



# European Real Estate Debt

Newsletter Q1 2023

## Summary

- > Annual European Real Estate investment volumes have decreased in 2022 by 18% compared to 2021.
- > Current market environment offers institutional investors interesting investment opportunities, as active alternative lenders can cherry pick and choose the most attractive financings in equity-rich structures.
- > Stable Q4 key figures in the alternative financing market with only small changes in returns and LTVs / LTCs of Whole Loan and Mezzanine financings, while returns have risen strongly YoY.

## Real Estate Market Europe

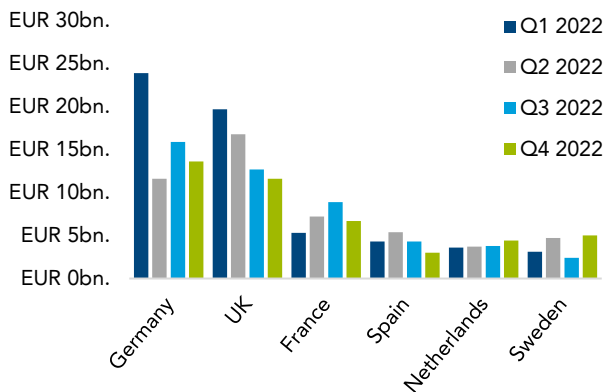


Figure 1: Transaction Volume by Quarter (Western Europe).

In the fourth quarter of 2022, the European real estate transaction volume amounted to EUR 62.8bn, leading to a 18% YoY decline with EUR 305bn for the total year<sup>1</sup> (2021: EUR 371bn). After the very strong first quarter, transaction volumes declined compared to the respective quarters in 2021 at increasing pace throughout the rest of 2022. The decline has peaked in Q4, recording a 58% YoY decrease against the highest ever Q4 one year ago (2021: EUR

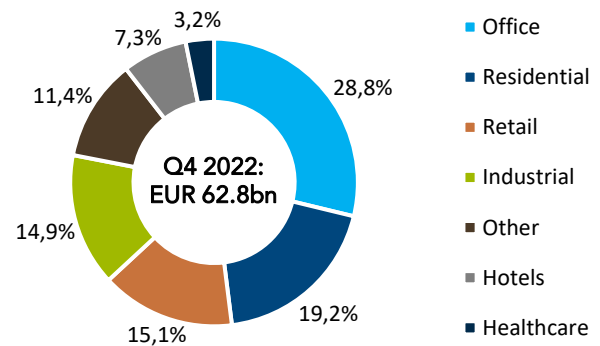


Figure 2: Transaction Volume by Asset Class (Western Europe).

148.6bn). The decreasing volumes in Q2-Q4 2022 reflect the current uncertainty in the market and the cautious attitude of investors as borrowing costs are increasing.

Country-wise, different trends can be observed. In comparison to 2021, investment volume increased in the low double digit percentage area in Southern Europe and even by 109% in Belgium, setting a new local record, while it decreased by 41% in Germany and by 52% in Sweden.

<sup>1</sup> Source: CBRE - European Real Estate Investment Volumes Q4 2022.  
Page 1

# PRIME CAPITAL

The decrease in Germany is strongly influenced by a 72% drop in Q4 volume as Q4 2021 was a very high benchmark. This is not only due a stronger market back then but also due to the huge single contribution of Vonovia’s takeover of Deutsche Wohnen bloating the volume statistics.

Different trends can also be observed among the sectors. Once again, office had the largest share with EUR 96.1bn in 2022, representing a 15% YoY decline largely driven by a weak Q4 compared to the exceptional Q4 2021 in line with the overall market.

The residential sector took the largest hit - mostly due to reduced platform activity - reporting 46% less volume than the year before. Thus, total 2022 volume came in at EUR 59.7bn, which was still enough to take the second spot in terms of market share, but the distance to the third spot is almost negligible.

The third place is taken by the industrial sector with EUR 57.7bn, a decrease of 8% compared to 2021. This decrease represents an above-market performance and can also be observed in the much smaller hotels sector, which experienced a 9% decline to EUR 16.1bn.

The only growing sector of 2022 was retail with 20% growth resulting in an investment volume of EUR 43.2bn. Even though this is by far the best performance across the sectors, it has to be contrasted against a very low 2021 influenced by Covid-19.

The smallest sector was again healthcare with EUR 9.8bn volume. This performance is in line with market, representing a 14% decline YoY.

## Mezzanine and Whole Loan Financing Market Overview<sup>2</sup>

In the fourth quarter of 2022, we observed stable LTVs at 75% for both Whole Loan and Mezzanine financings of existing properties. Simultaneously, IRRs for Whole Loans increased for the fourth consecutive quarter to now 6.50% (+25 bps, Figure 3) while IRRs for Mezzanine were unchanged at 12.0% (Figure 4). Taking a look at the whole year, IRRs have increased strongly in both categories reaching multi-year highs. This is an effect of both base rate increases as well as increased risk premiums following overall uncertainty. At the same time, LTVs have been broadly stable for both financing types.

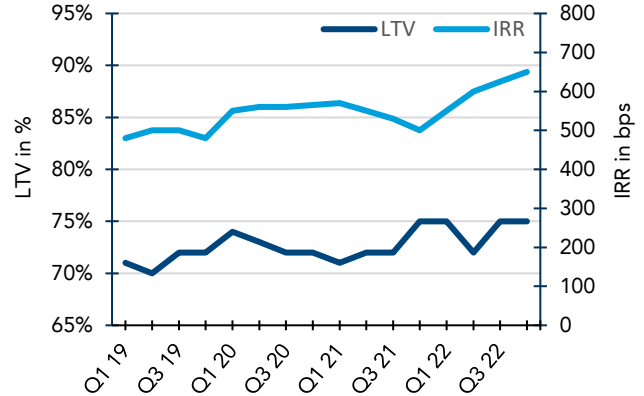


Figure 3: LTV and returns for existing properties Whole Loan financing in Europe.

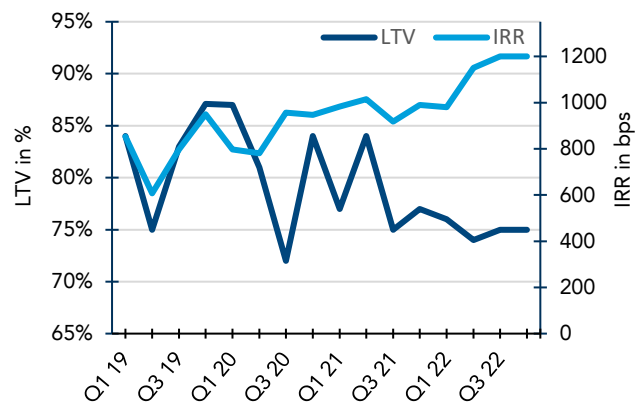


Figure 4: LTV and returns for existing properties Mezzanine financing in Germany.

Slightly higher LTCs were observed for project developments. Whole Loans had an average LTC of 73% in the last quarter of 2022, an increase of 1% compared to the quarter before (Figure 5). Looking at Mezzanine financings, average LTCs increased to 82% in Q4 2022 compared to 80% in Q3 (Figure 6). In regard to return levels, Whole Loans remained unchanged at 7.4% while Mezzanine Financings showed a continued increase to 12.75%, marking the fourth quarter of increases in a row.

Over the whole year, we observed strong increases in IRR levels across all Whole Loan and Mezzanine financings for existing properties as well as project developments as a result of the aforementioned trends of increasing interest rates and risk premiums. At the same time, LTV / LTC ratios remained broadly stable with YoY changes only in the lower single digit percentage range. This is partly a result of financing parties rather focussing on different risk metrics such as debt yields to factor in the increased refinancing risks due to higher rates and the slowdown in transaction volumes instead of solely analysing loan to value levels in relation to quickly changing property values.

<sup>2</sup> The aggregated data in this section is based on the transactions conducted by Prime Capital (closed-, pipeline- and rejected-deals).

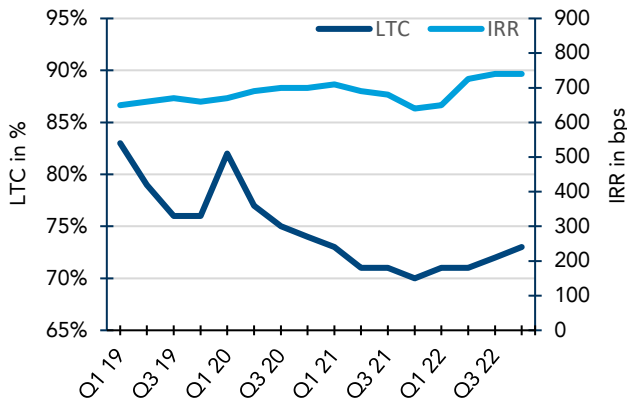


Figure 5: LTC and margins for Whole Loan project development financing in Europe.

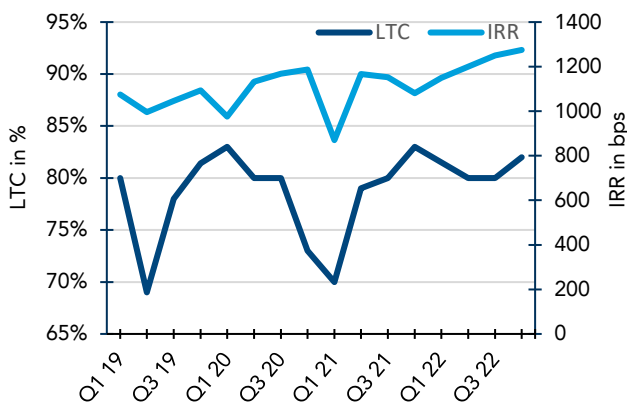


Figure 6: LTC and margins in Mezzanine project development financings in Germany.

## Current financing environment delivers attractive opportunities for Private Real Estate Debt investors

In the current market environment, we continue to see high demand for new financings and refinancings of real estate. Structural and regulatory changes have led to the withdrawal of traditional lenders in Germany and Core Europe.

Mortgage banks, larger regional banks and other domestic credit institutions typically offer senior financing with an initial LTV of up to 55-60%. A reversal of this trend is not expected at present. In this respect, there is currently a highly interesting market phase with many attractive investment opportunities:

**Active asset selection:** Due to the reluctance of banks, debt funds receive financing requests that were formerly reserved for classic financing and can select the most attractive transactions in terms of sponsor quality, risk and return. This increases the quality of financing requests on the part of alternative financing providers, who, however, face challenges in granting loans and go through a

correspondingly intensive credit approval process like banks.

**Current market environment leads to higher equity requirements:** For a successful closing, the contribution of equity in the form of an adequate amount of cash is the basic prerequisite for the structuring and issuance of debt capital to accompany project developments and existing real estate. Therefore, in the future, project developers will need more equity for a closed-end financing structure, loan-to-cost ratios will become more conservative and the risk for debt funds will decrease. 90%+ LTV/LTC structures that were seen by competitors in the market have nearly disappeared (partly together with the corresponding providers).

**Opportunities in refinancings:** Not all refinancings will be able to be carried out at the current interest rate level. In some cases, this will lead to the sale of assets, which will result in opportunities of lower purchase prices for equity-rich sponsors.

**Short maturities:** As opposed to long term oriented buy and hold equity strategies, alternative financiers generally invest on a short-term basis with average maturities of 1-3 years. This offers the advantage that the financing conditions are adjusted regularly and at shorter intervals to the current (higher) interest rate level and refinancings are made at correspondingly higher interest rates. As a result, in a rising interest rate environment, returns and distributions from investments made by the debt funds increase in favor of the investors.

**Market consolidation:** In recent years, a large number of new debt funds have appeared on the market. In particular, market participants with aggressive and highly leveraged funding structures have already been caught up in the consolidation wave. Further debt fund consolidation is expected in the market and many funds without funding or established track record will disappear from the market. This will result in further growth potential for established debt funds with moderate financing structures in order to be able to continue to operate in the market in the long term.

We thus have a well-filled and attractively priced pipeline for both Whole Loans and also Mezzanine Financings but remain very selective and reject about 95% of the opportunities out of various reasons (such as low debt yields, aggressive structures etc.).

Sample Q1 2023 transaction opportunities (pipeline)

Location	Sector	Asset Type	Financing Type	LTV	IRR	Size
Germany (Top 7)	Mixed Use	Development	Mezzanine	85.0% (LTC)	12.1%	20.9m
Netherlands	Residential	Existing	Mezzanine	75.0%	12.7%	11.2m
Germany (Top 7)	Logistics	Development	Mezzanine	85.0% (LTC)	11.5%	12.0m
Germany (Top 7)	Office	Existing	Whole Loan	72.2%	6.3%	35.0m
Germany (East)	Mixed Use	Existing	Whole Loan	66.0%	6.4%	57.7m
Germany (Top 7)	Mixed Use	Existing	Mezzanine	83.0%	11.5%	45.0m
Germany (South)	Office	Development	Whole Loan	73.0%	7.1%	16.0m

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 900m. 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.primcapital-ag.com](http://www.primcapital-ag.com).

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