German property prices – is the decline already over?

Dr. Marco Wagner

The recent stabilization of property prices in Germany hardly means the end of the price correction. The currently low transaction volume shows that the price expectations of buyers and sellers are often still far apart. Particularly in the case of existing properties, prices will probably still have to fall significantly to bring demand and supply back into line, especially since older properties are also losing value due to political decisions. For new buildings, on the other hand, the decline in prices is likely to be limited while supply is likely to decline noticeably.

Property prices have stabilized recently, ...

Is the big price correction on the German real estate market already done? At least at first glance it looks like it. After all, prices for existing residential real estate stabilized in the first four months of the year after falling by 9% in the second half of last year, according to Europace data (title chart).

This finding appears to contradict that of two other data sources, which are, however, only available on a quarterly basis:

- According to the Association of German Pfandbrief Banks (VDP), residential property prices fell by 2% in the first quarter compared to the previous quarter.
- According to the new price index GREIX (German Real Estate Index)[1], developed by a group of researchers at the University of Bonn, which is based on transaction data from the real estate industry's expert committees, real estate also fell significantly in price in the first quarter compared to the fourth quarter (Chart 1).

Chart 1 - Housing prices are already rising again in Bonn and Lübeck
Transaction prices for residential property, in percent compared to the previous quarter; missing bars do not mean stagnation of prices, but missing data for the first quarter 2023

Source: GREIX, Commerzbank Research

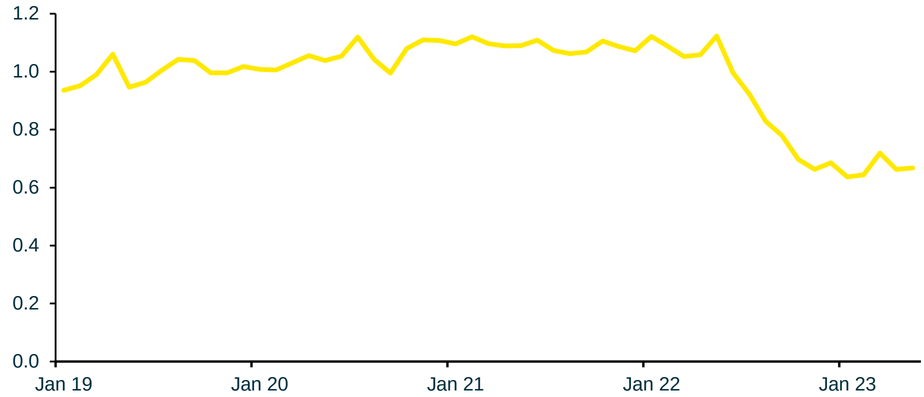
But these findings do not contradict the Europace data mentioned above, which show a stabilization of prices from January to April. If one converts the monthly Europace data to quarterly averages and makes them comparable with the quarterly data of the VDP and GREIX indices, they also show a minus for the first quarter compared to the fourth quarter (title chart).

... but still few transactions

However, the fact that only a few transactions have taken place in recent weeks speaks against the hope that the price correction on the German residential property market is already over. According to data from Schufa – a German credit bureau – and the Federal Statistical Office, the number of newly concluded mortgage contracts was recently about 40% lower than in the middle of last year, and so far there are no indications of an imminent improvement (Chart 2).

Chart 2 - 40% fewer real estate transactions

Number of new mortgage contracts concluded, index 2019=1, based on own seasonal adjustment



Source: Schufa, Federal Statistical Office, Commerzbank Research

Obviously, in view of the massive increase in financing costs, potential buyers of real estate can no longer pay the same prices as they did a year ago. Thus, according to our calculations, property prices – depending on the amount and equity share – would have to fall in total – i.e. compared to the peak of mid-2022 – by 15 to 25% so that the annuities (interest and repayment) of the buyers do not change despite the increased interest rates and the mortgage loan is still paid off after 30 years.[2]

But obviously the sellers have not been willing to make such concessions on sales prices so far, so that in many cases no agreement is reached. So the real estate market is still far from a balance of supply and demand.

Demand to remain subdued

At the same time, not much is likely to change on the demand side in the coming months. The interest rate for 10-year mortgage loans is likely to remain between 3.5% and 4% for the foreseeable future (Chart 3). Inflation will probably continue to fall, so that people's purchasing power will recover. However, in view of what we consider to be a rather weak economic development, this effect will hardly be significant this year and next year.

Chart 3 - Mortgage rates should settle between 3.5% and 4%

Interest rate for 10-year mortgage loans, in percent, as of May 2023 Commerzbank forecast

Source: Bundesbank, Commerzbank Research

Existing properties should see a decline in prices, ...

Consequently, the adjustment will probably have to take place primarily on the supply side, i.e. either through a reduction in supply or through considerable price concessions by sellers. Owners of existing properties in particular will probably not be able to avoid the latter. This is because the supply here is largely stable, at least in the medium term, since the sale of a property often occurs for "non-market" reasons such as a change of location or the death of the owner. Only a small proportion of these transactions will cease in the long term due to lower prices.

This is why the prices of existing properties are likely to fall by quite a bit, whereby the decline is even likely to be stronger than the 15 to 25% estimated above. This is because the need for renovation of existing properties is likely to continue to increase noticeably due to the political measures for climate protection, which will further depress the value of older properties in particular from the buyers' point of view.

... new buildings should see a decline in supply

On the other hand, suppliers of new buildings are likely to be prepared to make only very limited price concessions. While the owners of existing properties "only" forego book profits in most cases, project companies quickly find themselves in the red in the face of significantly higher construction and financing costs. Therefore, they are likely to react to the weaker demand primarily by putting new projects on hold, i.e. significantly reducing supply in the medium term.

Conclusion: Market realignment not over yet!

Overall, there are many indications that the price correction on the real estate market is not yet over. This applies in particular to existing properties, where prices are being depressed not only by higher financing costs but also by the politically induced need for additional renovation. By contrast, prices for new buildings are likely to remain largely stable, but supply is likely to decline noticeably.

[1] Since 2020, the researchers have digitized around one million transaction data from the purchase price collections of German expert committees. The purchase price collections cover property transactions in the respective cities over the last 60 years. The database bundles property prices over decades at regional level and makes them comparable. (back to the text.)

[2] In our calculations we have assumed that the mortgage loans are to be repaid in full after 30 years and that the interest to be paid does not change over the entire period. If the annuity to be paid by the buyer (i.e. interest

payments plus redemption) is to be the same as before the interest rate increase, the sales price must fall. The size of this decline depends on the previous price and the buyer's equity. With reasonably realistic values for these two variables, the necessary decline is between 15% and 25%. (back to the text)

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