



Birds-Eye View on Private Debt Markets

Q3 2021

Private Debt is an important and growing segment of financial markets for institutional investors. Prime Capital’s quarterly Birds-Eye View on Private Debt Markets aims to provide a concise assessment of trends and pricing in markets, which due to their private nature, are necessarily less transparent than public fixed income. We hope this publication will be helpful to investors in Private Debt.

We estimate current spreads based on the wide range of transactions we observe in the course of our business. Due to the heterogeneity of obligors, credit qualities, structural features, security packages, etc. a certain level of abstraction and significant degree of judgement is required to arrive at the estimates, which, as such, reflect a good deal of expert opinion. It is also to reflect this heterogeneity that we report spread ranges rather than point estimates. In addition, we put current spreads in historical perspective, based on our past estimates, as well as provide projections of future spread developments. These projections, enriched by Prime Capital’s Private Debt Portfolio Management team’s qualitative assessments, provide the basis for our Tactical Portfolio Allocation, which is reported at the end of the document. The Market Trends section both reports significant events and serves as a basis for the qualitative assessment.

Pricing

	Current Spread	LTM ¹	NTMe ²
Senior Infra Debt	190-300bps		
Mezzanine Infra Debt	400-580bps		
Mortgage Debt	110-140bps		
Senior Real Estate Debt	150-250bps		
Whole Loan Real Estate Debt	450-650bps		
Mezzanine Real Estate Debt	650-1,500bps		
Senior Corporate Debt	290-450bps		
Senior Government Risk Related Transport Debt	190-260bps		
Senior Commercial Transport Debt	300-450bps		
Mezzanine Transport Debt	500-650bps		

Figure 1: Pricing of selected Private Debt asset classes
Source: Prime Capital Research

Strong increase in spread level
Strong decrease in spread level

¹ Last twelve months
² Next twelve months expectation
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Methodology: The assessment of asset class pricing of the last and next twelve months is represented by the traffic-light system and based on Prime Capitals opinion and ranges from 0 to 5, where 0 indicates a strong decrease and 5 indicates a strong increase of spreads. A value of 3 indicates stable market spreads.

Market Trends

- > Most economic outlooks expect continuing low interest levels since the central banks further intend to support the suffering economies which were hit by COVID-19. This implies that residential and commercial real estate will continuously face high price levels since these asset class continues to offer interesting returns. Overall, the transaction volume of nearly EUR 24bn in H1 2021 is on par with pre-COVID-19 levels.
- > We observe that loan refinancings with existing senior lenders becomes more challenging since banks require more equity or are not willing to refinance hotel or retail loans. In addition, Timing for lending transactions becomes more crucial, especially for land acquisition development loans and construction loans, since short approval procedures generate competitive advantages in bidding procedures. This currently provides a clear advantage for Whole Loans.
- > The deal volume in the infrastructure market is still working on its recovery from the pandemic with the total deal value being 18.4% below H1 2020. Whilst sectors like Renewables and Telecommunication show stable to increasing activity, the Transport and Power sectors are still faced with consequences of global macro-trends, such as decarbonization and digitalization, as well as factors stemming from previous lockdowns. Whereas overall activity fell across the broad infrastructure market, the most significant impact is observed in the loan market. Although the pandemic led to a slowdown in transaction volume on the infrastructure debt market, as equity financing plays an increasing role, classical bank financing managed to establish their role as primary debt provider. Currently they still account for about 80% of total infrastructure debt volume.
- > In Europe, value can still be found in telecommunication projects, with a significant share of 34% of the market being allocated towards this sector in H1 2021. Backlog in the German fiber roll-out led to increased activity in the greenfield and value-add fiber market, whilst digital infrastructure is also going brownfield. In H1 2021, landmark brownfield deals in the tower, data center and fiber sub-sectors were closed in Central Europe. While telecom deals still offer attractive risk/return profiles for debt investors, other sectors experience further pressure on pricing. For example, the renewable sector has seen high interest from banks with further tightening margins alongside increasing merchant/price risks.
- > In the first half of 2021, the global air travel sector continued its recovery from a long hibernation. Passenger traffic saw continued modest improvements and the stored global aircraft fleet was steadily reduced during the second quarter. However, overall traffic remained well below pre-COVID-19 levels of 2019. In June 2021, Industry-wide revenue passenger kilometres (RPKs), as an indicator of global passenger demand, were -60% below the pre-crisis levels in June 2019. Furthermore, available seat kilometres (ASKs) in June 2021 show a -52% decline compared to June 2019. Although RPKs and ASKs remain subdued compared to pre-COVID-19 levels, they still demonstrate improvements compared to the prior months.
- > Value can still be found in more complex structures, including residual value risk or higher LTV's. Given that banks have reduced their lending levels, LTV's have decreased and borrowers may require mezzanine debt to close the gap between equity and senior. Taking into account the strengthened market positions of some airlines and the correction in asset values, such a portfolio should provide institutional investors with an attractive risk and return profile.

Tactical Portfolio Allocation

- > Our Tactical Portfolio Allocation model currently covers seven Private Debt asset classes across different seniorities.
- > In Q3 2021, the strongest asset classes are Transportation Mezzanine, Transportation Senior and Corporate Direct Lending. The asset class with the lowest score is Real Estate Senior.
- > Compared to Q2 2021, macroeconomic data in Q3 generally displays a higher score. Financial market indicators, especially concerning risk aversion, as well as asset class specific expert surveys (i.e. Lending survey), support the improved rating.
- > Apart from Corporate Direct Lending, liquid spreads generally increased, whereas the indicators for credit risk decreased for every asset class, except for Real Estate Senior and Transportation Senior, resulting in a slight decrease in the overall score.
- > In comparison to Q2, asset classes Transportation Senior and Mezzanine show the highest increase in their overall scores, with both asset classes showing increased scores for macroeconomic data and pipeline. Additionally the rating for liquid benchmark and financial market indicators improved for the Senior tranche, whereas it slightly decreased for the Mezzanine tranche. However, in the overall rating this is compensated by a significantly elevated expert opinion score.
- > The overall score for both Real Estate asset classes remained steady compared to Q2, with a slight increase in Real Estate Senior scores. This is partly due to deteriorating signals of the pipeline in combination with higher scores for the macroeconomic data. While the scores of expert opinion and the financial market indicators drift further apart, the

ranking of the liquid benchmarks reversed with lower scores in the Mezzanine market and increased scores in the Senior market.

- > In Infrastructure Debt, both, Senior and Mezzanine debt continuously show strong performances. The asset class can be understood as a basis investment with stable returns and low volatility. In more detail, Infrastructure Mezzanine scores equal or higher in all sub-categories than in Q2, apart from liquid benchmark. A similar trend can be observed in Infrastructure Senior with predominantly increased scores, except for the sub-category expert opinion.
- > The score for Corporate Direct Lending remains stable, however expert assessments are still above the historic average, which could indicate a market with interesting targets if you are selective.

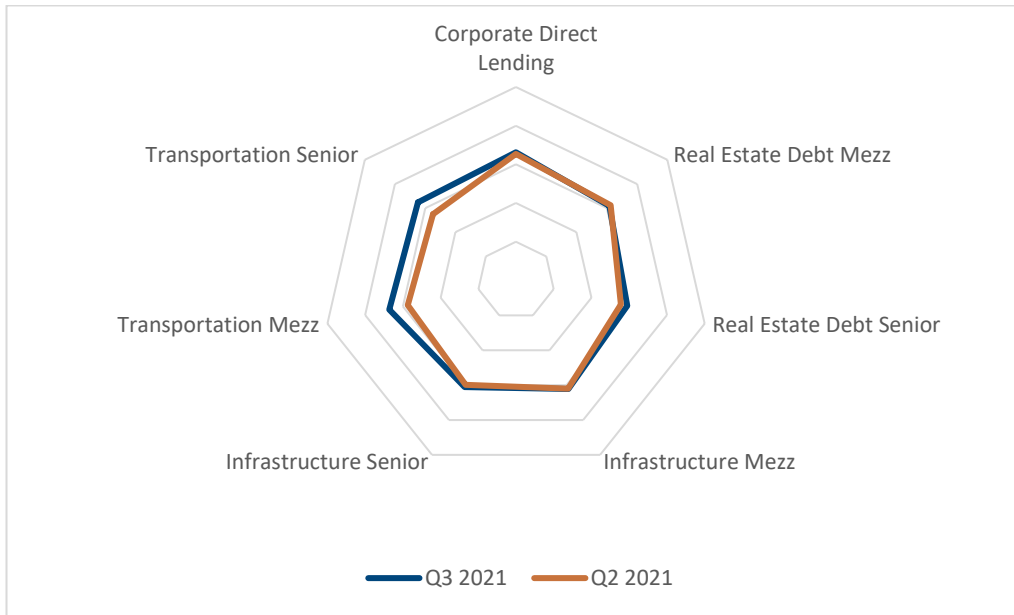


Figure 2: Assessment of selected Private Debt asset classes

Source: Prime Capital Research

Tactical Portfolio Allocation Methodology: The asset class specific grades describe the asset class specific investment environment relative to historic observations. Grades range from 0 to 5, where 0 indicates that the current investment environment compares to the worst observed historic outcomes and a value of 5 indicates a historically attractive investment environment. A value of 3 indicates the historic median. The grades are derived from 5 sub-categories: macroeconomic survey data, financial market variables, liquid benchmark proxies, pipeline and expert opinion. Each sub-category is comprised of several variables. For each variable we define a grade based on the comparison of the current realization to percentiles of the historic distribution. E.g. the PCAG illiquidity premium in June 2021 was 141bps, which is above the 75th percentile of the historic spread distribution and is associated with grade 5. A PCAG illiquidity premium close to the median would imply grade 3. To obtain the grades associated with the 5 sub-categories, we take the average across all individual variable grades associated with the respective category. The final grade is then the average of the 5 sub-categories.

About Prime Capital's Private Debt Team

Prime Capital's Private Debt Team manages in excess of EUR 2bn across asset classes for institutional investors. The Team invests in Infrastructure Debt, Real Estate Debt, Transport Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our predominantly institutional investors.

Further information about Prime Capital AG can be found at www.primecapital-ag.com

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Prime Capital Private Debt Expertise

- > Investment and Portfolio Management, advice and support for direct investments, portfolio strategy and sector allocation
- > Managed accounts and funds with investment expertise in various jurisdictions and markets
- > Unique “multi-channel sourcing” with access to transactions via direct lending, bank and advisor sourcing on the basis of longstanding relationships to market leading sponsors, equity funds and banks
- > Independent Risk Management function to improve sustainable investor yield
- > Investments in Senior and Mezzanine debt, global as well as local investment strategies
- > Specific ESG related strategies

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