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Birds-Eye View on Private Debt Markets

Q4 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	200 – 375 bps	●●●○○	●●●●○
Junior Infrastructure Debt	440 – 775 bps	●●●○○	●●●○○
Mortgage Debt	110 – 210 bps	●●●○○	●●●●○
Senior Real Estate Debt	130 – 420 bps	●●●●○	●●●○○
Whole Loan Real Estate Debt	525 – 775 bps	●●●●○	●●●○○
Mezzanine Real Estate Debt	725 – 1,600 bps	●●●●○	●●●○○
Senior Corporate Debt	325 – 470 bps	●●●○○	●●●○○
Senior Government Risk Related Transport Debt	170 – 270 bps	●●○○○	●●●○○
Senior Commercial Transport Debt	270 – 400 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

Market Trends

- The real estate debt market is currently facing various stress factors, including global conflicts, rising costs, supply chain issues and, most importantly, rising interest rates. Despite the challenging geopolitical market conditions, the German real estate investment sector remained active and achieved a satisfactory investment volume of EUR 53bn in the first nine months of 2022. Although this is a decrease of 13% YoY, the transaction volume improved compared to the previous quarter. As a result of the structural changes in the market, there is an opportunity for real estate private debt funds to invest in bankable projects, as banks focus on existing clients and put their own portfolio management at the centre of their activities. Due to uncertainties in the market, investors are more cautious and it remains to be seen how this will develop in the final quarter of the year.
- In the German real estate market, office properties remained the most important sector from an investor's perspective in the first three quarters of 2022, with a market share of 37%. In Q3 2022, this sector recorded an increase of 12 bps reaching a prime yield of 2.84%. This was followed by residential properties with a share of 23%, which used to be the largest sector in 2021 (48% market share). With a market share of 14%, the logistics sector reported a prime yield of 3.43% due to a significant increase of 32 bps compared to Q2 2022. Overall, yields for prime properties are still relatively stable but there has been a jump in yields for secondary properties, reflecting the more cautious attitude of investors.
- Looking at the European real estate market, the investment volume in Q3 2022 was down compared to the previous year, similar to the German market. Overall, however, a new record result was achieved in the first three quarters of 2022, which is attributable to the very strong first quarter. Nevertheless, due to factors such as rising borrowing costs affecting pricing, there will most likely not be a new record result at the end of this year.
- Despite various challenges affecting pricing and lending terms, the European real estate debt market remained liquid. According to CBRE, the total cost of debt regardless of sector increased for the G7, Rest of West, Scandinavia and CEE groups compared to Q2 2022, as did lending margins. Moreover, as in the previous quarter, LTVs continued to fall to lower levels and more equity is required in financing structures, reflecting more risk averse investors.
- Global private infrastructure transactions have reached another record level after Q3 2022 with 2,288 deals and a total transaction volume of USD 679bn. However, this is mainly due to the first quarter of 2022, as transaction volume declined in the second and third quarters. Compared to the same period last year, transaction volume in Q3 2022 decreased by 27% and the number of transactions by 12%. Several geopolitical and macroeconomic stress factors negatively impacted project financing, particularly projects financed through the capital markets, which declined by 42% YoY. By sector, energy had the largest market share at 23%, closely followed by the transport sector, which contributed 22% of the value. Telecommunications benefited from the global demand for connectivity, showing significant growth (+22% YoY) and reaching a market share of 19%. Another growing sector (+62% YoY) was social infrastructure, which increased its market share to 6%.
- In Europe and North America growth also slowed down significantly compared to previous years. Transaction value in the first nine months of 2022 increased by only 1% in Europe compared to the first three quarters 2021, while a 19% increase was reported for the first three quarters of 2021 compared to those in 2020, preceded by an increase of 9% in 2020. Europe is still ahead of North America in terms of both value and number of deals, but the gap is narrowing. In 2020 and 2021, North America was behind Europe in terms of deal value by 15% and 7%, respectively. This year, the difference has shrunk to just 2%. Although deal activity has slowed somewhat, the infrastructure sector is still performing strongly, but it remains to be seen whether it can match the all-time record year of 2021.
- In the aviation sector, the recovery continued with a 57% YoY increase in industry-wide revenue passenger-kilometers (RPKs) in September 2022, mainly driven by a strong increase in international RPKs of 122% YoY whereas domestic RPKs grew by 7% YoY. As a result, global air traffic reached 74% of pre-Covid levels. The recovery was held back by different factors, such as new restrictions in China, which led to a significant decline in domestic traffic (61% below September 2019 levels). However, other important markets such as the US (+0.4%) and Brazil (-4%) are roughly at the same levels as in 2019.
- Global air traffic faces different macroeconomic stress factors, including rising interest rates and energy costs, which could affect travel demand through a loss of purchasing power. Moreover, measures such as the restrictions in China show that Covid still has a significant impact on the market. Nevertheless, IATA reported that despite macroeconomic stress factors, advance bookings offer an optimistic outlook and the aviation industry continues its recovery momentum.

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Tactical Portfolio Allocation[4]

- We currently have a Tactical Portfolio Allocation model covering seven Private Debt asset classes with different seniorities.
- The model was adjusted compared to the previous quarter, by incorporating change in macro surveys to better capture the dynamics in the evolution of expectations. While order books are still at historic good levels, they declined significantly in recent months. The tool now incorporates this development. Further a new methodology to estimate the illiquidity premium was implemented to deal with an abruptly changing market environment better by extending the scope to credit risk based on the average term and an inflation premium.
- Infrastructure Junior secures its place at the top in Q4 2022 with an overall score of 3.6 mostly influenced by a continuous high risk appetite and expert opinion. The asset class with the lowest score is Transportation Senior and Corporate Direct Lending with a score of 2.9.
- Overall, the macroeconomic environment shows a continued decline across all major dimensions with scores below the historic average. Returns for taking risk declined, with spread curve flattening, while overall credit risk levels increased. Pipeline remains constant, apart from lower scores for Corporate Direct Lending. Expert opinion shows constant to slightly lower scores compared to Q3, but still remains above the historic average.
- Both, Real Estate Senior and Mezzanine score slightly lower compared to Q3 2022. This decline is due to the lower assessment of the macroeconomic environment. The pipeline scores still below the historic average, as it has to adjust to the changed market environment, but is expected to find its balance again in the following months.
- Infrastructure Senior and Junior scores remain among the highest scores, but the asset class also suffers from the worsening macroeconomic environment. Compared to other asset classes however, the pipeline scores above the historic average, supported by political, environmental and social factors.
- In line with the overall development, the scoring of Transportation Senior and Corporate Direct Lending has declined. The score is now slightly below the median. Transportation Mezz also shows lower scores, but remains above average for now.

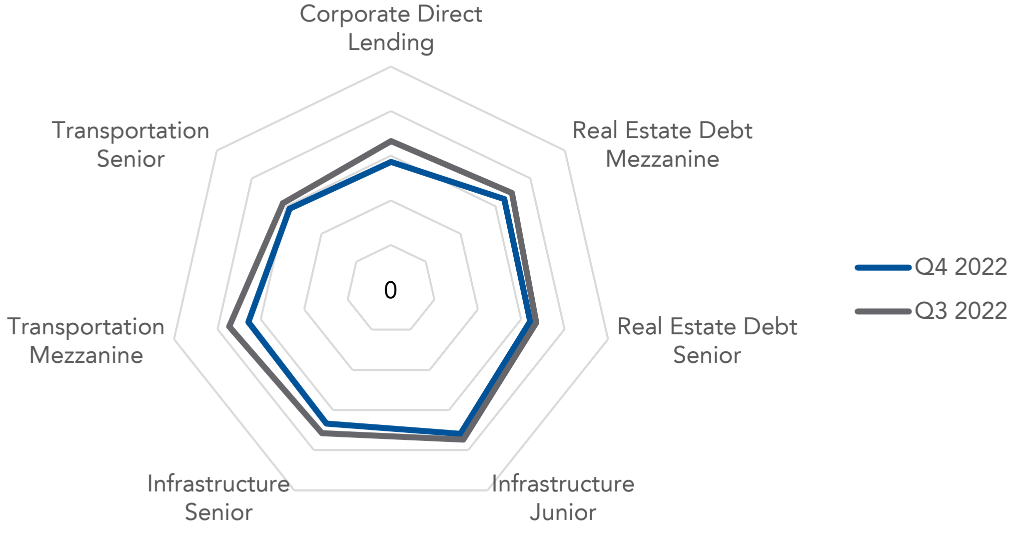

Figure 2: Assessment of selected Private Debt asset classes
Source: Prime Capital Research

[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 December 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.

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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

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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