



Institut der deutschen
Wirtschaft Köln

The Structure of Real Estate Markets & Finance in Germany

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Agenda

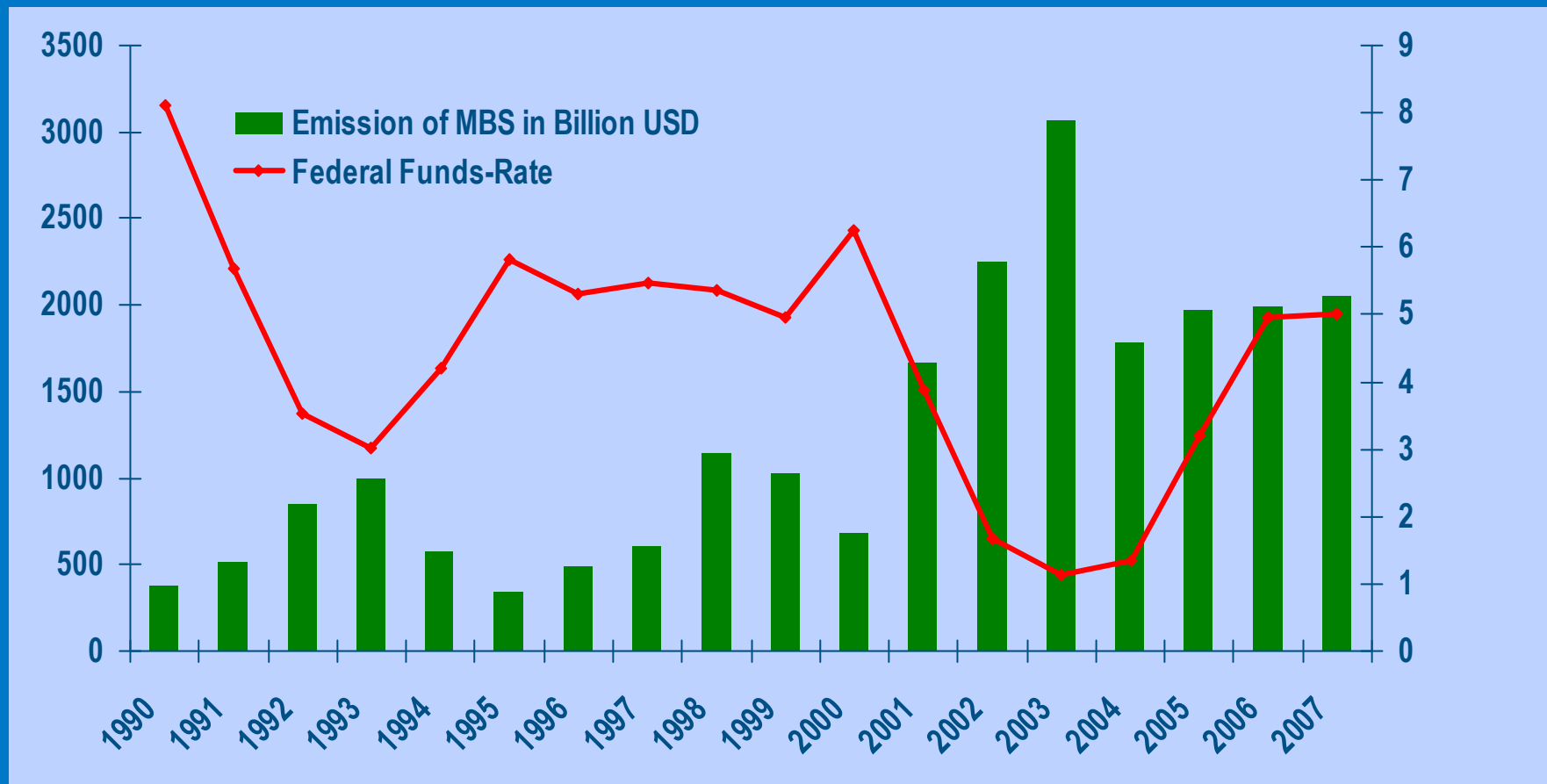
- **The financial crisis and housing markets**
- The link between real estate markets & finance
- Real estate finance in Germany
- Homeownership in Germany
- Conclusion

The financial crisis

- The financial crisis stresses the importance of real estate finance for real estate markets
- Low interest rates and high leverage rates increased housing demand
- Distortions in the subprime market and the MBS-market triggered the house price crash
 - Banks could pass risk too easily to the capital market
 - Moral Hazard was intensified by rating agencies which advised and rated at the same time

Interest rates triggered demand for MBS

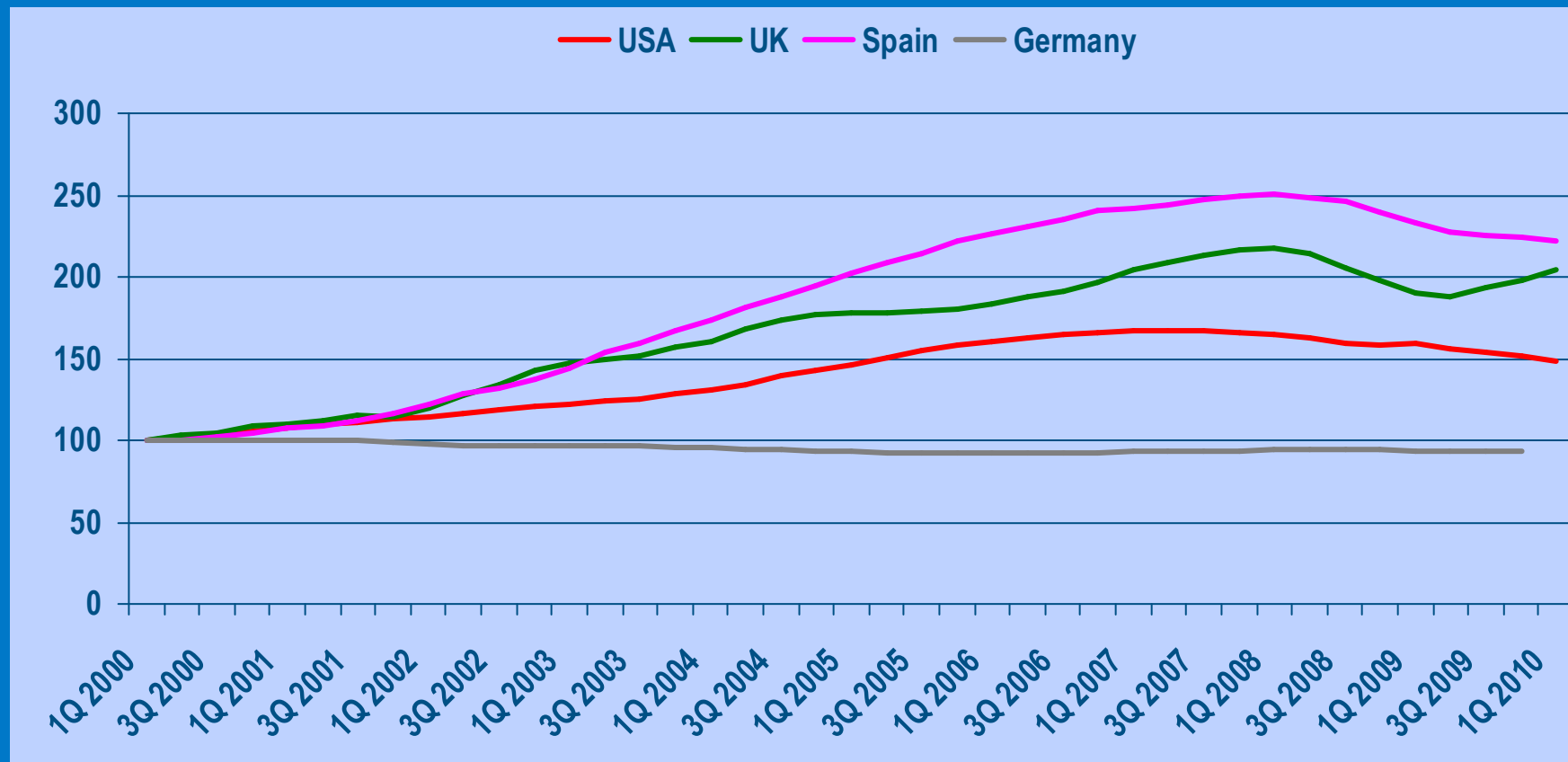
MBS: Mortgage-Backed Securities



Sources: Federal Reserve; SIFMA

Germany remained stable

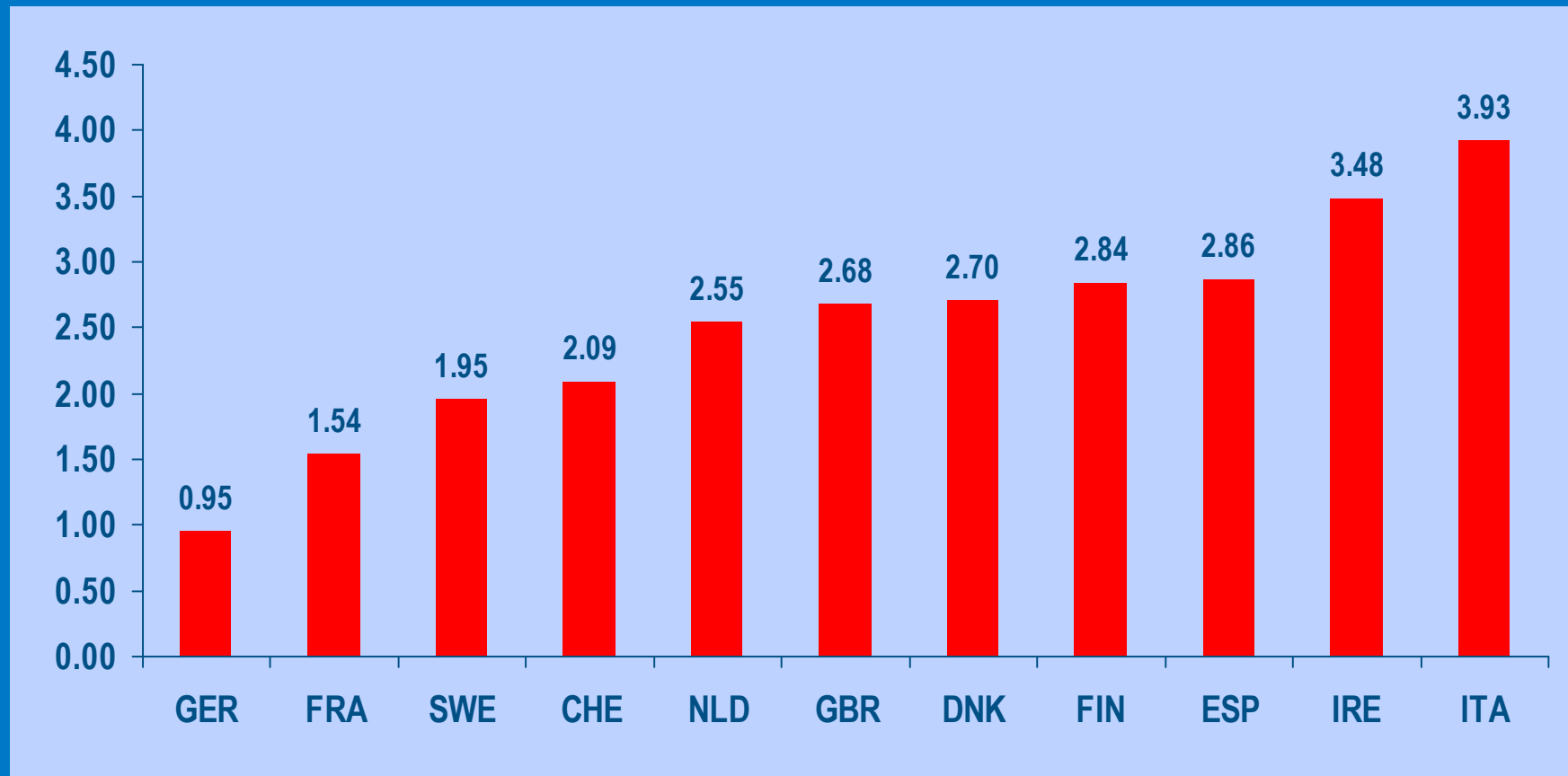
Nominal house price index (1 Q 2000=100)



Source: OECD

German housing market with low volatility

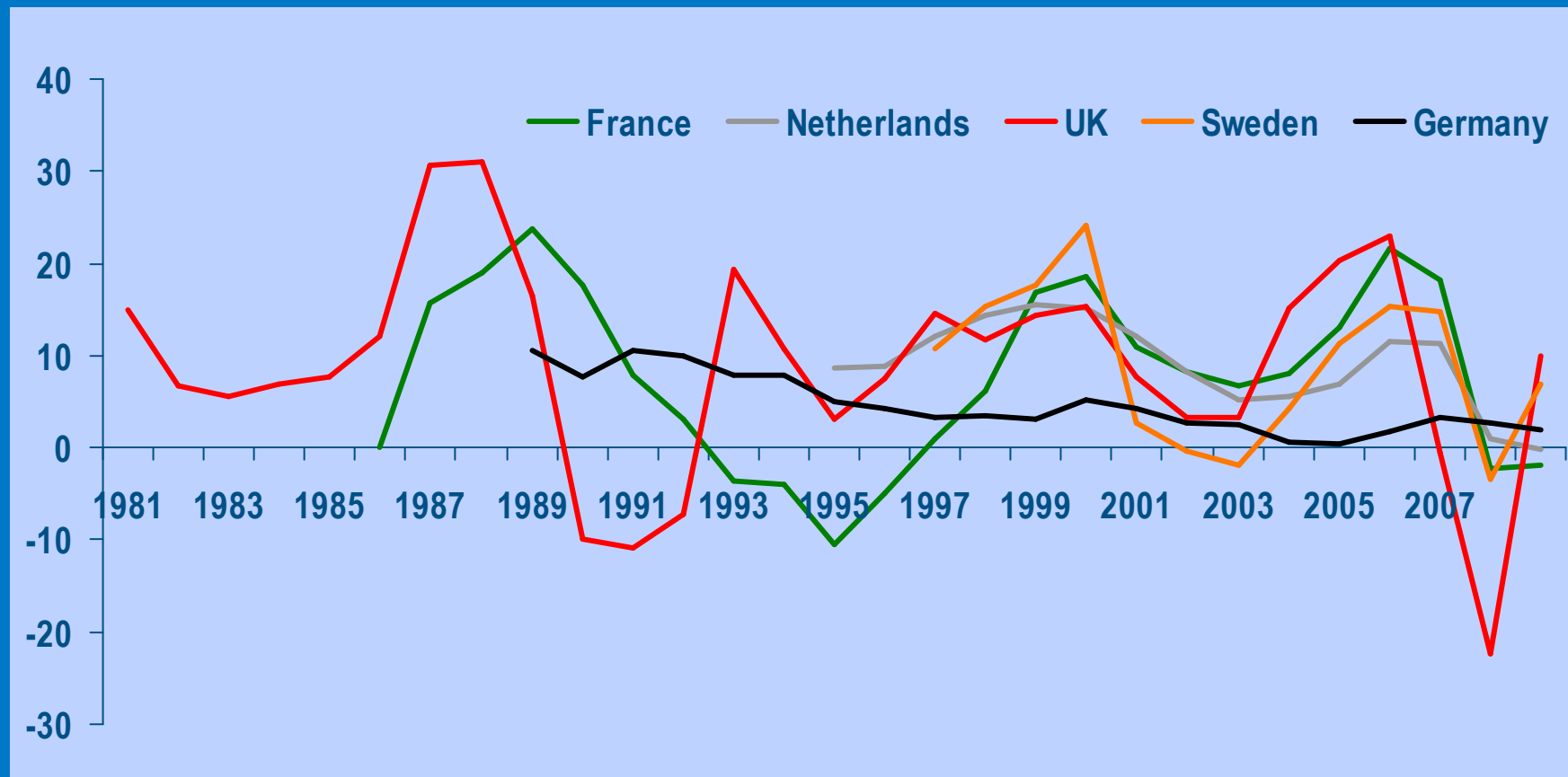
Standard deviation of house prices in percentage points (1970-2009)



Source: OECD

A flat cycle in Germany

Total Return of office property in percent

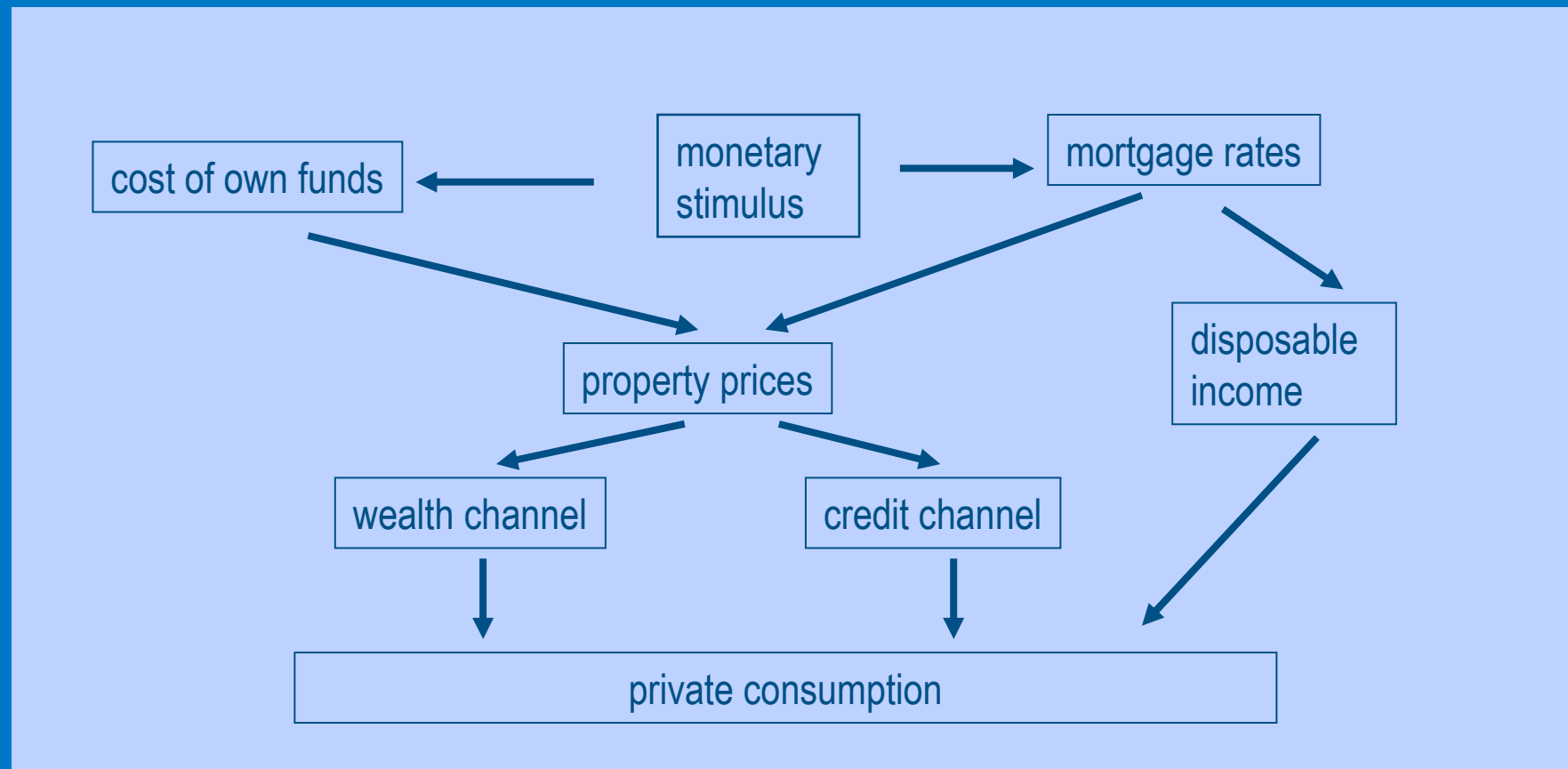


Source: IPD

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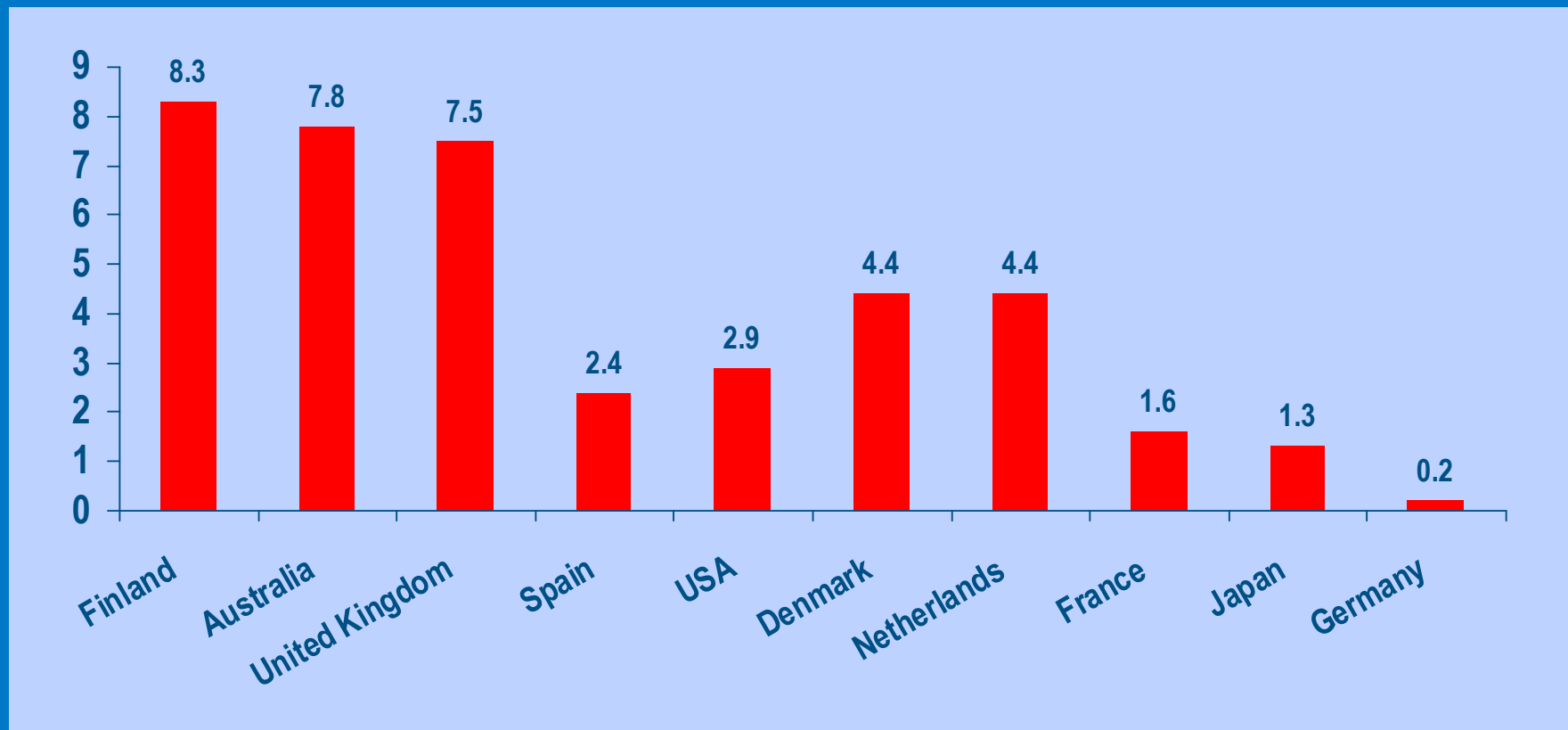
Monetary Policy and Real Estate Markets



Sources: ZEW; IW Köln

German house prices hardly react to interest rates

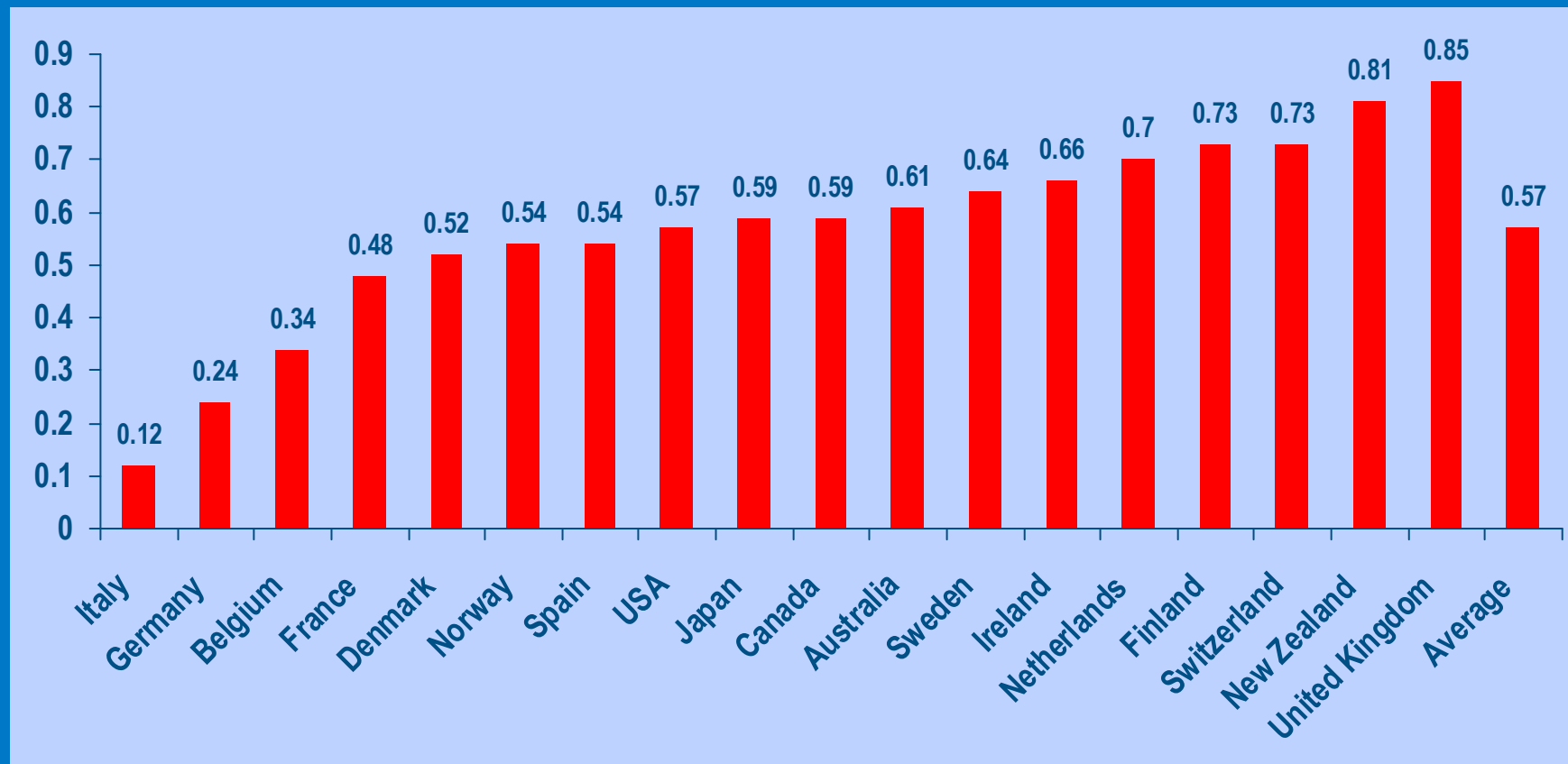
Due to a surprising interest rate decrease house prices increase in a period of two years about ... percentage points (1970-2005)



Source: Jäger und Voigtländer, 2006

A weak link between house prices and consumption

Correlation between real house price change and real change of consumption (1970-2005)



Source: OECD

Differences between Germany, UK and USA

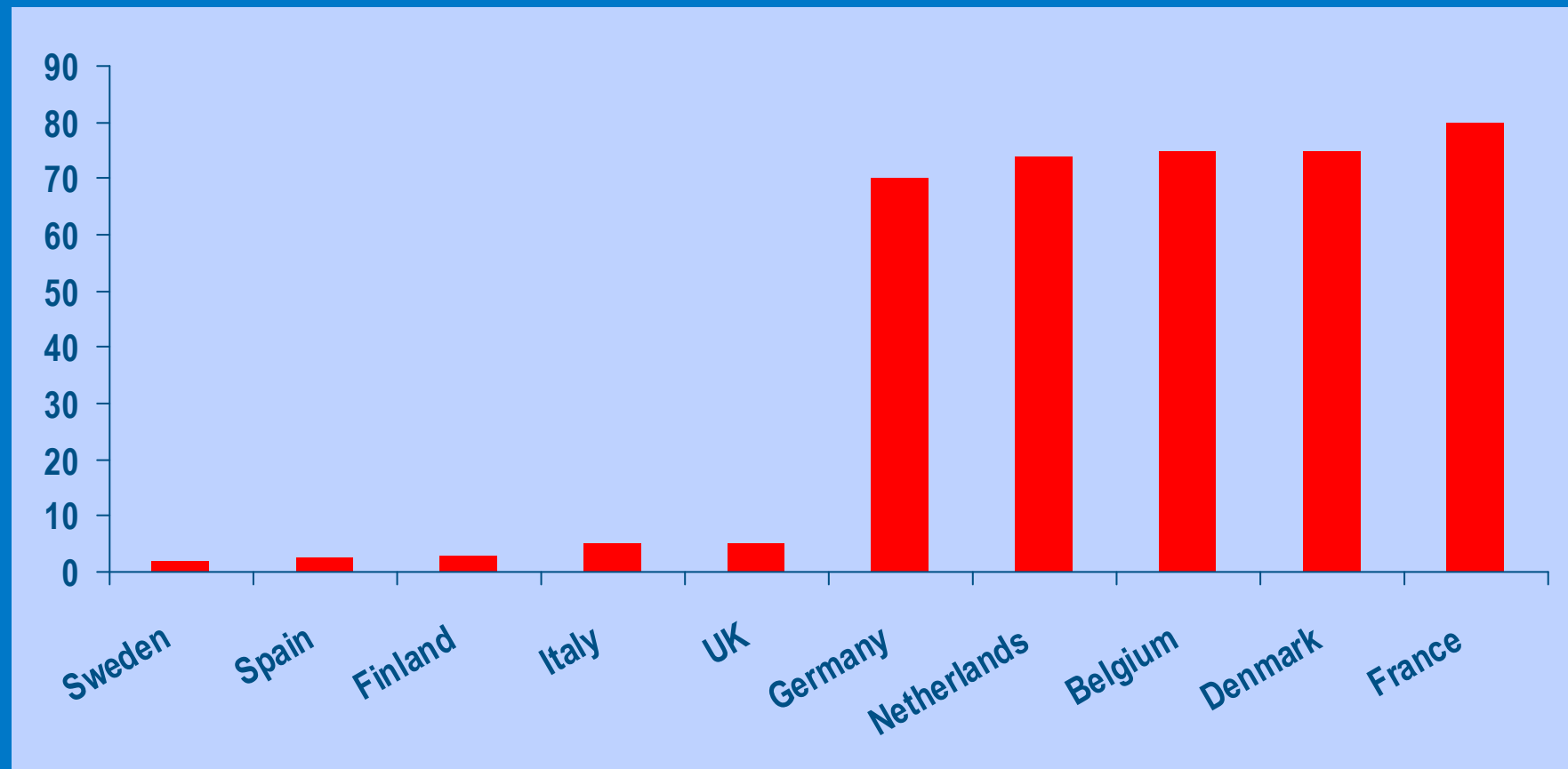
		Mortgage System			
	Homeownershiprate	Interest rates	MEW	Loan-to-value	Appraisal method for collateral
Germany	43.2%	fixed	no	60%	lending value
UK	71.3%	floating	yes	90%-100%	market value
USA	66.9%	mixed	yes	80%-90%	market value

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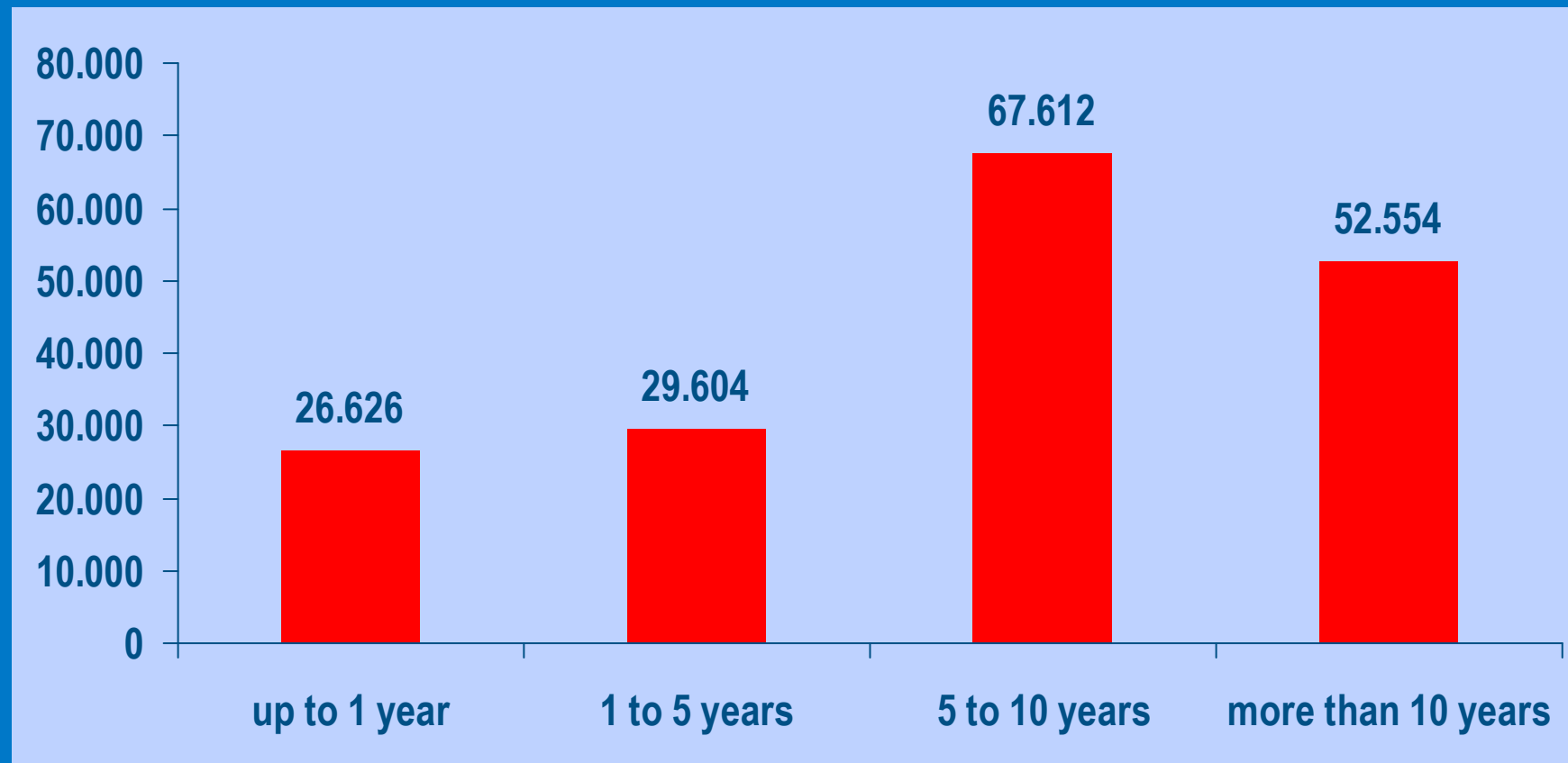
Fixed mortgages are common in Germany

Share of mortgages with a fixed interest rate of 5 years and more



Source: BIS

Distribution of private mortgage loans according to fixed-interest arrangements in billion Euro in 2009



Source: German Bundesbank

Fixed rate mortgages in the German industry in 2009



Source: German Bundesbank

Low loan-to-values in Germany

- own funds are a central part of financing self-occupied housing
- Households with lower income finance typically with a higher share of own funds (in contrast to the US!)
- interest payments for mortgages are not deductible from the tax base

Nominal value of outstanding mortgage Pfandbriefe (excluding registered bonds) according to maturity in billion Euro in 2010



Source: German Bundesbank

Building societies

- Customers are obliged to save money and accumulate own funds
- After a few years customers can lend money at interest rates below market-level
- Typically mortgages are fixed over a long period of time (up to 30 years)
- „Bausparen“ is an entrance to the self-occupied housing market for younger households

Differences between German and US real estate financing

Germany

- fixed mortgages (<15 percent variable)
- loan-to-value 60-80 percent (lending value)
- customers are liable for debt
- No subprime-market because of rental housing

USA

- mixed system (25-35 percent floating, but subprime 50-70 percent)
- LTV up to 90 percent (market value)
- mortgages are predominantly non-recourse
- subprime-market due to lack of alternatives

Typical subprime products

■ 2/28-hybrids

- fixed interest rates for two years, often with discount
- floating rates for 28 years

■ Interest only or negative amortization

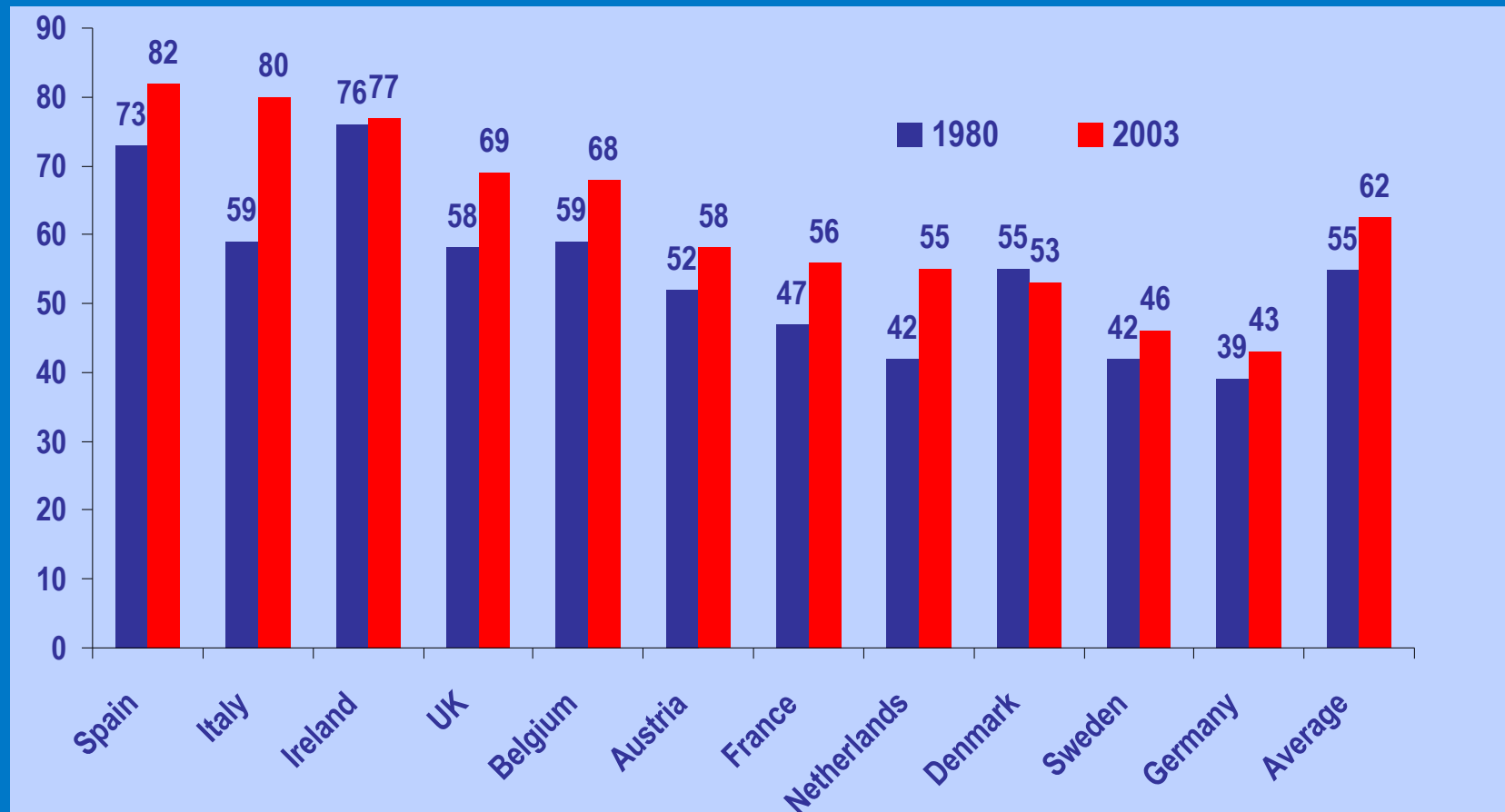
- no amortization in the first years
- in parts build-up of new debt (Cap: 15-25 percent of original debt)

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Germany: A nation of renters

Homeownership rates in percent



Sources: National Board of Housing et al., 2005; European Mortgage Federation, 2005

Social housing

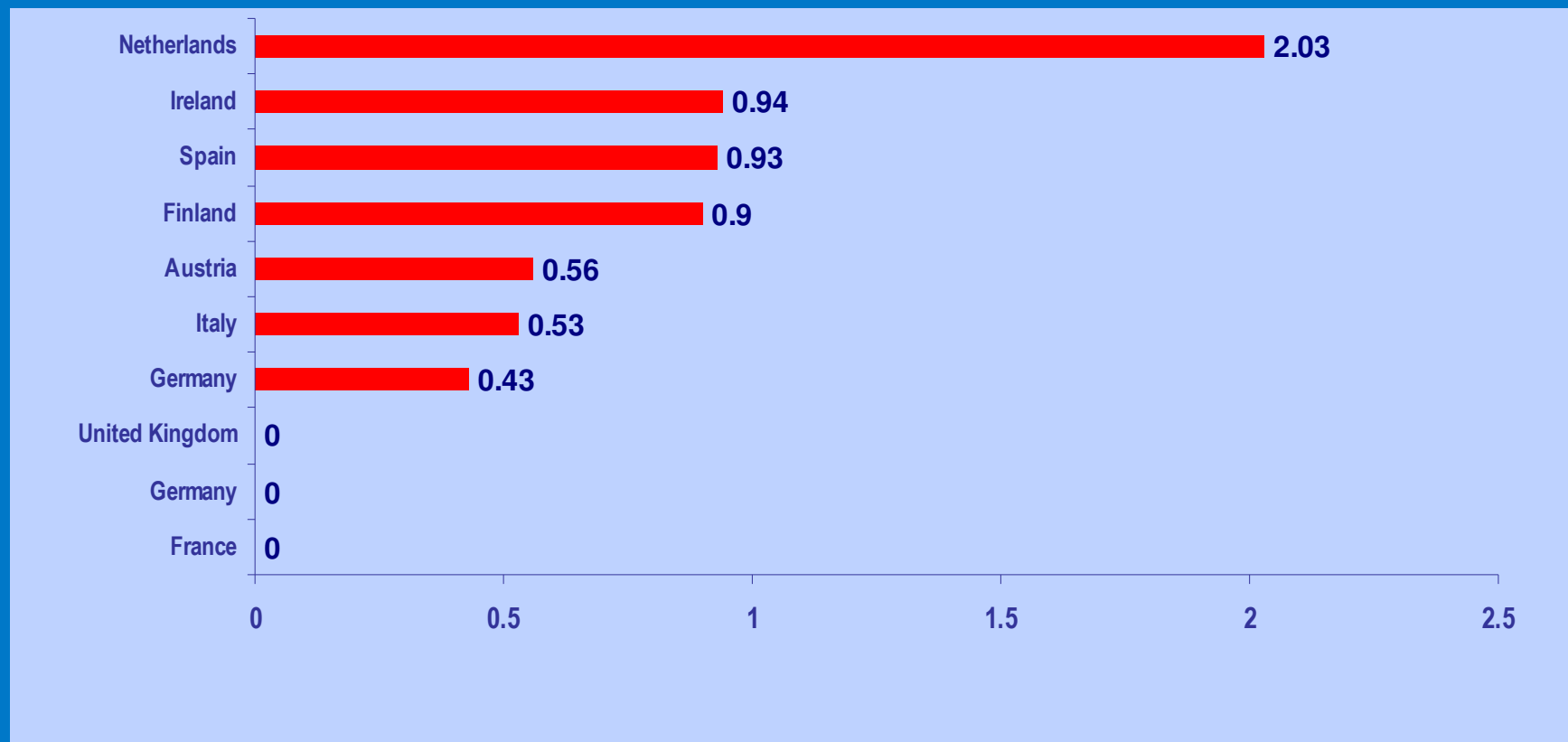
- After the second World War 4.5 million homes were missing
- To overcome the shortage, a social housing programme was developed
- Investors received subsidies but had to comply to rent limits (cost-based rents)
 - the programme included private investors so that after the commitment period a private supply developed
 - The quality of social housing was high so that renters were not stigmatised

Rental Housing Market Interventions

- In most countries with high homeownership rates rental laws had been very restrictive
 - rents had been fixed
 - Modernisation cost could not be passed over to tenants
- As a consequence, investors left the rental market
- In Germany, however, rents could be adjusted to market levels

Generous subsidies

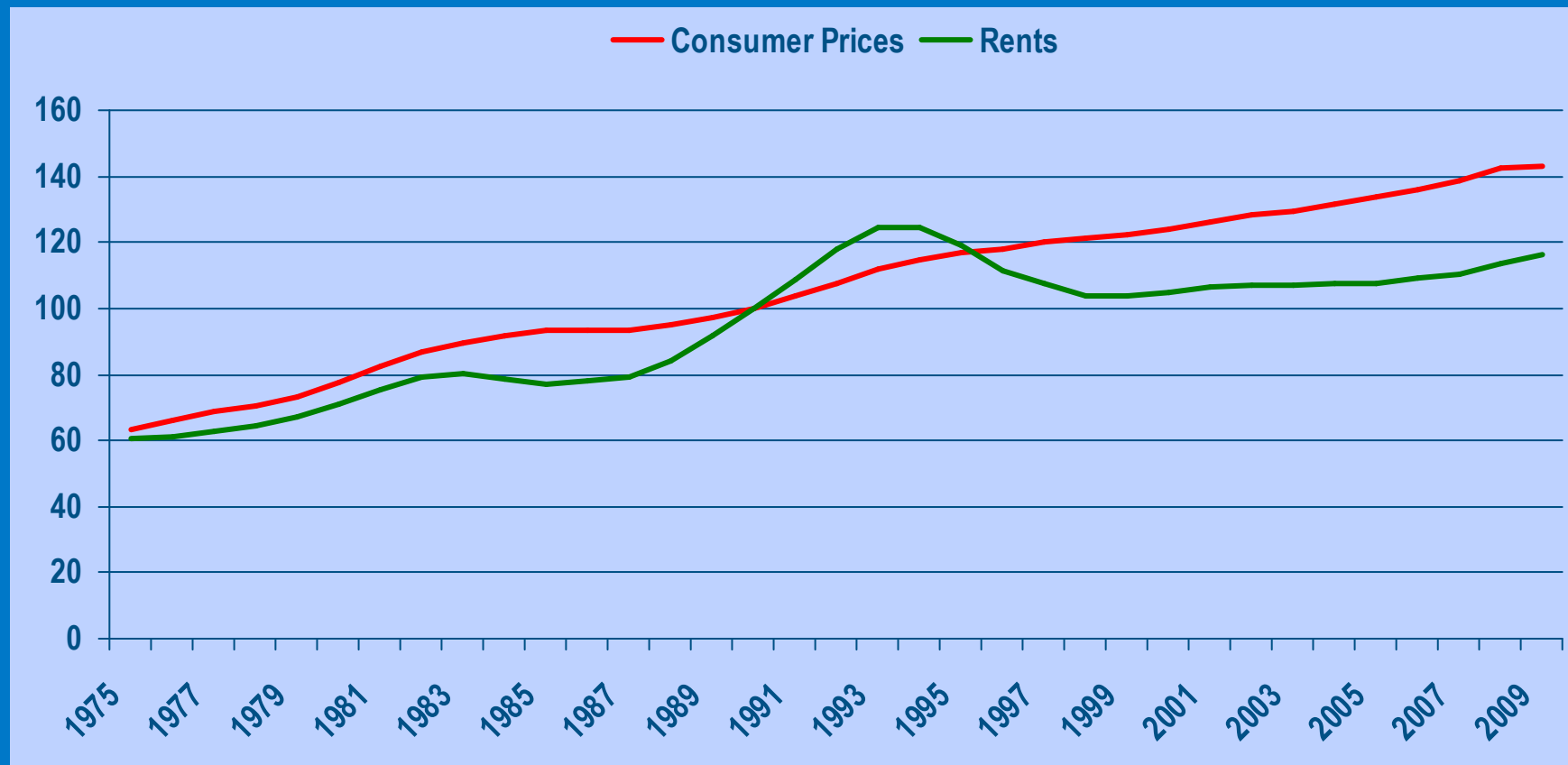
Reduction of effective mortgage rates due to tax laws in 2002



Sources: Voigtlaender (2009); IW Köln

Rents lag behind consumer prices

Index: 1990=100



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Conclusion

- **Germany has the most stable housing market in the OECD**
- **Property financing contributes to the stability by**
 - providing fixed-rate mortgages
 - and demanding own funds
- **Due to the sophisticated rental market only households who have enough own funds and income apply for a mortgage**



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