PRIME CAPITAL

German Real Estate Debt

Newsletter Q2 2021

Summary

- In Q1 2021 margins remained stable, whereas LTV and LTC levels of both existing properties and development projects have decreased. This can be regarded as a reaction due to the elevated uncertainty in the markets, given the ongoing pandemic situation in Germany.

- German real estate transaction volume reached EUR 16.6bn in Q1 2021, amounting to a YoY decrease of -40.7% compared with the last quarter not affected by COVID-19 (Q1 2020). This large drop, however, is mostly due to an unusually strong Q1 in the previous year.

- Alternative lending as a way to finance commercial real estate transactions is expected to grow throughout the entire year as more and more banks recede from the market and further regulation is enacted.

Real Estate Market Germany

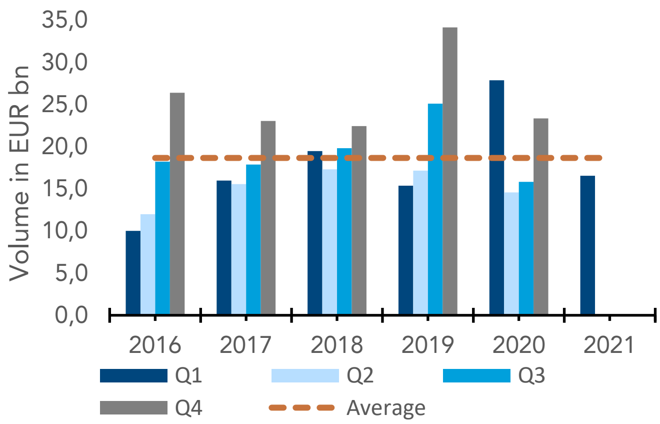

Figure 1: Transaction Volume by Quarter (Germany).

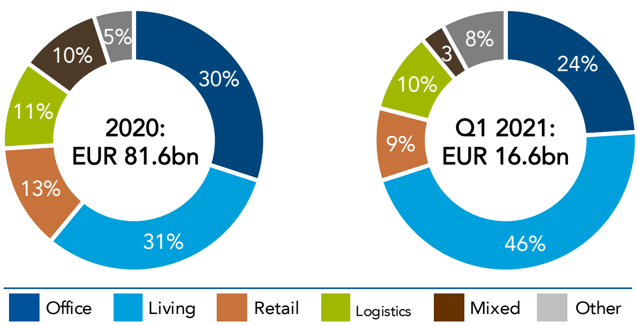

Figure 2: Transaction Volume by Asset Class (Germany).

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Figure 1[1] shows the development of the German real estate market: In Q1 2021, total transaction volume reached EUR 16.6bn (QoQ: -29.6% / YoY: -40.7%). The large YoY change has only limited significance because Q1 2020 was an unusually strong first quarter. Compared to the last six years, Q1 2021 is just below average in terms of transaction volume. Because investors are unlikely to have achieved their acquisition targets last year, we forecast the total 2021 volume at previous years' levels.

Total transaction volume in Q1 2021 was composed as follows: Top 7 cities accounted for EUR 6.7bn (40.4%), whereas the volume of the other cities and regions amounted to EUR 9.8bn (59.6%). Across all cities, average transaction volume decreased by -42%.

Looking at the split of transaction volume by asset class (see *Figure 2*), EUR 4bn (24%) of the total has been invested in the office sector, which is largely in line with the previous quarters. Residential properties once again constituted the largest share and amounted to EUR 7.6bn (46%). The remainder was split fairly evenly among logistics (10%), retail (9%) and other segments.

Generally speaking, prime yields have been stable across all segments, compared to the previous quarter. Yet we expect some equity yield compression for logistic properties and for some areas within the retail sphere going forward (especially retail parks with food anchored tenants).

Mezzanine Financing Market Overview

Looking at the financing sector, Q1 2021 was characterised by a small increase in interest rates, at high levels, for existing properties (*Figure 3*). The margins for subordinated development financings (*Figure 4*) rose as well by a small margin. LTVs and LTCs decreased for both categories.

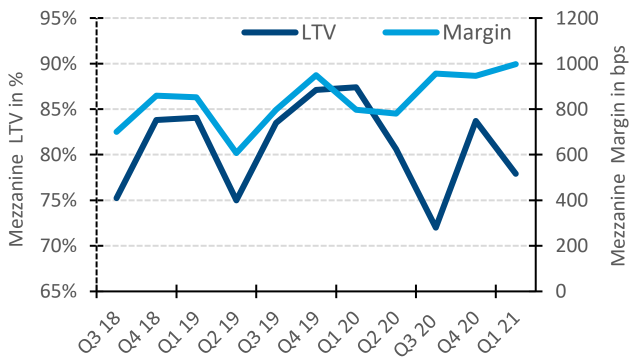

Figure 3: LTV and margins for mezzanine existing property financing in Germany.

Based on Prime Capital's proprietary deal database[2], average LTV values for mezzanine financings of existing properties over the observation period (Q3 2018 - Q1 2021) ranged from 72% to a maximum of 87%. The average LTV in Q1 2021 was in the middle of the range at 78% (-6pp vs. Q4 2020).

Margins[3] during Q1 2021 ranged from 850 bps to 1240 bps. The average margin across all property segments and locations in Q1 2021 was 998 bps - no significant change compared with the previous quarter.

For mezzanine financings of developments, average LTC values over the observation period (Q3 2018-Q1 2021) ranged from 67% to a maximum of 83%. The average for Q1 2021 was in the lower range around 67% (-7pp in comparison to Q4 2020).

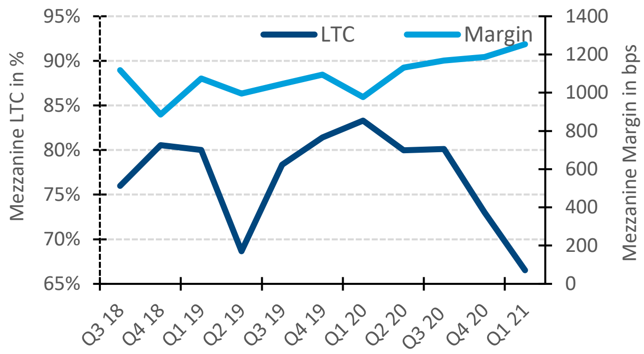

Figure 4: LTC and margins in mezzanine project development financings in Germany.

Margins during Q1 2021 ranged from 750 bps to 1350 bps. The average across all property segments and locations in Q1 2021 was 1254 bps, which implies a slight pick-up of 67 bps compared to Q4 2020.

Current Alternative Financing Market

Despite challenging circumstances due to COVID-19, conditions for alternative financing are expected to remain benign: In a recent survey conducted by PWC, alternative lending as a means for financing CRE transactions is expected to increase by appx. 56%, as Figure 5 shows. Furthermore, 2/3 of all respondents predict banks to reduce their exposure going forward.

This increases the lending gap and allows alternative lenders to play a more central role in real estate transactions by structuring Mezzanine and Whole Loans. Coupled with a speedier, digitalized investment process, this enables alternative lenders to obtain more favourable terms while

[1] Source: JLL, Investment Market Overview, April 2021, 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 not all-in margins, i.e. possible other fees (e.g. up-front) payable by the borrower are not included.

maintaining greater flexibility than traditional banks.

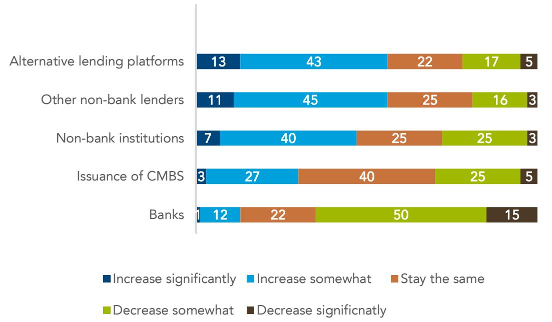

Figure 5: Respondents of the "Emerging Trends ins Real Estate" survey indicate a growing demand for alternative lenders.

There are several factors driving the rise of alternative lending, first and foremost regulation. In 2016, alternative investment funds (AIF) have been allowed to grant loans – which previously only banks were legally able to do. Furthermore Basel IV is due to be implemented by 2023, and with its rollout, the common equity tier one requirements will increase. Hence, for the same amount of risk-weighted assets, more equity is required. This implies that classic commercial lending activity (granting loans and retaining them on the balance sheet) is going to be more expensive. Apart from the previously mentioned fast, digitalized investment process, investors themselves also play a key role. Persistent low interest rates and yield compression in classic fixed income products are rendering more and more investors receptive to private debt investments.

Another reason for the success of alternative lending is differing valuation methodologies: Banks typically apply the mortgage lending approach, which is a conservative calculation methodology to assess the sustainable value of an asset. The gap between mortgage lending values and purchase price has increased in the last couple years. Lower bank values lead to lower loan amounts in relation to the purchase price. This also contributes to the lending gap that Whole or Mezzanine Loans are filling.

But this is just the beginning. According to the Bundesbank, German banks held more than EUR 1.6tn in real estate loans on their books at the end of Q1 2021, hinting at the enormous potential of the segment. Traditionally, alternative lenders' offerings were limited to higher LTVs with correspondingly high interest rates as well as mezzanine structures. Now, however, alternative lenders increasingly offer whole-loan financings, eating directly into the core business of commercial banks.

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 in mezzanine and whole loan financings. In addition, our wider Private Debt Team invests into Transport Debt, 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 private debt segments on behalf of institutional investors. Further information about Prime Capital AG can be found on our website www.primecapital-ag.com.

Contact:

Dennis Davidoff
Director
Real Estate Debt

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

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