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European Real Estate Debt

Newsletter Q4 2022

Summary

> The perceived slowdown in the market is currently not reflected in the annual transaction figures: The European real estate market has achieved another record result in transaction volumes for the first three quarters of 2022 with EUR 229bn.

> Stable key figures in the alternative financing market with only small changes in returns and LTVs / LTCs of Whole Loan and Mezzanine financings.

> Prime Capital's deal pipeline is well filled, as active alternative lenders can currently cherry pick and choose the most attractive financings in equity-rich structures.

Real Estate Market Europe

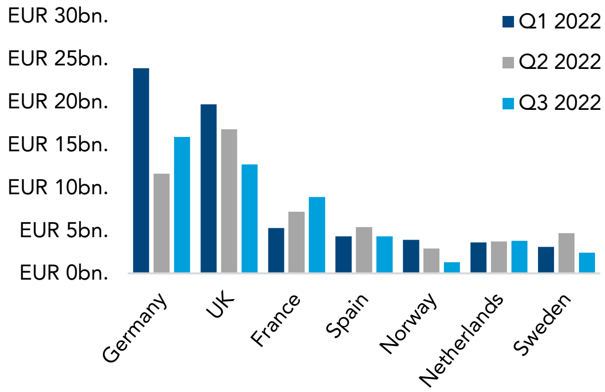

Figure 1: Transaction Volume by Quarter (Western Europe).

In the third quarter of 2022, the European real estate transaction volume amounted to EUR 68.4bn, setting a new record for the first nine months with a total investment volume of EUR 229bn[1] (+4% YoY). This is mainly due to the very strong first quarter, as transaction volume in Q3 2022 declined by 17% compared to the same period in 2021. The decline in Q2 and Q3 2022 reflects the current uncertainty in the market and the cautious attitude of investors as borrowing costs are increasing.

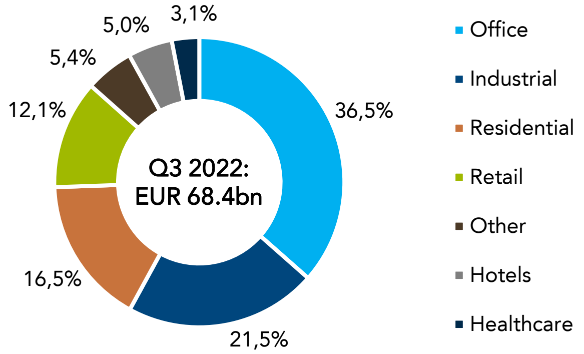

Figure 2: Transaction Volume by Asset Class (Western Europe).

Country-wise, different trends can be observed. While the investment volume in the BeNeLux countries increased by 45% compared to the first three quarters in 2021, thus

[1] Source: CBRE - European Real Estate Investment Volumes Q3 2022.

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reaching a new record, it decreased by 15% in Germany and by 47% in Sweden.

Looking specifically at the German real estate market, in contrast to the European market, transaction volumes improved in the third quarter compared to the second quarter, and volumes in the first nine months of 2022 were strong at EUR 51.9bn.

Different trends can also be observed in the sectors. The industrial sector was the most active with an investment volume of EUR 46bn in the first three quarters of 2022 (+18% YoY). Furthermore, its performance in the third quarter was up 13% compared to the previous year.

With an investment volume of EUR 8.3bn in Q3 2022, the retail sector reported a decline of 5% compared to Q3 2021. Comparing the performance of the first nine months of 2022 with that of 2021, this year saw an increase of 33%, mainly due to the sale of a portfolio in Spain worth EUR 2bn.

The office sector had the largest market share with an investment volume of EUR 25bn in Q3 2022 (+2% YoY). The volume for the first three quarters of 2022 increased by 14% compared to the same period in 2021.

There is a 14% increase in the healthcare sector when comparing the third quarter of 2022 to the third quarter of 2021, but there was a 6% decrease in the first nine months of 2022 compared to this time in 2021.

Looking at the hotel and residential sectors, transaction volume decreased both when comparing Q3 2022 to Q3 2021 (-17% and -55% respectively) and Q1-3 2022 to Q1-3 2021 (-13% and -25% respectively).

Mezzanine and Whole Loan Financing Market Overview[2]

In the third quarter of 2022, we observed a slight uptick in both returns and LTVs for Whole Loan and Mezzanine financings for existing properties. The average IRR for Whole Loans increased by 25bps compared to Q2 2022 to 6.25% (Figure 3). Looking at Mezzanine financings, the average IRR also increased by 50bps compared to Q2 2022, reaching 12.0% (Figure 4). At the same time, average LTVs are ticking slightly up for Whole Loans to 75% (+300bps – Figure 3) as well as for Mezzanine financings to also 75% (+100bps – Figure 4) compared to the previous quarter.

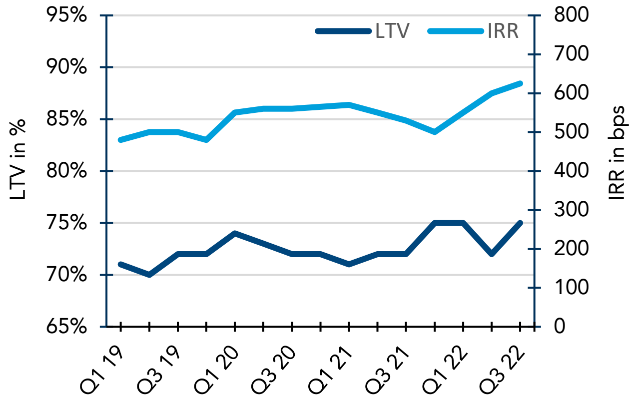

Figure 3: LTV and returns for existing properties Whole Loan financing in Europe.

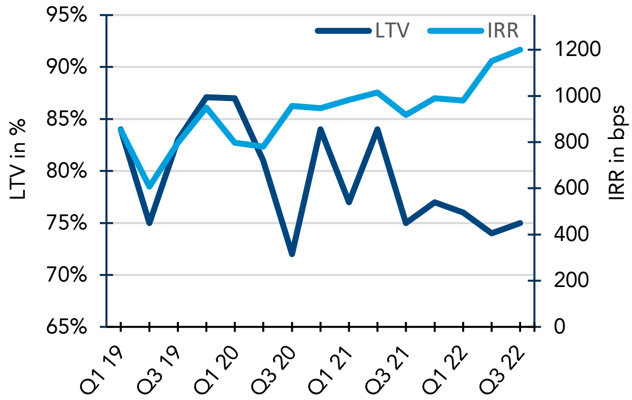

Figure 4: LTV and returns for existing properties Mezzanine financing in Germany.

Slightly higher IRRs were observed for project developments. Whole Loans had an average return of 7.4% in the third quarter of 2022, a small uptick of 15bps compared to the previous quarter (Figure 5). Looking at Mezzanine financings, average returns increased to 12.5% in Q3 2022 compared to 12.0% in Q2 2022 (Figure 6). Similar to IRR levels, Whole Loan LTCs increased slightly by 100bps to 72% compared to the previous quarter (Figure 5). For Mezzanine financings, LTCs remained steady at 80% (Figure 6).

Overall, we observed small upticks in almost all IRRs and LTVs / LTCs of Whole Loan and Mezzanine financings for existing properties as well as project developments, showing only a moderate development in a changing market environment.

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

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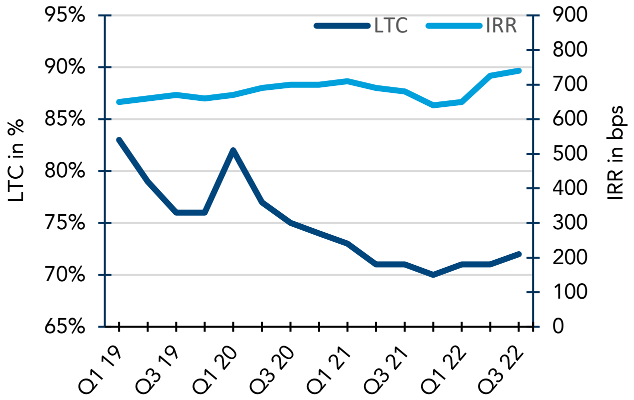

Figure 5: LTC and margins for Whole Loan project development financing in Europe.

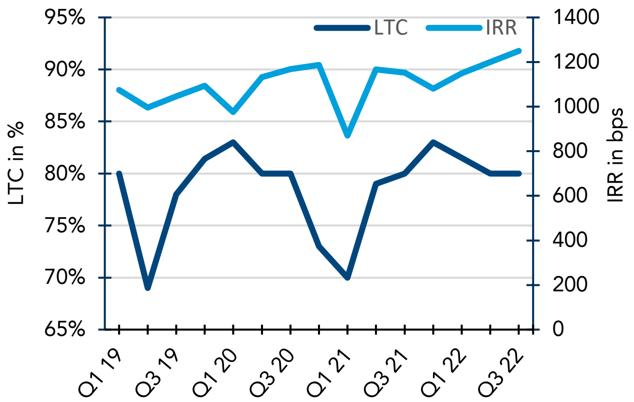

Figure 6: LTC and margins in Mezzanine project development financings in Germany.

In uncertain waters, it's time for fast moving alternative financiers

Prime Capital's real estate debt funds, which focus on Mezzanine and Whole Loans, have seen a sharp rise in demand for refinancing, whereas acquisition financing has declined sharply since the middle of the year due to the slump in the transaction market.

Whereas acquisition financing accounted for around 85% of our inquiries in the first half of the year and refinancing for the smaller share, this situation was completely reversed in the second half of the year. We observe a large number of borrowers in the market currently facing the challenge that projects and sales processes are delayed, but expiring loans from banks, insurers and subordinated financiers are not extended. Borrowers are currently being increasingly pushed by lenders to tackle the refinancing of soon-to-expire loans at an early stage. For fast moving alternative financiers this generally creates additional financing opportunities. As pleasing as the increased demand for our product (Whole Loans or Mezzanine) is, it must also be noted that some projects, particularly in the project development area, can no longer be profitably completed from today's perspective and are therefore no longer eligible for financing. Neither banks nor other financiers can offer follow-up financing here. The high land prices of recent years, the rapid rise in construction and financing costs and, last but not least, the falling selling prices could lead to significant refinancing problems so some project developments in Germany could be stranded and a certain market shakeout is inevitable. Nevertheless, there are still numerous projects by real estate investors that are commercially attractive and eligible for financing, especially in the financing of existing properties, even in the greatly changed market environment and under conservative assumptions. However, it is also clear that investors must bring substantial cash equity to the table in order to obtain financing in these times. We also observe that loans are underwritten much more on the basis of strong debt yield / DSCR ratios than LTV ratios so cash flow strong business plans are more likely to find funding here. Interesting opportunities are also currently arising from forced sales of high-quality assets trading at a discount. But also, here a fast execution is often critical for the success of the deal. Banks have virtually ticked off the year and are currently hardly initiating any new financings, so that alternative financiers who can execute fast and have the capacity can cherry-pick attractive opportunities and fill the financing gap.

Sample transaction in Munich

Attractive > 12% IRR return for a modern office value add project in Munich

Sector	Office	Amount	EUR 20.5m
City	Munich	Term	2.0y
Strategy	Value Add	LTC	55%
Total project costs	EUR >180m	IRR	12.0%

In September closed a large-volume real estate financing for a property company of CV Real Estate in a consortium with a big German Pfandbriefbank (LBBW) and other alternative lenders. Prime Capital participated in the project with one of its investment vehicles via a stretched senior financing of EUR 20.5m. Project NEXT is an office project development in Munich; the sponsor intends to implement a value-add strategy on the property by redeveloping it with an optimized layout and increased building rights. The property is located in an established commercial location in Munich and is currently fully let to an investment grade company. The stretched senior tranche is secured by subordinated land charges as well as with a guarantee and offers a moderate risk profile with an LTC of less than 55%. It achieves a double-digit IRR. Even in the current market environment, the planned project development benefits from stable demand for modern, flexible and sustainable office space in established locations in Munich.

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Due to the current reluctance of banks to provide financing, we are receiving more inquiries from experienced sponsors that were previously funded by banks, so our pipeline is well filled. On the other hand, we reject about 95% of financing requests for a wide variety of reasons (including missing equity commitment, low debt yields or weak business plans with aggressive cost calculations).

Sample Q4 2022 transaction opportunities (pipeline)

Location	Sector	Asset Type	Financing Type	LTV	IRR	Size
Germany (Top 7)	Office	Develop-ment	Whole Loan	70.0%	8.0%	140.0m
Germany (east)	Mixed Use	Develop-ment	Mezzanine	70.0%	12.5%	31.0m
Austria (Portfolio)	Logis-tics	Existing	Mezzanine	84.0%	12.5%	20.0m
Austria (Vienna)	Office	Existing	Mezzanine	83.0%	12.0%	16.0m
Germany (south)	Office	Develop-ment	Whole Loan	78.0%	7.0%	47.0m
Germany (Top 7)	Mixed Use	Existing	Whole Loan	71.0%	6.5%	88.0m
Germany (Top 7)	Resi-dential	Existing	Whole Loan	65.0%	6.8%	30.6m

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 800m. 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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