COMPARING GERMAN AND US MULTIFAMILY HOUSING

MULTIFAMILY SUPPLY MEETING CULTURAL DEMAND IN THE UNITED STATES AND GERMANY

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Compared to commercial real estate, investments in multifamily housing (MFH) generally offer investors a stable, long-term cash flow informed by a more balanced measure of economic, demographic, and regulatory considerations. There is far more at play than mere supply and demand.

Take a comparison of Germany and the US as an example.

MFH houses a large section of the population in both countries. This, combined with continuously low interest rates, makes MFH attractive to international investors. However, though such properties are part of the same investment sector, there are significant differences between rental properties in the US and Germany that can be confusing at first glance.
Some differences relate to building features, including construction styles and resident amenities. There are also critical market-related differences, such as data availability, market transparency, and demographics. Investors must sort through these complexities in order to develop a comprehensive risk-return profile when strategizing investment opportunities in both countries.¹

MULTIFAMILY HOUSING IN THE USA

There are 127 million households in the US, with a rate of home ownership around 64.2%. Rental households – roughly 45 million – account for the other 35.8%. Of these rental households, MFH (those buildings with five or more apartments) accounts for around 18 million rental units.

Many of the larger apartment complexes in the US include extensive communal facilities and attractive amenities, such as swimming pools, barbecue and sports areas, playgrounds, business centers, parcel drop-off lockers, and gyms. Unlike multifamily complexes in Germany, most US apartment units also include air conditioning and built-in kitchens. These amenities are typically provided by the landlords or building managers, who bear the associated procurement and operating costs. These costs are usually charged to tenants in the form of gross potential rent, which means, for tenants, that the use of these communal facilities is included in the monthly rent. For landlords, the maintenance costs for communal facilities and amenities are non-recoverable operational expenses, which are subtracted from the gross potential rent as operating expenses in order to arrive at a net operating income (or revenue for the landlord).

Both new and existing US rental properties are mostly built as timber frame constructions and do not usually include a basement. If they have no major renovations, most rental properties have a total economic useful life of around 50 or 60 years. The construction costs for new housing blocks are in the range of $116 to $278 per square foot, depending on regional price structures and the quality of the features. From a tax perspective, the amortization period for residential buildings is fixed at 27.5 years.

MULTIFAMILY HOUSING IN GERMANY

According to the Federal Statistical Office, there are around 40.8 million households in Germany.² The home ownership rate is 45.5% and the number of rental households is 55.5%, or roughly 22.6 million households, including 20.7 million multifamily units.

Compared to the US, communal amenities for German MFH are less abundant; in most cases, they are limited to a shared outdoor playground. The German Operating Cost Ordinance regulates the allocation of utility costs for German residential rental arrangements. According to Section 1 of the ordinance, consumption-dependent operating costs, and all other operating costs, are usually recoverable from the tenants.³ The operating costs that cannot be recovered from the tenants are therefore relatively small.

German MFH is almost exclusively built using concrete and brickwork construction, and buildings often include full basements. The construction costs for new apartment blocks are in the range of €214 to €371 per square foot, depending on regional price structures and the quality of the features. If no major renovations are carried out, most multifamily housing units have a total economic useful life of around 70 to 100 years. From a tax perspective, the amortization period for residential buildings is fixed at a linear amortization rate of 2.0% for 50 years.
THE POWER OF DEMOGRAPHICS

When investing in MFH, the three key determining factors for generating rental income and return (before financing and taxes), in both the US and Germany, include economics (e.g., jobs, purchasing power, etc.), socio-demographics, and regulatory conditions.

The time frames for housing investments are usually long-term. Housing demand is therefore largely determined by demographic trends, including the age of the population and the number of households.

In Germany, the ratio of births (785,000) to deaths (933,000) remained negative in 2017. However, due to a positive migration balance of 416,080 people, the population remained relatively constant at around 82.5 million. Assuming that an annual influx of an average of 200,000 immigrants continues into the future, the Cologne Institute for Economic Research predicts that the population level of the Federal Republic will reach 81.7 million persons by 2035. However, looking beyond 2035, the German population is expected to drop significantly. According to calculations by the United Nations, it will shrink to 74.5 million by 2050 and 63.2 million people by 2100, due to lower birth rates as well as the mortality rates affecting the Baby Boomer generation after 2040.

In contrast, a steady increase is predicted for population growth in the US. The ratio of births (4.1 million) to deaths (2.7 million) in the US remained positive in 2017. In addition, there was a positive migration balance of 997,000 people. According to forecasts by the US Census, this positive trend is set to continue. By 2035, the US population is expected to increase from a current number of 328 million residents to around 372 million residents. According to calculations by the United Nations, the US population will reach 388 million by 2050, and rise to around 450 million people by 2100.

HOUSING SUPPLY AND REGULATIONS

The number of households is another relevant factor when considering MFH investments. Since 2000, the number of private households in Germany has risen by around 7.7%. This positive trend is expected to continue until 2035, expanding to a total of around 43.2 million households, particularly due to an increase in new single-family households. As a result, housing demand is expected to remain stable until 2035, despite declining population numbers. It is questionable whether this course will continue beyond 2035.

Between 2000 and 2017, the number of private households in the US rose from 105 million to around 127 million. This positive trend is expected to continue and the number of total households in the US is set to rise to around 150 million by 2035. Additionally, the US population of Millennials (those between the ages of 20 to 34) currently totals 72 million people and represents a key demographic for future housing demand. The Millennial generation’s preference for living in cities and metropolitan areas, and a resulting high need for professional flexibility, are boosting the trend to rent, which is leading to high demand. Around 4.6 million new rental apartments must be built by 2030 in order to meet this growing demand, according to the National Multifamily Housing Council.

Exhibit 1: A comparison of US and Germany population growth through 2100
As an extension of understanding housing supply, rental law is another fundamental factor for determining potential rental income and return.

In Germany, rental law is codified in the Civil Code (BGB) and characterized by high regulatory density. Tenant protection is a high priority. Rental agreements for apartments are usually concluded for an indefinite period. Under the Civil Code, it is only possible to raise rent on the basis of local comparative rent, by graduated rent, or rent indexation. These legal requirements mean that rent levels are subject to political influence.

By contrast, rental legislation in the US is liberal in most states, with low regulatory density. Temporary leases with terms of one year are standard. This enables landlords to adjust the rent at relatively short intervals when re-letting.

### CONCLUSION

As a result of the predicted demographic development of Germany and the associated long-term decline in the number of households, MFH demand in Germany is likely to decline in kind. This especially holds true for many rural areas. Due to the ongoing trend towards urbanization, this risk is lower in the big cities, where continuous high demand can be expected. However, as a consequence of Germany’s regulatory conditions for MFH, the attractiveness of housing investments in Germany is declining for investors.

By contrast, the US housing market has the potential to benefit from long-term population growth, as well as a corresponding trend of rising household numbers, and a younger population compared to Germany. The US economic structure is forward-looking and shaped by digitization. Combined with the comparatively liberal rental legislation, housing investments in the US offer interesting opportunities. The trend to rent remains sustainably intact and leads to a situation in which housing demand exceeds housing supply. This opens up interesting investment perspectives for investments in the US market that go beyond conservative commercial strategy while still offering stable returns.

### ABOUT THE AUTHORS

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### NOTES

1. In terms of data availability and market transparency, there are significant differences between the US and Germany. While market and specific transaction data that names buyers and sellers is available in the US, this is not the case in Germany. As a result, the level of information of market participants is higher in the US than in Germany. Based on the real estate market reports from expert committees for land values, only aggregated data is provided in this analysis.


