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Update on German Housing Market Regulation

On February 7, the coalition partners CDU, CSU and SPD signed a coalition agreement[1] that will serve as the basis for their work in the current legislative period. Below is an overview of the main elements of the coalition agreement as far as the housing market is concerned.

The overriding objective of the coalition agreement is to secure the affordability of housing for tenants while safeguarding modernization investments that are aimed towards successfully coping with climate change and demographic challenges. The proposed measures in terms of regulation suggest that the coalition partners are specifically targeting rogue landlords, who push the envelope by carrying out costly modernization at the expense of their tenants, as well as speculative land buyers.

Rental cap („Mietpreisbremse“)	
Coalition Agreement	Expected Impact
The coalition partners want to make it mandatory for landlords to disclose the previous rental level. Background: A new letting rent currently must not be more than 10% above the local comparable rent. This is national law that is applied by federal states in areas that are defined as “strained housing markets” by the respective municipalities. As such, the Mietpreisbremse does not apply to every location in Germany. Two federal states, NRW and Schleswig Holstein, have even passed legislation to discontinue the Mietpreisbremse in their jurisdiction. Landlords, however, are not forced to relet below the previous rent. Currently there is no mechanism to make the previous rent transparent to potential new tenants.	This suggests that the Mietpreisbremse will not disappear as a concept. It will make it more difficult for rogue landlords to claim that the previous rent was more than 10% above the local comparable. Vonovia has respected the existing legislation and will continue to do so. Vonovia does not expect this new disclosure requirement to have a material impact on its business.

[1] See https://www.cdu.de/system/tdf/media/dokumente/koalitionsvertrag_2018.pdf?file=1 for the full text of the coalition agreement (German only).

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Modernization allocation	
Coalition Agreement	**Expected Impact**
Article 559 of the German Civil Code provides that up to 11% of the investment amount of a modernization project can be allocated to the annual rent of the property in perpetuity, provided the underlying work is modernization/value enhancing (i.e. not maintenance). **The coalition partners want to reduce the 11% to 8%. This shall only apply to areas with a lower "Kappungsgrenze,"** i.e. locations where rent growth on existing tenancies can be no more than 15% over three years (instead of 20%).[2] This is within the discretion of the federal states and implemented in various ways by some and not by others. **The coalition agreement states that this measure shall be reviewed after five years.**	This measure will have a larger impact on landlords that carry out expensive modernizations and a smaller impact on landlords that do more efficient modernization work. Historically, Vonovia has had an average allocation of around 7% of the investment amount, which is also the required average hurdle rate for approving the annual modernization budget. Hence, a reduction from 11% to 8% would have a minor impact on Vonovia. As this applies to some and not to other regions, Vonovia will also have the opportunity to direct investment funds to those regions that are not affected.

€3.00 per sqm rent growth cap following a modernization	
Coalition Agreement	**Expected Impact**
The coalition partners want to cap the absolute rent growth after a modernization to a maximum of €3.00 per sqm and extend the moratorium on modernization-related rent growth form currently three to six years.	This measure appears to be primarily aimed towards rogue landlords who use the modernization allocation to carry out luxury modernizations in order to implement excessive rent growth. Business models that push the envelope on the back of tenants by carrying out costly modernizations will find this to be more difficult going forward. Historically, out of thousands of modernization projects carried out by Vonovia only a small fraction have led to a rent growth of more than €3 per square meter, so this measure will not impact Vonovia.

[2] See https://www.haufe.de/immobilien/verwaltung/mietpreisdeckel-regelungen-der-bundeslaender-zur-kappungsgrenze/mietrechtsaenderung-ermoeglicht-laendern-senkung-der-kappungsgrenze_258_275652.html for more detail on the Kappungsgrenze (German only).

Extension of validity period for Mietspiegel	
Coalition Agreement	Expected Impact
The coalition partners want to extend the validity period of Mietspiegel from currently two years to three years. This shall only apply to Detailed Mietspiegel ("qualifizierte Mietspiegel").	Out of a total of 275 Mietspiegel in Germany, 105 are Detailed Mietspiegel and would be affected; the remaining 170 are Simple Mietspiegel and would not be affected. Markets with a Detailed Mietspiegel might see a time delay in rental growth or an expansion of the time frame under which rent growth can be implemented. It is unlikely that the main intended impact, lower costs for municipalities, will actually materialize. This legislation would have a limited impact on Vonovia and mostly affect the timing of rent growth.

Extension of reference period for Mietspiegel	
Coalition Agreement	Expected Impact
The coalition partners want to review the length of the reference period that serves as a basis for drafting a new Mietspiegel. The current reference period is 4 years.	The coalition agreement only includes one sentence, expressing the parties' intentions to "review" the reference period without any further specifics. The absence of any concrete language or plans suggests that there was little common ground during the coalition talks, hence the rather unspecific reference to review the issue at a later date. Any legislation in that direction would most likely prove to be rather difficult given the absence of comparable data on a continuous basis, as criteria and other parameters in the different Mietspiegel keep changing. In the absence of any specifics on this subject, the actual impact this could have on Vonovia cannot be estimated at this point. It is clear, however, that an extension of the reference period would have material negative consequences on the entire industry, and Vonovia would also be affected.

Subsidy for homebuyers	
Coalition Agreement	Expected Impact
The coalition partners want to grant €1,200 per annum and per child for up to ten years to families who are looking to buy or build, provided their taxable household income does not exceed certain thresholds (€90k in cases of families with one child and an additional €15k for each additional child)	In light of the prices in most urban areas this measure is unlikely to help many families afford a home in a city. Vonovia does not expect any substantial upward pressure on prices for its assets on the basis of these plans.

Subsidies	
Coalition Agreement	Expected Impact
The coalition agreement includes various examples how the new government would aim to subsidize energy efficient modernizations and renovations to enable the elderly to live in their homes longer. The coalition partners have also agreed to promote serial and modular construction and expressed their intention to support the individual federal states to streamline the building permit process and to investigate possibilities for serial construction permissions (potentially not dissimilar to the car industry, where a certain model receives standard approval rather than each vehicle being approved individually).	Modernization of the housing stock and more affordable construction of new apartments are key for the German housing market. Vonovia is a strong supporter of energy-efficient modernization, renovation of apartments for the elderly and intelligent, affordable space creation, as indicated by the annual €1bn investment program. Any further progress or additional support in this direction would be welcomed as a positive for the business.