



Asset Management

German Real Estate Debt Newsletter – Q4 2019

- Q4 2019 closed with record-breaking EUR 34bn transaction volume
- Risk profile of investments remains stable, with a slight shift towards riskier value-add investments
- Continued pressure on senior debt yields; mezzanine yields are not affected

Real Estate Market Germany (Equity)

According to JLL¹ as of Q4 2019 transaction volume increased by over 50% (y-o-y), including a few large portfolio deals (see Figure 1). The accumulated total transaction volume increased to EUR 91.3bn in 2019, of which single assets accounted for EUR 56.2bn and portfolio transactions for EUR 35.1bn.

Berlin once more increases its dominant position, with office property remaining in strong demand. Total transaction volume in Top 7 cities increased to EUR 52.6bn, of which Berlin accounts for EUR 15.8bn, Düsseldorf EUR 4.6bn, Frankfurt EUR 10.0bn, Hamburg EUR 5.5bn, Cologne EUR 3.4bn, Munich EUR 10.9bn and Stuttgart EUR 2.4bn.

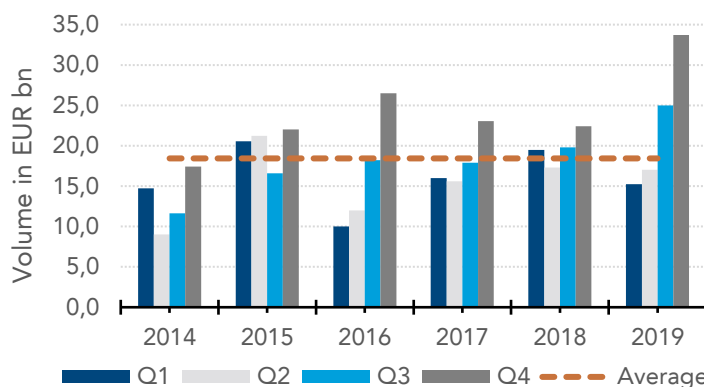


Figure 1: Transaction Volume Germany ; Source: JLL

As shown in Figure 2, office properties still account for around 40% (EUR 36.5bn) of the total transaction volume, followed by living properties with 24% (EUR 21.9bn). Investors are seeking major investment opportunities with a focus in the office sector. Accordingly, the dominance of office real estate has strengthened once again, with a high proportion accounted for by individual deals. A total of 70 transactions in the three-digit million range were recorded. Overall, with a share of 58%, transactions with a deal volume of more than EUR 100m reached the highest level in both relative and absolute terms in the last ten years. Thanks to high demand in the fourth quarter, foreign buyers account for almost 41% of the transaction volume realized in 2019. The German A-locations set a new record with EUR 46.6bn (+20%). With Berlin (EUR 12.8bn) and Munich (EUR 10.7bn), two locations exceed the EUR 10bn threshold.

¹ Source: JLL, Investment Market Overview, January 2020, page 5-6, available under: <https://www.jll.de/en/trends-and-insights/research>

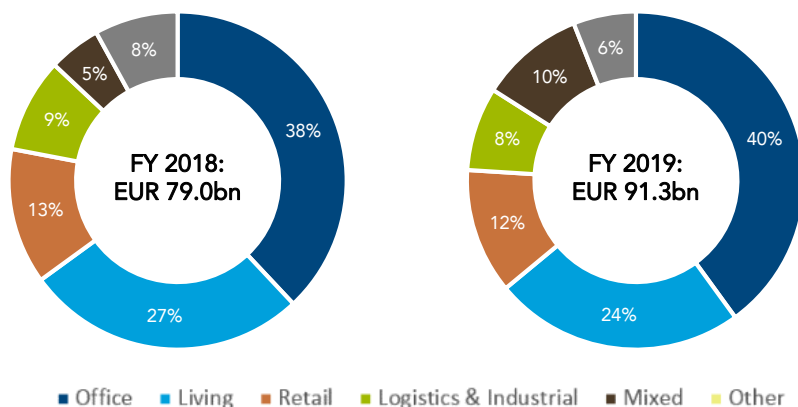


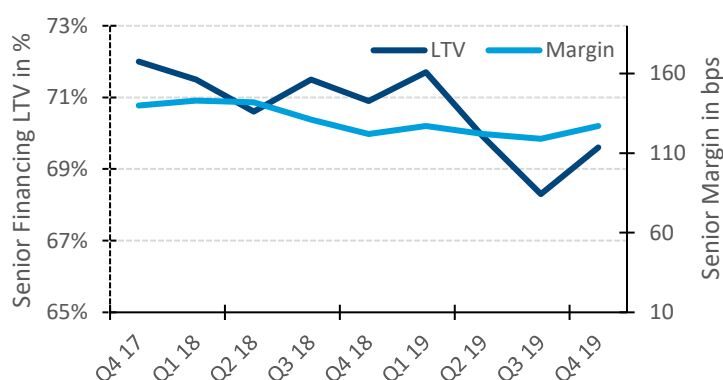
Figure 2: Transaction Volume by Main Asset Class ; Source: JLL¹

Senior Debt Financing Market Overview

LTV and Margins for Existing Properties Senior Financing²

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%.

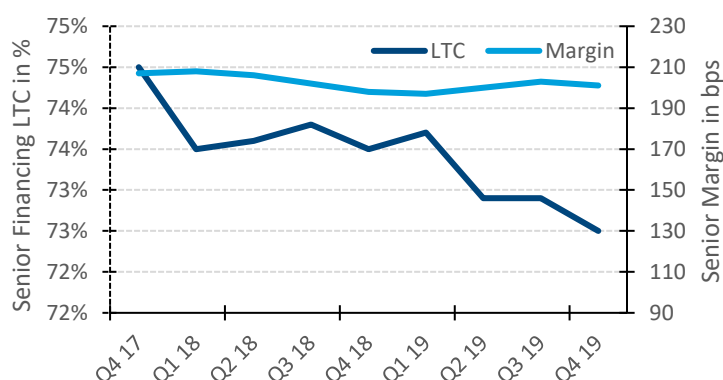
Margins for portfolio financings range from 25 bps to 450 bps. The average all-in margin across all property segments is around 127 bps (Q3 2019: 119 bps). The average gross margins of the individual property segments range between 96 bps and 167 bps.



LTC and Margins for Project Developments – Senior Financing²

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 these 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 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.

² Source: BF direct AG, BF Barometer, November 2019, page 7, available under: <https://www.bfdirekt.de/unternehmen/quartalsbarometer/>
Page 2

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.

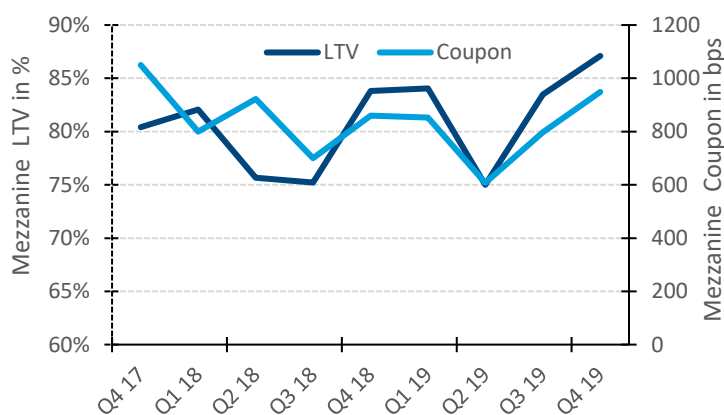
In summary, the German CRE mezzanine market remains attractive, particularly as realized gross IRRs of CRE mezzanine investments met the expectations of on average **10% IRR** for financings of existing properties and **12% IRR** for development financings respectively. (Source: Prime Capital, FAP Mezzanine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

LTV and Margins for Existing Properties Mezzanine Financing in Germany

Based on Prime Capital's proprietary data³, recent LTV values observed in the market over the observation period (Q4 17-Q4 19) range from 75% to a maximum of 87%. The average observed value for Q4 2019 is around 87.1%, implying an increase of 3.6%-points compared to Q3 2019 or a 3.3%-point increase compared to Q4 2018.

Coupons⁴ 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 949 bps. Analogous to the LTV, this implies an increase of 152 bps compared to Q3 2019 or an 89 bps increase compared to Q4 2018.

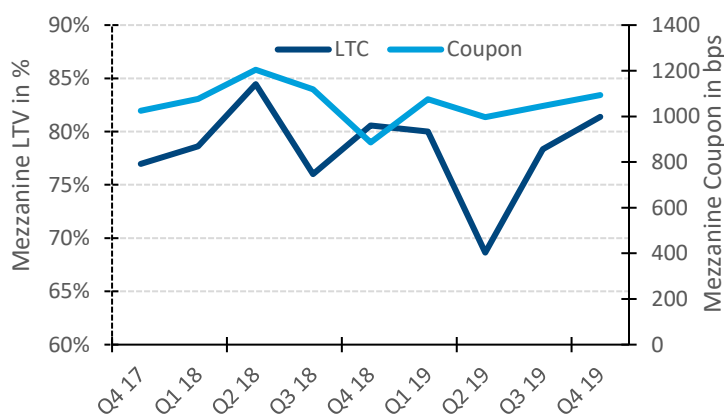
(Source: Prime Capital)



LTC and Margins in Mezzanine Project Development Financing in Germany

Based on Prime Capital's proprietary data³, 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 81.4%, implying an increase of 3.0%-points compared to Q3 2019 or a 0.8%-point decrease compared to Q4 2018.

Coupons⁴ for mezzanine financings of developments over the observation period range from 886 bps to 1,204 bps. The average margin across all property segments and locations in Q4 2019 is around 1,204 bps. Contrary to the LTC development, this implies an increase of 48 bps compared to Q3 2019 or a 208 bps increase compared to Q4 2018. (Source: Prime Capital)



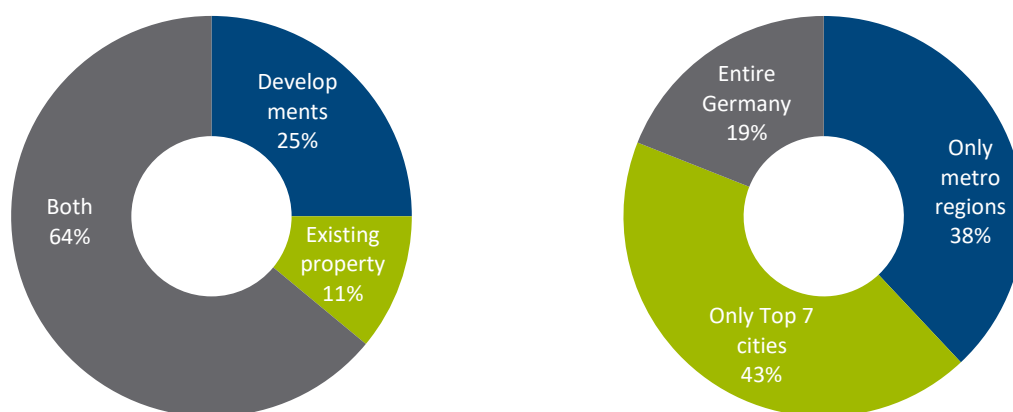
³ The aggregated data for subordinated financing in this section is based on the transactions conducted by Prime Capital (closed-, pipeline- and rejected-deals).

⁴ These are coupons which are not 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 continuous pressure on equity- and senior debt 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 BFE^{error} **Bookmark not defined.**, which investigates the financing preferences of real estate investors in the near-term future.

Firstly, the quarter-on-quarter financing preferences show a trend away from senior secured towards higher demand for junior and 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 36%.

Financing Type	Q4 in %	Q1 in %
Senior Secured Loans (Bonds and Whole-Loans)	6.5	5.6
Junior Secured / Senior Unsecured	13.0	19.4
Mezzanine (subordinated bonds and loans)	37.0	36.1
Equity	26.1	22.2
Forward Commitments	17.4	13.9

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), Infrastructure Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our largely 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

Contact:

Prime Capital – Portfolio Management Private Debt
impd@primecapital-ag.com

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