

How impact credit's financial and sustainability aims go hand in hand

From the Field
March 2024

Key Insights

- Fundamental research geared to delivering attractive investment returns must carry equal weight to an impact thesis.
- Sectors where the impact angle is naturally stronger are often those at the forefront of needed sustainable economic or social change, enhancing their long-term financial prospects.
- Renewable energy utilities, real estate, and not-for-profit health care are three sectors that feature businesses with appealing return potential and compelling positive impact characteristics.

Much of the attention on impact investing naturally, and understandably, zeroes in on major headline issues such as climate change or social inclusion. It is important, however, not to lose sight of the fact that generating attractive investment outcomes is every bit as important to the overall investment case.

Impact investing has a dual mandate. Investment decisions for securities are based on their potential to support a measurable positive environmental or social change and, in equal measure, identifying the prospect of returns (through the traditional fundamental analysis of factors—competitive advantage, balance sheet, cash flow generation, profit margin, and management quality).

A commonly held perception that impact and broader environmental, social, and governance-themed investing restrict the opportunity set is false. While positive impact screening can throw up some sector biases, the impact universe embodies ample scope to add value through active company and bond selection. It also encompasses opportunities in idiosyncratic segments such as emerging market bonds, which are generally more complex but have attractive return potential and are integral in impact investing.

Sectors where the impact angle is naturally stronger are often those at the forefront of needed sustainable economic or social change, making them well positioned from a long-term business and secular perspective.



Matt Lawton, CFA
Portfolio Manager, Global Impact Credit Strategy



Ellen O'Doherty, CFA
Impact Analyst, Global Impact Credit Strategy

“...the impact universe embodies ample scope to add value through active company and bond selection.”

— Matt Lawton, CFA
Portfolio Manager,
Global Impact Credit Strategy

Key impact credit sector investment fundamentals



Renewable energy

- Sector more idiosyncratic amid large-scale investment cycle
- Demand growth driven by data centers and green technology

As of February 2024.
Source: T. Rowe Price.



Real estate

- “Contrarian” opportunities in sell-offs
- Positive trends: demand for data centers, warehousing, and logistics



Children's hospitals (not for profit)

- Strong balance sheets and financials
- Stable income from longer-maturity bonds

Renewable energy utilities, real estate, and not-for-profit health care are three sectors where we see numerous examples of businesses that offer a solid fundamental investment case and appealing return potential, alongside compelling positive impact characteristics.

Renewable energy

Financial returns from the power utility sector are typically predictable and consistent. This is an attractive attribute to credit investors. But the sector is in the midst of big transitions that will result in it becoming increasingly idiosyncratic.

The move from fossil fuels to renewable energy power generation means operational and execution risk will be a key differentiating factor in the coming years. While the impetus for the shift is addressing climate change, companies that are proactive and execute this well should benefit, as we have seen in the recent past.

Enhancing resilience and reliability of power grids will also be important,

with ever-growing demand, intensifying climate risks, more frequent wildfires, and the need for efficiency in a world of high-cost-of-living pressures.

The process will be capital intensive, at a time of higher interest rates and inflation, as well as supply chain vulnerabilities and volatile input costs.

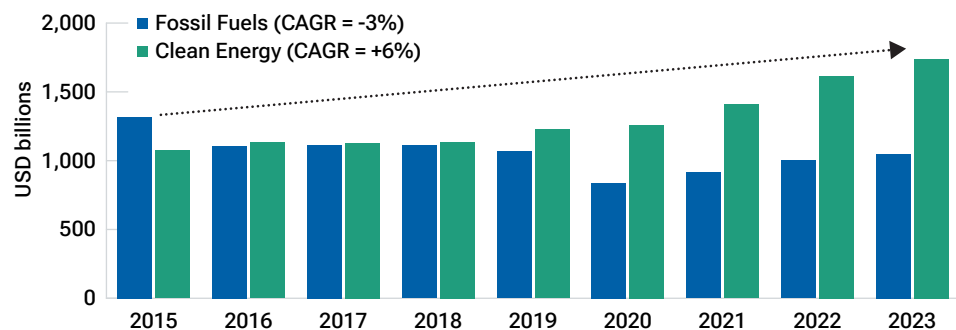
While there is government support, notably a sizable tax credit program under the 2022 U.S. Inflation Reduction Act,

undertaking this while maintaining creditworthiness will not be easy. Companies with strong management teams and a strong track record of operational execution and project completion look well placed.

At the same time, the sector has a notable opportunity to capitalize on long-term demand growth with the emergence of new customers, namely data centers, technology-related manufacturing, and vehicle electrification.

Balance of power shifting

(Fig. 1) Investment in clean energy versus fossil fuels



As of December 2023.
CAGR = compound annual growth rate. 2023 data forecast.
Source: International Energy Agency.

Real estate

Unlike utility companies, the real estate sector is more dependent on broader economic factors. This offers the opportunity to take a more contrarian approach and also to tap in to secular economic trends.

Given their sensitivity to economic factors, real estate corporate bonds can experience larger moves than the broader market. This can result in valuations falling too far. During the 2023 monetary tightening cycle, numerous real estate corporate bonds dropped to below par value (the price the issuer will pay for the bond at maturity).

Conversely, real estate assets should benefit during monetary easing phases. But navigating macroeconomic cycles with much accuracy is hard. Carefully selecting companies that can do well over the long term is more reliable, in our view. Solid financials are important, based on balance sheet health and liquidity, particularly factors such as the level of debt relative to the value of property assets, as well as the quality of management, assets, and tenants, and occupancy rates.

More excitingly, parts of the sector provide exposure to positive long-term trends. These include the growth in demand for data centers and warehouse space, driven by growth in online retail and logistics, as well as to cities where growing industries like life sciences and technology have clustered.

Not-for-profit health care

The impact case for not-for-profit children's hospitals and health centers is relatively straightforward—namely, providing health care to children and pediatric health care research. The more traditional

financial return perspective is less obvious. While these companies do not typically generate large financial returns, they rely on bond markets as a source of financing, in return offering steady, defensive income streams.

Following the coronavirus pandemic, hospitals are seeing increased patient volumes and easing in labor supply pressures and, therefore, costs, each of which are supportive of the financial performance of these institutions.

These organizations are often well managed, supported financially by state governments and wealthy philanthropic foundations. They tend to have strong balance sheets, holding significant cash balances that amply cover short-term debt liabilities, as well as operating expenses over periods of several months or even up to a year.

The sector typically issues bonds at longer maturities, which, when combined with decent coupon rates, can provide an overall all-weather, strong defensive element to a credit portfolio.

Researching fundamentals and impact potential in equal measure

Capital allocation is an effective and much needed way to drive positive environmental and social impact. But this needs to be done in the right way. Research and investment decisions must be based on sound fundamental analysis and the pursuit of attractive outcomes, partnering capital with a drive for positive change over time.

As these sector examples illustrate, there are ample opportunities in the market to ally impact objectives to sound, “traditional” investment objectives.

“

...investment decisions must be based on sound fundamental analysis and the pursuit of attractive outcomes, partnering capital with a drive for positive change....

– Ellen O’Doherty, CFA
Impact Analyst,
Global Impact Credit Strategy

INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

Additional Disclosure

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.

Important Information (cont.)

Australia—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

Colombia, Chile, Mexico, Peru, Uruguay—This material is prepared by T. Rowe Price International Ltd - Warwick Court, 5 Paternoster Square, London, EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority - and issued and distributed by locally authorized distributors only. For professional investors only.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

EEA—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors. Not for further distribution.

Mainland China—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

Malaysia—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), Warwick Court, 5 Paternoster Square, London EC4M 7DX, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, Warwick Court, 5 Paternoster Square, London EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2024 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.