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 JLL 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.

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.

Figure 1: Transaction Volume Germany; Source: JLL
Senior Debt Financing Market Overview

LTV and Margins for Existing Properties Senior Financing

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 Financing

Reported LC Ts 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.

---

1 Source for Senior Financing data is the quarterly “BF Barometer” from BF.direkt AG. In the creation of the quarterly BF barometer, a total of about 110 experts involved in commercial real estate lending are interviewed. The panel is composed of representatives of various banking types, including mortgage, regional, savings, cooperative and private banks as well as specialized financing companies such as development banks or building societies. Additionally, the panel also considers new financing providers, such as pension schemes/pension funds, insurance companies and credit funds or real estate private equity firms, which already now, but also in the future will be increasingly of real estate financing. The dedicated aim of the quarterly panel is to assess the quarter-ahead expectations of market participants and evaluate the perceived macro condition of the German commercial real estate financing market.
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.

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, recent LTV values observed in the market over the observation period (Q4 17-4 Q19) range from 75% to a maximum of 87%. The average observed value for Q4 2019 is around 87.1%, implying an increase of 3.8%-points compared to Q3 2019 or a 3.3%-point increase compared to Q4 2018.

Coupons 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 data, 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.

Coupons 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)

---

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

3 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%).

**Demand for Non-Bank Financing Solutions**

The above reported trends are supported by the outcome of the recent panel conducted by BF\(^1\), 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%.

---

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

Source: FAP Mezzanine Report 2019
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
Disclaimer:

The information and opinion contained in this document (hereinafter: "Information") is provided only for information purposes, and is not construed as a solicitation or an offer to buy or to sell any securities or financial instruments in any jurisdiction whatsoever. It does not constitute an official confirmation, invitation, solicitation or offer to subscribe for or purchase or sell any of the products or services of Prime Capital AG, Frankfurt am Main. No investment decision should be made on the basis of this document. The information contained herein may not be complete and may not contain all relevant material information related to any (financial) instrument presented. No representation or warranty is made or implied concerning, and Prime Capital AG assumes no responsibility for, the accuracy, completeness, reliability or comparability of the information contained herein relating to third parties.

The Information contained in this document was obtained in good faith from sources considered to be reliable, but its accuracy, completeness, reliability, or comparability is not guaranteed or otherwise warranted or represented by Prime Capital AG. Specifically, the Information contained herein has been obtained from third party sources, which is based solely on publicly available information. Prime Capital AG makes no representation, express or implied, as to the accuracy, correctness, suitability or timeliness of such data. In particular, Prime Capital AG is not obligated to update information provided in this document or to delete obsolete information from this document. The information provided in this document may change at any time without prior notification. As a result, information once published in this document may not be understood to mean that matters have remained the same since publication or that the information is still up-to-date following its publication. The validity of the information is limited to the point in time of their being issued and may change based on market developments.

This document and the Information contained herein is confidential and intended only for the person to whom it has been provided and under no circumstance may a copy be shown, copied, transmitted, or otherwise given to any person other than the authorized recipient without the prior written consent of Prime Capital AG.

The content of this document is protected by intellectual property rights owned by Prime Capital AG. The reproduction, transmission (electronically or by other means), linking, alteration, storage, archiving or other uses for public or private use of information or data, in whole or in parts, in particular, the use of texts, portions of texts or images requires the prior consent of Prime Capital AG. In particular, you are prohibited from:

i. copying this document in whole or in parts (whether by printing them on paper, saving them to a file or otherwise);
ii. removing, changing or otherwise making the content of this document incomprehensible or using the material contained on this document in a manner other than intended in these legal notices and terms of use;
iii. using this document or the information it contains for unlawful purposes.

The Information provided herein is not taking into account any particular person’s objectives, financial situation or needs. Investors should before acting on the information provided in this document, consider the appropriateness of the information having regard to their individual objectives, financial situation or needs.

Please bear in mind, that any forward looking statements re targets and achieving such targets is subject to unexpected risk and uncertainties and can not be guaranteed in any way.

Privacy:

Prime Capital AG is committed to protecting your privacy. The types of personal information we collect about you depends on the relationship with us. They include (i) your personal contact details such as name, title, postal addresses, email addresses and telephone numbers, (ii) the company you work for and your position, (iii) identification and background information we may collect about you as part of our business acceptance procedures, (iv) technical information such as information from your visits to our website or relating to the event invitations, updates, marketing material, and other communication we send to you electronically, (v) your communication preferences regarding marketing materials or (vi) any other personal information you provide to us during your relationship with us, such as dietary requirements, any physical disability and your views and comments.

They ways in which we collect personal information about you may include the following: (i) in the course of our business acceptance procedures, (ii) through your general use of our website. In particular, we collect personal information about you if you complete forms on our website and if you send emails to firm personnel; (iii) through your responses to our emails asking that you confirm and update information we maintain about you, or that you provide your consent for us to communicate with you, or (iv) through information you may provide to representatives of our firm at conferences or similar events.