

Germany

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IN A NUTSHELL

- Gross domestic product fell by 0.3%.
- High mortgage rates made housing less affordable; gross lending fell to EUR 196.3 bn (-28.2% y-o-y).
- Price decline of 4.1% for owner-occupied residential property.
- Continuous increase in new contract rents due to restrained construction activity.

MACROECONOMIC OVERVIEW

The economy contracted by 0.3%. Despite the recovery of the global economy, demand for German exports declined, particularly for energy-intensive goods, which are experiencing pressure from international price competition. Major setbacks in the construction sector, which accounts for about 12% of GDP, have had a negative impact on GDP, as the financial environment is significantly slowing investment and construction activity.

The labour market remained stable with an unemployment rate of 3.1%. The number of people in employment rose to around 45.9 mn in 2023 (+0.4% y-o-y). Germany additionally has the lowest youth unemployment rate in the EU (5.9%). In Q1 inflation gradually declined from the peak in Q4 2022 (8.8%). Average annual inflation fell to 5.9% (6.9% in the previous year). The inflation rate fell particularly towards the end of 2023 and is likely to decrease further at the beginning of 2024, as energy prices and food prices are also falling. The ECB's exit from its low interest rate policy had already a significant impact on financing conditions in 2022. In view of the high inflation the ECB continued its more restrictive monetary policy for 2023. The key interest rates were raised to 4.5% in September.

HOUSING MARKET

The combination of considerably higher mortgage interest rates and uncertain conditions has drained all momentum out of the Real estate market. This is reflected not only in a significant decline in the number of transactions and new construction, but also in a moderate fall in prices. Compared to 2022, there was a price decline of 4.1% for owner-occupied residential property. Despite the correction in house prices, high interest rates and relatively high construction prices have reduced the affordability of owner-occupied residential properties and rental properties. Even though construction costs have now stabilised, they remain high, which will not necessarily change regarding more stringent energy requirements. The shortage of skilled workers, inflation, high construction costs and difficult financing conditions are hitting the construction sector particularly hard. This is reflected in construction activity, particularly in new construction, which fell by 5.8% compared to the previous year. Construction activity on existing buildings in the other hand fell less sharply at just -0.7%. Although the increased financing costs have the same negative impact on larger modernisation measures as on new construction, many smaller modernisation

and maintenance measures are generally carried out without the usual market debt financing. 354,000 dwelling units were approved for 2022 and 260,000 for 2023. Building completions decreased slightly from 295,000 to 294,000. The number of transactions of existing homes fell sharply in 2023. A total of 400,000 detached and semi-detached houses, apartments and condominiums changed owners in 2023, 24% less than in 2022. The population has increased further to 84.6 mn by year-end. The low level of construction and excess demand for housing is causing new contract rents to rise significantly. With rising real incomes, more stable interest rate expectations over the course of 2023, and the latest subsidies and tax measures, this could revive the willingness to invest.

In addition to the current KfW programs: "Climate-friendly new construction", "Home ownership promotion for families" and social housing promotion, an additional funding program "Climate-friendly new construction in the low-price segment (KNN)" was presented in 2024 to increase willingness to invest in climate-friendly housing. In addition, with the Growth Opportunities Act, the German government has introduced a degressive tax depreciation (5% of the investment costs in the first year, then 5% of the residual value) for newly constructed residential rental properties with retroactive effect from October 1, 2023 for properties whose construction begins between October 1, 2023 and September 30, 2029. The degressive tax depreciation can also be combined with the special depreciation for the construction of new rental apartments (energy-efficient building standard EH40/QNG).

MORTGAGE MARKET

The average interest rate for residential mortgage loans rose from 3.78% in the first quarter to 4.15% in the last quarter of 2023. The second half of 2022 was already challenging for the real estate investment market, but in 2023 the situation worsened, making it more financially challenging to buy a home or invest in rental properties. Demand for new loans is also likely to remain low. However, expected stabilisation of interest rates and growth in real incomes gives some hope for the mortgage market. The development of lending in 2023 differs from that in 2022, as a record volume of loans was granted until mid-2022, resulting in a pull-forward effect in expectation of rising interest rates. Therefore, the gross lending in 2023 for housing fell to EUR 196.3 bn (-28.2% y-o-y). Outstanding loans increased by 1.5% to EUR 1.87 tn. While the affordability of credit-financed home purchases has decreased, the impact of new interest rates on existing loans is limited due to long-term fixed interest rates and high repayments.

MORTGAGE FUNDING

In Germany, banks' main funding instruments for housing loans are savings deposits and covered bonds (Pfandbriefe). Germany has a significant share of the total covered bond market. Volume outstanding in Pfandbriefe increased in 2023 as bonds worth nearly EUR 66 bn were issued (2022: EUR 82 bn). The decline compared to the previous year is mainly due to issues that were retained in previous years. This has reduced as reliance on the ECB became less and central bank funding programs were scaled back in 2023. For the first time since 2014 the total outstanding volume of Pfandbriefe exceeded EUR 400 bn (EUR 393.6

bn in 2022). In 2023 Mortgage Pfandbrief issuance was EUR 51.5 bn (EUR 67.3 bn in 2022), Public Sector Pfandbrief issuance was EUR 13.8 bn (2022: EUR 14.2 bn) and Ship Pfandbriefe accounted for EUR 0.4 bn. Outstanding Mortgage Pfandbriefe increased from EUR 282 bn to EUR 295 bn and Public Pfandbriefe decreased from EUR 110 bn to EUR 104 bn. The remainder accounted for Ship Pfandbriefe (EUR 1.4 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 Pfandbriefe. They include requirements for the energy efficiency of financed buildings as evidenced by energy performance certificates. The minimum standards for Green Pfandbriefe were complemented in March 2021 by minimum standards for Social Pfandbriefe. Lastly, minimum standards for the issuance of Green Public Pfandbriefe were published in June 2022. All 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 in a gradual manner. 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 2023 the amount of outstanding Green and Social Pfandbriefe was EUR 24 bn by 13 issuers. Issuance in 2023 was EUR 8.4 bn.

	GERMANY 2022	GERMANY 2023	EU 27 2023
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	1.8	-0.3	0.4
Unemployment Rate (LSF), annual average (%) (1)	3.1	3.1	6.1
HICP inflation (%) (1)	8.7	6.0	6.4
HOUSING MARKET			
Owner occupation rate (%) (1)	46.7	47.6	69.2
Gross Fixed Investment in Housing (annual change) (1)	-2.2	-3.4	-3.1
Building Permits (2015=100) (2)	113.0	83.0	94.0
House Price Index - country (2015=100) (2)	168.0	161.1	170.2*
House Price Index - capital (2015=100) (2)	170.7	161.1	165.1*
Nominal house price growth (%) (2)	9.0	-4.1	3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	1,842,773	1,871,314	6,782,375
Outstanding Residential Loans per capita over Total Population (EUR) (2)	22,139	22,183	15,114
Outstanding Residential Loans to disposable income ratio (%) (1) (2)	76.5	73.1	71.3
Gross residential lending, annual growth (%) (2)	-8.7	-28.2	-26.6
Typical mortgage rate, annual average (%) (2)	2.4	4.0	4.7

* Please note that this value is a simple average of the available values in 2023.

Sources:

(1) Eurostat.

(2) European Mortgage Federation - Hypostat 2024, Statistical Tables.

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?	70-80% (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?	<p>The acquisition of owner-occupied housing is promoted through various programmes of KfW, Germany's leading promotional bank. Currently, subsidised loans are granted for the following measures in connection with the acquisition of residential property by private households:</p> <ul style="list-style-type: none"> • KfW Home Ownership Programme (For the purchase or construction of a home) • Promotion of cooperative housing (For the purchase of cooperative shares) • Climate-friendly new construction - residential buildings (For building energy-efficient and sustainable houses and flats) • Home ownership for families (For families with children who build in a climate-friendly way) <p>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.</p>