

Focus on German Housing Market

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- Prices of German residential properties have been rising for about seven years. An end to the uptrend is not apparent. Prices are being driven by fundamental factors, as well as by low interest rates and a lack of investment alternatives (p. 2).
- Demand for residential properties remains high. The strong internal migration to the growth centres contributes to this trend, but so does the continued high rate of immigration (p. 3).
- Construction activity is responding to the shortage of living space, but much too slowly. Important obstacles are being created by government action (p. 4).

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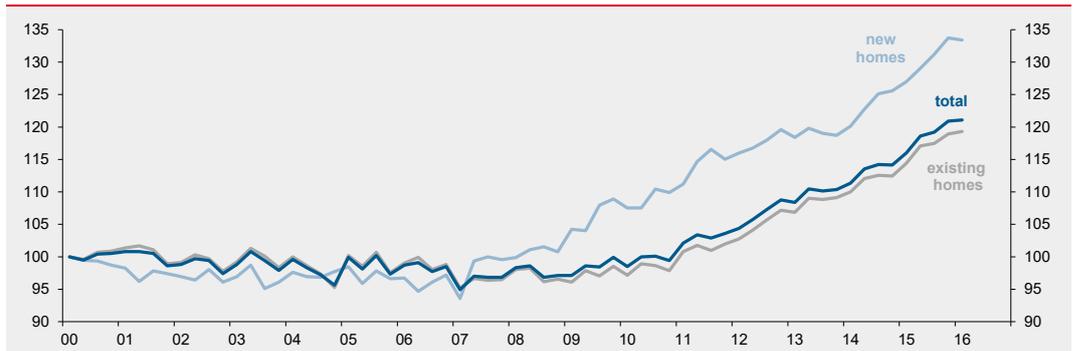
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1 At a glance

They rise, and rise, and rise...

Price index for German residential properties, rebased 2000 = 100



Sources: Statistisches Bundesamt, Helaba Research

After being in a slump for many years, German housing prices came alive around 2010. This is confirmed by the official statistics, but also by a number of other indicators. The annual rise of up to 5 % in terms of the national average continues to date, whereby the dynamic is – unsurprisingly – more pronounced for new construction than for the existing stock. Internationally this certainly does not put Germany at the top. In Sweden, for example, the inflation of housing prices is much greater. The national average values should not blind one to the fact that the price increase in Germany's large conurbations is in some cases twice as high.

This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data are based on sources that we consider reliable, though we cannot assume any responsibility for the sources being accurate, complete, and up-to-date. All statements in this publication are for informational purposes. They must not be taken as an offer or recommendation for investment decisions.

2 Selected real estate analyses

2.1 Upswing, overheating, or bubble?

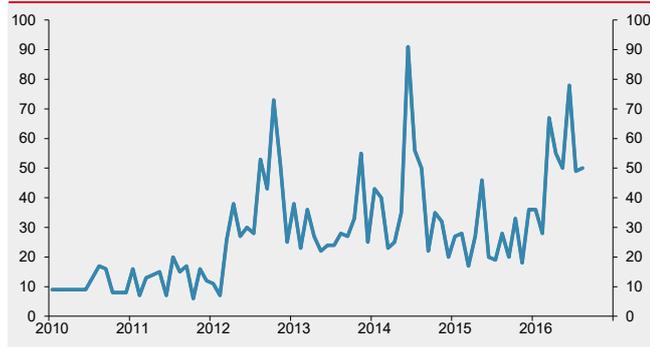
Prices for German residential properties have been rising for years, and an end to the uptrend is not apparent. Is this still a “normal” upswing, or is the next bubble growing here?

The German housing market, too, is cyclical

Shortly after prices for German residential properties had finally started to gain momentum in 2010, the question arose whether a real estate bubble was in the making. The very serious things that happened in many foreign housing markets before and during the most recent financial crisis have evidently become deeply engraved in the awareness of market participants. But while housing prices in the US, Great Britain, Spain, and Ireland exploded in the period leading up to the financial crisis, little happened in Germany. And so a lot of observers like to point out that a considerable backlog had developed with German housing prices. This argument fails to take into account that developments in the foreign markets in question were primarily credit-driven excesses, and not fundamentally justified. And the thesis that the German market is by its very nature less cyclical must also be consigned to the realm of myth. It is true that what is, by international standards, a quite conservative financing practice makes this market fundamentally less susceptible to the formation of a bubble. However, if one looks further back into the past, the German housing market is anything but dull: from the end of the 1980s until the middle of the 1990s, the market recorded average price increases of nearly 50 %.

Real estate bubble: a much-discussed topic

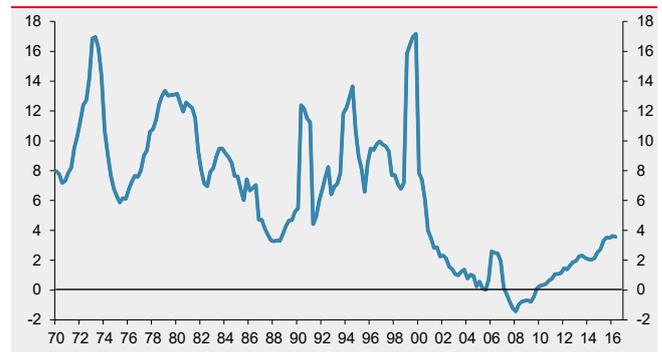
„Immobilienblase Deutschland“ (“Real estate bubble Germany”), search interest in Google Trends*



*relative to the highest value = 100
Sources: Google Trends, Helaba Research

Home financing: not critical

Loans for residential construction in Germany*, % yoy



*Loans to domestic companies and private persons
Sources: Deutsche Bundesbank, Helaba Research

Overheating in some sub-markets, but no bubble yet

In contrast to the reunification boom and to the development of many foreign housing markets, the current rise in prices in Germany can be explained to a large extent by the trend in supply and demand (see pp. 3-4). Little should change in this regard looking ahead to next year, and the same is true of the extreme low interest-rate environment as another driver of rising housing prices. The German housing market will thus remain in a boom phase. While one cannot yet speak of a general overheating for the nation as a whole, given the drifting apart of supply and demand, such a situation is likely to have occurred by now in the sought-after sub-locations of the large conurbations – something the German Bundesbank has noted for some time. However, what is missing in Germany as a constitutive element of a real estate bubble is very expansionary lending. Thus, the stock of housing construction loans is only 4 % above the previous year’s level – a rather unremarkable finding from a long-term perspective and by international standards. However, because of the persistent rise in prices (which may continue for a few years more), the housing market becomes more susceptible to correction. What we may therefore see sooner or later is not the bursting of a bubble with a price collapse. More likely is a “conventional” correction, perhaps once again with years of slightly declining or stagnating prices, just as we saw after the reunification boom.

2.2 Demand pressure in the housing market remains high

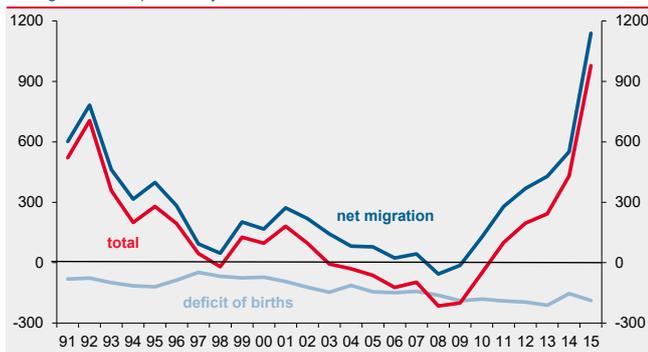
The demand for residential properties continues to grow. Strong internal migration into the growth centres and a persistent high rate of immigration contribute to this trend. Whether the trend of people moving into the big cities will continue is doubtful, given the high real estate prices.

High immigration increases pressure on the housing market

The population trend is a cause of surprises time and again. Did we not just get used to the idea that the population in Germany is declining long-term because of the high birth deficit? The turnaround came when immigration suddenly surged because of the financial crisis – two years with a negative “net foreign balance” were followed in 2010 by a net immigration of nearly 130,000. The higher influx of workers, especially from the problem countries at the European periphery and from Eastern Europe, was joined last year by the stream of refugees – with the result that net immigration, at more than 1.1 million, was higher even than it was in the early 1990s. To be sure, the number of asylum-seekers in 2016 should remain far below the peak in the previous year. However, since the problems in the most important countries of origin have in no way been resolved, the migration pressure into Europe remains high – mostly with Germany as the final destination. Net immigration will therefore remain at a high level and thus create additional demand for housing. Moreover, many asylum-seekers enter the “normal” housing market only after their status has been recognized, where they then look for cost-effective living space, which is already in short supply.

Immigration spurs demand for housing

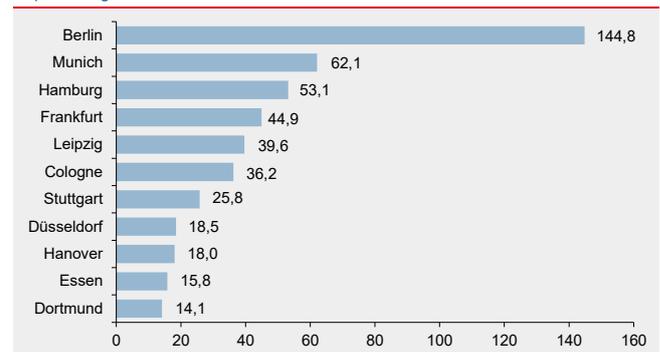
Change from the previous year in '000s



Sources: Statistisches Bundesamt, Helaba Research

Robust population growth in the large cities

Population growth 2013-2015, in '000s



Sources: Statistical offices of the federal states, Helaba Research

Most immigrants head for Germany’s dynamic growth centres. In addition, for years there has been a pronounced internal migration into these conurbations due to their above-average job opportunities. For example, last year the population grew by around 50,000 in Berlin, by nearly 25,000 in Hamburg, and by around 15,000 in Frankfurt. The higher housing construction activity cannot cope with this influx – for the reason alone that there is a limited availability of building land. The result is growing shortages in the urban housing market and a strong rise in purchase prices and rents. However, this trend will presumably not continue indefinitely.

Into the big cities – for how much longer?

One can therefore assume that a growing number of those looking for housing can no longer manage or are unwilling to accept the high prices. Many of those willing to move will therefore be forced to search out the more affordable outlying areas or will prefer smaller cities to the metropolises. Alternatively, they can accept the high cost of living in the centres and accept smaller living spaces. Smaller cities – e.g., universities towns – have already become more attractive. This presupposes an adequate supply of affordable residential real estate, as well as a functioning traffic infrastructure to limit potential commuting times. As it is, transportation costs and transportation times become relative for those who use telecommuting (at least on certain days) today or in the future. In many cases it would make more sense for housing and regional policies to orient their activities more strongly toward the relationship between the city and its surrounding regions, rather than trying to solve the problems only in the centres.

2.3 Housing construction activity remains inadequate

Housing construction has been growing in Germany for years. However, the number of new housing units coming onto the market is still far too small to satisfy the growing demand. Although politicians are discussing the problem, they do not (always) find the right solutions.

Permits suggest higher construction activity

Construction activity in Germany has expanded noticeably since the low in 2009 and 2010 of just under 160,000 housing completions. With 247,000 units last year, growth has been palpable. Still, the result in 2015 was disappointing: in spite of the strained situation in more and more regional housing markets, the increase in completions was only 1 % above the previous year's level. The plus of 1.4 % in housing construction investment was offset by a decline of the same magnitude in non-residential construction. However, the most recently very positive trend in construction permits points to more dynamism for 2016. Thus, in the first half of the year about 30 % more housing permits were issued than during the same time the previous year. Although not every permit leads invariably to construction activity, against the backdrop of what is by now a considerable backlog, we can expect a clear rise also in completions. However, the level of 300,000 will presumably be crossed only next year, the first time since 2001. With an estimated demand of 300,000 to 400,000 housing units annually, the strained situation in the German housing market will persist for some time. There are strong regional differences. Our analysis confirms that construction activity on a regional level is strong correlated with the population trend.

Only housing construction is humming along

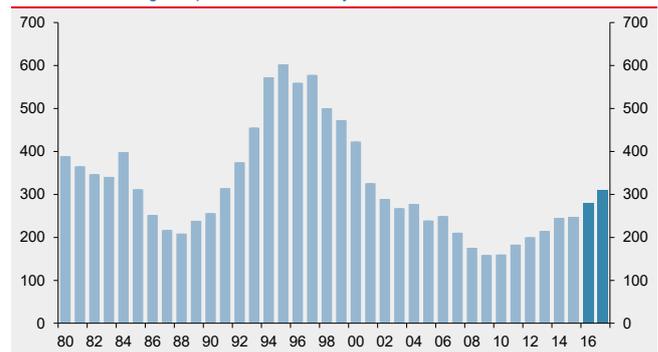
Real construction investment, Q1 2010 = 100



Sources: Macrobond, Helaba Research

Completions heading toward 300,000

Number of housing completions in Germany*, in 1,000 units



*until 1992 West Germany

Sources: Statistisches Bundesamt, Helaba Research

State intervention often counter-productive

The background conditions for housing construction are actually favourable at this time, thanks to a good income and employment situation and very low mortgage interest rates, which make residential property affordable for many interested buyers in spite of the elevated housing prices. Why, then, is there not enough construction? It would surely be a gross simplification to blame merely a mistaken housing policy for the inadequate housing construction activity. Overall, however, we posit that state intervention in recent years has thwarted housing construction. Measures like the increased funding for social housing schemes, because of the modest volume, are hardly suited to achieve a greater effect. The planned special write-off for the new construction of rental units has failed, at least for the time being. A counter-productive effect is coming from the rising cost of construction through ever higher environmental standards and the continuous increase in property and land transfer tax. The new rental cap ("Mietpreisbremse") is ineffective, at best, and at the latest after the further tightening that is currently being discussed, it should prove to be a brake on investment. Moreover, the especially restrictive translation of the EU housing credit guideline into German law threatens to turn into a boomerang if it is not amended. By contrast, much too little space is given in the discussion to proposals to zone additional building land or to create affordable housing. ■