DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 4th Quarter 2020
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DIFI recovery continues

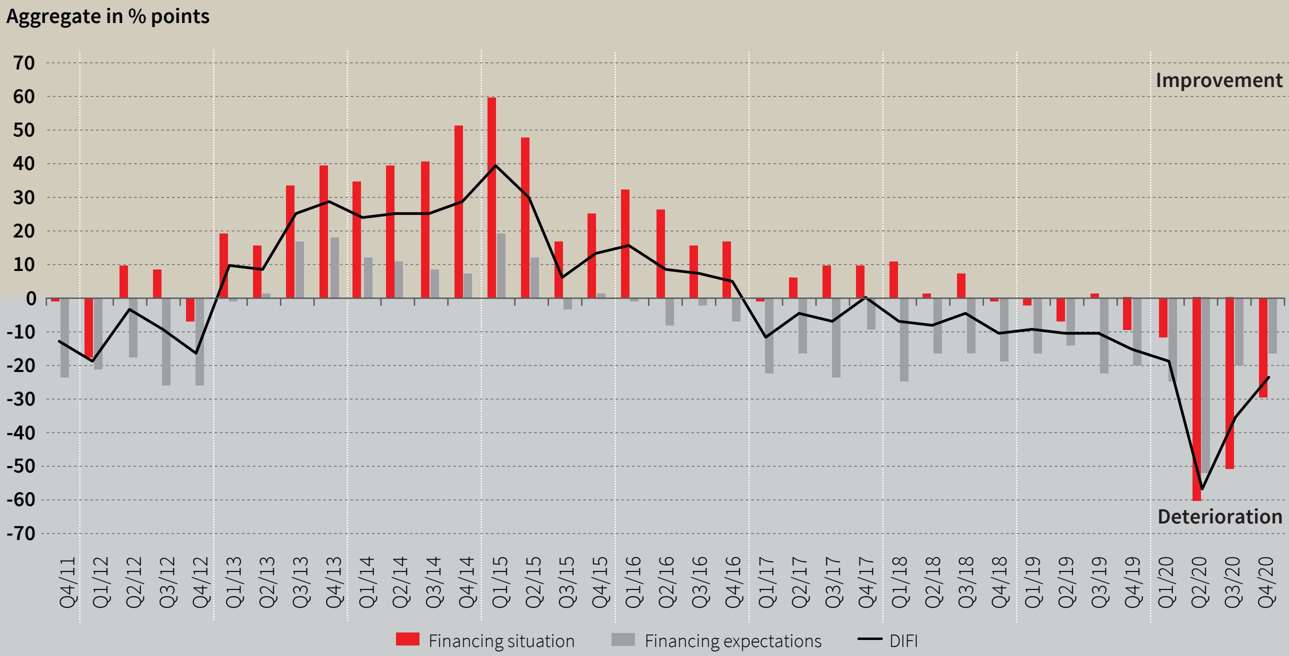
Residential and logistics sectors benefiting from the current environment

Special question: effects of the Covid-19 crisis on the performance of real estate financing

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 real estate market segments office, retail, logistics, residential and hotel. 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.

DIFI recovery continues

German Real Estate Finance Index (DIFI)



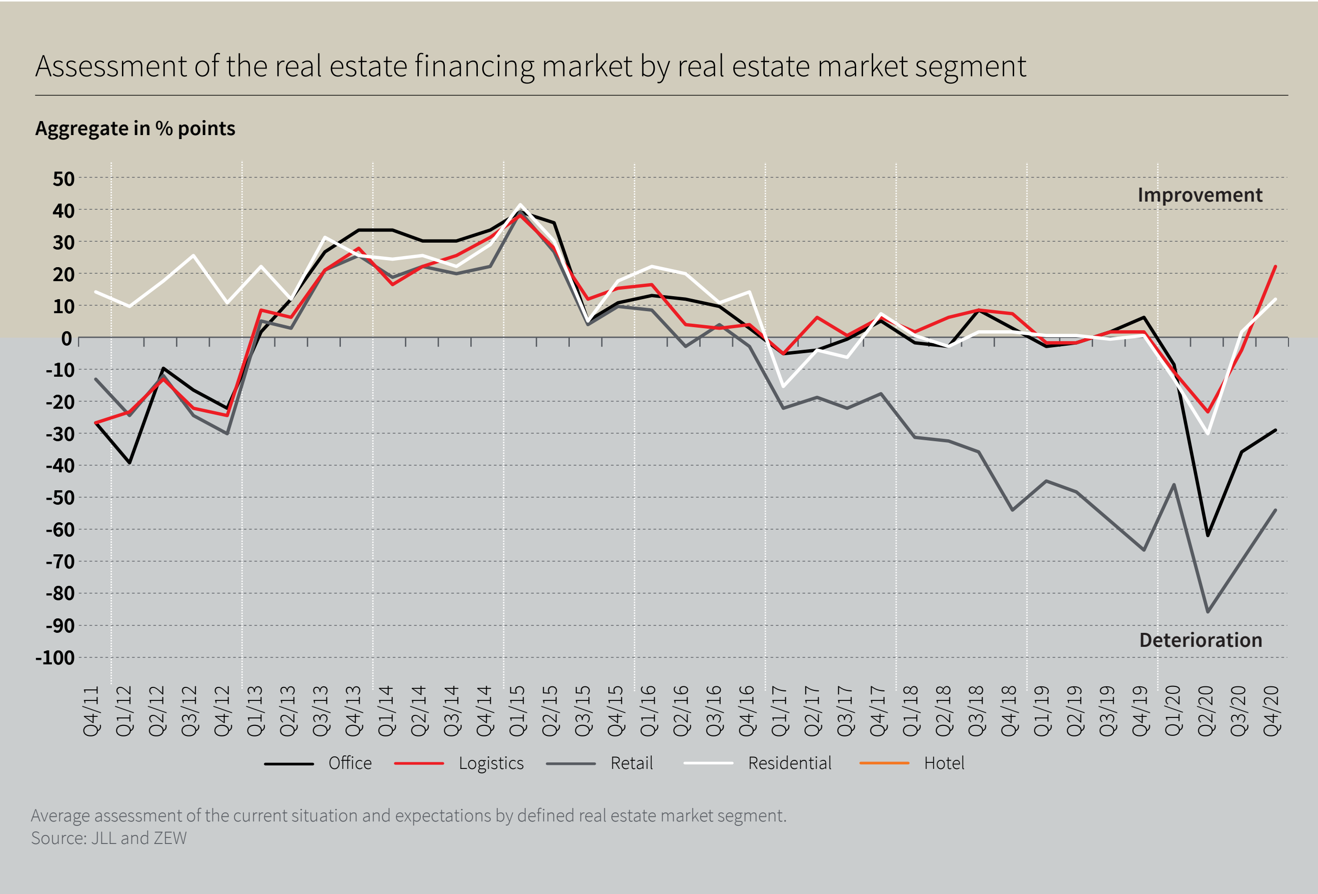
Average assessment of the current situation in and expectations for the five real estate market segments (Office, Retail, Logistics, Residential, Hotel).
Source: JLL and ZEW

Upward trend in financing situation continues

The **German Real Estate Financing Index (DIFI)** rose by 12.5 points in the 4th quarter of 2020 to its current level of **-23.5 points**. The third survey since the start of the Covid-19 crisis shows that our experts' assessments relating to the financing situation over the last six months have improved by 22.0 points to a new sub-indicator aggregate of -29.6 points. Although the respondents' expectations relating to the financing situation over the next six months remain very subdued, there is now evidence of optimism compared to the previous survey. The respective sub-indicator aggregate rose compared to the 3rd quarter of 2020 by 3.0 points to -17.4 points.

Logistics and residential sectors benefiting from the current environment

A look at the results of the survey reveals that the property sectors surveyed fall into two distinct groups. The real estate segments in the first group showed negative aggregates relating to both the financing situation and financing expectations over the 4th quarter. These use types have been negatively affected by the Covid-19 pandemic and this is likely to remain the case for the foreseeable future. Things are significantly different in the second group. According to the experts, these property sectors are actually benefiting from the current situation.



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

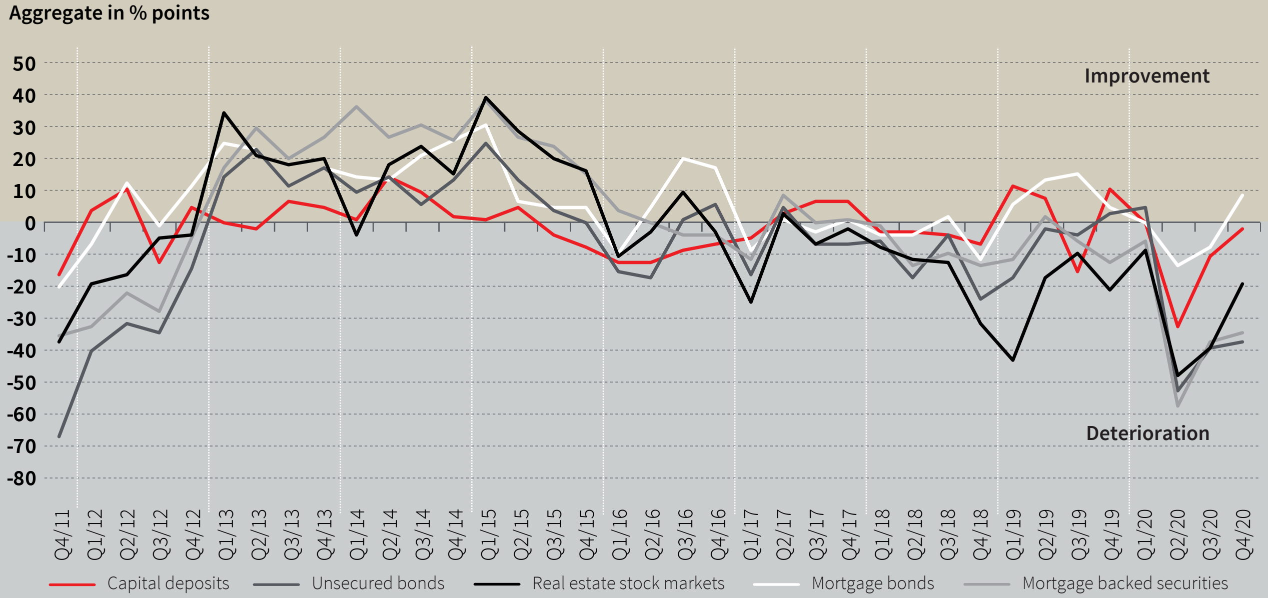
The first group comprises the office, retail and hotels use types, whereby the greatest pessimism is in hotels. In contrast to the previous survey, the current financing situation relating to these sectors is actually better overall. Whilst the experts' expectations relating to the financing conditions in the retail sector have improved slightly compared to the 3rd quarter survey (+8.5 points), there has been a further deterioration in the expectations relating to offices and hotels over the same period.

The second group comprises the use types logistics and residential. In the case of both sectors, the assessment of the current financing situation is actually better than before the outbreak of the Covid-19 pandemic. With scores of 29.4 points (logistics) and 12.2 points (residential), these use types have achieved their highest aggregates since the 1st quarter of 2016 and the 3rd quarter of 2019, respectively. Both use types are viewed more optimistically in the 4th quarter of 2020 than in the previous quarter. The aggregates for the financing situation over the last six months have improved by 42.9 points and 12.2 points respectively to 29.4 points and 12.2 points. The respective aggregates for the financing expectations have risen by up to 9.7 points (to 14.8 points and 12.2 points).

No sustainable improvement in sight for refinancing conditions

An analysis of the aggregates relating to expectations on the refinancing markets shows a mixed picture. There were positive aggregates in the capital deposits (0.1 point) and mortgage bonds (14.9 points) refinancing instruments, which are viewed more optimistically than in the previous survey. There are negative aggregates relating to the unsecured bonds (-32.0 points), mortgage backed

Development of the refinancing markets



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

securities (-26.0 points) and real estate stocks (-8.3 points) refinancing instruments. The real estate stocks instrument is viewed more optimistically than in the last survey. However, most respondents expect that refinancing conditions relating to the instruments surveyed will not change over the next six months.

Negative outlook in terms of the debt service capacity of borrowers with commercial real estate loans

The overall economic effects of the Covid-19 crisis are leaving continually increasing traces in terms of commercial real estate financing conditions. This edition of the DIFI report will look in greater detail at how the Coronavirus pandemic is negatively impacting the debt service capacity of borrowers with commercial real estate loans and how this could affect the non-performing loan (NPL) ratios experienced by the financing banks. There are various solutions available to banks affected by increased NPL quotas, both at financing level and institutional level. We asked our experts for their views on the probability that the suggested solutions would be used by the banks.

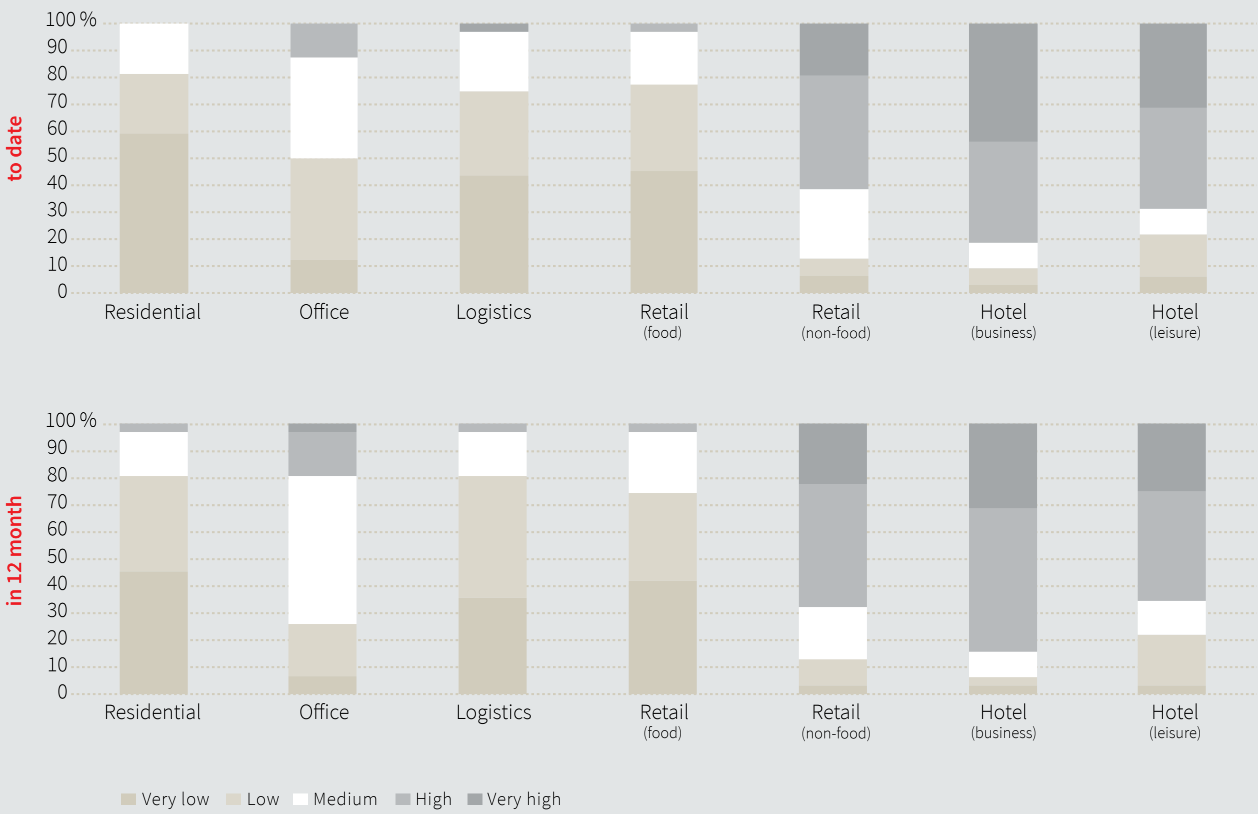
According to our experts' assessments of the debt service capacity of borrowers with commercial real estate loans, the residential and logistics sectors and food-anchored retail are least negatively affected. Over two thirds of the respondents estimated the effect to date of the Covid-19 crisis on debt service capacity of these use types as being very low to low. Looking at the next 12 months, the experts expect that the negative effect will become greater. However, their assessment of the outlook is only marginally worse. The assessments of the effects of the Covid-19 pandemic on the NPL ratios as they affect the use types under review are similarly positive.

According to our experts' assessments of the debt service capacity of borrowers with commercial real estate loans, the hotels use type is affected worst. The respondents also assume there will be a correspondingly great effect on the respective NPL quotas. The (business) hotels sector is more negatively assessed than the (leisure) hotels sector. In the case of both hotel categories, the respondents expect a more significant negative effect in terms of debt service capacity over the next 12 months and correspondingly greater effects on the banks' NPL ratios than at present.

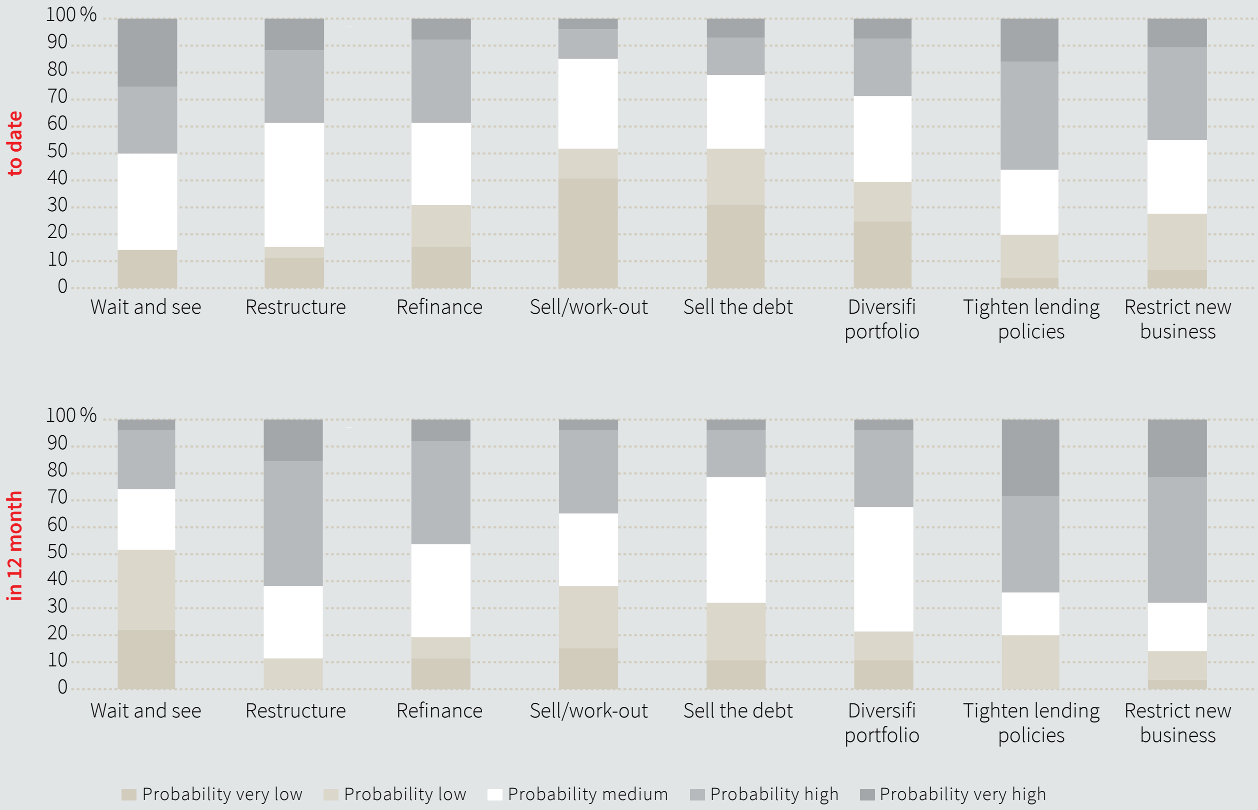
In the event that there is a significant increase in NPL quotas, all suggested solutions would probably be considered by the experts. At a portfolio level, most respondents see a medium to very high probability that banks will adopt a "wait and see" approach. Over the next 12 months, there is greater likelihood of the "restructuring" solution. In terms of the solutions on an institutional level, most respondents are currently of the opinion that there is a medium to very high probability of the "restriction on new business" solution over the next 12 months.

with non-food retailers is still rated poorly. This is because local lockdowns and other measures to contain the Coronavirus have encouraged even more consumers than before to switch to online retail. The two hotel categories will at least not see any further losses in new business until the end of 2020 and 2021, but the outlook remains predominantly bleak.

Effects of the Covid-19 crisis on the debt service capacity of borrowers by property sector



Suggested solutions in the event of rising NPL ratios



DIFI-Report: Results of Responses, 4th Quarter 2020

	improved	Δ Q3	unchanged	Δ Q3	deteriorated	Δ Q3	aggregate	Δ Q3
German Real Estate Finance Index	**12.2**	**(+ 2.9)**	**52.1**	**(+ 6.6)**	**35.7**	**(- 9.6)**	**-23.5**	**(+12.5)**
Financing situation	**improved**	**Δ Q3**	**unchanged**	**Δ Q3**	**deteriorated**	**Δ Q3**	**aggregate**	**Δ Q3**
Office	2.9	(+ 2.9)	57.1	(+17.1)	40.0	(-20.0)	-37.1	(+22.9)
Retail	3.0	(+ 3.0)	29.4	(+16.6)	67.6	(-19.6)	-64.6	(+22.6)
Logistics	35.3	(+21.8)	58.8	(- 0.7)	5.9	(-21.1)	29.4	(+42.9)
Residential	15.2	(+ 4.4)	81.8	(+ 3.4)	3.0	(- 7.8)	12.2	(+12.2)
Hotel	0.0	(+/- 0.0)	12.1	(+ 9.5)	87.9	(- 9.5)	-87.9	(+ 9.5)
All real estate segments	**11.3**	**(+ 6.4)**	**47.8**	**(+ 9.1)**	**40.9**	**(-15.6)**	**-29.6**	**(+22.0)**
Financing expectations	**improve**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**deteriorate**	**Δ Q3**	**aggregate**	**Δ Q3**
Office	14.3	(- 1.1)	51.4	(- 5.0)	34.3	(+ 6.1)	-20.0	(- 7.2)
Retail	0.0	(- 5.3)	55.9	(+19.1)	44.1	(-13.8)	-44.1	(+ 8.5)
Logistics	23.6	(+ 3.1)	67.6	(+ 3.5)	8.8	(- 6.6)	14.8	(+ 9.7)
Residential	15.2	(+ 2.0)	81.8	(+ 5.5)	3.0	(- 7.5)	12.2	(+ 9.5)
Hotel	12.5	(- 1.4)	25.0	(- 2.8)	62,5	(+ 4.2)	-50.0	(- 5.6)
All real estate segments	**13.1**	**(- 0.6)**	**56.3**	**(+ 4.0)**	**30.5**	**(- 3.6)**	**-17.4**	**(+ 3.0)**

Refinance market situation	improved	Δ Q3	unchanged	Δ Q3	deteriorated	Δ Q3	aggregate	Δ Q3
Capital deposits	6,7	(- 0.4)	83.3	(+ 8.3)	10.0	(- 7.9)	-3.3	(+ 7.5)
Mortgage bonds	16.6	(+13.5)	66.7	(- 8.3)	16.7	(- 5.2)	-0.1	(+18.7)
Unsecured bonds	3.8	(+ 0,7)	50.0	(+21.9)	46.2	(-22.6)	-42.4	(+23.3)
Mortgage backed securities	0.0	(+/- 0.0)	57,9	(+17.2)	42.1	(-17.2)	-42.1	(+17.2)
Real estate stock markets	7.7	(+ 7.7)	53.8	(+15.9)	38.5	(-23.6)	-30.8	(+31.3)
Refinance market expectations	**improve**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**deteriorate**	**Δ Q3**	**aggregate**	**Δ Q3**
Capital deposits	7.2	(+ 0.7)	85.7	(+ 8.3)	7.1	(- 9.0)	0.1	(+ 9.7)
Mortgage bonds	25.0	(+12.9)	67.9	(-10.9)	7.1	(- 2.0)	17.9	(+14.9)
Unsecured bonds	4.0	(-11.6)	60.0	(+ 3.7)	36.0	(+ 7.9)	-32.0	(-19.5)
Mortgage backed securities	5.2	(- 2.5)	63.2	(- 6.0)	31.6	(+ 8.5)	-26.4	(-11.0)
Real estate stock markets	12.5	(- 1.8)	66.7	(+13.1)	20.8	(-11.3)	-8.3	(+ 9.5)
Segment development	**increase**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**decrease**	**Δ Q3**	**aggregate**	**Δ Q3**
Mortgage bonds	24.2	(- 2.3)	69.7	(- 3.8)	6.1	(+ 6.1)	18.1	(- 8.4)
Unsecured bank bonds	69.0	(+14.9)	24.1	(-16.4)	6.9	(+ 1.5)	62.1	(+13.4)
Segment development	**increase**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**decrease**	**Δ Q3**	**aggregate**	**Δ Q3**
Syndication business (volume)	42.5	(- 0.8)	24.2	(- 8.2)	33.3	(+ 9.0)	9.2	(- 9.8)
Underwriting (volume)	9.4	(-12.8)	37.5	(+ 1.4)	53.1	(+11.4)	-43.7	(-24.2)

Comment: The German Real Estate Finance Index survey was carried out between 26.10.2020 – 09.11.2020 and involved 35 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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