DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 2nd Quarter 2019
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The sentiment barometer remains in the red zone

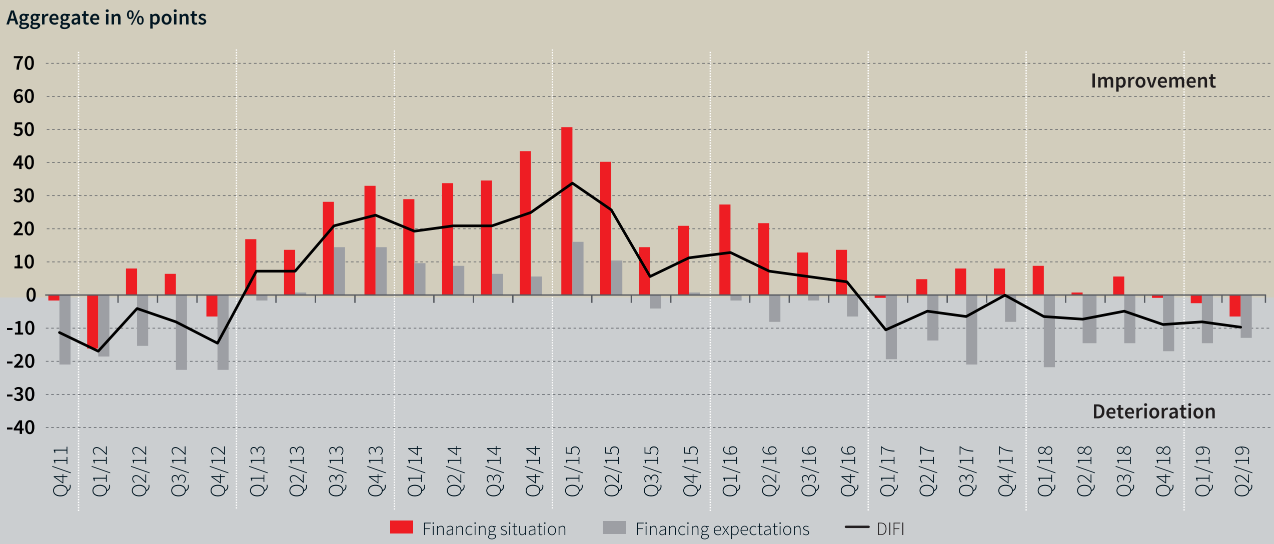
Sentiment in the financing market is negative for the first time for all use types

Special question: average margins rising, but not for hotels

The German Real Estate Finance Index (DIFI) reflects survey participants' assessments of the current situation (the last six months) and expectations (the coming six months) for the German real estate financing market. DIFI is produced quarterly and is calculated on the basis of an average of the results for the office, retail, logistics and residential real estate market segments. These figures reflect the percentage of positive and negative responses received from survey participants relating to the current situation in, and financing expectations for, the German real estate market. DIFI is produced and published in cooperation with JLL and ZEW (Zentrum für Europäische Wirtschaftsforschung – Centre for European Economic Research) in Mannheim.

Sentiment remains subdued

German Real Estate Finance Index (DIFI)



Average assessment of the current situation in and expectations for the four real estate market segments (Office, Retail, Logistics, Residential, Hotel).
The time series shown also contain assessments of the hotel real estate segment since Q3/2018

Source: JLL and ZEW

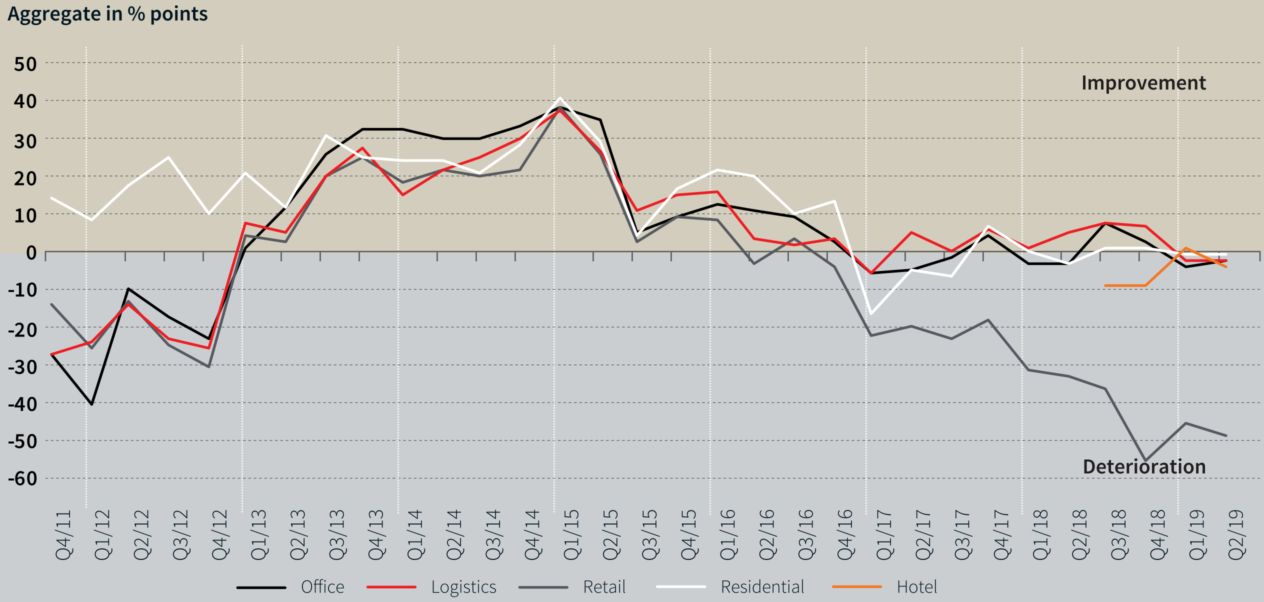
DIFI almost unchanged in negative territory

Despite some quite pleasing assessments of the situation and expectations in some sub-segments, the **German Real Estate Finance Index (DIFI)** continued to slide in the second quarter of 2019. Although the majority of the institutes participating in the survey did not see any changes over the past six months, nor for the coming six months, far more of those who expect a change are pessimistic than optimistic. The sentiment indicator for commercial real estate financing in Germany consequently reached a level of **-11.1 points** in this quarter, falling by a further 1.4 points since the previous quarter. This downturn is due to a noticeable slowdown in the financing situation: where respondents were still quite optimistic or only slightly pessimistic last year, the sentiment barometer for the current financing situation has fallen to -7.2 points (Q1 2019: -2.3 points): the sub-aggregate for financing expectations on the other hand, has remained negative since early 2016 and its slight increase of 2.1 points to a new level of -14.9 points cannot make up for the pessimism about the current situation. Overall, this development goes hand in hand with the rather subdued economic situation in Germany.

Assessments of the real estate financing market are still relatively pessimistic

The clear loser in the assessment of the financing situation and expectations is and remains bricks-and-mortar retail: since the end of 2016, this sub-indicator has been in an almost steady free fall. There is an overarching pessimistic view of both the financing situation (-46.4 points), which has seen a slight improvement compared to the previous quarter, and the coming six months (-48.3 points). The market for logistics real estate will benefit a little

Assessment of the real estate financing market by real estate market segment



Average assessment of the current situation and expectations by defined real estate market segment.
Source: JLL and ZEW

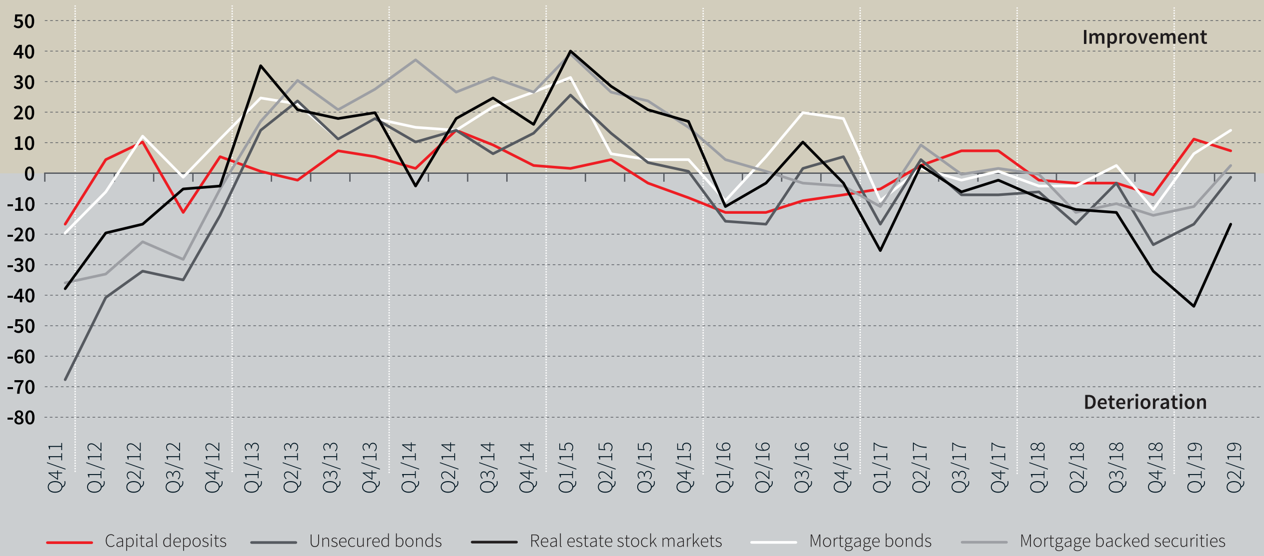
from this. According to our survey participants, the current situation in this segment has improved somewhat from -13.8 points in the previous quarter to -6.9 points in the current survey; however, expectations have remained unchanged at -1.7 points. The office and residential use types, which in the past were more of a driving force, are relatively weak in the survey for the 2nd quarter of 2019. Both have been slightly negative since the beginning of the year. However, the greatest decline was recorded for the hotel real estate segment. Despite a strong increase in the previous quarter, the mood of respondents is now slightly subdued, which is reflected in the sub-index which fell to -3.6 points (previous quarter: 1.9 points). This could be due to the current shortage of business hotels in the major markets.

Refinancing on the rise

After the collapse of all indicators in the two most recent quarters, the refinancing markets are now on the up again, although expert assessments for the coming six months are more cautious. Although two of the five refinancing instruments – real estate shares and bonds – are still listed in the red, capital deposits, mortgage bonds and mortgage-backed securities are rated as positive. This is attributable to the positive sentiment about both the current situation and expectations for the coming six months. Due to slightly rising margins (see the special question for this quarter) in the current climate, better conditions can now be negotiated for refinancing. The picture has deteriorated only slightly for capital deposits which remain positive. Real estate stocks and bonds have also recovered noticeably since the last quarter, but do not yet lie in the healthy zone. As far as refinancing via real estate shares in the coming six months is concerned, the picture is mixed: 17.4 per cent of survey participants expect an improvement, but twice as many expect a deterioration, 47.8 per cent expect no change. Expert opinions on expectations do not share such clear responses for any

Development of the refinancing markets

Aggregate in % points



Average assessment of the current situation and expectations by refinancing instrument.
Source: JLL and ZEW

other instrument. On the contrary, for the remaining instruments, only a few of the respondents deviate from the view that expectations will change in the coming six months. There are also significant deviations from the previous quarter in the spreads of unsecured bonds compared to government bonds: in this quarter, 40.0 per cent of respondents expect spreads to widen further. The corresponding sub-index has dropped by 40.0 points.

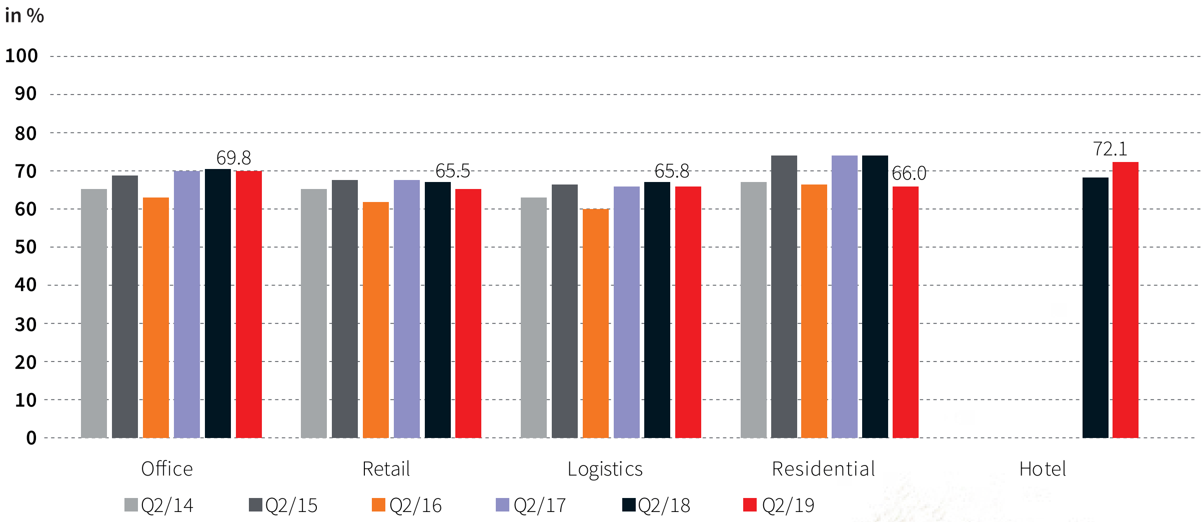
Margin races: euphoria for hotel real estate declines

Since 2014, and also in this current (second) quarter survey, participants have been asked to provide their assessments of typical margins and Loan-to-Value Ratios (LTV, leverage ratios based on market values) achieved in the market for real estate financing in the "Core" and "Value-Add" risk categories. Since the second quarter of 2018, financing experts have been asked to assess the hotel segment in addition to the office, retail, logistics and residential segments.

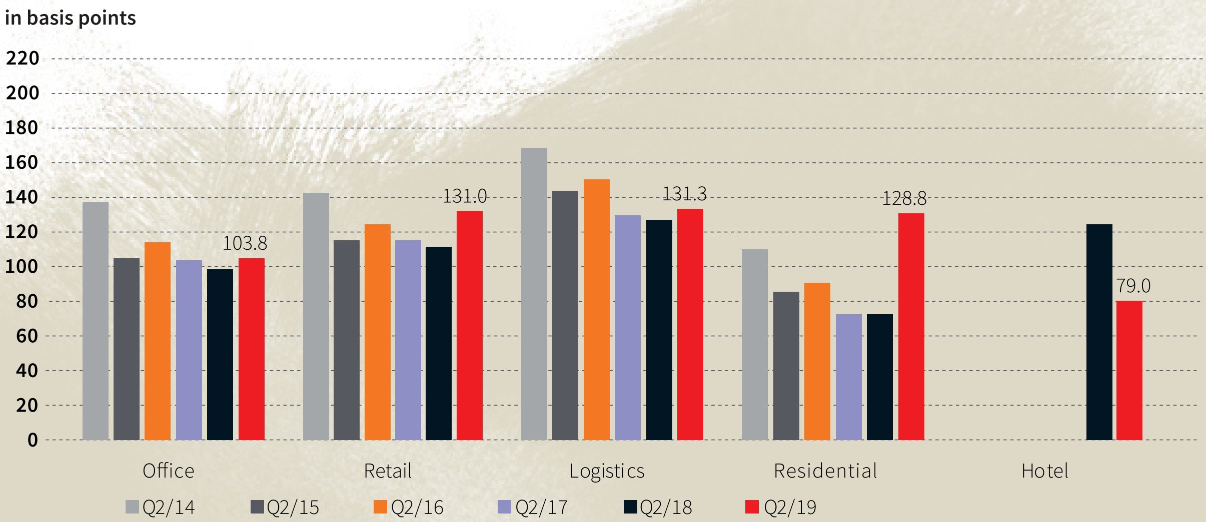
LTVs have tended to move sideways in both risk categories, despite lower yields and a high price level: office, retail and logistics real estate recorded only slightly lower LTVs than in the second quarter of 2018. Conversely in the case of residential real estate, LTVs have fallen more sharply since 2018. Only the LTVs for hotels are recording growth. These have been included in the survey since the second quarter of 2018 and have risen in both risk categories since the previous year: from 68.4 per cent to 72.1 per cent in the Core segment and from 65.1 per cent to 69.0 per cent in the Value-Add segment. A direct comparison between the two risk categories shows that the LTVs for portfolio properties in the Value-Add segment are on average around three percentage points lower than those in the Core segment.

Margins for all real estate segments except hotels have increased compared to the previous year. Residential real estate has gained the most: the construction industry continues to record high order numbers and the German Federal Bank's monthly report in February already showed that demand for residential space is also increasing strongly outside the major cities. However, the considerable decline in the number of hotels could be due to the current lack of supply in the top tier cities, where the margins to be generated are likely to be significantly higher than in less attractive locations.

Assessment of the average LTVs for commercial real estate financing of portfolio properties in the Core segment



Assessment of the average margins for commercial real estate financing of portfolio properties in the Core segment



Source: JLL and ZEW

DIFI-Report: Results of Responses, 2nd Quarter 2019

	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
German Real Estate Finance Index	**7.8**	**(+ 2.1)**	**73.4**	**(- 5.7)**	**18.9**	**(+ 3.6)**	**-11.1**	**(- 1.4)**
Financing situation	**improved**	**Δ Q1**	**unchanged**	**Δ Q1**	**deteriorated**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	13.8	(+/- 0.0)	72.4	(-10.4)	13.8	(+10.4)	0.0	(-10.4)
Retail	3.5	(+/- 0.0)	42.9	(-10.7)	53.6	(+10.7)	-50.1	(-10.7)
Logistics	14.3	(+ 0.5)	75.0	(- 7.8)	10.7	(+ 7.3)	3.6	(- 6.8)
Residential	13.8	(+10.3)	82.8	(-10.1)	3.4	(- 0.2)	10.4	(+10.5)
Hotel	14.8	(+ 3.7)	70.4	(-14.8)	14.8	(+11.1)	0.0	(- 7.4)
All real estate segments	**12.0**	**(+ 2.9)**	**68.7**	**(-10.8)**	**19.3**	**(+ 7.9)**	**-7.2**	**(- 4.9)**
Financing expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	6.9	(+ 6.9)	82.8	(+/- 0.0)	10.3	(- 6.9)	-3.4	(+13.8)
Retail	0.0	(+/- 0.0)	53.6	(+ 3.6)	46.4	(- 3.6)	-46.4	(+ 3.6)
Logistics	0.0	(+/- 0.0)	93.1	(+ 6.9)	6.9	(- 6.9)	-6.9	(+ 6.9)
Residential	3.6	(+ 0.1)	82.1	(-10.8)	14.3	(+10.7)	-10.7	(-10.6)
Hotel	7.1	(- 0.3)	78.6	(- 2.9)	14.3	(+ 3.2)	-7.2	(- 3.5)
All real estate segments	**3.5**	**(+ 1.3)**	**78.0**	**(- 0.7)**	**18.4**	**(- 0.7)**	**-14.9**	**(+ 2.1)**

Refinance market situation	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
Capital deposits	14.8	(+ 2.3)	81.5	(- 1.8)	3.7	(- 0.5)	11.1	(+ 2.8)
Mortgage bonds	33.3	(+ 6.4)	56.7	(- 1.0)	10.0	(- 5.4)	23.3	(+11.8)
Unsecured bonds	14.8	(+ 2.3)	70.4	(- 0.4)	14.8	(- 1.9)	0.0	(+ 4.2)
Mortgage backed securities	13.6	(+ 8.4)	77.3	(-12.2)	9.1	(+ 3.8)	4.5	(+ 4.6)
Real estate stock markets	8.3	(+ 8.3)	66.7	(+14.3)	25.0	(-22.6)	-16.7	(+30.9)
Refinance market expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Capital deposits	7.4	(-11.6)	88.9	(+12.7)	3.7	(- 1.1)	3.7	(-10.5)
Mortgage bonds	6.9	(- 5.1)	89.7	(+13.7)	3.4	(- 8.6)	3.5	(+ 3.5)
Unsecured bonds	7.4	(+ 7.4)	81.5	(+11.9)	11.1	(-19.3)	-3.7	(+26.7)
Mortgage backed securities	4.6	(- 0.9)	90.9	(+24.2)	4.5	(-23.3)	0.1	(+22.4)
Real estate stock markets	17.4	(+17.4)	47.8	(-12.2)	34.8	(- 5.2)	-17.4	(+22.6)
Spreads compared to German government bonds	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Mortgage bonds	26.7	(-21.3)	70.0	(+26.0)	3.3	(- 4.7)	23.4	(-16.6)
Unsecured bank bonds	40.0	(-26.7)	46.7	(+13.4)	13.3	(+13.3)	26.7	(-40.0)
Segment development	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Syndication business (volume)	50.0	(+ 1.8)	42.9	(- 1.5)	7.1	(- 0.3)	42.9	(+ 2.1)
Underwriting (volume)	17.2	(-12.5)	69.0	(+24.6)	13.8	(-12.1)	3.4	(- 0.4)

Comment: The German Real Estate Finance Index survey was carried out between 29.04.2019 – 17.05.2019 and involved 30 experts. These experts were asked for their assessments of the market situation (preceding six months) and market expectations (coming six months). The results shown are the percentages of the response categories and the changes in per cent compared to the previous quarter (Δ previous quarter). The aggregates are calculated from the difference between the positive and negative response categories (such as 'improved' and 'deteriorated'). DIFI is calculated as an unweighted average from the aggregates of the financing situation and financing expectations for all use types.

Source: JLL and ZEW

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