MARKET IN MINUTES
Savills Research

Residential Market Germany

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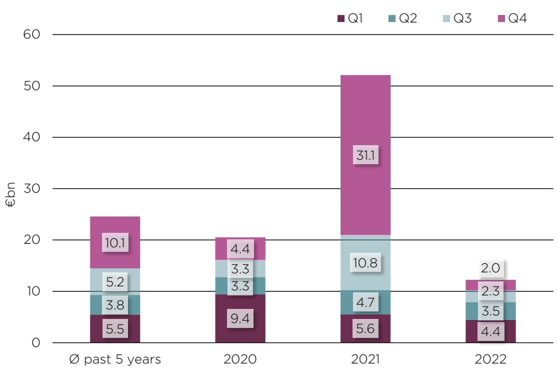
Everything remains different

From the point of view of landlords, the fundamental conditions on the German housing market not only remain favourable, the outlook has even improved compared to last year. The demand for rental apartments has risen noticeably, partly due to a strongly growing population. In addition, many households can currently no longer afford to buy their own home and therefore remain tenants. The increased demand is likely to be offset by a significant decline in the number of building completions. It can therefore be assumed that the already very low vacancy rates in most rental housing markets will continue to fall in the coming years and that rents will rise (Graph 2). Policymakers are likely to react to this situation with additional financial incentives to boost housing construction, but possibly also with further regulations. Since the latter acts as a barrier to market entry, regulatory interventions would actually reinforce the defensive investment character of German residential real estate. They cap the potential for rental growth and thus have the effect of reducing supply, thus ensuring secure and stable returns. For risk-averse investors, the market thus remains attractive in principle even in the event of new regulations.

Slump in turnover on the investment market

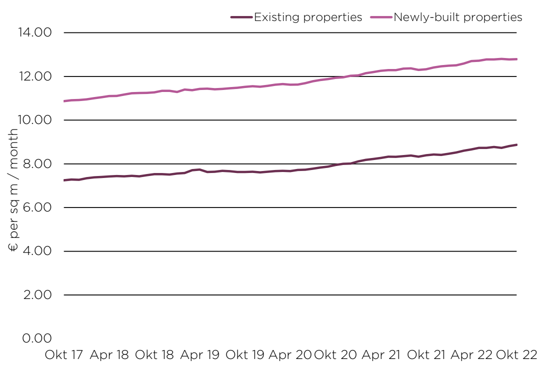
Although a massive housing shortage is looming and landlords will thus remain in a strong negotiating position, there is no sign of euphoria on the investment market for residential real estate. On the contrary: the interest rate turnaround has considerably slowed down activity on the market. In 2022, residential properties with about 67,000 units and for about 12.3 billion euros were traded (Graph 1). This does not even correspond to a quarter of the record transaction volume from 2021. Even if the takeover of Deutsche Wohnen in autumn 2021 is factored out, there would still be a 53% decline in volume on the books. Because initial yields for multi-family properties were among the lowest in the German real estate market

Graph 1: Transaction volume*



Source Savills / * only transactions with at least 50 units

Graph 2: Average asking rents*



Source VALUE Marktdaten / * nationwide average

Focus on selected figures

€1.2bn
The transaction volume of student and micro-living properties was around €1.2bn in 2022, 16% above the five-year average. It is the second highest volume recorded to date.

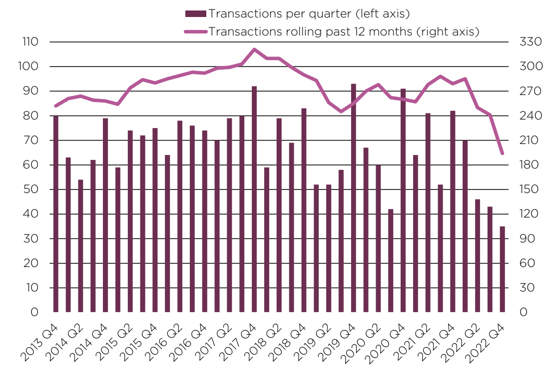
+12%
In transactions that include exclusively or partly subsidised apartments, the five-year average was exceeded by 12% in terms of volume. The transaction volume in 2022 amounted to just under €1.5bn.

Table 1: Transaction volume and number of traded units at a glance*

	Transaction volume (€m)		Number of traded units	
	Q1 - Q4 2022	y-o-y change	Q1 - Q4 2022	y-o-y change
A cities	4,624	-67%	16,017	-72%
B cities	2,338	+18%	14,229	+7%
C cities	1,227	-36%	5,989	-51%
D cities	1,155	-33%	10,881	-21%
Other	2,905	-91%	19,813	-90%
Germany	12,249	-77%	66,929	-77%

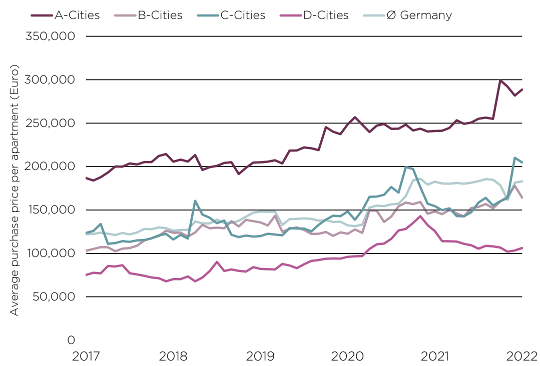
Source Savills / * only residential transactions with at least 50 units; city categories based on the Bulwiengesa classification

Graph 3: Number of transactions*



Source Savills / * only transactions with at least 50 units

Graph 4: Prices of traded units



Source Savills / Note: always past 12 months rolling; based on the Bulwiengesa classification

before the start of the interest rate turnaround, the segment was hit particularly hard by the changed financial market environment. Against this backdrop, many buyers expect significantly lower multipliers, while many owners have so far only been prepared to offer moderate price reductions or none at all. Due to this situation, the number of transactions in 2022 fell by around 60% and corresponded to the level of 2009. An increase in transaction activity was not observed in the fourth quarter either (Graph 3).

The reticence of a large number of players creates opportunities for those investors who are currently willing to make purchases. Last year, open-ended special funds and other funds and asset managers were the two most active buyer groups with volume shares of 29% and 18% respectively. Private equity funds and open-ended public funds came in third and fourth with shares of around 10% each. While almost all investor groups reduced their purchasing volume, private equity funds and open-ended public funds each directly invested more than at any time since the beginning of the last market cycle in 2009.

Market tightens for risk-averse investors

In addition to overcoming the housing shortage, achieving the envisaged climate targets for existing buildings will be a fundamental issue in the housing market in the coming years. As has already happened in other European countries, regulatory pressure on owners of unrenovated buildings could also grow in Germany, because so far the building sector has failed to meet the climate targets set. Regulations that focus on energy-efficient renovations no longer only affect the income side, but also the cost side, and thus represent a completely different kind of risk for investors. This risk can only be eliminated by purchasing new buildings or energy-efficient renovated existing properties. We assume that risk-averse investors will focus almost exclusively on this part of the market, narrowing their investment spectrum in the residential market – even more so against the backdrop of the current decline in new construction activity. The market is thus likely to become increasingly bifurcated between unrenovated and renovated or newly built properties.

New phase on the investment market initiated

In the course of 2023, we expect the residential investment market to regain some momentum, but for the time being it will not be able to return to the levels seen before the interest rate turnaround. The rally in the residential investment market in recent years was largely driven by capital seeking alternatives to bonds. German residential real estate was one of the best bond alternatives in the eyes of many investors due to the high stability of its rental income. However, in view of emerging risks in the form of possible additional regulations and uncertainties for existing buildings, only part of the market still meets the requirements as a bond surrogate. This is likely to have ushered in a new phase in the investment market with lower transaction volumes and fewer transactions.

In principle, the very good fundamental data still speak in favour of investments in the German residential market and the wave of refurbishments to be expected in the coming decades creates diverse potential for developers. Should the framework conditions for refurbishments change so that they become more profitable again from the owner's point of view, there would again be a story for domestic and foreign investors and the market could once again experience an investment rally. It remains to be seen whether and when the framework conditions for financing, construction costs and, above all, the apportionment of refurbishment costs will develop in favour of the owners. For opportunistic players focusing on portfolio upgrades, the year 2023 should offer purchasing opportunities.

Download the charts and raw data here

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