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DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 2nd Quarter 2020
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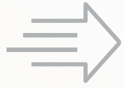
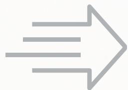
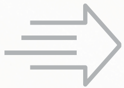


DIFI reaches a new low



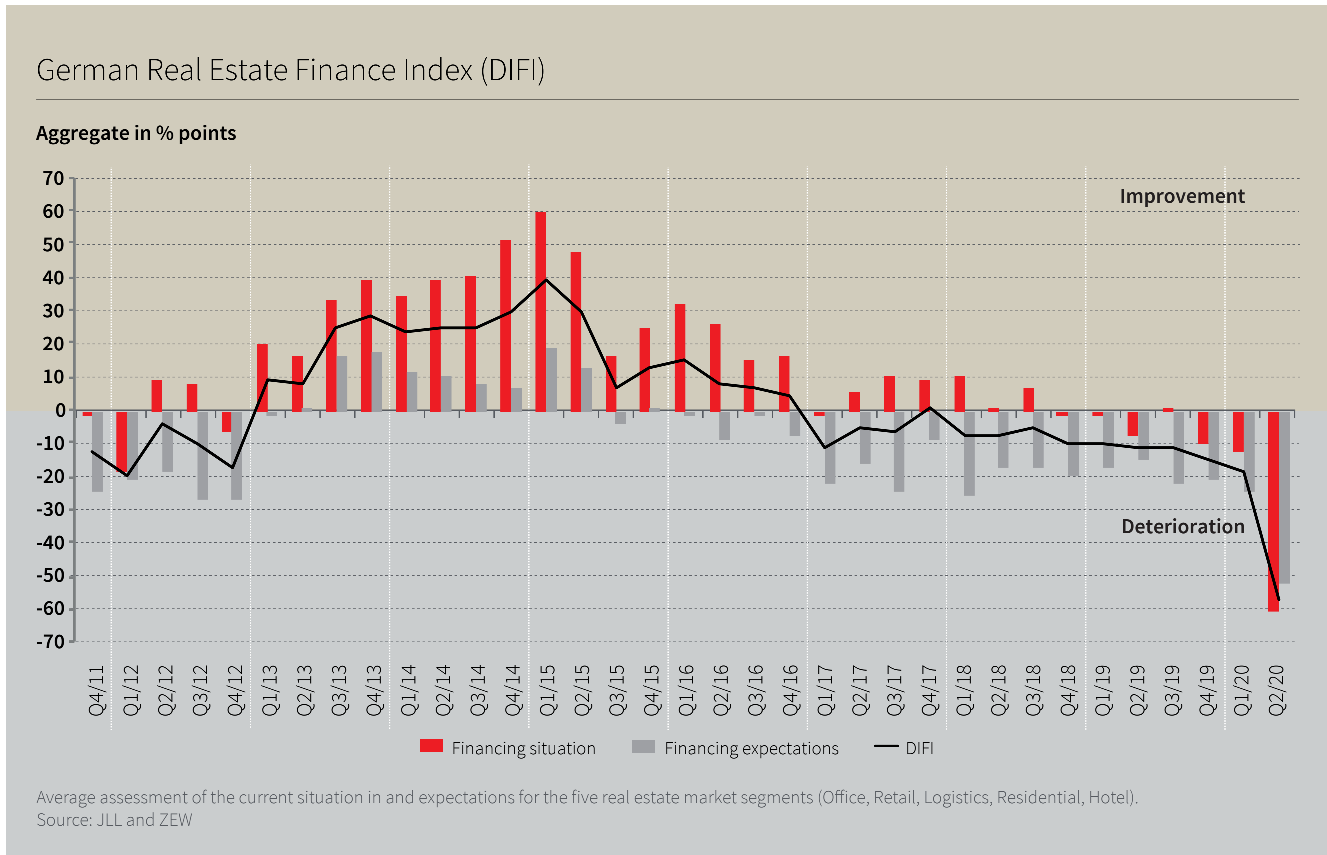
Offices and hotels are most affected



Special question: Current margins and LTVs in the financing of commercial real estate

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 experiences a sustained fall



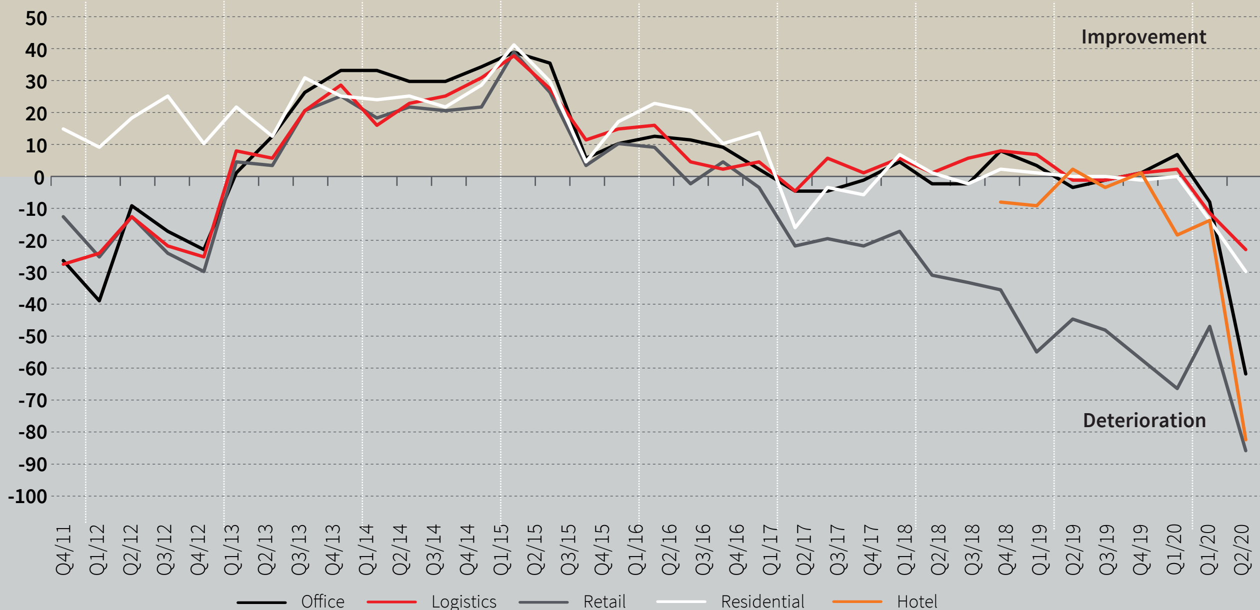
Average assessment of the current situation in and expectations for the five real estate market segments (Office, Retail, Logistics, Residential, Hotel).
Source: JLL and ZEW

The Corona crisis hits the industry with full force
The German real estate financing index (DIFI) slumped by 37.8 points in the second quarter of 2020, reaching a new low of **-56.7 points**. After the first few months of the Corona crisis, our experts' assessments of the financing situation of the past six months have deteriorated significantly by 48.2 points to a sub-aggregate of -60.8 points. Expectations for the coming six months are similarly pessimistic: here, too, the sub-aggregate has fallen to a new low of -52.6 points. In both sub-segments, i.e. the financing situation and expectations, the majority of those surveyed expect the situation to deteriorate (62.4% and 55.8%, respectively); only a small proportion of respondents anticipate improvements (1.5% and 3.1%, respectively). In the current quarter, the sub-aggregates of all real estate segments are in the red. All in all, this is the most pessimistic overall picture since the survey began in 2011. However, this cannot be described as a liquidity crisis because banks continue to seek and finance higher priced solid investment products, albeit at a lower loan-to-value ratio.

Only the logistics sector could benefit
According to our experts, none of the real estate segments surveyed have been spared the effects of the Corona crisis over the past six months, but logistics properties have been comparatively unaffected, with the aggregate decreasing by 30.8 points to reach -26.5 points. In terms of their future expectations, the respondents anticipate a slight improvement, resulting in a 2.6-point rise in the aggregate to -15.3 points. Consequently, only logistics properties, driven by the increase in online retail, appear to be relatively stable in value. Once again, sentiment about the financing

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

situation in the retail sector has fallen sharply over the past six months and is not expected to recover over the second half of the year. In each case, more than 80% of those surveyed gave a negative assessment; they do not perceive there to be any chance for improvement. Even before the Corona crisis, assessments in the retail sector were at a low level and have now fallen even further. In relative terms, the changes are therefore less significant at this point.
Office and hotel properties have been particularly hard hit. In the case of offices, the declining demand due to the uncertain economic situation and the expectation of increasing home office use is noticeable, at least in the short term. In the case of hotels, private and business travel and major trade fairs have been cancelled during the Corona crisis, which is reflected in an assessment of the financing situation of -65.4 and -84.0 points. This corresponds to a decline of 61.2 and 79.4 points since the previous quarter.

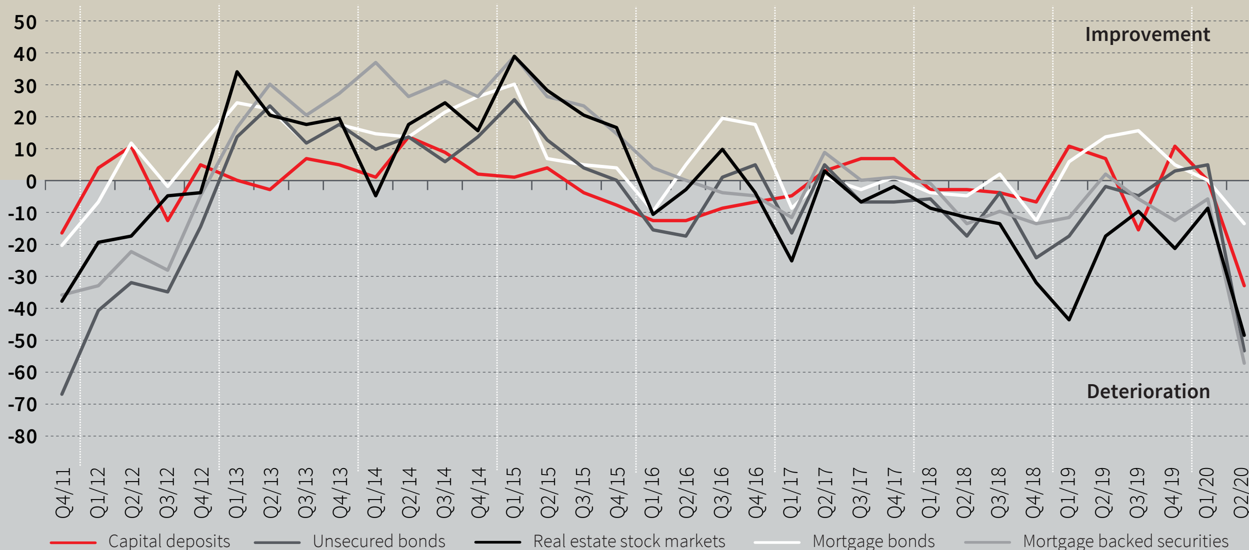
It is rather doubtful whether both real estate segments can at least recover slightly over the coming six months due to the easing of the initial restrictions. Only a small proportion of the survey participants believe this to be possible, whereas the majority expects that the sharp declines of recent months will leave their mark.

Renewed downward trend in the refinancing markets

A similar picture emerges for the refinancing markets. After giving renewed relatively positive assessments of the majority of the instruments surveyed in the previous quarter, the experts' assessments of the current situation and their expectations have deteriorated significantly in the current survey period. Our respondents only show slight optimism in the case of German mortgage bonds, expecting there to be a slight improvement in the situation for this instrument over the second half of the year.

Development of the refinancing markets

Aggregate in % points



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

This instrument, which is considered relatively safe, provides some confidence in times of global uncertainty. The situation and expectations for the other refinancing instruments are quite different, with unsecured bonds, mortgage-backed securities and real estate shares in particular showing strongly negative trends.

Pressure on margins appears to have eased

To gain a complete overview, since 2014 survey participants have been asked in the second quarter to provide their assessments of typical margins and Loan-to-Value ratios (LTVs, leverage ratios based on market values) achieved in the market for real estate financing in the 'Core' and 'Value-Added' risk categories[1]. They choose the most likely (in their opinion) from a predefined range of values. In their assessments of typical market LTVs, the Core and Value-Added segments show parallel trends: while LTVs for the retail and residential real estate segments are increasing slightly, the respondents perceive LTVs to be falling in the other real estate segments. The strongest decline in LTVs was recorded for hotels in the Core segment, falling from 72.1% to 59.7% since the corresponding quarter last year. The drop of 69.0% to 58.8% in the Value-Added segment was only marginally lower. Significantly more equity must therefore be held in reserve for new business, which is risky in the current climate.

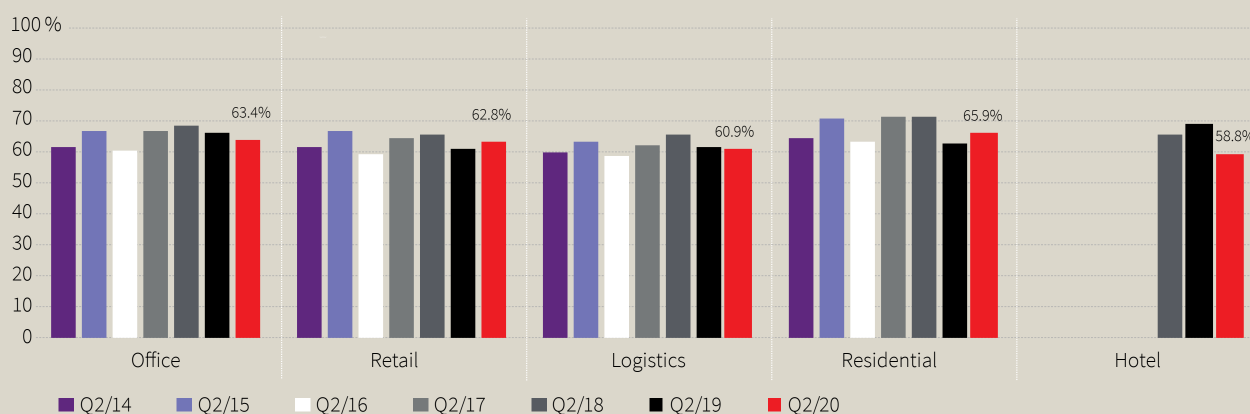
The period of pressure on margins in recent years now seems to have passed. Only residential property, which has proven to be a crisis-proof investment product, recorded declines of 33.4 bps (Core) and 18.2 bps (Value-Added). Here, equity investors and banks alike are still willing to invest, despite the lower margins. For the other real estate segments, average margins have risen. The strongest growth in margins for hotels was recorded, more than doubling in the Core

[1] 'Core' is defined as low risk property in a very good location, with a high occupancy rate (>90%) and long lease term (>5 years). 'Value-Added' is defined as high risk property (e.g. in a secondary location, with an occupancy rate of >75%, moderate investment requirement and average lease term (3 years)).

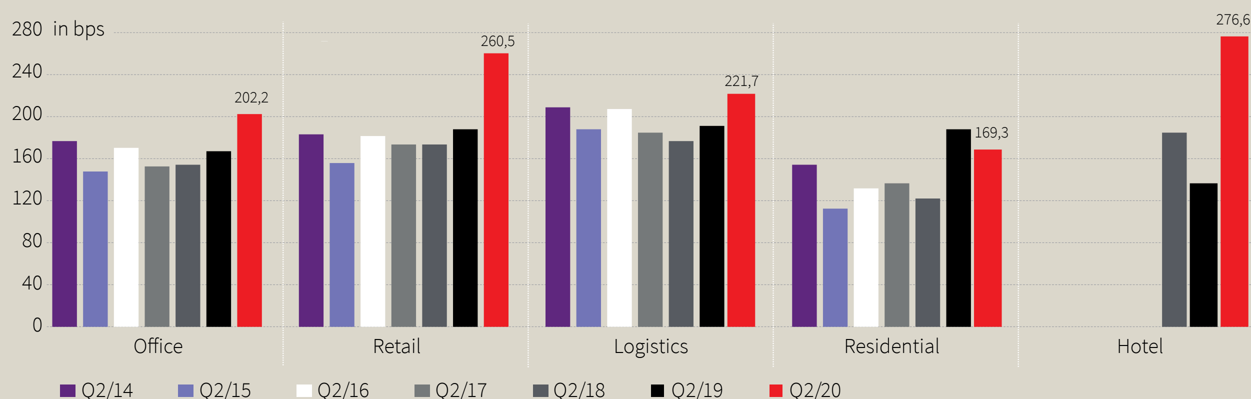
segment since the corresponding quarter last year; while in the Value-Added segment, they have at least doubled. But the margin in the retail sector has also increased significantly. At present, it is mainly convenience retail properties, also regarded as crisis-proof investments and therefore increasingly being financed, which are being traded here (with shopping centres currently playing a subordinate role). Nevertheless, the retail sector is associated with higher risk than residential, which explains the significantly higher margin.

It is therefore necessary to consider the increased liquidity costs which are passed on to the customer as part of the margin. During the Corona crisis, these have tended to rise more sharply in the case of Pfandbrief banks than for deposit refinancing. However, we expect a slight downward trend in liquidity costs and consequently in gross margins as soon as the situation returns to normal. The first signs of this have already been seen in isolated cases in the market since mid-June.

Assessment of average LTVs for commercial real estate financing of existing properties in the Value-Added segment



Assessment of average margins for commercial real estate financing of existing properties in the Value-Added segment



DIFI-Report: Results of Responses, 2nd Quarter 2020

	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
German Real Estate Finance Index	**2.30**	**(- 0.4)**	**38.60**	**(-37.3)**	**59.10**	**(+37.6)**	**-56.70**	**(-37.8)**
Financing situation	**improved**	**Δ Q1**	**unchanged**	**Δ Q1**	**deteriorated**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	0.0	(+/- 0.0)	34.6	(-61.2)	65.4	(+61.2)	-65.4	(-61.2)
Retail	0.0	(+/- 0.0)	12.0	(-42.5)	88.0	(+42.5)	-88.0	(-42.5)
Logistics	7.7	(- 1.0)	53.8	(-24.5)	38.5	(+25.5)	-30.8	(-26.5)
Residential	0.0	(- 8.7)	64.0	(-14.3)	36.0	(+23.0)	-36.0	(-31.7)
Hotel	0.0	(- 4.5)	16.0	(-70.4)	84.0	(+74.9)	-84.0	(-79.4)
All real estate segments	**1.5**	**(- 2.9)**	**36.1**	**(-42.6)**	**62.4**	**(+45.4)**	**-60.8**	**(-48.2)**
Financing expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Office	3.7	(+ 3.7)	33.3	(-53.7)	63.0	(+50.0)	-59.3	(-46.3)
Retail	0.0	(+/- 0.0)	15.4	(-37.0)	84.6	(+37.0)	-84.6	(-37.0)
Logistics	3.9	(+ 3.9)	76.9	(- 4.9)	19.2	(+ 1.0)	-15.3	(+ 2.9)
Residential	4.0	(+ 4.0)	68.0	(- 9.3)	28.0	(+ 5.3)	-24.0	(- 1.3)
Hotel	4.0	(- 0.7)	12.0	(-54.7)	84.0	(+55.4)	-80.0	(-56.1)
All real estate segments	**3.1**	**(+ 2.2)**	**41.1**	**(-31.9)**	**55.8**	**(+29.8)**	**-52.6**	**(-27.5)**

Refinance market situation	improved	Δ Q1	unchanged	Δ Q1	deteriorated	Δ Q1	aggregate	Δ Q1
Capital deposits	0.0	(-13.7)	60.0	(-12.7)	40.0	(+26.4)	-40.0	(-40.1)
Mortgage bonds	0.0	(- 4.8)	57.7	(-37.5)	42,3	(+42.3)	-42.3	(-47.1)
Unsecured bonds	0.0	(-10.0)	26.9	(-63.1)	73.1	(+73.1)	-73.1	(-83.1)
Mortgage backed securities	0.0	(+/- 0.0)	25.0	(-75.0)	75.0	(+75.0)	-75.0	(-75.0)
Real estate stock markets	8.7	(+ 3.4)	17.4	(-66.8)	73.9	(+63.4)	-65.2	(-60.0)
Refinance market expectations	**improve**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**deteriorate**	**Δ Q1**	**aggregate**	**Δ Q1**
Capital deposits	0.0	(- 4.7)	75.0	(-15.5)	25.0	(+20.2)	-25.0	(-24.9)
Mortgage bonds	32.0	(+32.0)	52.0	(-43.2)	16.0	(+11.2)	16.0	(+20.8)
Unsecured bonds	16.7	(+11.7)	33.3	(-56.7)	50.0	(+45.0)	-33.3	(-33.3)
Mortgage backed securities	0.0	(+/- 0.0)	60.0	(-28.9)	40.0	(+28.9)	-40.0	(-28.9)
Real estate stock markets	13.6	(+ 1.8)	40.9	(-23.8)	45.5	(+22,.0)	-31.9	(-20.2)
Segment development	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Mortgage bonds	52.0	(+42.9)	28.0	(-44.7)	20.0	(+ 1.8)	32.0	(+41.1)
Unsecured bank bonds	68.0	(+41.7)	20.0	(-43.2)	12.0	(+ 1.5)	56.0	(+40.2)
Segment development	**increase**	**Δ Q1**	**remain unchanged**	**Δ Q1**	**decrease**	**Δ Q1**	**aggregate**	**Δ Q1**
Syndication business (volume)	32.0	(+ 0.1)	24.0	(-30.5)	44.0	(+30.4)	-12.0	(-30.3)
Underwriting (volume)	12.5	(- 5.6)	20.8	(-24.7)	66.7	(+30.3)	-54.2	(-35.9)

Comment: The German Real Estate Finance Index survey was carried out between 04.05.2020 – 18.05.2020 and involved 27 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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