Research & Debt Advisory Germany

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DIFI-Report

Assessment of the Real Estate Financing Market

DIFI sees sixth consecutive rise

Significant downturn in assessments of the situation in the real estate refinancing markets

Special question: current margins and LTVs in the commercial real estate financing sector

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 sees sixth consecutive rise

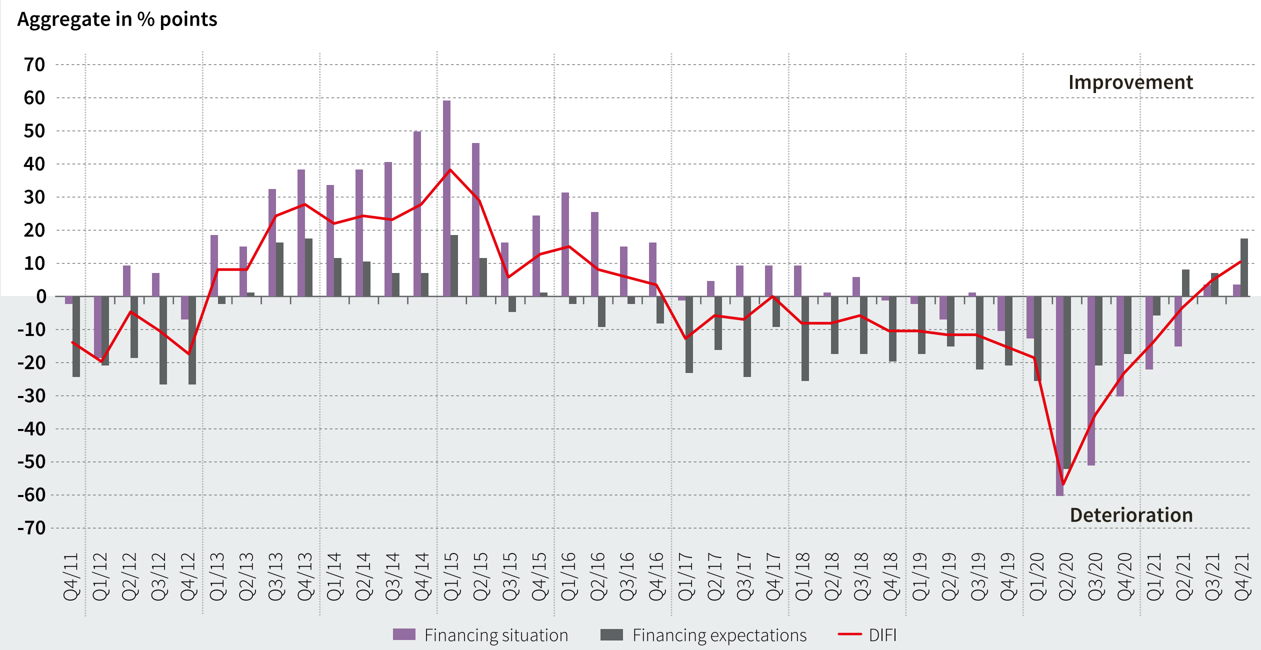
Expectations indicator rises sharply, situation indicator almost unchanged

The **German Real Estate Financing Index (DIFI)** rose for the 6th time in succession in the fourth quarter of 2021. The balance of **10.7 points** is a 5.1-point rise compared to the previous quarter and is now at its highest level since the first quarter of 2016. This is also a rise of 34.2 points compared to the fourth quarter of 2020. While the respondents' overall assessments of the financing situation over the last six months have remained almost unchanged since the previous quarter, the outlook for the financing situation over the next six months has improved. With a slight fall of 0.3 points compared to the previous quarter, the situation indicator of 4.0 points is in positive territory. The expectations indicator rose by 10.6 to 17.4 points, its highest level since the first quarter of 2015.

Further significant recovery in the office and hotel real estate segments

A glance at the individual real estate segments shows that the rise in the DIFI in the fourth quarter of 2021 is largely attributable to the office and hotel use segments. The DIFI shows the current situation and future expectations for all sub-indicators in the fourth quarter of 2021 and is only exceeded by the DIFI sub-indicator for the logistics segment. The situation indicators for the two real estate segments rose by 10.2 points (office) and 9.2 points (hotel). While the situation indicator for the office segment has been back in positive territory since the third quarter (17.4 points in the

German Real Estate Finance Index (DIFI)

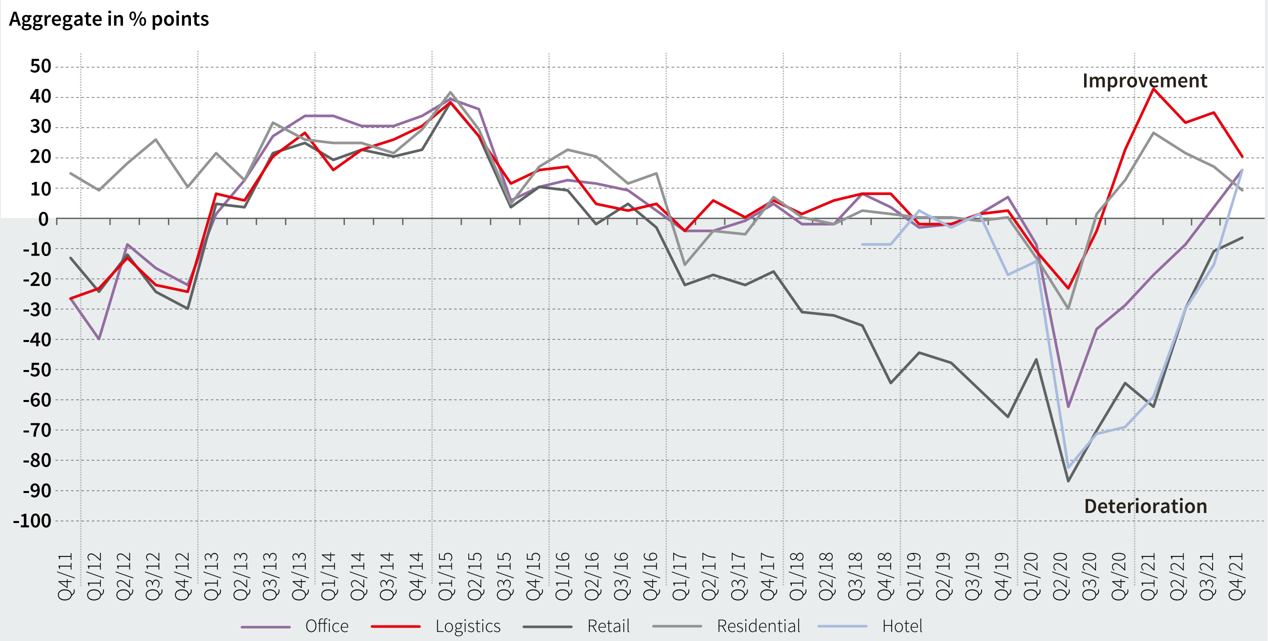


Average assessment of the current situation in and expectations for the five real estate market segments (Office, Retail, Logistics, Residential, Hotel).
Source: JLL and ZEW

fourth quarter of 2021), the aggregate for the hotel segment remains negative at -22.8 points. The expectations indicator in the office segment has risen by 13.6 points in the fourth quarter of 2021 and is now in positive territory for the first time since the third quarter of 2016. The biggest increase in terms of expectations is 55.0 points in the hotel segment, the first time that this indicator has been in positive territory. This significantly improved assessment may be due to the announcement that the government is hoping to avoid the widespread lockdowns of last year and the much-improved overnight stay and hospitality industry statistics.

Assessments in the real estate financing markets for the logistics and residential use segments in the fourth quarter of 2021 are again down on the previous quarter with a fall in both the situation and expectations indicators in the two real estate segments. While the situation indicator in the logistics segment of 39.1 points (-13.4 points compared to the third quarter of 2021) is still well into positive territory, the respective expectations indicator is still just above zero after a fall of 22.1 points. This expectations indicator balance in the logistics financing market is similar to the 0.0 points from the fourth quarter of 2019. The situation and expectations indicators in the residential segment fell by 0.3 points and 15.6 points, respectively, in the fourth quarter of 2021. The situation indicator of 18.2 points is still well into positive territory. The expectations indicator slid into the negative zone with a new aggregate of -0.1 points.

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

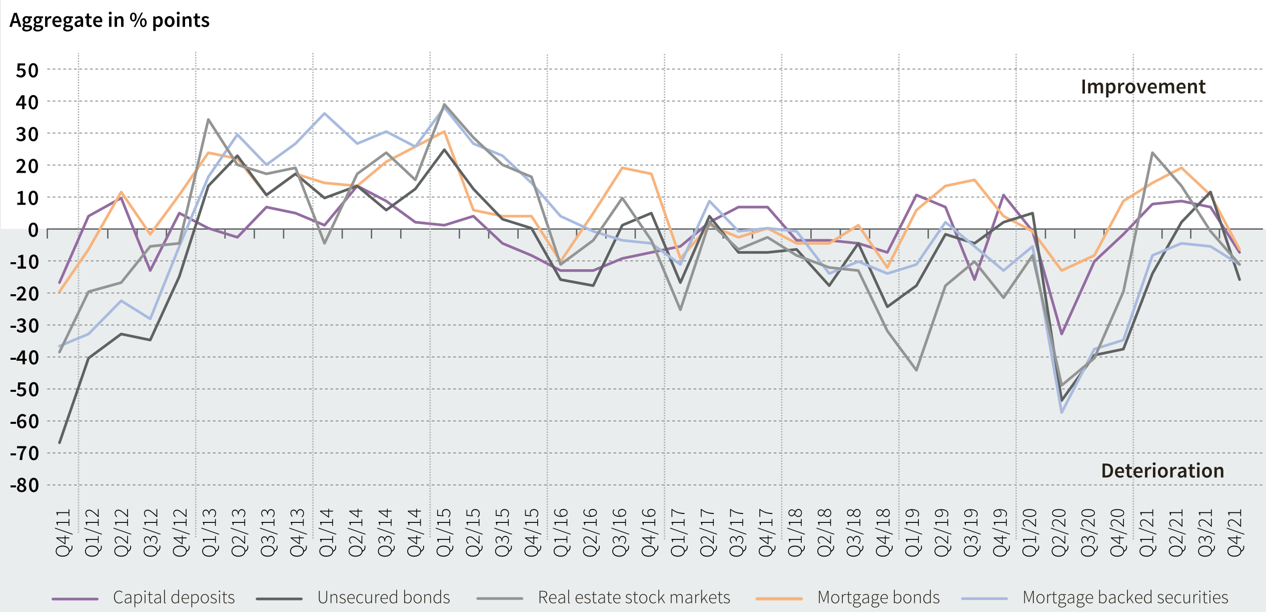
The only DIFI sub-indicator still in negative territory in the fourth quarter of 2021 is the retail segment. While the situation in the retail financing market over the previous six months is now worse than in the third quarter of 2021 (-13.4 points), the outlook for the next six months has improved. The expectations indicator for the retail segment has risen by 22.2 points to a new aggregate of 18.3 points. The respective DIFI sub-indicator rose by 4.4 points to its highest position since the fourth quarter of 2016.

Significant downturn in assessments of the situation in the real estate refinancing markets

The respondents have assessed the real estate refinancing markets much more negatively in the fourth quarter of 2021 compared to the third quarter. All refinancing instruments under review experienced double digit falls in their situation indicators compared to the previous quarter. The respective expectations indicators either fell or remained almost unchanged.

The falls in the situation indicators for the various refinancing instruments were between -11.1 points (mortgage-backed securities) and -42.3 points (unsecured bonds). All situation indicators are in negative territory. The highest situation indicator balance of -11.1 points in the fourth quarter of 2021 was for mortgage-backed securities. The worst score of -23.2 points was for unsecured bonds. The last time the respondents' views of the situation in the refinancing markets for unsecured

Development of the refinancing markets



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

bonds, mortgage-backed securities and real estate stock markets were worse was in the fourth quarter of 2020. The same can be said of capital deposits and mortgage bonds referring to the second and third quarters of 2020, respectively.

A glance at the individual expectations indicators paints a mixed picture. While the outlook for the refinancing markets for capital deposits, mortgage bonds and mortgage-backed securities is roughly the same as in the previous quarter, the future of unsecured bonds and real estate stock markets is assessed more negatively in the fourth quarter of 2021. The expectations indicators for both the latter categories fell by 7.7 points, and both now stand at an aggregate of -7.7 points. Despite a slight increase of 1.2 points in the mortgage-backed securities expectations indicator in the fourth quarter of 2021, this is lower than the other instruments with a score of -10.0 points. The respondents foresee no change in the refinancing instruments, capital deposits and mortgage bonds over the next six months. Both expectations indicators are at 0.0 points.

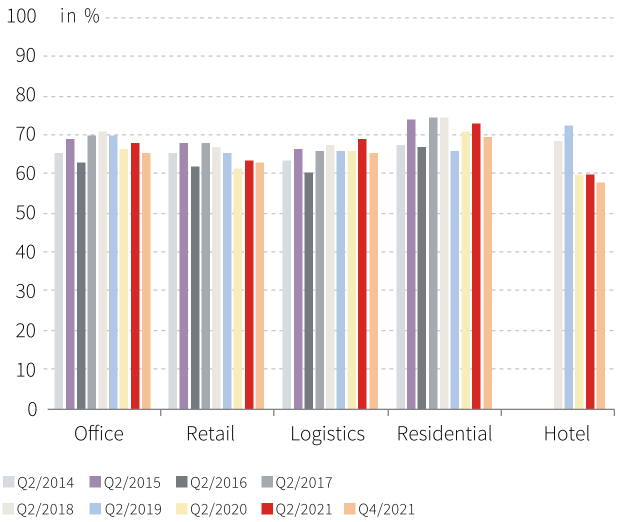
Current margins and LTVs in the commercial real estate financing sector

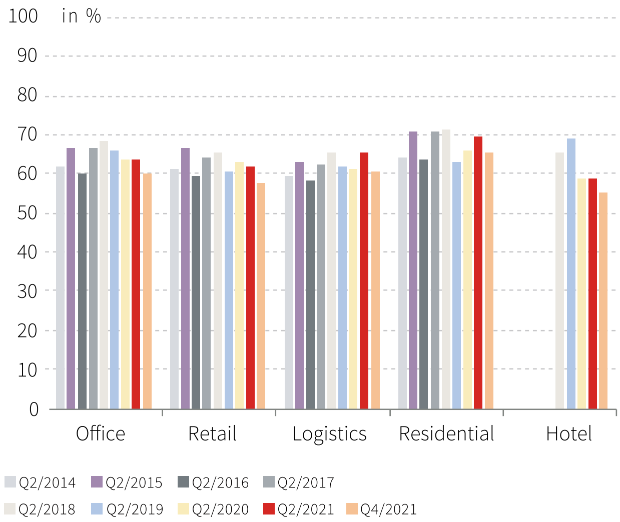
To provide a continual picture, since 2014 we have asked the respondents for their ongoing estimates regarding typical market financing margins and loan-to-value ratios (LTVs - debt financing as a proportion of market value) for property financing in the Core and Value-Add risk categories . Participants have the opportunity to indicate the most likely result from a selection of ranges.

The estimates relating to the development of typical market financing margins and loan-to-value ratios in the Core and Value-Add risk categories are very similar in the fourth quarter of 2021. Compared to the second quarter of 2021, the average LTVs for existing properties across most real estate segments are lower in both categories. The exception is the average LTV for office properties in the Core segment which remains unchanged at 63%. In the Core segment, the falls in average LTVs range from 2%-points (hotel) to 4%-points (residential). In the Value-Add segment, there was a fall of 3%-points in the hotel category and 4%-points in the remaining real estate segments. As in the second quarter of 2021, the lowest average LTVs are in the hotel segment (58% and 55% for Core and Value-Add, respectively) and the highest are in the residential segment (69% and 65% for Core and Value-Add, respectively).

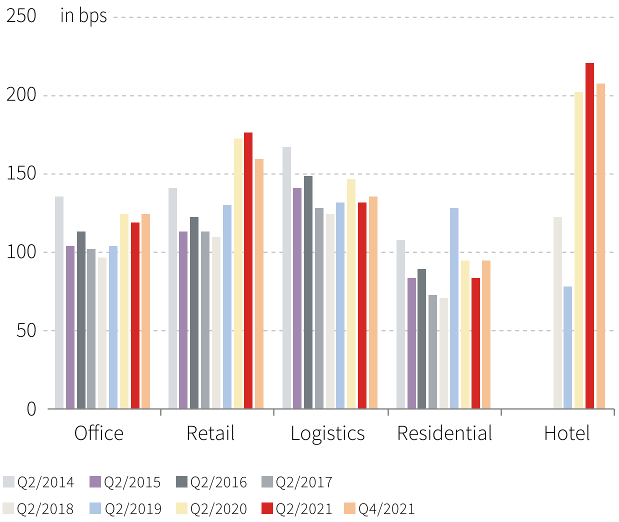
A glance at the typical margins for commercial real estate financing amongst the various use segments shows a mixed picture. In the Core segment, loans with terms of up to 10 years are preferred, which means that expectations relating to inflation and hikes in refinancing costs have a significant impact on banks' margins. The average margins for the office, logistics and residential segments have risen slightly compared to the second quarter. Rises in average margins range from 4.86 bps (logistics) to 9.77 bps (residential). By contrast, the margins for retail (-17.48 bps) and hotel (-13.4 bps) are lower. The resulting average margins in the Core segment are currently between 94.4 bps (residential) and 207.1 bps (hotel). In the Value-Add segment the average margins have fallen across all real estate segments compared to the second quarter of 2021. Falls ranged between 3.28 bps (office) and 32.55 bps (retail). Value-Add projects tend to be financed over a shorter period, which makes refinancing much cheaper for the banks, and this is now reflected in the margins. As in the Core segment, the lowest and highest average margins are in the residential (133.3 bps) and hotel segments (268.4 bps), respectively.

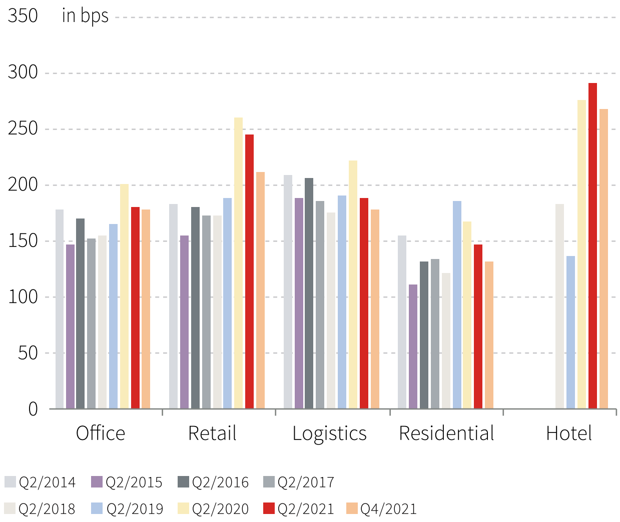
Estimates of the average LTVs for commercial real estate financing of existing properties in the Core (left) and the Value-Add risk categories (right)





Estimates of the average margins for commercial real estate financing of existing properties in the Core (left) and the Value-Add risk categories (right)





Source: JLL and ZEW

DIFI-Report: Results of Responses, 4th Quarter 2021

	Improved	Δ Q3	Unchanged	Δ Q3	Deteriorated	Δ Q3	Aggregate	Δ Q3
German Real Estate Finance Index	22.7	(+ 2.0)	65.5	(+ 1.2)	12.0	(- 3.1)	10.7	(+ 5.1)
Financing situation	**Improved**	**Δ Q3**	**Unchanged**	**Δ Q3**	**Deteriorated**	**Δ Q3**	**Aggregate**	**Δ Q3**
Office	17.4	(- 0,5)	82.6	(+11,2)	0.0	(-10,7)	17.4	(+10,2)
Retail	9.1	(- 9,5)	50.0	(+ 5,6)	40.9	(+ 3,9)	-31.8	(-13,4)
Logistics	39.1	(- 7,3)	60.9	(+ 7,3)	0.0	(+/- 0,0)	39.1	(- 7,3)
Residential	18.2	(- 0,3)	81.8	(+ 0,3)	0.0	(+/- 0,0)	18.2	(- 0,3)
Hotel	13.6	(+ 1,6)	50.0	(+ 6,0)	36.4	(- 7,6)	-22.8	(+ 9,2)
All real estate segments	19.5	(- 3,2)	65.1	(+ 6,1)	15.5	(- 2,8)	4.0	(- 0,3)
Financing expectations	**Will improve**	**Δ Q3**	**Will not change**	**Δ Q3**	**Will deteriorate**	**Δ Q3**	**Aggregate**	**Δ Q3**
Office	22.7	(+15,3)	68.2	(-17,0)	9.1	(+ 1,7)	13.6	(+13,6)
Retail	31.9	(+12,7)	54.5	(- 3,2)	13.6	(- 9,5)	18.3	(+22,2)
Logistics	4.6	(-17,6)	90.9	(+13,1)	4.5	(+ 4,5)	0.1	(-22,1)
Residential	4.7	(-14,6)	90.5	(+13,6)	4.8	(+ 1,0)	-0.1	(-15,6)
Hotel	65.0	(+40,0)	25.0	(-25,0)	10.0	(-15,0)	55.0	(+55,0)
All real estate segments	25.8	(+ 7,2)	65.8	(- 3,7)	8.4	(- 3,5)	17.4	(+10,6)
Situation in the refinancing markets	**Improved**	**Δ Q3**	**Unchanged**	**Δ Q3**	**Deteriorated**	**Δ Q3**	**Aggregate**	**Δ Q3**
Capital deposits	0.0	(-14,3)	86.7	(+ 1,0)	13.3	(+13,3)	-13.3	(-27,6)
Pfandbrief mortgage bonds	0.0	(-22,7)	87.5	(+10,2)	12.5	(+12,5)	-12.5	(-35,2)
Unsecured bonds	15.3	(-13,3)	46.2	(-15,7)	38.5	(+29,0)	-23.2	(-42,3)
Mortgage-backed securities	0.0	(- 5,9)	88.9	(+ 0,7)	11.1	(+ 5,2)	-11.1	(-11,1)
Real estate stocks and shares	7.2	(- 2,3)	71.4	(- 9,6)	21.4	(+11,9)	-14.2	(-14,2)
Expectations in the refinancing markets	**Will improve**	**Δ Q3**	**Will not change**	**Δ Q3**	**Will deteriorate**	**Δ Q3**	**Aggregate**	**Δ Q3**
Capital deposits	0.0	(- 5,2)	100.0	(+10,5)	0.0	(- 5,3)	0.0	(+ 0,1)
Pfandbrief mortgage bonds	0.0	(- 5,0)	100.0	(+10,0)	0.0	(- 5,0)	0.0	(+/- 0,0)
Unsecured bonds	7.7	(- 7,3)	76.9	(+ 1,9)	15.4	(+ 5,4)	-7.7	(-12,7)
Mortgage-backed securities	10.0	(+ 4,5)	70.0	(- 7,8)	20.0	(+ 3,3)	-10.0	(+ 1,2)
Real estate stocks and shares	0.0	(-15,8)	92.3	(+23,9)	7.7	(- 8,1)	-7.7	(- 7,7)
Spreads compared to German Government bonds	**Will increase**	**Δ Q3**	**Will not change**	**Δ Q3**	**Will reduce**	**Δ Q3**	**Aggregate**	**Δ Q3**
Pfandbrief mortgage bonds	19.0	(- 6,0)	76.2	(+ 9,5)	4.8	(- 3,5)	14.2	(- 2,5)
Unsecured bank bonds	38.1	(+ 0,6)	61.9	(+11,9)	0.0	(-12,5)	38.1	(+13,1)
Development of segments	**Will increase**	**Δ Q3**	**Will not change**	**Δ Q3**	**Will reduce**	**Δ Q3**	**Aggregate**	**Δ Q3**
Syndication business (volume)	50.0	(+23,1)	40.0	(-25,4)	10.0	(+ 2,3)	40.0	(+20,8)
Underwriting (volume)	25.0	(+13,9)	65.0	(- 9,1)	10.0	(- 4,8)	15.0	(+18,7)

Comment: The German Real Estate Finance Index survey was carried out between 25.10.2021 – 05.11.2021 and involved 24 experts. These experts were asked for their assess-ments 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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