

Weakening price growth in German Metros may signal a shift in demand



Scope
Ratings

The vdp property index hit its steepest-ever rate of growth in Q1 2018. A plateau may be reached as since the third quarter 2017 growth acceleration hit a peak in large cities. Scope takes comfort from the fixed lending market limiting refinancing risks.

The vdp real-estate index rose 8.8% year on year in the first quarter of 2018, supported by a stable economy and low interest rates. The mortgage bank association said there was no indication yet of any weakening in price growth. However, its figures might suggest otherwise. Indeed, looking ahead, the vdp itself expects price rises to decelerate across the country, including in metropolitan areas. That deceleration may already have begun.

The price 'surge' is decelerating in Germany's Big Seven markets (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart). The rise in residential property (13.1%) and multi-family (13.7%) prices hit a growth acceleration peak in the third quarter of 2017. Rates of growth have declined in the subsequent two quarters (see Table 1).

Table 1: VDP German real estate price index (y-on-y)

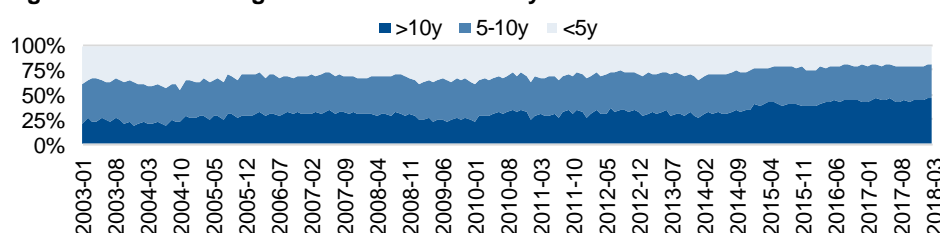
Top 7 Cities					
Owner-occupied housing			Multi-family houses		
Residential properties Top-7	Index	y-on-y change (%)	Capital value Top-7	Index	y-on-y change (%)
Q2 2016	164.6	11.7	Q2 2016	169.4	12.2
Q3 2016	169.5	10.7	Q3 2016	174.7	10.9
Q4 2016	174.9	11.9	Q4 2016	180.5	12.4
Q1 2017	180.7	12.0	Q1 2017	186.6	12.3
Q2 2017	187.7	14.0	Q2 2017	194.3	14.7
Q3 2017	194.1	14.5	Q3 2017	201.2	15.2
Q4 2017	199.6	14.1	Q4 2017	206.9	14.6
Q1 2018	204.3	13.1	Q1 2018	212.3	13.7

Source: VDP, Scope

"The cooling in price increases can't just be explained away by an increasing supply," said Mathias Pleissner, analyst at Scope. "It's also about already high price levels, especially in major cities. It's a story of stressed affordability leading to less attractive investment opportunities and a shift by investors to focus more on other areas of the country."

Scope believes the fixed-rate nature of the German lending market offers a degree of comfort despite the significant price increases. According to data from the German Central Bank, 46% (see Figure 1) of housing loans to households today are fixed for a period of at least 10 years (80% with re-fixings in five or more years). Scope notes that because of decreasing interest rates, the average fixing period has increased markedly: loans with a fixing of 10 years or more accounted for just 20% back in 2003. This mitigates potential revaluation shocks and lowers refinancing risks to German mortgage borrowers.

Figure 1: New Housing loans to households by initial rate fixation date



Source: German Central Bank

Analysts

Mathias Pleissner
+49 69 66 77 389 39
m.pleissner@scoperatings.com

Karlo Fuchs
+49 69 66 77 389 78
k.fuchs@scoperatings.com

Investor Outreach

Martin Kretschmer
+49 69 6677389 86
m.kretschmer@scoperatings.com

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Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com



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Real-estate prices in Germany's seven biggest markets more than doubled between 2007 and 2017 (see Table 2), significantly outperforming price rises in the whole of Germany over the same period and during a period of sub-2% inflation. The demand-shift assumption towards more rural areas is supported by the fact that prices for rented residential property (multifamily) country-wide moved into double digits for the first time in the first quarter of 2018 (+10.9%).

Table 2: VDP German Property Price Index (10y chg)

Real-estate market as a whole	2017	2007	% chg
All properties	138.3	103.4	34%
All residential properties	140.5	98.2	43%
Owner-occupied housing			
Owner-occupied housing	131.4	96.9	36%
Single-family houses	129.6	96.5	34%
Condominiums	138.5	98.4	41%
Owner-occupied housing Top 7			
Owner-occupied housing	167.3	93.9	78%
Residential properties	190.5	94	103%

Source: VDP, Scope

"This could well indicate that price increases in the top seven cities have reached a plateau. Yields are certainly less attractive. This is another driver of the deceleration and could indicate a shift in demand into more regional areas," says Pleissner. Scope does not expect prices to fall but believes that growth will moderately decelerate, especially for major cities where increases have been in double digits since 2015.

Even though prices are high (particularly in large cities and university towns) strong demand for residential and commercial property remains intact, the vdp said; and investors can still generate acceptable returns in both segments on the back of strong end-user demand.



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Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Paris

33 rue La Fayette
F-75009 Paris

Phone +33 1 82 88 55 57

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

info@scoperatings.com

www.scoperatings.com

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Scope Ratings GmbH, Lennéstrasse 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Torsten Hinrichs.