High Yield Impact Survey - 2022 Update

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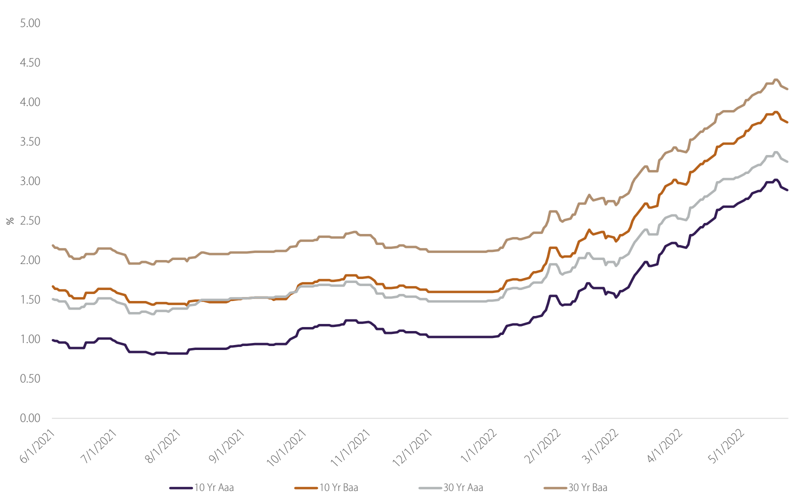
Given the dislocation in the market, over the last six months, Hilltop's Debt Capital Markets Team wanted to check in with municipal market participants including buy side analysts, sell side intermediaries, financial advisors, rating analysts, bond insurers, and counsel to share their insights and perspectives.

We all know that the volatility in 2022, has made it challenging to complete certain financings or deliver operating results that were forecast in 2021. So far in 2022, we have seen skilled nursing providers continue to face pressures of labor shortages and cost increases without significant revenue offsets thereby decreasing their financial margins and pressuring operations.

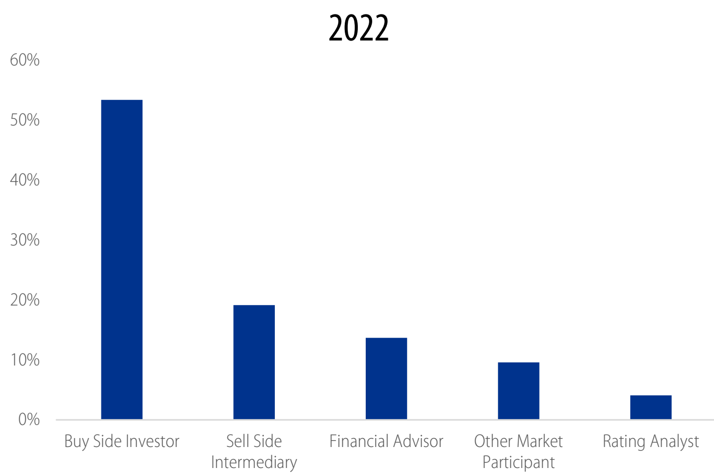
Our mid-year survey responders have signaled to us that they are less concerned about Covid–19 general disruptions. However, they are more concerned about labor shortages and cost increases that can challenge budgets. On the project finance front, responders are more than ever focused on liquidity and the type of equity brought to a project so there is sufficient liquidity to support an investment if the transition to commercial operations takes longer than projected. In this survey, we have also seen that investors are even more focused on location in the land secured sector given expected development challenges as development costs skyrocket. Perhaps the most interesting change between the 2022 and 2021 surveys is some responders are more willing to assign some value to the Green Bond Designation. We hope you enjoy the survey and encourage you to respond to us with any questions or comments.

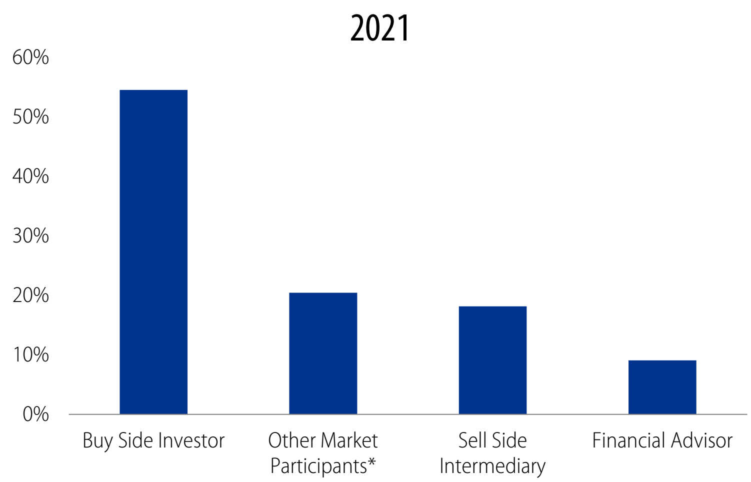


MMD, Last 12 Months

1. What is your role in the market?

The Hilltop DCM released the Survey in May to a diverse group of market participants including buy side investors, sell side intermediaries. In the 2021 Survey, 54% of our responders identified at Buy Side Investors and in this mid-year update 53.4% identified in this category. The largest difference in responders came from the "other category". In 2021, 17% responders identified as "other" where as in the midyear update 9.6% were categorized that way. Other incorporates, bond insurers, bond counsel, media, and market consultants.

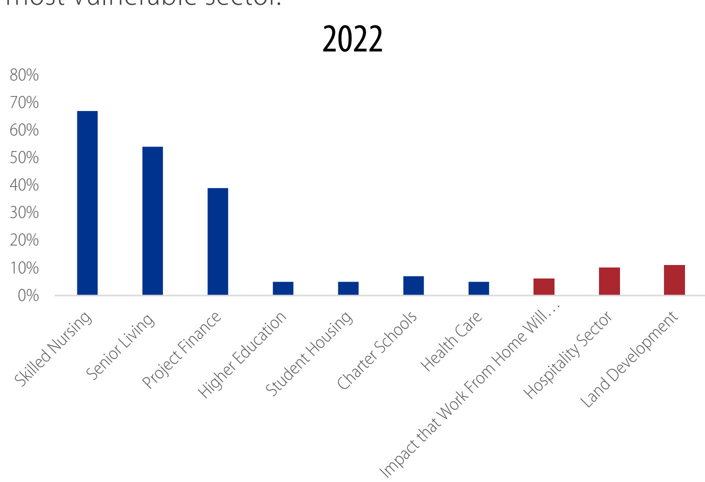


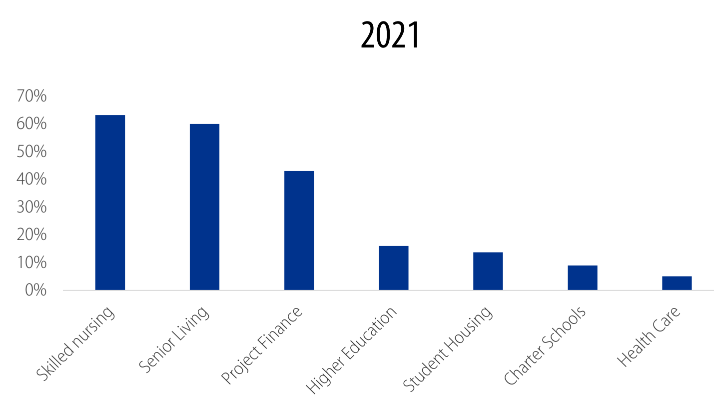


**Market particpants include: independent analysts, attorneys focused on High Yield projects and other market intelligence providers.*

2. What sector are you most concerned about in 2022? (Please rank)

In the Mid-Year update Skilled Nursing was named by 67% of responders in the 1st or 2nd category for concern and 54% of responders placed Senior Living, including Independent Living, Assisted Living and Memory Care in the 1st or 2nd category for concern. A strong third place finish is seen with Project Finance which accounts for almost 40% of responder's first and second choices. It is interesting to note that the level of concern in the SNF sector has increased between the surveys, while concern in the senior living sectors has decreased over the last 6 months. One factor, that can account for this trend is that we added three new choices to this question based on 2021 investor feedback. The additional options: Impact work from home, hospitality sector and land development would likely explain this difference as investors assigned some concern to these choices. Another interesting change is in the Student Housing space. In December, more than 13% of investors ranked student housing as most concerning. However, as colleges and universities have continued to operate, despite the pandemic, only 5% of responders find the sector most concerning. One really interesting comment to this question suggested that Land Secured should be broken into states. The responder states: California was not particularly concerning. However, this investor believes that Colorado Metro Districts are the single most vulnerable sector.

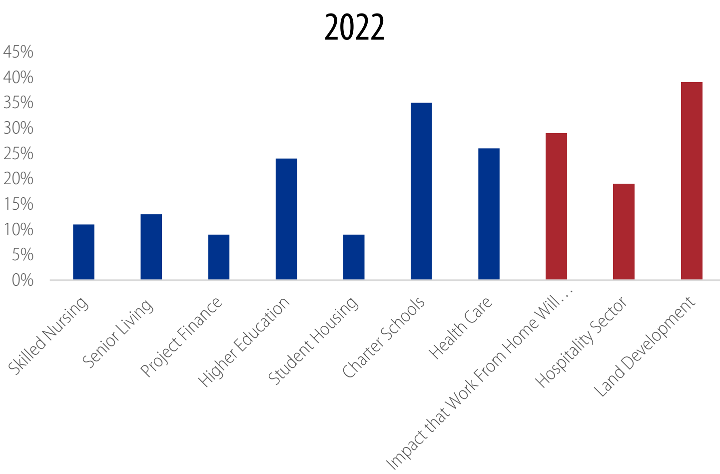


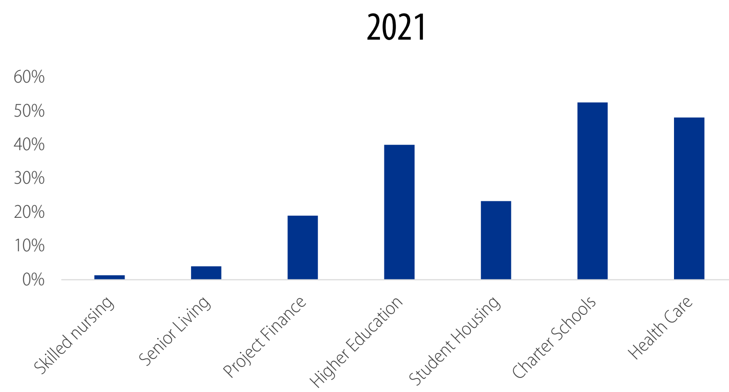


**Categories in red reflect new survey choices.*

3. What sector are you least concerned about in 2022?

This question was basically the inverse of the Q2. However, we asked it because we wanted to get a sense of the single least concerning sector from the responder's perspective. What is most interesting is that the findings are not identical to Q1. In 2022, they are definitively: Charter Schools, Impact from Work at Home and Land Development. Several responders commented that they would prefer that this type of double question not be included in the future.





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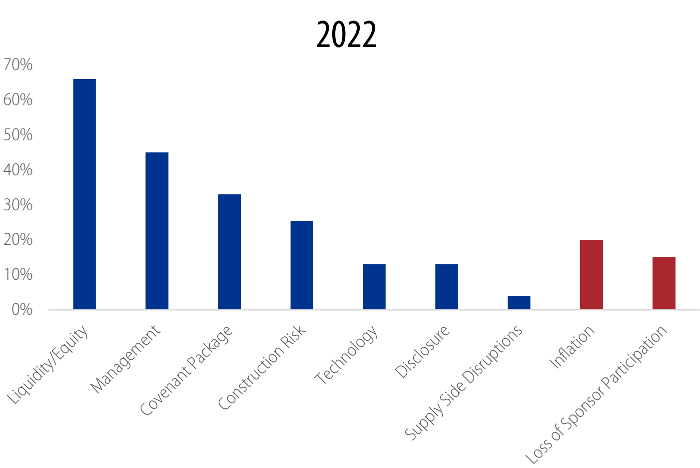
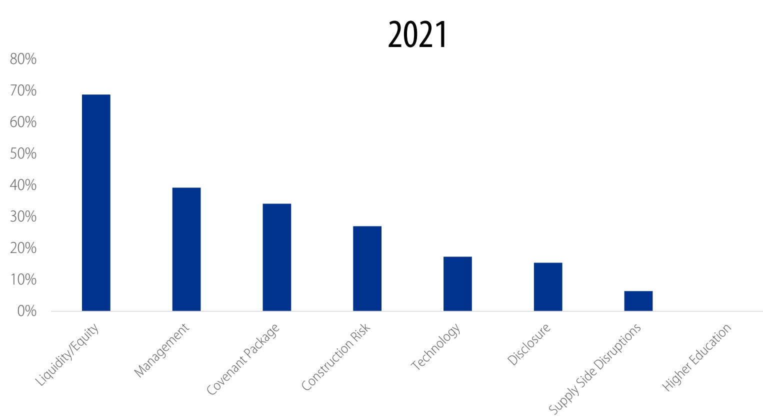
4. What concerns you the most on a High Yield Deal? (Please rank)

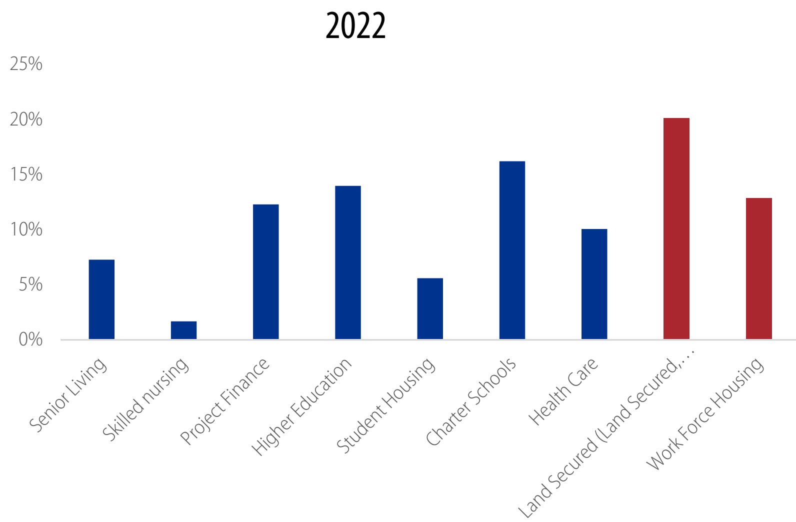
With respect to a HY deal, 66% of responders believe that liquidity and equity are the single most important areas of concern with management listed by 42% of responders as the next are of focus. These responses track very closely to the 2021 responses. There were a few interesting responses to share: "Many of these risks, I wanted to rank as most concerning. How do you distinguish between, management, construction risk, liquidity, technology, and supply side disruptions?" and "labor costs is an important one".

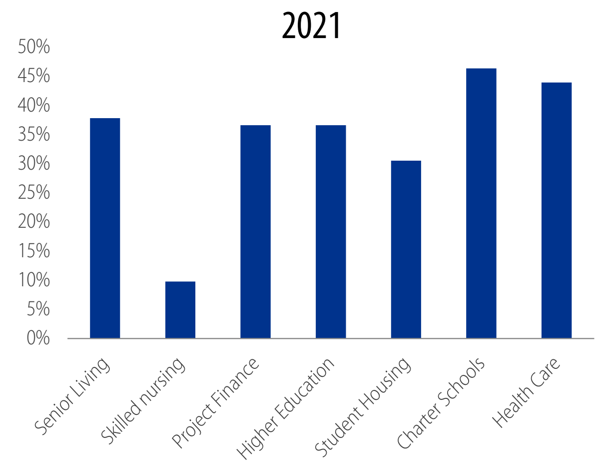




5. Which High Yield sectors are you looking to add exposure? (Choose up to 3)

The four top choices in which responders signaled interest in adding exposure are land secured, charter schools, higher education, and work force housing. This is interesting when compared to the 2021 results in which Charter Schools and Health Care were the first and second choices. Of note, the land secured sector and work force housing was added to the this question based on feedback from the 2021 survey.

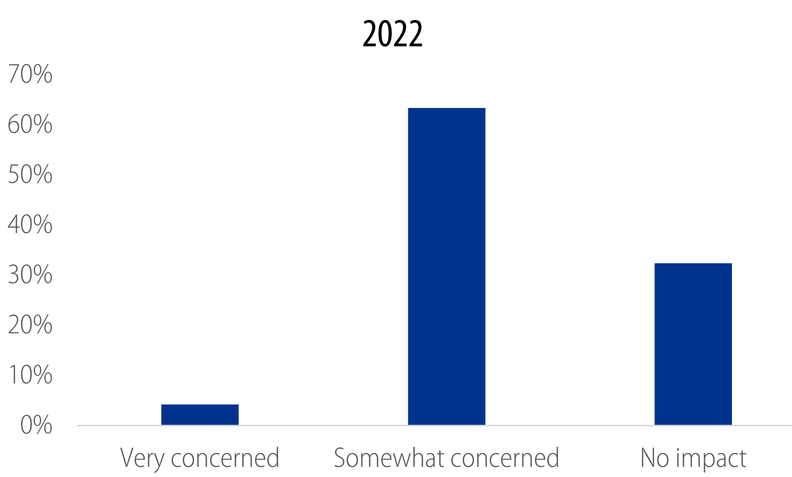


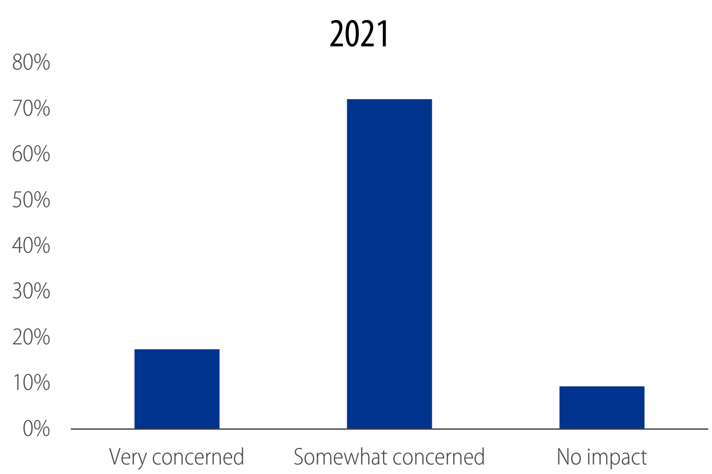


**Categories in red reflect new survey choices.*

6. How concerned are you that COVID-19 will disrupt operations at the project level in 2022?

Similar to 2021, almost two thirds of responders were somewhat concerned that covid would disrupt operations. However, more than 30% of 2022 survey responders believe that covid will have no impact. This is up from 14% in 2021 as domestically we continue to operate despite the covid environment. Two responders state: "Less Covid than supply chain and inflation issues" and "Secondary supply chain constraints will likely slow down construction for many projects - windows, for instance continue to be backordered 6 months".

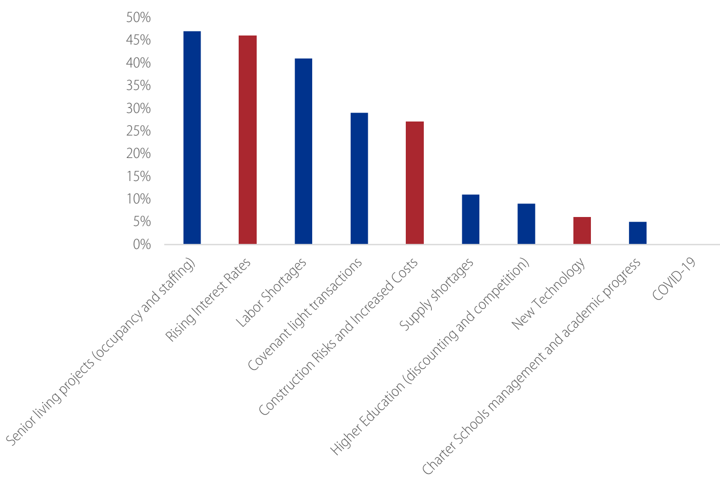




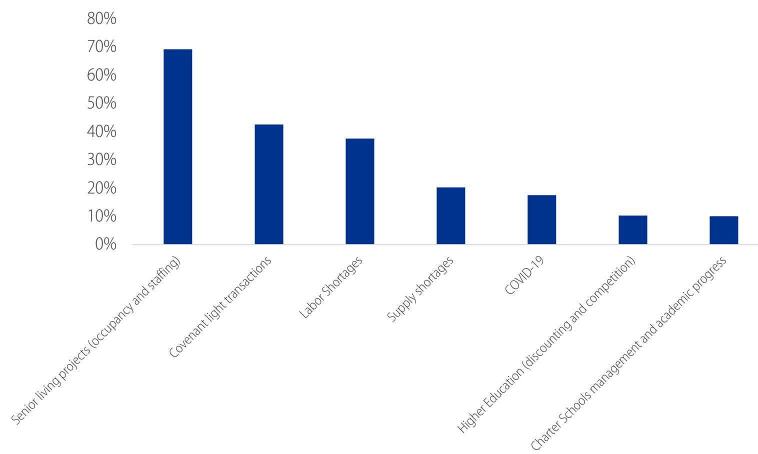
7. In your opinion, what is the biggest High Yield sector challenge to watch out for in 2022? (Please rank)

The two biggest High Yield challenges to watch out for the rest of 2022 are senior living vulnerabilities including occupancy and staffing and rising interest rates. To compare, Senior living was the largest challenge by far identified in the 2021 survey. Responder comments include: "I am focused on factors that will disrupt budgets and operating margins". "Covenant packages, while important will only provide some extra runway. They will not ultimately fix a deal". Another response worth noting is that one investor highlighted the impact from introduced Federal legislation on Charter schools is a concern.

2022



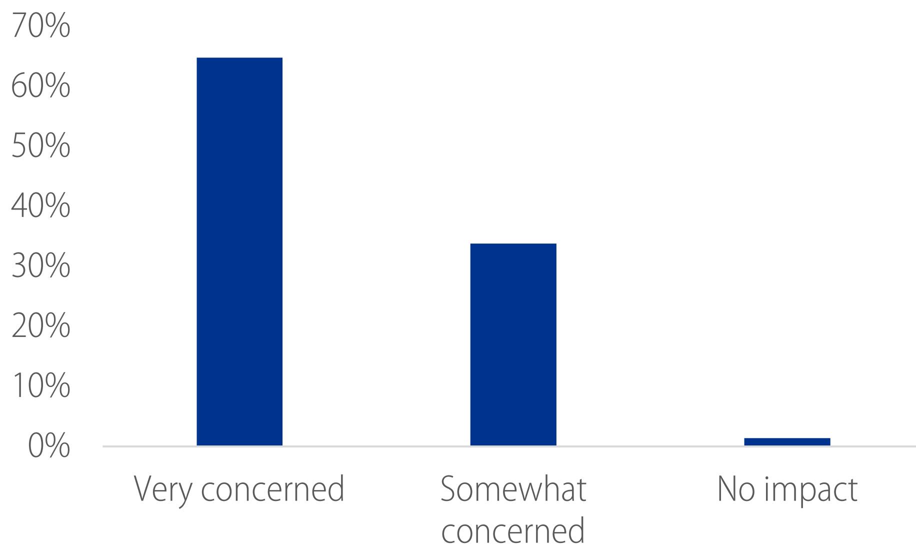
2021



**Categories in red reflect new survey choices.*

8. How concerned are you that labor shortages will affect cost containment, budgets, and operating margins for projects in 2022?

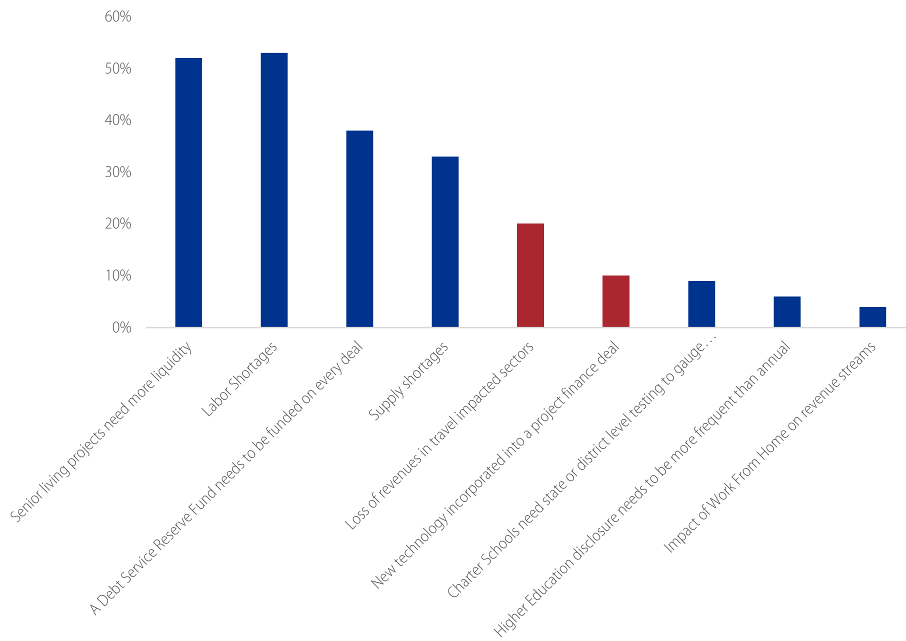
Almost two-thirds of responders are very concerned that labor shortages will affect cost containment, budgets, and operating margins and 34% are somewhat concerned. The magnitude of the concerns vary depending on responder perspective: "Believe federal relief offers some near-term cushion, more concerned about going into 2023/ longer term financial impact". Another responder stated: "can't build without the labor"; Yet another mentioned: "Hard to contain inflationary impact as well as service quality" and finally another states: "Difficult to retain teachers given the pressures they are under professionally and personally.



9. With the benefit of 4 months into 2022, in your opinion, what was the biggest High Yield Sector Challenge in 2021?

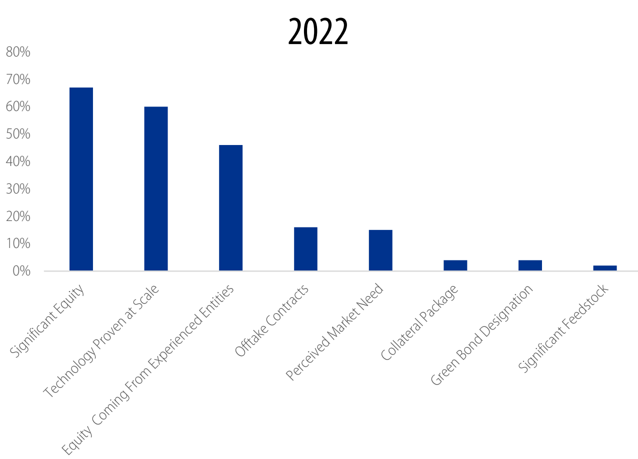
Senior living, the need for a DSRF, and labor shortages are identified as the high yield challenges. This is similar to factors that were identified in 2021.

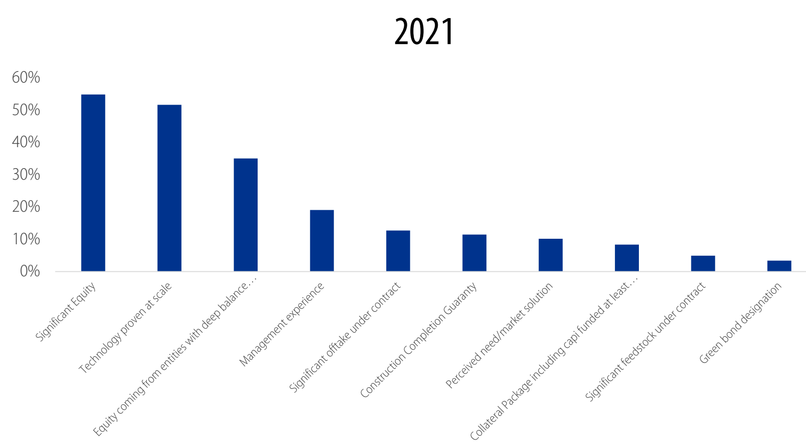
**Categories in red reflect new survey choices.*



10. What drives your assessment of a renewable energy bond?

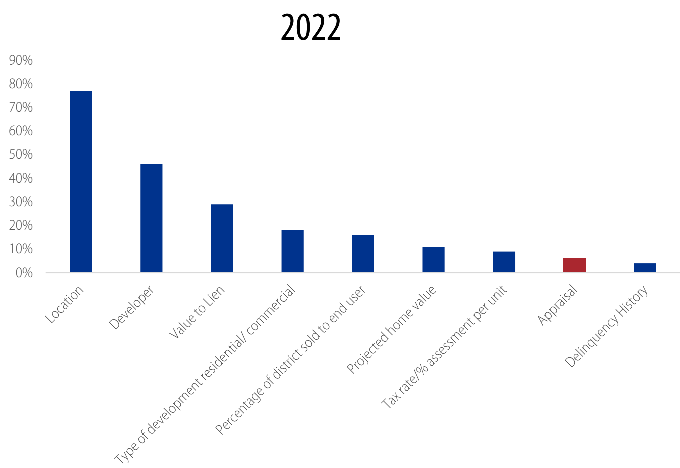
Over 66% of responders placed the need for significant equity as the biggest driver governing the decision to participate in a renewable energy bonds. The second largest response came from more than 60% of responders looking for technology proven at scale. Another 46% of investors want to see equity coming from experienced entities. One responder states: "lots of smart equity covers alot of issues" and another writes: "These are among the worst of the worst credits, just never seem to work". Given these thoughts, it is not a surprise that equity, the type of equity, technology proven at scale and off take contracts are some of the most important concepts that responders evaluate in their assessment of a HY credit..

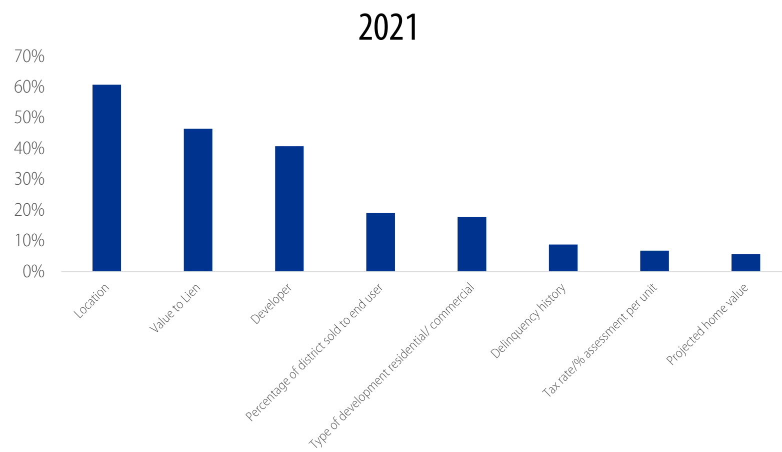




11. What drives your decision on development projects?

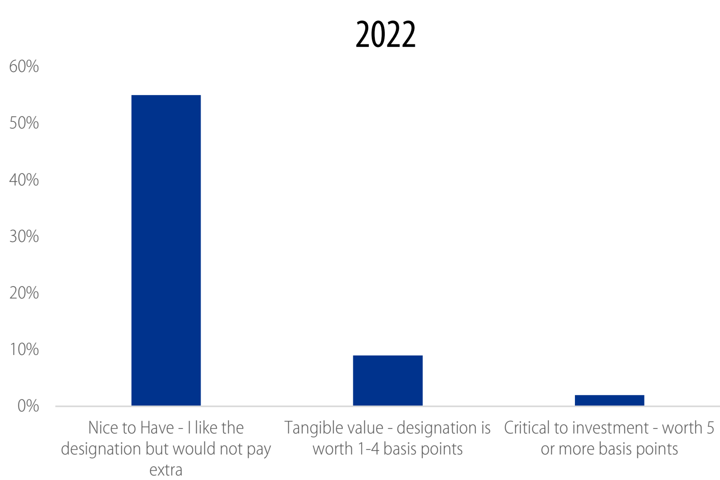
When assessing a land secured deal, location remained the most critical input and increased to 75% of responders from 60% in importance between the 2022 and 2021 surveys. This may be a reflection of a slowing residential and commercial market and skyrocketing development costs which may be mitigated in particularly well-located projects. The importance of the developer also increased between surveys and the importance of value to lien actually decreased. One responder writes: “Important to look at overall development plan, not just a specific phase under construction. In-fill projects better than outlaying locations”. Another responder commented: “closer to Pacific Ocean, the better”

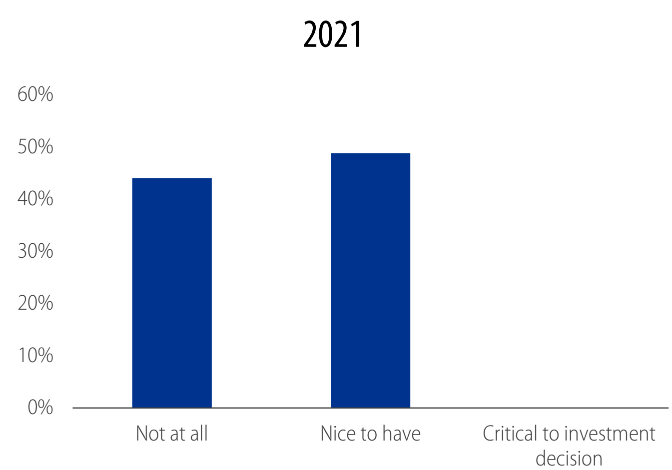




12. How important is the green bond designation to your investment in a High Yield credit? (Choose One)

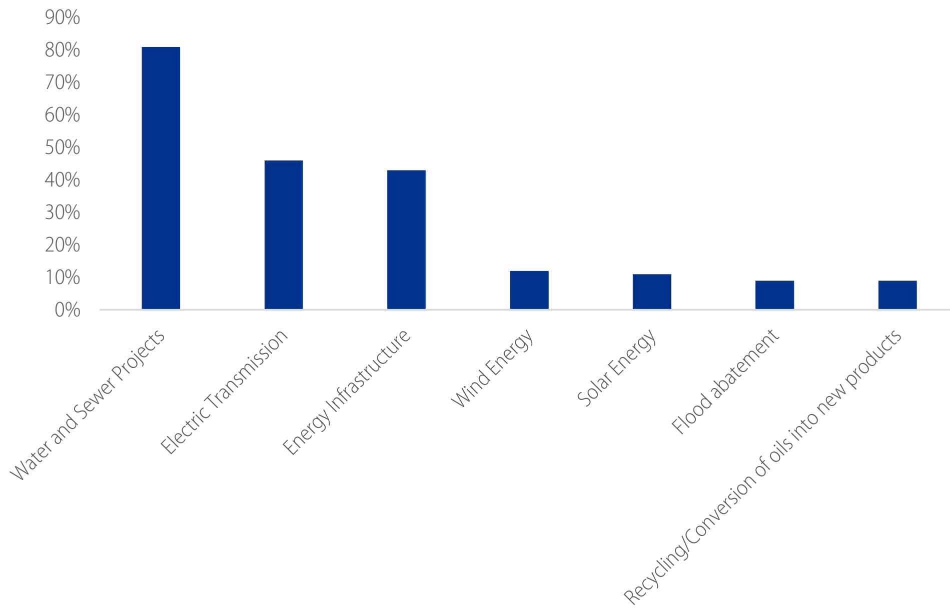
This is a question that showed movement between surveys. In 2022, almost 60% responded that the designation is nice to have, 10% responded that the designation has a tangible value of 1-4 basis points and 2% said the designation is critical and worth 1-5 basis points. To compare, in the 2021 survey, 45% of responders stated that they do not consider the Green bond designation in their decisions, 45% said it is nice to have, and no respondent reported that it was critical to their investment decision. As we reflect upon this change in sentiment, the cause could be attributed to the proliferation of bonds with an ESG designation or the widening of spread that we have seen over the last six months which has allowed for better investor economics.





13. Which High Yield projects in the utility/power sector would you most likely choose to invest in? (Please Rank)

80% of responders would most likely invest in water and sewer projects. Essential purpose water and sewer bonds have been historically straight forward to analyze and have benefitted from a history of timely debt service payments. To compare, responders would be least likely to participate in recycling and conversion of oils into new products. This response matches investor sentiment and comments made on project finance related questions especially when technology or market need is not proven.



14. Regarding Land Secured/Development transactions, which States are you most interested in future investment? (Please Rank)

Texas, Colorado and California are states that responders identified as being most interested for future investment. One responder commented: Wealth migration patterns and climate important in assessing development". This issue is particularly important as the country continues to experience demographic waves into states like Florida, Texas, Arizona, Nevada, Idaho and Utah and out of states like New York, California and Illinois which will have broad implication for housing and other revenue and development credits. Another investor responded: Missing Nevada, would be #2 if included.