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# A fresh take on Germany's future

*Real estate specialists say the country's market  
needs innovative lending solutions. By Lucy Scott*

**A**cross European real estate markets, borrowers are in urgent need of financing after around two years of muted lending activity. But it is the region's largest market, Germany, in which some believe the refinancing challenge is particularly acute. Debt specialists say higher interest rates and falling property values have caused stress across the country's real estate lending market, creating the need for additional financing providers.

*Real Estate Capital Europe* hosted a roundtable discussion at the Frankfurt office of Velo Capital – an alternative credit provider that forms part of real estate group Urban Partners – where participants outlined the current lending landscape, and the opportunities the situation has created for debt providers. Significant value falls, insolvencies and

thwarted development schemes mean there are immediate problems for lenders to solve. Moreover, the current crisis, they say, is a pivotal moment in the way real estate finance is provided in Germany in the future.

Emanuele Bena, managing partner, Velo Capital, says alternative lending capital is increasingly in demand: "Today we are getting calls from people who would never have considered talking to a non-bank lender before. Core funds, major sponsors and even larger corporates are looking for ways to balance their investments. And they are becoming more reasonable in expectations.

"I don't think this is a short-term situation. There is a piece of the capital stack that can't be financed by existing lenders. I very much believe banks won't get to anywhere close to where they used to be in terms of risk



### Patrick Züchner

Member of the management board and chief investment officer, Aukera Real Estate

Züchner has more than 25 years of experience in real estate, banking and private equity and is responsible for new investments, product development and fundraising at Essen-based alternative lender Aukera, which he joined in 2022.

### Emanuele Bena

Managing partner, Velo Capital

Bena is responsible for alternative credit manager Velo Capital, a strategy by investment platform Urban Partners. Velo currently advises four funds, managing approximately €1 billion of assets under management focusing on real estate credit investments in Germany and the Nordics.

### Ana Luz Silva Robles

Vice-president - senior analyst, Moody's

Based in Frankfurt, Silva Robles is responsible for a portfolio of predominantly real estate issuers for rating agency Moody's. She has worked for Societe Generale in Frankfurt, where she spent more than three years as a corporate credit analyst, covering large-cap and mid-cap companies from real estate and other industries.

### Ulrich Steinmetz

Head of European transactions - real estate, DWS

Steinmetz has over 30 years of experience in real estate and oversees DWS's real estate transactions in Europe. Before he took over the position of head of transactions Europe he was responsible for the open ended mutual fund business of DWS with AUM of circa €15 billion.

appetite. We are in a situation in which alternative financing will be crucial to the stabilisation of the commercial real estate industry.”

Patrick Züchner, member of the management board and chief investment officer of Essen-based investment management firm Aukera Real Estate, agrees with this assessment. He adds it is becoming easier to progress negotiations on deals because would-be borrowers have become more “realistic” about the terms on which they will be able to source financing.

“For me, the demand over the last three months has become more reasonable than the last 18 months,” he says. “For instance, there are structures, which have been fixed with fresh equity, now coming to us with more reasonable requests for debt. Whereas borrowers had previously sought loan-to-cost ratios of 80 percent, this has come down to between 60-70 percent. On the current value basis, this is quite reasonable.”

### Return of realism

Another kind of realism has come back, they say, as unhealthy lending practices from the top of the market have dissipated, particularly when it comes to development financing. Participants say rising real estate prices and almost flat construction costs for many years meant debt could be underwritten with minimal equity and with complex financing structures, sometimes including unsecured subordinated or mezzanine loans at the holding company level of development projects. These were high-interest, short-term loans that were meant to be repaid using high sales proceeds.

As Bena reflects: “A lot of mezzanine lenders in Germany in the past would finance development on loan-to-gross-development-value, even before planning was achieved. This was effectively providing finance



*“Today we are getting calls from people who would never have considered talking to a non-bank lender before”*

**EMANUELE BENA**  
Velo Capital

at a 98 percent loan-to-cost. One of the good things about this crisis is things like that will never happen again.”

The ready supply of unsecured debt prior to the past two years is one reason why it was difficult for some lenders to compete, says Züchner.

He reflects that borrowers had demanded loan conditions that were economically unviable for his business: “You have to calculate the project margin first without financing costs to judge whether the project makes sense at all, but then think about this margin being split between debt and equity. We always did this, and the fraction differed according to where we were in the cycle. However, there came a point where we had to stop [lending] because the numbers were in the equity’s favour and not ours. If the returns are not distributed fairly between sources of capital, you have to stop.”

Another barrier to non-bank lenders’ expansion in Germany was the

supply of finance from banks and through the capital markets. In the years that preceded interest rate hikes, access to corporate-style bank and capital markets debt made an “accommodative funding environment” for sub-investment grade and unrated real estate companies, says Frankfurt-based Ana Luz Silva Robles, vice-president – senior analyst, at rating agency Moody’s.

This situation, says Züchner, created a “structural problem” because companies could increase their leverage at very low cost and finance at the corporate rather than real estate level via the capital markets. “The difference between unsecured bond yields of around 35 basis points and secured debt was surprisingly negative. In the last cycle we never granted a loan with a margin over the reference rate that was lower than 200 basis points. If compared to the average cost of capital,

the unsecured part was so cheap against what a bank or alternative lender would grant.”

While Germany’s senior bank lenders have been a plentiful source of capital for borrowers, market conditions are restricting their ability to deploy new capital, removing some of the pre-existing competition for ambitious alternative debt platforms, the roundtable participants argue.

Ulrich Steinmetz, head of European real estate portfolio management/retail clients at manager DWS, representing the borrower side of the discussion, says companies’ ability to borrow cheaply was a key driver for valuations “becoming irrational”: “Borrowers, even at 2.5 percent yield, could find themselves with a margin over the reference rate of 30 basis points. Therefore, value falls have not only resulted in a complete loss

of equity for borrowers, but losses for senior financiers, too.”

### Range of opportunities

This situation is giving non-bank lenders a range of opportunities to appraise, says Bena: “In Germany, I continue to see a market where there are more opportunities than capital that is waiting to be deployed. It is still a lender market. I would never push out capital for the sake of it. A more selective access to capital for real estate equity investors means there is a good selection of borrowers. This is a great time to build relationships.”

An immediate opportunity, the discussion reveals, is in bridging finance. Due to acute problems for developers, bridge-to-exit or bridge-to-transition finance are in demand, say participants.

The type of situations Bena and Züchner see today, for instance,



*“In Munich, more projects stopped than proceeded, so the first scheme to be ready is the winner. That is an influencing factor in whether we would provide development finance”*

**PATRICK ZÜCHNER**  
Aukera Real Estate

include completed projects for which the developer cannot find a buyer. This inability to exit projects has led owners to hold assets for longer periods than they – and their lenders – had originally anticipated. In other cases, construction of a development has been halted or completion delayed, leading to a need for short-term capital.

These projects can be compelling lending propositions when there is an acute stock shortage in a particular location, created or further compounded by the difficulties in completing projects in recent months.

As Silva Robles says: “Cost inflation has been a natural break on

development. In the last 18 months the negative sentiment has been industry wide, but now the market can look at the situation with a greater sense of the nuances.”

Züchner agrees, adding: “It depends on the specific situation of the product that is being developed. In Munich, more projects stopped than proceeded, so the first scheme to be ready is the winner. That is an influencing factor in whether we would provide development finance.”

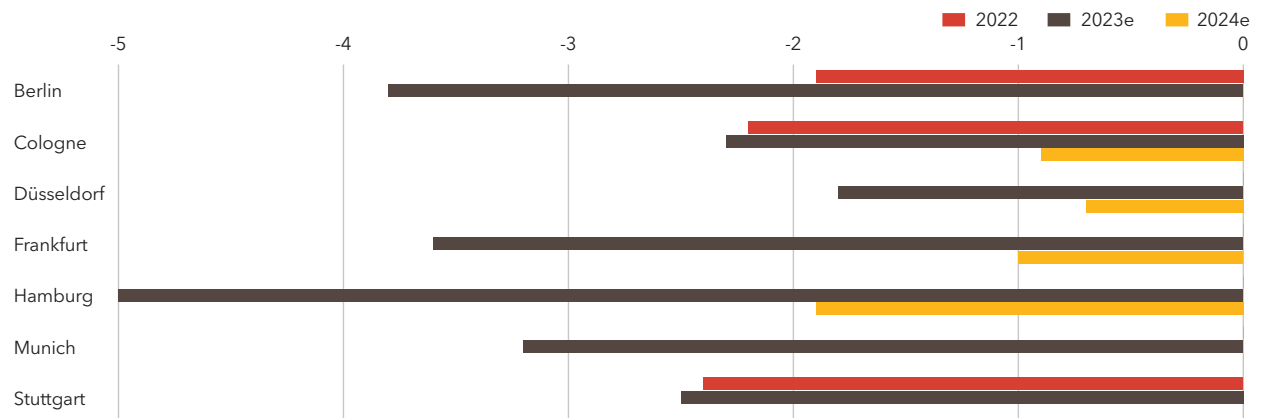
Bena agrees the demand dynamics for certain sectors is robust: “For two years, development has been limited, so the case for good office, residential

and logistics remains as strong as ever. Occupier demand is going to go up, so investors will have appetite to buy these projects from developers – as long as deals are properly priced and underwritten.”

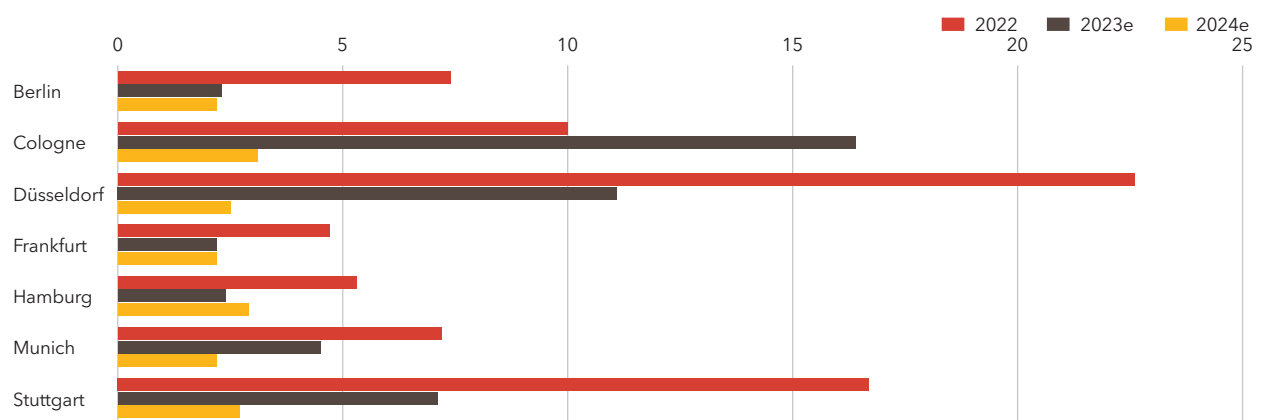
Steinmetz comments that this is how investors on the equity side are looking at the German market: “Residential, for instance, will be a very interesting opportunity. There is such an undersupply and such an occupier demand, and not just in Germany. Logistics is also favoured and, in Germany, we see core capital investing in it.”

He adds that there is also debt and equity capital available for offices

Germany's top seven locations for retail space: change in prime rent (%)



Germany's top seven locations for office space: change in prime rent (%)



Source: bulwiengesa, DZ BANK forecast



– albeit that capital is selective. He cites core office investments currently on the market where the owner received tens of offers – a lot in comparison with the past 18 months. “Companies are looking for sustainable office spaces, there is huge demand, but those spaces are rare.” Data shows there is some rental growth in the sector in the key markets (see charts).

Bena agrees there is opportunity for non-bank debt providers in the German office sector. “It took us a year to find a new office for our Munich team. There are fantastic deals to be done in the office sector, but it needs to be the city centre, and with a genuine sustainability profile. Out-of-town offices are properties that are unlikely to be attractive to lenders.”

Lenders say despite the pressing need for capital in some sectors, circumspection is crucial in terms of borrower choice and the risk involved in the various transactions the market will generate in the coming months and

*“In the last 18 months the negative sentiment has been industry wide, but now the market can look at the situation with a greater sense of the nuances”*

**ANA LUZ SILVA ROBLES**  
Moody's

years. As Bena says: “I would participate in recapitalisations where there is also incoming equity. I would not buy a non-performing loan portfolio for speculative purposes because what I care about is real estate value and not quick financial gain. The non-bank lending industry must accept the risk-return profile of funding it receives from investors and realise it doesn't have a mandate to solve everything. Lenders need to pick the right situations, to bring solutions and earn good interest for investors.

“As a non-bank lender, we pride ourselves on being flexible and being adaptable to our clients' needs. However, we are very clear with borrowers that there needs to be real equity for us to underwrite the loan. We would not rely on capital gains from ongoing planning as you sometimes saw with other lenders in the past.”

Bena says there are many situations in which smaller companies with “barely any equity on the table” need debt and lenders are unlikely to want back these borrowers. However, he adds there are sponsors that have their reputations at stake and have the skills to turn a project around, and these are the teams the lender would seek to work with.

Züchner says the current market situation does not lead him to conclude global brands make for the best borrower profiles: “Does it make more sense to grant a loan to a large private equity manager or to a high-net-worth local hero? Some of the latter I know have a €1 billion portfolio. In private equity firms, people come and go, part of team will move but the local hero will never move – so these investors are a reasonable client for us.”

### **Capital is returning**

The participants reflect that the capital raising environment for German-focused debt funds is improving,

alongside growing optimism among real estate equity managers. Steinmetz explains: “Institutions investing in debt funds are a mirror of the equity market. Capital allocations for debt or equity vehicles from international investors remain rare but the market is opening up. We see capital coming back, and Germany is one of our areas of focus.”

Bena’s experience chimes with this view. He says Velo’s investors – large pension funds, endowments, sovereign wealth funds, insurance and money managers – are considering the asset class again: “In the last six months, it is pretty obvious the situation has changed, and money is coming back to real estate generally but specifically to real estate credit due to very attractive returns at reasonable risk levels.”

Züchner says “early movers”, which earned money in the first part of the cycle, are now ready to invest in new structures “with different investment approaches”.

But he adds that losses by domestic alternative mezzanine lenders have impacted investor sentiment: “The investors which entered late have had their fingers burned, so it is simpler to invest in bonds rather than commercial real estate credit.”

Silva Robles says appetite is improving among bond investors for investment grade commercial real estate companies in Germany, helping to improve the diversity of debt available for such companies. “This is something available for well-established, investment grade companies. After the interest rate shock, a lot of companies found this funding dried up or became very expensive. We have since seen a recovery – the picture is improving for the companies we rate.”

But Silva Robles remains “vigilant about differentiation”. She explains: “It won’t go well for everyone in spite of interest rate cuts, as there are secular



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**ULRICH STEINMETZ**  
**DWS**

changes in addition to a weak economic environment, which will, for example, weigh on the performance of secondary office portfolios.”

Meanwhile, she adds market conditions will favour assets featuring stable rental income streams and good growth prospects, such as multifamily residential:

“The sector needs to acknowledge this is a very different environment and strategies and balance sheets need to recalibrate to adjust to the new normal,” Silva Robles says.

As legacy issues look set to continue, investors looking at Germany may need convincing to place capital with alternative lenders, particularly for vehicles focussed on loans higher up the capital stack. As Bena explains: “German mezzanine finance is sometimes seen as a swear word, investors think about the past. But it is a very different world in front of us.” ■