



German Real Estate Debt

Newsletter Q3 2021

Summary

- > In Q2 2021, both margins for mezzanine financing and LTV/LTC levels saw substantial upticks.
- > The German real estate transaction volume reached EUR 17.5bn in Q2 2021, for a y-o-y increase of +20.7% and q-o-q of +5.4%.
- > The market environment remains attractive for alternative lenders, and demand for whole loans in particular is very strong.

Real Estate Market Germany

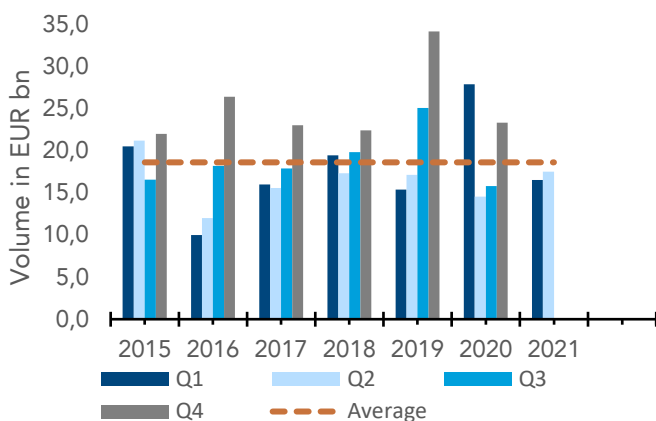


Figure 1: Transaction Volume by Quarter (Germany).

While total transaction volume declined by more than 40% in the first quarter, the situation was more favourable in the second quarter. During Q2 2021, total transaction volume of German real estate reached EUR 17.5bn (q-o-q: +5.4% and y-o-y: +20.7%; see Figure 1¹). The y-o-y number is slightly biased, given that the values start from a very low initial base

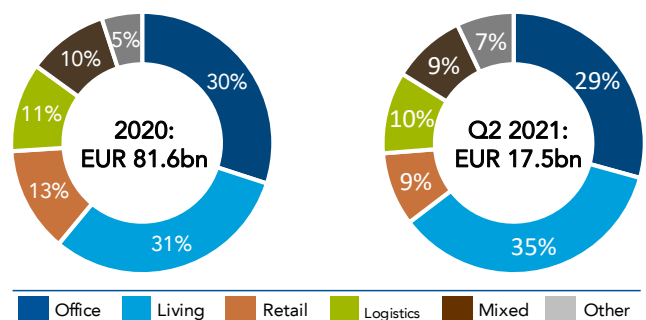


Figure 2: Transaction Volume by Asset Class (Germany).

due to the COVID-19 induced decline last year. But the q-o-q growth already indicates the trend towards a recovery. Heading back to normality with high vaccination rates and the easing of lockdown restrictions, investors start to focus again on macro trends such as the future of the office, the

¹ Source: JLL, Investment Market Overview, July 2021
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role of city centres as a central shopping location and the influence of sustainability on the property market.

The focus of investors on security and value preservation is currently reflected in the transaction figures of the Top-7 cities. Here EUR 10.7bn was invested in the second quarter, which corresponds to more than half of the total transaction volume. Across all cities, average transaction volume decreased slightly by 3%. In terms of the breakdown of transaction volume by asset class (see Fig. 2), the residential segment again accounted for the largest share (EUR 6.1bn, 35%). Half of the largest transactions involved portfolios with residential properties. The share of office properties in the mix accelerated significantly compared to Q1 (EUR 5.1bn, 29%). 90% of the largest office transactions this year have been conducted over the last three months. This encouraging development is mainly due to the presence of a COVID-19-induced bottleneck, composed of transactions initiated in 2020. The remainder of the sectors is split rather evenly between retail (EUR 1.6bn, 9%), logistics (EUR 1.8bn, 10%), mixed properties (1.6bn, 9%) and others (EUR 1.2bn, 7%).

Prime equity yields dropped marginally (10 – 15 bps) across all locations in the Top-7 cities. The anticipated yield compression from our previous newsletter publication now starts to materialize slowly, although the effect is not only felt in retail and logistics as forecasted, but also in the office sphere where developers cope with macro trends such as increasing sustainability requirements.

Mezzanine Financing Market Overview

Looking at the Mezzanine financing market for existing properties (Figure 3), the second quarter was characterised by a small increase in mezzanine margins, at elevated levels. The interest rates for development financings (Figure 4) bounced back significantly. Overall, the positive trend for real estate debt investors continued in the second quarter: LTV and LTC levels also saw a substantial increase.

Prime Capital’s proprietary deal database² provides some more transparency into the opaque CRE debt market. On average, LTV values for Mezzanine financings of existing properties during the quarter ranged from 75% to a maximum of 86%. The average LTV in Q2 2021 is located at the upper end of that range at 84%, implying a six percent increase over the previous quarter. In terms of pricing³, margins ranged from 783 bps to 1267 bps. The average margin was 1015 bps – a slight 33 bps increase compared to the previous quarter.

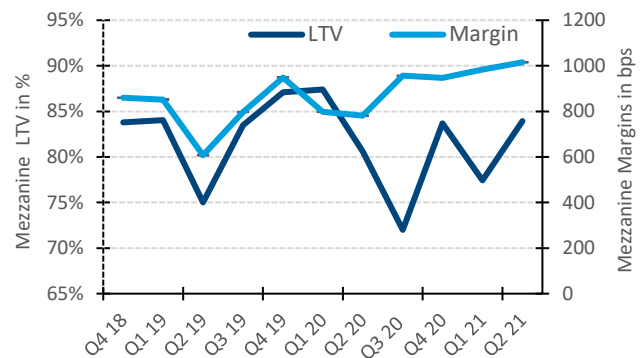


Figure 3: LTV and margins for existing properties mezzanine financing in Germany.

Mezzanine financing of developments exhibited LTC values during the quarter from 78% to a maximum of 85%. The average for Q2 2021 was at 79% (+9pp in comparison to Q1 2021). Margins during Q2 2021 ranged from 808 bps to 1450 bps. The average was at 1168 bps, implying a substantial increase of almost 300 bps compared to Q1 2021.

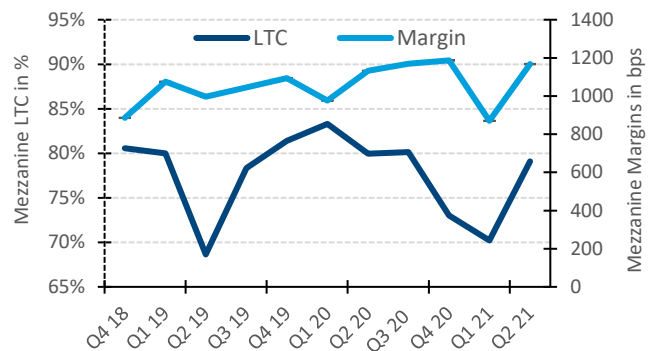


Figure 4: LTC and margins in mezzanine project development financings in Germany.

Current Alternative Financing Market

We continue to observe financing gaps in the market, that are no longer filled by banks. In this context, we observe high demand for whole loan financing. Whereas in the past the focus of debt funds was mainly on mezzanine, alternative providers are now taking advantage of the fact that they can also provide financing without a bank as a so-called “whole loan” lender, thereby covering the entire financing (senior and mezzanine) in one single tranche. As a result, the financing is also secured in the first rank, which increases the collateral position accordingly and at the same time reduces complexity as there is only one financing partner for the borrower.

Likewise, the advantage of whole loans - compared to traditional bank financing - lies in the greater flexibility of the

² The aggregated data for mezzanine financings in this section is based on the transactions conducted by Prime Capital1 (closed-, pipeline- and rejected-deals).

³ These are all-in margins, i.e. possible other fees (e.g. up-front) payable by the borrower are included in the data.

loan structure with LTVs of up to 80%, a high level of transaction security and fast credit and pay-out processes. Due to flatter hierarchies, a lower level of regulation and more agile operating models, credit funds can usually act quicker and be more flexible in their underwriting process, to the benefit of the borrower. The borrower, in turn, is willing to pay higher interest rates because he receives the entire financing from a single source as a one stop solution.

As an interesting case study, we present below a whole loan senior secured transaction which we closed this quarter with an experienced sponsor, moderate LTV level due to a high cash equity contribution and a double digit target IRR. The underlying asset is a mixed development project of three separate building blocks that are split into two office buildings and one residential property in a major city in Eastern Germany. The sponsor is an experienced project developer, specialized in residential and office properties and a hidden champion in Eastern Germany. Final building permit is expected beginning of next year. We structured the financing as follows:

Location	East Germany	Rank	Senior secured (Whole Loan)
Sector	Living & Office	Amount	EUR 15m
Strategy	Development	Term	2 years
Units	n/a	Exit-LTV	< 75.0%
Total Space	>30,000 sqm	Target IRR	11.0%
All in costs (acquisition phase)	EUR 26m	Covenants	LTV, LTC
DGNB certificate	Gold	Guarantees	Personal, maximum liability

The market environment remains attractive for alternative financiers. We have a full pipeline and are able to cherry-pick the most promising transactions for our investors.

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 570m 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.

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