PRESS RELEASE

FAP Mezzanine Report 2022

Subordinated capital providers optimistic: demand for alternative financing is rising

- **Developers are struggling to find the right fit for financing**
- **Demand for whole-loan solutions continues to rise**
- **ESG of increasing importance**

Berlin, 30 September 2022 – Rising inflation and interest rates, high building costs and lack of material – the property industry is facing immense challenges which are putting a damper on the overall real estate market, according to subordinated capital providers surveyed by FAP. The negative sentiment does not extend to their own business, however: some 53 percent of those surveyed expect a rise in demand for alternative financing solutions. They are already seeing a significant increase in demand as banks are not the predictable partners anymore that developers and investors could rely on in the past. At the same time, rising interest rates are making alternative financing solutions more attractive to borrowers.

The residential sector remains the most popular for financiers even outside of A- and B-cities. They reckon that the asset class is crisis-proof. Existing properties are coming to the fore while obtaining loans for developments is becoming increasingly difficult. In the future, only professionally planned projects and experienced players will prevail here. The trend towards larger tickets continues, as does the rising demand for whole-loan solutions.

These are the central results of the eighth Mezzanine Report of FAP Group, a leading independent advisory company specialized in raising and structuring capital for real estate investments and project developments in Germany. FAP counted 159 capital providers active in the subordinated bracket in Germany, slightly more than in the previous year (plus 4). The number of institutional investors lending directly fell again, while the number of debt funds increased. 55 market participants took part in the survey, providing 5.5 billion euro over the period under review (6.1 billion euro in the prior-year period).

“The numbers reflect the industry’s hesitation in the current market environment. Investors are biding their time and holding back on new investments,” said Hanno Kowalski, Managing Partner of FAP Invest. “At the same time, the current situation is creating a lot of opportunities for subordinated capital providers because not investing at all is not an option either. Banks’ hesitance and the rising interest rate level are stoking expectations. We are thus expecting a significant rise in new business over the coming years.”

Existing buildings and housing before developments and offices

The share of subordinated capital providers which is only providing financing for existing buildings rose by 5 percentage points on the previous year to 23 percent. Almost all surveyed provide financing for housing. The second most attractive asset class is offices, for which 91 percent provide capital (95 percent in the previous year). More financiers are willing to look into hotel projects again, with a clear preference for leisure instead of business hotels.

“In the past year, almost every project was financeable, but the tide has turned. The willingness to finance a development with any sort of question mark attached tends towards zero. Only professional projects and players have a chance these days. Pre-letting quotas, the equity base of the borrower as well as the content of contractor agreements are gaining in importance,” says Kim Jana Hesse, Head of Capital Partners at FAP Finance.

The average overall interest rate for financing existing buildings amounts to 10.33 percent, slightly above the previous year’s level (9.75). At between 7 and 15 percent, the interest rate range of mezzanine capital remains as broad as in the previous year (6 and 14 percent). For project developments, the range lies between 9 and 15 percent (10 and 14 percent).

Demand for whole loans on the rise

Whole-loan solutions are currently compensating for the loss of classic bank loans, especially seeing that the rising interest rates are decreasing the spread between the two financing options. For whole loans, capital providers are confident within an LTV ratio between 70 and 75 percent – apart from Anglo-Saxon investors which are assuming a larger imputed mezzanine share within this range.

In addition, club deals with senior lenders are on the rise. Subordinated capital providers and banks are working together. The joint loan provides for an attractive blended rate for the borrower.

ESG and looking into the future

If the war in the Ukraine and Covid-19 could be taken out of the picture, ESG would be the dominant theme in the industry. Not only are new regulatory initiatives advancing the sustainability of investments – ESG seems to have arrived in the hearts and minds of many players, with a corresponding impact on investment decisions.

“We are seeing more and more article-8 and article-9 funds on the market, with the clear goal of mapping out a portfolio of taxonomy-compliant assets. In the future, the only projects financeable will be those that conform to strict ESG standards,” said Kowalski.

If you are interested in the entire report, please contact us.

About FAP

The FAP Group is an independent advisory company that specialises in raising and structuring capital for real estate investments and project developments. The Group comprises FAP Invest, a leading real estate investment platform for institutional investors with a focus on debt products, and FAP Finance, which provides advice on capital and financing issues. FAP structures conventional debt finance as well as mezzanine, equity and capital market products. These services secure the overall financing from debt capital and – if necessary – equity substitutes. FAP, headquartered in Berlin, was founded in 2005 by Curth-C. Flatow. The group has since advised and structured capital with a volume of over €16 billion.

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