DIFI-Report

Assessment of the Real Estate Financing Market

Germany | 4th Quarter 2017
Published in December 2017

Brighter financing expectations for the coming half year

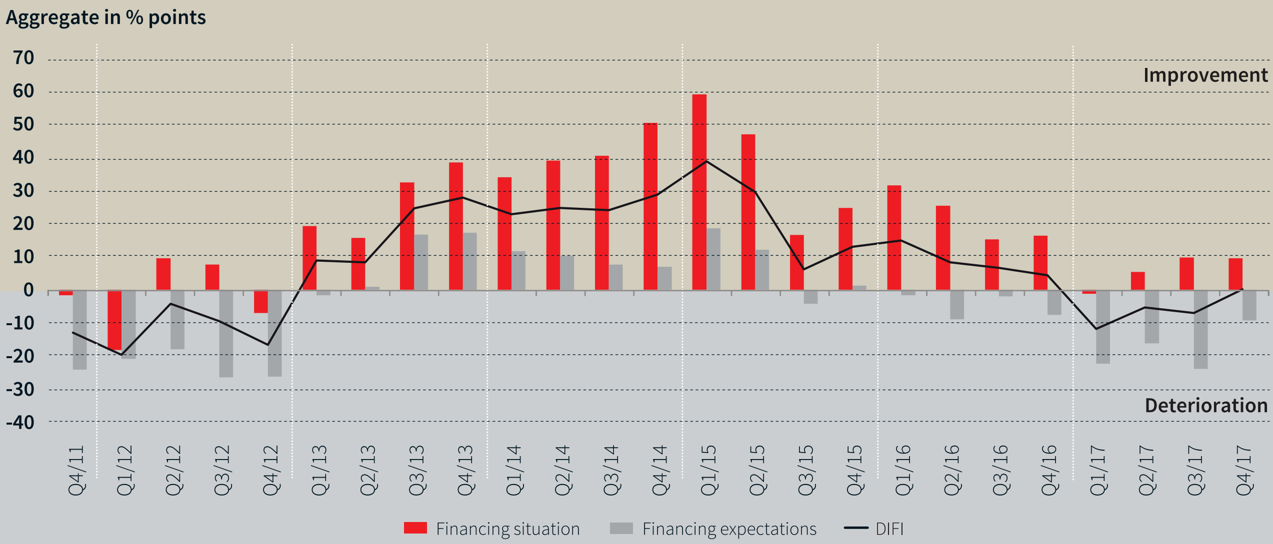
Assessment of the refinancing markets remains cautiously optimistic

Special question: extension of the ECB-programme may boost appetite to take on risk

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).

Stable business environment at year-end

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

Positive financing situation and improved prospects for 2018

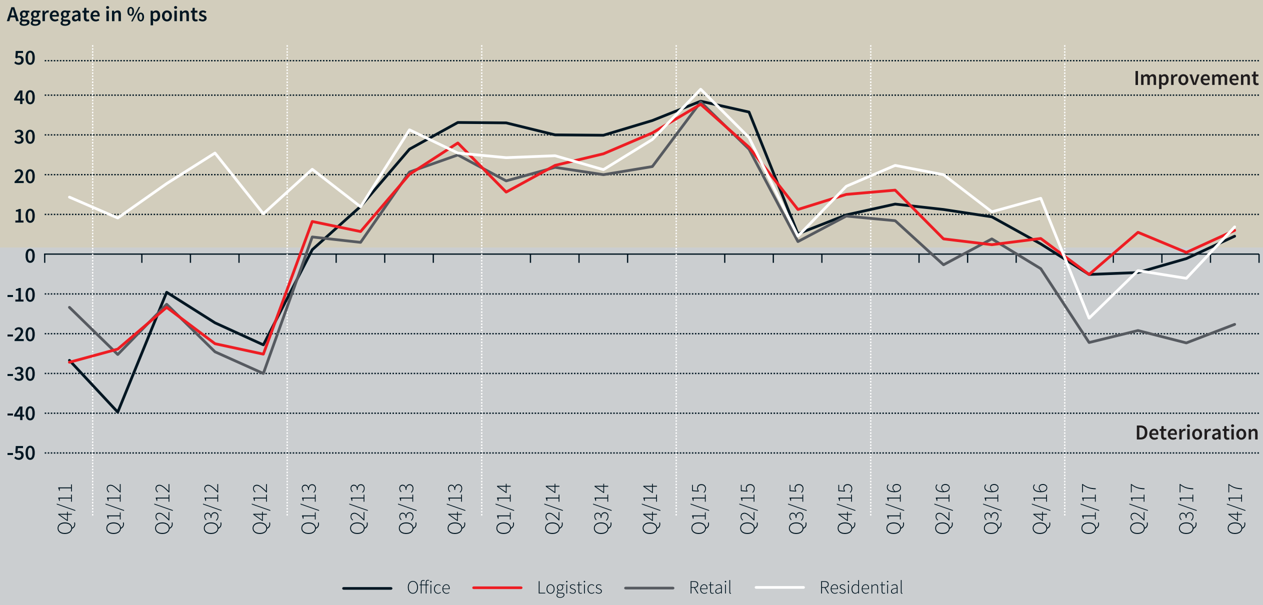
The German Real Estate Finance Index (DIFI) has broken through the zero line for the first time this year. After negative index positions for three quarters in succession, the sentiment barometer for commercial real estate financing in Germany reached a level of 0.1 points in the 4th quarter of 2017. This is 7.3 points higher than the previous quarter and the rise has been driven by the noticeable improvement in expectations relating to financing business for the coming half year: the relevant aggregate of positive and negative assessments has risen significantly by 14.7 points to its current level of -9.4 points. Despite the improvement, future expectations amongst finance providers remain cautious. One reason for this is the continuation of the highly positive assessment relating to the current financing situation: a marginal majority of the participating institutes indicated that their business situation improved again over the last six months (aggregate of positive and negative is 9.6 points).

The improvement in the DIFI is accompanied by the superb business situation in Germany and improving expectations relating to economic growth for 2018. The various research institutes have raised their growth forecasts for the coming year. Some of the forecasts are now in excess of 2%, which is around 0.5% higher than they were at the beginning of the year.

Robust financing environment for the logistics, residential and office sectors

The most significant improvements in expectations relating to the business situation for the coming half year are in the logistics, residential and office financing sectors. After significant negative values recently, the relevant aggregate of positive and negative forecasts from the participating institutes again indicate a stable financing environment for 2018. experts' expectations were only negative in the retail sector, similar to the previous quarter. Assessments relating to the growth in the financing business were positive over the last six months (with the exception of retail real estate financing), pointing to positive overall sentiment relating to the current and expected financing situation.

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

Virtually unchanged refinancing markets

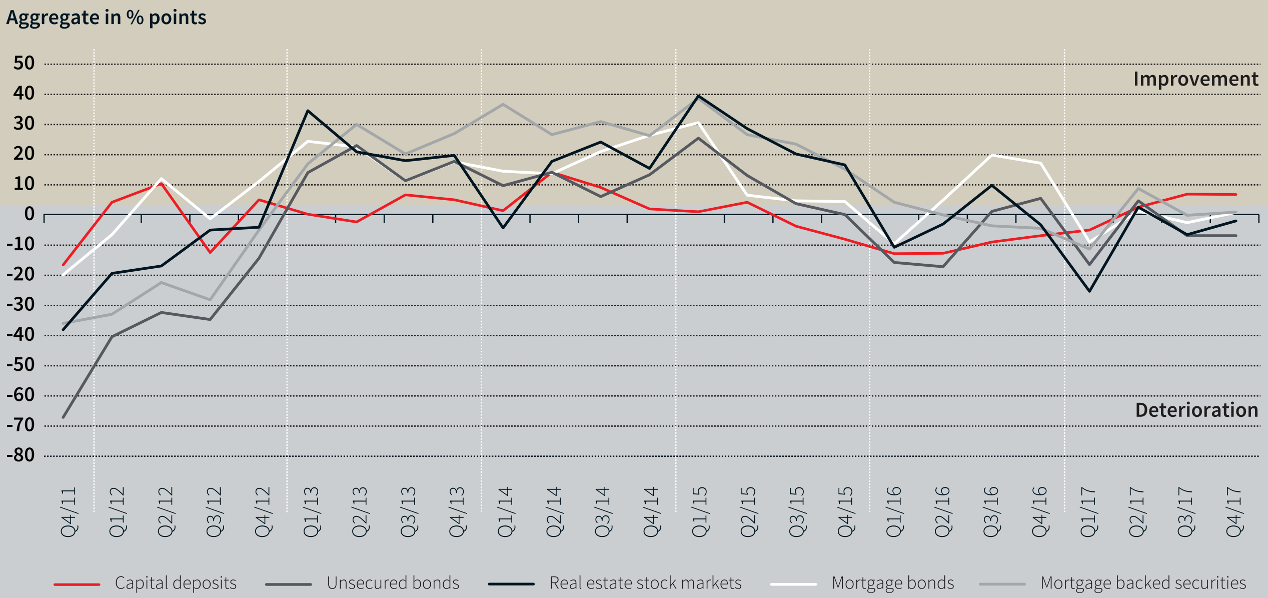
The previous quarter's neutral, cautiously positive assessment relating to the refinancing markets continued. Since the interim downturns in relevant indicators at the beginning of the year, the last three quarters' surveys have indicated stable development for all five refinancing instruments. Whilst there was a continual improvement in the assessment of the current situation relating to capital deposits, mortgage bonds, unsecured bonds and mortgage backed securities, the expectations for these fell slightly. There is a different picture emerging with regard to real estate stocks, for which the expectations improved significantly, whilst the development in the current situation over the last six months fell slightly compared to the previous quarter. The long-term trend shows that classic client capital deposits for the refinancing of deals appear to have recovered from the interim sub-zero cycle which has prevailed since mid-2015. Conversely, the period of dynamic growth in the mortgage bond market – in particular in 2016 – has died down slightly.

Special question: change in the ECB's bond purchase programme and interest rate expectations for 2018/2019

In the current quarter, financing experts were asked for their views on the effects of the extension and simultaneous modification of the ECB's bond purchase programme (announced on 26th October) on the price level and price structure of commercial real estate financing, the financing environment and the appetite amongst German real estate finance providers to take on risk. As the survey period commenced four days after the ECB council meeting, the same information was available to all participants. At its council meeting on the 26th October, the ECB decided to continue its bond purchase programme past the end of the year until at least September 2018. At the same time, the volume of purchases will halve from €60 billion to €30 billion per month from January 2018.

The most significant changes resulting from these measures are expected to be the financing price structure and the

Development of the refinancing markets

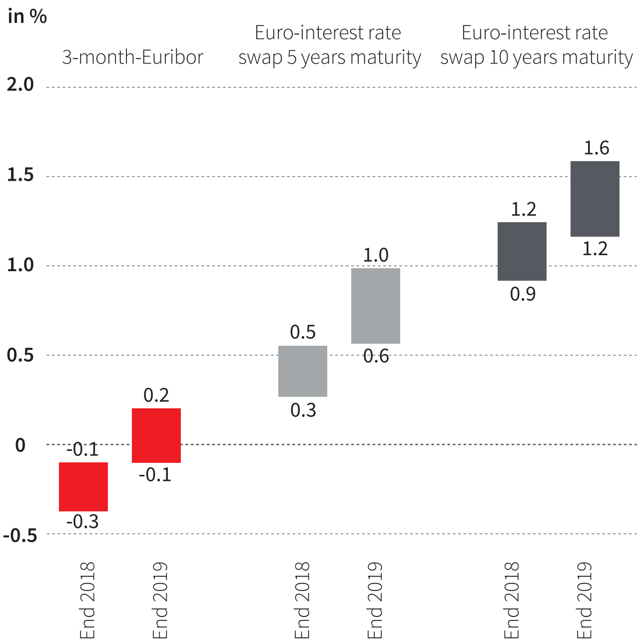


Average assessment of the current situation and expectations by refinancing instrument.
Source: JLL and ZEW

appetite of finance providers to take on risk. 34% expect that the margin will increase in importance compared to arrangement fees (no change at 52%). A further 33% believe there will be an increase in the inclination of finance providers to take on risk (no change at 51%). The latter is justifiable as long-term interest rates have remained at their historically low level as a result of the extension of the programme. In terms of the absolute financing price level and the financing environment, a large majority of respondents (82% and 70% respectively) expect that there will be no noticeable changes.

As in the final quarters of the preceding years, the experts were also asked for their forecasts relating to the critical interest rates for the coming two years. They expect that the 3-month Euribor rate is likely to be between -0.3% and -0.1% at the end of 2018 and between -0.1% and 0.2% at the end of 2019. They expect the 5 (10) year Euro Swap rate vs. the 6-month Euribor rate to be between 0.3% and 0.5% (0.9% and 1.2%) at the end of 2018 and between 0.5% and 1.0% (1.2 and 1.6%) at the end of 2019.

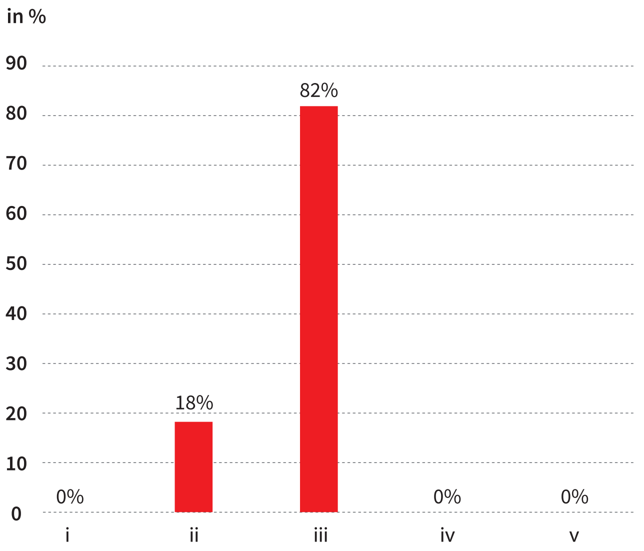
Range of interest rate forecasts for 3-month Euribor and Euro Swaps



Source: JLL and ZEW

Effects of the modification of the bond purchase program of the ECB

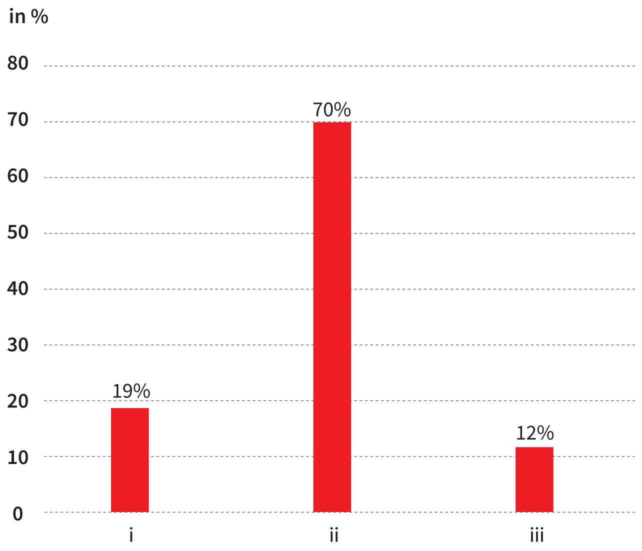
Overall price level of commercial real estate financing in Germany



i) Significant increase
ii) Increase
iii) Remains the same
iv) Decrease
v) Significant decrease

Source: JLL and ZEW

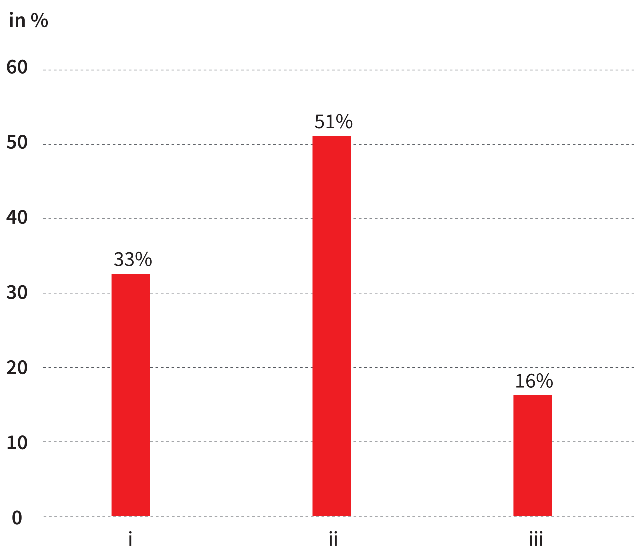
Price structure of commercial real estate financing



i) Margin loses importance in relation to fees
ii) Price structure remains the same
iii) Margin gains importance in relation to fees

Source: JLL and ZEW

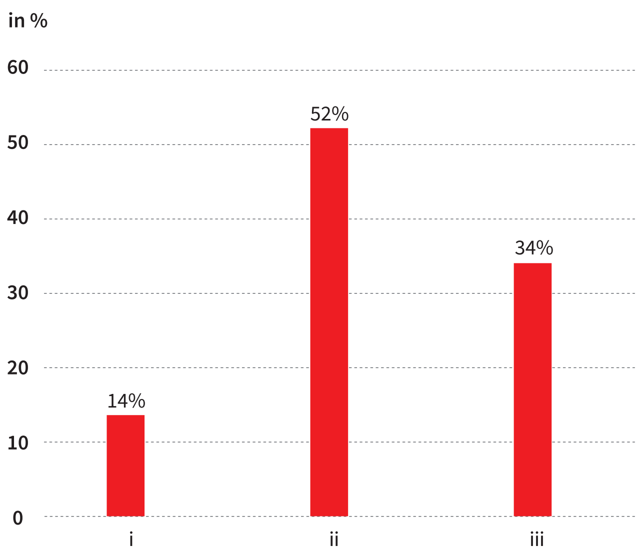
Real estate finance providers' appetite to take on risk in a competitive market



i) Increase
ii) No change
iii) Decrease

Source: JLL and ZEW

Commercial real estate financing environment



i) Increased consolidation
ii) Financing environment remains the same
iii) Increased diversification

Source: JLL and ZEW

DIFI-Report: Results of Responses, 4th Quarter 2017

	improved	Δ Q3	unchanged	Δ Q3	deteriorated	Δ Q3	aggregate	Δ Q3
German Real Estate Finance Index	**9.0**	**(- 1.4)**	**82.1**	**(+ 9.9)**	**9.0**	**(- 8.5)**	**0.1**	**(+ 7.3)**
Financing situation	**improved**	**Δ Q3**	**unchanged**	**Δ Q3**	**deteriorated**	**Δ Q3**	**aggregate**	**Δ Q3**
Office	14.3	(- 2.8)	85.7	(+ 2.8)	0.0	(+/- 0.0)	14.3	(- 2.8)
Retail	7.3	(- 0.2)	80.5	(+ 3.0)	12.2	(- 2.8)	-4.9	(+ 2.6)
Logistics	17.1	(- 5.4)	80.5	(+ 3.0)	2.4	(+ 2.4)	14.7	(- 7.8)
Residential	16.6	(+ 2.3)	81.0	(+ 2.4)	2.4	(- 4.7)	14.2	(+ 7.0)
All real estate segments	**13.8**	**(- 1.6)**	**81.9**	**(+ 2.8)**	**4.3**	**(- 1.2)**	**9.6**	**(- 0.2)**
Financing expectations	**improve**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**deteriorate**	**Δ Q3**	**aggregate**	**Δ Q3**
Office	4.8	(- 2.3)	85.4	(+18.7)	9.8	(-16.4)	-5.0	(+14.1)
Retail	2.5	(- 2.3)	65.0	(+11.3)	32.5	(- 9.0)	-30.0	(+ 6.7)
Logistics	5.0	(+ 0.2)	87.5	(+18.5)	7.5	(-18.7)	-2.5	(+18.9)
Residential	4.6	(- 0.2)	90.7	(+19.3)	4.7	(-19.1)	-0.1	(+18.9)
All real estate segments	**4.2**	**(- 1.2)**	**82.2**	**(+17.0)**	**13.6**	**(-15.8)**	**-9.4**	**(+14.7)**

Refinance market situation	improved	Δ Q3	unchanged	Δ Q3	deteriorated	Δ Q3	aggregate	Δ Q3
Capital deposits	18.9	(+ 2.3)	75.7	(- 2.1)	5.4	(- 0.2)	13.5	(+ 2.5)
Mortgage bonds	9.8	(+ 0.1)	90.2	(+ 4.8)	0.0	(- 4.9)	9.8	(+ 5.0)
Unsecured bonds	9.8	(- 0.8)	87.8	(+ 8.9)	2.4	(- 8.1)	7.4	(+ 7.3)
Mortgage backed securities	17.3	(+ 7.0)	79.3	(- 3.5)	3.4	(- 3.5)	13.9	(+10.5)
Real estate stock markets	22.6	(- 3.2)	64.5	(+/- 0.0)	12.9	(+ 3.2)	9.7	(- 6.4)
Refinance market expectations	**improve**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**deteriorate**	**Δ Q3**	**aggregate**	**Δ Q3**
Capital deposits	9.1	(- 2.3)	81.8	(+ 1.8)	9.1	(+ 0.5)	0.0	(- 2.8)
Mortgage bonds	0.0	(- 5.0)	91.9	(+11.9)	8.1	(- 6.9)	-8.1	(+ 1.9)
Unsecured bonds	0.0	(- 5.6)	78.9	(+ 3.9)	21.1	(+ 1.7)	-21.1	(- 7.3)
Mortgage backed securities	0.0	(-10.7)	88.0	(+13.0)	12.0	(- 2.3)	-12.0	(- 8.4)
Real estate stock markets	6.9	(+ 0.5)	72.4	(+14.3)	20.7	(-14.8)	-13.8	(+15.3)
Spreads compared to German government bonds	**increase**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**decrease**	**Δ Q3**	**aggregate**	**Δ Q3**
Mortgage bonds	22.0	(+ 4.1)	75.6	(+ 3.8)	2.4	(- 7.9)	19.6	(+12.0)
Unsecured bank bonds	45.0	(+16.1)	50.0	(-13.2)	5.0	(- 2.9)	40.0	(+19.0)
Segment development	**increase**	**Δ Q3**	**remain unchanged**	**Δ Q3**	**decrease**	**Δ Q3**	**aggregate**	**Δ Q3**
Syndication business (volume)	38.4	(- 7.7)	59.0	(+20.5)	2.6	(-12.8)	35.8	(+ 5.1)
Underwriting (volume)	28.2	(-10.2)	61.5	(+23.0)	10.3	(-12.8)	17.9	(+ 2.6)

Comment: The German Real Estate Finance Index survey was carried out between 30.10.2017 and 14.11.2017 and involved 44 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. Figures have been rounded to one decimal place.

Source: JLL and ZEW

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