Interest-rate dampener for the German real estate market

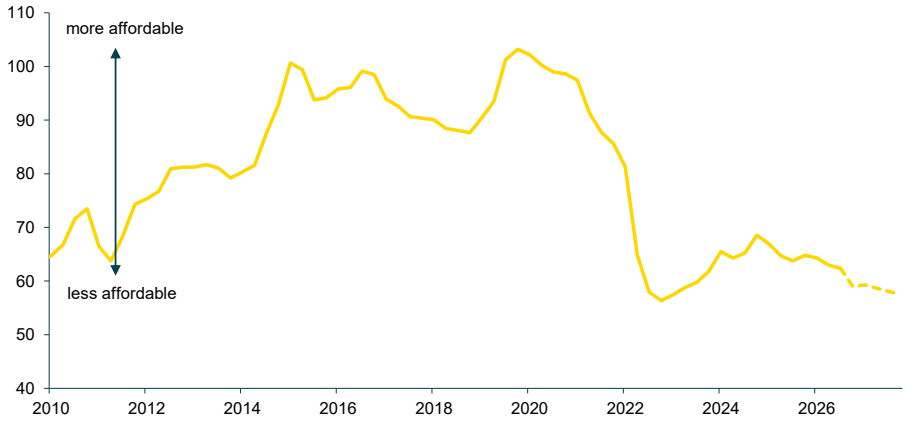
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The German residential real estate market is coming under pressure—primarily because of higher interest rates. In the coming months, prices for existing properties are therefore likely to decline, and new construction activity is expected to decrease.

Real estate prices have risen for two and a half years

In Germany, residential property prices have shown an upward trend over the past two and a half years (Title chart). The key reason for the recovery in the real estate market that began in 2024 was the slight downward trend in mortgage rates that year, following their sharp rise over the preceding two years. This easing, combined with steadily increasing incomes, made property somewhat more affordable (Chart 1). Although interest rates on real estate loans have tended to rise again since the beginning of 2025, the recovery in the property market has continued—probably because of the excess demand that has persisted for years and solid income growth, which was able to cushion the impact of higher interest rates to some extent. However, our affordability index shows that properties have become less affordable for households since the end of 2024. In this respect, the most recent increase in property prices was not based on solid foundations.

Chart 1 - Rising interest rates worsen affordability
Affordability Index: disposable income as a percentage of debt service (interest payments and principal repayment), Commerzbank forecast starting in 2026



Source: Federal Statistical Office, Bundesbank, Commerzbank Research

The straw that breaks the camel's back?

In recent months, affordability has deteriorated further. The war in Iran has made energy more expensive and pushed up inflation. This reduces purchasing power and fuels uncertainty, which in itself should lead to some reluctance to buy. In addition, concerns about the sustainability of government debt—especially France's—are prompting investors to demand higher risk premiums. This also indirectly affects mortgage rates. For example, interest rates on 10-year real estate loans have now risen significantly above 4%, and we expect them not to decline for the foreseeable future.

Under the same assumptions as above—namely moderately rising house prices and solid income growth—property affordability would deteriorate further because of higher interest rates (Chart 1, dashed yellow line). The affordability index would fall to a level similar to that seen immediately after the interest-rate shock of 2022/23. Consequently, demand for real estate is likely to decline somewhat.

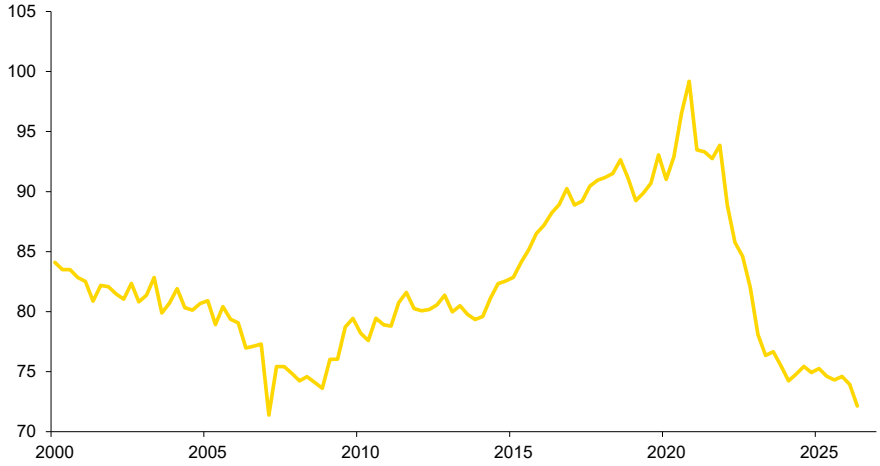
Existing properties: Price discounts expected

In response, prices for existing properties are likely to decline, although not as sharply as after the 2022/23 interest-rate shock. Here, weaker demand is meeting a largely stable supply. While many sellers are not necessarily forced to sell and can wait for prices to rise again, there are also owners who have to sell their properties—for example, when refinancing becomes unaffordable because of higher interest rates; when a jointly owned home must be sold following a divorce or separation in order to divide assets; when heirs disagree on how to use an inherited property and a sale is therefore forced; or when a job change and a move to another city or abroad make it impractical to retain the property.

New builds: High construction costs prevent price concessions

The situation is different for new builds. Here, too, demand is likely to decline in light of higher financing costs. However, developers and construction companies are unlikely to respond with price concessions—as they did in 2023/24 (Title chart). Construction costs have recently risen more sharply again, making the relationship between selling prices for new builds and construction costs as unfavourable as it was nearly 20 years ago (Chart 2). In addition, property developers are once again facing higher costs for the interim financing of their projects.

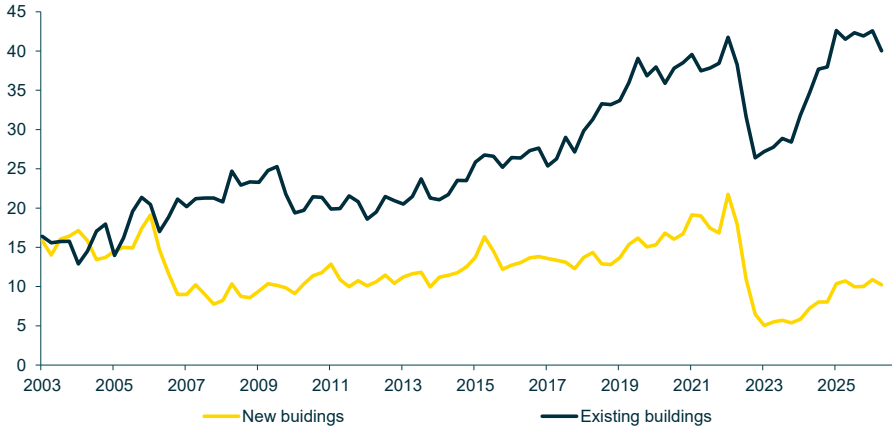
Chart 2 - Construction as unprofitable as it has been in a long time
Ratio of residential property prices to construction prices, quarterly data, index 2015=100



Source: Federal Statistical Office, Commerzbank-Research

They are therefore unlikely to respond to weaker demand with significant price concessions, but rather by reducing supply—that is, by scaling back construction activity. This was also the case after the last interest-rate shock, when sales of newly built properties plunged from just over €20 billion at the beginning of 2022 to only €5 billion, and have since recovered to only around half of their previous level (Chart 3).

Chart 3 - Still significantly fewer mortgages for the purchase of newly built properties than before the interest-rate turnaround
New mortgage lending, € billions



Source: Bundesbank, Europace, Commerzbank Research

“Building Type E” is cheaper, but not a cure-all

The new Building Type E (“efficient” or “experimental”) could help reduce costs—by an estimated 10% to 15%, thanks to savings in materials and construction time. Building Type E is not a new construction standard; rather, developers and companies will be able to agree to use a basic standard and dispense with requirements aimed purely at comfort. For example, there may be fewer electrical sockets per room than usual and reduced impact-sound insulation. The approach also relies on using recycled construction materials, such as reused steel or door frames. At the same time, the safety of the building remains unaffected, and core standards relating to fire protection, structural integrity, health, ventilation and lighting are retained.

However, Building Type E also has limitations: it reduces only the building’s construction costs. The costs of the plot, site development and financing interest remain unchanged. There are also warnings regarding costs over the building’s entire life cycle. For instance, saving on

cable ducts or electrical sockets could make later modernisation or retrofitting significantly more expensive. As a result, savings during construction could be offset by higher operating costs over a period of 20 to 30 years.

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