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German homes market making up for lost ground, says developer

But not everyone is bullish about the market; Fitch predicts price gains will slow to 5% this year while Deutsche Bank sees rising risk of a bubble

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The brightly coloured exterior of a block of residential apartments in the Mitte district of Berlin, Germany. The Bundesbank said properties in locations such as Berlin, Frankfurt and Munich may be overvalued by as much as 35 per cent. PHOTO: BLOOMBERG

Berlin

GERMAN home prices are rising at the fastest pace in decades, reviving talk of a property bubble. Michael Zahn's company owns more than 160,000 apartments and he's having none of it.

"For 20 years, we had no growth in Germany at all - nothing," the 54-year-old chief executive officer of Deutsche Wohnen said in an interview. "We're now making up for lost ground, but that doesn't mean the market has peaked."

German homes have appreciated by about 60 per cent since 2010, Fitch Ratings said in a report last week. That's an unprecedented increase for a market that was slow to embrace home ownership and attract foreign investors.

"Property yields have come under extreme pressure in the big cities," said Udo Cordts-Sanzenbacher, co-head of residential investment at BNP Paribas Real Estate in Frankfurt. "On the other hand, there's a huge amount of liquidity in the market, and prices are still relatively low by international standards."

Berlin, Deutsche Wohnen's base and its largest market, has been the boom's biggest winner. This month, the city came out top in a global ranking of 150 residential property markets compiled by Knight Frank, sealing its transformation from a grungy backwater to one of Europe's most sought-after locations. Three other German hot spots - Hamburg, Munich and Frankfurt - also appeared in the top 10.

Mr Zahn has spent his entire career working for Berlin-based property companies. Yet even he was surprised by the speed of the change, which he attributes to the city's rising population, combined with record-low unemployment, a shortage of new properties and high levels of liquidity. "There's still a lot of upside potential," he said.

Not everyone is so bullish about German real estate. Fitch last week predicted that price gains will slow to 5 per cent this year and 3 per cent in 2019, compared with 8.6 per cent last year. In a January report, Deutsche Bank said the risk of a bubble is increasing, while a month later, Germany's central bank expressed its concern about the boom.

The Bundesbank said properties in locations such as Berlin, Frankfurt and Munich may be overvalued by as much as 35 per cent.

"Market crashes are typically caused by too much construction, and the opposite is true in many German cities," said Michael Voigtlaender, a senior economist at the German Economic Institute. A potential drop in immigration is a bigger issue, said Mr Voigtlaender, who expects prices to be little changed next year after a further increase in 2018.

Rising borrowing costs may also dampen demand. Deutsche Bank expects five- to 10-year mortgage rates to rise to 2 per cent by the end of the year, from about 1.7 per cent at the moment. However, the speed of the increase - from a very low level - is likely to limit the impact, according to German lender Helaba.

Mr Zahn was appointed Deutsche Wohnen CEO in December 2008. Since then, the company's rental income has more than doubled, helped by acquisitions such as the 3.4 billion euro (\$5.5 billion) purchase of GSW Immobilien AG and of 13,500 homes from Patrizia Immobilien AG for 1.1 billion euros. That's lifted its market value to more than 13 billion euros.

However, Mr Zahn can no longer count on acquisitions for growth because far fewer large portfolios are coming onto the market.

"These days, our strategy isn't M&A, it's asset management," he said. Deutsche Wohnen is spending one billion euros to add value to its properties. That includes modernising homes, expanding them by adding an extra storey or even, in some cases, rebuilding them. "We are not in a position where we can expand at the same pace as we did in the last three or four years," Mr Zahn said. "That's why we're investing so much in our existing portfolio." BLOOMBERG

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