Zentrum für Europäische
Wirtschaftsforschung GmbH

DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 2nd Quarter 2018
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Financing situation is currently subdued, negative financing expectations persist

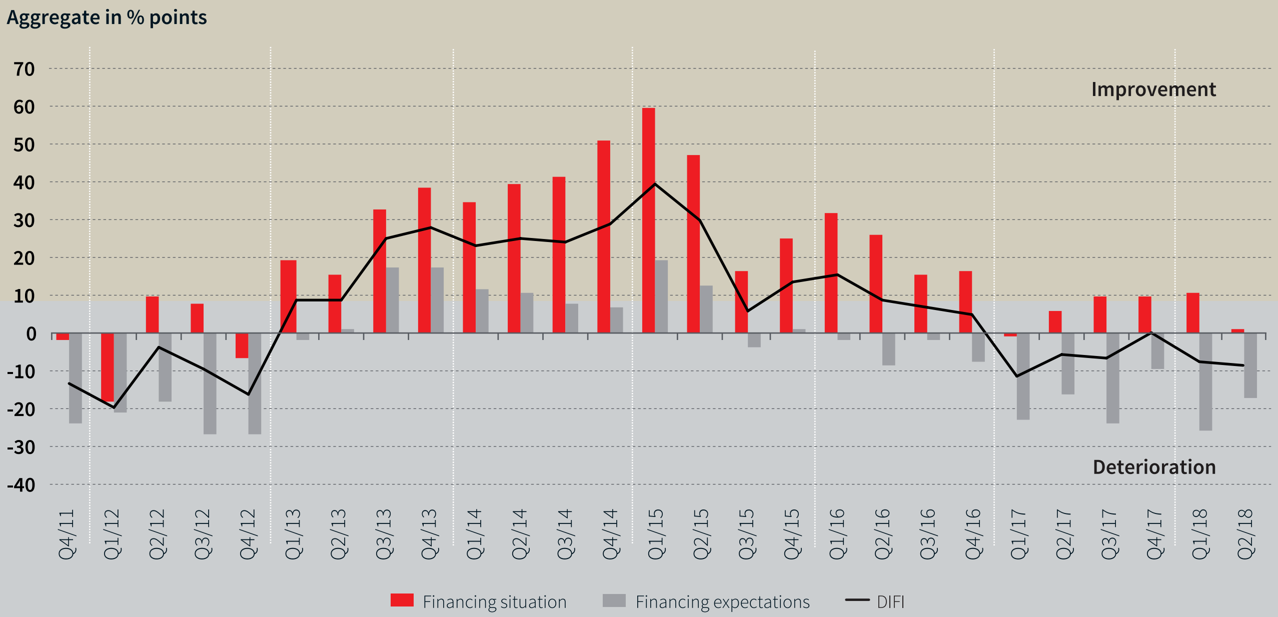
Continued downturn in retail financing

Special topic: the highest margins are achieved for hotels in the Value Add risk category

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. It 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 the Zentrum für Europäische Wirtschaftsforschung (Centre for European Economic Research, ZEW).

Pessimism outweighs optimism

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).
Source: JLL and ZEW

DIFI slips further into negative territory in response to subdued confidence

The downturn in the **German Real Estate Finance Index (DIFI)** since early 2016 continued in the second quarter of 2018. At **-8.2 points**, the DIFI fell by a further 0.4 points against the previous quarter (-7.8 points) to reach its lowest level of the year so far and was due to declining confidence in the current financing situation. Whilst optimism continued to outweigh pessimism in the first quarter of the year with an aggregate of 10.1 points, in the most recent survey the experts' assessment of the current situation has deteriorated by 9.5 points to fluctuate just above the zero mark (0.6 points). Although expectations for the financing of commercial real estate over the next six months have improved by 8.7 points compared to the previous quarter, they remain at a low level of -16.9 points. These subdued expectations can be explained by the anticipated rise in interest rates in the Eurozone, should the European Central Bank end its current bond purchase programme in the autumn. Even then however, significant interest rate rises cannot be expected until there has been any movement in the key interest rate.

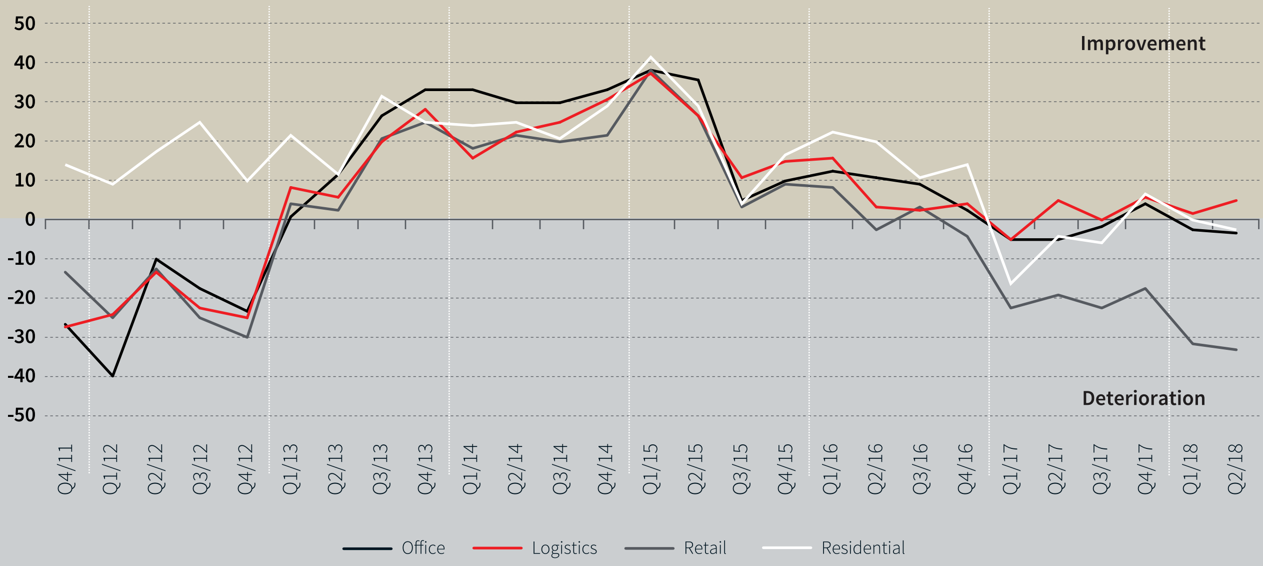
No signs of recovery in retail financing

Assessments of the financing markets for the office and residential real estate segments have hardly changed between the first and second quarters of 2018 and the corresponding sub-indicators have both seen marginal falls down to -2.7 points. However, there has been a noticeable continued decline in retail financing from the previous quarter's already low level of -30.9 points to -32.8 points, the lowest level since the survey began. This is explained by the increasing pessimism in respect of the current financing situation (fall of 9.5 points). The downward trend in the retail real estate segment observed since early 2017 persists and is principally attributable to the growth of online retail; this is also reflected in the pessimistic expectations.

The market for the financing of logistics real estate is unaffected by these trends: at 5.6 points, this sub-indicator is fluctuating at a similar level to the previous calendar year and is mainly due to the positive assessments of the financing situation over the past six months (by 22.3% of respondents). The experts' expectations for the coming six

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

Aggregate in % points



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

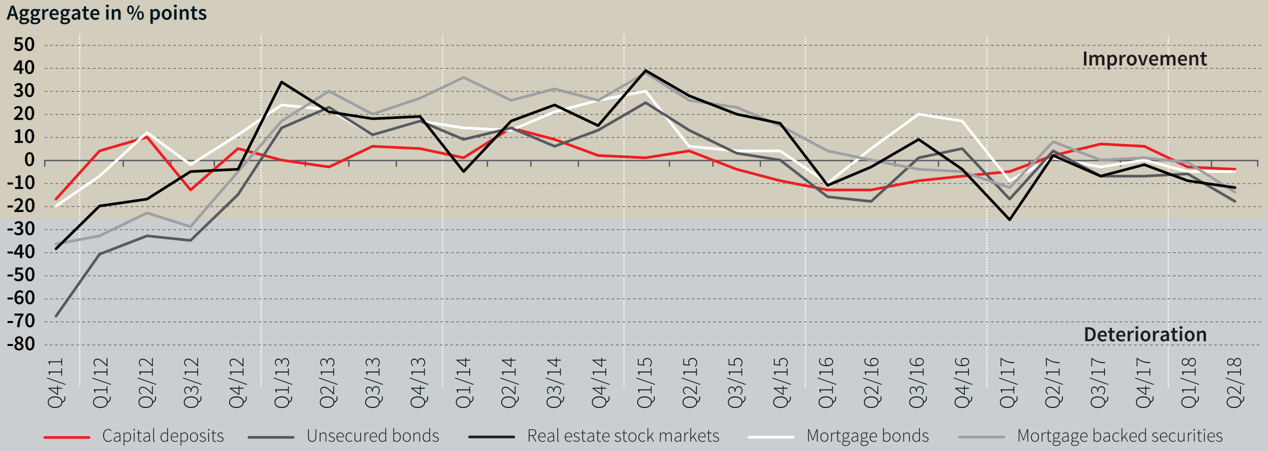
months have even increased by 14.3 points since the previous quarter in response to improving business sentiment in the logistics sector and to the downturn in bricks-and-mortar retail as demand for warehousing and distribution space strengthens.

Mixed sentiment in the refinancing markets

There is a wide variation in experts' assessments of the current situation and expectations for the refinancing markets, but these assessments have generally seen a slight deterioration compared to the previous quarter. What stands out most over the past six months is the decline in refinancing activities using bonds (fall of 16.9 points), mortgage-backed securities (fall of 17.7 points) and real estate stocks (fall of 9.3 points). All refinancing instruments are viewed rather critically for the coming six months and the experts' assessments are considerably more pessimistic than in respect of the current situation. Slightly optimistic tendencies were noted only for Pfandbriefs (German mortgage bonds) and real estate stocks.

Similar to the previous quarter, the experts anticipate spreads for bank bonds to widen in the second quarter. The percentage of respondents who expect spreads over government bonds to widen has even increased slightly over the recent survey period. Spreads between Pfandbriefs and government bonds are also expected to widen over the coming six months.

Development of the refinancing markets



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

Special topic: the development of LTVs and margins in various real estate segments and risk categories

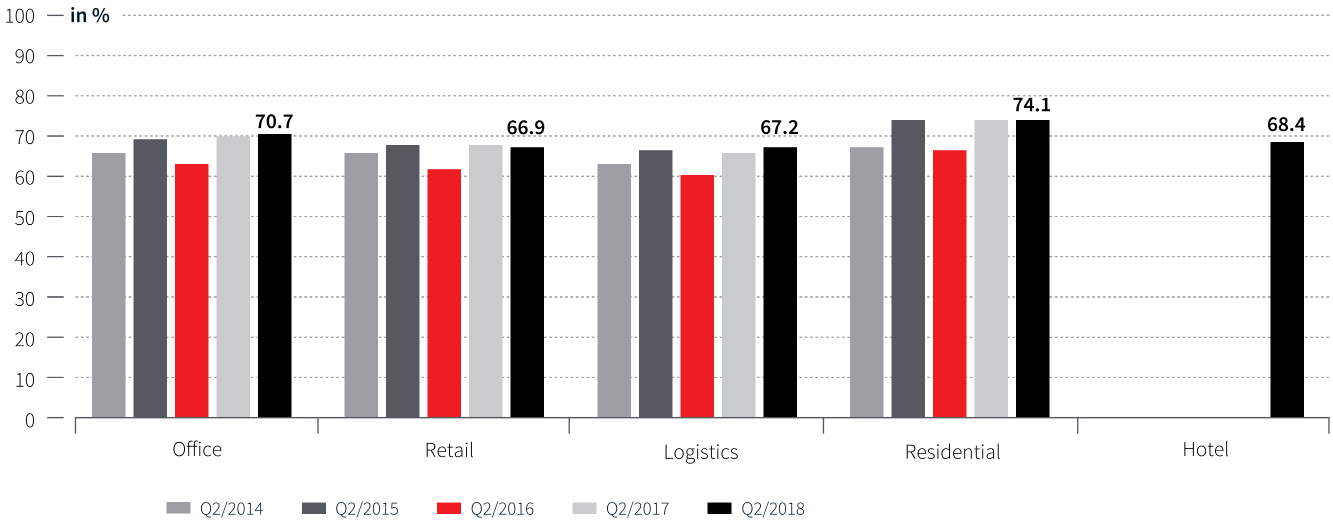
Every year since the second quarter of 2014, the financing experts have been asked to assess standard market margins and loan-to-value ratios (LTV) for property financing in the Core and Value Add risk categories. In the second quarter of 2018, for the first time the financing experts were asked for their opinions not only on the familiar office, retail, logistics and residential real estate segments, but also for their assessments of the hotel segment.

Assessments of average LTVs for Core real estate have risen slightly in the current quarter. There was a very slight change in the retail sector, where the standard market debt ratio fell marginally to 67% year-on-year. In the case of residential real estate, the trend of slightly higher LTVs continues. On average, debt ratios for hotel financing usually correspond with the LTVs for the other real estate segments. This is also the case with Value Add property, although LTVs across the real estate segments are around one to three percentage points lower than in the Core risk category.

As expected however, there is a wide variation in the assessments of margins between the two risk categories: consistently lower margins are achieved for Core real estate than in the much riskier Value Add category. The differences between the two risk categories average 57 basis points (bps), but the experts' assessments also differ within the risk categories themselves. Whilst the highest margins could be achieved in the financing (125 bps) of Core logistics property in the second quarter of 2018, hotels in the Value Add category achieved the highest margin (184 bps), which is over 60 bps more than for residential property in the same risk category.

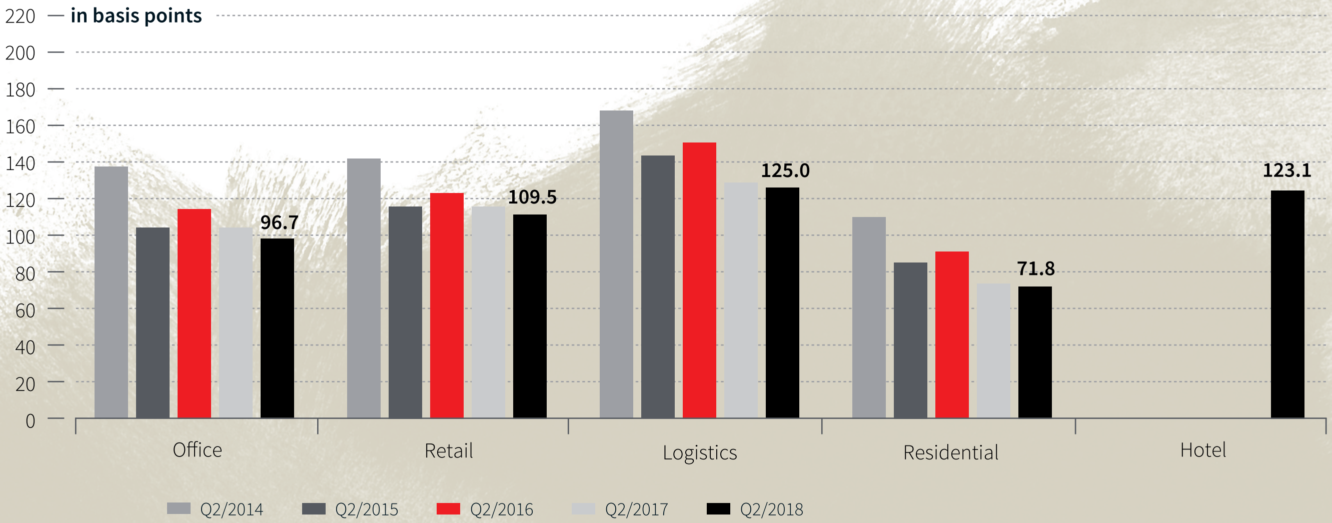
Overall, following a brief increase in early 2016, the increasing pressure on margins is noticeable across various segments, although the rate of change compared with the previous quarter appears to be slowing in the current year. This could be interpreted as a sign that LTVs are beginning to offer little room for manoeuvre due to rising prices and margins in response to internal bank costs.

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



Source: JLL and ZEW

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



Source: JLL and ZEW

DIFI-Report: Results of Responses, 2nd Quarter 2018

	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
German Real Estate Finance Index	**9.5**	**(-2.4)**	**73.0**	**(+ 4.4)**	**17.6**	**(- 2.0)**	**-8.2**	**(- 0.4)**
Financing situation	**improved**	**Δ Q1**	**unchanged**	**Δ Q1**	**deteriorated**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	11.4	(- 6.5)	82.9	(+ 3.4)	5.7	(+ 3.1)	5.7	(- 9.6)
Retail	8.6	(+ 0.8)	60.0	(-11.1)	31.4	(+10.3)	-22.8	(- 9.5)
Logistics	22.3	(- 0.7)	69.4	(- 5.0)	8.3	(+ 5.7)	14.0	(- 6.4)
Residential	11.1	(- 9.4)	83.3	(+ 6.4)	5.6	(+ 3.0)	5.5	(-12.4)
All real estate segments	**13.4**	**(- 3.9)**	**73.9**	**(- 1.6)**	**12.8**	**(+ 5.6)**	**0.6**	**(- 9.5)**
Financing expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	2.8	(- 2.9)	83.3	(+14.7)	13.9	(-11.8)	-11.1	(+ 8.9)
Retail	2.9	(- 0.1)	51.4	(+ 5.9)	45.7	(- 5.8)	-42.8	(+ 5.7)
Logistics	11.1	(+ 2.5)	75.0	(+ 9.3)	13.9	(-11.8)	-2.8	(+14.3)
Residential	5.4	(- 2.9)	78.4	(+11.7)	16.2	(- 8.8)	-10.8	(+ 5.9)
All real estate segments	**5.6**	**(- 0.8)**	**72.0**	**(+10.4)**	**22.4**	**(- 9.6)**	**-16.9**	**(+ 8.7)**

Refinance market situation	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
Capital deposits	3.0	(- 7.8)	97.0	(+15.9)	0.0	(- 8.1)	3.0	(+ 0.3)
Mortgage bonds	11.1	(- 4.3)	83.3	(+ 6.4)	5.6	(- 2.1)	5.5	(- 2.2)
Unsecured bonds	11.8	(-10.5)	73.5	(+ 4.1)	14.7	(+ 6.4)	-2.9	(-16.9)
Mortgage backed securities	3.7	(-13.5)	85.2	(+ 9.3)	11.1	(+ 4.2)	-7.4	(-17.7)
Real estate stock markets	12.9	(- 5.8)	74.2	(+ 2.3)	12.9	(+ 3.5)	0.0	(- 9.3)
Refinance market expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Capital deposits	3.1	(+ 0.2)	84.4	(- 1.3)	12.5	(+ 1.1)	-9.4	(- 0.9)
Mortgage bonds	5.7	(+ 3.0)	74.3	(- 4.1)	20.0	(+ 1.1)	-14.3	(+ 1.9)
Unsecured bonds	3.1	(- 5.5)	62.5	(+ 5.4)	34.4	(+ 0.1)	-31.3	(- 5.6)
Mortgage backed securities	3.8	(+/- 0.0)	73.1	(- 7.7)	23.1	(+ 7.7)	-19.3	(- 7.7)
Real estate stock markets	10.0	(+10.0)	56.7	(-17.5)	33.3	(+ 7.5)	-23.3	(+ 2.5)
Spreads compared to German government bonds	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Mortgage bonds	20.0	(+ 6.5)	74.3	(+ 4.0)	5.7	(-10.5)	14.3	(+17.0)
Unsecured bank bonds	57.6	(+ 4.9)	39.4	(- 5.3)	3.0	(+ 0.4)	54.6	(+ 4.5)
Segment development	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Syndication business (volume)	34.4	(-12.8)	53.1	(+ 3.1)	12.5	(+ 9.7)	21.9	(-22.5)
Underwriting (volume)	25.0	(+ 6.1)	59.4	(-13.6)	15.6	(+ 7.5)	9.4	(- 1.4)

Comment: The German Real Estate Finance Index survey was carried out between 07.05.2018 – 28.05.2018 and involved 36 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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