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# German Real Estate Debt

## Newsletter Q1 2021

## Summary


- In Q4 2020, financing margins stabilised at high levels. LTV levels of existing properties increased, whereas LTC levels of developments decreased.
- German real estate transaction volume reached EUR 81.6bn in 2020, an 11.1% decrease vs. 2019. After a strong Q1 (+81.2% YoY), the following three quarters suffered from the impact of the Covid-19 pandemic. Despite the YoY drop, German real estate transaction volume in 2020 was still higher than in any of the years prior to 2019, mostly due to the exceptionally strong activity experienced in Q1.
- Financing developments: Margins for development transactions increased, banks further withdrew from the market opening further opportunities for alternative lenders.
- Our Prime Capital Commercial Real Estate Debt team closed four transactions this past quarter.


## Real Estate Market Germany

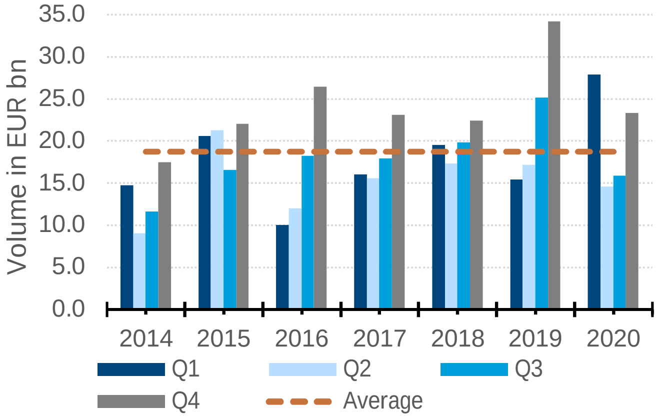


*Figure 1: Transaction Volume by Quarter (Germany)*

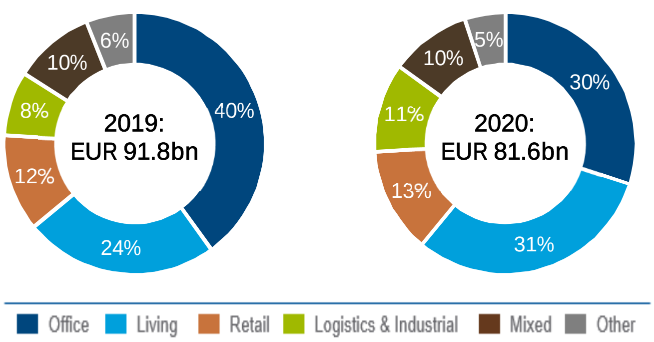


*Figure 2: Transaction Volume by Asset Class (Germany)*

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As shown in Figure 1[1], the total German transaction volume in 2020 amounted to around EUR 81.6bn, which is 11.1% less than the volume of 2019. The Top 7 cities accounted for a total volume of EUR 39.9bn, corresponding to a 48.9% share of the total transaction volume. Compared to the same period last year, the transaction volume in these cities decreased by -25%. Berlin remains by far the largest market, although transaction volume has decreased by 19% to EUR 12.8bn. Hamburg is the only city where transaction volume has increased: deal volume was EUR 6.9bn in 2020, an increase of 24% compared to 2019. This surge was driven by a number of large projects which began construction in 2020: the Deutschlandhaus, the Burstah Ensembles, the Überseequartier and the Edge HafenCity.

Looking at the different segments, EUR 25.3bn or 31% of the total transaction volume has been invested in the residential sector, representing the largest share of all segments (see *Figure 2*). Office properties that have been traded in 2020 accounted for EUR 24.5bn or 30% of total transaction volume. Retail properties accounted for EUR 10.6bn (13%).

Net initial prime equity yields for logistic assets in Top 7 cities fell to 3.38% in Q4 2020 (-15 bps vs Q3 2020), and to 2.81% for office assets (-4 bps). Yields in the retail sector moved in different directions for different store types. Shopping-centre yields increased by 10 bps to 4.85%, warehousing-park yields dropped by 10 bps to 3.9%, warehousing-solus-unit yields were stable at 4.6% and high-street yields increased by 2 bps to 2.91%.

## Mezzanine Financing Market Overview

Q4 2020 was characterised by a stabilisation of interest rates at high levels in the mezzanine financing market. LTVs increased for existing properties, whereas LTCs decreased for developments. In general, banks' reduced participation in the real-estate financing market allows alternative lenders to play a more central role in real estate-financing transactions, which allows them to obtain more favourable terms.

Based on Prime Capital's proprietary deal database[2], average LTV values for mezzanine financings of existing properties over the observation period (Q2 2018-Q4 2020) ranged from 72% to a maximum of 87%. The average LTV in Q4 2020 was in the higher end of the range at 84% (+12pp vs. Q3 2020).

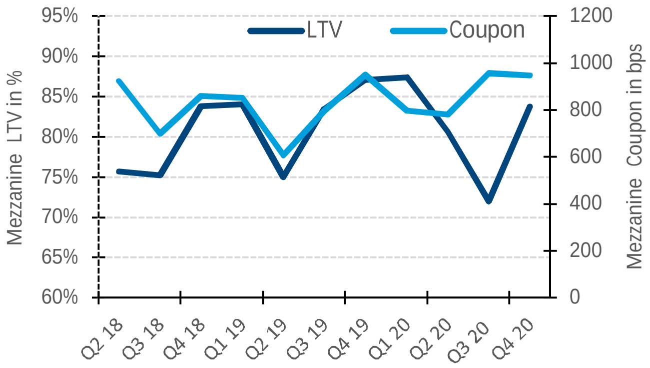


*Figure 3: LTV and margins for existing properties mezzanine financing in Germany*

Coupons[3] during Q4 2020 ranged from 400 bps to 1,100 bps. The average margin across all property segments and locations in Q4 2020 was 947 bps and thus no significant change was observed compared with the previous quarter.

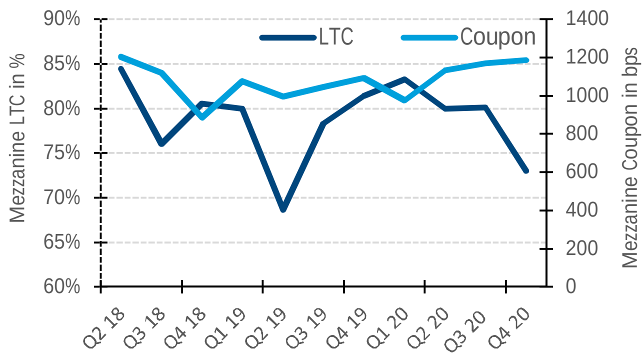


*Figure 4: LTC and margins in mezzanine project development financings in Germany*

For mezzanine financings of developments, average LTC values over the observation period (Q2 2018-Q4 2020) ranged from 69% to a maximum of 84%. The average for Q4 2020 is in the lower range at 73% (-7pp in comparison to Q3 2020).

Coupons[3] during Q4 2020 ranged from 1,000 bps to 1,300 bps. The average margin across all property segments and locations in Q4 2020 was 1,187 bps, which implies an increase of 55 bps compared to Q3 2020.

## Current Alternative Financing Market

In Q4 2020 and also in the first weeks of Q1 2021, financing conditions have remained advantageous for alternative lenders, confirming the trend seen in the previous two

[1] Source: JLL, Investment Market Overview, January 2020, page 2, available under: https://www.jll.de/content/dam/jll-com/documents/pdf/research/emea/germany/en/Investment-Market-Overview-JLL-Germany.pdf

[2] The aggregated data for mezzanine 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 are not included.

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quarters. High margins are a direct result of banks' decision to reduce their exposure to the real-estate financing sector in the face of the risk increase brought about by the Covid-19 pandemic and its economic fallout. Overall, as the pandemic will most likely not be over before the summer in Europe, we can expect that financing conditions will remain favourable for alternatives lenders at least until the end of 2021.

Below are further observations about the current debt market in Germany:

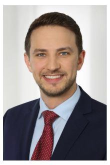
- Since the beginning of 2020, margins for development transactions have risen by more than 200 basis points
- Even experienced sponsors with long track records have had difficulties financing projects (LTV > 55%) with their house banks in 2020, as banks were focused on their credit positions.
- We expect that banks will continue to withdraw from the market, also due to the steadily increasing regulatory pressure.
- Often planned refinancings were halted
- Diversification of lenders is gaining further momentum, with debt funds and insurance companies entering the market

## About Prime Capital's Private Debt Team

Our team has been active in the Real Estate Debt market for many years and has already carried out transactions for a total volume of over EUR 560m. Our Private Debt Team additionally invests into Aviation Debt & Equity, Infrastructure Debt and Corporate Lending. We expect significant further growth in these areas, which provide attractive risk-adjusted returns to our investors.

Prime Capital's Private Debt Team manages assets in excess of EUR 2bn across the aforementioned asset classes on behalf of institutional investors. Further information about Prime Capital AG can be found on our website www.primecapital-ag.com.

### Contact:



**Dennis Davidoff**
Investment Manager
Private Debt

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

## Prime Capital's deal flow in Q4 2020

As expected, Q4 was a busy quarter for our CRE Debt team. In the last quarter of the year, we closed four mezzanine transactions for a total volume of EUR 65.7m. Three transactions are existing properties located in the Top-7 German cities and one is a development property in Vienna. We structured the financings with terms of 2 to 4 years, strong covenants and attractive IRRs in a range of 10%-13% with moderate LTV levels. The investor is a Prime Capital managed real estate mezzanine debt fund. Below is an overview of the financings:

### Prime Capital's Mezzanine Financings in Q4 2020

| Location | Berlin | Munich | Vienna | Düsseldorf |
|---|---|---|---|---|
| Sector | Mixed-Use | Office | Office | Office |
| Amount | €12.0mn | €30mn | €10.5mn | €13.2mn |
| Rank | Junior | Junior | Junior | Junior |
| Term (in months) | 26 | 44 | 35 | 27 |
| IRR | 13% | 12% | 10% | 11% |
| Covenants | LTV; project milestones | LTV, DSCR and WALT | LTV, DSCR and WALT | LTV, DSCR and WALT |
| Collateral | 1st lien share pledge i.a. | 1st lien share pledge i.a. | 1st lien share pledge i.a. | 1st lien share pledge i.a. |
| Format | Bearer Bond | Promissory Notes | Bearer Bond | Bearer Bond |

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