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Asset Management

German Real Estate Debt Newsletter – Q3 2019

- Q3 2019 growth rates have fallen marginally short of projections
- Less deals, bigger tickets with growing interest from Anglo-Saxon and Asian investors
- Number of market participants continues to rise, with now 146 institutions operating as sub-ordinated capital providers
- Continued pressure on senior-debt yields; mezzanine yields are not affected

Real Estate Market Germany

According to JLL[1] as of Q3 2019 transaction volume increased by almost 25% (y-o-y), including a few large portfolio deals (see Figure 1). The accumulated total transaction volume increased to EUR 57.3bn in Q3 2019, of which single assets accounted for EUR 34.2bn and portfolio transactions for EUR 23.1bn.

Berlin significantly increases its dominant position, with office property remaining in strong demand. Total transaction volume in Top 7 cities increased to EUR 31.7bn, of which Berlin accounts for EUR 11.8bn, Düsseldorf EUR 2.5bn, Frankfurt EUR 5.6bn, Hamburg EUR 3.8bn, Cologne EUR 1.6bn, Munich EUR 4.9bn and Stuttgart EUR 1.5bn.

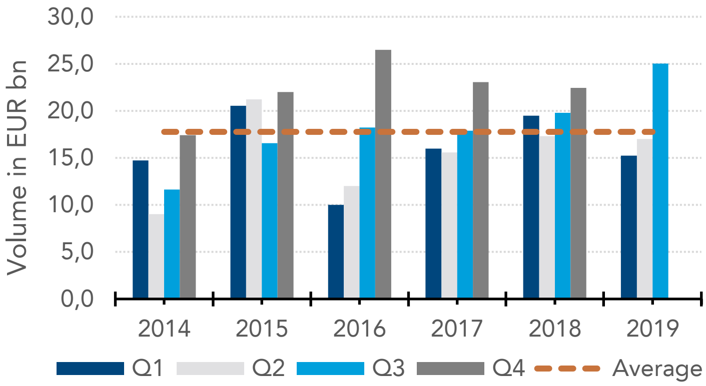


Figure 1: Transaction Volume Germany ; Source: JLL

As shown in Figure 2, office properties still account for around 36% (EUR 20.7bn), followed by Living with 27% (EUR 15.8bn). Investors are seeking major investment opportunities with a focus in the office sector. This has also been reflected in real estate development (green-field) where 48 office transactions above EUR 100m (single-asset and portfolio transactions) were completed in the first three quarters. At the same time, this analysis and the assessment of all office transactions reveal a 14% decline in the number of traded properties compared to the previous year. Fewer but larger transactions were carried out. There is also another persistent trend: Investors are increasing the efforts to diversify their portfolios. This is clearly reflected by the share of mixed-use single assets or portfolios, which now account for 10% or EUR 5.6bn. This asset class includes all transactions in which none of the uses accounts for more than 75% of rental income.

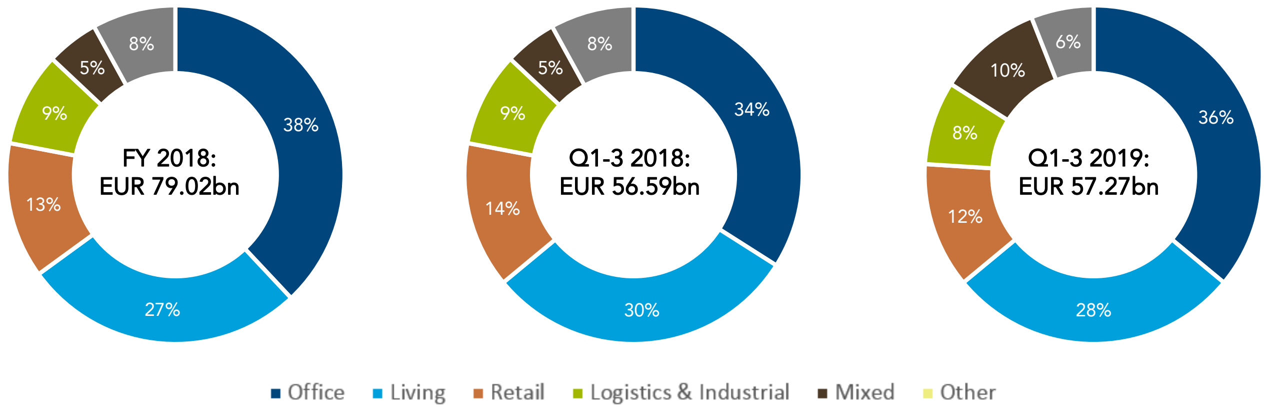


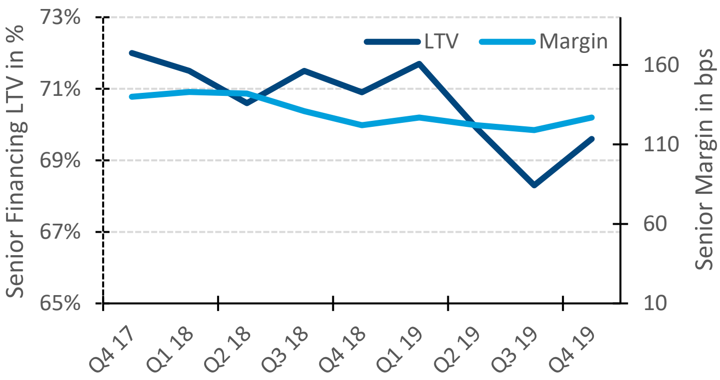
Figure 2: Transaction Volume by Main Asset Class ; Source: JLL[1]

Senior Debt Financing Market Overview

LTV and Margins for **Existing** Properties **Senior** Financing in Germany[2]

The range of the LTV values reported from the interviewed market participants in Q4 2019 range from 40% to a maximum of 100% (full-recourse). The average reported value is around 69.6 % (+1.3 pp vs. Q3 2019). The average LTV of the individual real estate segments ranges between 63% and 79%.

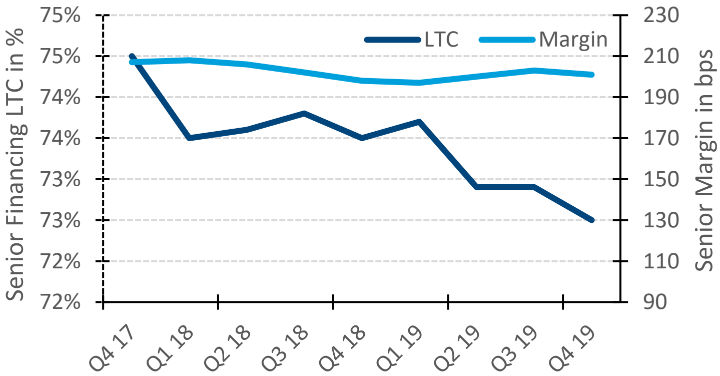
Margins for portfolio financings range from 25 bps to 450 bps. The average all-in margin across all property segments is around 127 bps (Q3 2019: 119 bps). The average gross margins of the individual property segments range between 96 bps and 167 bps.



LTC and Margins in **Senior** Project **Development** Financing in German[2]

Reported LTCs in Q4 2019 for project developments range between 30% and 100%. On average the LTC is 72.5% (-0.5 pp vs. Q3 2019). The average LTC of the individual real estate segments ranges between around 67% and 83%.

Project development financing achieves margins between 25 bps and 500 bps. The average all-in margin is 201 bps. This was slightly below the previous quarter (Q3 2019: 203 bps). The average margins of the individual property segments are between 189 bps and 212 bps.



Mezzanine / Junior Debt Financing Market Overview

More than 80% of CRE mezzanine providers now offer capital for existing property up to a LTV of 90%+, with maturities longer than three years and tranche sizes ranging from EUR 10m to EUR 30m, which represents an increase compared

[1] Source: JLL, Investment Market Overview, October 2019, page 5-6, available under: https://www.jll.co.in/en/trends-and-insights/research/real-estate-market-update-q3-2019-office
[2] Source: BF direct AG, BF Barometer, August 2019, page 7, available under: https://www.bf-direkt.de/unternehmen/quartalsbarometer/

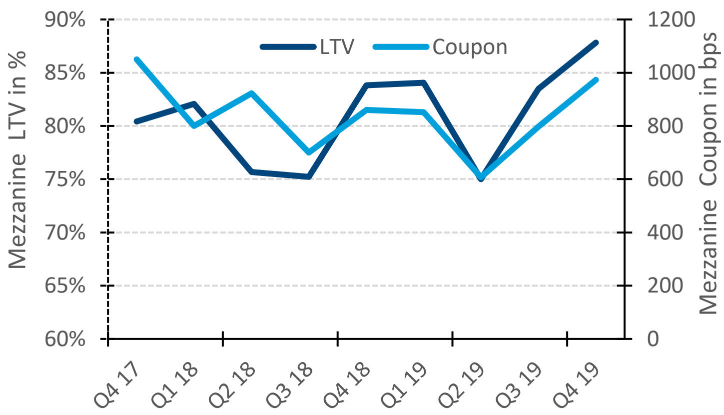
to last year's range from EUR 7m to EUR 20m. Furthermore, the increase in whole-loan financing solutions leads to a convergence between subordinated financing and traditional senior financing.

Even though LTVs and LTCs slightly declined over recent quarters, equity requirements further dropped from 8-10% to a new range around 5-7% y-o-y, consequently leaving even more volume to mezzanine providers. Mezzanine investors in turn, especially pay closer attention to property, location, sponsor, business plan and exit / refinancing opportunities to mitigate the risks of lower equity capitalization of assets.

In summary, the German CRE mezzanine market remains attractive, particularly as realized gross IRRs of CRE mezzanine investments met the expectations of on average **10% IRR** for financings of existing properties and **12% IRR** for development financings respectively. *(Source: Prime Capital, FAP Mezzanine Report 2019)*

LTV and Margins for **Existing** Properties **Mezzanine** Financing in Germany

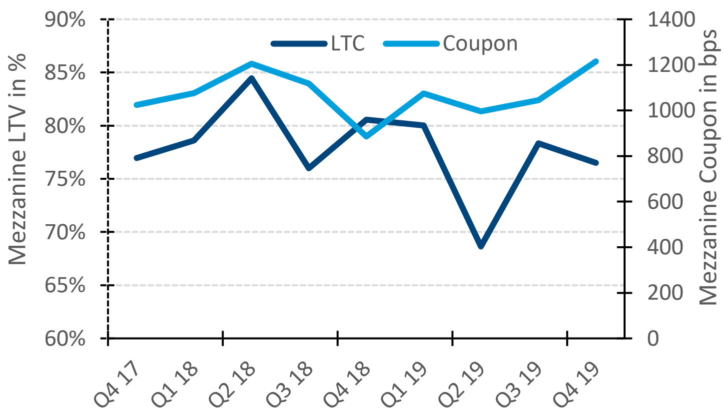
Based on Prime Capital's proprietary data[3], recent LTV values observed in the market over the observation period (Q4 17-Q4 19) range from 75% to a maximum of 88%. The average observed value for Q4 2019 is around 87.8%, implying an increase of 4.3%-points compared to Q3 2019 or a 4.0%-point increase compared to Q4 2018.



Coupons[4] for mezzanine financings of existing properties over the observation period range from 607 bps to 1,050 bps. The average margin across all property segments and locations in Q4 2019 is around 973 bps. Analogous the LTV, this implies an increase of 176 bps compared to Q3 2019 or a 366 bps increase compared to Q3 2019. *(Source: Prime Capital)*

LTC and Margins in **Mezzanine** Project **Development** Financing in Germany

Based on Prime Capital's proprietary data[3], recent LTC values observed in the market over the observation period range from 69% to a maximum of 84%. The average observed value for Q4 2019 is around 76.5%, implying a decrease of 1.8%-points compared to Q3 2019 or a 4.0%-point decrease compared to Q3 2019.



Coupons[4] for mezzanine financings of developments over the observation period range from 886 bps to 1,215 bps. The average margin across all property segments and locations in Q4 2019 is around 1,215 bps. Contrary to the LTC development, this implies an increase of 169 bps compared to Q3 2019 or a 329 bps increase compared to Q4 2018. *(Source: Prime Capital)*

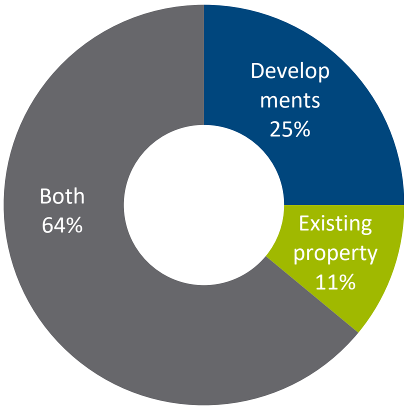
[3] The aggregated data for subordinated financing in this section is based on the transactions conducted by Prime Capital (closed-, pipeline- and rejected-deals).

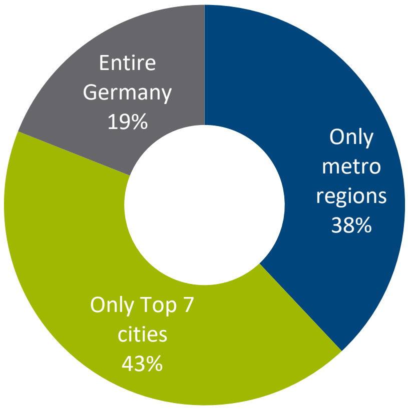
[4] These are coupons which are not the all-in margins, i.e. possible other fees (e.g. up-front) payable by the borrower would have to be added.

Investment Focus of Mezzanine Investors in Germany

Due to the maintaining pressure on margins, prices, growth and availability of real estate assets and financing volumes, capital providers became more flexible regarding the target allocation of mezzanine investments. Especially, the relative proportion of mezzanine financing providers that previously only funded developments increased, with 64% of providers now financing both segments (existing & development). The increased share of existing segments is mainly due to liquidity and security reasons.

Compared to the prior year, an increasing share of providers is only financing projects in Top 7 cities or metropolitan regions. For Top 7 cities, providers also focus on peripheral locations within the "commuter belt" due to scarcity of suitable investment opportunities. On a y-o-y basis, fewer providers of mezzanine capital invest throughout whole Germany (19% vs. last year 55%).





Source: FAP Mezzanine Report 2019

Demand for Non-Bank Financing Solutions

The above reported trends are supported by the outcome of the recent panel conducted by BF[5], which investigates the financing preferences of real estate investors in the short-term future.

Firstly, the quarter-on-quarter financing preferences show a trend away from senior secured and junior loans but towards higher demand for mezzanine financings. Secondly, it shows that the demand for alternative financing instruments (besides senior bank financing) has increased significantly and thirdly it highlights the importance of mezzanine capital, being most frequently structured with 37%.

Financing Type	Q3 in %	Q4 in %
Senior Secured Loans (Bonds and Whole-Loans)	7.7	6.5
Junior Secured / Unsecured Loans	15.4	13.0
Mezzanine (subordinated bonds and loans)	33.3	37.0
Equity	23.1	26.1
Forward Commitments	15.4	17.4

[5] Source: BF direct AG, BF Barometer, August 2019, page 8, available under: https://www.bf-direkt.de/unternehmen/quartalsbarometer/

About Prime Capital's Private Debt Team

Our Real Estate team, which has been active in the Real Estate Debt market for many years, has already carried out transactions worth approx. EUR 400m. The Private Debt Team additionally invests in Aviation Debt (& Equity), Corporate Lending, and Infrastructure Debt. We expect significant further asset growth in these areas, providing for satisfactory risk adjusted returns to our institutional investors.

Prime Capital's Private Debt Team manages in excess of EUR 2bn across these asset classes for institutional investors.

Further information about Prime Capital AG can be found on the web site
www.primecapital-ag.com

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