FAPGROUP
CONNECTING REAL ESTATE AND CAPITAL

Press Release

5th FAP Mezzanine Report: Mezzanine Market more agile, more flexible and more stable

- **Less deals, bigger tickets, weakening margins, longer running times**
- **Market participants more cautious, more willingness to compromise!**
- **Family offices and international investors more active**

Munich/Berlin, October 4th, 2019. The FAP Mezzanine Report 2019 shows an agile, flexible and stable market for subordinated financing. The 5th edition of the industry analysis released by the FAP Group, one of the leading independent consulting companies for the procurement and structuring of capital for real estate investments and project development in Germany, reports a stabilization of subordinated capital provided at a high level over the past twelve months, a growing international interest in the German real estate market and growing pressure on margins.

53 of the current 146 investors in this area have participated in the FAP mezzanine report this year. These alone provided EUR 5.8 billion in mezzanine capital in the past twelve months, with which a project volume of EUR 38 billion has been realized. For the coming year, they expect an increase in the volume provided by them to EUR 7.7 billion.

Curth-C. Flatow, founder and Managing Director of the FAP Group: "The market for subordinated financing is agile and dynamic! We are observing a stabilization at a high level. While the growth rates forecast by us have almost been reached, the average volume has increased. Companies, especially from the Anglo-Saxon region, which have withdrawn from the German mezzanine market, have been replaced by other international investors and funds. International interest in the German real estate market is growing, explicitly also for the debt segment. The growing number of market participants is currently leading to increased pressure on margins. Consequently, the expectations for interest rates and returns have been and are often disappointed".

Mood positive, euphoria has cooled down

The results of the survey and the accompanying investor interviews show: Investors are in a positive mood, but the euphoria of past years has cooled down. Overall, investors and financers are becoming more reserved due to the evaluation of the market cycle, the margin pressure, the price development of land and construction costs. It is becoming increasingly difficult for investors to find suitable deals, to price them with an appropriate risk/return ratio and implement them within the specified budget. The number of deals is lower, but the volume tends to be higher.

Hanno Kowalski, Managing Director FAP Invest GmbH: "In order to be able to realise deals, investors have once again become more willing to compromise. Requirements on `hard` equity capital are diminishing and are often compensated by guarantees or e.g. higher pre-sales quotas.

The project-immanent risk potential can often no longer be differentiated via the interest rate. A mixing and compressing of the forms of financing is taking place. The boundaries between the different forms of financing, in terms of interest rate expectations and hedging requirements, are becoming blurred. In the meantime, mezzanine capital has now taken on a vital function: Without mezzanine, there are no more deals; they are now a `normal` part of financing, practically a core product. Investors and capital providers are forced into greater flexibility. As a result, trust and security aspects play an even stronger role than in the past. Such funds are thus becoming more and more interesting from a risk perspective".

Interest rates, loan-to-capital ratios, capital tranches

Interest rates on subordinated loans are coming under increasing pressure. The spread of interest rates is expanding.

The interest rates achieved in 2019 are between 5 and 14 percent (previous year: 7-10 percent) p.a. for portfolio financing, as well as between 10 and 15 percent (previous year: 8 to 15 percent) for project developments.

Although, with that, the average interest rate level of the previous year has still been reached, the pressure on margins, however, has noticeably increased recently, especially at the lower end. The most noticeable pressure on margins is with premium properties or developments.

80 percent of offerors now provide capital for portfolio properties of up to an LTV of 90 – 95 percent. A constantly high proportion of investors are prepared to accompany very high loan-to-value ratios, provided that the property, location, real estate investor, business plan and exit by sale or refinancing are conclusive.

In project developments, the clear majority (80 percent) of providers finance between 90 percent and 95 percent of the total investment costs (TIC). Depending on the strategy and risk tolerance of the provider, loan to capital ratios (LTC) of up to 100 percent will continue to be supported. Against the background of further increases in property prices, capital providers must be prepared to consistently take over higher risks with respect to their lending limits (LTV), in order to be able to realise deals.

Regular durations in portfolio and project development financing tend to extend to up to three years.

With portfolio financing, the majority of the providers surveyed focus on capital tranches between EUR 10 million and EUR 30 million per investment.

Thus, an increase in tranches compared with the previous year (EUR 7 - 20 million) can be observed.

In the case of project developments, 80 percent of market participants concentrate on capital tranches between EUR 3 million and EUR 25 million, with the “sweet spot” being between EUR 10 million and EUR 30 million. Top providers with volumes of up to EUR 2.5 million, continue to be the established crowdfunding platforms and single family offices.

Financers had to become more flexible again

Against the background of market developments (margin pressure, price increases, availability), investors had to become even more flexible.

Thus, the proportion of financers, who in the past only realised project developments and now also finance portfolio developments has risen. 64 percent of the providers (previous year 54 percent) now finance in both areas.

The prevailing pressure on margins in project development is also affecting financers, resulting in an increased “blending ratio” with existing properties, primarily due to liquidity and security considerations.

Major cities in demand (again)

A significant change can be observed in location preference. Particularly due to new, mostly institutional providers, there has been a significant increase in those who finance only TOP 7 or metropolitan locations compared to the previous year. 43 percent (previous year 7 percent) of the providers concentrate exclusively on TOP 7 locations. At such a location, B and C areas or peripheral locations adjacent to the metropolises ("commuter belts") are also financed by experienced providers, if they are attractive (connections, infrastructure, price structure). This is particularly due to the increased involvement of institutional investors as well as the shortage of suitable properties.

Individual providers also switch to C-regions (surrounding areas) on the basis of regional or installed know-how, provided that the attractiveness of the project and the quality of the developer are assessed positively. Only 19 percent (previous year 55 percent) operate nationwide. 74 percent finance in B-regions, 26 percent in C-regions.

Office and Residential always top

Office and residential financing (of all kinds) is at the top of the popularity ranking.
As in the previous year, 100 percent of the providers finance investments for existing office buildings. In the meantime, pure residential investments have closed the gap. Student housing and co-living also increased, while hotels and boarding houses drop slightly. Losses were also recorded in retail, shopping centres and the logistics sector.
The office and residential sectors are also considered safe havens when it comes to financing project developments. Both asset classes are financed by 100 percent of the capital providers. Student housing, hotels and the retail segment recorded slight losses. Property developers and land see slight growth.

The willingness to finance land has increased significantly. In this way, the financer secures the possibility of earlier entry into the project. This ensures a higher variance in projects and opportunities.

About the FAP Group

The FAP Group is one of the leading independent consulting companies for the procurement and structuring of capital for real estate investments and project development in Germany and selected European markets. FAP was awarded the title of "Property Debt Investor of the Year" by the renowned Europe Property Finance Awards 2016 of the Magazine Property Investor Europe (PIE) and in November 2018 named "Mezzanine Lender of the Year".
The services of the one-stop single source agency ensure total financing from loan capital and, when appropriate, equity capital replacement funds. These services are among other things for transactions and projects, which is the reason for being engaged by buyers, sellers, investors and capital-seekers.
FAP, with its headquarters in Berlin, was founded in 2005 by Curth-C. Flatow and has since then advised and structured capital at a volume of over € 14 billion.

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