

»» Housing – new-builds continue to lag behind demand in 2016

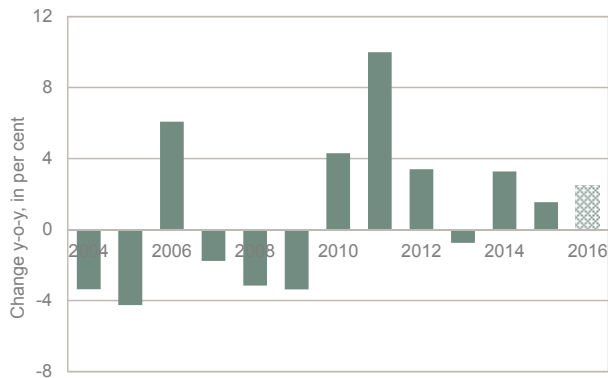
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- Immigration from EU states and countries affected by civil war and increased numbers of students have driven the demand for housing in sought-after regions sky high. Housing has become particularly expensive and difficult to find in major cities and their surrounding areas.
- At 3 %, investment in housing construction is significantly higher in 2016 than it was in 2015 (1.6 %). 2016 will see around 300,000 new housing units completed, compared to 252,000 last year.
- In some regions property prices once again rose more rapidly than rents in 2015, increasing the risk of regional property price bubbles. German banks, however, continue to maintain high credit standards.

Strong increase in housing construction investment in 2016

(actual housing construction investment year on year)



Source: Destatis, KfW Research

Approx. 300,000 completions in 2016

(new housing unit completions)



Source: Destatis, KfW Research

Immigration and increasing numbers of students fill construction industry order books

The number of skilled workers coming to live in Germany, especially from inside the EU, has risen substantially over the last five years. Last year the number of asylum-seeking refugees exceeded the number of migrants from within the EU. On balance, approximately one million people migrated to Germany in 2015 – the highest number since the Federal Republic came into existence. The number of students has risen by more than 700,000 since 2007, causing demand for housing in university cities to swell.

Construction industry order numbers have risen sharply. Orders in the fourth quarter of 2015 were up 22.8% on the

same period in 2014. As in previous years, 2016 is likely to see a particular rise in the amount of construction destined for the rental sector. However, it is also expected that there will be greater investment in construction for the owner-occupier sector. This is supported, on the one hand, by further falls in construction interest rates and, on the other hand, by the expectation that income and employment figures will continue to rise.

Estimates place the number of new housing units that will be required over the next few years at between 350,000 and 400,000. With roughly 300,000 completions in 2016, new-build housing construction is expected to continue to lag behind demand this year. In 2017, however, it is likely that

sufficient housing units will have been completed to satisfy demand. For this to happen, however, sufficient building land has to be made available in growing cities and both the federal government and state governments have to introduce their planned special write-downs this year. Construction interest rates are expected to remain favourable and are unlikely to exceed 2 or 3 % in 2016. The doubling of federal funding for social housing promotion means that between 20,000 and 30,000 additional new social housing units can be constructed each year. Construction industry estimates suggest that capacity problems are unlikely to hinder the expansion of construction levels.

Investment in modernisation stabilising at a high level

Investment expansion in existing buildings is expected to continue in 2016, albeit at a slower rate. Roughly 70 % of construction industry investment currently goes on modernisation work, approximately 20 % of which is aimed at making buildings more energy-efficient.

There are no indications so far that the brakes applied to existing property rents have deterred investment to any meaningful extent. Rental increases of 10 % and more remain rare. Throughout Germany as a whole, basic net rents rose by an average of 1.2 % in 2015. Rental income brakes could even encourage landlords to invest, as the restrictions do not apply to the re-letting of housing that has been comprehensively modernised.

The risk of regional property bubbles continues to grow

In sought-after housing markets property prices once again rose more rapidly than rents in 2015. It appears that, with housing continuing to be in short supply, some investors are speculating that they will be able to achieve further rent increases. This is particularly the case in cities of

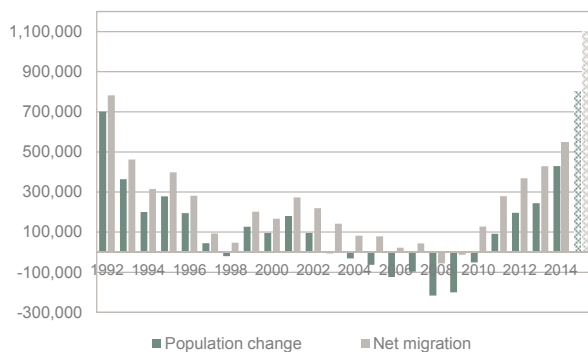
international importance, such as Berlin, Munich, Hamburg, Cologne and Frankfurt/Main. This intensifies the risk of regional property price bubbles, as an increasing housing supply is likely to make it more and more difficult to make higher rents stick.

Another warning sign is the major expansion of housing loans granted last year. In 2015 banks granted roughly 22 % more housing loans to private households than they had in 2014. There was a 53 % expansion in bank-issued mortgages with fixed-interest periods in excess of ten years.

It remains to be seen whether this expansion in mortgage lending will lead to the creation of regional property price bubbles. It is possible that borrowers simply wanted to grab low interest rates while they could. Mortgage rates fell to a new historic low in 2015. The effective interest rate for mortgages with fixed-interest periods in excess of five years was a mere 2 %, while, at the same time, returns available from alternative forms of investment sank even further. The average running yield for bonds in 2015 was a very low 0.5 %. Adjust this for inflation and the average bond only just manages to maintain the value of the original investment, whereas net rents of 3 % and above can still be achieved on residential property, depending on region and location, providing the investor is prepared to accept the risk that prices in certain cities may have been over-inflated. So far, there has been no expectation of significant levels of loan default. The banks have maintained their high credit standards and most loans exclude the possibility of interest rate increases for at least the first five years. Furthermore, in an effort to nip the possibility of a nationwide property price bubble in the bud, improvements have been made to the standards of macro-prudential supervision exercised by the German supervisory authorities. ■

Population growth stimulates housing construction

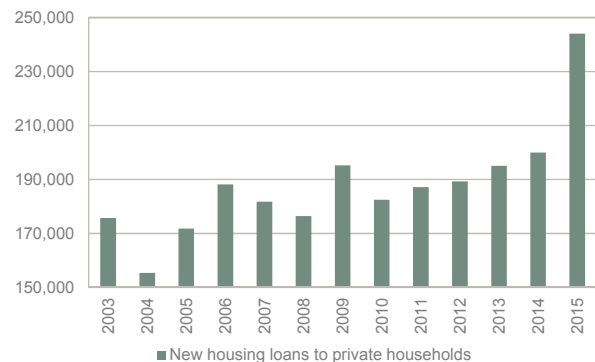
(net migration and population change)



Source: Destatis, KfW Research

Sharp increase in value of housing loans in 2015

(new loans granted to private households, EUR million)



Source: Deutsche Bundesbank, KfW Research