PRIME CAPITAL

# 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

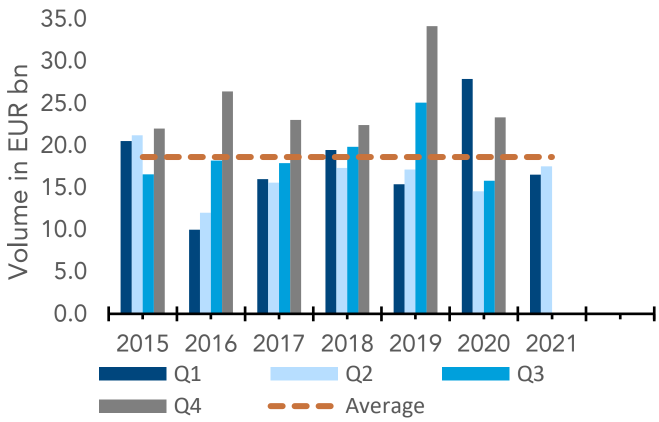


*Figure 1: Transaction Volume by Quarter (Germany).*

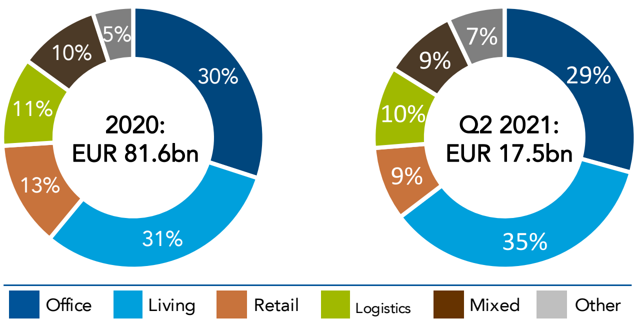


*Figure 2: Transaction Volume by Asset Class (Germany).*

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 1[1]). The y-o-y number is slightly biased, given that the values start from a very low initial base 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

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 were 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 margins for development financings (Figure 4) have normalized again from the exceptionally low level of the previous quarter. Overall, the positive trend for real estate debt investors continued in the second quarter.

Prime Capital's proprietary deal database[2] 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 pricing[3], margins ranged from 783 bps to 1267 bps. The average margin was 1015 bps – a slight 33 bps increase compared to the previous quarter.

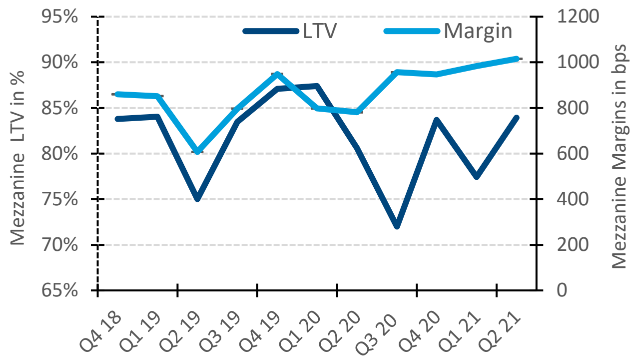


*Figure 3: LTV and margins for existing properties mezzanine financing in Germany.*

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.

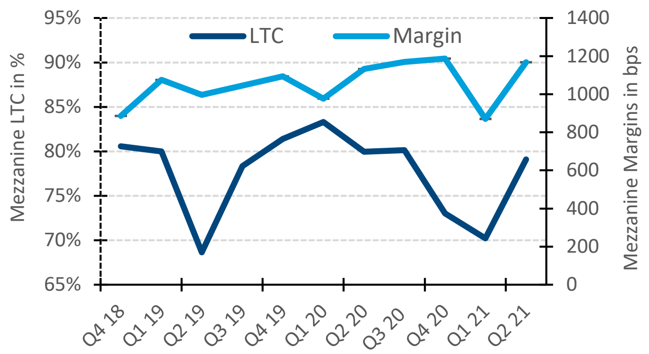


*Figure 4: LTC and margins in mezzanine project development financings in Germany.*

## 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 Capital (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.

PRIME CAPITAL

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.

### Contact:

**Dennis Davidoff**
Director
Real Estate Debt

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

PRIME CAPITAL

*Disclaimer:*

*The information and opinion contained in this document (hereinafter "**Information**") is provided only for advertising 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.*