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Research & Debt Advisory Deutschland

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DIFI-Report

Assessment of the Real Estate Financing Market

- DIFI sees fifth consecutive rise
- Positive assessment of current situation in the refinancing markets, outlook slightly gloomier
- Special question: attractiveness of individual real estate segments when considering the development of inflation

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.

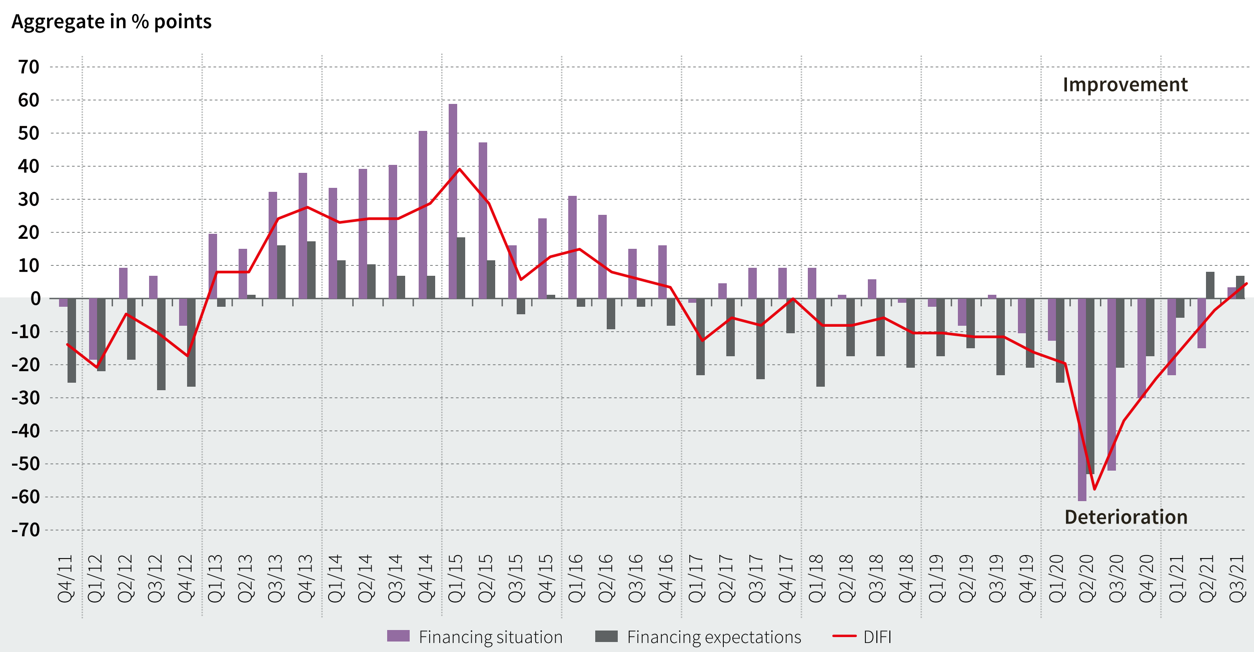
DIFI sees fifth consecutive rise

Situation indicator rises sharply
The **German Real Estate Financing Index (DIFI)** saw its fifth consecutive rise in the 3rd quarter of 2021 and, at **5.6 points,** is 8.9 points higher than in the previous quarter. While the experts' assessments of the financing situation in the past six months are significantly more optimistic than in the previous quarter, the outlook for the financing situation in the coming six months remains almost unchanged. With a rise of 19.1 points compared to the 2nd quarter of 2021, the situation indicator has returned to positive territory with 4.3 points, the highest level since the 3rd quarter of 2018. The expectations indicator also remains positive but, at 6.8 points, is slightly lower than in the 2nd quarter of 2021 (-1.4 points).

Outlook gloomier for the office, retail and hotel segments while the logistics and residential segments are still attractive in the current market environment

Looking at the individual real estate segments, it is clear that the German real estate financing market will continue to be significantly affected by the COVID-19 pandemic in the 3rd quarter of 2021. While the situation indicators for the segments most susceptible to the effects of the pandemic (office, retail and hotel) improved significantly compared to the previous quarter due, in part, to a vaccination campaign that is progressing well, the outlook for these segments becomes slightly gloomy again against the concerns of a possible fourth wave of infections in Autumn 2021. This is evident from a rise in the

German Real Estate Finance Index (DIFI)

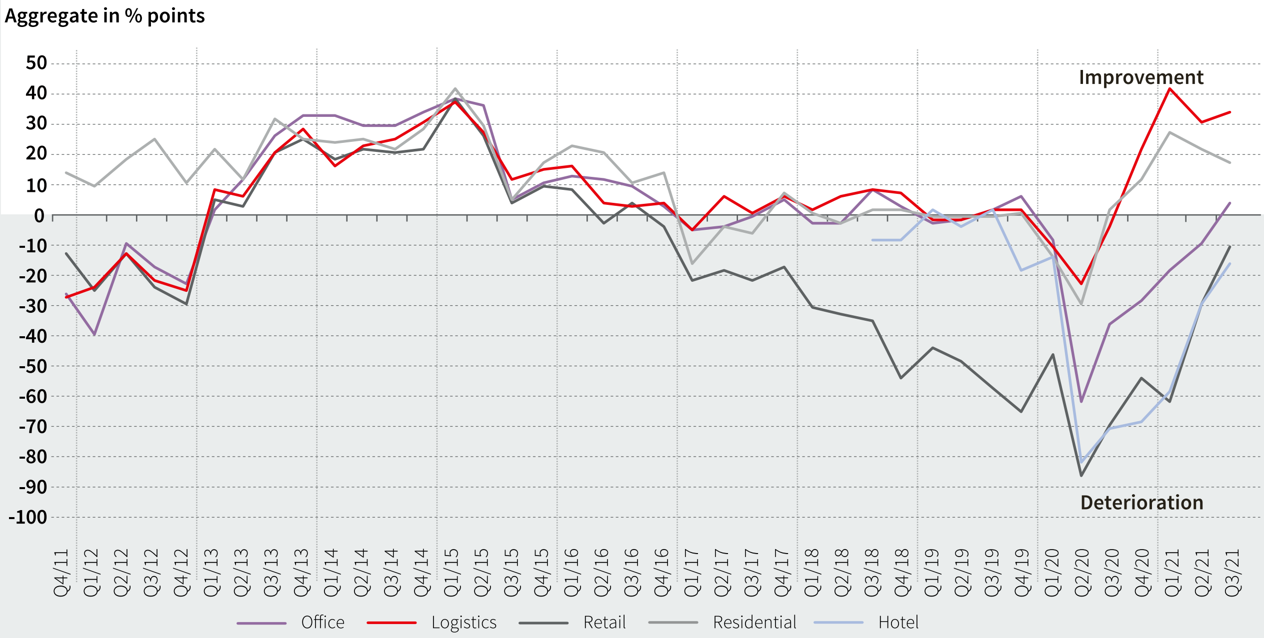


Average assessment of the current situation in and expectations for the five real estate market segments (Office, Retail, Logistics, Residential, Hotel).
Source: JLL and ZEW

respective situation indicators by 33.4 points (office), 38.4 points (retail) and 36.6 points (hotel) and a fall in the expectations indicators by 7.8 points (office), 1.2 points (retail) and 8.5 points (hotel). Of the three segments, the respondents are most optimistic about offices and most pessimistic about hotels. Therefore, the aggregates of the corresponding DIFI sub-indicators, which reflect both the current situation and future expectations, are 3.6 points and -16.0 points, respectively.

According to the experts, the segments most likely to profit from the pandemic, logistics and residential, should continue to profit from the current environment, although it is felt that the financing situation for residential real estate deteriorated significantly between the 2nd and 3rd quarters. While the expectations indicator for the residential segment rose by 7.0 points, the situation indicator declined by 15.8 points. Despite this downturn, the residential segment remains attractive according to the respondents, and the corresponding DIFI sub-indicator is clearly in positive territory at 17.0 points. After declining in the previous quarter, the situation indicator (+3.2 points) and expectations indicator (+3.3 points) for the logistics segment were slightly higher again in the 3rd quarter than in the previous quarter. The corresponding DIFI sub-indicator also rose by 3.3 points and, at 34.3 points, reached the highest aggregate of all of the real estate segments considered and its second-highest value since the outbreak of the pandemic.

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



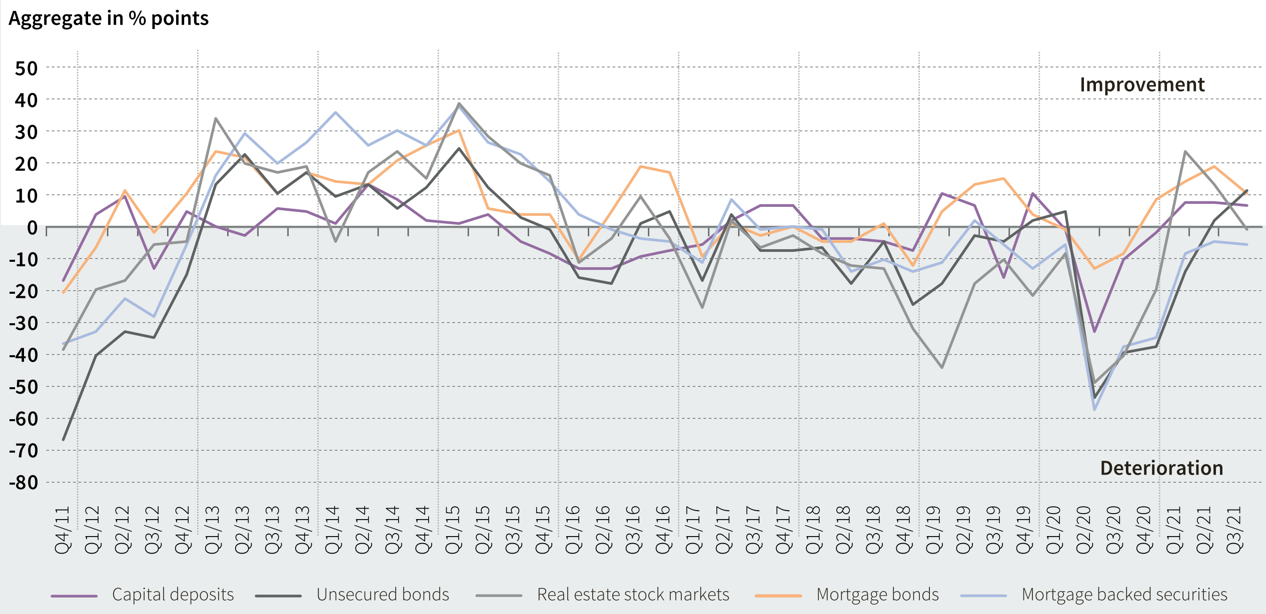
Average assessment of the current situation and expectations by defined real estate market segment.
Source: JLL and ZEW

Positive assessment of the current situation in the refinancing markets; the outlook remains mixed

In the 3rd quarter of 2021, the experts view the situation on the refinancing markets as positive overall. The corresponding indicators for capital deposits (14.3 points), Pfandbrief mortgage bonds (22.7 points) and unsecured bonds (19.1 points) as refinancing instruments are in positive territory, while those for mortgage-backed securities and real estate stocks and shares have an aggregate of 0.0 points. Compared to the previous quarter, the situation indicators for unsecured bonds and mortgage-backed securities have improved, while those for capital deposits, Pfandbrief mortgage bonds and real estate stocks and shares have deteriorated. The indicators for unsecured bonds and mortgage-backed securities have risen by 15.2 points and 4.2 points, respectively; their fifth consecutive rise. The indicators have recovered significantly since the 2nd quarter of 2020, rising by 92.2 points and 75.0 points, respectively.

The outlook for the real estate refinancing markets surveyed is mixed in the 3rd quarter of 2021. While the expectations indicators for capital deposits (-0.1 points) and mortgage-backed securities (-11.2 points) show negative aggregates, as a refinancing instrument, only unsecured bonds (5.0 points) have a positive aggregate. The aggregates of the remaining instruments are all 0.0 points. Similar to the situation indicator, only the expectations

Development of the refinancing markets



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

indicator for unsecured bonds has improved since the previous quarter (+4.9 points). While the expectations indicator for capital deposits remains unchanged compared to the previous quarter, the remaining expectations indicators are lower. The strongest decline is seen in real estate stocks and shares, whose indicator has reduced by 14.0 points.

Real estate investments in light of current inflation expectations

In the 2nd quarter of 2021, the Federal Statistical Office again recorded inflation rates of over 2% compared to the respective months of the previous year. Inflation rates are expected to be even higher in the 2nd half of the year. At the same time, the European Central Bank intends to continue to pursue its current, very expansive monetary policy as part of its new strategy. With this in mind, we asked the experts for their assessments of the further development of inflation and refinancing costs. Based on the experts' outlooks for inflation, we also wanted to know how they assess the attractiveness of the various real estate segments.

At 59.3%, the majority of respondents expect the inflation rate to fluctuate between 2% and 3% in 2021. 22.2% expect a lower inflation rate and 18.5% expect an inflation rate of over 3%. According to the experts, the inflation rates in 2022 and 2023 will be lower than in 2021. While just under half of the respondents expect an inflation rate of between 0% and 2% in 2022, 29.6% and 22.2% forecast values of between 2% and 3% and above 3%, respectively. For 2023, most responses range between the two response options '0% – 2%' and '2% – 3%', with 63.0% opting for the former and 33.3% for the latter.

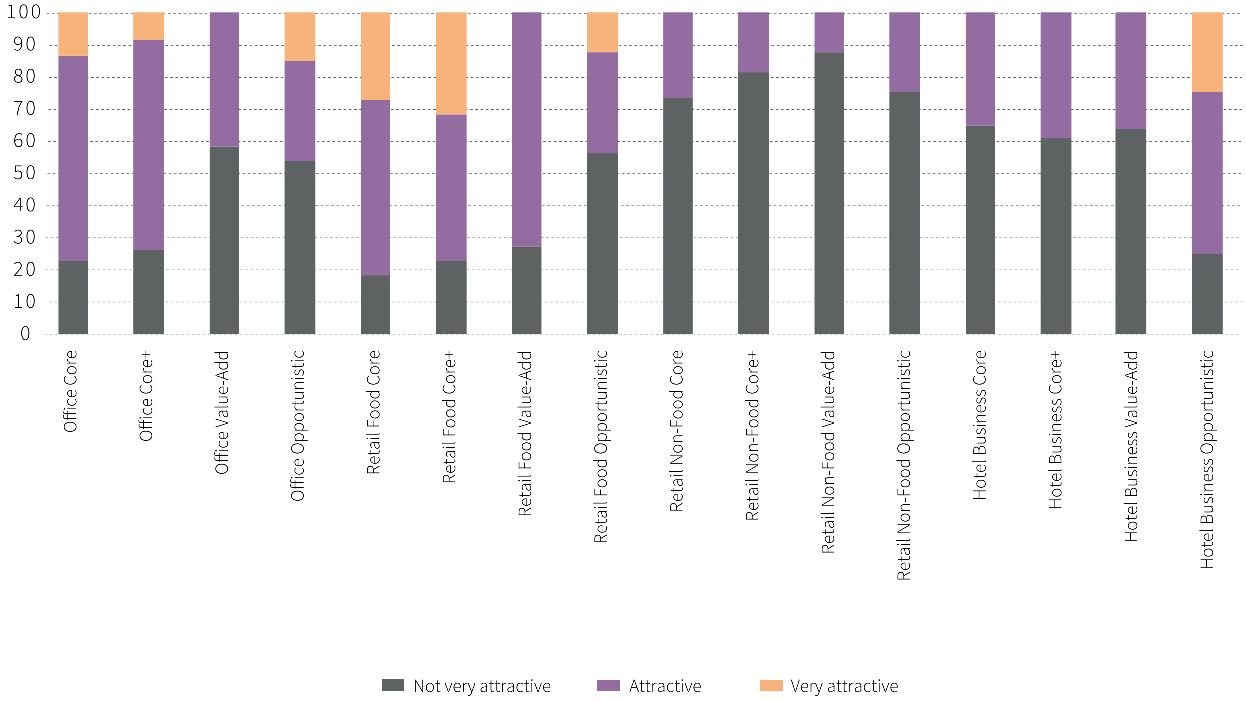
In terms of interest rate margins, around 72% of respondents expect refinancing costs to increase slightly in 2022 compared to 2021. Just 5.6% anticipate a sharp rise, while around 16.7% of the participants expect no change in refinancing costs and 5.6% forecast a decline compared to 2021.

Regarding the expected development of inflation until the end of 2023, the assessment of the attractiveness of the various real estate segments surveyed is similar to that of their respective financing conditions. The logistics and residential segments tend to be assessed as more attractive than the office, retail and hotel segments across the Core, Core+, Value-Add and Opportunistic risk categories. The respondents see the best inflation protection in the Logistics Core, Logistics Core+, Residential Core and Residential Core+ categories. According to the experts' assessment, Retail Non-Food Value-Add, Retail Non-Food Core+, Hotel Leisure Value-Add remain the categories firmly established as niche products. More than 80% of the respondents rate these as 'Not very attractive' and none as 'Very attractive'. The remaining respondents rate them as 'Attractive'.

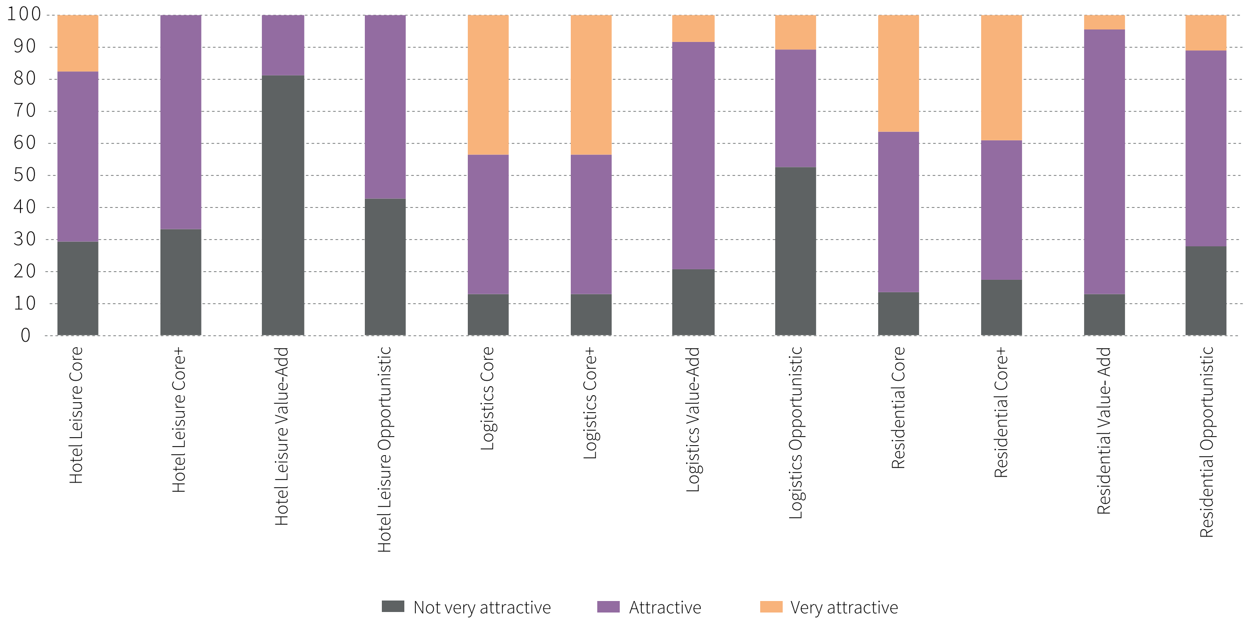
Within the risk categories for the real estate segments, the attractiveness generally decreases from Core to Opportunistic, although there are some exceptions where the Opportunistic risk category is at least assessed as more attractive than Value-Add. Examples are Hotel Business Opportunistic and Hotel Leisure Opportunistic. The former is even considered more attractive than the Core to Value-Add risk categories from the same real estate segment. It can be concluded that market participants in this segment currently prefer assets with the potential to be repositioned due to the high profit potential. This is also consistent with the results of our special question from the DIFI Report of the 1st quarter of 2021, in which market participants placed significantly greater emphasis on the third-party usability of properties compared to the pre-pandemic situation. We are currently observing that a high degree of third-party usability is crucial, particularly in the consideration of financing such countercyclical investment approaches.

The attractiveness of individual asset classes with a view to inflation development until the end of 2023

in Percent



in Percent



Source: JLL and ZEW

DIFI-Report: Results of Responses, 3rd Quarter 2021

	Improved	Δ Q2	Unchanged	Δ Q2	Deteriorated	Δ Q2	Aggregate	Δ Q2
German Real Estate Finance Index	20.7	(+ 1.7)	64.3	(+ 5.6)	15.1	(- 7.2)	5.6	(+ 8.9)
Financing situation	**Improved**	**Δ Q2**	**Unchanged**	**Δ Q2**	**Deteriorated**	**Δ Q2**	**Aggregate**	**Δ Q2**
Office	17.9	(+15.2)	71.4	(+ 3.0)	10.7	(-18.2)	7.2	(+33.4)
Retail	18.6	(+15.9)	44.4	(+ 6.6)	37.0	(-22.5)	-18.4	(+38.4)
Logistics	46.4	(+ 0.5)	53.6	(+ 2.2)	0.0	(- 2.7)	46.4	(+ 3.2)
Residential	18.5	(-15.8)	81.5	(+15.8)	0.0	(+/- 0.0)	18.5	(-15.8)
Hotel	12.0	(+12.0)	44.0	(+12.6)	44.0	(-24.6)	-32.0	(+36.6)
All real estate segments	22.7	(+ 5.6)	59.0	(+ 8.1)	18.3	(-13.6)	4.3	(+19.1)
Financing expectations	**Will improve**	**Δ Q2**	**Will not change**	**Δ Q2**	**Will deteriorate**	**Δ Q2**	**Aggregate**	**Δ Q2**
Office	7.4	(-13.6)	85.2	(+19.4)	7.4	(- 5.8)	0.0	(- 7.8)
Retail	19.2	(+ 0.3)	57.7	(- 1.8)	23.1	(+ 1.5)	-3.9	(- 1.2)
Logistics	22.2	(+ 0.6)	77.8	(+ 2.1)	0.0	(- 2.7)	22.2	(+ 3.3)
Residential	19.3	(+ 7.9)	76.9	(- 8.8)	3.8	(+ 0.9)	15.5	(+ 7.0)
Hotel	25.0	(- 6.4)	50.0	(+ 4.3)	25.0	(+ 2.1)	0.0	(- 8.5)
All real estate segments	18.6	(- 2.3)	69.5	(+ 3.0)	11.9	(- 0.8)	6.8	(- 1.4)
Situation in the refinancing markets	**Improved**	**Δ Q2**	**Unchanged**	**Δ Q2**	**Deteriorated**	**Δ Q2**	**Aggregate**	**Δ Q2**
Capital deposits	14.3	(- 9.8)	85.7	(+16.7)	0.0	(- 6.9)	14.3	(- 2.9)
Pfandbrief mortgage bonds	22.7	(- 9.6)	77.3	(+ 9.6)	0.0	(+/- 0.0)	22.7	(- 9.6)
Unsecured bonds	28.6	(+ 5.5)	61.9	(+ 4.2)	9.5	(- 9.7)	19.1	(+15.2)
Mortgage-backed securities	5.9	(- 6.6)	88.2	(+17.4)	5.9	(-10.8)	0.0	(+ 4.2)
Real estate stocks and shares	9.5	(-13.6)	81.0	(+11.8)	9.5	(+ 1.8)	0.0	(-15.4)
Expectations in the refinancing markets	**Will improve**	**Δ Q2**	**Will not change**	**Δ Q2**	**Will deteriorate**	**Δ Q2**	**Aggregate**	**Δ Q2**
Capital deposits	5.2	(+ 1.7)	89.5	(- 3.4)	5.3	(+ 1.7)	-0.1	(+/- 0.0)
Pfandbrief mortgage bonds	5.0	(- 1.7)	90.0	(- 3.3)	5.0	(+ 5.0)	0.0	(- 6.7)
Unsecured bonds	15.0	(+ 3.4)	75.0	(- 1.9)	10.0	(- 1.5)	5.0	(+ 4.9)
Mortgage-backed securities	5.5	(+ 5.5)	77.8	(-17.9)	16.7	(+12.4)	-11.2	(- 6.9)
Real estate stocks and shares	15.8	(- 4.2)	68.4	(- 3.6)	15.8	(+ 7.8)	0.0	(-12.0)
Spreads compared to German Government bonds	**Will increase**	**Δ Q2**	**Will not change**	**Δ Q2**	**Will reduce**	**Δ Q2**	**Aggregate**	**Δ Q2**
Pfandbrief mortgage bonds	25.0	(+ 9.9)	66.7	(-12.1)	8.3	(+ 2.2)	16.7	(+ 7.7)
Unsecured bank bonds	37.5	(- 6.2)	50.0	(+ 3.1)	12.5	(+ 3.1)	25.0	(- 9.3)
Development of segments	**Will increase**	**Δ Q2**	**Will not change**	**Δ Q2**	**Will reduce**	**Δ Q2**	**Aggregate**	**Δ Q2**
Syndication business (volume)	26.9	(-34.2)	65.4	(+29.3)	7.7	(+ 4.9)	19.2	(-39.1)
Underwriting (volume)	11.1	(-16.7)	74.1	(+13.0)	14.8	(+ 3.7)	-3.7	(-20.4)

Comment: The German Real Estate Finance Index survey was carried out between 26.07.2021 – 17.08.2021 and involved 29 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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