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German Real Estate Debt

Newsletter Q1 2022

Summary

> Q4 2021 was the strongest quarter for the German RE market in terms of transaction volume over the last 5 years with a total deal volume of EUR 50bn and EUR 111bn for the full year 2021.

> Loan margins for mezzanine financing remain stable at high levels for the past three quarters.

> The pipeline and opportunity set for established alternative lenders continues to grow. Prime Capital was able to close an attractive financing for an office development in Frankfurt CBD with an IRR of > 12%.

> The office segment continues to play an important role in the real estate market, particularly as supply shortages of high quality office space in CBDs of major cities will lead to increasing rents and the need for new developments.

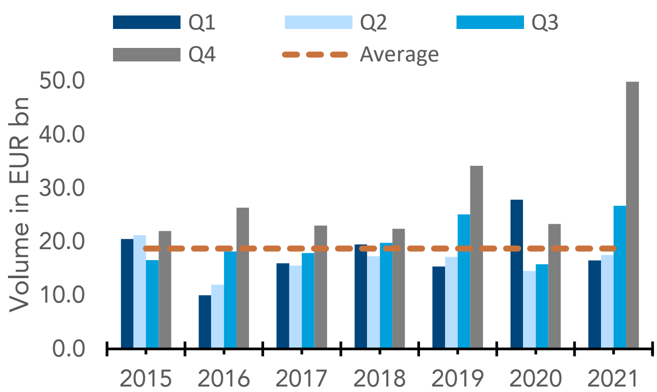

Figure 1: Transaction Volume by Quarter (Germany).

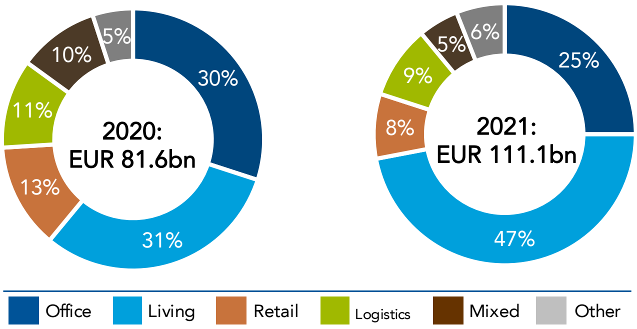

Figure 2: Transaction Volume by Asset Class (Germany).

Real Estate Market Germany

The transaction volume in Germany has hit a new record in 2021 amounting to EUR 111bn for the full year, up 36% from 2020. With a transaction volume of EUR 49.9bn in Q4 2021, the second half of the year was particularly strong, accounting for almost 70% of the total transaction volume for the year (see Figure 1[1]). The record transaction volume – in particular in the second half of 2021 – was driven by continuous capital pressures from investors and rising inflation that made real estate attractive as a protecting

[1] Source: JLL, Investment Market Overview, January 2022.

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asset class. 10 high-profile transactions with a volume of more than EUR 1bn, seven of which were completed in Q3 and Q4, made a particular contribution to the H2 volume. Particularly outstanding are the €23.5bn residential portfolio deal in the course of the Vonovia/Deutsche Wohnen merger and the sale of the Frankfurt office tower T1 for €1.4bn, the largest single deal in 2021. In the fourth quarter, the sale of an Oppenheim/Esch fund for EUR 1.1bn to RFR gained a lot of attention.

In 2021, investments in residential assets remained in the spotlight. Around EUR 52.2bn, or 47% of the total transaction volume has been invested in residential real estate. Office properties follow with a share of 25% of the total transaction volume, amounting to EUR 27.5bn for the year 2021. Although the share has dropped by 5% YoY, 2021 has delivered the third-best result for the past ten year with 27 large transactions, each worth more than EUR 200m. The strong performance was mainly driven by investors' confidence in the asset class as well as a better than expected recovery of the office letting market. Logistics has maintained its steep growth in the shadow of the two dominant segments. With more capital than ever invested in distribution, warehousing and production facilities, the total transaction volume amounted to EUR 10.2bn, equivalent to a share of 9.3%. This trend is expected to continue in 2022, as demand in the e-commerce, healthcare and life sciences segments continues to rise, while production sites are moving closer to Germany as global supply chains are optimized. Only EUR 8.5bn was invested in retail properties in 2021, representing 8% of the total transaction volume. However, with 64% of the volume achieved in the second half of the year, an encouraging recovery start can be observed for the retail segment. Nonetheless, disturbances of the Covid-19 pandemic are still present as foreign investors continue to withhold capital, while the investments into the segment have been very homogenous with 70% of the total transaction volume (ca. EUR 6bn) going towards more resilient, food-centred properties such as supermarkets and discounters.

The top 7 German cities continue to be the main target for investors. With a transaction volume of EUR 70.7bn, they account for 64% of the total transaction volume in 2021, an increase of 75% vs. the previous year. Due to its large residential market, Berlin has strengthened its lead for national and international investments with a transaction volume of more than EUR 37bn (+192% year-on-year).

Mezzanine Financing Market Overview

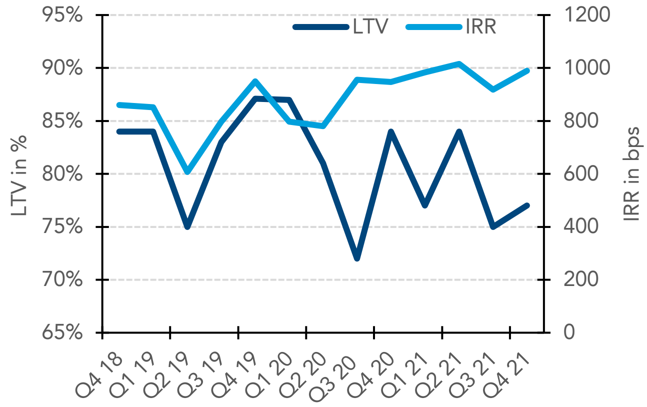

Figure 3: LTV and margins for existing properties mezzanine financing in Germany.

Prime Capital's proprietary deal database[2] provides more transparency into the opaque CRE debt market. For the full year 2021, we have observed stable mezzanine debt returns for existing properties of around 9.7% IRR (Figure 3) on average. In Q4, we saw a recovery from the slight compression in the previous quarter to around 10%. On average, LTVs for mezzanine financings of existing properties during the fourth quarter ranged from 65% to a maximum of 80%. The average LTV in Q4 2021 is at 73%, implying a two percentage point decrease compared to Q3. Returns for development financings (Figure 4) have been rather stable during 2021, hovering around 11% over the past three quarters. In Q4 the IRR for development financing dropped slightly by 70bps to 10.8%. With the demand for new developments increasing, returns for this segment have stabilized. Mezzanine financing of developments exhibited LTC values during Q4 2021 ranging from 65% to a maximum of 95%. The average stood at 83%, ticking 3 percentage points higher in comparison to the previous quarter.

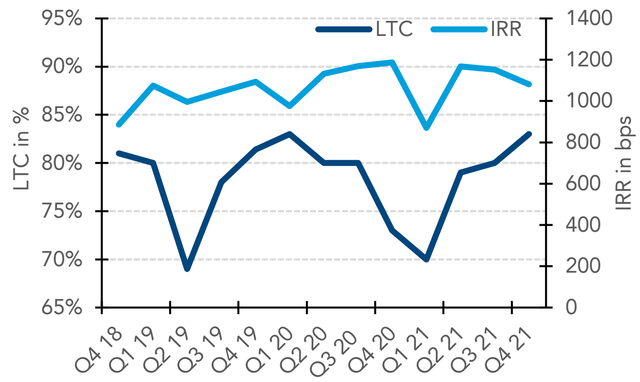

Figure 4: LTC and margins in mezzanine project development financings in Germany.

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

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Increased capital requirements for banks generate opportunities

The German financial regulator BaFin recently announced to raise capital requirements for banks' risk-weighted-assets (RWAs) by an anti-cyclical component to 0.75% starting from February 1st, 2023. In addition, the regulators plan to establish a systemic risk buffer for real estate loans. This sector specific capital requirements are expected to be around 2% of RWAs from loans backed by residential mortgages, making the issuance of real estate loans more expensive. With higher capital requirements increasing a bank's cost of lending, they could either reduce their RWAs by lending less and/or smaller ticket-sizes or they could increase interest rates as a way to pass on increased costs to borrowers. Both cases lead to lower competitiveness of banks. Alternative financiers fill the gaps left by banks and cover increasingly complex financing situations and gain more and more market share. At the same time, due to the financing gap, alternative financiers are able to achieve higher margins. Institutional investors can participate in higher returns in this market through new, flexible financing structures without increasing the risk of their investments.

Office segment – how sustainable is the recovery?

In 2021 the top 5 German letting markets generated a total transaction volume of 2.6m sqm, outperforming the 2020 result by 21%. Although, there is still uncertainty in the market due to the continuous presence of the Covid-19 pandemic and various restrictions still being in place, the market development in the top 5 office markets generally points towards companies' growing confidence. This trend is expected to carry through 2022 as positive backlog effects should lead to another sharp recovery in the office leasing market, along with rising demand for office space.
Despite the now undisputed place of remote work in everyday work, we believe the office will continue to be the place for knowledge sharing, communication and creative collaboration. Nonetheless, the requirements occupiers have for their office spaces will change as a physical representation of the added value of the office for their employees will be the focus. These changed requirements are likely to cause rent levels in good locations in the top office markets to rise further. Along with the recent surge in building costs, rents will also be driven by the prevailing shortage of sufficient large office spaces with high quality fit-outs. This shortage is manifested in extremely low vacancy rates of below 2% in the CBDs of major office centres, such as Berlin or Munich.

To counterbalance the high excess demand for large and high quality office space in major city centres, property development becomes critical. It is estimated that by 2024 7.0m sqm of newly built or renovated office space will be placed on the German market, of which 40% are already pre-let or owner occupied. In 2022 alone, 2.0m sqm is expected to be put on the market with a current pre-letting rate of 56%

In order to close the supply gap for high quality office space, Prime Capital is committed to invest in office developments in top locations and support experienced sponsors that centre their developments on digitalization, and the implementation of ESG standards.

Sample Q4 2021 transactions within the office segment

In Q4 2021 our real estate debt team was able to close a landmark office project development in the CBD of Frankfurt. The property is located in a very good inner city location, particularly suited for the planned use as one of Frankfurt's most modern "New Generation" office buildings with flexible layout. The asset offers flexibility for a single as well as a multi-tenant rental strategy. We arranged a EUR 90m Senior tranche with a German institutional investor and a EUR 40m Mezzanine tranche for one of our discretionary debt fund vehicles. The transaction provides an attractive risk/return profile due to a strong collateral package in combination with a reasonable Exit-LTV at an above-market IRR level for both the Senior and Mezzanine tranches.

Transaction 1: EUR 130m Real Estate financing for a modern office project development in Frankfurt CBD

City	Frankfurt CBD	Rank	Senior & Mezzanine
Sector	Office	Size	EUR 190m of which EUR 130m were arranged by Prime Capital
Strategy	Project development	Term	1.5 years
Land plot size	5,620 sqm	LTV (Mezz)	< 75 %
Rentable area	35,820 sqm	IRR	Senior: > 4% Mezz: > 11%
Parking lots	100	Covenants	LTV, LTC, milestones
Total project costs	c. EUR 250.9m	Collaterals (among others)	1st / 2nd lien mortgages, share pledges, guarantees

As one of our most recent transactions, we were able to close an office development financing with our mezzanine debt fund. The financed development project is a 5-story office building with around 10.000sqm rentable office space, and 150 underground parking lots. The project is located in

greater Stuttgart, right next to an international airport and with good access to individual and public transportation. A building permit has been obtained and the construction work started last year. With the mandate of a general contractor, the sponsor achieved a high degree of cost security. Furthermore, the sponsor was able to secure an international tenant with an investment grade rating. We structured our mezzanine financing with an IRR of >11%, an Exit-LTV of c. 75%, and a strong collateral structure with a subordinated land charge, a sponsor guarantee, and a first-ranking share pledge.
Due to the high demand for Mezzanine and Whole Loan capital, we have more attractive opportunities in our pipeline.

Transaction 2: Attractive > 11% IRR return for a modern office project development in greater Stuttgart

Sector	Office	Amount	EUR 8.0m
Strategy	Project development	Term	1.5y
Energy efficiency	KfW-55	LTV	c. 75%
Rentable area	> 10.000 sqm	IRR	> 11.0%
Pre-letting	Investment grade tenant	Covenants	LTV, milestones
Market Value (at completion)	EUR 54.9m	Collaterals (among others)	2nd lien mortgage, Sponsor guarantee

About Prime Capital's Private Debt Team

Our team has been active in the Real Estate Debt market for many years, with a particular expertise in mezzanine and whole-loan transactions and has already carried out transactions of more than EUR 700m. 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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