Housing policy gains importance as house prices and rents increase. During the past four years, prices for owner-occupied homes have risen by c. 30% and rents by 15% across Germany. This uptrend was caused by a shortage of more than one million residential units, mainly in large cities. So far, the government’s housing policy has hampered rather than promoted residential construction. A few weeks ahead of the parliamentary elections we take a look at the housing policies spelled out in the election programmes of the six largest parties.

Liberals and conservatives focus on promoting new construction. The CDU has abandoned the interventionist stance it took before the elections in 2013. Sentences such as “residential construction is the best protection for tenants” suggest that the party intends to return to a market-oriented policy. In addition, the CDU recently clearly opposed the “rent brake”, a provision which aims to slow down the uptrend in rents. The AfD also regards the rent brake as counterproductive, and the FDP wants to abolish it altogether. All three parties aim to promote residential construction.

The CDU is the only party which has announced a clear goal for new residential construction. It plans to have 1.5 million new residential units built between 2017 and 2021. This is a clear increase from one million new homes built between 2013 and 2016 and from our forecast of roughly 1¼ million for the new legislative period. If the plans are realised, vacancies might rise again in a few years—a development which would dampen price and rent increases.

Social Democrats and Greens focus on even more protection for tenants. While the SPD also hopes to support new construction activity, its proposals are limited to introducing “nationwide construction standards” and “investment incentives”. German tenant protection law is already quite restrictive, and a number of proposals to tighten it further will counteract efforts to stimulate construction. In the end, stricter tenant protection is likely to reduce expected investor yields, hamper investment and thus increase the pressure on prices and rents further. The Left go even further than the Greens or the SPD. They plan to strengthen tenant protection by introducing controls and fines. This is actually tantamount to a disinvestment programme.

Lower property transfer taxes + child benefits for homes = support for families? There are several ideas to make it easier for people, in particular families with children, to buy homes. Many parties promise a reform of the property transfer tax to reduce the ancillary costs of buying a home and the introduction of child benefits for families who buy a home. However, additional policy-induced stimulus for demand might push prices upwards, particularly since supply is relatively inelastic. In that case, any electoral gifts would not benefit the families, but only the property sellers. We would, therefore, recommend limiting these measures to the purchase of newly-constructed homes.
In contrast to 2013, the CDU keeps its distance from the SPD

Housing policy has traditionally played a minor role in federal elections. In 2013, it was a side issue at best. While the CDU supported the introduction of a “rent brake” to keep rent increases in check, it did so more for reasons of electoral strategy than because it was convinced of the concept. The conservatives did, in fact, succeed in neutralising a potential election campaign issue of the social democrats. Still, the current government did not make any major efforts to stimulate residential construction, even though they would have been necessary. The grand coalition clearly broke one of its electoral promises, namely to ensure that homes remained affordable. Neither has the government substantially increased new construction nor has the “rent brake” palpably slowed down the uptrend in rents. As housing is scarce, the CDU is unlikely to adopt social democratic positions in the area of housing policy once again. According to the latest news, Chancellor Merkel herself advocates a turnaround.

Housing policy gains importance as house prices and rents come under pressure

During the current legislative period, prices for owner-occupied homes have risen by c. 30% and rents by 15% across Germany. As average incomes have increased only by about 10%, affordability has declined for the average tenant. Potential homeowners find themselves in a similar situation. While the low rates make it attractive for German households to buy a house or a flat, the share of households which can afford low-risk financing is decreasing. One of the reasons is that the grand coalition went beyond the provisions of the EU Mortgage Credit Directive during the implementation of this legislative act. To be fair, several governments were involved in this 15-year project. With affordable homes scarce in large cities and house prices and rents under persistent upward pressure, housing policy will have a larger impact than ever on voters’ decisions on 24 September.

What is driving prices up? Scarcity, as always

During the last few years, the number of inhabitants rose by c. 1.5 million – and this development exacerbated scarcities on the housing market. More than one million housing units are currently lacking nationwide, above all in large cities. High demand has stimulated new construction. In 2017, the number of newly completed residential units might rise to more than 300,000 per year for the first time during the current cycle. However, this is not enough to satisfy annual demand. The federal government estimates that at least 350,000 new residential units are needed every year – and this estimate is still relatively cautious. A number of structural factors, such as a scarcity of building land, tighter regulations, rising construction costs, red tape and a lack of skilled labour, make supply relatively inelastic. Affordable housing will, therefore, likely remain, scarce in the coming years.

Housing policy is one reason for scarcity and price increases

With construction flagging and demand still high, house prices continued to rise strongly in 2016, as expected. According to BulwienGesa data, house and apartment prices rose by an average 5 - 7% and 7 - 8%, respectively, in 126 German cities. As in the preceding years, the strongest price increases were
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registered in metropolitan areas and large cities. But even smaller cities saw considerable price growth in some cases. Based on OECD affordability indices (price-to-income and price-to-rent), relative prices have reached their historical average, which means that the normalisation is over. The price uptrend also affects rents. In 2016, rents for newly-completed homes rose by 4½% and rents for existing homes by more than 4¾%. This is the strongest increase since 1994. The introduction of the rent brake in 2015 only dampened the uptrend in rents for a short period, if at all; in the medium term, the rent brake probably exacerbated the scarcity of housing and the price uptrend. Investor uncertainty at the time of the introduction of the rent brake probably dampened construction activity. Moreover, housing policy focused on protecting tenants. This was a clear signal to investors that homes would remain in short supply for years to come. Ultimately, policymakers thus gave an investment guarantee to investors. According to Hypoport, prices continued to rise strongly in 2017. Low supply inevitably drives prices up – and the more so as demand is rising thanks to the excellent labour market situation. The recent rise in capital market yields and the slight uptrend in mortgage rates are unlikely to dampen price growth much. Unless there is considerable new construction activity, house prices will remain excessive until the end of the decade. And, if the price uptrend continues after that, we might be in for a house price bubble.

The solution: new construction

Persistently rising house prices and rents can result in enormous social and economic costs. For this reason, housing policy should have been a much more important issue during the current legislative period. Apart from the ineffective rent brake, the government has not yet developed a concept to stimulate new construction. We have therefore examined the parties’ electoral programmes with a view to understanding whether and to what extent they plan to address and remove obstacles to investment (see box on the left-hand side). In doing so, we assume that the electoral programmes are implemented in full. We have not taken into account any distortions and dissolutions, which are, however, very likely to take place during coalition negotiations or during the legislative process.

Liberals and conservatives focus on promoting new construction

The CDU has abandoned the social-democratic positions it took before the elections in 2013. Sentences such as “residential construction is the best protection for tenants and the best measure against booming rents” suggest that the party intends to return to a market-oriented policy. The rent brake, which was adopted in the current legislative period, is not mentioned in the electoral programme at all. In fact, Chancellor Merkel recently told the newspaper Frankfurter Allgemeine Zeitung that the rent brake had failed. This unequivocal statement underlines that the CDU really plans to change tack. The AfD believes that the rent brake is counterproductive, and the FDP wants to abolish it altogether (this plan already forms part of the coalition agreement in North Rhine-Westphalia). All three parties aim to promote residential construction. The CDU is the only party which has set a clear goal for the upcoming legislative period: it wants to have 1.5 million new residential units built. This is a clear increase from one million new homes built between 2013 and 2016 and from our forecast of roughly 1¼ million for the new legislative period. If 1.5 million new residential units are indeed built, we might see somewhat higher vacancy ratios in a few years. However, with housing particularly scarce in metropolitan regions, the uptrend in prices will slow only if the new construction takes place in these areas. The CDU plans to introduce a degressive tax depreciation on residential property in order to boost residential investment. A time limit on these tax depreciations – another proposal by the CDU – makes sense in order to prevent misallocations towards the end of the boom. The FDP plans to increase depreciations linearly, from 2%...
to 3% p.a. In 2016, several federal states opposed the introduction of new tax relief for residential construction. The FDP is the only party which aims to abolish certain rules introduced during the implementation of the Mortgage Credit Directive, namely all national provisions which go beyond the European regulations. This might boost residential construction, too. However, it would make more sense not to support lending growth in general, but to focus on new construction. This is the only way to slow the uptrend in prices.

Social Democrats and Greens focus on even more protection for tenants

While the SPD also hopes to support new construction activity, its proposals are limited to introducing “nationwide construction standards” and “investment incentives”. If the party really wanted to stimulate construction, it should not call for additional tightening of the strict German tenant protection law, such as

1. a cap on rent increases after renovation works
2. stricter rules for landlords who want to terminate tenancy agreements and use the property themselves in order to prevent abuse
3. improving the rent brake by increasing transparency and introducing a duty of disclosure for landlords
4. introducing “better and more binding rental tables”.

The Greens emphasise tenant protection, too. Rent increases are to be limited more strongly; the Greens are calling for a “real rent brake”. In addition, they want to strengthen tenants’ protection against a termination of the tenancy agreement and to introduce a ban on converting let apartments into owner-occupied apartments. However, stricter tenant protection rules do not necessarily improve tenants’ positions. As the experience of the rent brake has shown, tenants will be reluctant to drag their landlords to court, as, even if they win, they will remain dependent on their landlords for many years to come. In the end, stricter tenant protection is likely to reduce expected investor yields, hamper investment and thus increase the pressure on prices further. In addition, these measures might result in a considerable increase in bureaucracy.

SPD massively underestimates construction needs

The SPD’s electoral programme says that the alliance for affordable housing and construction should be continued, but it does not contain any ambitious goals. This idea goes in the wrong direction. Obviously, Minister Hendricks still does not fully understand the situation. In July 2017, a press release on the internet site of the ministry said: “Thanks to the close and good cooperation of the alliance partners, we have succeeded in changing the situation on the housing market. In all probability, more than one million new residential units will be completed during the current legislative period.”

This statement is incorrect. The number of completions started to rise in 2011, i.e. three years ahead of the formation of the alliance in 2014. Moreover, the figure of “one million new residential units” rather underlines the failure of the current housing policy, seeing that it is considerably below what would be necessary. In order to reduce the pressure

1 During the coalition negotiations for the grand coalition in 2013, we wrote: “The “affordable housing” package might limit the rise in rents temporarily, but in the medium term, the negative incentives for investment are likely to intensify the demand overhang and thus drive rents upwards.”

Source: Ausblick Deutschland “Strengere Mietregulierung und mehr Investitionen?”, Nov. 2013.

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on prices and rents seen in the last few years, roughly 1.5 million new units would need to have been built, particularly in the metropolitan areas.

The Left take the most extreme positions

Like the Greens, the Left want to introduce a ban on the conversion of let apartments into owner-occupied apartments. The binding rental tables are to include rents from the past four years as well. Numerous ideas go beyond what the Greens and the SPD are calling for. The Left want to stop rent increases and abolish landlords’ right to raise rents if they have made renovations to the properties. They plan to introduce stricter controls and higher fines. The idea is to monitor the housing market and introduce high fines if apartments are vacant. All in all, the programme of the Left looks like a disinvestment programme which would lead to further price increases and a massive decline in housing quality. One of the few ideas of the Left which make economic sense, however, is the abolishment of the ten-year limit for the speculation tax. As housing is scarce, it makes sense to reduce any incentives for buying existing houses. At the moment, buying a home presents small risks, as long as no renovation is necessary to improve the quality of the housing and as long as there is no considerable new construction activity. Tax incentives are, therefore, unnecessary, above all in the current market phase. In fact, they even increase the pressure on prices and rents. Instead, the incentives for new construction should be improved. However, the Left do not differentiate between existing and new homes.

Lower property transfer taxes + child benefits for homes = support for families?

There are several ideas to make it easier for people, in particular families with children, to buy homes. Many parties promise a reform of the property transfer tax to reduce the ancillary costs of buying a home and the introduction of child benefits for families who buy a home. The CDU, the FDP and the AfD plan to reduce property transfer taxes. The FDP proposes a tax-free allowance of up to EUR 500,000 for natural persons. The CDU, too, intends to introduce tax-free allowances for adults and children for the first-time purchase of a home. The AfD plans to abolish property transfer taxes for families. In addition, the large parties are offering families attractive child benefits for the purchase of a home. The CDU plans to provide child benefits of EUR 1,200 per child for a period of ten years. The SPD wants to introduce a family allowance for the purchase of a home by low and medium-income families. New homes can help to improve the work-life balance and thus have favourable effects on the economy as a whole. Moreover, it certainly makes sense to invest in families and children. Still, all these proposals will not really help to resolve the problem. In fact, additional policy-induced stimulus for demand will give prices and rents another boost, particularly since supply is relatively inelastic. In that case, any electoral gifts would not benefit the families, but only the property sellers. We, therefore, recommend restricting these measures to newly-constructed homes, even though in this case, too, price effects may counteract the benefits for families to some extent.
Residential construction by the public sector and by cooperatives: preferred by left-wing parties

The SPD, the Greens and the Left largely agree on raising non-private-sector investment in residential construction. This applies both to social housing and (tax) incentives for cooperative housing projects. While these proposals are certainly helpful, neither social housing nor a strengthening of cooperative residential construction will resolve the problem of scarce housing. In Germany, social housing and cooperative housing each make up only 5% of the aggregate available housing. In large cities, however, where housing is particularly scarce, the cooperatives run long waiting lists. Ultimately, it will be necessary to stimulate construction activity. Public-sector and cooperative investors are subject to the same restrictions as private construction companies. As capacity utilisation is currently very high, public-sector investment will result in the crowding out of private-sector investment. The Greens in particular say that they plan to build one million new residential units which shall be “subject to social housing provisions, affordable in the long run, attractive and in central locations” during the coming legislative period. Remember that less than 280,000 new residential units were built in Germany in 2016. Taking this into account, the Greens’ proposal would mean that 75% of aggregate new construction during the next legislative period would be taken up by social housing. This would have devastating consequences for metropolitan areas, as prices and rents in the private sector would go through the roof. While the AfD also wants to promote construction activities by cooperatives, it does not say much on social housing. Neither does the CDU. The CDU points out that the federal states received EUR 1 bn for social housing purposes during the current legislative period. It seems that the CDU shares the FDP’s view that social housing should be provided only for those who, even if they can claim housing benefits, cannot find a home on the free market. The CDU remains vague on housing benefits, too: “We want to reform the system of housing benefits”. The fact that public-sector and cooperative residential investment does not play a major role in the CDU’s programme suggests that the party plans to pursue a liberal-conservative housing policy in the next legislative period.

Red tape, construction law and housing policy management

Numerous electoral programmes contain plans to improve the institutional framework conditions. In most cases, the goal is to support construction activity. The SPD wants to introduce uniform standards and the AfD intends to streamline construction standards and cut red tape. The CDU promises “not to adopt measures which make it more expensive to construct residential space during the coming legislative period.” In contrast, the Greens want to update construction law to include climate-friendly provisions. The last few years have shown that this goal tends to make construction projects even more complex. The CDU’s plan to organise a housing summit during the first half of 2018 and achieve “binding commitments by all stakeholders” relies on the hope that all stakeholders will enter into such commitments. However, it does not foresee sanctions.

Summary and assessment of the parties’ positions

While the CDU adopted interventionist positions originally pursued by the SPD ahead of the parliamentary elections in 2013, it is now moving towards a more market-oriented policy. The CDU promises investment incentives and hopes to boost construction activity. In addition, it wants to keep a lid on construction costs. The FDP’s programme is similar to that of the CDU and supplements the
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The latter’s positions. The FDP is the only party which aims to reform the Mortgage Credit Directive implemented in 2016. The AfD also takes a more market-oriented stance, even though its programme does not contain important details such as concrete incentives for investment. The Greens and the SPD do not propose many measures to strengthen construction activity, probably because they tend to distrust market mechanisms. Rather, they aim to tighten existing regulations and intensify tenant protection – an idea which might have just the opposite effect of what they hope to achieve. Such measures will reduce the profit expectations of landlords and real estate investors in the first step and intensify the scarcity of housing space later on. As a result, prices and rents are likely to rise further. The yield guarantee of the current legislative period would be extended by another four years. With a view to construction costs and the complexity of construction projects, the SPD’s and Greens’ programmes also point to more rather than less red tape. In part, this is due to the fact that both parties want to achieve climate-policy goals via their housing policy. The Left want to strengthen tenant protection by controls and higher fines. This is actually tantamount to a disinvestment programme. None of the parties is specifically paying attention to another problem, namely the lack of skilled construction workers.

Conclusion: Implications for residential construction in 2017 – 2021

The latest polls suggest that the CDU will likely lead the new government. There is no doubt that a CDU/FDP government would do most to boost construction activity. In any other constellation, housing policy might become a difficult issue during the coalition negotiations, seeing that the positions of the CDU/FDP on the one hand and the Greens on the other (in case of a “Jamaica” coalition) or the CDU on the one hand and the SPD on the other (in case of a continued grand coalition) diverge considerably. As the CDU has clearly distanced itself from more interventionist instruments, housing policy looks set to become more market-oriented than under the current grand coalition. In case of a “Jamaica” coalition, the CDU will be able to rely on the FDP to push through a more market-oriented stance, and in case of another grand coalition, it will be able to point to the negative experiences of the current legislative period. Interestingly, almost all parties plan to sell federal land to the local authorities at below-market prices in order to create new building land. This gives rise to hopes that new construction will play a more important role than during the past four years.

Housing policy probably has a relatively small effect on construction activity, but a considerable impact on prices and rents

Finally, we would like to point to the potential impact of housing policy on construction activity, on prices and on rents. If the status quo continues, the number of newly constructed residential units will rise by another 30,000 in both 2017 and 2018, as in 2016, to 305,000 and 335,000, respectively. However, at least 350,000 – 400,000 new units are needed each year. If housing policy successfully reduced this gap between actual and needed new construction and thus gave rise to hopes that the scarcity of housing space might vanish in the medium term, pressures on prices and rents might abate in the coming years. We would like to emphasize once again that it makes sense to introduce a time limit for investment incentives, as foreseen in the CDU programme. Otherwise, we might be discussing high vacancy rates and declining prices in a few years.

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