Schroders capital

23 September 2021

CFA SOCIETY VBA NETHERLANDS

Private Debt Seminar

Natalie Howard, Head of Real Estate Debt
Jerome Neyroud, Head of Infrastructure Debt Investment

SCHRODERS CAPITAL

Private Debt team biographies

Natalie Howard

Head of Real Estate Debt

- Natalie is Head of Real Estate Debt at Schroders Capital Real Estate
- She has more than 30 years experience in the Real Estate debt markets
- Natalie previously worked at DRC Capital, AgFe, Lehman Brothers, Barclays Capital, Morgan Stanley and Paribas

Jerome Neyroud

Head of Infrastructure Debt Investments

- Jerome is Head of Infrastructure Debt Investments within the Schroders Capital Infrastructure business
- He has 22 years experience in the infrastructure market
- Jerome graduated from Ecole Nationale des Ponts & Chaussées (1998)
- From 2012-2015, Jerome was a Senior Fund Manager of the infrastructure debt team at AXA IM
- At Dexia until 2012, director and deal team leader in energy & infrastructure finance
- 1998-2012, project finance at SG and BNPPP

Contents

01

Introduction to Schroders Capital

02

European Real Estate Debt market

03

European Infrastructure Debt Market

Schroders capital

An investment business founded on performance, innovation and integrity

$70bn

assets under management in direct, primary, secondary, and co-investment capabilities

Private Equity $13.5bn
Small and mid-sized buyout in Europe and US as well as Growth investment in Asia and Global venture capital

Securitised Credit $17.5bn
Full spectrum of securitised assets and asset-related private debt in data-rich credit sectors across the US, Europe and APAC

Real Estate $25.0bn
Operational excellence, hospitality and sustainability expertise driving performance across the value chain in Europe and Asia

Infrastructure $4.8bn
Essential infrastructure in Europe across the capital structure

Insurance-linked $4.7bn
Uncorrelated long-term returns across life and non-life insurance risk globally

Impact $4.0bn
A global impact investment capability dedicated to generating lasting positive changes and attractive returns

82%

of assets outperforming over 5 years

250+

investment professionals

450+ employees directly dedicated to private assets globally with many more supporting the proposition across the group

Long and consistent track record of delivering strong risk-adjusted returns

Transparent ESG integration, sustainability and impact measurement capabilities

Flexible suite of tools and services for institutional and private investors

Dedicated Private Assets Solutions team

In-house data science team supporting our investment practice

Source: Schroders Capital, 2021. AUM and performance as at June 2021 (includes non-fee earning dry powder). Past performance is not a guide to future performance and may not be repeated.

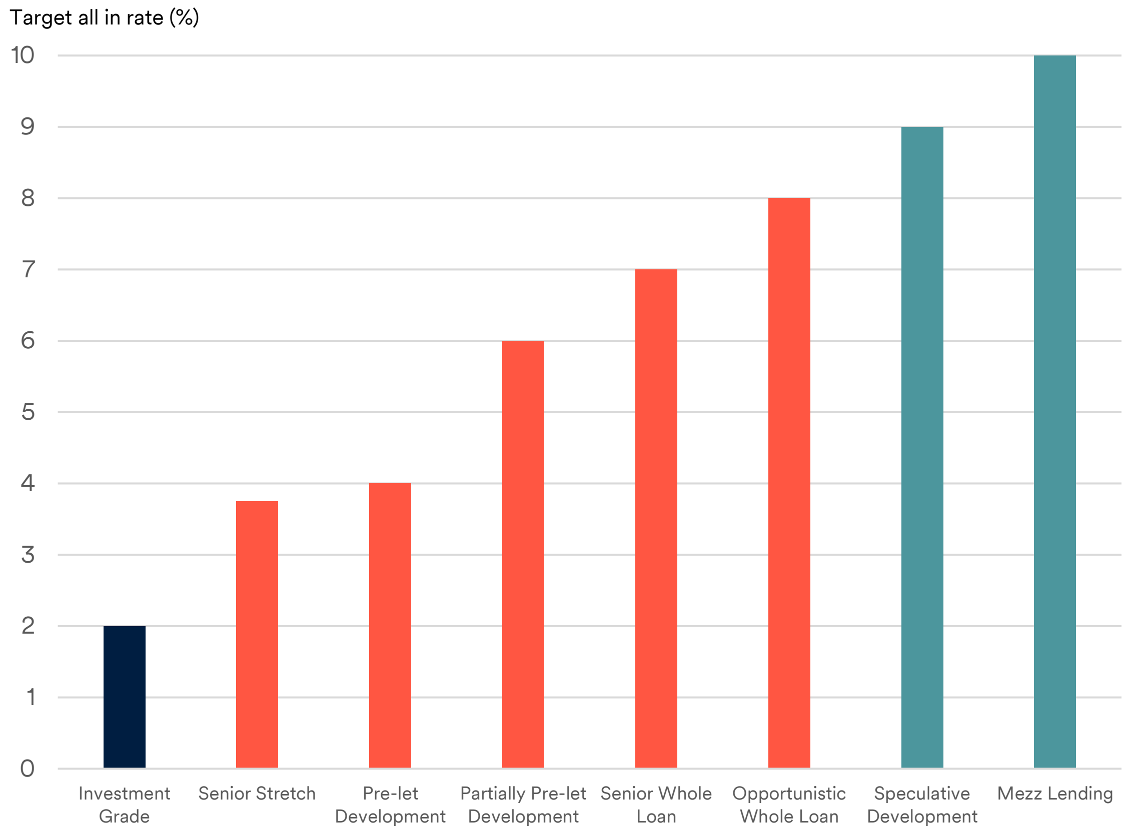
Commercial Real Estate Debt Market

Attractive risk/return profile from lending secured against physical assets

Market context

- Traditional lenders retrenching due to increased regulation and a reducing risk appetite
- Expanding opportunity for non-bank lenders to fill the funding gap, particularly in Europe
- Estimated €1.09 trillion of European Real Estate Debt outstanding, with a finance requirement of c.€250 billion p.a.[1]
- Economic recovery driving increasing real estate investment activity and leading to a growth in lending opportunities
- Attractive risk/return profile
- Strong downside protection from fixed mortgages with significant sponsor equity cushion and robust loan structures

Target all in rate by property loan style (Europe)



Schroders, July 2021. [1]Schroders/PMA/CBRE

Real estate debt in the context of fixed income returns

	Real Estate Debt Investment Grade	Real Estate Debt Senior Loan	Real Estate Debt High Yield	Global	European Bond Market			US Bond Market				Emerging Market Bonds
Sector	EUR IG RED	EUR SL RED	EUR HY RED	Global Fixed Income	European Government	European Investment Grade	European High Yield	US Treasuries	US Fixed Income	US Investment Grade	US High Yield Constrained Index	EMD
Index	-	-	-	Bloomberg Barclays Aggregate Credit Index	European Government	European Investment Grade	European Currency High Yield Index	US Treasuries Index	US Aggregate Fixed Income	US Investment Grade	US High Yield Constrained Index	EMD Hard Index
Duration (years)	4.5	3.5	2.5	7.28	9.33	5.76	3.51	6.93	6.48	8.65	3.99	6.85
Credit Quality	BBB	BB	-	A-	AA-	A-	BB-	AAA	AA	A-	B+	BBB-
YTM (%)	1-2%	5%	8-10%	1.48%	0.29%	0.54%	2.88%	0.95%	1.5%	2.04%	4.62%	3.81%
1 year vol	-	-	-	6.1%	3.56%	2.37%	4.26%	3.37%	3.21%	5.87%	5.71%	5.48%
3 year vol	-	-	-	6.4%	4.11%	5.71%	9.63%	4.46%	3.49%	7.06%	9.46%	8.36%

Source: Schroders and Bloomberg as of June 30, 2021. For illustration only. Duration, credit quality and performance may differ across representative accounts within any composite. Yields are subject to fluctuate over time. Past performance is no guarantee of future results. Index returns are unhedged.

Market opportunity post Covid-19

Attractive risk/return profile from lending secured against physical assets

We observe	Opportunity set
A further **retrenchment of banks** from providing real estate debt across Europe, especially in non-home markets	**Alt. lenders** have a key role to play in filling the financing gap
Divergence of real estate sector performance during the pandemic – retail vs logistics	**Experienced debt providers** are able to cherry pick opportunities as banks/lenders avoid sectors
Acceleration in the focus on ESG from regulators, governments and Borrowers accelerates	**Opportunity to be a market leader** under SFDR regulations in Europe
Central bank response to pandemic **drives down bond yields**	**Spread pick up** in private real estate debt continues to offer relative value

Key characteristics of Real Estate Debt

1

Consistent return profile

- Quarterly income payments, asset backed debt and significant Sponsor equity cushion provides strong downside protection

2

Ability to dial the risk/return up or down

- The market range of returns is from 2-3% for IG, 6.5% for Senior Loan to 10% (EUR) for High Yield
- Each risk bucket attractive for different client profiles
- Lenders can work with Borrowers to structure transactions for required return

3

Equity alternative

- High yield transactions offer short duration (c2.5 year) debt, with up to 8% quarterly income and Borrower fees to generate 10% (EUR) returns
- Offers clients the ability to recycle equity returns in to a debt product while maintain target returns

4

Attractive market entry point

- LTV's at 10 year lows
- Full suite of covenants employed
- Huge transaction volumes
- Structural decline of bank financing accelerated due to the pandemic

Schroders, 2021.

Key takeaways

1

Traditional lenders retrenchment

- Bank regulations, combined with Covid-19 drive structural changes in the market in favour of alternative lenders

2

Capital constraints drive Lender friendly terms

- Reduction in available capital results in a Lender friendly environment in which full suites of covenants are utilised

3

Opportunities exist across sectors

- Volume of Borrower demand ensures opportunities across all sectors, provided unwriting and covenant process mitigates risk

4

Pick up vs comparable public debt

- Significant pick up over unsecured corporate debt makes the asset class attractive for clients across a range of risk profiles, from 2-3% to 10%

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INFRASTRUCTURE DEBT: AN ALL-WEATHER SOLUTION?

Jerome Neyroud
Head of Infrastructure Debt, Schroders Capital
Deputy CEO, Schroder AIDA

INFRASTRUCTURE DEBT

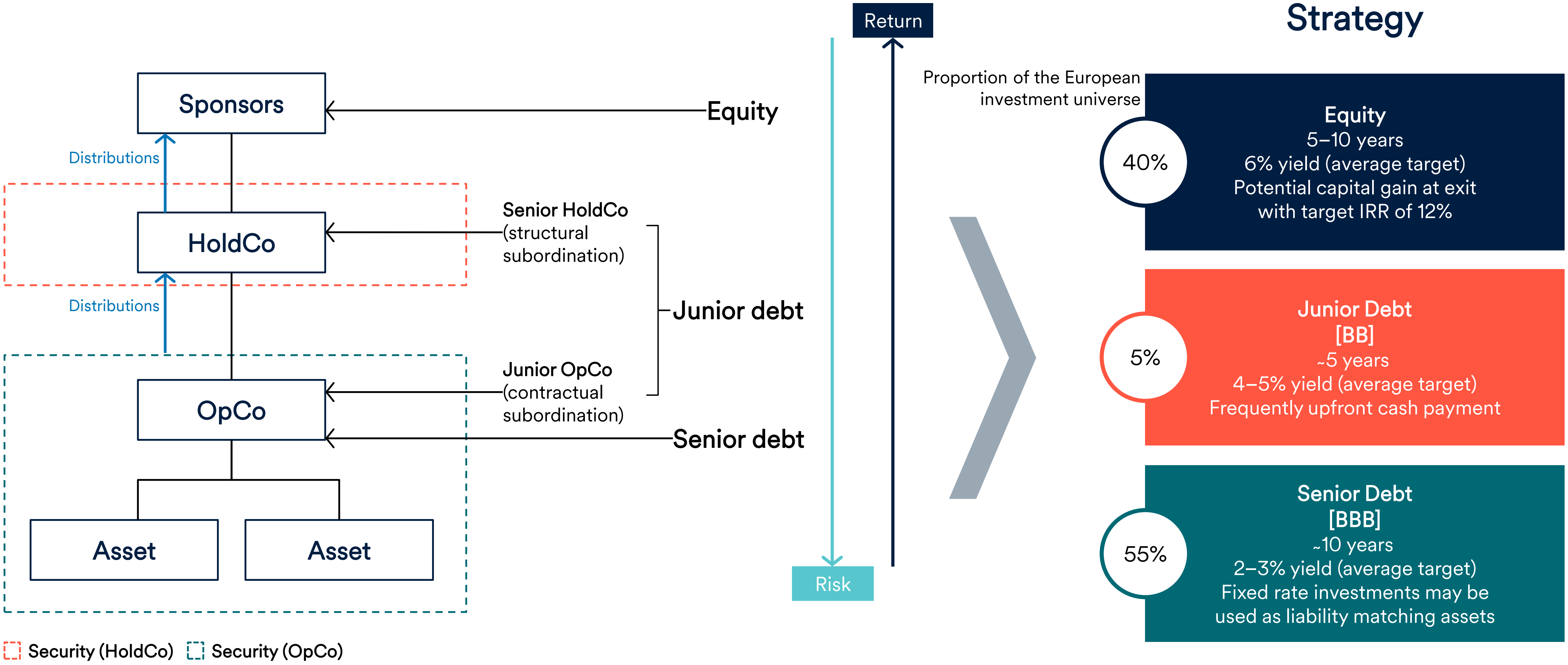
What it is (and is not)

Infrastructure is the backbone of our economy

Source: Schroders, August 2020.

Opportunities across the capital structure

Typical capital structure for an infrastructure corporate



Source: Schroders, July 2020. For illustrative purposes only. Standard capital structure of an 'infrastructure' company. Returns expressed gross of management and administration fees – asset characteristics presented as investment horizon, estimated yield payment in EUR, and estimated Solvency II capital requirement of the strategy (SCR). Estimated proportion of the investment universe by financial instrument.

THE WEATHER

What does it tell us?

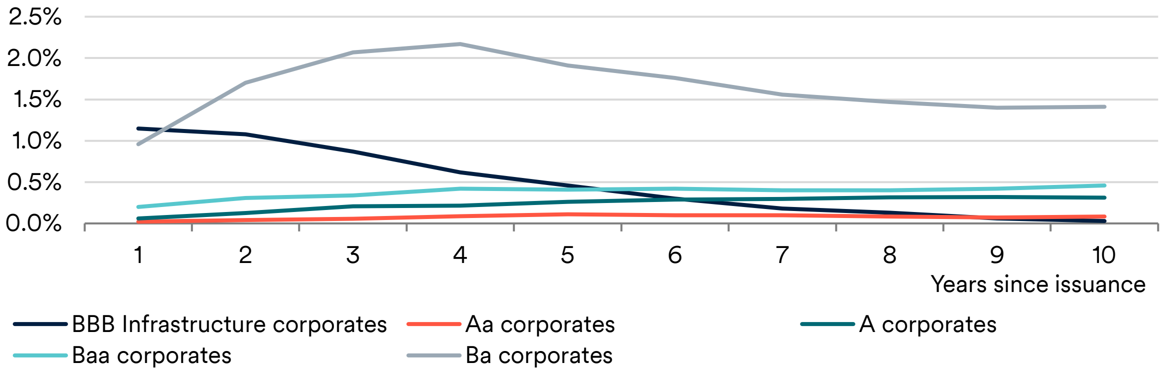
2.875

ESSENTIAL INFRASTRUCTURE/ SUSTAINABLE PERFORMANCE

Cost of risk

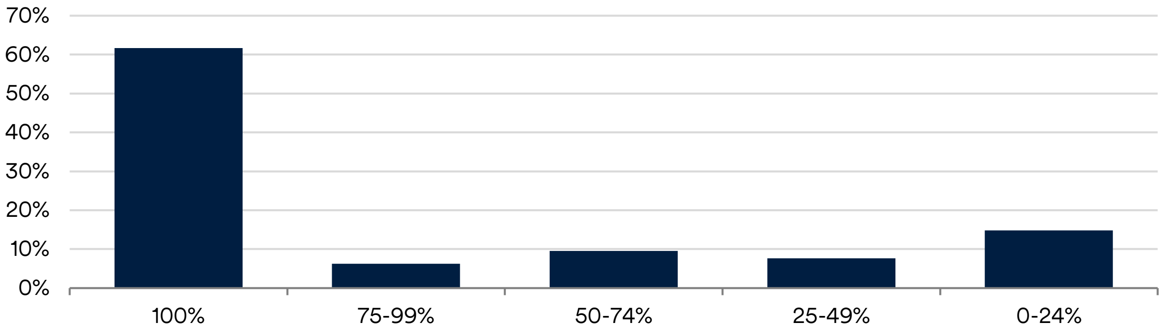
Probability of default

Annual recovery rate



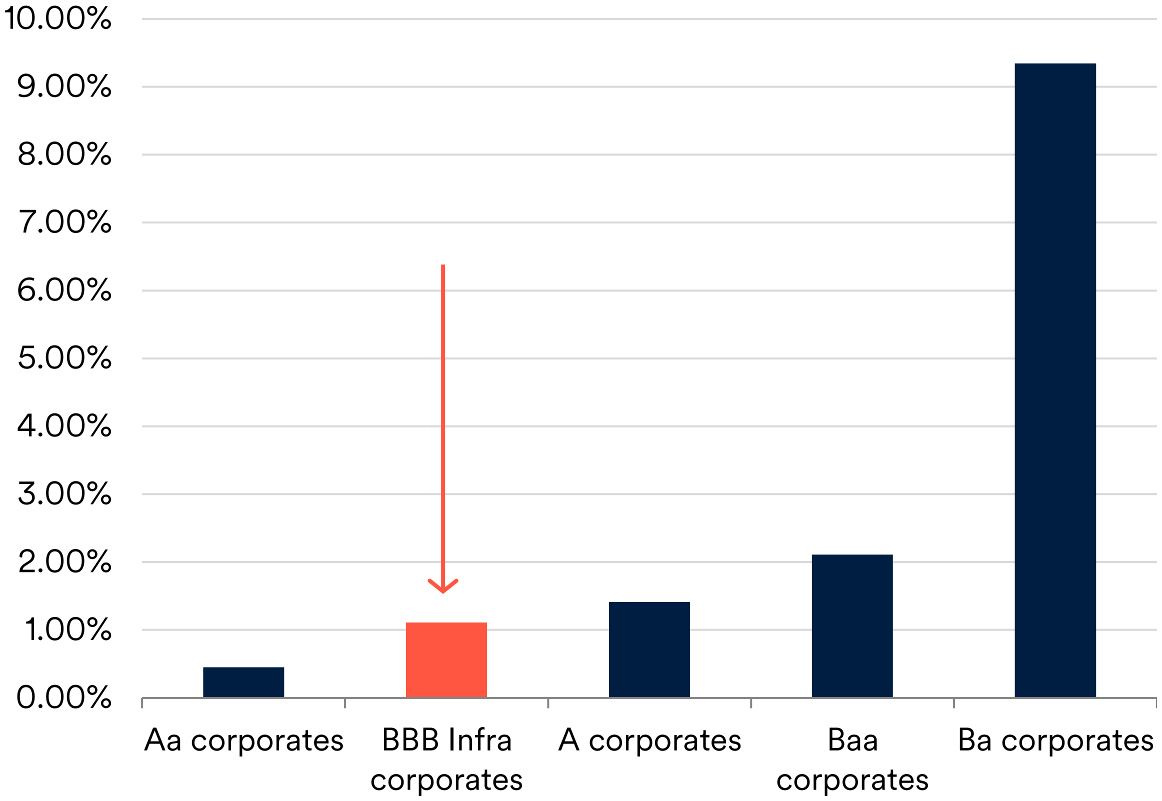
Infrastructure loss given default

Proportion of debt recovered



Expected loss

Credit loss rate

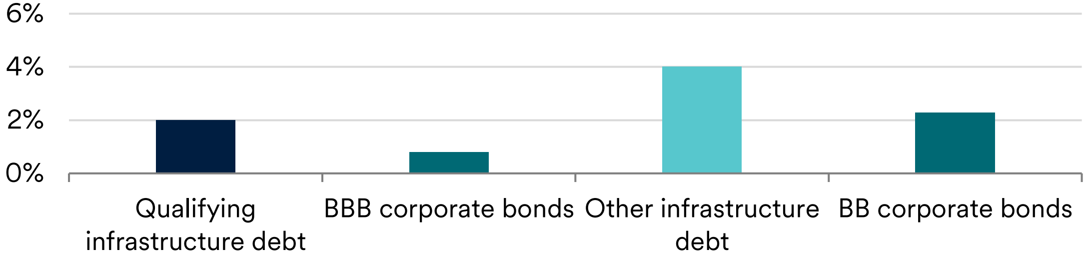


Past performance is not a guide to future performance and may not be repeated.

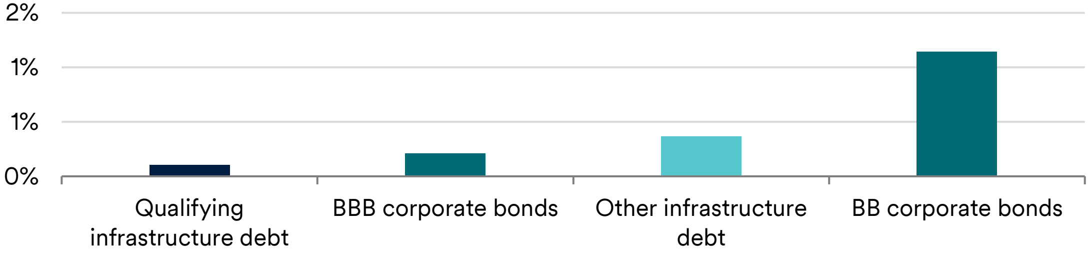
Source: Moody's 'Default and Recovery Rates for Project Finance Bank Loans, 1983–2015' and Moody's 'Corporate Default and Recovery Rates, 1920–2015.

An attractive risk/return/cost profile

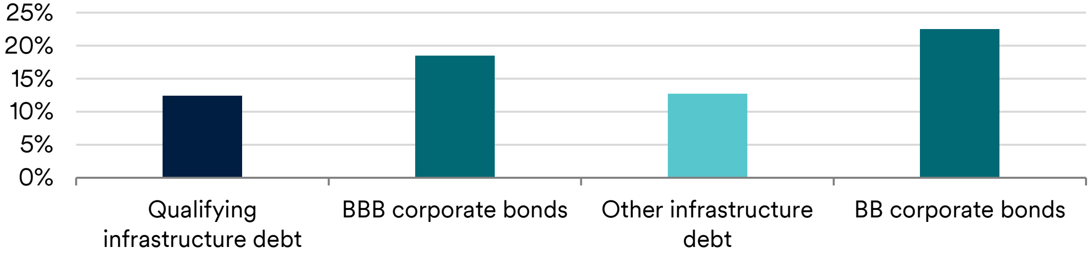
Spread



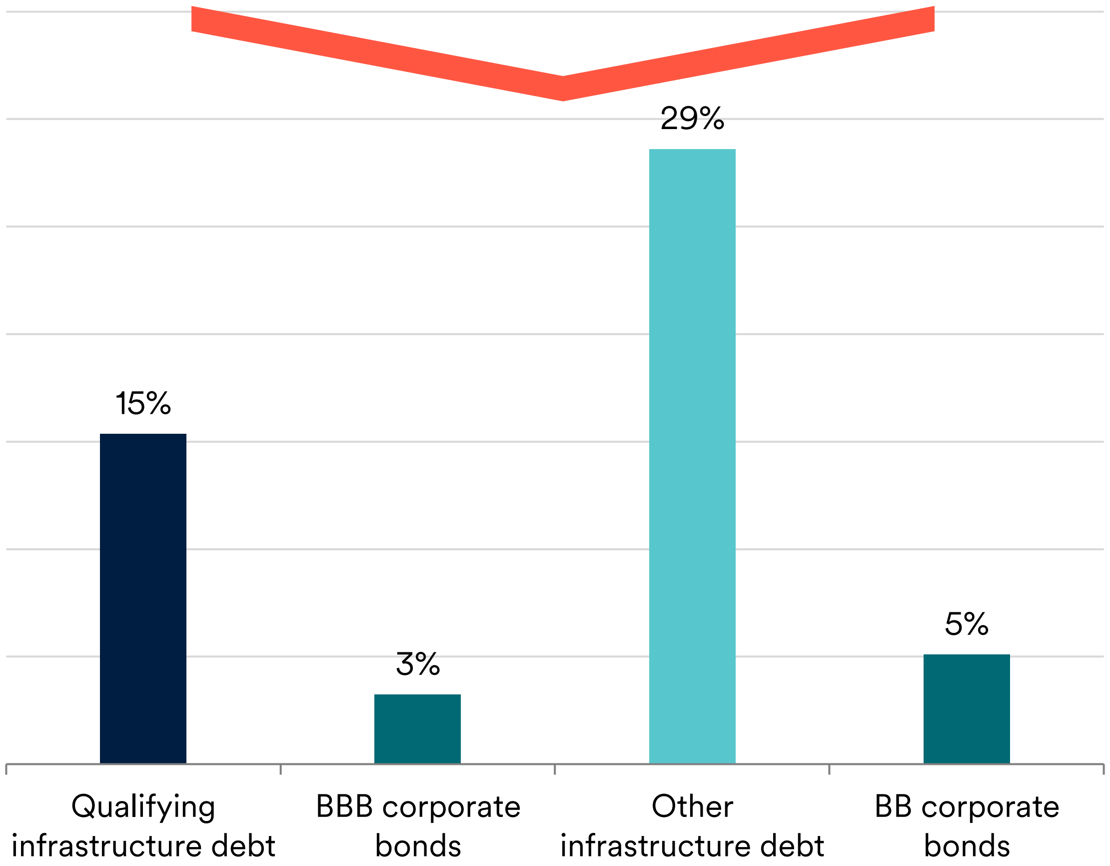
Annual expected loss[1]



Solvency II capital charge (SCR)



Solvency II risk adjusted return on capital



Source: Schroders, Thompson Reuters Datastream, BAML, JP Morgan, Moody's 'Infrastructure Default and Recovery Rates, 1983–2015.' Corporate bonds spreads as at 30 April 2018. [1]Expected loss equal to average historical loss rate plus downgrade losses, with downgrade losses assumed to be zero for private infrastructure debt. Annual losses for 1983-2015. EIPOA guidelines. Adjusted returns as of 30 April 2018.

Past Performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

Infra Debt an all-weather solution

1. **Duration**

2. **Sustainable Income (yield and low volatility)**

3. **Efficient Regulatory Capital Treatment (S2 or eq.)**

CONTACT

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BUILDING CHANGE

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Risk considerations

Main risks associated with the asset class and strategy

Interest rate risk for fixed-rate instruments: interest rate volatility may reduce the performance of fixed-rate instruments. A rise in interest rates generally causes prices of fixed-rate instruments to fall.

Deterioration of the credit quality of the bond: caused by a change in the market environment (for commercial activities) or a change in law/regulation (for all infrastructure activities).

Risk of issuer default: a decline in the financial health of an issuer can cause the value of its bonds to fall or become worthless.

Prepayment risk: the capital may be repaid by the borrower before reaching maturity.

Exchange rate risk: where assets are denominated in a currency different to that of the investor, changes in exchange rates may affect the value of the investments.

Illiquid and long term investment risk: due to the illiquid nature of the underlying investments, an investor may not be able to realise the invested capital before the end of the contractual arrangement (which is likely to be long term). If the investment vehicle is required to liquidate parts of its portfolio for any reason, including in response to changes in economic conditions, the investment vehicle may not be able to sell any portion of its portfolio on favourable terms or at all.

Capital loss: the capital is not guaranteed and investors may suffer substantial or total losses of capital.

Greenfield risks: in contrast to 'brownfield' investments, investments in 'greenfield' infrastructure assets expose investors to additional risks, in particular construction risk (e.g. construction delays, cost overruns, etc.) and deployment risk (e.g. capital being deployed in several instalments during construction period rather than upfront for brownfield investments).

Operational risks

Trade cancellation risk: trades and settlements are made on a bilateral, negotiated basis. A last-minute trade cancellation can occur in the absence of standard trade and settlement processes via clearing houses.

Service provider risk: investments can be at risk due to operational and administrative errors, or the bankruptcy of service providers.

Please check the relevant offering documents for a full list of risk factors.

Source: Schroders, July 2021.

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