DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 3rd Quarter 2019
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Further sideways movement

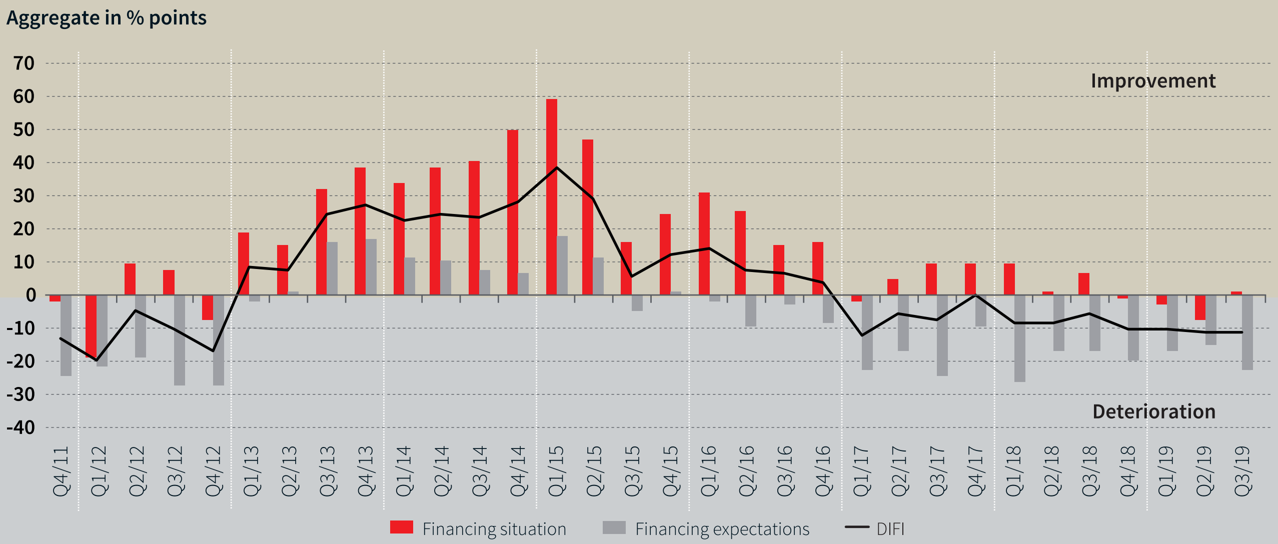
Upswing in the markets for Pfandbrief mortgage bonds and real estate stocks

Special question: the increasing importance of mezzanine capital

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.

No reversal of trend in sight

German Real Estate Finance Index (DIFI)



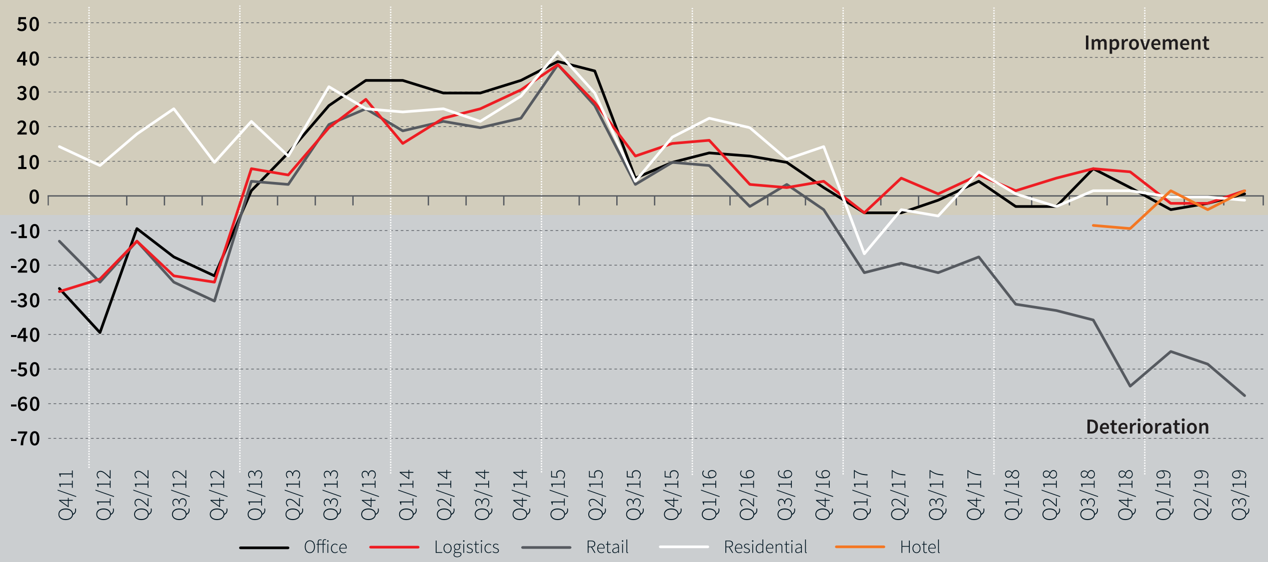
Average assessment of the current situation in and expectations for the five real estate market segments (Office, Retail, Logistics, Residential, Hotel).
Source: JLL and ZEW

The outlook is not good
With a current level of -10.8 points in the 3rd quarter of 2019, the **German Real Estate Finance Index (DIFI)** has now been below zero for 11 consecutive quarters (except for a short interruption at the end of 2017). The overall sentiment barometer for commercial real estate financing in Germany improved by a marginal 0.3 points compared to the previous quarter. Although the financing situation for which the participating institutions provide their assessment for the previous six months is now just above the zero line (0.8 points), the financing expectations for the next six months have deteriorated significantly to a level of -22.4 points (previous quarter: -14.9 points). The main reason for this is the continued gloomy outlook for the bricks-and-mortar retail segment, which is reflected in scores of -51.9 points for the financing situation and -62.5 in terms of financing expectations.

Sideways movement for most use types
Apart from the long-term loser retail, the participating experts assess the financing situation of the other asset classes as generally positive for the last half year. The experts' view of offices (+14.2 points) and hotels (+16.6 points) has improved significantly, and even logistics (+7.1 points) and residential (+3.8 points) have improved slightly. All these asset classes are now back above the zero line in terms of the financing situation. The situation in the retail sector is still assessed as poor and fell by a further 1.8 points compared to the previous quarter. In terms of the financing expectations for the next six months, the results of the survey relating to the bricks-and-mortar retail segment have continued to deteriorate: the sub-balance of -62.5 points in the current quarter is a new record low. Not one single participating institution expects any improvement in the market for financing bricks-and-

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

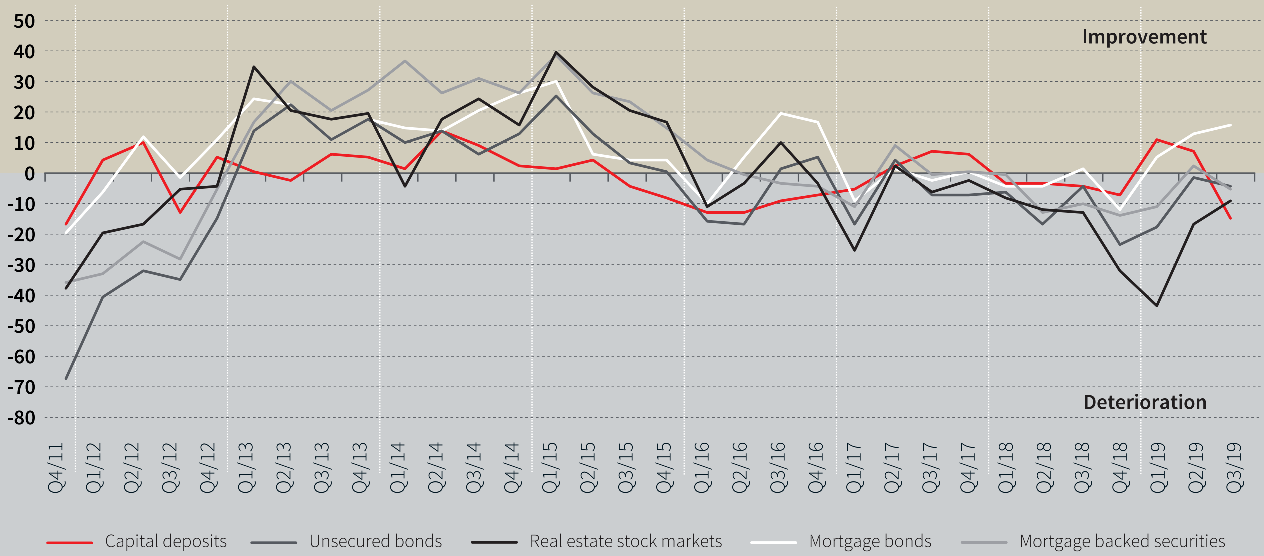
mortar retail properties, and two-thirds forecast further deterioration. The respondents even view the other asset classes pessimistically for the second half of the year. The sub-balances relating to financing expectations have fallen again by between 1.1 points (logistics) and 8.6 points (office) compared to the previous quarter, but these numbers are not expected to cause alarm.

Noticeable effects of continued low base rate

Exactly on its 250th birthday, the Pfandbrief mortgage bond is now the top refinancing instrument. With a current level of 15.7 points, the highly secure but low yielding refinancing instrument is once more at the same level it was for a short period three years ago. The main reason for this is the improvement in the positive assessment of future growth in the Pfandbrief mortgage bond market, which has reached a new record high of 24.0 points. Conversely, the assessment of the current situation has deteriorated by almost 16 points compared to the previous quarter. The other refinancing instruments have slipped back to below the zero line in the overall survey. After discussions of a potential expropriation of residential property companies were held in the capital still in spring of this year, there has been a further hike in real estate stocks, due in part to the base rate increase now anticipated to be in 2020 at the earliest. Mortgage-backed securities and unsecured bonds have fallen slightly in terms of both the current situation and future expectations, with a noticeable fall in the case of capital deposits.

Development of the refinancing markets

Aggregate in % points



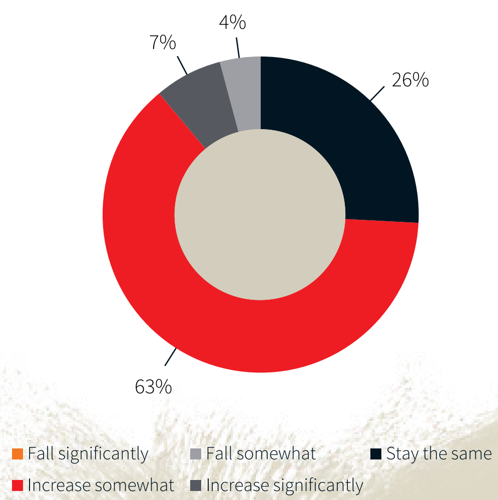
Average assessment of the current situation and expectations by refinancing instrument.
Source: JLL and ZEW

Mezzanine capital gaining importance as an alternative financing instrument

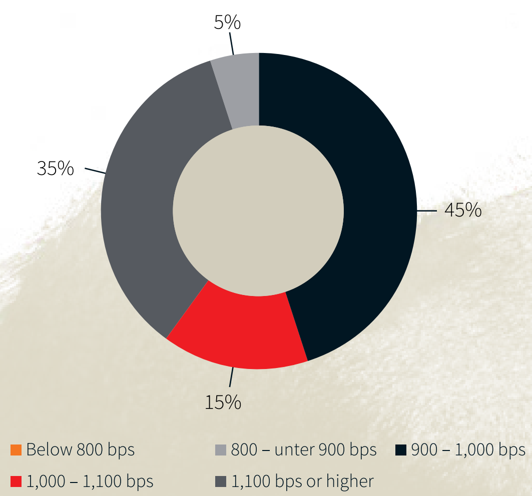
The combination of rising property prices and low risk tolerance amongst traditional banks is making it difficult for property companies to finance new purchases. In the current 3rd quarter of 2019, we are examining mezzanine capital as an alternative financing instrument and have asked our experts for their views on the current and future relevance in terms of financing structure and financing costs.

In the first part of the special question, we are looking at the current and future relevance of mezzanine capital in terms of the financing structure. The opening question has already divided the respondents into two camps: whilst 52% of the experts said that mezzanine capital already plays a role in the financing structure, 48% were of the opposite opinion. A large majority (70%) of respondents expects the relevance of mezzanine capital to increase somewhat to significantly in future. Around one-quarter expected no change, whilst a small group of 4% expects the importance of this financing instrument to fall. The following picture emerges from the opening question: all those for whom mezzanine capital is already relevant in terms of their financing structure expect that it will play a greater role in future. Conversely, those who said that it plays no role at present expect it to play no role in future or that its importance will increase slightly. There is therefore some divergence between the two camps. The participating institutions often secure mezzanine capital by entries in the land register in several forms at the same time: subordination (48%), by way of a share pledge (36%) or other forms of entry (8%). Conversely, 44% of respondents said that they do not secure mezzanine capital at all. A divergent picture emerges from the question relating to the level of financing costs. In the first instance, it appears that mezzanine capital involves costs of below 800 bps for almost half of all respondents. 15% of the experts indicated costs between 800 bps and 900 bps and 35% experienced costs of 900 bps to 1,000 bps. Costs in excess of 1,000 bps are the exception. Referring to the opening question relating to current relevance, it appears that companies who are of the opinion that mezzanine financing already plays an important role tend to pay more for their financing (900 bps to 1000 bps) than the companies for whom mezzanine financing plays a subordinate role (below 800 bps).

Will the relevance of mezzanine capital in terms of your financing structure change in future?



What are your financing costs* relating to mezzanine capital?



*Marge, arrangement fee pro rata temperis

Source: JLL and ZEW

DIFI-Report: Results of Responses, 3rd Quarter 2019

	improved	Δ Q2	unchanged	Δ Q2	deteriorated	Δ Q2	aggregate	Δ Q2
German Real Estate Finance Index	**10.4**	**(+ 2.6)**	**68.4**	**(- 5.0)**	**21.3**	**(+ 2.4)**	**-10.8**	**(+ 0.3)**
Financing situation	**improved**	**Δ Q2**	**unchanged**	**Δ Q2**	**deteriorated**	**Δ Q2**	**aggregate**	**Δ Q2**
Office	17.8	(+ 4.0)	78.6	(+ 6.2)	3.6	(-10.2)	14.2	(+14.2)
Retail	3.7	(+ 0.2)	40.7	(- 2.2)	55.6	(+ 2.0)	-51.9	(- 1.8)
Logistics	14.3	(+/- 0.0)	82.1	(+ 7.1)	3.6	(- 7.1)	10.7	(+ 7.1)
Residential	17.8	(+ 4.0)	78.6	(- 4.2)	3.6	(+ 0.2)	14.2	(+ 3.8)
Hotel	20.8	(+ 6.0)	75.0	(+ 4.6)	4.2	(-10.6)	16.6	(+16.6)
All real estate segments	**14.9**	**(+ 2.9)**	**71.0**	**(+ 2.3)**	**14.1**	**(- 5.2)**	**0.8**	**(+ 8.0)**
Financing expectations	**improve**	**Δ Q2**	**remain unchanged**	**Δ Q2**	**deteriorate**	**Δ Q2**	**aggregate**	**Δ Q2**
Office	4.0	(- 2.9)	80.0	(- 2.8)	16.0	(+ 5.7)	-12.0	(- 8.6)
Retail	0.0	(+/- 0.0)	37.5	(-16.1)	62.5	(+16.1)	-62.5	(-16.1)
Logistics	4.0	(+ 4.0)	84.0	(- 9.1)	12.0	(+ 5.1)	-8.0	(- 1.1)
Residential	8.0	(+ 4.4)	68.0	(-14.1)	24.0	(+ 9.7)	-16.0	(- 5.3)
Hotel	13.6	(+ 6.5)	59.1	(-19.5)	27.3	(+13.0)	-13.7	(- 6.5)
All real estate segments	**5.9**	**(+ 2.4)**	**65.7**	**(-12.3)**	**28.4**	**(+10.0)**	**-22.4**	**(- 7.5)**

Refinance market situation	improved	Δ Q2	unchanged	Δ Q2	deteriorated	Δ Q2	aggregate	Δ Q2
Capital deposits	4.2	(-10.6)	75.0	(- 6.5)	20.8	(+17.1)	-16.6	(-27.7)
Mortgage bonds	14.8	(-18.5)	77.8	(+21.1)	7.4	(- 2.6)	7.4	(-15.9)
Unsecured bonds	16.7	(+ 1.9)	62.5	(- 7.9)	20.8	(+ 6.0)	-4.1	(- 4.1)
Mortgage backed securities	10.0	(- 3.6)	80.0	(+ 2.7)	10.0	(+ 0.9)	0.0	(- 4.5)
Real estate stock markets	9.1	(+ 0.8)	68.2	(+ 1.5)	22.7	(- 2.3)	-13.6	(+ 3.1)
Refinance market expectations	**improve**	**Δ Q2**	**remain unchanged**	**Δ Q2**	**deteriorate**	**Δ Q2**	**aggregate**	**Δ Q2**
Capital deposits	4.5	(- 2.9)	77.3	(-11.6)	18.2	(+14.5)	-13.7	(-17.4)
Mortgage bonds	24.0	(+17.1)	76.0	(-13.7)	0.0	(- 3.4)	24.0	(+20.5)
Unsecured bonds	13.6	(+ 6.2)	68.2	(-13.3)	18.2	(+ 7.1)	-4.6	(- 0.9)
Mortgage backed securities	11.1	(+ 6.5)	66.7	(-24.2)	22.2	(+17.7)	-11.1	(-11.2)
Real estate stock markets	15.7	(- 1.7)	63.2	(+15.4)	21.1	(-13.7)	-5.4	(+12.0)
Segment development	**increase**	**Δ Q2**	**remain unchanged**	**Δ Q2**	**decrease**	**Δ Q2**	**aggregate**	**Δ Q2**
Mortgage bonds	17.8	(- 8.9)	67.9	(- 2.1)	14.3	(+11.0)	3.5	(-19.9)
Unsecured bank bonds	33.3	(- 6.7)	55.6	(+ 8.9)	11.1	(- 2.2)	22.2	(- 4.5)
Segment development	**increase**	**Δ Q2**	**remain unchanged**	**Δ Q2**	**decrease**	**Δ Q2**	**aggregate**	**Δ Q2**
Syndication business (volume)	29.6	(-20.4)	66.7	(+23.8)	3.7	(- 3.4)	25.9	(-17.0)
Underwriting (volume)	11.1	(- 6.1)	66.7	(- 2.3)	22.2	(+ 8.4)	-11.1	(-14.5)

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

Contacts JLL

Anke Herz
Team Leader Debt Advisory Germany
Frankfurt
+49 (0) 69 2003 1943
anke.herz@eu.jll.com
jll.de

Helge Scheunemann
Head of Research Germany
Hamburg
+49 (0) 40 350011 225
helge.scheunemann@eu.jll.com
jll.de

Contact ZEW

Dr. Carolin Schmidt
Department International Finance
and Financial Management
+49 (0) 621 1235 287
carolin.schmidt@zew.de
zew.de | zew.eu