European Residential Property
Rising Construction, Falling Prices – End of the Party?

The European housing market has been showing signs of fatigue since mid-2017 – particularly in Northern Europe. After many years of real price rises, property markets in Norway, Sweden and Switzerland saw corrections last year, with major cities such as Oslo, Stockholm, Zurich and London the worst affected. Has the house price boom come to an end?

Increased construction leads to house price corrections

Recent house price corrections have, in part, been caused by the significant expansion in the supply of apartments in the last three years. In 2017, supply grew across almost all of Europe for the first time in years. However, growth differs widely among countries.

In Sweden especially, construction of new apartments is well above the long-term average. Construction levels are also above average in Switzerland, Norway, Denmark, Finland and Austria, although not to the same extent.

In Germany, on the other hand, construction is at more normal levels. Although the number of newly-built apartments since 2010 has grown rapidly each year (to around 285,000 in 2017), this followed a 15-year decline between 1996-2010. As of 2017, construction in Germany was close to the long-term average of 3.5 apartments per 1,000 residents.

Construction lags household growth

Should investors worry about increased construction levels in several major European cities? Is there a speculative over-supply of housing? In a word: no. Residential construction still lags demographic changes in most of the major cities considered in this report.

Even in Stockholm and Oslo, the number of households has grown faster than the number of completed apartments in recent years. Of the cities analysed, Munich had the largest imbalance: just 55,000 new apartments for more than 115,000 new households between 2010 and 2017.

Outlook: Apartment and house prices to stabilise in 2018

The current decline in apartment prices should not be confused with the bursting of a speculative bubble due to overly optimistic expectations or irrational exuberance. Speculative construction is not widespread across Europe. The only exceptions are the high-price segments in major cities such as London, Paris or Munich.

Price corrections after years of real price growth are not unusual. Robust economic and demographic conditions will ensure that residential property prices in Oslo and Stockholm will continue to stabilise this year.

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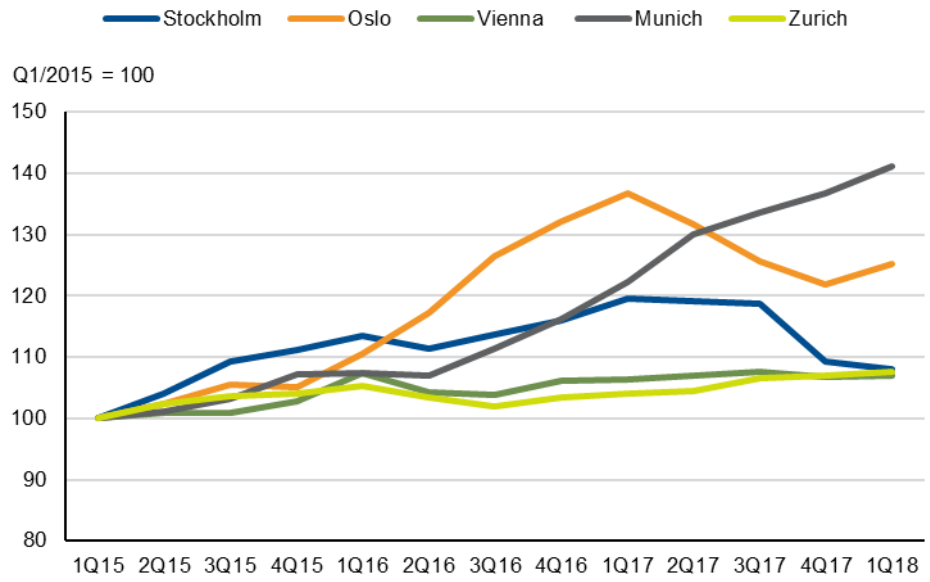
European housing markets – end of the price boom?

European housing markets have shown signs of fatigue since mid-2017 – especially in Northern Europe. The long-standing property boom markets of Norway and Sweden saw a marked fall in house and apartment prices this year, with Oslo and Stockholm particularly affected.

Property prices fall noticeably in Stockholm and Oslo

In 2017, residential property prices fell by 7.8% in Oslo (Eiendomsverdi) and 11.6% in Stockholm (HOX Valuegard index). The residential property markets in Zurich and London also saw price corrections.

Figure 1: Nominal price development for apartments



Sources: Haver, Scope.

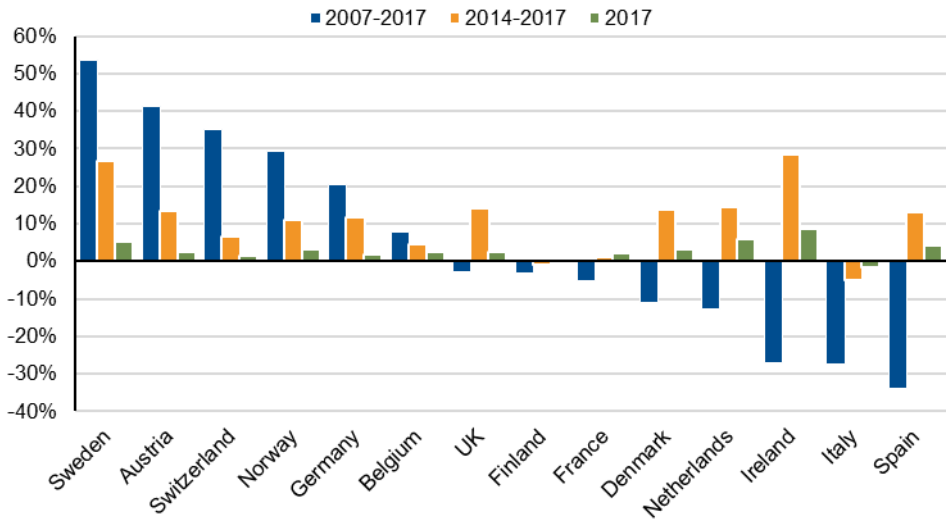
Prices in Sweden grew more than 50% between 2007-2017 in real terms

In the past 10 years, prices in some markets have risen significantly. In Sweden, Austria, Switzerland, Norway and Germany, growth in real residential property prices ranged from 20% to above 50% (see Figure 2).

These price increases resulted from a combination of unprecedented financing conditions, dynamic population and economic growth as well as relatively low construction activity.

Since 2017, however, residential construction in many European countries has been increasing for the first time in years. For investors, it remains to be seen whether housing shortages will still hold as an argument for further price increases in the future.

Figure 2: Real price development for residential property since 2007



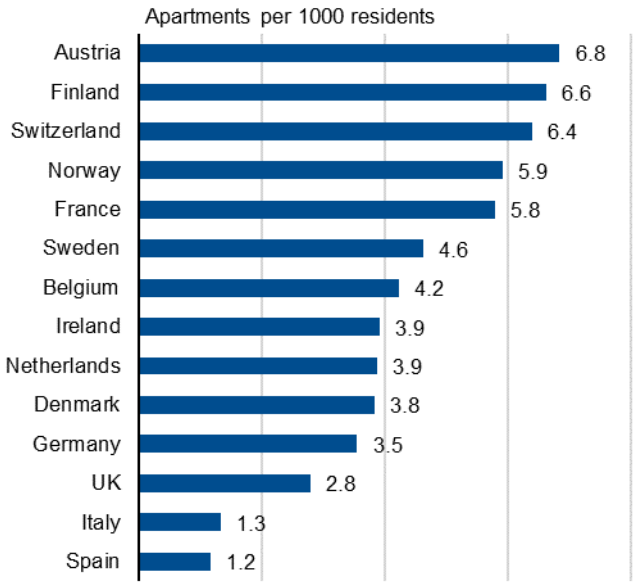
Sources: OECD, Scope.

Price corrections driven by increased construction

Apartment supply rose across Europe in 2017

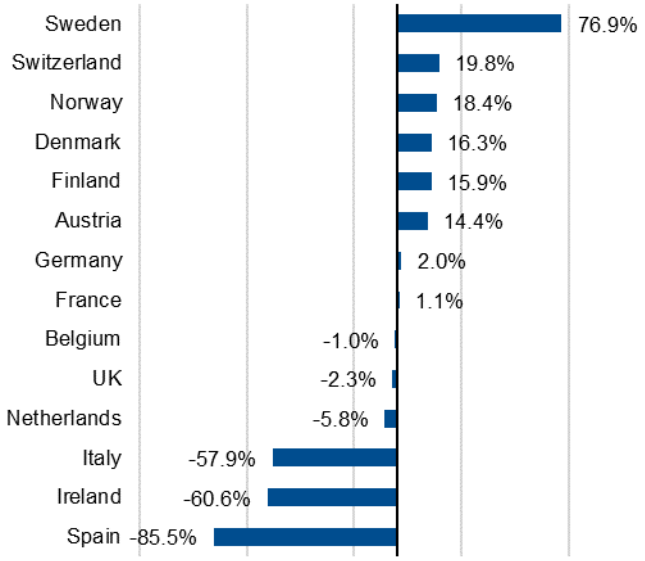
A major reason for recent price corrections in Sweden, Norway and Switzerland is the significant expansion in apartment supply in the last three years. According to a recent EUROCONSTRUCT study, apartment supply in 2017 increased across almost all of Europe for the first time in years. However, growth in the individual countries varies widely – as shown in the charts below:

Figure 3: Construction rate 2017



Sources: National statistical offices, Scope.

Figure 4: Deviation from the 20-year average



Source: National statistical offices, Scope.

The construction rate reflects the ratio of new apartments per 1,000 residents. If this figure is well above the average of the past 20 years, this indicates that the market is reacting to shortages.

Construction of new apartments in Sweden is significantly above the long-term average

Residential construction has increased in all Nordic countries since 2010. In Sweden especially, construction of new apartments is considerably above the long-term average. Construction levels are also above average in Switzerland, Norway, Denmark, Finland and Austria, although not to the same extent.

The situation is different in countries where housing markets collapsed during the financial crisis. In Ireland, Spain, Portugal and Greece a surplus of new apartments led to massive price corrections. In these countries, up to 20 apartments were built per 1,000 residents (see Figure 5).

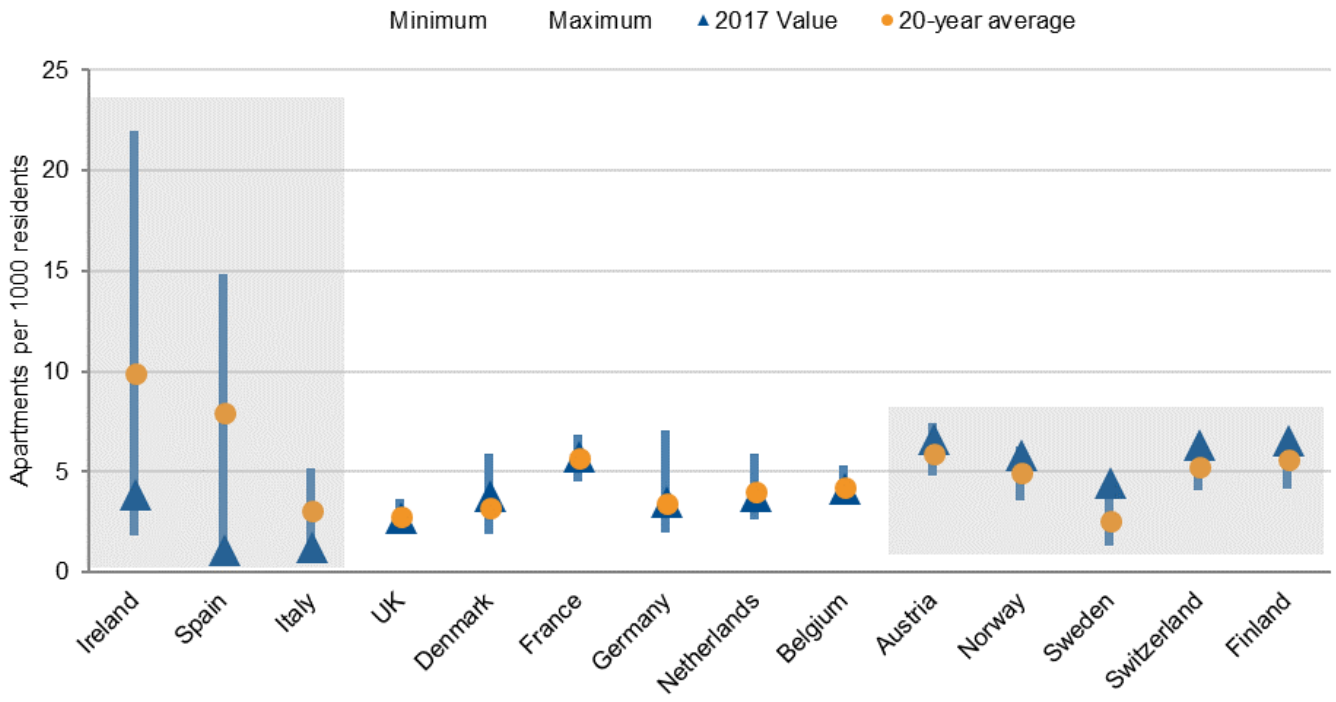
Such values are well above the "normal" range of four to eight that other European countries experienced during boom phases. However, 10 years after the financial crisis, the construction rate in the affected countries is low in comparison with other countries.

Construction rate in Germany close to 20-year average

In Germany, the construction rate is in the normal range Since 2010, the number of new apartments has grown each year, reaching 284,500 in 2017. However, this increase followed a 15-year decline between 1996 and 2010.

In 2017, Germany's construction rate was close to the long-term average of 3.5 apartments per 1,000 residents. The figure will only exceed five if significantly more than 400,000 new apartments are built every year. However, such a scenario is unlikely for the time being, due to capacity constraints in German construction, a lack of buildable land in cities, and restrictions in planning and construction approvals.

Figure 5: Completed apartments per 1,000 residents (construction rate)



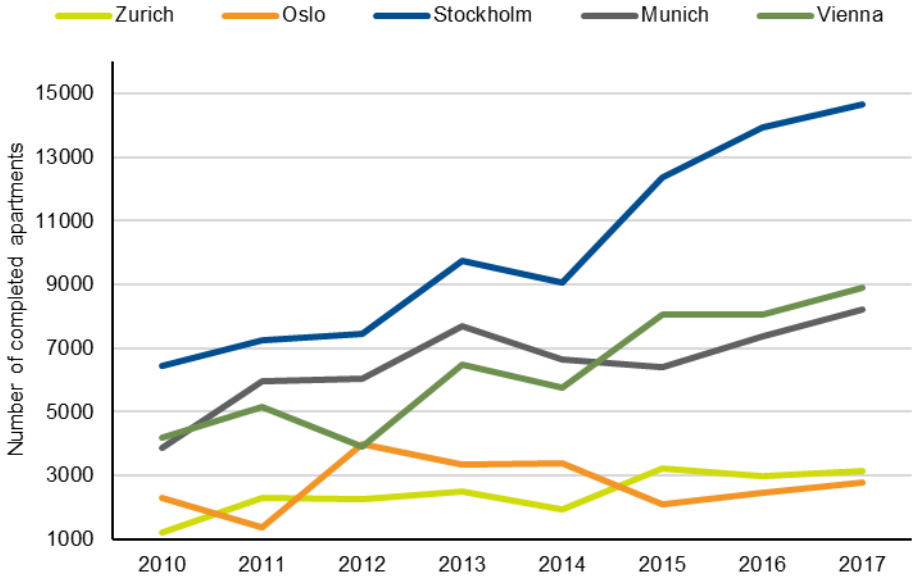
Sources: National statistical offices, Scope; Sorted by distance between current construction intensity and long-term average.

In the last five years, the greater Stockholm area in particular has exhibited a dynamic, price-driven increase in apartment construction (figure 5). In both 2015 and 2016, 13,000-15,000 apartments were built in the Swedish capital. By comparison: in the last 10 years, only around 8,000 new properties on average entered the market each year.

Zurich also saw a marked increase – 13,000 new apartments between 2012-2016 compared with 8,400 units between 2007-2011. In Zurich, expansion is taking place in the rental segment, resulting in declining rents.

In Oslo, the increase in new apartment construction started in the early 2000s. More apartments are also being built in Munich and Vienna. However, the increase in construction in these cities is at the national average.

Figure 6: Completed apartments 2010-2017



Sources: National statistical offices, Scope.

Construction activity: a sign of speculative oversupply?

Should investors worry about increased construction levels in several major European cities? Is there a speculative oversupply in housing? In a word: no. Even in Stockholm, Oslo and Munich, the number of new households is outpacing the number of new apartments.

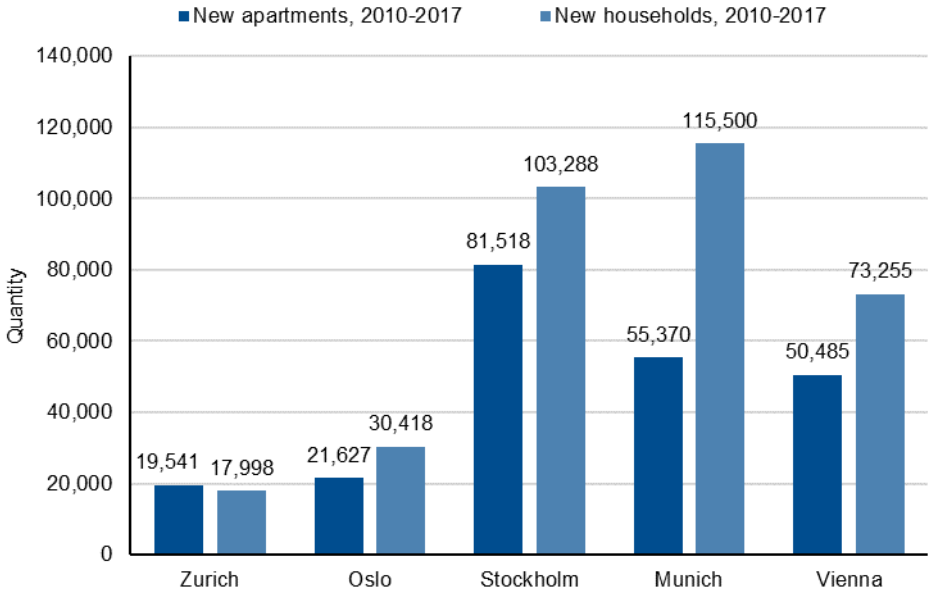
Apartment construction cannot keep pace with demographic changes

When comparing the number of new households with new apartments (see Figure 7), it is evident that construction is not keeping pace with demographic changes in most of the cities analysed.

In both Stockholm and Oslo, the number of households is growing faster than the number of new apartments. Munich has the largest imbalance of the cities analysed, with just 55,000 new apartments for 115,000 new households between 2010 and 2017.

What is driving these imbalances? Cities are encountering a number of obstacles that hinder their flexibility to expand apartment construction, which in turn constricts over-supply. In particular, a lack of buildable land, regulatory obstacles, steeply increasing land prices and construction costs, as well as lengthy approval times are making it difficult to react quickly on the supply side.

Figure 7: New apartments versus new households



Sources: National statistical offices, Scope.

Outlook: Apartment and house prices 2018-2019

The current price correction for apartments in Oslo, Stockholm and Zurich can be attributed to the relationship between effective demand and supply: temporary economic slowdown and weaker population growth have been offset by a higher supply of apartments. In addition, several macroprudential measures have made it more difficult to obtain loans for households willing to buy.

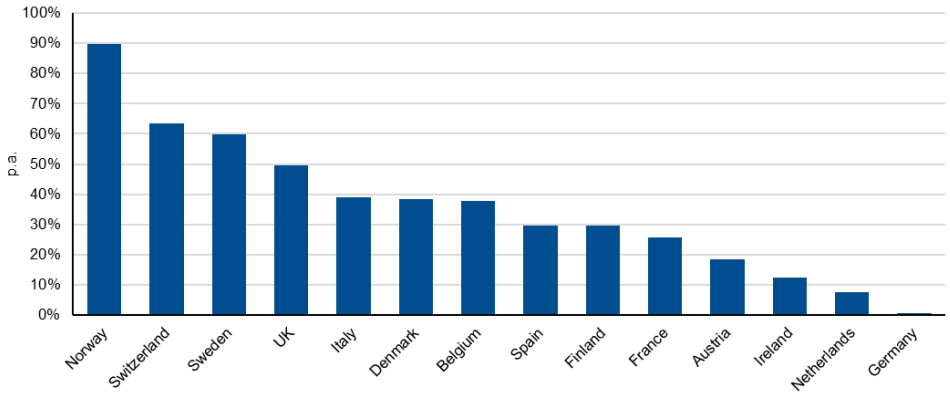
The current decline in apartment prices should not be confused with the bursting of a speculative bubble due to overly optimistic expectations or irrational exuberance. Speculative construction is not widespread across Europe. The only exceptions are the high-price segments in several attractive global cities such as London, Paris or Munich.

The current price corrections after years of real price growth are not unusual. Robust economic and demographic conditions will ensure that residential property prices in Oslo and Stockholm will continue to stabilise this year and increase moderately again from 2019. The same applies for apartments in Zurich.

A decline in residential property prices that threatens the economy and financial system is possible in the event of a severe recession or a massive, sudden rise in interest rates. Both scenarios are unlikely.

Background

Figure 8: UN population forecasts 2017-2030



Source: UN population forecast

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