

## **Dutch residential mortgage market**

The Dutch residential mortgage debt stock is relatively sizeable, especially when compared to other European countries. Since the 1990s, the mortgage debt stock of Dutch households has grown considerably, mainly on the back of mortgage lending on the basis of two incomes in a household, the introduction of tax-efficient product structures such as mortgage loans with deferred principal repayment vehicles and interest-only mortgage loans, financial deregulation and increased competition among originators. Moreover, Loan-to-Value (LTV) ratios have been relatively high, as the Dutch tax system implicitly discouraged amortisation, due to the tax deductibility of mortgage interest payments. After a brief decline between 2012 and 2015, mortgage debt reached a new peak of EUR 813.1 billion in Q4 2022<sup>1</sup>. This represents a rise of EUR 28 billion compared to Q4 2021.

### *Tax system*

The Dutch tax system plays an important role in the Dutch mortgage market, as it allows for partial deductibility of mortgage interest payments from taxable income. Historically, this has resulted in various deferred amortisation mortgage products, most importantly the use of interest-only loan parts.

Since 1 January 2013, all new mortgage loans have to be repaid in full in 30 years, at least on an annuity basis, in order to be eligible for tax relief (linear mortgage loans are also eligible). The tax benefits on mortgage loans, of which the underlying property was bought before 1 January 2013, have remained unchanged and are grandfathered, even in case of refinancing and relocation. As such, new mortgage originations still include older loan products, including interest-only. However, any additional loan on top of the borrower's grandfathered product structure, has to meet the mandatory full redemption standards to allow for tax deductibility.

Another reform imposed in 2013 was to reduce the tax deductibility by gradually lowering the maximum deduction percentage. The highest tax rate against which the mortgage interest may now be deducted is 36.93% (equal to the rate of the lowest income tax bracket).

There are several housing-related taxes which are linked to the fiscal appraisal value ("WOZ") of the house, both imposed on national and local level. Moreover, a transfer tax of 2% is due when a house is acquired for owner-occupation. From 2021, house buyers aged between 18 and 35 years will no longer pay any transfer tax. Currently, this exemption only applies to houses sold for 440,000 euros or less and can only be applied once. For 2023, a transfer tax of 10.4% is due upon transfer of houses which are not owner-occupied (compared to 8% in 2022).

Although these taxes partially unwind the benefits of tax deductibility of interest payments, and several restrictions to this tax deductibility have been applied, tax relief on mortgage loans is still substantial.

### *Loan products*

The Dutch residential mortgage market is characterised by a wide range of mortgage loan products. In general, three types of mortgage loans can be distinguished.

Firstly, the "classical" Dutch mortgage product is an annuity loan. Secondly, there is a relatively big presence of interest-only mortgage loans in the Dutch market. Full interest-only mortgage loans were popular in the late nineties and in the early years of this century. Mortgage loans including an interest-only loan part were the norm until 2013, and even today, grandfathering of older tax benefits still results in a considerable amount of interest-only loan originations.

Thirdly, there is still a big stock of mortgage products including deferred principal repayment vehicles. In such products, capital is accumulated over time (in a tax-friendly manner) in a linked account in

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<sup>1</sup> Statistics Netherlands, household data.

order to take care of a bullet principal repayment at maturity of the loan. The principal repayment vehicle is either an insurance product or a bank savings account. The latter structure has been allowed from 2008 and was very popular until 2013. Mortgage loan products with insurance-linked principal repayment vehicles used to be the norm prior to 2008 and there is a wide range of products present in this segment of the market. Most structures combine a life-insurance product with capital accumulation and can be relatively complex. In general, however, the capital accumulation either occurs through a savings-like product (with guaranteed returns), or an investment-based product (with non-guaranteed returns).

A typical Dutch mortgage loan consists of multiple loan parts, e.g. a bank savings loan part that is combined with an interest-only loan part. Newer mortgage loans, in particular those for first-time buyers after 2013, are full annuity and often consists of only one loan part. Nonetheless, tax grandfathering of older mortgage loan product structures still results in the origination of mortgage loans including multiple loan parts.

Most interest rates on Dutch mortgage loans are not fixed for the full duration of the loan, but they are typically fixed for a period between five and 15 years. Rate term fixings differ by vintage, however. In recent years, there has been a strong bias to longer term fixings (20-30 years) but recently 10 year fixings are rapidly increasing in popularity as the sharply increased mortgage rates drive borrowers to seek lower mortgage payments by going for shorter fixings. Most borrowers remain subject to interest rate risk, but compared to countries in which floating rates are the norm, Dutch mortgage borrowers are relatively well-insulated against interest rate fluctuations.

#### *Underwriting criteria*

Most of the Dutch underwriting standards follow from special underwriting legislation (“Tijdelijke regeling hypothecair krediet”). This law has been present since 2013 and strictly regulates maximum LTV and Loan-to-Income (LTI) ratios. The current maximum LTV is 100% or 106% when financing energy saving measures. The new government has indicated not to lower the maximum LTV further. LTI limits are set according to a fixed table including references to gross income of the borrower and mortgage interest rates. This table is updated annually by the consumer budget advisory organisation “NIBUD” and ensures that income after (gross) mortgage servicing costs is still sufficient to cover normal costs of living.

Prior to the underwriting legislation, the underwriting criteria followed from the Code of Conduct for Mortgage Lending. Although the Code of Conduct is currently largely overruled by the underwriting legislation, it is still in force. The major restriction it currently regulates, in addition to the criteria in the underwriting legislation, is the cap of interest-only loan parts to 50% of the market value of the residence. This cap was introduced in 2011 and is in principle applicable to all new mortgage contracts. A mortgage lender may however diverge from the cap limitation if certain conditions have been met.

#### **Recent developments in the Dutch housing market**

Following years of strong house price growth, the Dutch housing market has started to cool down rapidly as a significant rise in mortgage interest rates in 2022 has put affordability under substantial pressure, with households able to borrow tens of thousands of Euros less and faced with higher monthly mortgage payments. Moreover, declining consumer confidence and increased supply has put further pressure on house prices. Whilst existing house prices (PBK-index) in March 2023 declined by 2.3% year-on-year, the month-on-month decline slowed compared to February to 0.5%. It followed a number of month-on-month price declines in recent months, and declining faster than anticipated due to the stronger than anticipated rise in interest rates.

Despite the correction that’s underway, transaction volumes are not collapsing. In the first quarter of 2023, a little over 40,400 homes changed hands, down 7.9% year-on-year and dropped by 21.2% compared to the fourth quarter last year. The number of homes for sale has rapidly increased, though

coming from a low level, resulting in more choice for potential homebuyers and contributing to a more normal property market. Overall, homes are still being sold and sold relatively fast as well so buyers are ultimately found, though at a lower price level than before.

Positive factors for the Dutch housing market and house prices are the persistent housing shortage, generally high levels of home equity for subsequent homebuyers moving, a large pool of subsequent buyers able to take their low mortgage rates with them to a new house and high rents and limited supply in the rental sector. Negative factors are risks like even higher interest rates, a renewed energy price shock, higher building costs, general inflation that's high and the impact of housing market policies of the government and municipalities.

### **Forced sales**

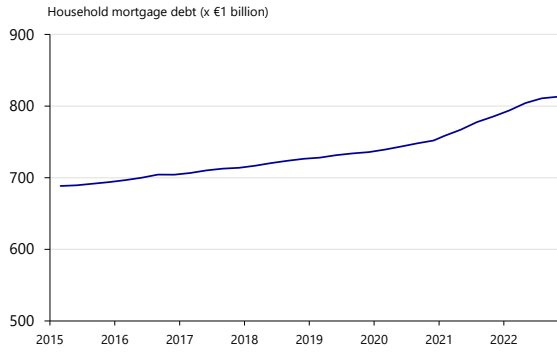
Compared to other jurisdictions, performance statistics of Dutch mortgage loans show relatively low arrears and loss rates<sup>2</sup>. The most important reason for default is relationship termination, although the increase in unemployment following the economic downturn post financial crisis was increasingly also a reason for payment problems. The ultimate attempt to loss recovery to a defaulted mortgage borrower is the forced sale of the underlying property.

For a long time, mortgage servicers opted to perform this forced sale by an auction process. The advantage of this auction process is the high speed of execution, but the drawback is a discount on the selling price. The Land Registry recorded 54 forced sales by auction in the first quarter 2023 (0.13% of total number of sales in the same quarter).

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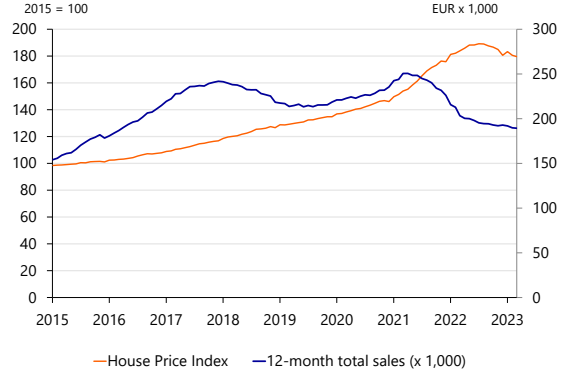
<sup>2</sup> Comparison of Moody's RMBS index delinquency data.

**Chart 1: Total mortgage debt**



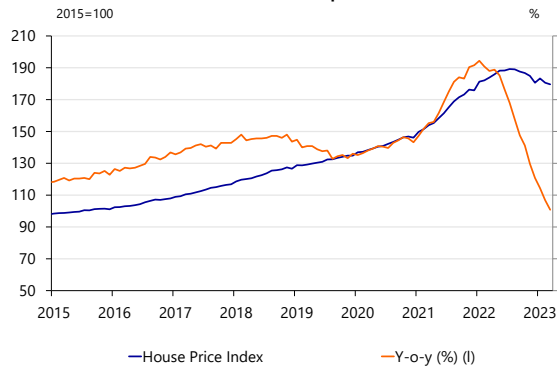
Sources: Statistics Netherlands, Rabobank

**Chart 2: Sales**



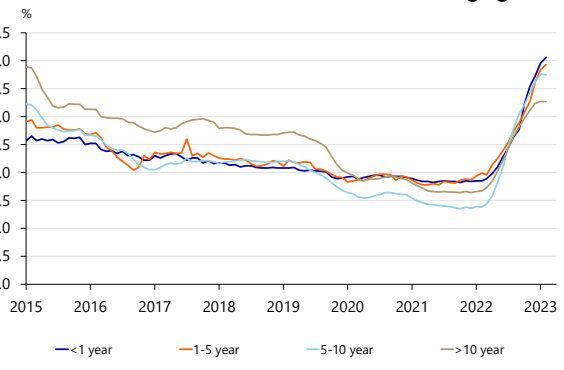
Sources: Dutch Land Registry (Kadaster), Statistics Netherlands (CBS)

**Chart 3: Price index development**



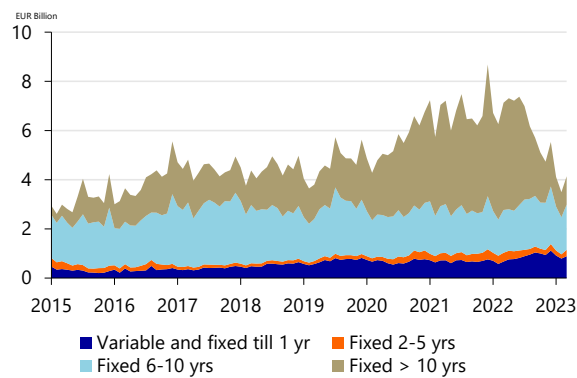
Sources: Statistics Netherlands, Rabobank

**Chart 4: Interest rate on new mortgage loans**



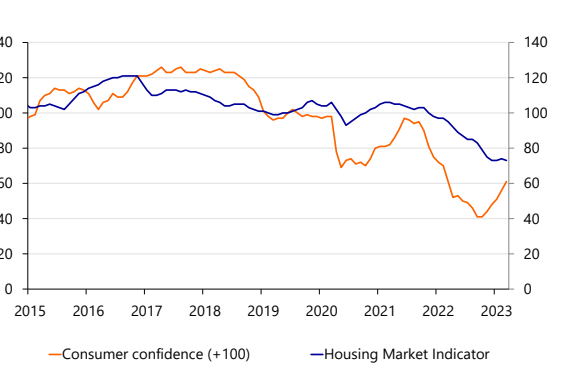
Source: Dutch Central Bank

**Chart 5: New mortgages by interest type**



Source: Dutch Central Bank

**Chart 6: Confidence**



Sources: Statistics Netherlands, OTB TU Delft and VEH