DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 1st Quarter 2020
Published in March 2020

The market sentiment barometer reaches its second lowest-ever level

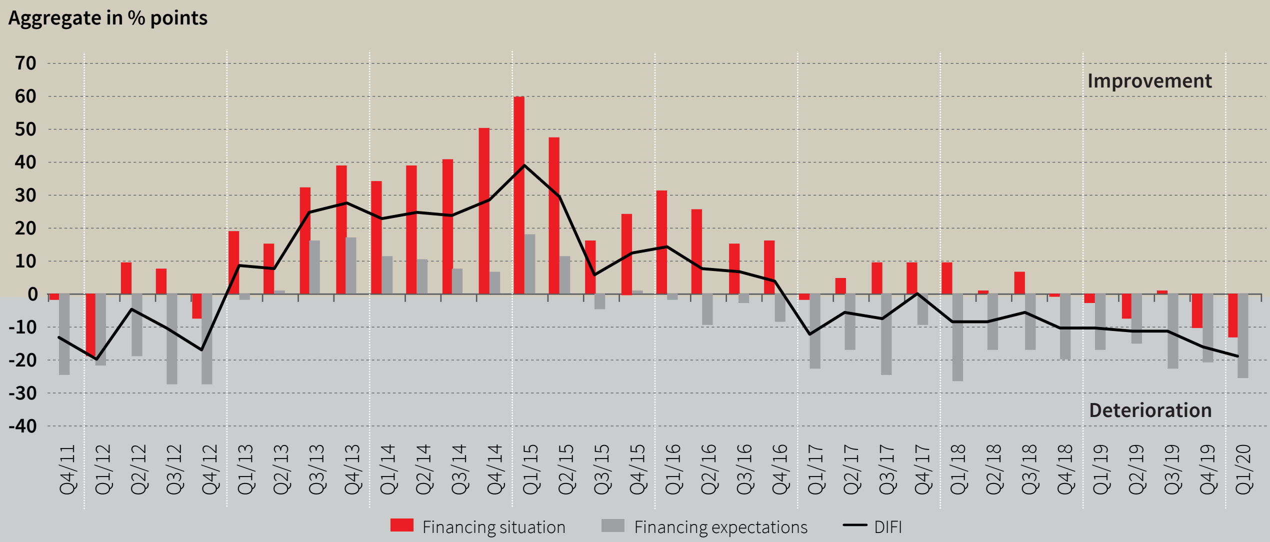
Few respondents expect to see improvement

Special question: sustainability is on the advance

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 (since the 3rd quarter of 2018) 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.

The market sentiment barometer is approaching its all-time low

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

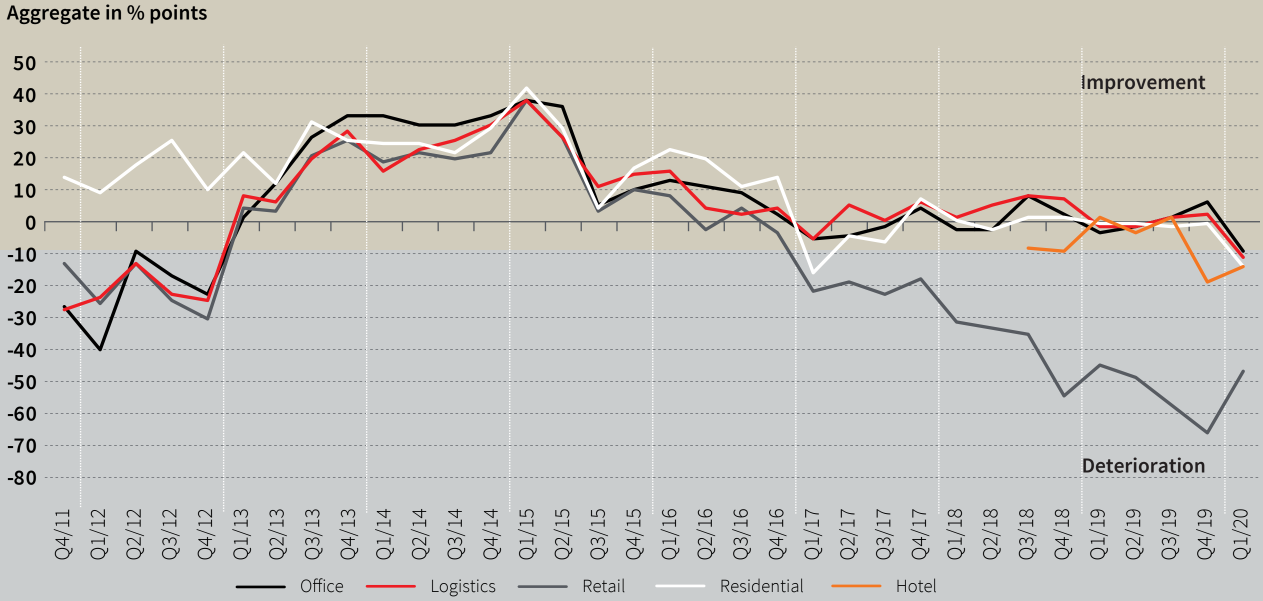
The restrained sentiment continues

The **German Real Estate Finance Index (DIFI)** fell by 3.7 points in the first quarter of 2020. With a value of **-18.9 points**, this is only slightly below the level of the previous quarter yet is still its second worst result since DIFI records began. As with the weather, one would think that rain is followed by sunshine, but there is not much to suggest that this is the case in the current quarter: at -12.6 points, respondents' assessments of the financing situation in the past six months was worse than it was three months ago. Similarly, at -25.1 points, expectations for the coming half-year have fallen by 4.3 points compared to the previous quarter. This quarter, no respondents have said that the financing situation for the office and retail segments had brightened or suggested that expectations for office, retail, logistics and residential assets have improved. Therefore, the sub-indicators are in the red for all real estate segments over the past six months and the coming six months.

The low point in the retail sector seems to be over

In previous quarters, while there was consensus amongst respondents that the trajectory for bricks-and-mortar retail was downward, the picture is now completely different: with an increase of 18.2 points for the financing situation and 20.6 points for expectations for the half-year, the retail segment is ahead of the other real estate segments in both sub-indicators. Although figures for the past six months and the coming six months are still clearly in the red at -45.5 points and -47.6 points respectively, the share of those who see deterioration over the past six months has fallen sharply. Only the hotel segment can boast slightly positive changes since the previous quarter. Here, the two indicators have increased by 4.9 points and

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

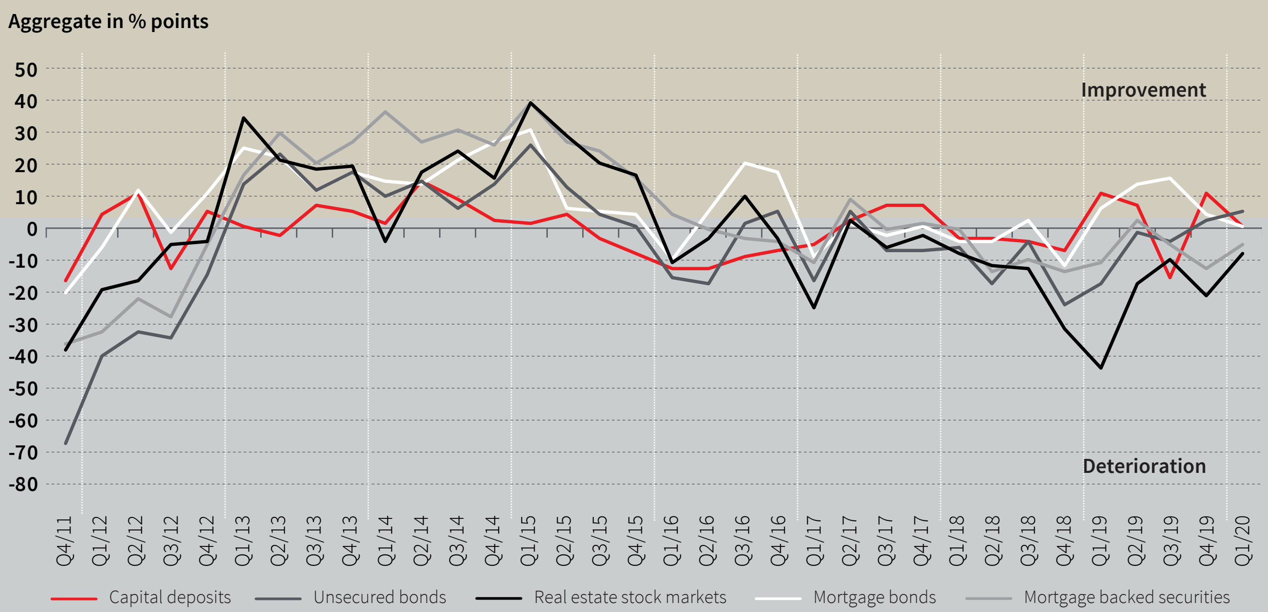


Average assessment of the current situation and expectations by defined real estate market segment.
Source: JLL and ZEW

3.4 points respectively but, like the other real estate segments, are still in the red. The fact that the German economy started the New Year rather cautiously is also noticeable in the real estate environment.

The somewhat better development of the financing situation for retail properties may come as a surprise in view of the structural change, but it is certainly explainable given the different asset types. In particular, the transaction volumes for retail warehouse portfolios increased last year compared to the previous year. The changes in the hotel segment indicated by the respondents are also rather encouraging: the rising number of overnight stays from Germany and abroad is likely to make itself felt here. Survey participants suggest that this is the only real estate segment in which the financing situation will improve over the first half of the year. However, it remains to be seen how the further spread of the coronavirus will affect international tourism flows. In the office segment, most respondents anticipate no changes in the financing situation (95.8% of respondents) or expectations (87%). However, the sub-aggregate of the financing situation has fallen by more than 20 points since the previous quarter. As the office segment is more closely linked to employment figures than other types of use, the declining momentum of employment figures at the end of 2019 may have been the decisive factor. The financing expectations for all real estate segments remain well below the current assessment of the situation.

Development of the refinancing markets



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

Real estate stocks perform worst in terms of situation and expectations

The gloomy mood does not stop at the refinancing markets. Although unsecured bonds, mortgage-backed securities and real estate stocks and shares as instruments for refinancing have recovered slightly since the previous quarter, only bonds are in the black at 5.0 points. Deposits and Pfandbrief mortgage bonds have fallen by 10.8 points and 4.7 points respectively since the fourth quarter of 2019, to a level of zero. Real estate stocks and shares continue to be the most volatile refinancing instrument, accounting for the lowest expectations with an aggregate of -8.5 points. The situation is also assessed as the worst. As with the financial markets, the assessment of the situation is consistently better than the assessment of expectations, which are still clouded by ongoing global uncertainty.

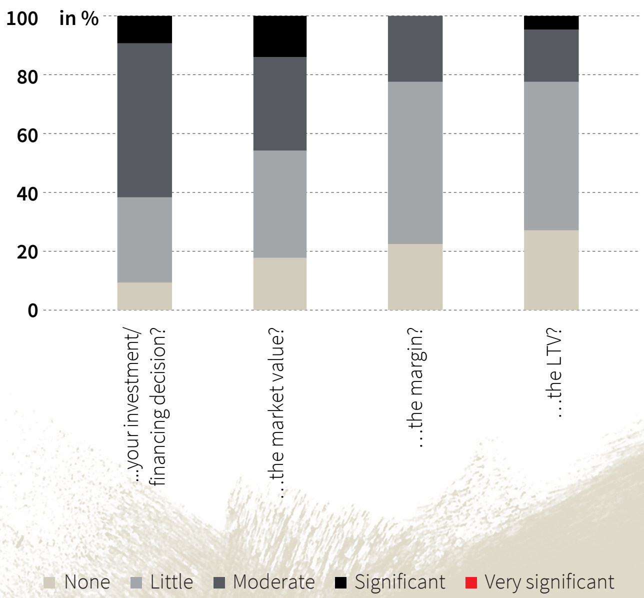
Sustainability aspects mainly influence loan portfolios and market values

Sustainability, both in terms of climate protection and social concerns, has also found its way into the real estate industry. After climate aspects had already emerged as a significant influencing factor in real estate financing in the previous quarter‘s special question, we would like to take a closer look at green building certifications and the much broader ESG aspects in this issue of the DIFI Report.
In the first part of the special question, we asked real estate experts about the influences of the two categories mentioned above on investment and financing decisions, the

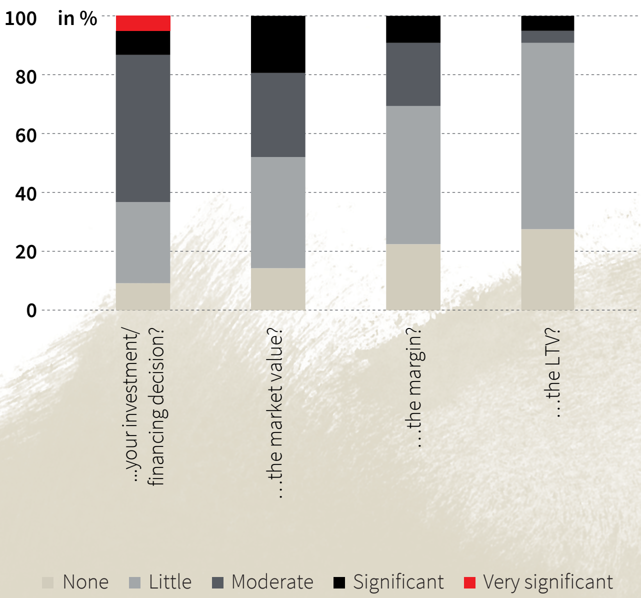
market value of the property, and the margin and LTV. For both sustainability factors, the picture is relatively consistent: ESG sustainability aspects and green building certifications appear to have a predominantly medium to very strong influence on the investment and financing decisions of the respondents. International studies show that „green“ office buildings can be let or sold at higher prices than comparable properties without certification. It is therefore unsurprising that around half of the survey participants attribute a certain influence to climate aspects on the market value of a property which, in turn, has an impact on the volume of financing. However, sustainability aspects appear to be irrelevant for the margin and the LTV.

In the second part of the special question, almost half of the respondents stated that they would finance a share of up to 10 per cent with green building certified properties in prime locations. However, the experts agree that this proportion will increase slightly (59 per cent) to strongly (41 per cent) within the next two years. This is probably also due to the voluntary commitment of many city councils to tolerate only climate-neutral real estate within their city limits from 2030.

What influence have the ESG Sustainability Aspects of a real estate on…



What influence has the Green Building Certification of a real estate on…



Source: JLL and ZEW

DIFI-Report: Results of Responses, 1st Quarter 2020

	improved	Δ Q4	unchanged	Δ Q4	deteriorated	Δ Q4	aggregate	Δ Q4
German Real Estate Finance Index	**2.7**	**(- 7.3)**	**75.9**	**(+11.1)**	**21.5**	**(- 3.7)**	**-18.9**	**(- 3.7)**

Financing situation	improved	Δ Q4	unchanged	Δ Q4	deteriorated	Δ Q4	aggregate	Δ Q4
Office	0.0	(-16.7)	95.8	(+12.5)	4.2	(+ 4.2)	-4.2	(-20.9)
Retail	0.0	(- 4.5)	54.5	(+27.2)	45.5	(-22.7)	-45.5	(+18.2)
Logistics	8.7	(+ 0.4)	78.3	(- 9.2)	13.0	(+ 8.8)	-4.3	(- 8.4)
Residential	8.7	(- 8.7)	78.3	(+ 8.7)	13.0	(+/- 0.0)	-4.3	(- 8.7)
Hotel	4.5	(- 9.8)	86.4	(+24.5)	9.1	(-14.7)	-4.6	(+ 4.9)
All real estate segments	**4.4**	**(- 7.8)**	**78.7**	**(+12.8)**	**17.0**	**(- 4.8)**	**-12.6**	**(- 3.0)**

Financing expectations	improve	Δ Q4	remain unchanged	Δ Q4	deteriorate	Δ Q4	aggregate	Δ Q4
Office	0.0	(- 4.2)	87.0	(- 0.5)	13.0	(+ 4.7)	-13.0	(- 8.9)
Retail	0.0	(+/- 0.0)	52.4	(+20.6)	47.6	(-20..6)	-47.6	(+20.6)
Logistics	0.0	(-12..5)	81.8	(+ 6.8)	18.2	(+ 5.7)	-18.2	(-18.2)
Residential	0.0	(- 8.7)	77.3	(- 1.0)	22.7	(+ 9.7)	-22.7	(-18.4)
Hotel	4.7	(- 8.9)	66.7	(+21.2)	28.6	(-12.3)	-23.9	(+ 3.4)
All real estate segments	**0.9**	**(- 6.9)**	**73.0**	**(+ 9.4)**	**26.0**	**(- 2.6)**	**-25.1**	**(- 4.3)**

Refinance market situation	improved	Δ Q4	unchanged	Δ Q4	deteriorated	Δ Q4	aggregate	Δ Q4
Capital deposits	13.7	(- 6.3)	72.7	(+ 7.7)	13.6	(- 1.4)	0.1	(- 4.9)
Mortgage bonds	4.8	(-13.4)	95.2	(+27.0)	0.0	(-13.6)	4.8	(+ 0.2)
Unsecured bonds	10.0	(-11.1)	90.0	(+21.6)	0.0	(-10.5)	10.0	(- 0.6)
Mortgage backed securities	0.0	(-11.7)	100.0	(+23.5)	0.0	(-11.8)	0.0	(+ 0.1)
Real estate stock markets	5.3	(- 0.6)	84.2	(+25.4)	10.5	(-24.8)	-5.2	(+24.2)

Refinance market expectations	improve	Δ Q4	remain unchanged	Δ Q4	deteriorate	Δ Q4	aggregate	Δ Q4
Capital deposits	4.7	(-17.5)	90.5	(+18.3)	4.8	(- 0.8)	-0.1	(-16.7)
Mortgage bonds	0.0	(- 9.5)	95.2	(+ 9.5)	4.8	(+/- 0.0)	-4.8	(- 9.5)
Unsecured bonds	5.0	(- 0.3)	90.0	(+ 5.8)	5.0	(- 5.5)	0.0	(+ 5.2)
Mortgage backed securities	0.0	(- 6.2)	88.9	(+26.4)	11.1	(-20.2)	-11.1	(+14.0)
Real estate stock markets	11.8	(- 0.7)	64.7	(+ 2.2)	23.5	(- 1.5)	-11.7	(+ 0.8)

Segment development	increase	Δ Q4	remain unchanged	Δ Q4	decrease	Δ Q4	aggregate	Δ Q4
Mortgage bonds	9.1	(+/- 0.0)	72.7	(+ 4.5)	18.2	(- 4.5)	-9.1	(+ 4.5)
Unsecured bank bonds	26.3	(- 4.1)	63.2	(+ 2.3)	10.5	(+ 1.8)	15.8	(- 5.9)

Segment development	increase	Δ Q4	remain unchanged	Δ Q4	decrease	Δ Q4	aggregate	Δ Q4
Syndication business (volume)	31.9	(- 9.8)	54.5	(+ 8.7)	13.6	(+ 1.1)	18.3	(-10.9)
Underwriting (volume)	18.1	(+ 9.8)	45.5	(- 8.7)	36.4	(- 1.1)	-18.3	(+10.9)

Comment: The German Real Estate Finance Index survey was carried out between 02.02.2020 – 17.02.2020 and involved 24 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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