

Germany

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IN A NUTSHELL

- Gross domestic product rose by 2.9%, less than originally expected.
- Stable household incomes and favourable financing conditions, made investment in housing attractive for private households.
- Gross residential lending and the volume of loans outstanding increased further.
- Significantly higher mortgage interest rates in 2022 make housing less affordable and are likely to reduce demand for new residential loans.

MACROECONOMIC OVERVIEW

The effects of the pandemic influenced the economy in 2021, so the recovery was more muted than expected. Economic growth slowed in Q4 and Q1 2022 because of renewed intensification of pandemic-related protective measures to contain new virus variants and the associated supply bottlenecks. Real gross domestic product (GDP) in Germany grew by 2.9%, it is still below the pre-pandemic level despite a strong recovery in the summer.

Overall, the labour market recovered quite well from the pandemic-related impairments. Although the unemployment rate increased from 3.2% to 3.8% during 2020, it recovered in the course of 2021, standing at 3.6% on average for the whole year. The number of people in employment again increased slightly to around 45.1 mn (+0.6%).

Supply chain problems, rising energy prices and special factors such as the temporary reduction in VAT in 2020 meant that inflation reached a record high (since 1992) in the second half of the year and became the number one economic issue. Consumer price pressures have become increasingly entrenched over the course of 2022, causing a turnaround in monetary policy and changing capital market conditions, which are reflected in significantly higher interest rates for mortgage loans.

HOUSING MARKET

Prices of residential properties increased also in 2021. The vdp property price index for single family houses rose by 11.2% and for condominiums by 11.7%. The index for owner occupied housing, which is based on these two indices, increased by 11.3% overall and in the 7 largest cities (Berlin, Hamburg, Munich, Cologne, Frankfurt a.M., Stuttgart and Düsseldorf) by 9.8%.

Demand for housing continues to outstrip supply in many cities and regions, and in many places the pandemic may have caused demand for housing to rise further. In addition, the population has risen steadily over the past ten years, partly due to immigration. At the same time, the average number of persons per household is shrinking and per capita living space is increasing. Higher energy efficiency requirements, complex regulations for new buildings, and

the subsidy to support families building or purchasing homes that expired in March 2021 are likely to have additionally driven prices. Due to ongoing capacity bottlenecks in the construction industry, lengthy planning and approval procedures, and scarce building land, excess demand remains. Accordingly, construction services and building land, and consequently real estate, are becoming more expensive.

Construction has been affected by material shortages and sharply increased prices, particularly for steel and wood. In addition, the cold weather in January and February and the withdrawal of the VAT cut initially had a negative impact on production. In 2021, 293,000 dwellings were completed in Germany, 4.2% or 13,000 less than in the previous year. Completions of both single-family houses and multi-family residential buildings decreased compared to the previous year. In contrast, building permits have continued to rise. At 381,000, the number of building permits rose by 3.3% and was still significantly higher than building completions. This has resulted in a surplus of approved but not yet completed dwellings of 846,000.

The number of transactions of existing properties remained almost unchanged. In total, 600,000 single- and two-family houses, multi-family houses and condominiums changed owners in 2021, just as many as in the year 2020. The turnover in money terms rose due to increasing prices.

The continued increase in the demand for residential properties despite the severe crisis was due not least to the stabilisation of household incomes as a result of government measures. The high savings that many households built up during this period are likely to have additionally boosted demand. In addition, the labour market has recently recovered well and favourable interest rates continued to keep owner-occupied housing, which is growing in importance for retirement provision, attractive.

MORTGAGE MARKET

The strong demand for residential real estate was reflected in lending. In 2021, gross residential lending rose to EUR 299.6 bn (+11.1% y-o-y) and the volume of loans outstanding rose to EUR 1.74 tn, an increase of +7.1%.

In 2021, the Association of German Pfandbrief Banks conducted a new survey on the structure of residential property financing among its member banks¹ following up on surveys that have been conducted for many years. It shows that house prices have risen faster than net household incomes since 2015. As interest rates for housing loans have declined over a long period, home ownership has remained affordable for broad groups of the population. Nevertheless, since 2019 price increases have no longer been offset by more favourable financing conditions, making it increasingly difficult for first time buyers to form home ownership.

The study also showed that borrowers and banks continued to put safety first. The total maturity of the loans remained the same. The average LTV ratio in 2021 was 80%, the DSTI ratio 25%. This means that both indicators declined slightly compared with the previous study from 2019. Borrowers also increased the time period for fixed interest rates from an average of 10 to 14 years between 2009 and 2021.

¹ https://www.pfandbrief.de/site/dam/jcr:10611f1d-67f9-4d80-8086-506d1fca4270/vdp_Spotlight_Residential_Property_Finance_EN.pdf

Financing conditions were favourable in 2021. The interest rate (effective interest rate, averaged across all interest rate fixed periods) for loans for house purchases remained low, averaging 1.26%, mainly due to favourable refinancing conditions. The ECB's purchases of short- and long-term securities have significantly reduced capital market interest rates. Because of the recent sharp rise in consumer prices the ECB is tightening its monetary policy: scaling back securities purchases and increasing interest rates. This is already noticeably impacting financing conditions in spring 2022 - interest rates for mortgage loans have recently risen significantly and are currently at their highest level since 2014.

Due to long-term fixed interest rates and high amortisation, hardly any impact is expected on existing loans. In new lending, however, debt-financed purchases will become significantly more expensive. The affordability of home ownership will decline accordingly, and with it (loan) demand.

MORTGAGE FUNDING

In Germany, banks' main funding instrument for housing loans are savings deposits and covered bonds (Pfandbriefe).

Germany has one of the largest markets representing a significant share of the total covered bond market. Both segments, Mortgage Pfandbriefe and Public Sector Pfandbriefe, increased in volume outstanding as Pfandbriefe worth nearly EUR 65 bn were issued (2020: EUR 60 bn). At the same time, the primary market continued to be strongly affected by the pandemic and ECB measures. Thus, slightly less than half of the issued Pfandbriefe were retained and used as collateral for ECB liquidity at very favourable refinancing conditions.

2021 Mortgage Pfandbrief issuance was EUR 46 bn (EUR 41 bn in 2020), Public Sector Pfandbrief issuance was EUR 18 bn (2020: EUR 19 bn) and Ship Pfandbriefe accounted for EUR 0.6 bn. Therefore, the outstanding volume of Pfandbriefe increased to EUR 391 bn (EUR 372 bn in 2020). Outstanding Mortgage Pfandbriefe increased from EUR 246 bn to EUR 264 bn and Public Pfandbriefe increased slightly from EUR 123 bn to EUR 125 bn. The remainder is accounted for Ship Pfandbriefe (EUR 2.1 bn).

GREEN FUNDING

The first ESG (Environmental, Social and Governance) Pfandbrief issued in September 2014 (EUR 300 mn) pioneered a new sustainable covered bond market segment. Since then German Pfandbrief banks have been very active in both green and social lending and issuing Green and Social Pfandbriefe. Several Pfandbrief banks offer a discount on mortgage loans provided the building is energy efficient and fulfils certain requirements. In 2019, Pfandbrief issuers under the umbrella of the vdp published minimum standards for Green Pfandbriefe². They include requirements for the energy efficiency of financed buildings based on the definition developed within the Energy Efficient Mortgage Initiative of the ECBC. These were complemented in March 2021 by minimum standards for Social Pfandbriefe³.

The minimum standards take account of the initiatives under way at the EU regarding the taxonomy for sustainable economic activities and the introduction of the EU Green Bond Standard. Moreover, the minimum standards oblige Pfandbrief banks to provide a high degree of transparency. Issuers are required to establish their own Green or Social Bond Framework which must be based on the ICMA Green or Social Bond Principles.

At the end of 2021 the amount of outstanding Green and Social Pfandbriefe was EUR 9 bn by six issuers.

| | GERMANY 2020 | GERMANY 2021 | EU 27 2021 |
|--|-----------------|-----------------|---------------|
| MACROECONOMIC VARIABLES | | | |
| Real GDP growth (%) (1) | -4.6 | 2.9 | 5.4 |
| Unemployment Rate (LSF), annual average (%) (1) | 3.8 | 3.6 | 7.0 |
| HICP inflation (%) (1) | 0.4 | 3.2 | 3.0 |
| HOUSING MARKET | | | |
| Owner occupation rate (%) (1) | 50.5 | 49.5 | 70.0 |
| Gross Fixed Investment in Housing (annual change)(1) | 3.4 | 0.7 | 6.6 |
| Building Permits (2015=100) (2) | 117.6 | 121.5 | 134.0 |
| House Price Index – country (2015=100) (2) | 138.5 | 154.1 | 145.2* |
| House Price Index – aggregate seven largest cities*** (2015=100) (2) | 144.1 | 158.2 | 146.1* |
| Nominal house price growth (%) (2) | 7.4 | 11.3 | 10.3* |
| MORTGAGE MARKET | | | |
| Outstanding Residential Loans (mn EUR) (2) | 1,629,423 | 1,744,433 | 6,508,621 |
| Outstanding Residential Loans per capita over 18 (EUR) (2) | 23,449 | 25,132 | 17,782 |
| Outstanding Residential Loans to disposable income ratio (%) (2) | 75.1 | 78.7 | 62.8* |
| Gross residential lending, annual growth (%) (2) | 10.1 | 11.1 | 12.2 |
| Typical mortgage rate, annual average (%) (2) | 1.3 | 1.3 | 2.0 |

* Please note that this value is the simple average of the available values in 2021.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2022, Statistical Tables.

² https://www.pfandbrief.de/site/en/vdp/sustainable_finance0/sustainable_pfandbrief/green-pfandbrief.html

³ https://www.pfandbrief.de/site/en/vdp/sustainable_finance0/sustainable_pfandbrief/social_Pfandbriefe.html



GERMANY FACT TABLE

| | |
|---|--|
| Which entities can issue mortgage loans in your country? | MFI's and Life Insurers |
| What is the market share of new mortgage issuances between these entities? | MFI's: 96% Life Insurers: 4% |
| Which entities hold what proportion of outstanding mortgage loans in your country? | MFI's: 96% Life Insurers: 4% |
| What is the typical LTV ratio on residential mortgage loans in your country? | 80% (average for purchase of owner occupied residential properties) |
| How is the distinction made between loans for residential and non-residential purposes in your country? | Type of use (buildings with different types of use: predominant use) |
| What is/are the most common mortgage product(s) in your country? | Mortgage loans with fixed interest rates for about 10-15 years |
| What is the typical/average maturity for a mortgage in your country? | About 25 years |
| What is/are the most common ways to fund mortgage lending in your country? | Deposits, mortgage covered bonds, other bank bonds |
| What is the level of costs associated with house purchase in your country (taxes and other transaction costs)? | 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. |

What is the level (if any) of government subsidies for house purchases in your country?

In 2018 a grant scheme to support families building or purchasing homes for their own use has been introduced. With the so called "Baukindergeld" the government promotes families with children who want to buy a house or a condominium for their own use with EUR 12,000 per child, paid out in 10 annual instalments of EUR 1,200 each.

In order to receive the promotion, certain conditions must be met:

- There are children under the age of 18 living in the household,
- The household income is a maximum of EUR 90,000 per year for one child plus EUR 15,000 for each additional child,
- The purchase contract or the building permit has been signed or received between 01.01.2018 and 31.03.2021,
- The new home is the only residential property on the cut-off date.

The program follows the Home Ownership Allowance, with which the government 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.