"The market is changing from week to week"

Q&A

Curth-C. Flatow

Managing partner, FAP Finance

When former Credit Suisse banker Curth-C. Flatow founded FAP Finance in 2005, it was among the first real estate debt advisory firms in the German market. Now, the Berlin-based company advises a range of domestic and international clients on financing property, mainly in Germany. The wider FAP Group also includes a separate debt investment business, FAP Invest, launched in 2017. *Real Estate Capital* spoke to Flatow about financing conditions amid covid-19.

Q What are borrowers turning to you for during the pandemic?

A We are receiving enquiries from borrowers seeking capital, in some cases for refinancing, but also from new clients having problems sourcing or structuring finance. Some are struggling to close agreed financing deals, something we have seen since March as the market has changed and lenders are withdrawing or aiming to change terms during the process. We are also helping clients arrange mezzanine finance owing to the gap that is arising due to covid-19 as senior banks lower their leverage.

Q Are your clients actively seeking purchasing opportunities?

A Some, especially German investors, are using these times to increase their allocation to residential as they see opportunities arise. Some potential investors are not able to deliver due to less availability of finance. Some are withdrawing from the market while they keep an eye on valuations.

Q How has covid-19 affected debt liquidity in Germany?

A It is still a liquid market, but you can divide the lender groups, including domestic and foreign lenders, into categories. There are those lenders doing business as usual, especially German mortgage banks. Some of them are doing more business than they could have done before because there is less competition to offer higher leverage. Insurance companies, pension funds and debt funds are also doing business, and using the shortage of capital to do business at higher margins – maybe senior loans at 3.5-4 percent, which is high for Germany, and 8-12 percent for mezzanine.

There are those that have virtually stopped new business, especially for new clients – including the German savings banks, which are using their capital to prioritise lending to mid-cap companies. Then there are those doing business on a selective basis, offering lower leverage and higher margins.

There are also opportunistic lenders in the market, which are trying to hunt for whole loan or mezzanine-type bridge loans. But we are not seeing too much business by them, as the market is liquid enough that borrowers are not desperate for finance.

Q How are bank lending terms changing?

A It is important to keep in mind that this is not a financial crisis. German banks' costs of capital have increased due to the pandemic, meaning higher liquidity premiums – 30-50 basis points – have been added to net margins on senior loans. That is a moving target though, as banks' funding costs are changing from one week to another. Senior margins have increased from the low levels in recent years, and typically start at 150-180bps all-in for senior loans.

Banks have also reduced their leverage to no more than 75 percent. But the key thing is that banks are still lending.

Q How are you keeping up with where the available capital is?

A It is more important than ever for a debt advisor like us to be close to the market and to know who is active.

FAP's founder on how covid-19 is affecting the German lending landscape

SPONSOR

FAP FINANCE

Things have calmed down since June, but the market is changing from week to week. It can be challenging for borrowers to find financing partners that will stay on board until the deal closes. We have someone in-house constantly in contact with lenders to ask whether they are doing business and what type of lending they are willing to do, and to discuss all further details. A big part of our job right now is keeping in contact with lenders' risk departments to make sure terms as discussed are going through and borrowers can expect deliverability.

Q Is covid-19 creating problems for borrowers with their existing loans?

A We are not seeing many of them struggling to service existing debt, or breaching loan terms. There does not seem to be much of a need for borrowers to request covenant waivers from lenders – not yet, anyway. Most of their problems are to do with accessing finance, rather than making interest payments on existing loans. Maybe by Q1 or Q2 next year there will be more focus by lenders on where values are, and they may test covenants, but it is not a big problem in Germany now.

Q Do you expect a return to the recapitalisation work you did, post 2007-08?

A As we do not have a financial crisis, I do not think there will be much need for recapitalisation. There may be the need for restructuring when it comes to highly leveraged mezzanine, as loan-to-value ratios come down. We will be prepared to do such work, as we have experience in intensive recapitalisation, but we do not expect that for now.

There is liquidity in the market from non-banks, so even if the banking market were to dry up, alternative lenders would be an option for sponsors. That is something we did not have in 2009, when the capital markets completely dried up.

Q Are debt advisors becoming an accepted part of the German market?

A When we launched in 2005, we were one of the first movers. The idea of providing German lending market advice to international investors was new.

However, as the financing process becomes more complex, sponsors are increasingly willing to outsource or seek additional support on structuring debt, loan application, documentation and aspects like 'knowing your customer'. The market is also growing in terms of financing sources, so a major part of the job is to grant clients access to capital and ensure they have a more expansive network than the three or four banks they are used to dealing with.