



Birds-Eye View on Private Debt Markets

Q4 2021

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 Infra Debt	180 – 300 bps		
Junior Infra Debt	425 – 650 bps		
Mortgage Debt	110 – 140 bps		
Senior Real Estate Debt	160 – 280 bps		
Whole Loan Real Estate Debt	450 – 650 bps		
Mezzanine Real Estate Debt	650 – 1,500 bps		
Senior Corporate Debt	300 – 450 bps		
Senior Government Risk Related Transport Debt	200 – 300 bps		
Senior Commercial Transport Debt	275 – 400 bps		
Mezzanine Transport Debt	500 – 600 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

- While there was a large and deep cut in transactions during last year's summer low, 2021 had a very strong Q3 investment volume. This is supported by the comparison of the total transaction volume in Germany, with EUR 58.1bn in Q1-3 2020, whereas it amounted to EUR 60.8bn in Q1-3 2021. It is expected that there will be a total investment volume of up to EUR 100bn in 2021 considering the Vonovia / Deutsche Wohnen merger.
- ESG and digitalization have arrived in the present: While those areas were perceived as "topics of the future" for the past years, they are now increasingly becoming a key aspect investor's focus on. However, as of now by their very nature, they are rather tasks for the equity side.
- The continuously increasing shortage of skilled workers in the real estate industry, as well as the limited availability of construction materials on construction sites will potentially influence the construction activity and completion.
- The deal volume in the infrastructure market is back on track and surpassed the USD 500bn threshold in Q1-3 2021. With a deal volume of USD 513bn in total, Q1-3 2021 stands 4% higher than pre-pandemic levels of Q1-3 2019. Whilst sectors like Renewables and Telecommunication show stable to increasing activity especially in the European and North American markets, the Energy sector still stems against the trend of decarbonization in Emerging markets. With 27% of total market share, landmark deals in the Oil & Gas sector in the Middle East and Asia shape the market in 2021. Although overall transaction volume is higher compared to pre-Covid-19 levels in 2019, debt financing fell by 3%. Classical bank financing keeping their role as primary debt provider. Currently they still account for about 80% of total infrastructure debt volume.
- In Europe, value can still be found in telecommunication projects, with a significant share of 27% of the market being allocated towards this sector in Q1-3 2021. Apart from Telecoms, notable deals closed in the sectors Utilities (District Heating) and Transport. While telecom deals still offer attractive risk/return profiles for senior debt investors, other sectors experience further pressure on pricing. However, on the back of stable and regulated cash-flows in the sectors Transportation, Renewables and Utilities, an increasing interest for higher yielding HoldCo and Junior financings can be observed. In these highly regulated markets with quasi monopolistic market features, alternative structures offer added value compared to senior bank financings.
- The recovery in demand continued for both passenger and cargo markets in Q3 2021. That said, passenger volumes are pressured by continued travel restrictions, while air cargo drivers remained strong. Recovery remained mostly driven by domestic markets while recovery of international traffic remains unclear with new outbreaks and restrictions imposed, while coordinated moves to implement efficient testing methods at airports have not been put into effect yet. However, vaccinations and testing are expected to support global travel to 50%-60% of 2019 levels in 2021.
- There is increased activity in the mid-life market, while banks still remain cautious due to internal restrictions and risk budgets. The continuously limited supply for more complex structures still offers an attractive premium for investors.

Tactical Portfolio Allocation⁴

- Our Tactical Portfolio Allocation model currently covers seven Private Debt asset classes across different seniorities.
- In Q4 2021, the strongest asset class is Transportation (Mezzanine and Senior). The asset class with the lowest score is Real Estate Mezzanine.
- Compared to Q3 2021, macroeconomic data in Q4 generally displays a higher score again. Financial market indicators on the other hand show overall a lower score, mostly due to lower scorings of illiquidity premiums.
- Apart from Real Estate Debt, liquid spreads generally remained steady, whereas indicators for credit risk show a more diverse development, with decreased scores for Corporate Direct Lending and all Mezzanine asset classes, and increased scores for all Senior asset classes.

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 September 2021 amounts to 134bps, between the 35th and 65th percentile of the historic spread distribution, and is associated with grade 3. 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.

- While the overall score for Transportation Mezzanine remains stable in Q4, the score for Transportation Senior catches up, leading to a shared “first rank” within our observation. This is especially due to the rating for liquid benchmark, with an improved score for the Senior tranche, whereas it decreased for the Mezzanine tranche. Further, the improved expert opinion for the Mezzanine tranche supports the catch-up of the overall score.
- In Real Estate Debt the Senior score in Q4 surpasses the Mezzanine score, which remained steady compared to Q3. This is mostly due to liquid benchmark scores drifting further apart, in combination with a slightly enhanced expert opinion rating for the Senior tranche.
- Infrastructure Debt shows continuous improvements with similar developments in both, Senior and Mezzanine debt. Although we can observe slightly decreased financial market scores in both Infrastructure tranches, the remaining sub-categories remain on an equal or improved rating compared to Q3. The only exception can be seen in liquid benchmarks ratings, where the contrary development of both tranches increases the gap between the higher score for Infrastructure Senior and the lower score for Infrastructure Mezzanine.
- The score for Corporate Direct Lending still remains stable, with expert assessments continuously ranking above the historic average, which could indicate a market with interesting targets if you are selective.

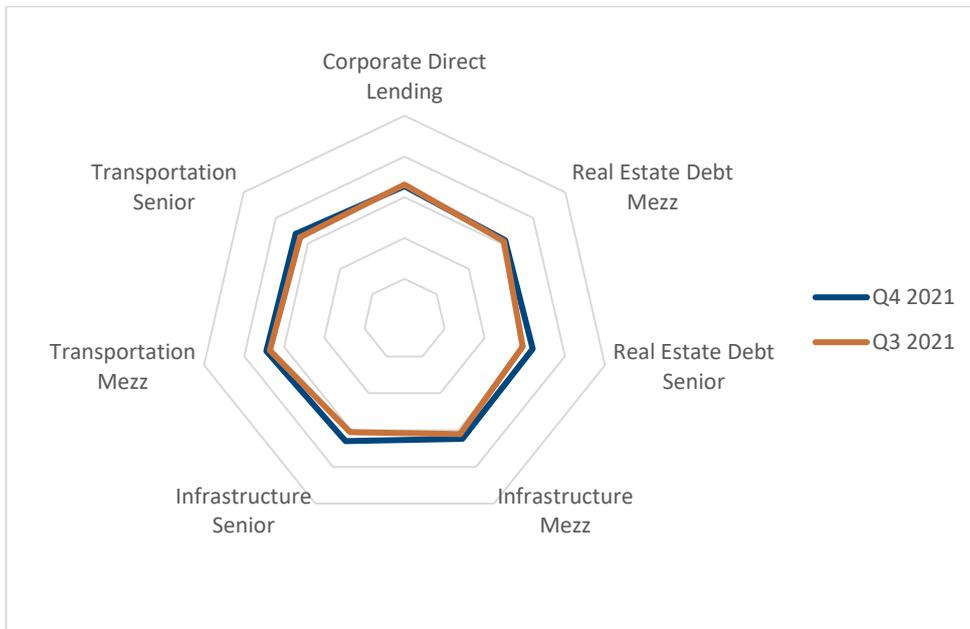


Figure 2: Assessment of selected Private Debt asset classes

Source: Prime Capital Research

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

- > 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 Mezzanine debt, global as well as local investment strategies
- > Specific ESG related strategies

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