



## Momentum in the German real estate market

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- Slowly rising mortgage rates are not a short-term threat to the German housing market. A price correction is not in sight (p. 2).
- The new government has many ideas about housing policy. Real estate taxes also play a role in this (p. 3).
- Since last year, investment in German commercial construction has picked up: orders received and permits are increasing (p. 4).

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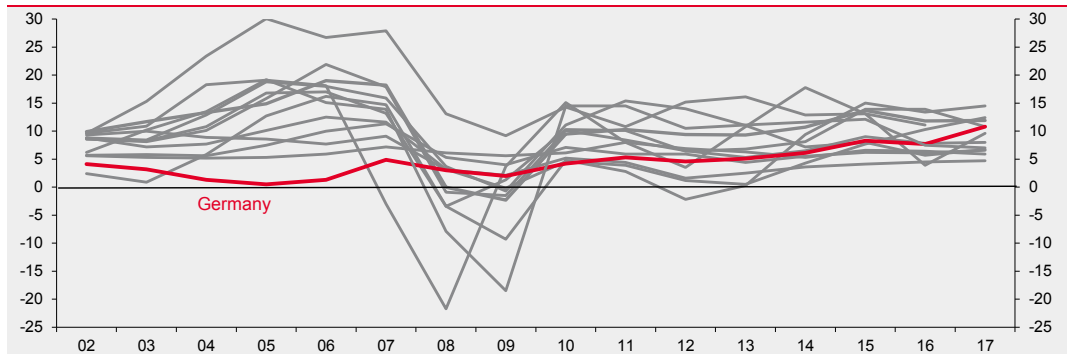
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## 1 At a glance

### German real estate on the way to being top performer?

Total returns on directly held real estate\*, % y/y



\*gray: data series for Australia, Canada, South Africa, United Kingdom, Italy, Netherlands, Italy, Sweden, Switzerland, Spain and France  
Sources: MSCI Real Estate, Helaba Research

For years, German real estate did rather poorly by international standards, and according to the performance data of MSCI Real Estate, it was able to score only with the very low volatility of its total return (calculated from capital growth and income return). In recent years, Germany worked its way up at least into the middle of the pack. With the just published German real estate index DIX for 2017, the domestic real estate market made another leap forward in the international performance comparison: not only did it achieve the highest value since the beginning of the data series in 1996 with a total return of nearly 11 %, this time German real estate also did better than other important real estate markets, like the US, United Kingdom, and France. Higher up in the ranking were above all Spain and the Netherlands.

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## 2 Selected real estate analyses

### 2.1 Rising interest rates – no panic in the housing market!

Could rising interest rates potentially put an end (soon) to the party in the German housing market, or could that party go on (for quite some time)? We are joining the lively and heated discussion.

The rise in interest rates at the beginning of the year caused some temporary anxiety, until a decline in bond yields was recorded again most recently. Mortgage rates in Germany have also risen slightly – but less than the yield on German sovereign bonds. However, interest rates that are slowly rising from a very low level do not possess the quality of putting a sudden end to the upswing in the German housing market. Home builders can secure the still low interest rates through forward loans. Over the short term, a turnaround on interest rates could even invigorate the demand for residential real estate. In recent years, many buyers of residential properties took advantage of lower interest rates: as a result, the average maturity has risen and the amortization rate is substantially higher than before. Anyone who secures the low mortgage rates for 15 (preferably) rather than 10 years and can afford an amortization rate of 3 %, should hardly have any problems with future refinancing. The trend today is for more equity to be contributed than in the past – in absolute figures. However, since the loan amounts have also increased along with the robust rise in housing prices, the share of equity is not likely to have increased, especially in the conurbations. All in all, private construction financing in Germany remains conservative compared to other European countries. For the economy overall, as well, housing construction loans do not play a big role in Germany, which is reflected in what is a low share of GDP by international standards.

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Conservative financing  
reduces refinancing risks

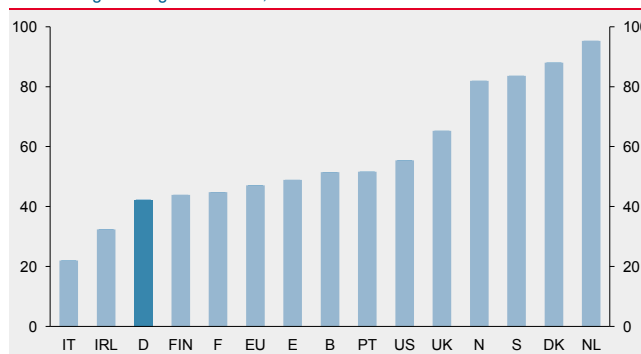
#### Interest rate trough is behind us



Sources: Datastream, Deutsche Bundesbank, Helaba Research

#### Scale of residential loans in Germany small

Outstanding housing loans 2016, % of GDP



Sources: European Mortgage Federation, Helaba Research

Excess valuations do  
not automatically lead  
to a correction

Long-term interest rates will likely rise, though at a leisurely pace. By the end of 2018 we see a rise in 10-year Bund yield to around 1 %. A corresponding movement can be expected with mortgage interest rates. With a rise in interest rates on this scale and thanks to conservative financing practices, we do not expect a price correction for German housing real estate this year and presumably also next year – in spite of the understandable estimate by the German Bundesbank that current prices in the cities are overvalued by up to 35 %<sup>1</sup>. For in the wake of a change in the trend, such high valuations do not lead invariably and suddenly to a correction on the calculated scale. More likely from the current perspective is that price increases will be initially smaller and then come to an end. That could be followed – as it was after the end of the reunification boom in the ‘90s – by a prolonged sideways movement in the market overall with moderate declines in certain submarkets. By contrast, a stronger downward movement would be expected in case of a real “interest rate shock” or an economic recession.

<sup>1</sup> Deutsche Bundesbank, Monthly Report, February 2018, p. 54.

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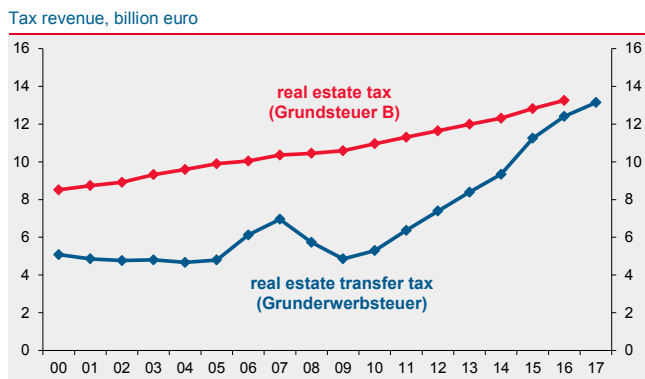
## 2.2 The new government’s housing policy: real estate taxes

The coalition agreement of the Grand Coalition in Germany contains a hotchpotch of different measures concerning housing policy,<sup>2</sup> some of which relate to taxation. Above all, what is one to think about the introduction of a building land tax?

The big give and take

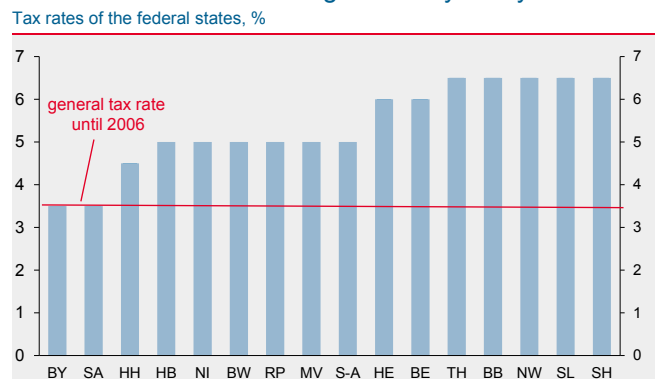
It’s a big give and take. On the one hand, the government wants to combat the housing shortage with subsidies such as an allowance for families with children, special deductions, and considerable additional spending for public housing. On the other hand, every year it takes away from home buyers, owners, and renters an amount in the form of ever higher real estate taxes that is equal to several times the budgeted funds. An efficient economic policy looks different. For the sake of fairness, however, it should be noted that the money raised does not go to the federal government. Most recently, local municipalities took in more than 13 billion euro per year through the property tax (“Grundsteuer B”), while the federal states took in a similar sum through the real estate transfer tax (“Grunderwerbsteuer”). Many communal budgets are replenished through a regular increase in the multiplier on the property tax. Also, there are only two federal states which have maintained the earlier rate of 3.5 % on the real estate transfer tax.

### Real estate taxes – a nice source of income



Real estate transfer tax 2017 according to tax estimates from November  
Sources: Federal Statistical Office, Helaba Research

### Real estate transfer tax: higher nearly everywhere



Sources: German federal states, Helaba Research

Federal government must come to an agreement with the states

According to the coalition agreement, going forward a “Property Tax C” is supposed to be used to acquire additional building land, and when it comes to the real estate transfer tax, the introduction of an exemption “for the first-time acquisition of residential properties” is to be evaluated. However, since we are dealing with a tax levied by the local or state authorities, these measures do not fall (solely) within the purview of the federal government. This is also likely to be the reason why we have not yet seen a reform of the property tax, even though the very outdated assessed values on which it is based have been considered unconstitutional for years. As expected, this was just recently affirmed by the Federal Constitutional Court, which demanded a reform by the end of 2019 – but the old regulation may still be used until the end of 2024. The coalition partners can thus not limit themselves to an additional Property Tax C in order to levy a higher tax on unused building land and thus contain speculation about a continued rise in prices for building land. However, for this effect to actually take place, a Property Tax C would presumably have to be very high. It is possible that the higher taxation would be passed on to later real estate buyers or renters. Experiences in the early ‘60s with a similar tax were sobering. Moreover, the new tax would not generate additional building land, but would at best lead to more rapid building on already existing land ready for construction. It is questionable whether a currently presumably helpful “building land tax” would make sense also in other market phases. In a downturn, it could make sense not to promote the premature building on scarce land. We do take a positive view, meanwhile, of the introduction of an exemption on the real estate transfer tax, though it should not be too restrictive (only for families for the first-time acquisition of residential property). A bolder move in this regard would have been a general lowering or capping of the tax rate.

<sup>2</sup> See also Helaba Real Estate Report of 7 March: “German housing policy: ambitious goals”, p. 2.

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## 2.3 German commercial construction: companies are investing more

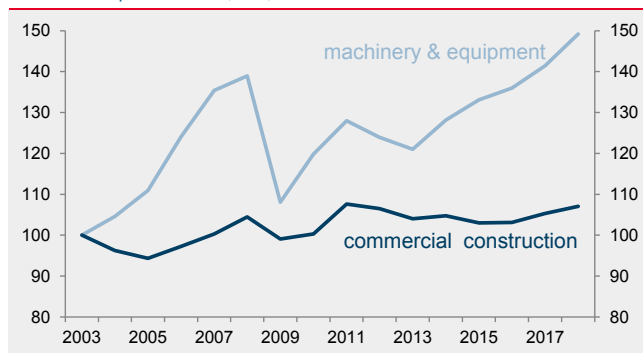
Investment in German commercial construction had made hardly any headway after 2011. However, an invigoration has been evident since last year: orders received and permits are rising.

Positive underlying conditions for investment

The underlying conditions are positive for commercial construction. Thus, with 5.5 % growth, German equipment investment in 2018 should expand again even stronger than last year (4.0 %). The high capacity utilization in manufacturing and the positive trend in demand in both industry and the services sector are causing companies to boost in capital-widening investment. Moreover, because of the growing shortage of skilled workers, rationalisation is on the agenda. The positive earnings picture and favourable financing conditions make it easier to expand physical capital. However, the spreading protectionism has become a threat that could unsettle investors. If these tendencies are not stopped, they could lead to a slower investment activity on the part of companies.

### Commercial construction with weak long-term growth

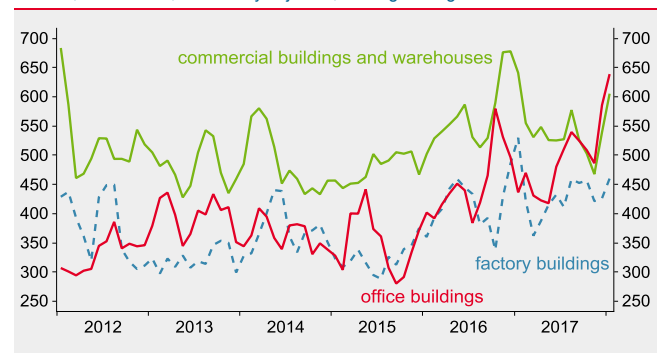
Gross fixed capital formation, real, index: 2003 = 100



Sources: Federal Statistical Office, Helaba Research

### Building permits for offices in an upswing

Permits, million euro, seasonally adjusted, moving averages



Sources: Macrobond, Helaba Research

More office buildings against low vacancy rate

Investment in German commercial construction picked up steam already in 2017 with a plus of 2 %. Commercial building permits, starting from a very high level, expanded overall by nearly 3 % last year. Once again, office and administrative buildings performed at an above average rate. The continuous rise in employment in recent years has led to a boost in this area. Vacancy rates in the leading German office centres have dropped to their lowest levels in the last fifteen years, and the growing scarcity of modern office space seems to be slowly reflected in a growing construction activity. However, permits for factories and workshop buildings, as well as for retail buildings and warehouses were not able to match their levels from the previous year. A very gratifying development has taken place for years in the small segment of hotel and restaurant buildings. The positive trend in private tourism and business travel is making itself felt here. Impulses for commercial civil engineering are coming from the construction activities of the Deutsche Bahn, which are recorded in commercial construction. Furthermore the expansion of broadband, politically desired and supported in this legislative period, will also have a positive impact, even though it is likely that the dynamic can be boosted only slightly over the short term given the already high capacity utilization rate. The plan is to achieve a nationwide build-out with gigabit networks by 2025. Incoming orders in commercial construction picked up speed at the end of 2017. For the year as a whole, they have risen by a solid 7 %.

At 1.7 %, investment in commercial construction should grow more slowly in 2018 than investment in equipment. This trend will continue over the medium term. For not all equipment requires new commercial buildings, since in many cases it can be integrated into existing ones. However, some buildings will need to be altered, which will lead at least to expansion construction. Moreover, motor vehicles are included in equipment. As a consequence, investment in German commercial construction have for years been developing much more weakly than investment in equipment. ■