Prestige Funds

RECENT MARKET VOLATILITY AND COVID-19

SITUATION - ANALYSIS AND OBSERVATIONS

We continue to monitor this situation closely. This is clearly very serious and, in many ways, it is unprecedented, but it has also generated an extraordinary global response both from a fiscal and a science / research perspective.

However, our current position remains that much of this is relatively short-term creating current disruptions to normal business operations. As we have recently seen in China, many businesses, both in manufacturing and services, have now resumed operations with some publicly announcing that they will be fully operational before the end of April. The faster the infection curve can be flattened; the faster normal life can resume. Almost everyone, everywhere, now properly understands this.

In the short-term, new lending approvals have essentially been suspended until after the Easter break. There is, however, still some engagement with new SME finance inquiries, but the ones currently being targeted are businesses deemed to be essential by the UK Government. Specifically, food and alcohol related businesses are considered essential and they usually have good turnover and require funding for stock as they are filling the gap that the big supermarkets etc. are unable to fill. A further review will take place after Easter and, where possible, we are increasing our cash balances and provisioning in these areas.

Operationally, our lending criteria in both our agri-finance and SME finance businesses has evolved considerably since the 2016 Brexit vote which has resulted in lending to fewer sectors and customers in areas that we do not like and / or understand. Since then and more recently our restricted sector list has significantly expanded. Much of our SME underwriting has evolved in terms of the number of metrics and variables used to make a credit decision and typical loan security is stronger today than four years ago. Most of our lending involves a ‘personal guarantee’ from the owners / controllers of the underlying business. There is also a significantly greater use of technology in both the origination / underwriting process and the ‘in life management’ of a loan / customer. Given the volume of loan enquiries we now source directly and indirectly, we are amassing a great deal of ongoing cloud-based data around companies, sectors and trends.

Our SME finance business now operates several managed accounts for UK based banking groups, and this clearly demonstrates how our business has evolved in terms of size and capability.

We continue to expect all our clients to service their debts and an essential operational part of this is the collections team and process that we currently have in place. Over the past year, our SME lending business has expanded and improved its collections process with several additional team members joining and a significant investment in technology. They are proactive (and incentivised) in advising underlying clients prior interest payment due dates with various forms of communications (text / email / phone) and by having a more direct dialogue with clients and engaging in these specific processes. For example, average individual loan arrears have reduced over the past two years.

Additionally, both of our main credit funds have seen modest reductions in overall investment / loan portfolio duration while portfolio diversification has increased. The key to good portfolio management in times such as these is not to predict, but to prepare for the unexpected. This approach involves holding diversified portfolios of quality assets and maintaining strong relationships with borrowers as well as a strong team and process.

Unlevered or lowly levered funds / portfolios appear more conservative during 'risk on' environments - but they add much-needed defensive characteristics during downturns such as the one we are experiencing now.

MACRO OVERVIEW

The human cost of COVID-19 is likely to rise for some time, along with its impact on economies and financial markets as nations enact measures to contain its spread. Two questions are key to understanding the longer-term economic consequences:

1. How long will major disruption last; and
2. How effective will governments' and central bank policy responses be?

In the first instance, the primary policy concern is to manage the spread of the virus. The UK Government, like some others in Europe, has now restricted movement to slow and ultimately stop infections and higher mortality rates. Governments in the UK and Europe have also announced fiscal measures totalling hundreds of billions of euros to help businesses through the COVID-19 shock. Ultimately a vaccine will likely be developed. Given the unprecedented level of international cooperation and focus on this, it would not be surprising if something were created in a far shorter time scale than current estimates suggest.

According to Bloomberg, the UK is facing the crisis from a stronger fiscal position than some other major European countries. At 2% of gross domestic product, the budget deficit is only slightly lower than those in Italy, Spain and France. But at about 85% of GDP, the UK has built up far less debt.

SOURCE: Bloomberg

SME - SECTORS

As outlined previously, non-discretionary retailers such as grocers, pharmacies and food delivery may be less affected by the drop in demand. Sectors that rely on tourism including hotels, restaurants and leisure operators, are likely to be in an increasingly challenging position in the short-term. Businesses with healthy balance sheets and low leverage will be more resilient. In addition, those businesses that play an integral role in the functioning of society and the broader economy may be more likely to receive government support.

A larger percentage of the population will become dependent on e-commerce. The UK has one of the largest tech industries in Europe and some of the most integrated logistics and e-commerce sectors. In the short-term, however, the logistics sector and some additional sectors may be impacted by disruptions to global supply chains.

INFRASTRUCTURE

Infrastructure investments are generally long-term in nature and designed to withstand economic downturns. Government-backed, long-dated cashflows will be beneficial in the current environment. Relative to other asset classes, social infrastructure investments such as renewable energy and waste-to-energy should be well positioned to weather the COVID-19 crisis.

Investors should take some comfort from the widespread expectation that extensive state financial support will be provided in certain core sectors, including infrastructure, and this sector is key to the continuity and recovery of the economy. Most infrastructure assets play an essential role in our society and will be vital in assisting the global economy to get back on its feet. Therefore, government policy in this area is likely to be supportive.

Most of the funding activity in both our agri-finance and SME finance credit funds are often focused directly and indirectly on infrastructure-related business sectors. Almost all our agri renewables projects are government backed.

ARTICLE OF INTEREST

Green Projects Could Pull Economies Out of the Coronavirus Slump

https://www.bloomberg.com/news/articles/2020-03-18/green-projects-could-pull-economies-out-of-the-coronavirus-slump

SOURCE: Prestige Capital Management / Aviva Investors / Bloomberg / BBC News

GOVERNMENT SUPPORT

It has been encouraging to see the UK Government moving swiftly to provide significant temporary support and targeted measures to small businesses and self-employed tradespeople through this period of disruption caused by COVID-19. It recently launched a dedicated Coronavirus Business Support Funding Package worth more than GBP 330 billion which includes:

- A Coronavirus Job Retention Scheme
- Deferring VAT and Income Tax payments
- A Statutory Sick Pay Relief Package for small and medium-sized enterprises (SMEs)
- A 12-month business rates holiday for all retail, hospitality, leisure and nursery businesses in England
- Small business grants funding of GBP 10,000 for all business in receipt of small business rate relief or rural rate relief
- Grant funding of GBP 25,000 for retail, hospitality and leisure businesses who own property with a rateable value of between GBP 15,000 and GBP 51,000
- The Coronavirus Business Interruption Loan Scheme offering loans of up to GBP 5 million for SMEs through the British Business Bank
- A new lending facility from the Bank of England to help support liquidity amongst larger firms, helping them bridge the disruption to their cash flows through loans
- The HMRC Time To Pay Scheme

SOURCE: UK Government / BBC News

Prestige Funds

From this month, businesses will be able to access UK Government funding in the form of loans and guarantees to help keep them operating.

Both of our dedicated, specialist Finance Arrangers (Nucleus and Privilege) are actively making businesses aware of what they are eligible to claim from the UK Government to assist them in the short-term.

For small and medium-sized businesses, the new Coronavirus Business Interruption Loan Scheme will help any viable business with a turnover of up to GBP 45 million to access government-backed finance of up to GBP 5 million. Interest payments and any lender-levied fees for businesses will be covered by the UK Government for an initial period of up to twelve months.

The UK Government will provide lenders with a guarantee of 80% on each facility to give lenders further confidence in continuing to provide finance to SMEs.

SOURCE: UK Government / BBC News

The UK Government - Chancellor of the Exchequer, Mr Rishi Sunak, said, "We are working round the clock to do whatever it takes to protect our people and businesses. That means that we are not only taking unprecedented action but doing so at unprecedented speed because we know that businesses and their employees need help now."

The UK Government - Business Secretary, Mr Alok Sharma, said: "We know that businesses are in urgent need of access to funding during these unprecedented times. The Business Interruption Scheme will make it easier for banks to lend and businesses to borrow. This will ensure that credit keeps flowing to where it is needed, when it is needed."

The Bank of England - Governor, Mr Andrew Bailey, added: "The Bank of England has taken a number of steps in recent weeks to support the UK economy through the economic shock caused by COVID-19. On Monday, a new lending scheme, the COVID Corporate Financing Facility, will open to help businesses manage through this period of uncertainty. Combined with steps taken by the Government, this will help companies through this difficult time and support the needs of the people of this country."

Additionally, during March, the Bank of England also cut its base interest rate from 0.75% p.a. down to 0.10% and announced a new bond buying programme of quantitative easing of up to GBP 200 billion.

Additional UK Government support for small businesses and homeowners was announced in the 11th March fiscal budget including five ways companies can get UK Government help to deal with Coronavirus.

Workers whose jobs are at risk will see up to 80% of their wages paid by the Government, potentially costing the Government at least GBP 10 billion. Companies will also get a GBP 30 billion tax holiday, with the Government suspending value-added tax (VAT) payments for a quarter. Renters and self-employed workers will also get assistance.

1. **Revenue's 'time to pay' tax suspension**

SMEs that cannot afford to pay their tax bills can ask HM Revenue and Customs for a "time to pay" agreement which would suspend debt collection. The system has been used to help businesses affected by significant flooding in the past as well as the 2008 Financial Crisis.

Each agreement is negotiated on an individual basis through a dedicated hotline. During the coronavirus outbreak, the usual 3.5% annual interest on deferred tax payments will be waived.

2. **Business rates relief for 900,000 properties**

The UK Government will not charge business rates (i.e. a property tax) on companies in the retail, leisure and hospitality sectors in 2020-2021. This includes hotels, restaurants and coffee shops. There is also a GBP 5,000 business rates discount for pubs with a rateable value below GBP 100,000 in England.

These measures mean that around 900,000 properties, or 45% of all business premises in England, will not pay business rates in 2020-2021. Local authorities, which collect business rates, will be provided with GBP 2.2 billion by the UK Government to make up for the shortfall.

3. **Grants for the smallest enterprises**

The 700,000 smallest businesses who are already exempt from paying rates will be eligible for GBP 3,000 grants to help meet their business costs. That is a three months' rent bill for a typical small shop, according to the UK Government.

4. **Risky loans underwritten by UK Government**

The UK Government is offering to underwrite loans to businesses adversely affected by the coronavirus outbreak. The Coronavirus Business Interruption Scheme will replace the Enterprise Finance Guarantee Scheme (EFG), under which the UK Government guarantees debt to encourage lenders to give loans to companies that would otherwise be deemed too risky. Interest rates will be similar to existing bank lending.

The Scheme will be delivered by the British Business Bank (BBB), a state-owned wholesale bank that currently operates the EFG. More than 40 lenders including the big four banks - Barclays, RBS, HSBC and Lloyds – will provide funds under the scheme as term loans, overdrafts, or asset-based lending secured on equipment or invoices. Under the coronavirus scheme, the BBB will provide lenders with a guarantee of 80% of each loan.

5. **Sick pay costs can be reclaimed**

SMEs will be able to reclaim the cost of 14 days of sick pay - just under GBP 200 - per employee. However, the UK Government has cautioned that they may have to wait months for reimbursement.

6. Mortgage Holidays for Homeowners

Mortgage Holidays of up to three months are being offered to borrowers, as an emergency measure announced by Chancellor of the Exchequer, Rishi Sunak, following the coronavirus pandemic hitting the UK.

UK mortgage lenders have agreed to offer three-month "mortgage payment holidays" in a bid to help ease the financial burden of borrowers affected by the coronavirus pandemic.

SOURCE: UK Government / BBC News / Bloomberg / Financial Times
NOTE: As at 26/03/2020 All figures are approximate and subject to change without notice.

PRIVATE DEBT

Since the 2008-2009 financial crisis, capital flows from institutional investors into private debt have reached record levels as many bank lenders retreated from the sector due to stricter regulations. Lower risk private debt is often considered a defensive asset class. Working closely with borrowers will help them to maintain debt repayments over the medium-term, protecting investments.

The current volatile public market environment is often why investors increasingly choose alternative investment strategies such as private debt.

Some alternative investments, such as real assets and private debt, have historically performed well in stressed situations relative to other asset classes. They also provide diversification benefits and income at a time when Government bond yields are likely to fall as investors seek safety. Nevertheless, in the short-term, pricing may come under some pressure in certain sectors, though opportunities may also emerge. Significant opportunities could arise in the aftermath of COVID-19 to fund real estate and infrastructure projects at attractive yields, with risk being well compensated. While further volatility in the short-term is expected, opportunities will no doubt arise. The diversification benefits associated with an allocation to these types of funds / assets will likely also play an integral role in weathering the storm.

With the medium-term future for the global economy unclear, it could be advantageous to own assets with an array of risk drivers. With the medium-term future for the global economy unclear, it will be advantageous to own assets with an array of risk drivers.

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