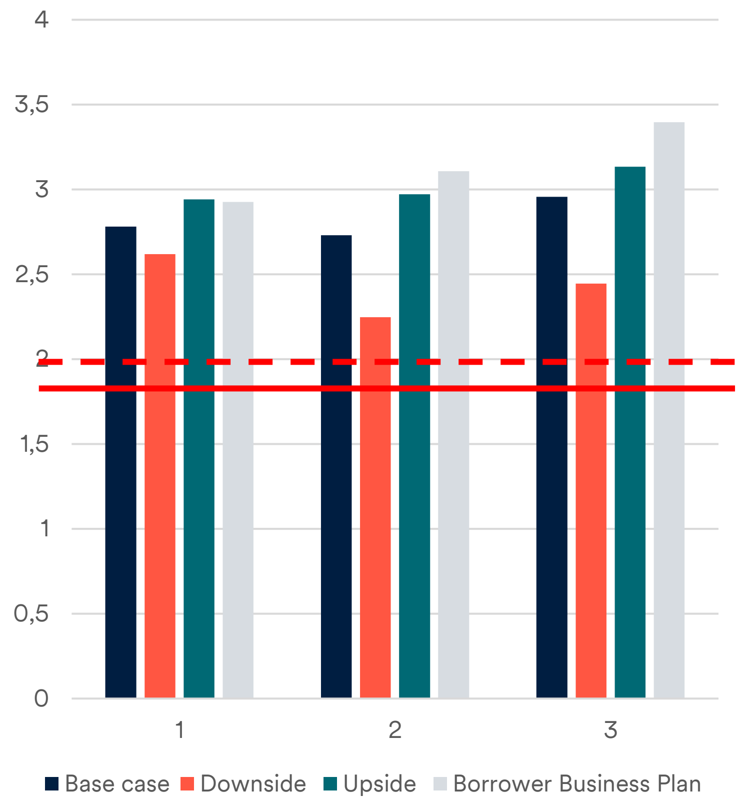
Provide capital in a constrained market

- Target returns can be achieved at leverage of c50-55% rather than c65-75%
- Remaining active and opportunistic in the market – using our internal RE expertise to get comfortable with valuations (not having to wait for 3rd party valuation reports)
- Provide capital where it is otherwise not available with full covenant packages and lender friendly terms as a result

Outsized returns now available

- Senior secured, first mortgage positions are now generating gross IRR's of 6-7% in Europe
- Senior secured loans are rated AA-B using S&P rating methodology (internal rating)
- Recovery rates in event of default very high given the equity cushion and conservative starting LTV's. In event of default the lender can take control of the asset.

Covenant packages standard, including ICR



Schroders, 2022.

Transaction example

Senior secured loan against Dutch industrial assets to an institutional borrower with 25 year lease

2x Dutch Industrial assets

Key loan information

- EUR 17.2m, 5 year loan
- Gross IRR of 6.5%+
- 67% LTV (of a conservative asset value)
- Two assets in the Netherlands near the German border
- Senior secured first charge position
- Tenant has a 25 year lease on both assets
- Rental uplifts due to inflation indexation
- Sale and leaseback strategy by US sponsor – sponsor has been running the strategy for 16 years and never missed a payment or defaulted on a loan
- Bank guarantee of 12 months
- Loan is less than the vacant possession value of the assets, providing strong recovery position in a worst case scenario
- LTV and ICR covenants and prepayment fees
- Tenant has occupied the asset for 75 years and it is the global HQ. The second asset has been occupied by the tenant since 1964

Schroders, 2022. Any reference to sectors/countries/stocks/securities are for illustrative purposes only and not a recommendation to buy or sell any financial instrument/securities or adopt any investment strategy. Gross IRR's are not guaranteed. This is not a recommendation to buy or sell.

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THE OPPORTUNITY FOR INVESTORS TODAY IN SENIOR SECURED AND MEZZANINE LOANS

The opportunity for investors

Senior secured and mezzanine loans targeting 10-12% gross IRR

Provide capital to a capital constrained market

- Lack of capital availability most acute in the higher yielding part of the market
- Higher LTV's especially difficult for borrowers to source
- Opportunity for High Yield returns are lower leverage than at other points in the cycle
- Gap financing/ junior debt opportunity will emerge over time – today the opportunity is in high yielding whole loans until values stabilise
- Target returns can be achieved at leverage of c60-75% rather than c70-85% for whole loans generating double digit IRR's
- WAL of loans is 2.5 years meaning loans are re-pricing quickly, supporting new pricing if inflation persists

Schroders, 2022.

Outsized returns now available

- Senior secured, first mortgage positions can now generate gross IRR's up to 10%
- Senior secured loans are rated AA-B using S&P rating methodology (internal rating)
- Recovery rates in event of default very high given the equity cushion and conservative starting LTV's. In event of default the lender can take control of the asset

Mezzanine requirement will emerge over time

Transaction example

Senior secured loan against newly refurbished asset in Milan

Low leverage whole loan with High Yield pricing

Key loan information

- EUR 27m loan
- Loan is at 55% LTV given the lack of funding available in the market today. Hotels in particular are struggling to attract debt capital
- Coupon is 8%, 1% arrangement fee and 1.5% exit fee giving a gross IRR of 10%
- We use the expertise of our internal hotel team to analyse hotel opportunities
- 3 year facility
- Newly refurbished hotel located North of Milan, close to San Siro Stadium. 310 keys operated on 20 year management contract with global multi-national. Hotel opened late 2019 and didn't ramp due to the pandemic
- First charge whole loan of to refinance existing debt and provide working capital line to cover any opex and interest service shortfalls during the first year of ramp up
- Cashflow projections underwritten at discount to the competitive set

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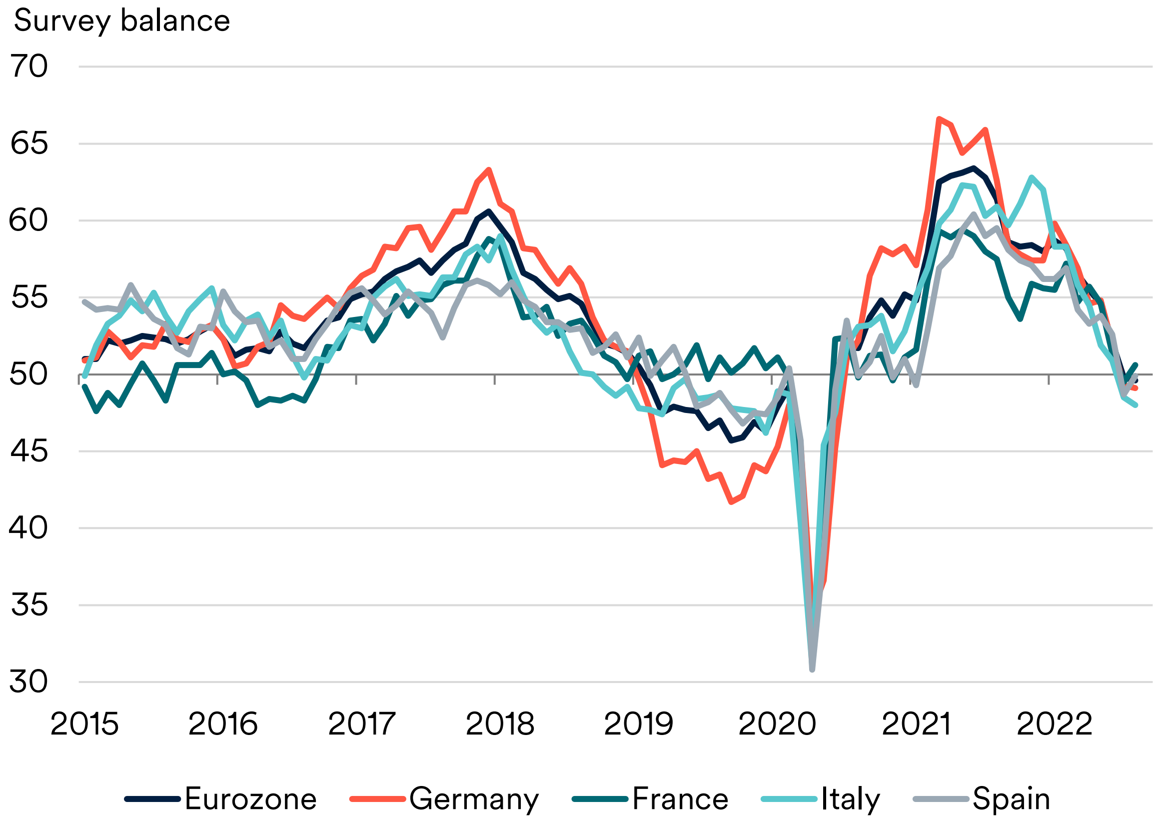
HOW CAN WE LEND SUCCESSFULLY THROUGH A CHALLENGING MACRO ENVIRONMENT

How to lend through challenging markets

1. Recession

Manufacturing PMI's



Key considerations and risk mitigants

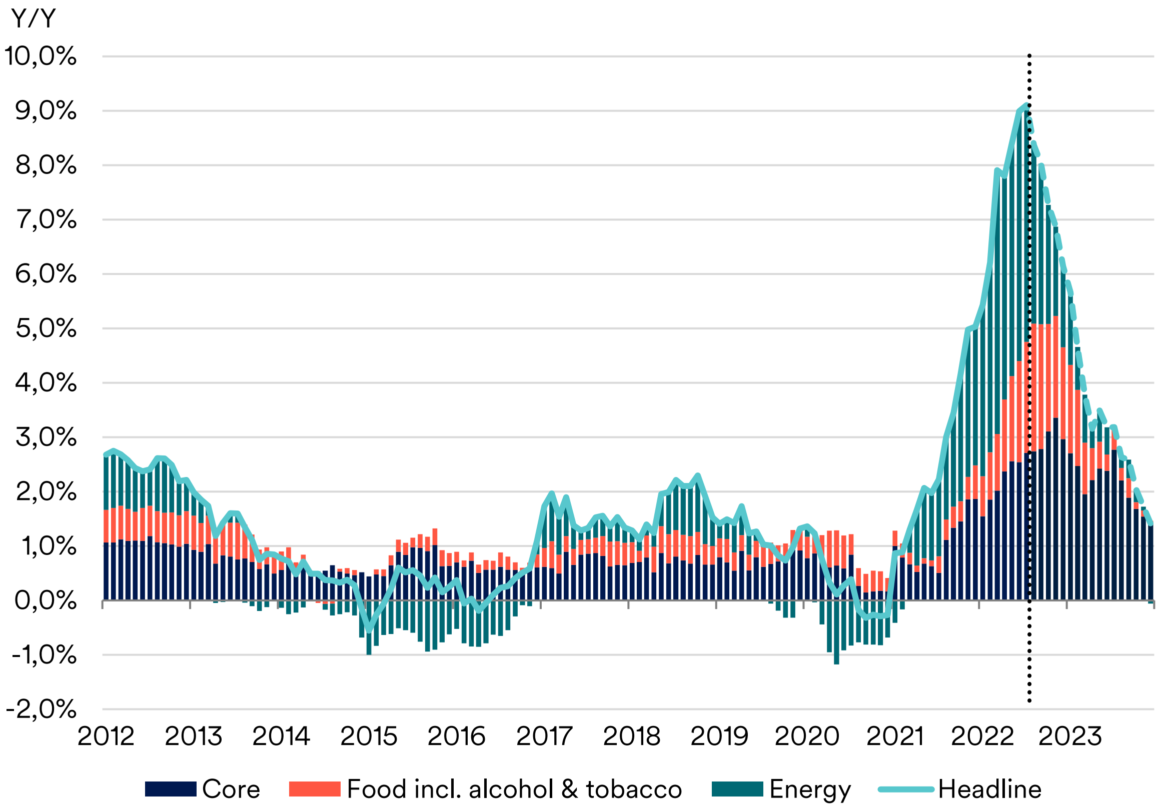
- Senior secured position in the capital stack
- Sole lender to provide control in a challenging market
- Higher quality assets, improved location, higher tenant quality (either through diversification of tenants or by number/sector)
- Lower leverage (LTV's) to protect loan exit-position to re-finance the loan and repay the principle
- Assets which will be improved during the life of the loan help to support asset value
- Full suite of covenants as standard – tight covenants which bring the lender to the table early
- Fewer development loans

Source: Markit, Refinitiv, Schroders Economics Group. September 2022.

How to lend through challenging markets

2. Inflation

European inflation



Key considerations/risk mitigants

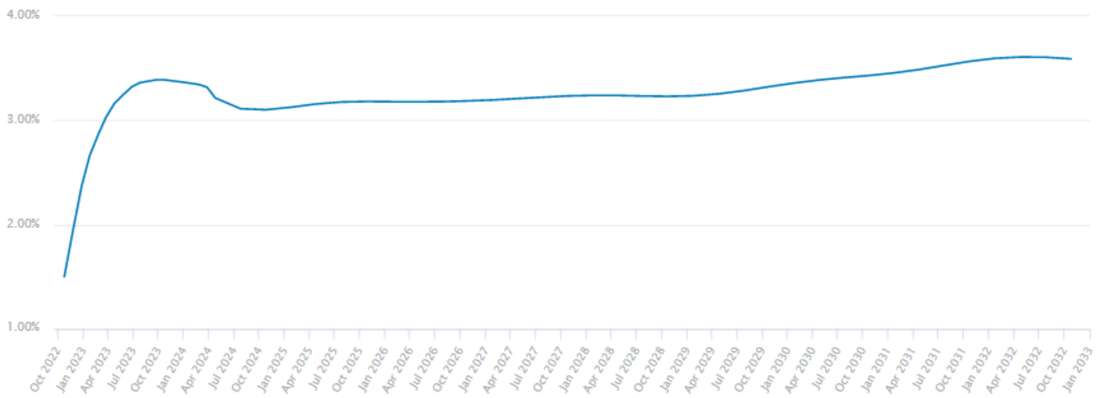
- Rents are correlated with inflation over time, albeit with a lag. 70% of European rental contracts have a contractual inflation adjustment
- Shorter rental contracts are able to be re-set more regularly – sectors such as purpose built student accommodation and single/multi-family assets are examples
- Growing income can help offset rising property yields to sustain values
- Private real estate lending transactions can be floating rate, providing investors with potential inflation protection

Schroders, 2022. RCA, Schroders. PMA, JLL June 2022.

How to lend through challenging markets

3. Rising interest rates

EURIBOR forward curve



Key considerations/risk mitigants

- Focus on tenant profile and the quality of the cashflows servicing the loan
- Structuring the right covenants to ensure there is tight control over debt serviceability
- Margins increasing to compensate for macro risks
- Focus on sectors where rental contracts are shorter and can therefore be re-based (student accommodation, build to rent) but also sectors where there is structural growth in rental payments, and this can be maintained even in a slowly economy (life science, healthcare)
- Increased swap rates result in higher absolute returns

Schroders, Chatham Financial, 21 October 2022.

How to lend through challenging markets

4. Falling asset values

Values expected to fall through 2022–2023

OXFORD ECONOMICS

17 October 2022

Research Briefing | Global

Soaring debt costs increase the risk of real estate distress

- **Debt costs continue to soar across advanced economies, threatening to push commercial real estate markets into distress. We believe that the transmission mechanism for forced selling will be refinancing shortfalls, but interest coverage ratios are also looking dangerously low.**

Key considerations/risk mitigants

- Significant equity cushion behind a high quality sponsor
- Looking to lend up to 75% max LTV, giving a minimum of 25% cushion of further valuation falls
- Lend to sponsors who have deep pockets and can inject equity if needed to make-whole the loan at re-finance
- Borrowers who are larger/institutional and can inject more capital in to deals
- Better assets with alternative uses to underpin value

Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 30 September 2022. Any reference to sectors/countries/stocks/securities are for illustrative purposes only and not a recommendation to buy or sell any financial instrument/securities or adopt any investment strategy.

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ACCESSING THE OPPORTUNITY

Marketing material for professional clients only.

Two ways to access the opportunity today set

	Senior Secured Loan	High Yield
Strategy	Stretch senior and whole loans	Whole loans and mezzanine loans
Return target (gross IRR)	6-7%	10-12%
Max leverage	75%	85%
Geography	Western Europe with a focus on jurisdictions with stronger creditor rights	Western Europe with a focus on jurisdictions with stronger creditor rights and the UK (70/30%)
Sectors	All real estate sectors – main sectors; logistics, office, industrial and retail	All real estate sectors – main sectors; logistics, office, industrial and retail
Average loan size	€15-100m	€15-100m
WAL	3.5 years	2.5 years
Product term	6 years	5 years
Management fees	57.5-65bps depending on size	105-125bps depending on size*
SMA	Yes €100m minimum	No

Schroders, 2022. Gross IRR's are not guaranteed. This is not a recommendation to buy or sell. HY management fees charged on committed vs invested capital.

KEY TAKEAWAYS

Key takeaways

Real asset provides downside protection, potential inflation protection and contractual cash flows

Cost of capital ↑

Size and speed of the increase contributing to a challenging market for levered real estate borrowers

Inflation ↑

Above target across developed economies with expectations for rate rises to continue in to 2023. Loans can be floating rate

RE values ↓

Falling due to the increased cost of capital and reduction in risk appetites from the macro environment

Lack of capital

Few lenders active in the market. Re-finance risk for existing loans. Regulatory changes preventing banks extending current loan books. Deal flow to alternative lenders to increase.

Opportunity

Borrowers will struggle to re-finance. Demand for alternative sources of capital will increase.

Outsized risk adjusted returns

Supply/demand imbalance gives lenders the opportunity to achieve attractive risk adjusted returns. Covenants and debt structuring provide downside protection.

Schroders, 2022.

Important information

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Risk Factors

- The Fund invests primarily in real estate-related loans, the value of which could be impacted by factors affecting property assets securing the loan. Property assets are inherently difficult to value and are generally a matter of a valuer's opinion.
- Borrowers may fail to make interest or principal payments on a loan. Defaults may adversely affect the income received and or the value of the fund.
- In the event of a borrower default, any security taken may not be sufficient to cover amounts due.
- The capital may be repaid by the borrower before reaching maturity which may affect the value of the fund.
- There is no recognised secondary market for interests in the fund and, as a result, reliable information about their value or the extent of the risks to which they are exposed may not be readily available.
- Changes in currency exchange rates may adversely affect the value of the investments or the borrowers' ability to service their debts.
- Failures at service providers could lead to disruptions of fund operations or losses.

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