Excerpt FAP Mezzanine Report | 2015 Edition

CREATING TRANSPARENCY

® FAP MEZZANINE REPORT

We, FAP, have been supporting clients with advice on all forms of financing for real estate in Germany and selected European countries for more than ten years. Three years ago, we successfully launched the FAP Barometer for commercial real estate financing and established the quarterly publication as an indicator in the market. Following the stabilisation of the „normal" debt financing market, the time is now right for us as first movers to create transparency in the subordinated capital market in Germany for the first time.

As Managing Director and Head of Capital Partners, Jörg Scheidler has been our expert „with his ear to the ground" since the formation of the company and is the key figure behind the present report. Together with his team, he has analysed current market conditions and will accompany you throughout the report.

Curth C. Flatow
Managing Partner FAP

Our experience has shown that a transparent market is a stable market. Our Mezzanine Report offers you an insight into the extremely active segment of subordinate financing for the German real estate market, which can now be considered an asset class in its own right.

For a long time, there was a sense that interest rate expectations and security guidelines were pushed through in something of a crude manner wherever possible.
The last two years in particular, however, have shown a clear trend towards somewhat more consistency and professionalism in capital provision. And since all market participants anticipate continued growth in subordinate financing, we would like to take the opportunity to familiarise you with current market activity in the „asset class of subordinate capital" over the following pages. Certain comments have been highlighted to draw your attention to particular aspects of the report.

Jörg Scheidler
Managing Director FAP & Head of Capital Partners

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CURRENT **MARKET ENVIRONMENT**

Alternative forms of financing are enjoying a significant increase in market share both throughout Europe and in the USA. Explanations for this global trend include falling lending ratios (average LTV of 53% in Europe according to DTZ report on 30.06.2015) and rising capital requirements.

The „safe haven of German real estate“ plays a quite unique role here, however.

We, too, are currently seeing investors suffering from the challenges of the low interest rate environment.

Developers and portfolio holders are also having to contend with increased capital requirements when seeking financing.

Nevertheless, in stark contrast with the global market, the once again well-structured German banking landscape, with its own unique guidelines and regulatory requirements, still provides little scope for a larger and well-collateralised mezzanine segment.

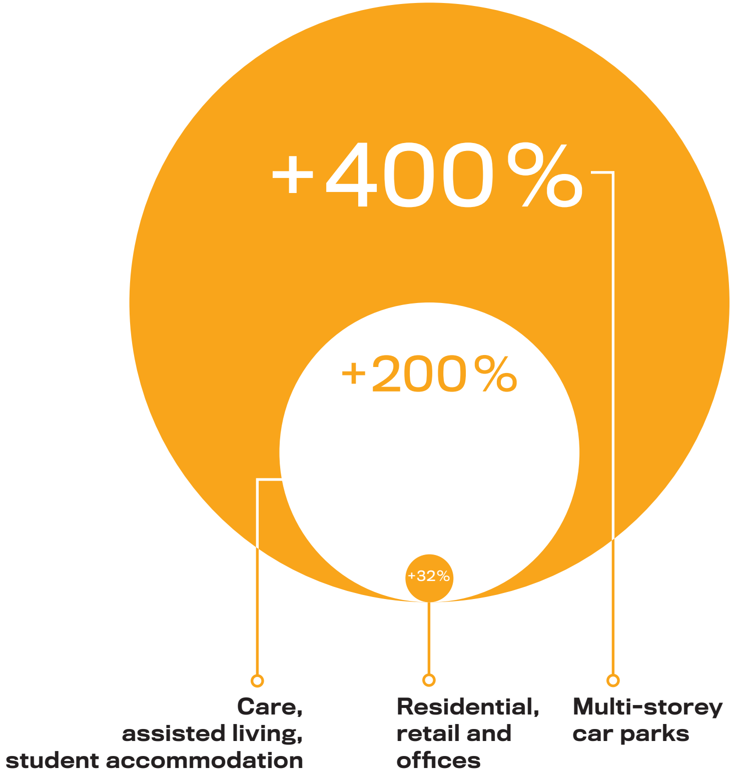
This requires a much more entrepreneurial approach, extensive professional expertise and an extremely co-operative process structure from all market participants when it comes to implementing subordinated capital in German real estate projects.

STRONG **INTEREST**

32% more subordinated capital providers indicated greater interest in financing in the residential, retail and office sectors for existing property over the last 12 months.

200% growth in providers in socially-oriented sectors such as care and assisted living as well as student accommodation.

400% rise in interest in existing multi-storey car parks.



STRONG **GROWTH IN COMPETITION**

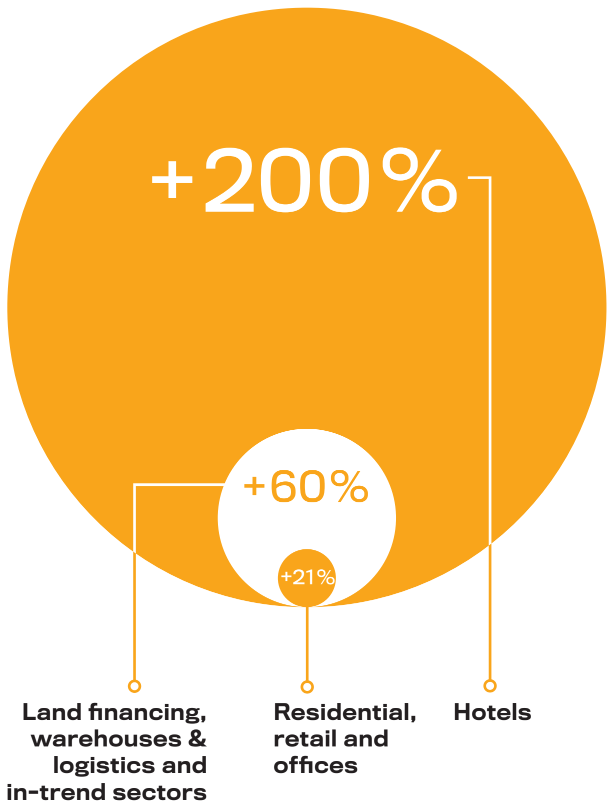
21% more subordinated capital providers indicated greater interest in financing for developments in the residential, retail and office sectors over the last 12 months.

60% increase in providers in sectors previously difficult to finance, such as land, warehouses & logistics or in-trend sectors such as student accommodation.

200% rise in interest in hotel financing.

Subordinated capital is primarily preferred by capital providers for „difficult" situations, such as stressed assets / value-add / heavy refurbishment bridging and re-positioning of properties. The sponsor's business plan and participants' track records are decisive factors.

The operative phrase is co-partnership with local experts.



STRONG **APPETITE FOR RISK** MODERATE **CAPITAL REQUIREMENT**

85% of market value is viewed by the majority of subordinated capital providers as an appropriate **loan-to-value ratio (LTV)**. More risk-prone exceptions allow LTVs up to 95%.

85%

15% of the market value must be contributed as **equity** by the project initiator.

15%

STRONG **APPETITE FOR RISK** MODERATE **CAPITAL REQUIREMENT**

Developments are financed at a **loan-to-cost (LTC)** of 93% – 97.5% of the total investment.

93–97,5%

This implies a capital requirement from the developer of 2.5% – 7% of the **total investment cost**.

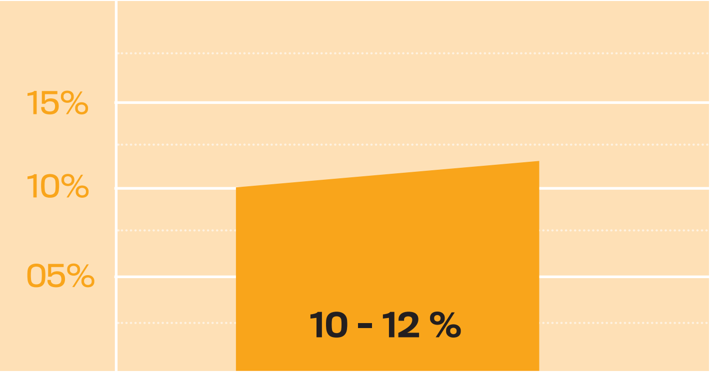
2,5–7%

VARYING **INTEREST RATES**

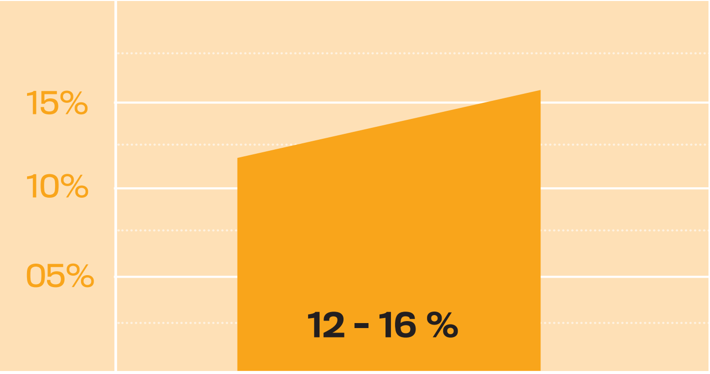
Financing on existing property with subordinated capital commands average ongoing interest rates of 6 – 9% p.a. This produces IRRs of approx. 10 – 12% p.a. plus individual remuneration components, such as kickers.

Overall interest rates on developments currently reflect a broad spectrum of returns with IRRs ranging from 8 – 20%, with a majority in the 12 – 16% segment.

… FINANCING ON EXISTING PROPERTY



… ON DEVELOPMENTS



THE GREATEST CHALLENGES

Due diligence, documentation, security and collaboration are key areas that must be managed in the current subordinated capital environment, and preferably at the outset. Due diligence requirements have become more complex at all levels. This can result in longer processing times for projects.

As a rule, all subordinated capital providers adhere largely to the guidelines of the primary debt capital provider and are prepared to structure their security requirements individually. However, methods such as step-in rights and the golden share are becoming increasingly popular.

Calls for consistency in information standards are also becoming louder from all parties involved. Such standards would allow investors, developers and capital providers, as well as their consultants, to analyse and evaluate data and conditions efficiently and sustainably. Thus, it makes sense to consolidate on previous work, to further reduce due diligence costs and to define common areas of work more precisely.

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DETAILED **REPORT**

The detailed FAP Mezzanine Report will be available for download with costs by mid of October at **FAP-finance.com**

Data and institutions

Segmentation of capital providers

Distribution by investment sector

Regional coverage

Subordinate financing on existing property

- Sector coverage
- Capital tranches available
- Loan-to-value ratios
- Maturities
- Average interest rate expectations
- Achieved interest rates
- Equity contribution & security

Subordinate financing on developments

- Sector coverage
- Capital tranches available
- Loan-to-value ratios
- Maturities
- Average interest rate expectations
- Varying interest rates
- Equity contribution & security

Capital with an entrepreneurial approach

Types of collaboration

What is the current state of the market?

Transaction volume

Glossary

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