

# Economic Positions

## Germany's Housing Market: Market Developments and Macroprudential Measures

Berlin, 24 June 2019

### Summary

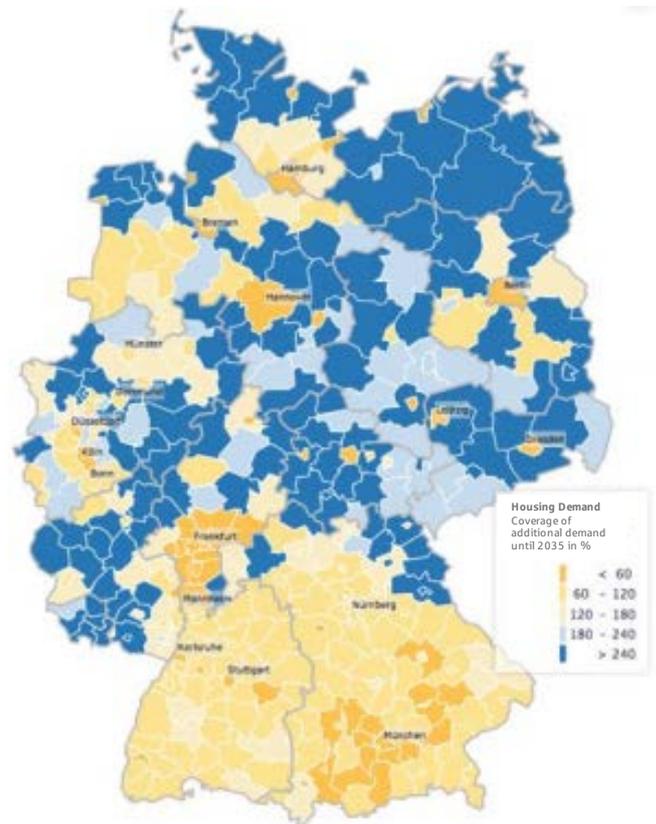
- Pressure on the housing market continues.
- No real-estate bubbles in sight.
- No action needs to be taken by macroprudential supervision, but it should remain vigilant.

### 1. Need for housing construction

The tense situation which has held sway in the German housing market since 2011/2012 has intensified in recent years, particularly in the largest cities, as well as in many university cities and in flourishing medium-sized cities. The housing supply is still unable to keep up with demand and, as a consequence, the larger and more popular cities, in particular, are recording considerable price and rent increases. The problem of affordable housing in conurbations is growing, especially for lower and middle income groups and it is increasingly becoming a "social issue". Many low-income households are already forced to spend between 40% and 50% of their income on housing.

Demand for housing has risen steadily in recent years due to internal migration to metropolitan areas, the influx of migrant and refugee workers and the increased usage of a growing number of single-person households. This development has also been reinforced by the low interest rate environment and the lack of investment alternatives, as well as the strong labour market and income development.

Diagram 1: Housing requirement prognosis 2035

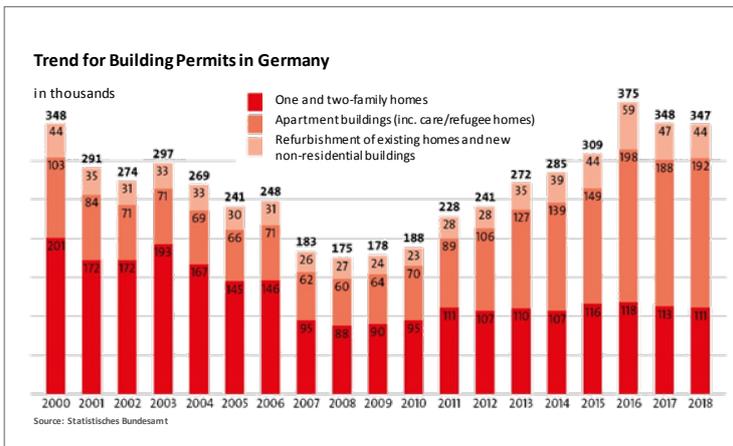


Source: bulwiengesa, 2018

In order to return to a balanced housing market, building experts estimate that around 350,000 to 400,000 new homes will have to be built annually over the coming years (taking into account the accumulated backlog). If this does not take place, less than 60% of housing demand will be met by 2035, particularly in the large cities and in southern Germany (see diagram 1).

Over the past few years, the number of building permits for new apartments, which are usually completed within 18 months, has increased much more dynamically than the number of building completions. However, after ten years of upward development, the number of building permits dropped in 2017 in comparison with the previous year by 7.3% or around 27,000 homes. In 2018, the number of approved properties was again 347,000, which is roughly at the same level (see diagram 2).

Diagram 2: Number of building permits in Germany 2000 – 2018



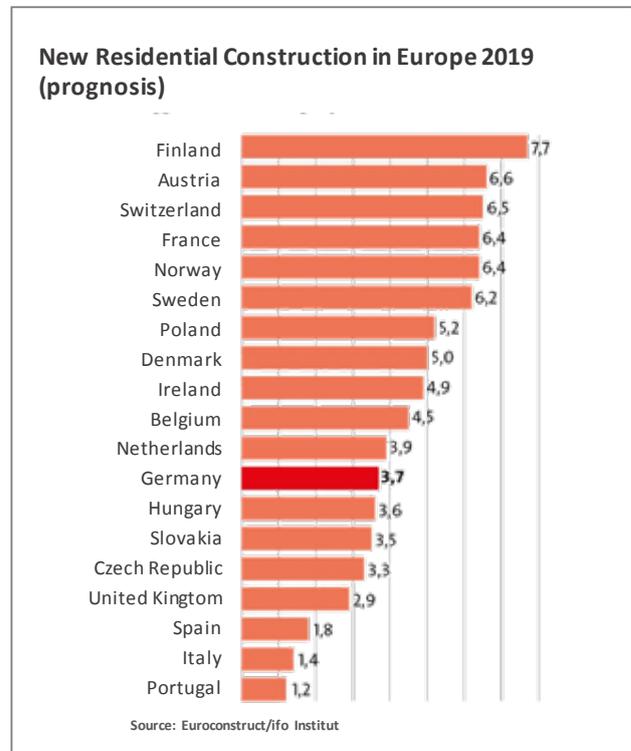
The figures for building permits, which are the most important indicator of future housing completions, clearly show that the momentum in housing construction has slowed. In many cases, this is due to insufficient building land, as well as insufficient planning and approval capacity within the building authorities and capacity constraints in construction. Whether this can be referred to as a trend reversal remains questionable.

## 2. Housing completions

Of greater relevance for the housing market is the number of completed apartments, which can be seen from the completion figures. These totaled around 285,000 apartments in 2018 and include the renovation of existing buildings and newly constructed non-residential buildings, which is 2.6% higher than in 2016. Building experts at the Ifo Institute estimate housing completion rates for 2018 to be around 300,000, which still falls short of the new annual construction requirement of 350,000 to 400,000.

An EU comparison also indicates that Germany still has plenty of room for improvement in terms of completion rates, and that there is a substantial backlog. According to estimates by the Ifo Institute, Germany's housing construction activity is in the lower middle range, with 3.3 apartments per 1,000 inhabitants. In the Nordic countries of Sweden, Finland and Norway, the rate is in some instances over 7; the neighboring countries of Switzerland, France and Austria are also building more housing with quotas of around 6 (see diagram 3).

Diagram 3: An international comparison of housing completion per 1,000 inhabitants



### 3. Construction backlog

At the same time, the gap between housing permits and completions has created a construction backlog. This backlog has increased from year to year and now stands at around 650,000 apartments. The main reasons for this are the increasingly time-consuming construction projects, as well as capacity constraints in the construction industry which are steadily increasing due to the on-going construction boom and the growing shortage of skilled workers. Furthermore, in some cases, the implementation of already approved construction projects has been deliberately delayed in anticipation of even better prices and marketing conditions (speculation).

### 4. Price developments in residential properties

Purchase prices for apartments in Germany as a whole also increased by more than 5% in 2018. Therefore, the price increases are below those of the previous years, but still noticeably above general inflation. Demand for apartments is growing more slowly than it did a short while ago, as immigration from abroad has receded. At the same time, the supply of apartments is increasing faster than has hitherto been the case. There are some indications that development in the housing market will soon reach a more balanced level, resulting in reduced pressure on rents.

### 5. Purchase of residential property becoming increasingly difficult

Not only the lack of building land, but also the extremely low capital market interest rates are currently driving up prices in new construction. Investors from all over the world have "discovered" the real estate market in Germany, which is considered to be particularly secure. The result is a sharp rise in real estate prices, especially in apartments purchased in conurbations as capital investments. It is becoming increasingly difficult for private builders and buyers who wish to live in the houses or flats rather than rent them out. Generally speaking, the equity necessary for acquisitions is not increasing sufficiently to meet the sharply rising real estate prices. In addition to this, incidental acquisition costs have also increased proportionally. These also have to be covered by existing financial assets, in particular the property transfer tax. The result is that, despite the strong labour market situation, rising incomes and historically low interest rates, fewer and fewer young households can afford to buy residential property. According to calculations by empirica, the potential for first-time homeowners or new homeowners has been declining since 2007.

### 6. No real-estate bubbles in sight

The Bundesbank recently confirmed in its monthly report of February 2019 that no threat of real-estate bubbles is currently anticipated in the residential real estate market. Based on the purchase price/annual rent ratio for city apartments, analysts are registering price inflation of 20%, and 30% in the "Top 7 cities" of Berlin, Dusseldorf, Hamburg, Frankfurt am Main, Cologne, Munich and Stuttgart. However, price dynamics from a macroeconomic perspective are largely in line with developments in supply and demand. From the viewpoint of the Savings Banks Finance Group, it is also difficult to draw generalised conclusions about the overall housing market situation from the "city freehold apartment" segment, which is strongly influenced by capital investors.

The Bundesbank's Financial Stability Report published in November 2018 concludes that the price trend in the real estate markets currently poses no risk to financial stability. For this reason, supervision sees no urgent need to use macroprudential instruments specifically in the residential real estate market.

This is logical, as there are no worrying developments in lending: the financing structures for residential construction are sound, credit institutions have not lowered their standards for creditworthiness and still expect equity of 20-25%. The volume of new residential mortgage loans continues to develop discreetly. The share of housing loans with a fixed interest rate of more than 10 years has continued to increase, so irrespective of the future development of housing prices, the macroprudential risks are manageable. Therefore, supervision must remain vigilant, but at the moment it does not need to take any action.

### 7. Political measures

Due to the urgent need for affordable housing, a "joint housing offensive" was agreed on 21 September 2018 during the housing summit between the federal government, the federal states and the municipalities. One of the major goals is the creation of new housing space. This is welcomed, as it is clear that without increasing the supply, the rising prices and rental costs in the housing market cannot be effectively curbed. The fact that all segments benefit - social housing construction, privately financed rental construction (new special depreciation of 5% over four years in addition to linear depreciation) as well as owner-occupied housing (construction child allowance for first-time buyer families) - is due to the respective focus areas of the parties in the grand coalition.



In addition, the two main obstacles to more new construction are to be addressed: these are on the one hand, the lack of construction land, which is fast becoming the major bottleneck factor and price driver and, on the other hand, the lack of equity, which is increasingly becoming a problem, especially for private builders and buyers. An expert commission on the mobilisation of sustainable building land and land policy is to develop new approaches to mobilise building land. Of particular importance, especially for the Federal Republic of Germany with its low homeownership quota, is the active promotion of home ownership since September 2018. The construction child allowance not only promotes the construction of new buildings, but also the purchase of existing housing, which is equally suitable for private wealth and retirement provision. In addition to this, the housing premium for building society savings is to be improved in order to strengthen owner occupation of residential property, in particular by stimulating a more intensive and early accumulation of equity capital. A KfW guarantee programme is also planned for buyers with limited equity.

Further measures include building cost reduction (further development of building regulations, serial and modular construction etc.) as well as securing skilled workers in the construction sector. Moreover, in order to ensure the affordability of housing, tightening of the tenancy law, restrictions in modernisation allocation and reforms in housing allowance are planned in order to provide support for the housing costs of low-income households.

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