GENERALI REAL ESTATE

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Part of GENERALI INVESTMENTS

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PRIVATE COMMERCIAL REAL ESTATE DEBT
A higher yielding alternative to investment grade bonds

Executive Summary

Amid an environment of historically low government bond yields, institutional investors are increasing their strategic asset allocation towards alternative asset classes, which are typically less correlated to traditional investments and are able to deliver a premium over traditional fixed income.

Real Estate is one sector experiencing steady interest from investors. **Commercial real estate ("CRE") backed financing represents a large element of the real estate universe.**

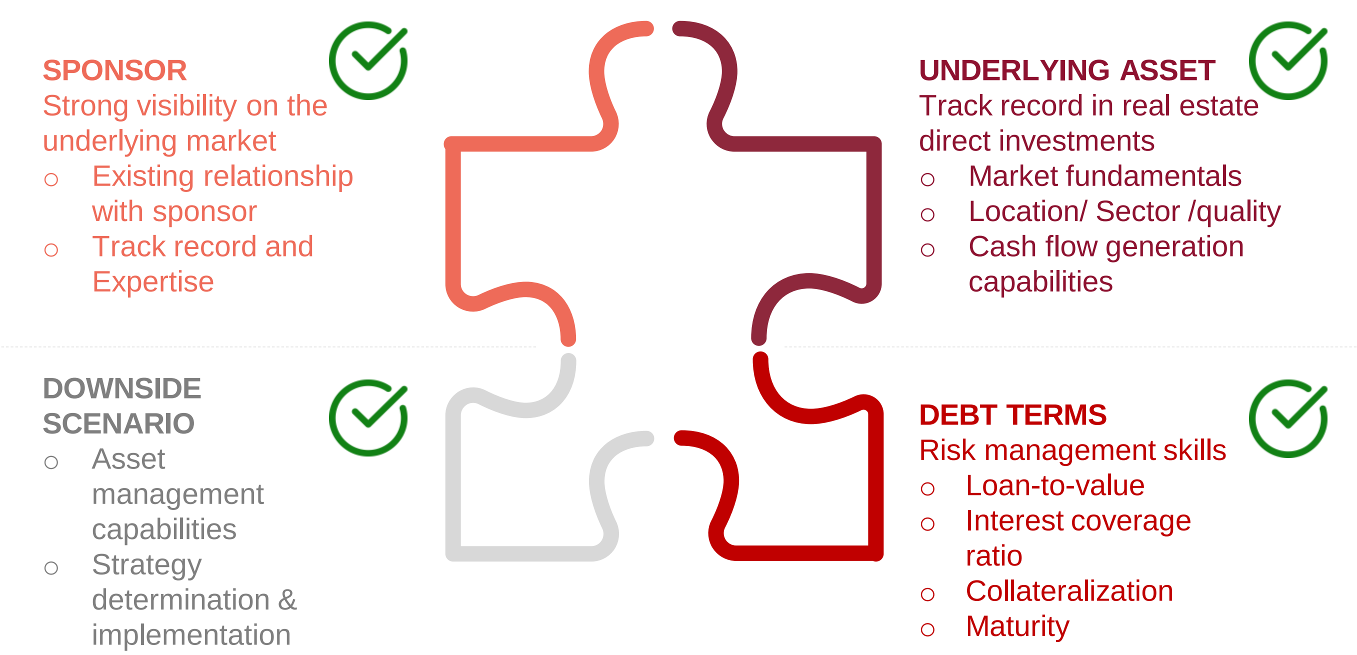
Regulatory constraints and fading risk appetite from the European banking sector over past years have created an **opportunity for non-bank lenders to fulfill a lending gap for the real estate sector that has emerged during the last few years**.

The European commercial and residential property loan market has become an increasingly significant investible universe, **with impressive growth potential**. In contrast to the US market, where alternative lenders are more consolidated, **the European CRE debt market is still mostly penetrated by traditional lenders.**

Despite the steady compression in interest rates seen the past decade, margins on real estate senior loans have remained fairly stable, making the asset class appealing on a risk-adjusted basis.

With low yields across Europe, real estate debt has become an asset class with potential to generate attractive and stable net income yields for investors, as well as **becoming an asset class complementary to real estate equity**.

Figure 1 – Benefits of a real estate asset manager
Alternative lenders typically benefit from robust in-house skills to analyze commercial real estate debt investments



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The commercial real estate debt environment

The commercial real estate debt market in Europe has historically been dominated by banks, which have experienced significant structural changes since the global financial crisis (GFC). The pandemic accelerated pre-existing trends, with the European banking system now increasingly focused on supporting the recovery of companies and real economy.

Since the GFC, banks have deleveraged their balance sheet and reduced their exposure to real estate lending following ever-greater regulatory interventions. Basel II and III has lead to increased bank capital requirements for real estate lending, especially for lending with higher loan-to-value (LTV) levels. This environment has reinforced the opportunity for non-bank lenders to move into a market which is structurally growing due to the higher appetite for real estate combined with lower competition from traditional banks. As INREV data on the European non-listed real estate market demonstrates in Figure 2, the debt vehicles universe featured 95 vehicles in 2021, a figure that has nearly doubled since 2016.

However, the real estate debt market remains challenging with main risks related to the potential deterioration in the underlying real estate asset values and wider economy conditions. However, these risks can be mitigated by financing projects characterized by resilient collateral (i.e. location, tenant, asset technical characteristics), negotiating strong, protective covenants (i.e. first mortgages/ LTV) and by creating a well diversified portfolio (e.g. borrowers, asset types and geographies).

In the light of these tailwinds, investors have been drawn to commercial real estate debt in the last few years mainly because:

- Returns are more attractive than in the traditional fixed income markets (with government bonds returns mostly in negative territory, see Figure 3)
- Potential to limit downside risk should real estate values fall
- Short duration acts as a protection against a rise in interest rates

CRE debt funds offer an attractive income-generating investment opportunity for investors while at the same time offering good downside protection. This is particularly true for senior real estate debt exposure where a >40% equity/ mezzanine cushion is safeguarding investors. In addition, adding CRE debt allows investors to further diversify their risk-return profile.

Figure 2 - Numbers of INREV debt vehicles[1]

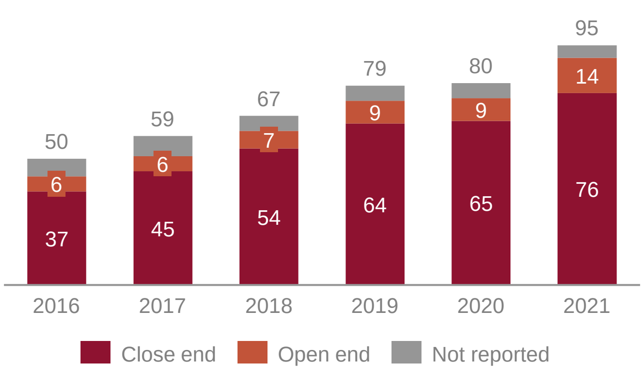
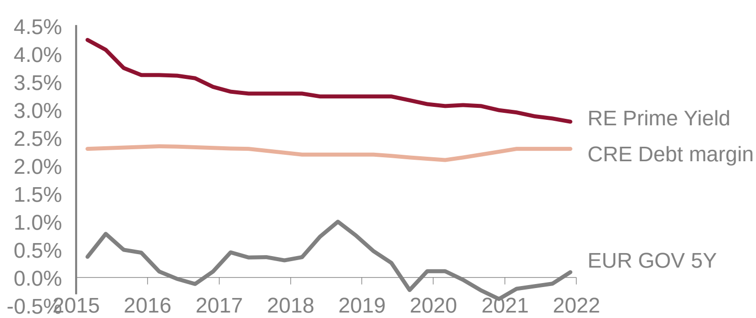


Figure 3 – Real estate prime yields vs government bonds & CRE debt yields[2]



1. By INREV "Debt Vehicles Universe 2021" Report; 2. Generali Real Estate Research internal analysis; CBRE, Bloomberg. Please note that RE Prime Yield and EUR GOV 5Y are weighted on Generali Real Estate Debt fund geographical exposure

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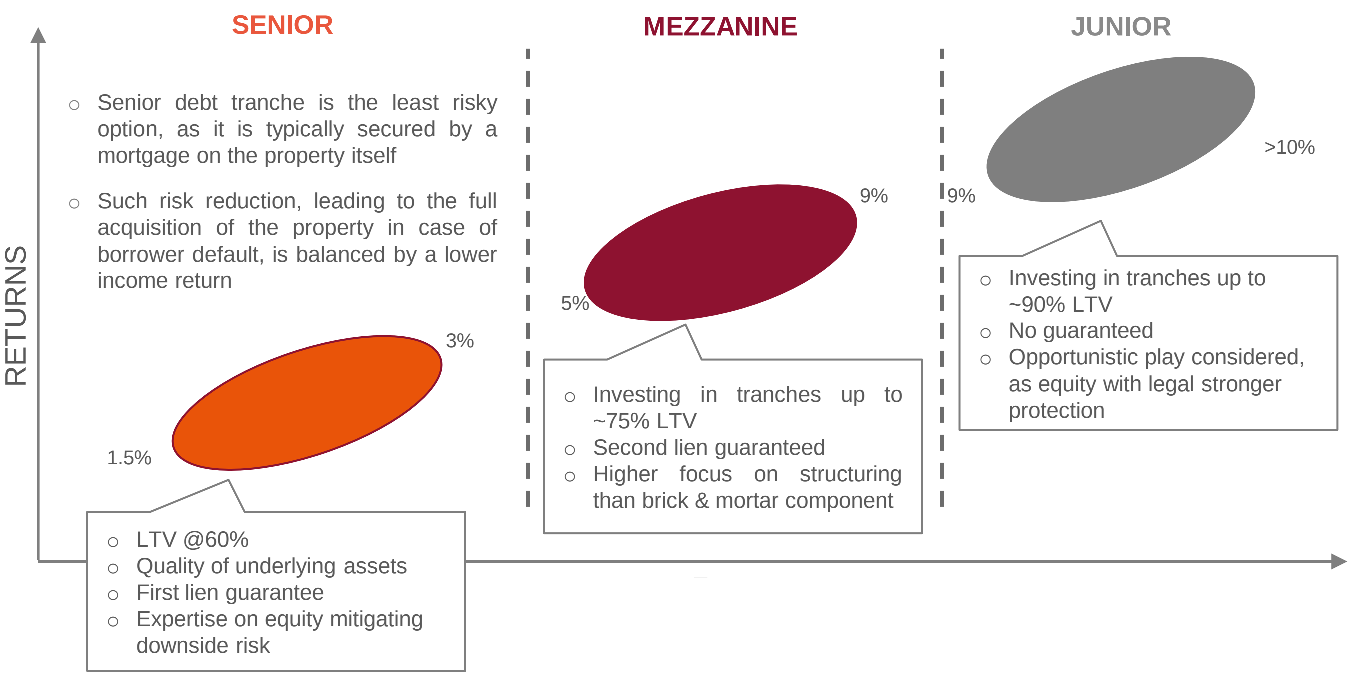
CRE debt is applied across the entire real estate spectrum including property acquisitions (usually more stable and less risky as they are backed by an income-producing asset), value add projects (usually with an asset to be refurbished/ repositioned) and development. Depending on risk appetite, CRE debt investments can be typically divided in three capital tranches (Figure 4).

Figure 4 – CRE debt capital tranches overview



Senior CRE debt market in Europe

Despite the significant reduction of interest rates, CRE debt margins remained fairly stable. According to data from real estate services firm CBRE, the senior CRE lending average margin landscape in Europe ranges from 90 bps in Denmark, 110bps in Germany, 130bps in France and 220bps in Italy, depending on the asset class and location.

As real estate debt is backed by buildings and projects, it is not immune to the wider economic factors, some of which are more evident after the outbreak of Covid 19:

OFFICE

Occupiers will **favor higher quality, wellness-capable and tech-enabled buildings** that are in an appealing location

LOGISTICS

Shift in consumer demand and consolidation of trends like e-commerce **allow the logistics sector to consolidate its strength and deploy relevant capital**

RETAIL

In the light of changes in consumer behavior, **the sector is adapting rapidly to new market trends and omnichannel strategy is key**

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Although debt represents lower risk than equity, it is still possible to adequately diversify portfolios by building loan portfolios with a multi-sector and multi-country approach, with a large number of borrowers and spread risk accordingly.

In addition, it is crucial to maintain discipline on LTV levels. Indeed, before the GFC, lenders provided higher LTV for loans (up to 90% in some markets like Germany). Now, the average LTV for senior CRE loans in Europe is about 60% of underlying real estate values (according to CBRE figures) to protect lenders from a 30-40% fall in collateral values. The lower LTV ratios that we see today are a direct result of greater regulatory interventions, with a higher regulatory capital requirement, as well as increased regulatory oversight of bank activities in real estate lending. The turbulence due to the Covid-19 crisis has also added more caution on LTV levels.

With European market valuations having increased over the last few years, accurate valuations and efficient due diligence are vital in preventing deals from becoming overpriced. Nevertheless, covenants, which tests both property value and cash flow generating capacity, need to be suited and properly negotiated with the borrower.

As shown in the table below, stable and resilient CRE debt returns can be attractive for long term investors, especially if collateralized by liquid/high quality assets located in top European investments locations.

Figure 5 – Senior commercial real estate lending terms [%][1]

	Prime Office			Prime Retail			Prime Logistics		
City	LTV	Margin	**Total cost of debt**	LTV	Margin	**Total cost of debt**	LTV	Margin	**Total cost of debt**
Paris	60	1.20	**1.30**	55	1.30	**1.40**	60	1.20	**1.30**
Frankfurt	60	1.00	**1.14**	60	1.20	**1.38**	60	1.00	**1.10**
Amsterdam	60	1.20	**1.27**	55	1.50	**1.60**	60	1.10	**1.17**
Brussels	60	1.20	**1.27**	55	1.50	**1.60**	60	1.10	**1.17**
London	55	1.65	**2.49**	50	3.00	**3.90**	60	1.65	**2.49**
Copenhagen	60	0.90	**1.03**	60	0.90	**1.03**	60	0.90	**1.03**
Milan	55	1.80	**1.95**	50	3.00	**3.20**	60	1.70	**1.85**
Madrid	55	1.50	**1.65**	60	1.50	**1.65**	55	1.50	**1.65**
Warsaw	60	1.80	**1.92**	-	-	**-**	60	1.70	**1.82**
Vienna	65	1.95	**2.05**	65	2.20	**2.30**	65	1.95	**2.05**
Prague	62.5	2.05	**2.15**	60	2.20	**2.30**	62.5	2.05	**2.15**

1.Souce: CBRE European Debt Map, Q2 2021

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Macroeconomics and the medium terms impact on CRE Debt

At the ECB December meeting, the ECB announced an exit from emergency QE. It will terminate the Pandemic Emergency Purchase Programme "PEPP" in March 2022.

In the light of recovering economies and higher inflation, central banks have started to withdraw from the ultra-loose monetary policy that followed the outbreak of Covid-19 and the related GDP contraction in 2020. With most economies experiencing high levels of indebtedness, a sharp rise in rates is expected to limit the economic expansion. Government bond yields are therefore expected to remain at historically low levels for the medium term.

In an environment of rising rates, CRE debt, structured as floating-rate loans, offers investors the possibility to avoid duration risk and thus earn additional interest in a scenario with further rate increases (see Figure 7).

MONETARY POLICY

After a long period of very accommodative policies, central banks are expected to tighten policy in 2022

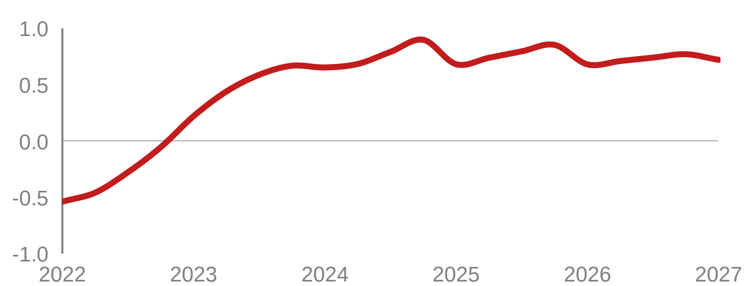
CRE DEBT OPPORTUNITY

CRE debt proved itself stable on margins, despite yield compression both on the real estate equity and bond side. Looking ahead, an increase is expected, although it should be limited

Figure 6 – Interest rates trends[1]

Key indices	2021	2022 Δbps	2023 Δbps
UK 1 10 Yr Corp	2.64%	+3	+8
Euro 10 Yr Corp	1.25%	+11	+11
Euro High Yield	2.71%	+18	-131
1-Mo LIBOR	0.08%	-	(7)
10- Year Gov. Bonds			
Austria	0.12%	+12	+51
Belgium	0.19%	+11	+53
Denmark	0.15%	+6	+59
Finland	0.12%	+13	+50
France	0.22%	+11	+52
Germany	(0.11%)	+11	+46
Ireland	0.26%	+12	+48
Italy	0.97%	+18	+21
Netherlands	0.02%	+13	+49
Norway	1.73%	+27	+99
Switzerland	(0.08%)	+9	+45
Spain	0.51%	+10	+32
Sweden	0.40%	+6	+40
UK	1.14%	+22	+86
US	1.63%	+19	+79

Figure 7 – 3m Euribor forward rates for a series of future dates (next 5 years from February 2022)[2] [%]



1. Generali Real Estate Research internal analysis (Outlook 2022, as of December 2021); 2. Bloomberg and Generali Real Estate BD&IR market intelligence

CRE debt sustainability approach

In CRE debt, the sustainability impact is mostly dependent on the environmental characteristics of the underlying asset. To be in line with the latest sustainability requirements, properties need a high degree of energy efficiency and low greenhouse gas emissions. In case assets needs to be repositioned/ developed, projects and related renovation material need to be compliant with the highest environmental and technical standards.

Examples of environmental guidelines that needs to be implemented by a borrower at asset level are: (i) responsible design of new developments; (ii) capital expenditure aimed at ensuring the best achievable result in energy consumption and greenhouse gas emissions; (iii) continuous improvements in building operational performance and optimization, through robust monitoring and (iv) integration of green lease contracts with tenants to ensure optimal building efficiency.

In order to have a third-party/independent rating of the ESG characteristics of an asset, international environmental rating firms such as Leed, BREEAM are typically mandated by the sponsors to run their analysis and to issue the asset's Green Certification.

The Generali Real Estate view on debt: from theory to practice

Generali Real Estate launched a dedicated Commercial Real Estate Debt strategy with the Generali Real Estate Debt Investment Fund ("GREDIF I") in 2019. This leveraged on the track record developed over many years of managing a series of direct CRE loans (>€1bn of financing with underlying assets spread across Europe) on behalf of Generali Group investors.

The GREDIF I strategy aims to deliver stable and recurrent income distribution with low correlation to wider property and investment markets. It targets exposure to senior loans with an average maturity of five to seven years, covering the full risk spectrum of underlying assets (core, core plus and value add, backed by location).

As of the end of 2021, GREDIF I deployed ~€900m in 20 loans with underlying assets spread over France, Germany, Italy, UK, Spain, Finland and other CEE countries, with an average margin of 2.3% and weighted average LTV of 50%.

LEVERAGING GENERALI GROUP EXPERTISE AND GENERALI REAL ESTATE UNDERWRITING

With both a real estate equity and a private debt team in place, Generali Real Estate – with a team of ~370 professionals in 9 European offices – has the advantage of being able to assess every collateral/ investment by leveraging its investment management expertise to analyse the creditworthiness and robustness of the underlying project. For example, during the underwriting phase, the team's deep expertise in equity real estate allows them to understand if the sponsor business plan is based on sustainable/ reasonable assumptions and if asset valuation is coherent with market trends.

MULTIPLE SOURCING SPONSORS/ BANKS

The team is able to have an up-to-date visibility on the European market thanks to extensive relationships established over time in the market with international/ reputable sponsors, banks and financing partners. Transactions are scouted directly from sponsors and debt advisors, and indirectly through bank syndications.

Generali Real Estate CRE Debt platform: implementing ESG at sponsor and asset level

ESG is at the heart of Generali's real estate strategy. As part of Generali Group's route for sustainability, Generali Real Estate has designed a specific ESG framework for GREDIF I consistent with the "Green Bond Principles" developed by the International Capital Market Association (ICMA).

The fund has thus received the below from assessment form a primary international ESG consultant "*GREDIF I ESG Framework is credible and impactful and will deliver overall positive environmental impacts. We are of the opinion that the principles of impact and transparency that underlie the green and responsible investment industry, as well as many of its norms and standards, are applicable to green debt funds, and that the Fund aligns with those principles*".

As of today, over 70% of GREDIF I underlying assets have Green Label Certification granted by the most reputable certifications bodies in the industry.

In its subsequent fund "GREDIF II" to be launched in Q2 2022 and replicating the GREDIF I strategy, sustainability will continue to be targeted as the fund will be classified as Article 8[1] under the Sustainable Finance Disclosure Regulation (SFDR)[2].

GREDIF II investments will exclusively focus on loans backed by objective and measurable ESG credentials. In order to develop such a strategy **Generali Real Estate has developed a proprietary scorecard based on a series of ESG KPIs representing a binding element in the investment decision making process.**

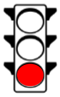
ESG characteristics of the projects under assessment are deeply analyzed during the underwriting phase and are based on (i) environmental and social characteristics of the underlying assets and (ii) sponsor commitment to ESG factors.

The investment decision on the proposed project will be positive only if ESG score reaches **a minimum ESG threshold.**

Figure 8 – How does the Generali Real Estate CRE debt scorecard works

Assessment Perimeter	Environment	Social	Governance
Asset Level	XX	XX	XX
Sponsor Level	XX	XX	XX

	SCORE	
Very good	XX- 100	Go ahead
Good	XX- <XX	Go ahead
Medium	XX - <XX	Go ahead
Poor	0 - <XX	Rejected



1. A financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics.
2. For further information on Generali Real Estate SGR SFDR framework please refer to "Sustainability policy and adverse sustainability impact statement implementation of regulation (EU) 2019/2088 art. 3 and art. 4"- at https://www.generalirealestate.com/regulatory/

Generali Emergency Fund of 3 million euros and Global Fundraising Campaign for Ukrainian Families and Children

In line with our Purpose and commitment to supporting the communities when they need it the most, Generali has decided to create an Emergency Fund of 3 million Euro to support refugee programs, including a donation to UNHCR, that is currently at the forefront of the humanitarian response in Ukraine, and to launch a global fundraising campaign open to all the Generali People.

By leveraging the network of The Human Safety Net, all funds will be deployed to support UNICEF in the work that it will carry out in the coming weeks and months addressing impacted families with children.

It is possible to take part in these fundraising efforts to support those affected by the conflict through this donations page.

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Generali Real Estate

Generali Real Estate ("GRE") is a real estate asset management specialist currently managing assets for €36.3bn

GRE is part of Generali Group, one of the leading European insurance companies

GRE has a unique Pan-European footprint, with a team of 370 working from 9 European offices

Historically, GRE has mostly managed the entire Real Estate value-chain process developing unparalleled industry capabilities

GRE, coherently with Generali Group strategy, serving the Group (eleventh investor in Real Estate in the World) is expanding its product catalogue thanks to 10 cross-border vehicles and targeting also external clients, institutional ones in particular

Only for professional investors subject to the Directive 2014/65/UE that act on their owns and/or on behalf of third parties on discretionary basis.