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Edison Explains

The German real estate market

With the price of German real estate in the big seven cities rising, is growth the result of Brexit or macroeconomic conditions?

How is the German real estate market faring?

The availability of German real estate has declined, illustrated by a 5.3% year-on-year decline in 2017 residential permits. This is a symptom of persistent construction bottlenecks due to workforce shortages, insufficient contractor capacity and inefficient bureaucracy.

In Munich residential vacancy rate is near zero. Frankfurt was 40,000 homes short in 2015, suggesting that 2017's 15% year-on-year increase in apartment prices was not just Brexit related.

The seven German real estate hubs of Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart are all demonstrating low vacancy rates, and purchasing prices are expected to grow.

Meanwhile, demand is set to come under pressure from lifestyle changes, urbanisation, macroeconomic factors and political policy. This will increase house prices and lower vacancy rates even further.

How have demographic changes increased housing demand?

The process of singularisation is when the proportion of residents living alone grows. It is particularly pronounced in Germany, which retains an average household size of 2.0 people. This is below the European average of 2.3, with only 22.3% of German households containing children.

The result is greater demand in individual housing units, which is putting pressure on an already underperforming supply side.

Over the long term, demand may suffer from an ageing population. Germany's low rate of 1.5 births per woman make its population one of the oldest in Europe.

High levels of urbanisation may shield cities from the effects, with the populations of Berlin and Frankfurt expected to grow by 7.5% and 6.9% respectively by 2030.

What economic factors are strengthening the German real estate market?

Macroeconomic factors, such as low unemployment rates of 3.4% and solid disposable income growth of 3.7%, have strengthened the German real estate market.

At the same time, low interest rates are making more mortgages readily available and are increasing residential sales. That said, interest rates are set to rise and the ECB will probably terminate its bond purchases by September.

If yields on bonds increase as ECB, the main buyer driving up prices since 2015, drops out of the market, companies with exposure to German bonds may suffer.

What is the state of the German office market?

Office real estate is doing well in Germany, with strong demand exemplified by a Colliers report that shows take up on offices was 18% ahead of the 10-year average in 2018.

Supply increased only moderately during that time, putting office vacancies in the big seven at all-time lows of 3.7% in June.

As expected, average office rents across the big seven cities increased considerably on the back of low vacancies, with strong growth of 22%, 10% and 7% year-on-year reported in Berlin, Munich and Frankfurt respectively.

Edison's Insight

"The German real estate market is assisted by strong macroeconomic factors, including a low unemployment rate (currently at c 3–4%), solid disposable income growth (+3.7% in 2017 according to Destatis) and record-low interest rates translating into high mortgage loan availability." Milosz Papst, analyst

What is the outlook for the German real estate market?

Expectations are that price and rent growth will continue over the next few years. This is especially true in Frankfurt, where Brexit will attract financial institutions that wish to maintain access to the EU's single market into Germany's financial hub.

That said, demand may suffer as high prices squeeze out potential buyers and dampen demand. There is also a risk that mortgage rates rise over the next five to 10 years, starting with a likely 0.3% increase by the end of 2018.

At the same time, government policies focused on renewing urban areas have made it on to the political agenda after the residential shortages of the last five years.

Which companies are heavily involved in the German real estate market?

Two of the largest landlords in Germany, Vonovia and Deutsche Wohnen, retain a strong market presence. Vonovia's portfolio is €33bn and is spread among the big seven cities. Deutsche Wohnen is focused on Berlin, where it holds 70% of its assets, mostly in or around the city's outskirts.

Consus Real Estate, another German developer, focuses on highly standardised rental apartment blocks. Its residential developments, which make up 85% of its 2017 pro forma sales, are mostly one to two bedroom apartments.

Finally, Aroundtown's commercial and residential portfolio saw some of the largest price inflation among its peer group, gaining more than 60% of its value.

Developers are not alone in the German real estate market and property (immobilien) trusts and funds are active, often as private limited companies (GmbH), limited partnerships (GmbH & Co. KG), or public limited companies (AGs), for example, the IVG Institutional Funds GmbH, Union Investment Institutional GmbH and the IC Immobilien AG group.