



Birds-Eye View on Private Debt Markets

Q1 2023

Private Debt is an important and growing segment of financial markets for institutional investors. Prime Capital’s quarterly Birds-Eye View on Private Debt Markets aims to provide a concise assessment of market trends and pricings, which due to their private nature, are necessarily less transparent than public fixed income. We hope this publication will be helpful to investors in Private Debt.

We estimate current spreads based on the wide range of transactions we observe in our course of business. Due to heterogeneity of obligors, credit qualities, structural features, security packages, etc. a certain level of abstraction and significant degree of judgement is required to arrive at estimates, which, as such, reflect a good deal of expert opinion. It is also to reflect this heterogeneity that we report spread ranges rather than point estimates. In addition, we put current spreads in historical perspective, based on our past estimates, as well as provide projections of future spread developments. These projections, enriched by Prime Capital’s Private Debt Portfolio Management team’s qualitative assessments, provide the basis for our Tactical Portfolio Allocation, which is reported at the end of the document. The Market Trends section both reports significant events and serves as a basis for the qualitative assessment.

Pricing¹

	Current Spread	LTM ²	NTMe ³
Senior Infrastructure Debt	185 – 345 bps		
Junior Infrastructure Debt	410 – 765 bps		
Mortgage Debt	130 – 200 bps		
Senior Real Estate Debt	140 – 430 bps		
Whole Loan Real Estate Debt	250 – 500 bps		
Mezzanine Real Estate Debt	450 – 1,350 bps		
Senior Corporate Debt	400 – 450 bps		
Senior Government Risk Related Transport Debt	170 – 270 bps		
Senior Commercial Transport Debt	270 – 425 bps		
Mezzanine Transport Debt	500 – 760 bps		

Figure 1: Pricing of selected Private Debt asset classes
Source: Prime Capital Research

Strong increase in spread:

Strong decrease in spread:

¹ Pricing Methodology:

The assessment of asset class pricing of the last and next twelve months is represented by the traffic-light system and based on Prime Capital’s opinion and ranges from 0 to 5, where 0 indicates a strong decrease and 5 indicates a strong increase of spreads. A value of 3 indicates stable market spreads.

² Last twelve months

³ Next twelve months expectation

Market Trends

- The real estate debt market is still facing various stress factors, including global conflicts, rising costs, supply chain issues and, most importantly, rising interest rates. This feeds into transaction data for the German real estate investment sector with a 41% YoY decline to EUR 65bn. The decline was especially due to a comparatively weak Q4 volume dropping by 72%, driven by the generally lower volumes following the aforementioned reasons and the Q4 2021 one-off Deutsche Wohnen/Vonovia deal. Due to uncertainties around valuations, investors are more cautious until there is a clear path on future interest rates.
- With a market share of 33%, office properties remained the most important sector in the German real estate market in 2022 from an investor's perspective. The sector recorded an increase of 67 bps reaching a prime yield of 3.31% in Q4 2022, thus above 3% for the first time since Q2 2019. Older offices in B cities even yield more than 5% now, which has not been seen since 2018. Residential properties took the second spot with a share of 22%, after being the top sector with a 48% market share in 2021. This also shows the statistical distortion caused by the Deutsche Wohnen/Vonovia deal last year. The logistics sector managed to increase its market share to 15% and retail also increased its share to 14% especially due to the very resilient food anchored and specialty retail centers.
- Looking at the European real estate market, the investment volume in Q4 2022 was down 58% compared to the previous year, similar to the German market. For the whole year, volume has also declined though less severe by only 18%. However, the submarkets have developed heterogeneously, with Germany (-41%) and Sweden (-52%) leading the declines while other countries such as Belgium and Spain recorded very strong increases by 109% and 38%, respectively.
- Despite the various challenges affecting pricing and lending terms, the European real estate debt market remained liquid. According to CBRE, both lending margins and total cost of debt increased for the G7, Rest of West, Scandinavia and CEE groups regardless of sector throughout 2022, with cost of debt stabilizing on the higher level in Q4. Moreover, LTVs continuously fell to lower levels and more equity is required in financing structures, reflecting more risk averse investors trying to improve downside protection for a case in which the decline in property values does not stop.
- Global private infrastructure transactions have reached another record in 2022 with 3,369 deals and a total transaction volume of USD 1,071bn. However, this is mainly due to the first quarter of 2022, as transaction volume declined in the following three quarters. Compared to the same period last year, transaction volume in Q4 2022 decreased by 11%. Several geopolitical and macroeconomic stress factors negatively impacted project financing, particularly projects financed through the capital markets, which declined by 37% YoY. By sector, transport had the largest market share at 25% due to a 39% YoY volume increase driven by road and airport recovery investment after Covid. The renewables and the energy sector follow in terms of market share, each contributing 20%. Telecommunications benefited from the global demand for connectivity, also showing good growth (+20% YoY) and reaching a market share of 17%. Another strongly growing sector (+42% YoY) was social infrastructure, which increased its market share to 4%.
- After consistent growth for a long time, transaction value in Europe decreased by 3% in 2022 compared to 2021, while a 27% increase was reported for 2021 compared to 2020. Still, Europe is ahead of North America in terms of both value and number of deals, but the gap has been narrowing recently. While North America was 20% behind Europe in terms of deal value in 2021, the difference has shrunk to just 9% this year as North American volume increased by 10%. Although deal activity has declined slightly in the last quarters, the infrastructure sector continues to perform strongly and with the underlying drivers remaining intact, 2023 is expected to be another good year.
- In the aviation sector, the recovery continued with a 40% YoY increase in industry-wide revenue passenger-kilometers (RPKs) in December 2022, mainly driven by a strong increase in international RPKs of 80% YoY whereas domestic RPKs grew by only 3%. As a result, global air traffic reached 77% of pre-Covid levels. Different factors but mostly Chinese Covid restrictions up until recently still held back a stronger recovery with China remaining 56% below its December 2019 values. At the same time, other countries such as the US and Brazil are almost fully recovered, only 1% and 5%, respectively, below their pre-Covid levels.
- The outlook for the new year is uncertain with different drivers for both increasing and decreasing volumes: On the one hand, global air traffic faces different macroeconomic stress factors, including rising interest rates and energy costs, which could affect touristic travel demand through a loss of purchasing power and a possible economic downturn potentially lowering business travel if firms become more cautious on spending. On the other hand, the sudden end of Covid restrictions in China has the potential to start a strong recovery in the region, which could offset or even overcompensate the other factors.

Tactical Portfolio Allocation⁴

- We currently have a Tactical Portfolio Allocation model covering seven Private Debt asset classes with different seniorities.
- Infrastructure Junior continues its strong performance in 2023 with a total score of 3.6, especially due to a strong pipeline and expert opinion. However, all subordinated sectors score high this quarter, as the tool indicates the most attractive risk return profiles for those strategies in the current market environment. This leads to a shared first place between Infrastructure Junior, Real Estate Mezzanine and Transportation Mezzanine this quarter.
- The asset class with the lowest score is Corporate Direct Lending with a score of 3.1.
- Compared to the last months of 2022, the macroeconomic environment starts to improve again, with most categories scoring above the average of 3 again. Returns for taking risk are still declining, with the spread curve flattening, but still remain relatively steep in a historical context. Scores on liquid benchmarks improved across the board. While pricing for all asset classes remains attractive, overall credit risk declined.
- Both, Real Estate Senior and Mezzanine scores increased compared to Q4 2022. This change can be especially seen in scores for liquid benchmarks. While scores for expert opinion declines slightly for Real Estate Senior, they remains stable for the Mezzanine tranche.
- Infrastructure Senior and Junior strategies remain attractive, with all scores above the historic average. Expert opinion on pipeline slightly declines for Infrastructure Senior, however, overall the asset class is seen as a “save haven” investment, which makes it particularly attractive in a more volatile market environment.
- The scores for Transportation Debt, as well as Corporate Direct Lending overall increased compared to Q4 2022. This development is primarily influenced by the increase in liquid benchmark scores, similarly to Real Estate Debt.
- Overall, the investment environment for Private Debt, based on the asset classes covered in this assessment, became more attractive compared to the past months, with all sectors scoring above the historic average.

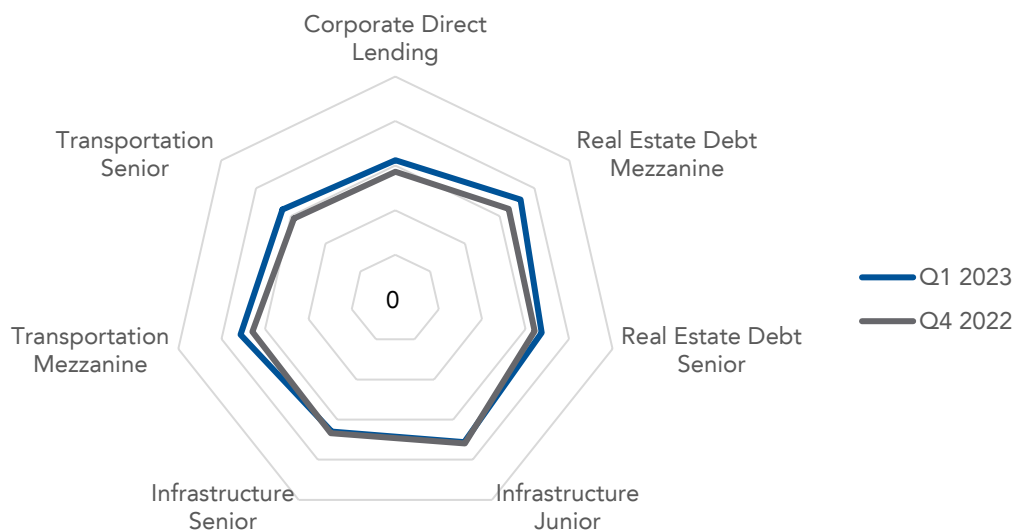


Figure 2: Assessment of selected Private Debt asset classes

Source: Prime Capital Research

⁴ Tactical Portfolio Allocation Methodology:

The asset class specific grades describe the asset class specific investment environment relative to historic observations.

Grades range from 0 to 5, where 0 indicates that the current investment environment compares to the worst observed historic outcomes and a value of 5 indicates a historically attractive investment environment. A value of 3 indicates historic medians.

Grades are derived from 5 sub-categories:

Macroeconomic survey data, financial market variables, liquid benchmark proxies, pipeline and expert opinion.

Each sub-category is comprised of several variables. For each variable we define a grade based on the comparison of current realization versus percentiles of historic distribution of this variable. E.g. the PCAG illiquidity premium in February 2022 amounts to 112bps, above the historic average of the last ten years, and is associated with grade 3.7. To obtain grades associated with the 5 sub-categories, we take the average across all individual variable grades associated with the respective category. The final grade is the average of the 5 sub-categories.

About Prime Capital's Private Debt Team

Prime Capital's Private Debt Team manages in excess of EUR 2bn across asset classes for institutional investors. The Team invests in Infrastructure Debt, Real Estate Debt, Transport Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our predominantly institutional investors.

Further information about Prime Capital AG can be found at www.primecapital-ag.com

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Prime Capital Private Debt Expertise

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- > Managed accounts and funds with investment expertise in various jurisdictions and markets
- > Unique "multi-channel sourcing" with access to transactions via direct lending, bank and advisor sourcing on the basis of longstanding relationships to market leading sponsors, equity funds and banks
- > Independent Risk Management function to improve sustainable investor yield
- > Investments in Senior and Junior/ Mezzanine debt, global as well as local investment strategies
- > Holistic integration of ESG risks in the investment process
- > Specific ESG related strategies

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