Germany

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IN A NUTSHELL

→ German economy experienced continuing strong growth in 2017 and the employment situation has further improved.

→ The economic background of growing wages, higher employment and favourable financing conditions maintains investments in housing attractive for private households.

→ Gross residential lending, and especially the volume of mortgage loans outstanding, follows a steady upward trend.

→ Due to house prices increasing more than disposable household incomes, debt to income ratio and the share of borrowed funds rose slightly for the last two years.

→ Borrowers and lenders continue to put safety first when financing residential property: arranging longer term interest rate fixation periods, locking favourable loan conditions and agreeing higher initial amortization rates which ultimately leads to a slightly decreasing loan maturity.

MACROECONOMIC OVERVIEW

In 2017, economic growth exceeded again initial expectations. The Gross Domestic Product (GDP) grew in real terms by +2.2% y-o-y (after +1.9% in the previous year). The unemployment rate was reduced further reaching 3.8% while employment recorded another marked increase. Consumer price inflation reached 1.7% approaching the target of 2%, and public finances are in extremely good shape.

The buoyant economic situation also supports the labour market. Therefore, employment in Germany has increased steadily for years: job creation is still recording growth while unemployment is on a continuous downward path. The unemployment rate reached 3.8% in 2017 (2016: 4.1%). Consumer price inflation, which in 2016 was very low at 0.5%, picked up pace appreciably in 2017, and was ultimately up by 1.7% on average for the year.

Moreover, there is considerable consensus on the fact that not only the current situation is positive but also the prospects for the coming years. The German Council of Economic Experts, the Deutsche Bundesbank and the leading economic research institutes are forecasting that the rise in real GDP will continue in 2018 and 2019, although it could lose some of its momentum over time.

The combined factors of growing wages, higher employment, favourable financing conditions and the positive sentiment among private households will sustain investment in housing attractive.

HOUSING AND MORTGAGE MARKETS

HOUSING MARKETS

Residential properties located in Germany went up sharply in price in 2017. The vdp property price index for single family houses rose by 5.5% and for condominiums by 6.8% on average for the year. Yet, even more striking than the nationwide figures are the index values for Germany's largest cities (Berlin, Hamburg and Munich). Prices for owner-occupied housing (condominiums and single-family houses) in these locations increased by 12.4% compared with the previous year. Like the movement in prices, the upward trend in residential construction has intensified continuously too since 2010. In 2017, 285,000 dwelling units were built: the highest result since 2002. This growth was accompanied by structural shifts between single- and two-family houses and multi-family houses. Last year, more than 60% of newly constructed dwellings were accounted for by multi-story buildings. The last time a similar distribution was recorded was in the mid-1990s. The figure of 285,000 dwellings will probably be exceeded in 2018. Although recently building permits were down slightly, a substantial number of dwellings not yet started or already under construction means that more than 300,000 completed dwellings can be expected in 2018. Once again, the new construction of multi-family houses will outstrip that of single-family houses. This is mainly attributable to the sustained demand for housing in the economically vibrant conurbations and the larger urban regions, where multi-family houses typically predominate. Particularly in the prosperous urban concentrations, where home-seeking is a time-consuming and nerve-wracking activity, even more new dwellings are needed in the short term. However, this potential is limited by the high level of capacity utilization that the construction sector is already experiencing (as reflected in the growing number of dwellings not yet started or already under construction) and by a shortage of building plots.

In contrast to the new construction of residential properties, sales figures for existing residential real estate have stagnated for many years. All in all, 564,000 single- and two-family houses, multi-family houses and condominiums changed owners in 2017. Compared with the previous year, the number of transactions decreased by 2.9%. By contrast, the sales volume associated with these transactions rose once again (+2.4% y-o-y). This was due to the aforementioned strong increase in prices, as a result of which purchase amounts rose accordingly.

MORTGAGE MARKETS

The growth of construction and monetary turnover associated with transaction activities on the residential property market has been accompanied by increasing residential mortgage lending for several years. In 2017, gross residential lending rose again and amounted to EUR 214.3 bn. The volume of residential loans outstanding summed up to EUR 1,379 bn, which corresponded to an increase of +3.9% on 2016.

Growth in residential property finance reflects a high demand for houses and apartments. The underlying conditions for home-buying continued to be favourable in recent years and are attributable, not least, to a consistently positive macroeconomic momentum since 2010. As mentioned above, the positive labour market situation leads to sustained positive households' income expectations. In addition, financing conditions become more and more favourable. The interest rate (effective interest rate, average across all interest rate fixation periods) for loans for house purchase fell – with short interruptions – from 4.5% at the beginning of 2009 to 1.8% in mid-2015. Since then, interest rates for loans for house purchase have ranged between 1.6% and 2.0%. From 2009 onward, the year in which the financial crisis struck, housing prices in

Germany have climbed continuously. And up until 2014, this trend was accompanied by an almost equally strong increase in household disposable income. Over this period, average growth in both cases came to around 2% p.a. However, residential property prices have surged at a clearly stronger pace than before over the last three years. Between mid-2014 and mid-2017, housing prices climbed by roughly 5% p.a. – much faster than household incomes, which experienced growth of 3% p.a.

Up to 2015, the effect on financing structures was low, as financing conditions were becoming more and more favourable at the same time. As a result, the affordability for homebuyers remained constant as credit burden did not increase in relation to disposable incomes. The situation proved to be different in 2017, however: the gap between the trend in housing prices and incomes has widened further since 2015. Interest rates have been moving sideways since 2015 and so no longer offset the rise in property prices. So residential property price growth, which has gained increasingly in momentum over the last years and is today considerably stronger than growth in household disposable incomes, is impacting on the financing structure as well.

The average share of borrowed funds employed to buy property has edged up to 78%, and the burden as a result of the loans in relation to disposable income has likewise risen to 25%, although the debt burden ratio is low when viewed from a long-term perspective. The fact that borrowers and lenders alike continue to put safety first in questions of residential property finance is borne out in particular by the fact that they again agreed on longer interest rate fixation periods (14 years on average) and higher initial amortization rates (3.2% on average). This means, on the one hand, that homebuyers are locking in the favourable loan conditions over a long period of time and, on the other, that the average maturity of the loans is decreasing slightly.

The Act Supplementing Financial Supervision Legislation (Finanzaufsichtsrechtergänzungsgesetz), adopted in 2017, has conferred additional powers on Federal Financial Supervisory Authority (BaFin) to allow it to better counter risks to financial stability resulting from real estate financing. The new legislation enables the Federal Financial Supervisory Authority to govern new mortgage lending business in a more targeted fashion by capping, if necessary, mortgage financing for property purchases. It can also impose requirements governing the repayment of loans and hence stipulate the minimum amount of a loan that has to be repaid within a specified period (amortisation requirement).

MORTGAGE FUNDING

In Germany, the main funding instruments on the banking side for housing loans are savings deposits and mortgage bonds (Pfandbriefe). Germany has one of the largest covered bond markets in Europe, representing a significant share of the total market. The market sub-sector for mortgage-backed covered bonds is also strong in Germany and in the total EU market.

In the year under review, Pfandbriefe totalling EUR 49 bn were brought to the market (in 2016 the figure was EUR 45 bn). Mortgage Pfandbriefe sales accounted for EUR 37 bn (EUR 35 bn in 2016), and Public Pfandbriefe worth EUR 12 bn were sold (10 in 2016).

As repayments exceeded new sales, the outstanding volume of Pfandbriefe decreased to EUR 366 bn in 2017 (from EUR 374 bn in 2016). Whereas the volume outstanding of Mortgage Pfandbriefe increased from EUR 207 bn in 2016 to EUR 215 bn in 2017, Public Pfandbriefe experienced a further decline from EUR 162 bn to EUR 148 bn. In 2017, Ship and Aircraft Pfandbriefe accounted for EUR 3 bn (EUR 5 bn in 2016).

	GERMANY 2016	GERMANY 2017	EU 28 2017
Real GDP growth (%) (1)	1.9	2.2	2.4
Unemployment Rate (LSF), annual average (%) (1)	4.1	3.8	7.6
HICP inflation (%) (1)	0.4	1.7	1.7
Outstanding Residential Loans (mn EUR) (2)	1,326,901	1,378,810	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	19,272	19,968	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	67.3	67.3	73.8*
Gross residential lending, annual growth (%) (2)	0.4	2.3	3.5
Typical mortgage rate, annual average (%) (2)	1.8	1.8	2.4**
Owner occupation rate (%) (1)	51.7	n/a	66.4*
Nominal house price growth (%) (2)	6.0	5.8	6.0

* The aggregate EU figure is from 2016.
** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

GERMANY FACT TABLE

Entities which can issue mortgage loans:	MFI's and Life Insurers
The market share of the mortgage issuances:	MFI's: 96% Life Insurers: 4%
Proportion of outstanding mortgage loans of the mortgage issuances:	MFI's: 96% Life Insurers: 4%
Typical LTV ratio on residential mortgage loans:	78% (average for purchase of existing single family houses)
Any distinction made between residential and non-residential loans:	Type of use (buildings with different types of use: predominant use)
Most common mortgage product(s):	Mortgage loans with fixed interest rates for about 10-15 years
Typical maturity of a mortgage:	About 25 years
Most common way to fund mortgage lending:	Deposits, mortgage covered bonds, other bank bonds
Level of costs associated with a house purchase:	Transaction costs vary by federal state because of different land transfer tax rates and if a real estate agent is involved or not. Overall, transaction costs can vary between 5% and 15% of the house price.
The level (if any) of government subsidies for house purchases:	Families who want to buy a house or a condominium for their own use will benefit from subsidies in future. The Government plans to introduce a grant scheme to support families building or purchasing homes for their own use. With the so called "Baukindergeld" the state promotes families with EUR 12,000 per child. The necessary law should come before the summer break. The program follows the Home Ownership Allowance, with which the State supported the creation of home ownership between 1995 and 2005. Besides that, the German states (Bundesländer) support home ownership within the scope of publicly assisted housing. Depending on the policy and cash balance of each State, several programmes are offered. The KfW Förderbank (KfW promotional bank) offers promotional programmes for housing construction or modernisation and for first-time buyers.