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German Real Estate Debt

Newsletter Q1 2020

German Real Estate Q1 2020 Overview

> Q1 2020 closed with a transaction volume of EUR 28bn, a new record compared to the first quarters of the last six years.
> Due to COVID-19, the approval of senior loans within banks is delayed and takes currently considerably more time. Some banks have even stopped new business (especially for non-existing relationships and in project development).
> Conditions in new business are deteriorating for borrowers (pricing up, leverage down, collateralization, tighter covenants, etc.).
> Current situation is a major driver for an increasing demand for alternative lending solutions.

Real Estate Market Germany (Equity)

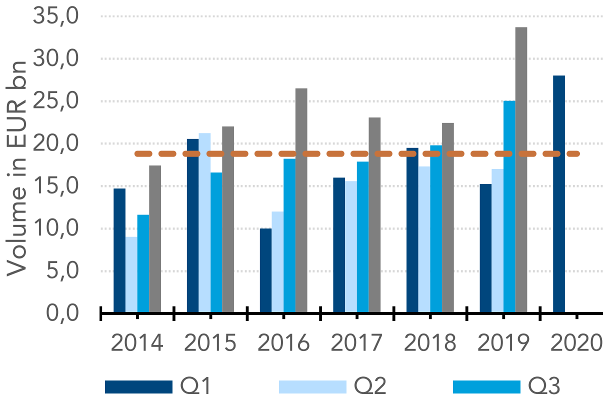

Figure 2 Transaction Volume Germany[1]

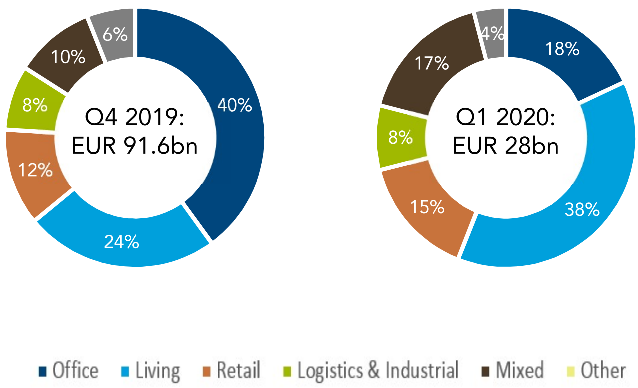

Figure 1 Transaction Volume by Main Asset class[1]

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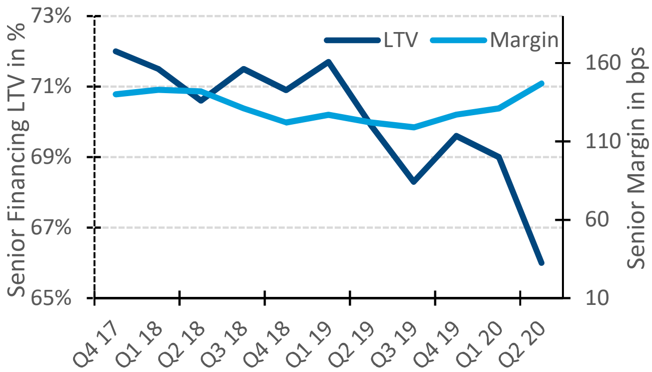
According to JLL report, the transaction volume in Q1 remains stable. In fact, the total German transaction volume amounted to around EUR 28 bn, of which EUR 18.3 bn is for commercial real estate and EUR 9.7bn is for residential property. This is a new record compared to the previous first quarters of the past six years.
Berlin once more remains in its dominant position, with office property remaining in strong demand. In Munich and Frankfurt, the total transaction volumes increased considerably by 125% to almost EUR 1.5bn and 117% to around EUR 2.4bn respectively. Furthermore, total transaction volume in Top 7 cities is around EUR 11.5bn, of which Berlin accounts for EUR 3.9bn, Hamburg EUR 1.7bn, Düsseldorf EUR 1.2bn, Cologne EUR 450mn and Stuttgart EUR 350mn.

As shown in Figure 2, real estate segment volumes shifted in Q1/2020 compared to Q4/2019. Living properties account for around 38% (EUR 10.7bn) of the total transaction volume, followed by office with 18% (which account now for a much lower share compared to 40% in Q4/2019). Furthermore, retail accounted for a slightly higher share of 15% compared to the previous year[1]. The underlying reason is that essential-needs-retailers are immune to the Covid-19 pandemic, since supermarkets, drugstores among other provide groceries and other necessities to the population. Logistics still account for 8% of the volume.
Moreover, equity yields in the majority of asset classes remain stable for the first quarter. Yields currently stand at 5% for specialist stores and 4.2% for retail parks. Shopping center yields are at 4.65%, which is 55 basis points higher than 12 months ago. Furthermore, office prices remained at a high level in the Top 7, with an average office prime yield of 2.93%. This is 13 basis points lower in a 12-month comparison.

Senior Debt Financing Market Overview

Q1 2020[2]
Reported LTV and all in margin in Q1 have both decreased in comparison to the previous quarter; average reported LTV is around 69% (-0.6 pp vs. Q4 2019) and average all-in margin is around 131 bps.

LTV and margins for existing properties - senior financing



Outlook for Q2 2020[3]
The range of the LTV values from the interviewed market participants in Q2 2020 is expected to range from 40% to a maximum of 100%. The expected average reported value is around 66% (-3.3 pp vs. Q1 2020). The expected average LTV of the individual real estate segments ranges between 57% and 74%.
Margins for portfolio financings are expected to range from 65 bps to 250 bps. The expected average all-in margin across all property segments is around 147 bps (Q1 2020: 131 bps). The average gross margins of the individual

[1] Source: JLL, Investment Market Overview, April 2020, [5-6], available under: https://www.jll.de/en/trends-and-insights/research/investment-market-overview

[2] Source: BF direct AG, BF Barometer, February 2020, [7], available under: https://www.bf-direkt.de/unternehmen/quartalsbarometer/

[3] Source: BF direct AG, BF Barometer, April 2020, [7], available under: https://www.bf-direkt.de/unternehmen/quartalsbarometer/

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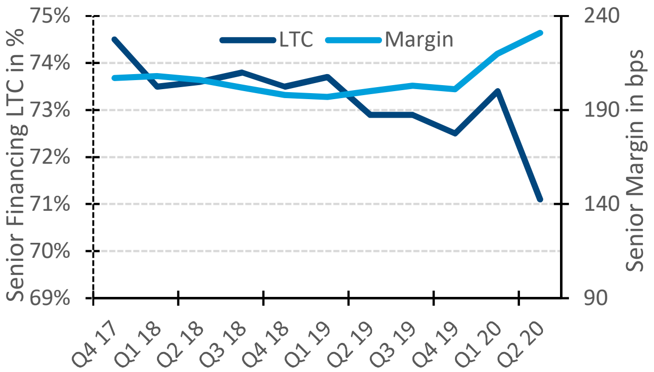
property segments are expected to range between 109 bps and 185 bps.
The data reveals a negative emerging correlation between LTVs and all in margins in the last months since Q4 2019.

LTC and margins for project developments – senior financing



Q1 2020Error! Bookmark not defined.
In contrast with the existing properties' results of Q1 2020, reported LTC and all in margins for project developments have both increased in comparison to the previous quarter; average reported LTC is around 73.4% (+0.9 pp vs. Q4 2019) and average all-in margin is around 220 bps.

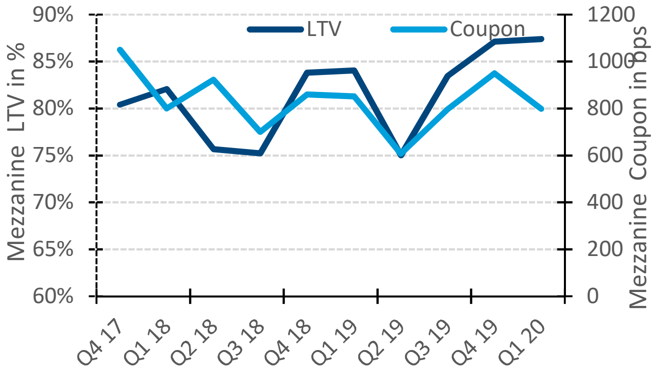
Outlook for Q2 2020[3]
LTCs in Q2 2020 for project developments are expected to range between 50% and 100%. On average the LTC is expected to be around 71.1% (-2.3 pp vs. Q1 2020). The average LTC of the individual real estate segments is expected to range between around 66% and 81%.

Project development financing achieves margins between 85 bps and 500 bps. The average expected all-in margin is 231 bps. This would be significantly above the previous quarter (Q1 2020: 220 bps). The average margins of the individual property segments are expected to range between 203 bps and 258 bps.

The data reveals an inverse relationship emerging between LTCs and all in margins in the last months.

Mezzanine Financing Market Overview

LTV and margins for existing properties mezzanine financing in Germany



(Source: Prime Capital)

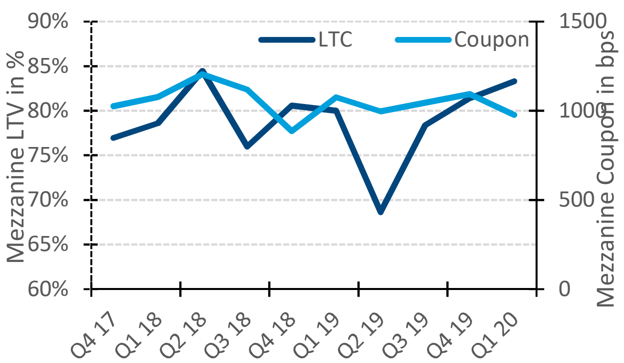
Based on Prime Capital's proprietary data[4], recent LTV values observed in the market over the observation period (Q4 17-Q1 20) range from 75% to a maximum of 87%. The average observed value for Q1 2020 is around 87.4%.

Coupons[5] for mezzanine financings of existing properties over the observation period range from 607 bps to 1,050 bps. The average margin across all property segments and locations in Q1 2020 is around 797.76 bps. This implies a decrease of -151.26 bps compared to Q4 2019 or a 54 bps decrease compared to Q1 2019.

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

[5]These are coupons which are not all-in margins, i.e. possible other fees (e.g. up-front) payable by the borrower would have to be added to receive all-in margins.

LTC and margins in mezzanine project development financing in Germany



(Source: Prime Capital)

Based on Prime Capital's proprietary data recent LTC values observed in the market over the observation period range from 69% to a maximum of 84%. The average observed value for Q1 2020 is around 83.3%.

Coupons for mezzanine financings of developments over the observation period range from 886 bps to 1,204 bps. The average margin across all property segments and locations in Q1 2020 is around 976.35 bps. Contrary to the LTC development, this implies a decrease of -117 bps compared to Q4 2019 or a -98 bps decrease compared to Q1 2019.

Demand for Non-Bank Financing Solutions

The reported figures are supported by the outcome of the recent panel conducted by BF direkt[3], which investigates the non-banking financing demand of real estate investors in the near-term future. Firstly, the quarter-on-quarter financing preferences show a trend away from senior secured towards higher demand for subordinated financing, e.g. demand for junior secured instruments rose considerably in Q1/20 to 19.4% then declined again to 14.3% in Q2 2020. Mezzanine financing remains with 36% the most sought-after financing alternative

Financing Type	Q4/19 in %	Q1/20 in %	Q2/20 in %
Senior Secured Loans (Bonds and Whole-Loans)	6.5	5.6	3.6
Junior Secured / Senior Unsecured	13.0	19.4	14.3
Mezzanine (subordinated bonds and loans)	37.0	36.1	39.3
Equity	26.1	22.2	25.0
Forward Commitments	17.4	13.9	17.9

Impact and implications of the COVID-19 pandemic on the real estate market

The outbreak of Covid-19 pandemic is generating several effects on the real estate sector. As such, real estate segments have been affected differently. In that regard, segments such as retail, hospitality and office are the ones mostly affected. . On the flip side, essential needs retailers (e.g. supermarkets) or the logistic sector (e.g. self-storage, warehouse) as well as residential have faced little impact. In that regard, according to a member survey of the housing industry associations[6]; approximately 1% of residential rents were delinquent.

Furthermore, the commercial real estate financing market is facing significant changes, namely:

- The granting of senior loans is delayed and takes currently considerably more time.
- Some banks stopped new business (especially for non-existing relationships).
- In new business, banks focus mainly on core properties and avoid cyclical asset classes (hotel, co-working, retail, etc.).
- Pricing is adjusted during the credit process (also for term sheets already issued and sometimes even for interest rate fixings for signed credit agreements).
- In general, conditions in new business are deteriorating for borrowers (pricing, leverage, collateralization, covenants, etc.).

The current situation is a major driver for an increasing demand for alternative lending solutions, such as real estate private debt via whole loans or mezzanine loans. Real estate investors and project developers require leverage on their equity in order to generate suitable returns on their equity or generate sufficient liquidity in order to develop projects. The fact that commercial and mortgage banks reduce lending volumes opens up the option to combine mezzanine loans with senior loans in a single tranche. A so-called whole loan combines the security position of a senior lender with returns from a mezzanine loan and generates a higher blended rate with an improved collateral position. Borrowers benefit from lower transaction costs and a faster approval process which allows them to act quickly on arising opportunities with increased LTV levels, allowing for higher returns on equity.

[6] Im immobilienmanager, Unterschiedliche Corona-Folgen bei Wohn- und Gewerbemieten, April 2020, available under https://www.immobilienmanager.de/unterschiedliche-corona-folgen-bei-wohn-und-gewerbemieten/150/76040/

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About Prime Capital's Private Debt Team

Our Real Estate team, which has been active in the Real Estate Debt market for many years, has already carried out transactions worth approx. EUR 400m. The Private Debt Team additionally invests in Aviation Debt (& Equity), Infrastructure Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our largely institutional investors.

Prime Capital's Private Debt Team manages in excess of EUR 2bn across these asset classes for institutional investors.

Further information about Prime Capital AG can be found on the web site
www.primecapital-ag.com

Contact:

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