Germany

By Thomas Hofer, vdp

IN A NUTSHELL

- → Gross domestic product grew by 1.8%.
- → Significantly higher mortgage rates in 2022 make housing less affordable and reduce demand for new housing loans.
- → For the first time since 2009, gross lending for residential property fell on a y-o-y basis.
- → As the housing shortage persists, demand for housing is now increasingly being directed towards the rental market. As a result, new rental contracts in the housing market are rising faster than in previous years.

MACROECONOMIC OVERVIEW

The economy grew by only 1.8%. At the end of the year, the decline in production meant that economic output was even lower than before the outbreak of the pandemic. Ongoing supply problems with intermediate products, energy price volatility and a shortage of labour reduced production and prevented growth.

Overall, the labour market has recovered relatively well from the pandemic disruptions and has not suffered from the current difficult macroeconomic conditions. After rising from 3.0% to 3.7% in 2020 and 2021, the unemployment rate recovered in the course of 2022, averaging 3.1% for the year. The number of people in employment rose slightly again in Q4 to around 45.6 million (+1% y-o-y).

Consumer price inflation accelerated very sharply, averaging 6.9% for the year, and reached record levels in recent months. In February 2023, the inflation rate was 8.7%, close to the peak of 8.8% in October and November last year. Energy prices appear to have peaked. In particular, the price caps for electricity and gas have had a dampening effect on inflation since December.

After barely changing during the two pandemic years, Germany's population reached a new high of 84.3 mn in 2022. The growth was driven by immigration, not only but mainly by Ukrainian refugees.

HOUSING MARKET

The ECB's normalisation of monetary policy, which began in spring 2022, lead to higher financing costs and yield requirements, so that the demand for residential property investment fell significantly in the second half of 2022, and the steady price increase that had previously lasted for more than a decade turned into a sideways movement or decline.

On average, prices for owner-occupied residential property rose significantly by 9% compared to 2021, but the rate of increase slowed steadily. In the fourth quarter of 2022, prices declined in the quarter for the first time.

The main reasons for the fall in demand for housing were rising interest rates on loans, combined with the fact that house prices remained high while construction costs have risen, making households reluctant to buy. Even in the market for existing property, higher financing costs, particularly in markets where prices have risen sharply in recent years, have led to a reduction in demand for owner-occupied housing. While new construction activity has declined as a result of higher construction costs, excess demand for housing remains.

After the construction boom of recent years, inflation and supply constraints hit the industry hard. While completions rose slightly from 293,000 to 295,000 dwellings, building permits for new housing fell sharply (from 381,000 to 354,000 units). Even though construction activity is twice as high as in 2009, there is still a shortage of housing, especially in the larger cities and their surrounding areas. Given the ongoing shortage of housing, demand for housing is now increasingly shifting to the rental market as financing conditions tighten. As a result, new rents in the residential market are rising faster than in previous years.

In 2023 investors are expected to hold back as construction costs rise and financing conditions tighten. However, given the still strong demand for housing and the efforts of policymakers and the construction industry, construction activity is expected to increase in the medium term.

The number of existing home transactions fell sharply in 2022. A total of 480,000 detached and semi-detached houses, apartments and condominiums changed hands in 2022, 20% fewer than in 2021.

MORTGAGE MARKET

The ECB's exit from its low interest rate policy had a significant impact on financing conditions over the course of the year. The average interest rate on residential mortgages rose from 1.5% in the first quarter to 3.45% in the last quarter.

This has made it more difficult to buy a home or invest in rental property. The price increases in the German property market over the past decade, combined with the sharp rise in financing costs, have significantly reduced the affordability of residential property. In addition, the return requirements for property investments have risen as other asset classes, such as bonds, have become more attractive in relative terms. Demand for financing is also likely to remain subdued until the current period of uncertainty about future price and interest rate developments is over.

These developments are reflected in banks' lending activity. Gross lending for housing fell to EUR 273.5 bn (-8.7% y-o-y), this development had two parts: record volumes were lent in the first half of the year, partly due to pull-forward effects in anticipation of rising rates, loan commitments declined significantly in the second half of the year. Growth in the volume of outstanding loans slowed slightly, rising by 5.6% to EUR 1.84 bn.

While the affordability of credit-financed home purchases has decreased, the impact of the new interest rate environment 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 one of the largest markets representing a significant share of the total covered bond market. Volume outstanding in Pfandbriefe increased as bonds worth nearly EUR 82 bn were issued (2021: EUR 65 bn). The primary market was boosted by record mortgage lending figures and early repayment of TLTROs and corresponding release of ECB collateral in the shape of retained Pfandbrief issues.

In 2022 Mortgage Pfandbrief issuance was EUR 67 bn (EUR 46 bn in 2021), Public Sector Pfandbrief issuance was EUR 14 bn (2021: EUR 18 bn) and Ship Pfandbriefe accounted for EUR 0.75 bn. Therefore, the outstanding volume of Pfandbriefe increased to EUR 394 bn (EUR 391 bn in 2021). Outstanding Mortgage Pfandbriefe increased from EUR 264 bn to EUR 282 bn and Public Pfandbriefe decreased from EUR 125 bn to EUR 110 bn. The remainder is accounted for Ship Pfandbriefe (EUR 1.9 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 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 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. 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 2022 the amount of outstanding Green and Social Pfandbriefe was EUR 18 bn by 12 issuers. Issuance in 2022 came in at a record EUR 9 bn.

	GERMANY 2021	GERMANY 2022	EU 27 2022
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	2.6	1.8	3.5
Unemployment Rate (LSF), annual average (%) (1)	3.7	3.1	6.2
HICP inflation (%) (1)	3.2	8.7	9.2
HOUSING MARKET			
Owner occupation rate (%) (1)	49.5	46.7	69.1
Gross Fixed Investment in Housing (annual change)(1)	0.7	-2.1	1.5
Building Permits (2015=100) (2)	121.5	113.0	125.8
House Price Index – country (2015=100) (2)	154.1	168.0	164.6*
House Price Index – aggregate seven largest cities* (2015=100) (2)**	158.2	170.7	163.8*
Nominal house price growth (%) (2)	11.3	9.0	10.6*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	1,744,433	1,842,773	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	25,132	26,563	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	78.7	76.3	71.5
Gross residential lending, annual growth (%) (2)	11.1	-8.7	-6.5
Typical mortgage rate, annual average (%) (2)	1.3	2.3	3.1

* Please note that this value is the simple average of the available values in 2022.

Sources:
(1) Eurostat
(2) European Mortgage Federation – Hypostat 2023, 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?	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: • 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) 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.