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Birds-Eye View on Private Debt Markets

Q3 2022

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.

Pricing[1]

	Current Spread	LTM[2]	NTMe[3]
Senior Infrastructure Debt	180 – 360 bps	●●●○○	●●●●○
Junior Infrastructure Debt	425 – 775 bps	●●●●○	●●●●○
Mortgage Debt	100 – 200 bps	●●●○○	●●●○○
Senior Real Estate Debt	130 – 380 bps	●●●●○	●●●○○
Whole Loan Real Estate Debt	500 – 750 bps	●●●●○	●●●○○
Mezzanine Real Estate Debt	700 – 1,600 bps	●●●●○	●●●○○
Senior Corporate Debt	300 – 450 bps	●●●●○	●●●○○
Senior Government Risk Related Transport Debt	150 – 250 bps	●●○○○	●●○○○
Senior Commercial Transport Debt	250 – 375 bps	●●●●○	●●●○○
Mezzanine Transport Debt	500 – 750 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 Capitals 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

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Market Trends

- As a result of inflation and rising interest rates, the market for real estate financing has changed. Banks further reduced their new lending exposures and focus on existing lending relationships with reduced new business activities. This leads to a spill-over effect in a way that former bankable assets are now financed by alternative lending vehicles, leading to higher asset qualities in the deal pipelines. At the same time, rising interest levels also lead to a tighter credit structuring with higher equity requirements.
- Financing conditions changed in the second quarter. Average IRRs increased for both whole loan financings and mezzanine financings. At the same time, average LTVs or LTCs fell to lower levels. This is the result of rising interest rates and increased risk awareness among banks as they continue to further retrench from the market.
- Due to the more volatile market situation, the transaction momentum on the German real estate investment market has slowed down significantly, resulting in the second quarter of 2022 achieving approximately half of the volume of the first quarter. However, the first half of 2022 still recorded a transaction volume 5% higher than the first half of the previous year. The tighter market situation is also reflected in the prime yields of certain sectors in Germany's top 7 cities. The office market shows an increase of 10 basis points amounting to a prime yield of 2.72%. The logistics market also recorded a significant increase of 15 basis points to a total prime yield of 3.11%. In addition, the residential market recorded a prime yield of 2.30%.
- In the European real estate market, the transaction volume decreased slightly in the second quarter of 2022. On the other hand, due to the very strong first quarter of 2022, the first half of 2022 is the strongest first half of any year ever. In the second quarter, Belgium (+134%) and Ireland (+47%) in particular recorded record high Q2 volumes. Other core markets such as Italy (+54%), Spain (+44%), the Netherlands (+37%), Denmark (+33%), and France (+24%) also recorded higher transaction volumes during Q2 2022.
- Global private infrastructure transactions reached a record level in the first half of 2022 with 1,452 transactions and a total transaction volume of USD 464bn, even though activity slowed down in the second quarter of the year. Transaction volumes declined by 11% in Q2 2022 compared to Q2 2021, and the number of transactions fell by 8%. In addition, refinancing activity slowed down in Q2 2022, possibly as a result of uncertainty due to high inflation and interest rates. On the other hand, the energy sector in particular is benefiting from the current situation with a continuing trend towards privately financed transactions due to the energy transition. They only sector surpassing the energy sector in terms of global transaction volume is the transport sector. According to Inframation, the sector reported 120 transactions with a total transaction volume of USD 58 bn in the second quarter of 2022.
- According to Inframation, North America outperformed Europe in Q2 2022 in terms of volume with a total transaction volume of USD 83bn compared to USD 67bn. This is the result of the sharp decline since Q4 2021, when transaction volumes in Europe reached USD 173bn. However, the long-term trend remains clear: transaction volumes are rising. Compared to the second quarters of 2019 and 2020, European transaction volumes in Q2 2022 increased by 31% and 5%, respectively. Furthermore, Europe remained at the forefront in terms of number of transactions with 325 transactions compared to 173 transactions in North America in Q2 2022.
- Global air traffic continued to recover in June 2022 with revenue passenger kilometers (RPKs) up 76% (YoY), both in and domestic RPKs (YoY: +5%) but particularly in international RPKs (YoY: +230%). As a result, domestic air traffic is now at 81% of pre-Covid levels. Overall, the market recovery has continued despite economic uncertainties such as the war in the Ukraine and the Covid restrictions. In addition, the reopening of the Asia-Pacific market will provide further recovery potential.
- Rising interest rates to combat persistently high inflation, staff shortages, and rising energy costs will work against the expected recovery in air travel. According to IATA, cost pressure will be the focus for airlines and future Covid outbreaks in winter could also have a decisive impact, depending on future Covid response policies. On the other hand, there is a great willingness to travel, supported by the current loosening of travel restrictions.

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Tactical Portfolio Allocation[5]

- We currently have a Tactical Portfolio Allocation model covering seven Private Debt asset classes with different seniorities.
- Infrastructure Junior remains as the strongest asset class in Q3 2022 with an overall score of 3.5 mostly influenced by increased risk appetite. It is also the only asset class which remained on the same level compared to Q2. The asset class with the lowest score is Transportation Senior again with a score of 2.8, which is below the median.
- Although the macroeconomic environment is assessed with lower scores due to lower consumer confidence and weaker survey results, macroeconomic liquidity remains at a high level. Overall the macroeconomic environment reflects the tightening economic conditions.
- Overall, financial ratios are expected to improve in Q3 2022, in particular due to a significant increase in risk appetite. At the same time, the illiquidity premium fell to a historically low level, below the 1% percentile of the last 10 years. The drop could be caused by rising interest rates in combination with an imperfect interest rate pass-through from lender to borrower. This refers to the fact that lenders often do not pass on 100% of the rising interest rates, and the entire pass-through process is delayed.
- In the Real Estate Debt sector, the two asset classes Real Estate Senior and Real Estate Mezzanine received slightly lower scores in the third quarter of 2022. This development is mostly based on lower expectations on the transaction volume of the deal pipeline, and increased refinancing risk due to rising interest rates. However, asset quality remains high in the sector.
- The Transportation Mezzanine score slightly declined in the third quarter. However, the asset class still remains well above the median with an overall score of 3.4. Compared to other asset classes, Transportation Mezzanine is still among the top three asset classes, on par with Infrastructure Senior.
- In line with the overall development, the scoring of Corporate Direct Lending has declined. The score is now slightly below the median.

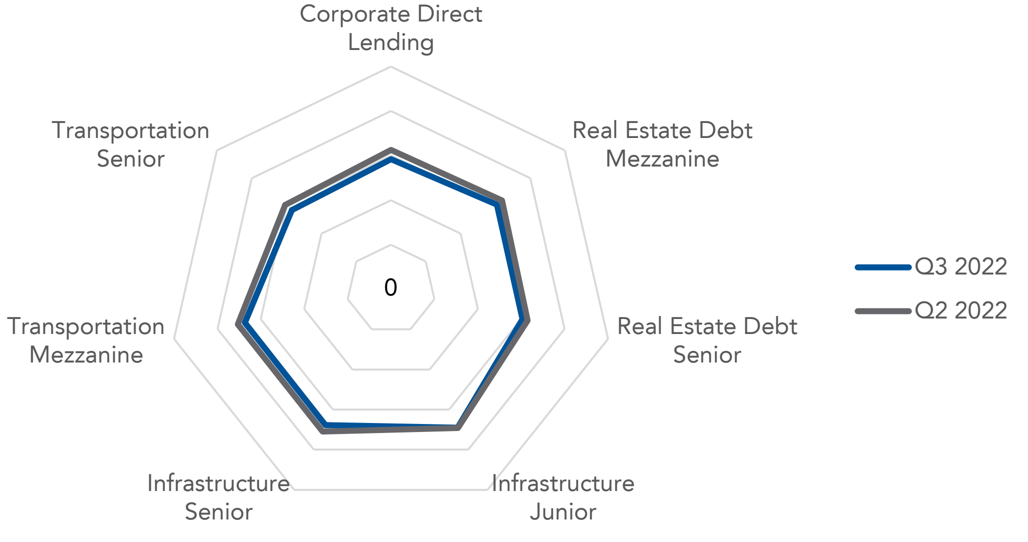

Figure 2: Assessment of selected Private Debt asset classes
Source: Prime Capital Research

[5] **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 June 2022 amounts to 73bps, in the lowest 1% percentile of the historic spread distribution of the last ten years, and is associated with grade 0. 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

Contact:

Stefan Futschik
Head of Private Debt, Managing Director

Prime Capital – Investment Management Private Debt

mailto: impd@primecapital-ag.com

Prime Capital Private Debt Expertise

> Investment and Portfolio Management, advice and support for direct investments, portfolio strategy and sector allocation

> 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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