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German Real Estate Debt

Newsletter Q2 2020

German Real Estate Q2 2020 Overview

> German real estate proved to be resilient and despite a lower transaction volume in Q2 2020 it remains an attractive investment location in selected sectors (e.g. residential, logistics).

> During the first half of 2020, the German transaction volume exceeded the previous year's result by 31% (EUR 42.5bn), although Q2 2020 was significantly impacted by the Covid-19 pandemic and closed with a transaction volume of EUR 14.7bn, 14% less than last year's Q2 result.

> Higher coupons and lower LTVs for German CRE-debt are generally observed as well as further demand for alternative lending solutions.

Real Estate Market Germany

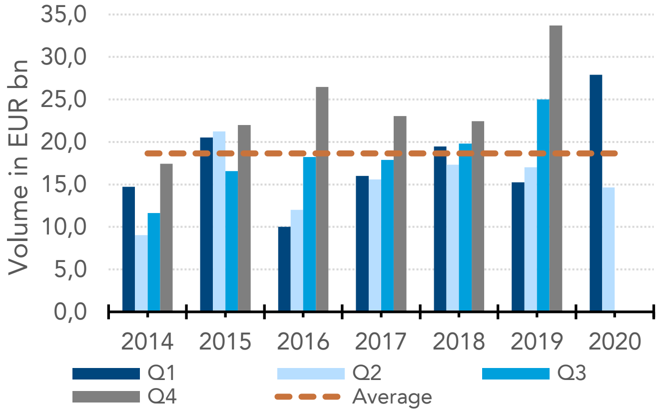

Figure 1: Transaction Volume Germany

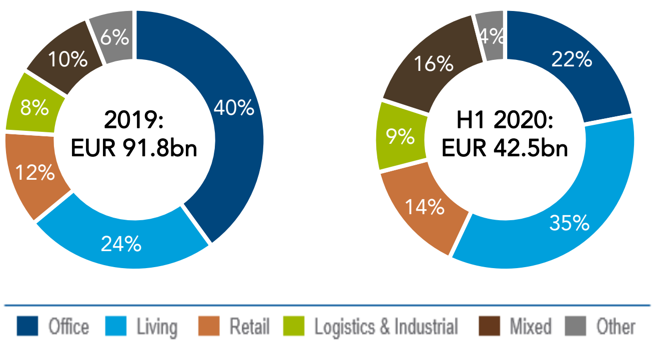

Figure 2: Transaction Volume by Asset Classes

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As shown in Figure 1[1] , the total German transaction volume in the first half of 2020 amounted to around EUR 42.5bn which is higher than the previous first year's result by 31%. The Top 7 cities accounted for a total volume of around EUR 18bn, equating to a 42% share of the total transaction volume and represent a 4% increase compared to the same period of last year. Berlin remains in its dominant position and Hamburg's transaction volumes grew significantly amounting to nearly EUR 3bn which corresponds to an 83% increase compared to the previous first half year's result. Hamburg's landmark building projects the southern "Überseequartier HafenCity" and the "Deutschlandhaus" at Gänsemarkt played an essential role in the city's transaction volume increase.

Looking at different segments EUR 14.7bn or 35% of the total investment volume were invested in the living sector, representing the largest share of all segments in terms of transaction volumes (see *Figure 2)*. Secondly, office properties that were traded in the first half of the year accounted for a significantly lower share of EUR 9.4bn or 22% of first half's total transaction volume. Mixed-use properties or portfolios are of much greater relevance and amount to EUR 6.8bn (16%). Retail properties account for EUR 6bn (14%). Sales drivers in the retail sector were in particular the asset acquisitions of the REAL markets and TLG Immobilien supermarket portfolio. Furthermore, logistics properties represent EUR 3.8bn (9%). The logistics sector is currently benefiting from the growing demand in the e-commerce sector, boosting transaction volumes.

Net initial prime yields for office, logistics and in some cases retail assets remained stable on a low level after the first six months with an average office prime yield of 2.9% for the Top-7 German cities.

Mezzanine Financing Market Overview

The interest rates for project developments have increased significantly due to limited risk appetite from banks. Higher interest rates are also paid for existing properties, although the increases here have been lower. Key driver is that the funding premiums for banks remain high. In addition, we are also observing that banks and alternative lenders require higher margins due to an increase in the risk weighted assets (RWA) and the overall risk assessment.

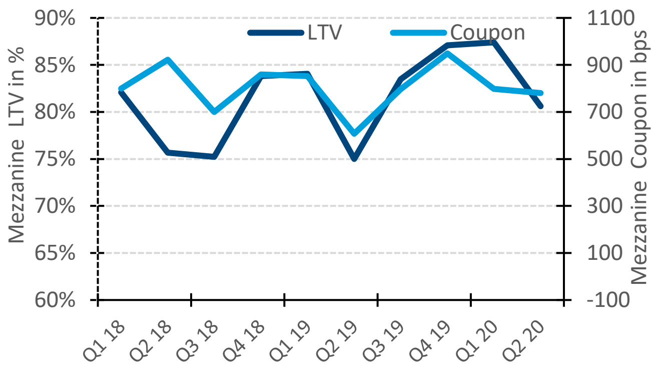

Figure 3: LTV and margins for existing properties mezzanine financing in Germany

Based on Prime Capital's proprietary deal database[2], recent LTV values for mezzanine over the observation period (Q1/2018 - Q2/2020) range from 75% to a maximum of 87%. The average for Q2/2020 is 80.6%.

[1] Source: JLL, Investment Market Overview, July 2020, page 5-6, available under: https://www.jll.de/en/trends-and-insights/research/investment-market-overview

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

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Coupons[3] for mezzanine financings of existing properties range from 607 bps to 949 bps. The average margin across all property segments and locations in Q2/2020 is 780 bps. This implies a 173.6 bps increase compared to Q2/2019.

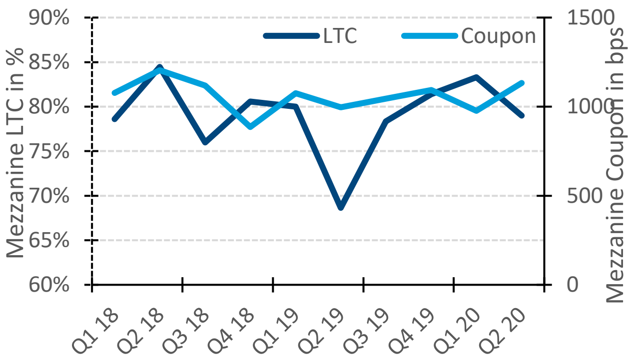

Figure 4: LTC and margins in mezzanine project development financings in Germany

Based on Prime Capital's proprietary deal database[2] recent LTC values over the observation period (Q1 18-Q2 20) range from 69% to a maximum of 84%. The average for Q2 2020 is around 80%.

Coupons[3] for mezzanine financings of developments range from 886 bps to 1,204 bps. The average margin across all property segments and locations in Q2 2020 is around 1,132 bps, which implies an increase of 156 bps compared to Q1 2020 and a 136 bps increase compared to Q2 2019.

As shown in Figure 3 and 4 above, LTC and LTV values have decreased during the first half of 2020 while margins of project developments and existing properties are on a continuous ascending curve. In the second half of the year, we expect to see a similar development as what have been seen in the first half of 2020.

Current market developments

The Covid-19 situation continues to impact the European economy and German chancellor Merkel has named the crisis as "the most challenging crisis German has faced since the Second World War".

The current crisis continues to impact the real estate finance sector. Banks are further reducing their risk exposures and reduce leverage levels. Project developments are currently finding less risk appetite from banks, a challenge for project developers in discussing new business proposals.

Further, banks tend to reduce their lending exposures and limit new business activities with a strong focus on existing and long-established client relationships and on their portfolio management. The limited availability of senior lending is creating a gap that offers new business potential for alternative lenders who take up the vacuum that banks are leaving in the real estate lending market.

The asset classes "Residential" and "Logistics" are resilient to impacts of the current crisis. In spite of the impacts of Covid-19, German housing prices have further increased. One additional effect from the crisis might be increased residential space demand due to the requirement of home office space in residential units. The increasing vacancy of centrally located retail space is leading to new concepts for logistics and storage, e.g. transformation from retail space into small inner-city logistic hubs, which can serve as local pick up points or supply the last mile concept for delivering online orderings.

In contrast "Hotel" and "Retail", with the exception of supermarkets, are expected to face a challenging time due to less travel activities and an increase in online sales.

[3] These are coupons which are not all-in margins, i.e. possible other fees (e.g. up-front) payable by the borrower are not included.

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 500m. 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

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