

BAI-Webinar „Real Estate Debt“

Speakers:

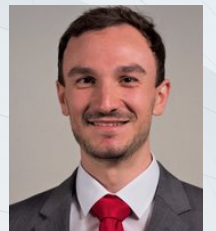
Ralf Kind, Managing Director, Head of Real Estate Debt, Edmond de Rothschild REIM
Andreas Schäfer, Director - Real Estate Finance, M&G Investments

August 25, 2021

Philipp Bunnenberg

**Consultant
Alternative Markets, BAI**

Poppelsdorfer Allee 106
53115 Bonn
+49 (0) 228 96987-52
bunnenberg@bvai.de



Next event: 30 september: BAI InnovationsDay

- *technological developments in the asset management industry*
- *focus on digitalization, DLT and artificial intelligence*

Recently: **letter to the EU commission** on appropriate and differentiated risk weighting of investments into specific types of alternative investments under CRR

Ongoing consultations:

- **27 august: draft proposal on an extended taxonomy to support economic transition:** the EU Platform on Sustainable Finance has presented the draft taxonomy extension to support economic transition (Public Consultation Report on Taxonomy extension options linked to environmental objectives) and put it out for consultation.
- **27 august: draft report on social taxonomy**
- **24 september:** „draft report by the Technical Working Group (TWG) for a call for feedback on preliminary recommendations on “**technical screening criteria**” for the remaining four environmental objectives and a few additional activities and according criteria for the climate objectives of the EU taxonomy
- **6 september: BaFin Guideline for Sustainable (Public) Investment Assets**
- **13 september: Modification of the FAQ on the distribution and acquisition of investment funds under the KAGB** (adjustments as a result of the FoStoG or the directive on cross-border fund distribution implemented therein).

Upcoming papers

- **Infrastructure Investments**
- **Conclusions from Covid-19 on tail risks**

The speaker from our BAI members



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Ralf Kind is responsible for the development of the real estate debt business at Edmond de Rothschild REIM. He has over two decades of experience and track record in real estate finance. Ralf has acted as a banker/lender in the UK, German, Austrian, Dutch and Swiss markets, as a borrower/investor in private markets and as a borrower/issuer in the capital markets. Previously he was CEO/CFO of DEMIRE Deutsche Mittelstand Real Estate AG and CEO of Fair Value REIT AG, both listed German commercial property companies. In 2013, he co-founded Arbireo Capital, an investment manager and advisory firm in the German real estate market. Prior to that, he spent 12 years at Barclays Capital, in Frankfurt and London, where he worked in the Structured Finance Team and later led the Real Estate Investment Banking Team in the DACH region. Ralf started his career at PwC in Tokyo in 1998. Ralf is a graduate business economist from FH Nürtingen.



Andreas Schaefer has over 10 years sector experience within the Real Estate Finance industry, having joined the M&G Real Estate Finance team in 2011. During this time he has been focused on the origination, structuring and execution of senior, junior and whole loan positions, and has been particularly involved in expanding the teams European origination efforts, having transacted on more than €1bn across Germany, France, Ireland and Italy. Andreas has been a CFA charterholder since 2014 and holds a dual degree (BSc and Diploma (FH)) in International Business from Northeastern University, Boston and the European School of Business, Germany. He is a native German speaker.



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REAL ESTATE
DEBT

Real Estate Debt Investments in Europe

A Winner of the Covid-19 Crisis

25 August 2021

EDMOND DE ROTHSCHILD GROUP

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MARKET DYNAMICS & INVESTMENT OPPORTUNITY

ACHIEVE HIGH RISK ADJUSTED RETURNS THROUGH INVESTING IN EUROPEAN PRIVATE REAL ESTATE DEBT

1.

Limited supply



- ▶ Real estate is a capital intense industry where debt plays a key role in financing assets or development projects
- ▶ Regulatory capital requirements are forcing traditional European lenders (i.e. banks) to reduce their real estate exposure and focus on lower LTV financings - Senior loan LTVs are expected to fall further
- ▶ >80% of European commercial real estate debt is held by banks whose lending model is impaired

2.

Strong demand



- ▶ Borrowers are looking for flexible and reliable capital sources providing higher LTV loans in an efficient manner
- ▶ Supply / demand imbalance creates a funding gap that alternative lenders are capturing
- ▶ Pressure on banks has given private debt funds a competitive advantage by faster deal execution at better terms
- ▶ In addition to acquisition related financing there is a sustainable debt investment pipeline from > €100bn of maturing real estate loans in Europe every year

3.

Covid-19



- ▶ COVID-19 has put pressure on real estate valuations in certain markets making debt investments with a secure income component and security package even more attractive - Credit is the safer place to be when markets are going through a correction
- ▶ We are now in a lenders' market, hence new loans can be made at lower LTVs and higher pricing. The next 1-2 years will be an excellent vintage for debt investing as was the case in previous crises such as 2009-10, 2001-2 and 1990-91

Source: CBRE, INREV

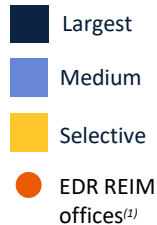
HUGE REAL ESTATE DEBT MARKET IN EUROPE

OUR REAL ESTATE TEAMS ARE PRESENT IN ALL MAJOR FINANCING MARKETS

Scale of Debt Investment Universe

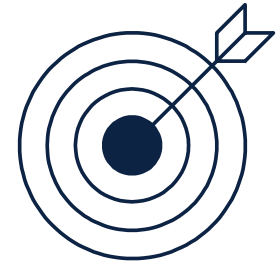
Size of European real estate markets	debt
UK	€262 billion
GERMANY	€237 billion
FRANCE	€150 billion
IBERIA	€71 billion
NETHERLANDS	€53 billion
REST OF EUROPE	€282 billion
TOTAL	€1.1 trillion

Source: LaSalle (01/2019)



Key Attraction of Real Estate Debt

- ✓ Reliable income streams
- ✓ Attractive risk-adjusted return
- ✓ Diversification benefit
- ✓ Downside risk protection
- ✓ Low correlation to other asset classes
- ✓ Favorable regulatory treatment under Solvency II



⁽¹⁾ EDR Real estate teams are present in Amsterdam, London, Frankfurt, Berlin, Munich, Stuttgart, Paris, Geneva and Zurich

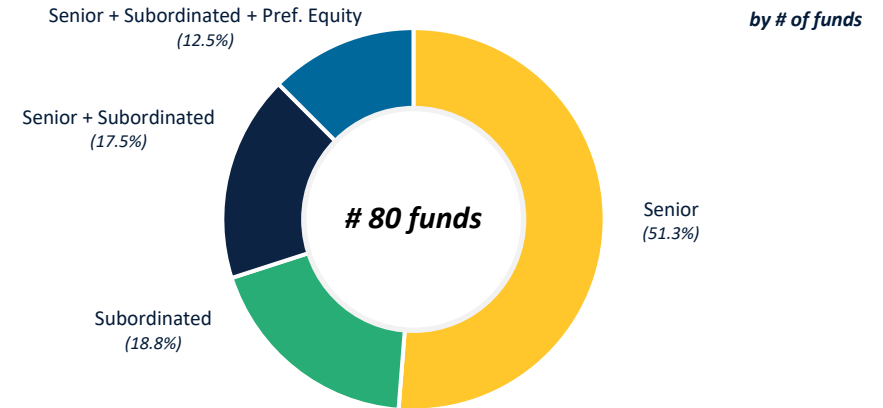
EUROPEAN PRIVATE REAL ESTATE DEBT FUNDS

MOST OF THE EXISTING DEBT FUNDS FOCUS ON SENIOR DEBT

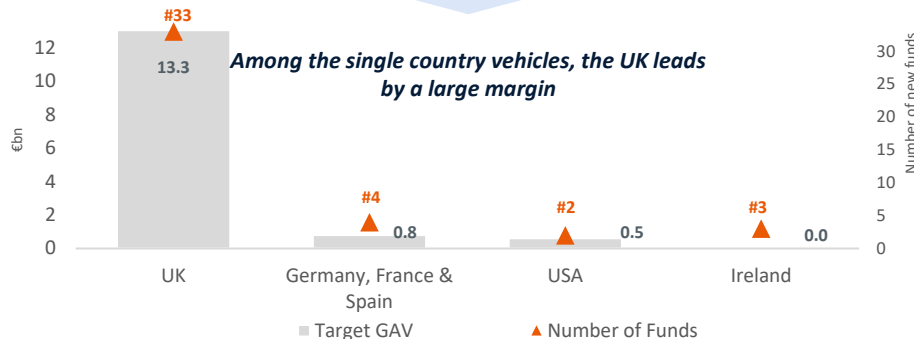
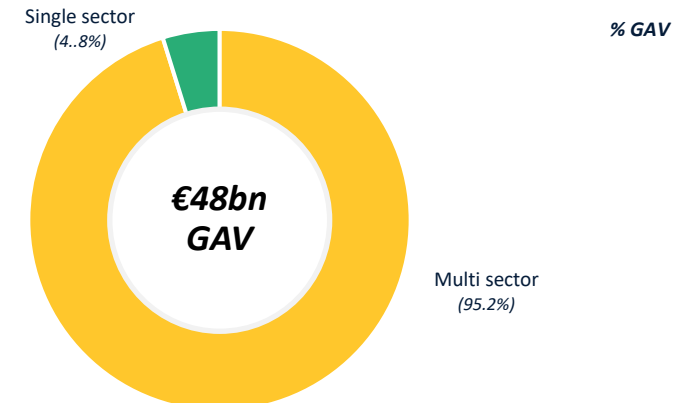
Real estate debt fund universe - Factsheet

1. 80 vehicles active across Europe with total target GAV of €47.8bn
2. 41 of the funds focus on senior debt, 10 funds pursue a mixed debt strategy
3. Median target IRR of all funds is recorded at 7.7%
4. 81% of the funds are closed end structures
5. More than 95% of the funds in terms of GAV pursue multi-sector strategy
6. Majority of debt funds (#42) pursue a single country investment strategy

Most real estate debt funds focus on senior debt



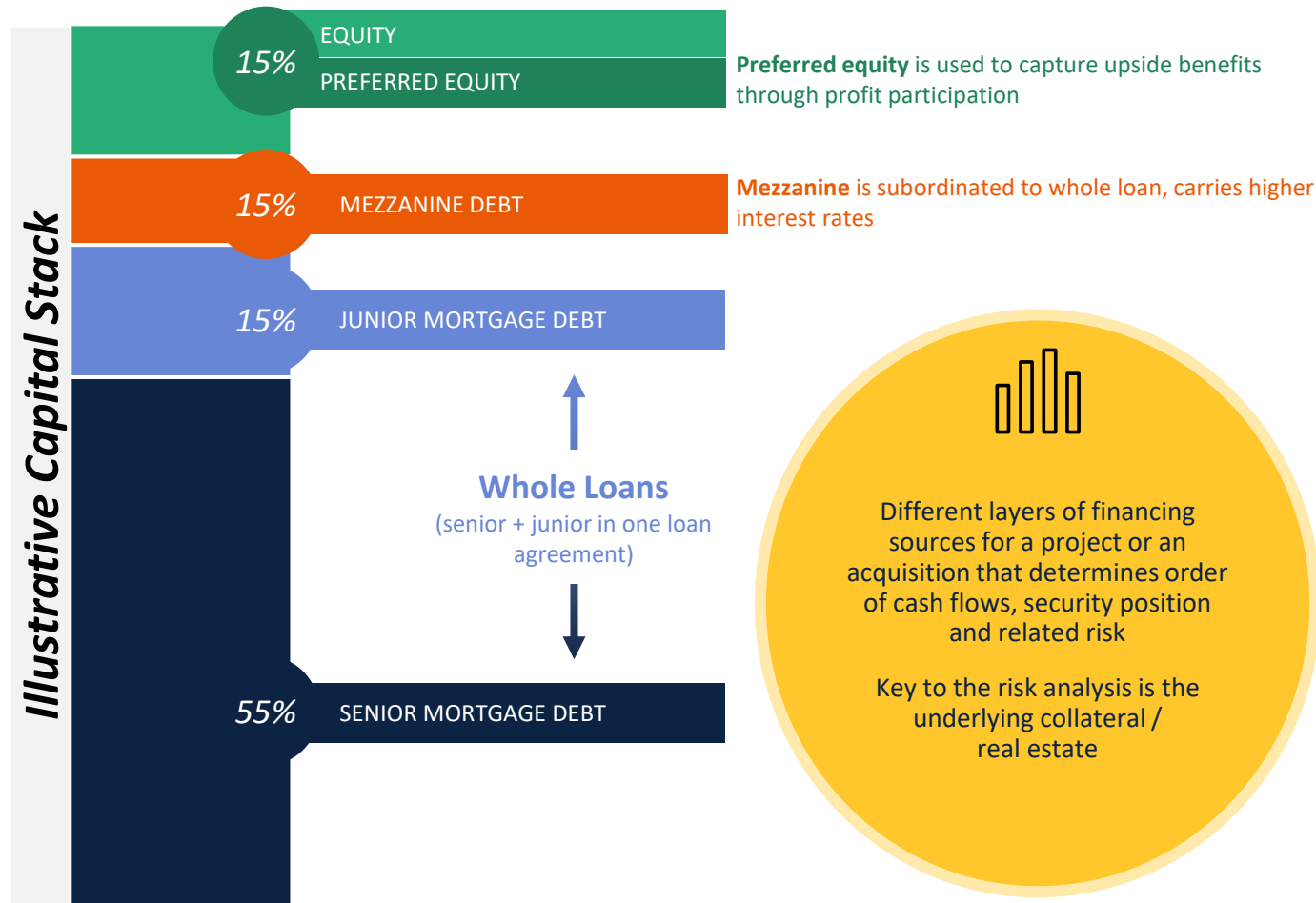
Majority of debt funds pursue a multi sector strategy



Source: INREV "Debt Funds Universe 2020"

REAL ESTATE CAPITAL STACK

DIFFERENT INVESTMENT TYPES WITH DIFFERENT RISKS AND RETURNS



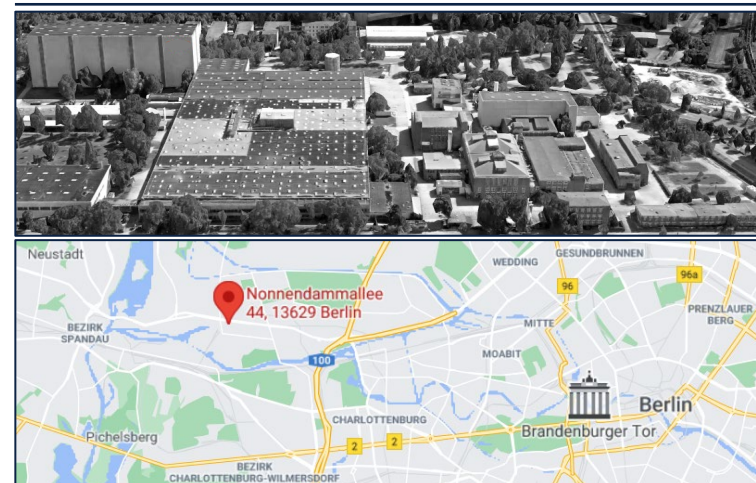
EDR EUROPEAN HIGH YIELD FUND - CASE STUDY (1/2)

MEZZANINE LOAN – LIGHT INDUSTRIAL/LOGISTICS (BERLIN)

Transaction Overview

- Edmond de Rothschild Real Estate Debt SCA SICAV-RAIF through its **European High Yield I Fund** (“EdR Fund”) provided mezzanine financing for the acquisition of the OSRAM site in Berlin-Siemensstadt (Spandau). The **funding** of its first loan was **end of June 2021**
- Independent investment manager AVENTOS acquired the large scale light industrial/logistic complex in a sale-and-leaseback transaction with OSRAM
- The asset comprises **c. 80,000 sqm of space leased back by OSRAM** and includes approx. **150,000 sqm of development areas** which will be converted into a mixed-use urban commercial area in the coming years
 - Main tenant OSRAM is a subsidiary of AMS Group
 - OSRAM, former subsidiary of Siemens, has been located on this site since its foundation in 1919 and is expected to remain in predefined core areas while vacating non-core areas
- **AVENTOS**, founded by former BEOS senior management **team around Prof. Dr. Stephan Bone-Winkel**, is a specialist asset manager and developer of light industrial and corporate real estate in Germany
- **Term sheet** for the mezzanine loan was **negotiated around mid-May 2021** leaving c. 6 weeks for due diligence, documentation, approval and funding process
- The underwriting process involved local asset managers of the **EdR REIM platform** based in Germany
- The mezzanine loan provided by the EdR Fund is structurally subordinated to the **senior financing provided by Hamburger Sparkasse (HASPA)**
 - Intercreditor agreement governs rights and obligations of the two lenders

Location & Asset



Asset & Loan Metrics

Asset Sector	Light Industrial / Logistics
GLA	c.80.000 sqm + 150.000 sqm development areas
Risk Type	Core + / Value add
Transaction Type	Acquisition Financing
Investment Type	Mezzanine Loan
Loan Amount	c. € 20m
Tenor	Up to 5 years
Security Package	Standard Mezzanine / structurally subordinated
LTV	c. 75%
Target Return*	IRR >11%, incl. cash coupon of >4%

EDR EUROPEAN HIGH YIELD FUND - CASE STUDY (2/2)

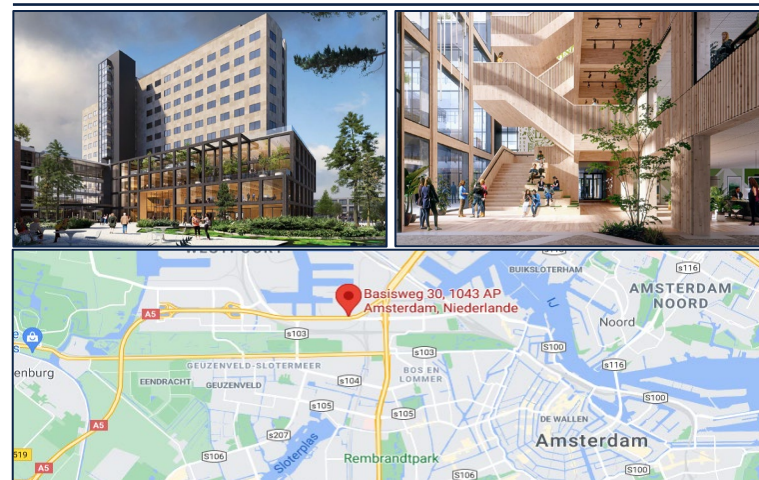
WHOLE LOAN – OFFICE (AMSTERDAM)

Transaction Overview

- Edmond de Rothschild Real Estate Debt SCA SICAV-RAIF through its **European High Yield I Fund** and a **dedicated fund** (together “EdR funds”) provided whole loan financing for the acquisition & re-development of two office buildings being part of the **District West Complex in Amsterdam Sloterdijk**
- **Funding** of the **€€55m whole loan** was **mid July 2021**
- The Sponsor, a **joint venture between Angelo Gordon and APF International**, acquired the office properties in 2020
- Both buildings are currently occupied with short remaining lease terms, once vacated the **properties will be subject to an extensive refurbishment plan**
- The Sponsor’s ambitious plans for the site will see the creation of a new and attractive office location in the Sloterdijk area, which will **establish high standards for sustainability and wellbeing**
- The provided financing is split into an **acquisition facility** and a **CapEx facility** during a term of 4 years
- The loan underwriting process involved local asset managers of the **EdR REIM platform based in Amsterdam**
- Security package includes a **1st priority security over all assets and undertakings** including a first demand **Sponsor interest guarantee**

(1) Asset pictures post refurbishment

Location & Assets⁽¹⁾



Asset & Loan Metrics

Asset Sector	Office
LFA	c20.500m ² (pre-refurb) / c22.000m ² (post-refurb)
Risk Type	Value Added
Transaction Type	Acquisition & Refurbishment Financing
Investment Type	Whole Loan
Loan Amount	€€55m
Tenor	Up to 4 years
Security Package	Standard Senior / 1st priority security package
LTV	c70%
Target Return*	IRR >6%, incl. cash coupon of >4%

*Performance objective is based on the realization of market assumptions adopted and is by no means a promise of performance

EDR REAL ESTATE DEBT INVESTMENT TEAM

RED TEAM IS PART OF THE WIDER EDR REAL ESTATE INVESTMENT PLATFORM

EDR Real Estate Debt Team

- **Dedicated and experienced** international Real Estate Debt Team based in Frankfurt
- The Real Estate Debt Team is part of the EdR Real Estate Investment Management platform with approx. **€12 billion AuM** and **120 real estate professionals** in **9 offices** across **7 countries** in Europe

Edmond de Rothschild

- EDR is an ambitious, **independent family-run** investment house with **€155 billion AuM**, more than 2,500 employees in 32 locations worldwide

For more information, please contact:

- **Ralf Kind**, Head of Real Estate Debt
- Email: r.kind@reim-edr.com
- Phone: +49 (0) 69 7430388-22



**Ralf
KIND**

HEAD OF REAL ESTATE
DEBT



**Etienne
NAUJOK**

ASSOCIATE DIRECTOR



Max GRAFMÜLLER

DIRECTOR



**Léo
BÉCHET**

ASSOCIATE DIRECTOR

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July 2021

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INVESTMENT ADVISOR

EDMOND DE ROTHSCHILD REIM (Germany) GmbH

Taunusanlage 16

60325 Frankfurt

Germany

www.reim-edr.com

ALTERNATIVE INVESTMENT FUND MANAGER

Alter Domus Luxembourg S.à r.l.

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Investing in Commercial Real Estate Debt in Times of Market Uncertainty

August 2021

For Investment Professionals only.

Asset Class Overview



Asset Class

**Logistics, residential
and long income**

Office

Student Housing

Hotels

Retail

Considerations & Outlook

Asset classes may continue to provide access to good quality defensive opportunities, with potential to access income reversion in some opportunities

Structural shift in office demand may lead to more grey space and vacancy. High quality office in prime locations should continue to perform well.

Many high quality university markets remain undersupplied with appropriate provisions and quality of student housing.

Some operators will require short term cash injections to address liquidity shortages. Leisure travel potentially less impacted in the longer term than some forms of business related travel.

There is currently significant uncertainty as to the long term underwritable cashflows for high-street retail and shopping centres. Retail warehousing and grocery retail continue to perform strongly.

Covid Influence

Strong income collection, tenant and investor appetite

Changes in working habits

Impact on students ability to travel

Impact on business and leisure travel, operating cost

Accelerated shift to online

Market Returns Available

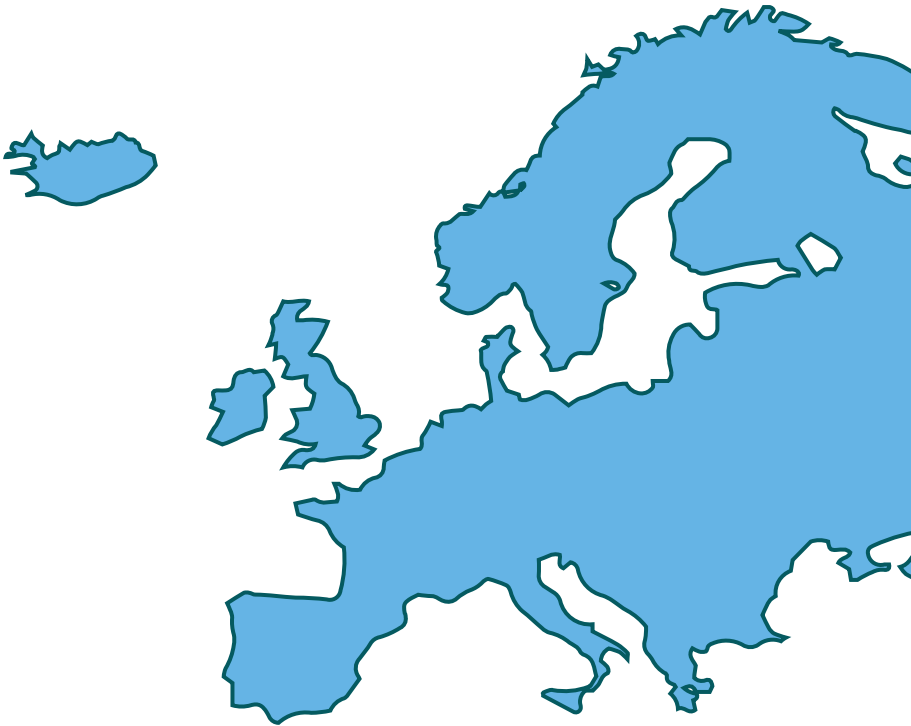
Geographic & Investment Style Considerations

Northern Europe	Senior (Gross DM)	Junior (IRR)
Core	175-225bps	6-7%
Transitional	225-350ps	7-9%
Development	250-500ps	10-13%

UK	Senior (Gross DM)	Junior (IRR)
Core	200-250bps	7-10%
Transitional	275-350bps	8-11%
Development	375-500bps	12-16%

Southern Europe	Senior (Gross DM)	Junior (IRR)
Core	225-275bps	7-9%
Transitional	300-450bps	8-15%
Development	400-600ps	13-18%

- Gross DMs/IRRs are calculated via:
- a. Loan margin
 - b. Upfront fees (i.e. origination fee for structuring loans)
 - c. 50bps benefit of Euribor zero floor for euro denominated loans.



Opportunity Set

High Level Risk Parameters

Capital Structure

- Senior Loan
- Whole Loan
- Mezzanine Loan
- Preferred Equity

Asset Quality

- Core
- Core+
- Value Add
- Opportunistic

Loan Type

- Investment
- Capex Tranche
- Full Development

Jurisdiction

- Lender friendly
- Borrower friendly

Origination

- Direct
- Secondary

- Sponsor quality can also be crucial.

Debt Structuring Considerations

The Tool Box

Loan Covenants

- Early warning / stop-loss triggers
- Oblige borrower to do / not do something
- May trigger default, cash traps and/or change in economics
- Can be tied to any kind of financial metric
- Contractual definitions are key

Security

- Mortgages (1st ranking or subordinated, active or passive)
- Share pledges
- Bank account pledges, receivables pledges, fixed and floating charges, subordination agreements etc.
- Guarantees and other recourse

Other

- Funding sequence (sequential / equity first, pro-rata debt & equity)
- Repayment sequence (incl. from sales, scheduled amortisation or cash sweeps)
- Margin ratchets & profit share agreements
- ESG targets
- Prepayment fees

- In multi-tranche capital structures, the above needs to be considered vis-à-vis the borrower & the other creditors.
- Having a manager with in-house workout experience can be beneficial.

Brief Case Study: Hotel Refinancing Loan

- Lending Opportunity: Whole Loan paying EURIBOR + 5.00% @ 60% loan to value
- Established and well reviewed 4* hotel portfolio in Italy on a franchise agreement

Loosely Structured Loan

- **LTV:** Loan Amount / Market Value
- **ICR:** 12 month look-back

Covenants

- 1st ranking mortgage
- PropCo share pledge

Security

- Interest accrual feature
- Capex obligation on borrower tied to margin step-ups

Structural Enhancements

More Firmly Structured Loan

- **LTV:** adjusted for employer liabilities and future capex obligations
- **ICR:** 12 month look-back / 12 month look forward
- **Increasing EBITDA thresholds**

- 1st ranking mortgage
- PropCo share pledge + Lux HoldCo share pledge
- Security over OpCo
- Badboy guarantee

- Interest reserve
- Opex reserve
- Capex reserve + longstop dates for spending
- Sponsor guarantee

Brief Case Study: Office Portfolio Repositioning Loan

- Lending Opportunity: Mezzanine Loan paying 7.50% fixed @ 65% to 85% loan to cost
- Portfolio of secondary office assets partially requiring complete refurbishment

Loosely Structured Loan

- **LTV:** Loan Amount / Market Value
- **ICR:** tested on NOI grossed up for rent free amounts
- Little headroom to senior loan

Covenants

- HoldCo share pledge only

Security

- Capex covenant
- Pro-rata capex funding
- Passive mezz with no significant rights

Structural Enhancements & Intercreditor Considerations

More Firmly Structured Loan

- **LTV:** accrued debt / adjusted market value
- **ICR:** tested on true NOI
- Mezz covenants bite first
- ESG Targets for new builds

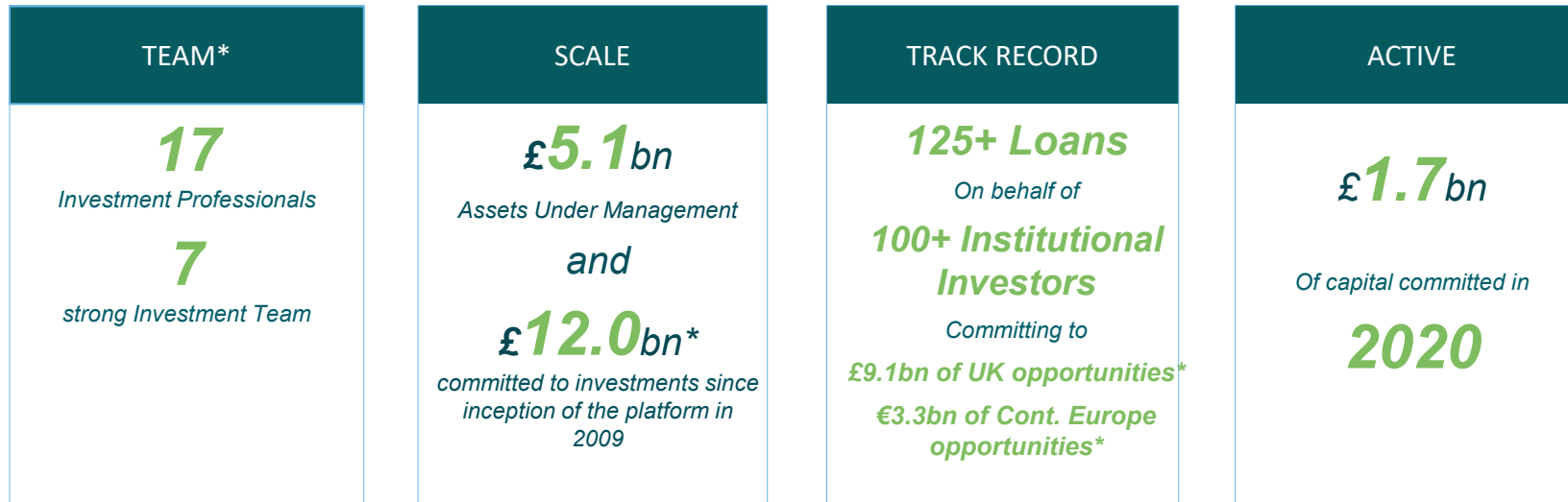
- Passive 2nd ranking mortgage
- HoldCo Share pledge
- Full development security package as appropriate

- Capex covenant backed by letter of credit
- Equity funding capex first
- Mezz with step-in rights and additional rights and protections

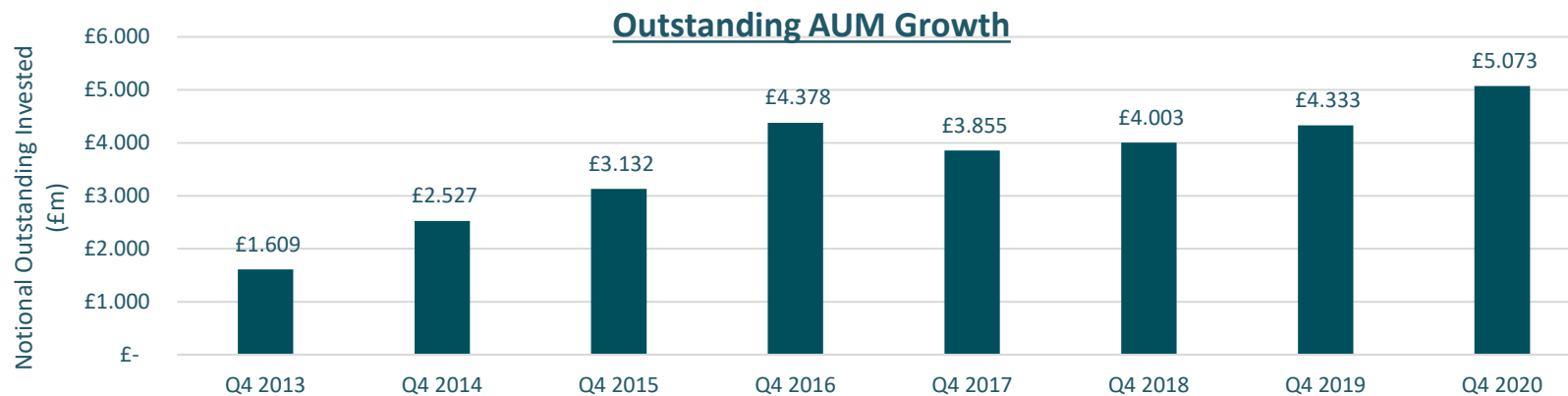
Portfolio Construction Considerations

- Tying mandates to certain restrictions can lead to unintended consequences. E.g.:
 - Discretionary versus non-discretionary mandates
 - max LTV
 - minimum occupancy
 - minimum debt yield
 - minimum or maximum investment sizes
- Investment and repayment speed will vary based on mandate criteria

M&G Real Estate Finance: Established and Experienced Platform



M&G Managed Real Estate Finance AUM (£)



Source: 31 December 2020 *Information as at July 2021. Past performance is not a guide to future performance

Contact Information



Ingo Matthey, CAIA

Head of Institutional Business Development

Germany & Austria

ingo.matthey@mandg.com

T: +49 69 1338 6716

M: +49 152 0154 2674

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