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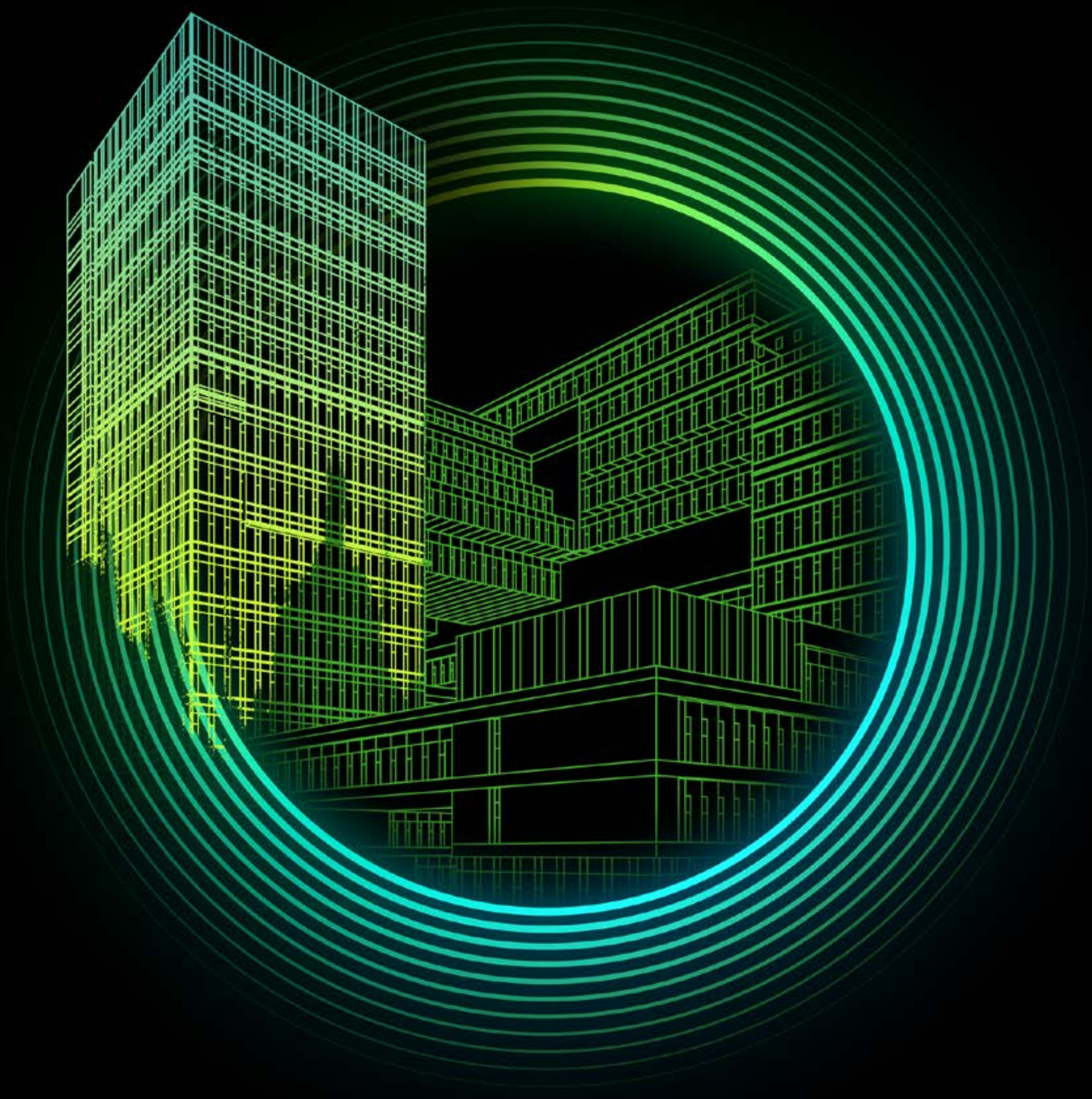


Real Estate Debt & Capital Advisory Marketbeat Q3-2023

Deloitte EMEA

MAKING AN IMPACT THAT MATTERS since 1845

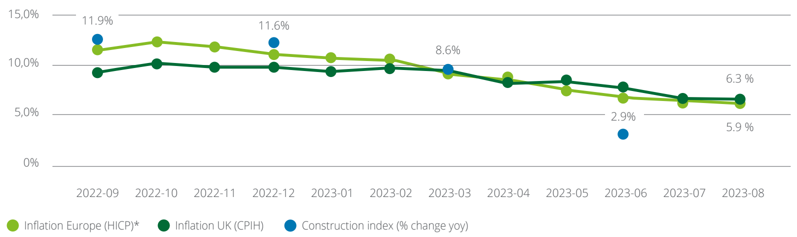
October 2023

Macroeconomic outlook

Inflation outlook

The resurgence of inflation continues to evolve at a surprisingly high pace, requiring a more aggressive tightening of Central Bank's policies. Economic growth has varied significantly from one country to another with countries, such as Denmark and Ireland recording strong growth, while others, like Germany, are in a mild recession with growth currently estimated at -0.3%. Economic activity appears to have slowed down during Q3-2023 as a consequence of a decrease in private investments. However, a slowdown in the construction cost index's recent surge has led to greater positivity within the development sector.

Inflation* (one year average rate of change)



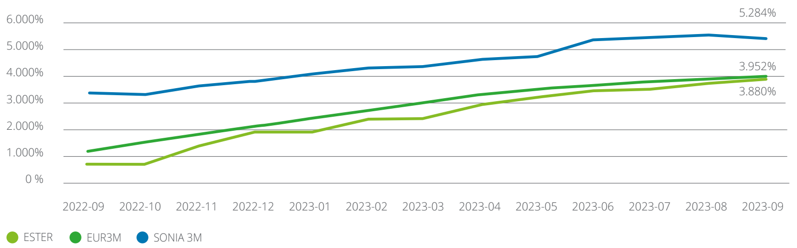
Note: (*) The Harmonized Index of Consumer Prices (HICP) is used in the analysis and is a measure of inflation in the European Union (EU).

Financing market outlook

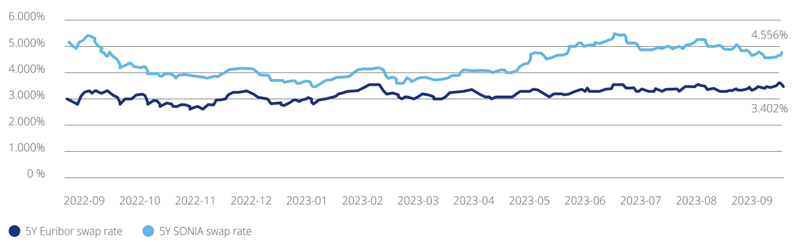
3.880%	3.952%	5.284%	3.402%
ESTER**	Euribor +3M**	SONIA 3M**	5Y Euribor swaps**

The real estate financing market has continued to be increasingly challenging for clients (developers as well as portfolio holders) during the last quarter due to the new interest rate environment. In terms of covenants, the focus has now turned to ICR rather than LTV, as borrowers' liquidity is being scrutinized and debt servicing costs increase. Overall senior debt funding levels have tightened significantly. Traditional lenders are being increasingly selective and following de-risking strategies, excluding whole sectors from their policies. Alternative providers, offering junior and mezzanine debt, while continuing their growth have also become more selective. It is to be expected that lenders will act in an even more risk-averse manner in the last quarter of 2023, following the insolvency of some well-known developers and institutional property owners.

Euribor +3M, ESTER & SONIA 3M (one year evolution)



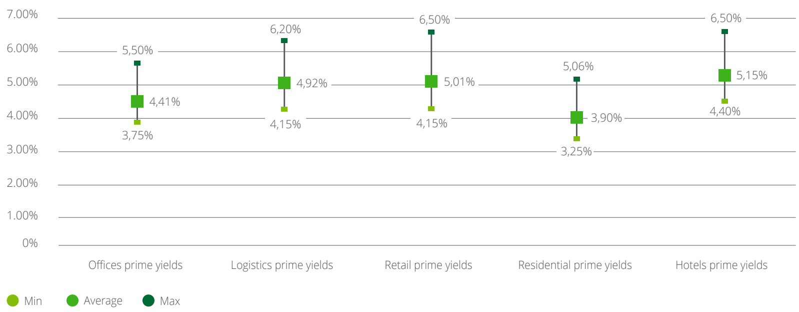
5Y Euribor & SONIA swap rates



Investment market outlook

Investment volumes have decreased sharply since 2022 because of the interest rates rise and market uncertainties resulting in a "wait and see" approach from investors. For prime and core assets, achievable rents sometimes do not even remotely cover debt service requirements on the sums borrowed against such properties during the lower rate environment of recent years. Similarly muted expectations for rental growth in many sectors means returns at recent pricing levels often fail to provide a sufficient premium to the risk-free rate making investment unattractive. Although values have adjusted to a degree in most countries, a gap remains between the expectations of sellers and buyers. These are, expected to align as interest rates start stabilizing although investment activity might continue to remain muted for the rest of this year.

Prime yields levels by asset class (Europe)



Sources : Eurostat, Refinitiv, Statitsta, Bank of England Database

Markets drivers

Raise of ECB interest rates

In September 2023, the European Governing Council decided to raise the three key ECB interest rates by 25 basis points. In the UK, the Bank of England voted to hold the rate at 5.25%.

War in Ukraine

The Ukrainian conflict sparked rapid inflation in Europe, directly affecting the development sector with heightened construction costs in all countries. Many Ukrainian companies closed or relocated, driving investments in logistics and industry sectors, notably in Poland.

Importance of ESG

Energy and sustainability targets and ESG criteria have become key drivers for financing new projects. In some countries, environmentally responsible projects even benefit from legislative actions from regulatory authorities.

(**) Numbers as of the 22nd of September 2023

Real estate financing trends

Trends in financing products

In the context of higher risk and rising interest rates, traditional senior lenders are becoming increasingly cautious in terms of financing leverage and pay extra-attention to the quality and the knowledge of the borrower and its ability to inject equity. Some of them have even shied away from some asset classes considered as too risky, leaving borrowers with fewer financing options. In this context, borrowers' requirement for liquidity has led to opportunities for alternative lenders which have the capacity to finance less core assets or to provide products across the capital stack. Consequently, non-bank lenders have been most active, offering equity or preferred equity to address capital gaps, especially in riskier sectors like development where equity is largely required to unlock viable residential development schemes. We have also seen examples of borrowers looking to extract equity from existing successful projects to provide capital injections across their groups.

- ★ **Equity**
- Whole loans
- Junior & mezzanine
- Financial leasing
- Senior Debt

Trends in financed purposes

With lower transaction volumes due to high interest rates, acquisition financing volumes have decreased. Conversely, refinancing is currently the highest trending activity among lenders, often a consequence of vendors postponing sales where they have been unable to obtain a satisfactory offer. However, companies looking to refinance or increase borrowings are finding themselves in a changed environment. A year ago, the EMEA lending markets were awash with capital looking for returns but now, lenders are retreating, trying to reduce their commitment and pushing for stricter terms and higher pricing. With the traditional banks on which a lot of the EMEA markets have been reliant for the past decade closing their doors, borrowers are having to find alternative often more expensive financing means, making refinancing very challenging.

- ★ **Refinancing**
- Fund Finance
- Asset acquisition
- Corporate financing
- Portfolio acquisition

Trends in financed sectors

Residential and living segments in general, are the most active asset classes in the financing sector and have been driven for the last quarter by limited supply and robust demand from both the private and public (social and affordable) sectors. In the UK Purpose-Built Student Accommodation (PBSA) and Build To Rent (BTR) have performed particularly strongly with strong levels of rental growth mitigating outward pressure on yields and supporting debt service. However, it is to be noted that the residential development sector, in common with the wider development industry, has been particularly impacted by construction cost inflation, supply chain constraints and reduced levels of sales, reducing lender appetite to finance residential development projects.

- ★ **Residential**
- Hotels
- Logistics
- Offices
- Retail

Deloitte's sample of credentials for the quarter

Residential

Urban Splash

Amount raised :
£20m + £20m accordion

Debt :
Revolving Credit Facility

Lender :
Barclays

Deloitte UK helped Urban Splash obtain an RCF to support the growth of their UK residential investment fund.

Residential

Confidential

Amount raised :
Confidential

Debt :
Corporate level - Revolving Credit Facility

Lender :
SOCFIM & Arkea

Deloitte France coordinated structuring and corporate debt raising for a French real estate residential developer. The loan was provided by a consortium of two banks and will be used to finance the group's development and its growth objectives.

Mixed portfolio

Rhatigan Property Group

Amount raised :
Confidential

Debt :
Senior

Lender :
Confidential

Deloitte Ireland provided debt & capital advisory services to the Rhatigan Property Group in relation to securing new long-term debt facilities for their predominantly Dublin City based commercial portfolio.

Real estate financing sectorial trends and key indicators

Offices

Remote work, tech changes and a challenging financing environment have impacted the office sector and have led to a rising vacancy rate due to weaker occupier demand. Despite those challenges, lenders are generally available to finance assets in the sector but are much more selective, notably regarding occupancy & leasing, flexibility, quality of infrastructure and ESG which have become key considerations for lenders. Hence, the focus is mainly driven towards prime assets meeting the minimum energy efficiency standards in metropolitan area as the financing viability of older offices is questioned.

	Financing			
Countries	**Senior LTV Levels**	**Trends**	**Senior debt margins**	**Trends**
France	50-60%	↓	180-260 bps	↑
Germany	50-55%	↓	140-160 bps	→
Ireland	45-55%	↓	250-275 bps	→
Italy	40-60%	↓	250-300 bps	→
Poland	55-70%	→	280 bps	↑
Spain	50-60%	→	200-250 bps	↑
The Netherlands	50-55%	↓	250-375 bps	↑
United Kingdom	50-57.5%	→	200-375 bps	→

Source : Deloitte based on a market sounding

Residential

Lenders' appetite in the residential sector has remained strong at a European level. In fact, compelling demographic trends and continuing undersupply continues to attract activity and in regions where property prices have not risen so sharply in recent years, the perception of relative value at current pricing is leading to burgeoning demand. In terms of sector trends, viability, planning, location, sponsor experience, ESG characteristics and availability of land remain the key areas of focus for lenders. However, in some markets such as Germany, Luxembourg and France, the lenders' appetite for residential has been reduced due to market headwinds, most notably: developers being unable to raise sufficient equity, inflation on constructions costs, delays, and lower demand for new-homes due to home buyers' difficulties obtaining loans.

	Financing			
Countries	**Senior LTV Levels**	**Trends**	**Senior debt margins**	**Trends**
France	55-60%	↓	150-250 bps	↑
Germany	55-60%	↓	100-120 bps	→
Ireland	50-60%	→	225-250 bps	→
Italy	40-60%	→	250-300 bps	↑
Poland	55-70%	↑	300 bps	↑
Spain	50-65%	→	200-250 bps	→
The Netherlands	60-65%	→	175-275 bps	→
United Kingdom	50-62,5%	→	200-300 bps	→

Source : Deloitte based on a market sounding

Retail

The sector continues to see a reduced level of activity as a consequence of rising concern about the liquidity of the asset class. However, in many locations market rents are now much lower and better aligned with the future structural demand and hence, retail parks in medium sized cities, prime shopping centers and high-street units showing good performance should remain attractive for lenders who remain selective. Despite the tense economic market environment, the rental market for retail space is almost at the previous year's level, confirming the trend of the past two years. The trend is mainly driven by leases over 2,000 sqm. Most of the leases are from providers of young fashion, health/beauty and high-end food.

	Financing			
Countries	**Senior LTV Levels**	**Trends**	**Senior debt margins**	**Trends**
France	50-55%	→	180-300 bps	↑
Germany	45-55%	↓	150-170bps	→
Ireland	50-55%	→	250-275 bps	→
Italy	40-50%	→	300-350 bps	→
Poland	50-65%	→	270 bps	↑
Spain	50-60%	→	300-350 bps	→
The Netherlands	50-55%	→	250-400 bps	↓
United Kingdom	50-57.5%	→	200-375 bps	→

Source : Deloitte based on a market sounding

Real estate financing sectorial trends and key indicators

Logistics

Despite the slowdown in investment volumes in logistics, the sector represents one of the few sectors for which lenders have appetite for fully speculative development. This is mainly driven by the fact that the sector continues to see strong occupier demand (with vacancy rates in low single digit figures) with very limited supply. Additionally, yields are largely stabilized showing only slight expansion in some markets, maintaining strong fundamentals for the sector. Hence, despite some repricing of logistics assets lenders continue to be active with lending volumes second only to those in the residential sector.

	Financing			
Countries	**Senior LTV Levels**	**Trends**	**Senior debt margins**	**Trends**
France	55-65%	→	170-290 bps	→
Germany	50-55%	↓	140-160 bps	→
Ireland	50-60%	→	225-250 bps	→
Italy	40-60%	→	250-300 bps	→
Luxembourg	60-75%	→	270 bps	↑
Spain	50-60%	→	250-300 bps	↑
The Netherlands	50-60%	→	175-275 bps	↓
United Kingdom	50-62,5%	→	200-300 bps	→

Source : Deloitte based on a market sounding

Hotels

While lenders appetite remains strong for assets in the most touristic countries of Europe, lenders' sentiment has deteriorated elsewhere. As a consequence of the increasing appeal for good quality assets (with strong fundamentals) from investors, the outlook of lenders is generally positive in France, Italy, the UK and Spain. However, in Germany, Ireland, Poland and the Netherlands, investment volumes have been low (sometimes due to limited supply) and lenders' negative sentiment for this market segment remains.

	Financing			
Countries	**Senior LTV Levels**	**Trends**	**Senior debt margins**	**Trends**
France	60-65%	→	120-250 bps	↓
Germany	50-55%	↓	160-180 bps	→
Ireland	50-60%	→	275-350 bps	→
Italy	40-60%	→	270-350 bps	→
Poland	50-60%	→	280 bps	↑
Spain	50-65%	→	200-300 bps	→
Netherlands	50-55%	→	275-350 bps	↓
United Kingdom	50-55%	→	200-375 bps	→

Source : Deloitte based on a market sounding

Ireland / Irish team's view

Despite a challenging global economic environment, the Irish economy continues to display resilience. Inflation overall continues to be a concern as it rose to 6.3% in August, however construction materials inflation has eased quicker than anticipated. In terms of Real Estate financing, we are seeing 3 key trends at present:

i) Sector focus with financing appetite remaining very strong for Residential followed by Industrial / Logistics and then Hotels. There remains reduced leverage appetite for Retail though valuations have reduced to a level that has started attracting opportunistic investors. Office is the most challenged real estate sector, noting it is difficult to secure financing prior to the asset being substantially let/ stabilised and there is minimal appetite amongst institutional lenders for speculative office development in the current environment;

ii) Given the current interest rate environment, the lending market is primarily focused on the Interest Cover metric and it is this metric which significantly influences the level of LTV achieved. Senior lenders are being conservative on LTVs particularly as there is still valuation adjustments ongoing in the market; and

iii) Sponsor / borrowers track record.

Residential is the trending financing sector in Ireland at present driven by the limited supply and hence demand by both the private and public (social and affordable) need. The delivery of social and affordable homes is a key focus for government, with the Irish state becoming a significant player in the market. This is evidenced in the Governments Housing for All policy which envisages that c. 46% of all new housing units delivered to 2030 will be social and affordable.

John D.

Meet the team

The European Debt & Capital Advisory team assists you in your debt and fundraising processes through a large European lenders and investors' network thanks to an in-depth expertise of the financing and investment market.

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