DUTCH RESIDENTIAL MORTGAGE MARKET

Compared to other mortgage markets in Europe, the Dutch residential mortgage market is typified by a wide range of mortgage loan products and a high degree of competition between mortgage lenders. The latter has recently been questioned by consumer organisations. In their view margins have become too high due to government interference. Banks who received government support were restricted in the sense that they are not allowed to be a price leader. The Dutch competition authority concluded that this was not the case.[1] Furthermore, historic practices, culture and most importantly tax legislation (especially those pertaining to the deductibility of mortgage interest) have shaped the Dutch residential mortgage market in quite a unique way.

Dutch mortgage loans predominantly carry fixed rates of interest that are typically set for a period of between 5 and 10 years. The historically low mortgage loan interest rates in the last decade provided an incentive for households to refinance their mortgage loans with a long-term fixed interest rate (up to as much as 30 years, which gives people almost life-long certainty).[2] For this reason Dutch mortgage borrowers are relatively well-insulated against interest rate fluctuations.[3]

Even though Dutch house prices have declined since 2008, the principal amount outstanding of Dutch mortgage loans has continued to increase until the second quarter of 2011. Since then the aggregate outstanding mortgage debt of Dutch households is stabilising (Chart 1)[4]. The Dutch mortgage market is still supported by a gradual increase in the levels of owner-occupation and an environment of low mortgage loan interest rates.

In the period prior to the credit crisis increased competition and deregulation of the Dutch financial markets resulted in the development of tailor-made mortgage loans consisting of different loan parts and features, including mortgage loans involving investment risks for borrowers. The relatively risky mortgage loan products have since the start of the credit crisis in 2007 lost their attraction and are nowadays no longer provided.[5]

Tax deductibility and regulation
The mortgage loan products offered by lenders reflect the tax deductibility of mortgage loan interest (which was deductible in full until 2001, see next paragraph) and enable borrowers to defer repayment of principal so as to have maximum tax deductibility. This is evidenced by relatively high loan to foreclosure values and the extensive use of interest-only mortgage loans (which need only be redeemed at maturity). For borrowers wanting to redeem their mortgage loan without losing tax deductibility, alternative products such as 'bank saving mortgage loans' were introduced. The main feature of a bank savings mortgage loan is that the borrower opens a deposit account which accrues interest at the same interest rate that the borrower pays on the associated mortgage loan. At maturity, the bank savings are used to redeem the mortgage loan.

As from January 2001, mortgage loan interest tax deductibility is restricted in three ways. Firstly, deductibility applies only to mortgage loans on the borrower's primary residence (and not to secondary homes such as holiday homes). Secondly, deductibility is only allowed for a period of up to 30 years. Lastly, the top tax rate has been reduced from 60% to 52%. However, these tax changes did not have a significant impact on the rate of mortgage loan origination, mainly because of the ongoing decrease of mortgage interest rates at that time.

On top of the limitations that came into force in 2001, tax deductibility of mortgage loan interest payments has been further restricted as from 1 January 2004 for borrowers that relocate to a new house and refinance their mortgage loan. Under the new tax regulation (*Bijleenregeling*), tax deductibility in respect of interest on the mortgage loan pertaining to the new house is available only for that part of the mortgage loan that equals the purchase price of the new house less the realised net profit on the old house.

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[1] NMA, Sectorstudie Hypotheekmarkt, 30 May 2011
[2] Dutch Central Bank, statistiek, statistieken DNB, financiële markten, rentes, T1.2.2 (31 October 2012)
[3] Maarten van der Molen en Hans Stegeman, 2011, De ongekende stabiliteit van de Nederlandse woningmarkt, 7 May 2011
[4] Dutch Central Bank, statistiek, statistieken DNB, huishoudens T11.1 (31 October 2012)
[5] Boonstra and Treur (2012) "Reactie op: Hollands hoge hypotheekrentes" ESB, 12 October 2012

Since 1 August 2011, the requirements for mortgage lending have been tightened by the Financial Markets Authority (*AFM*) leading to a revised Code of Conduct for Mortgage Lending (*Gedragscode Hypothecaire Financieringen*), to limit the risks of over-crediting. Under those tightened requirements, the principal amount of a mortgage loan may not exceed 104% of the market value of the mortgaged property plus transfer tax. In addition, only a maximum of 50% of the market value of the mortgaged property may be financed by way of an interest-only mortgage loan. In addition, the revised Code of Conduct provides less leeway for exceptions using the 'explain' clause.[6] Consequence is that banks are less willing to deviate from the rules set by the revised Code of Conduct. This will make it more difficult for especially first-time buyers to raise financing as they used to be overrepresented as borrowers of mortgage loans subject to an explain clause. In practice, expected income rises of first-time buyers were frequently included, which lead to additional borrowing capacity.[7]

Recent changes in regulation

On 26 April 2012, five political parties agreed on an austerity package to reduce the Dutch budget deficit to less than 3% in 2013. As part of the agreement (referred to as the Spring Agreement), from 1 January 2013 new mortgage loans will only qualify for tax deductibility if the relevant borrower redeems his mortgage loan on an amortisation basis or faster. Furthermore, the maximum loan-to-value (mortgage loan versus the market value of the house) will be gradually lowered to 100%. The transfer tax that was already temporarily lowered from 6% to 2% on 1 July 2011 with effect from 15 June 2011, will remain at 2%.[8] In the coalition agreement that was agreed after the elections in September 2012 the proposals contained in the Spring Agreement were broadly retained. However, certain additional measures are proposed in the coalition agreement, such as the lowering of the income tax rate which may be used for mortgage tax deductibility from 52% to 38% over28 years, so a 0.5 per cent reduction per year. In addition, interest paid on any outstanding debt from a mortgage loan remaining after the sale of a home could be deducted for up to five years. This measure will be in place from 2013 up to and including 2017. Both the Spring Agreement and coalition agreement are not incorporated into legislation yet. It is likely that the impact on the house price level will be negative[9], but the extent is uncertain and depends amongst other things on the overall confidence level and the real disposable income development.

Recent trend in house prices and transactions[10]

The Dutch residential property market is still not showing any signs of recovery. In the third quarter of 2012 the average house price fell by 8.0% as compared to the same period last year (Chart 2). A lack of confidence among house buyers has sapped momentum from the market. From peak-to-trough the price decline amounts to 15.6% (Chart 3). Residential property sales went down in the third quarter and still fluctuate at a low level. On a twelve-month basis, the number of transactions amounts to 113,637 which is around 45% lower than pre-crisis (Chart 4).[11]

Foreclosures

The number of arrears and involuntary sales of residential property by public auction ("forced sale") in the Netherlands is traditionally very low compared to international standards.[12] Especially in the second half of the 1990s, when the demand for residential property was exceptionally strong, house sales by auction, even in the event of a forced sale, almost never occurred or were required. Moreover, the 1990s were characterised by very good employment conditions and a continuing reduction of mortgage interest rates. In the years before 2001, the total number of foreclosures was therefore limited compared to the number of owner-occupied houses.[13]

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6 Under the "explain" clause it is in exceptional cases possible to deviate from the loan-to-income and loan-to-value rules set forth in the Code of Conduct

7 M.T. van der Molen, 2012, Aanschaffen woning is makkelijker, January 2012

8 Rijksoverheid, 2012, Stabiliteitsprogramma Nederland, april 2012 actualisatie

9 CPB, 2012, Analyse economische effecten financieel kader Regeerakkoord, 29 October 2012

10 Rabobank Economic Research Department - Dutch Housing Market Quarterly August 2012

11 Statistics Netherlands, cijfers, cijfers per thema, bouwen en wonen, verkochte woningen (31 October 2012)

12 Comparision of S&P 90+ day delinquency data,

13 Kadaster and CBS, cijfers, cijfers per thema, bouwen en wonen, verkochte woningen (31 October 2012)

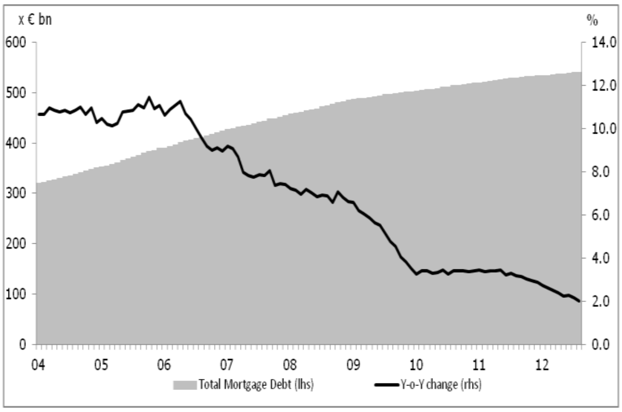
The relatively prolonged economic downturn from 2001 to 2005 led to a significant rise in the amount of mortgage loan payment arrears and correspondingly forced house sales (Chart 5). The number of foreclosures in the Netherlands reported by the Land Registry (*Kadaster*) rose from 695 in 2002 to about 2,000 forced sales from 2005 onwards. This increase was mainly the result of a structural change in the Dutch mortgage loan market during the nineties: instead of selling single income mortgage loans only, lenders were allowed to issue double income mortgage loans. The subsequent credit crisis and the related upswing in unemployment led to a rise of the number of forced sales. The Land Registry (*Kadaster*) recorded 2,811 forced sales in 2011. In the third quarter of 2012 the number of foreclosures amounted to 520, compared to 432 in the same period in 2011 (Chart 5). Recent research confirms that the number of households in payment difficulties in the Netherlands is low from an international perspective and that problems mainly have 'external' causes such as divorce or unemployment as opposed to excessively high mortgage debt.[14]

The proportion of forced sales is of such size that it is unlikely to have a significant impact on house prices. The Dutch housing market is characterised by a large discrepancy between demand and supply, which mitigates the negative effect of the economic recession on house prices. In the unforeseen case that the number of foreclosures were to increase significantly, this could have a negative effect on house prices. Decreasing house prices could in turn increase loss levels should a borrower default on his mortgage loan payment obligations.

Even though in a relative sense the increase over the last years is substantial, the absolute number of forced[15] sales is obviously still small compared to the total number of residential mortgage loans outstanding. There is no precise data of the number of residential mortgage loans outstanding in the Netherlands. However, based on the published total amount of residential mortgage debt outstanding[16] and the current average mortgage loan principal amount it is estimated that the total number of residential mortgage loans outstanding in the Netherlands exceeds 3 million. A total of approximately 2,500 foreclosures per year since 2005 therefore corresponds to approximately 0.1% of the total number of residential mortgage loans outstanding.

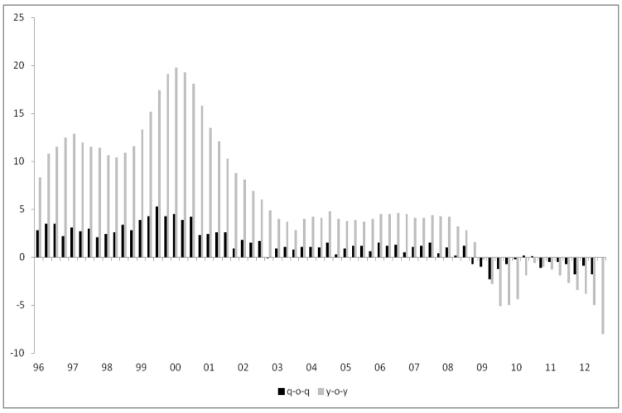
[14] Standard & Poor's, 2010, Mortgage lending business supports some European banking systems
[15] Kadaster
[16] Dutch Central Bank, statistiek, statistieken DNB, huishoudens T11.1 (31 October 2012)

Chart 1: Total mortgage debt



Source: DNB

Chart 2: Dutch property price development

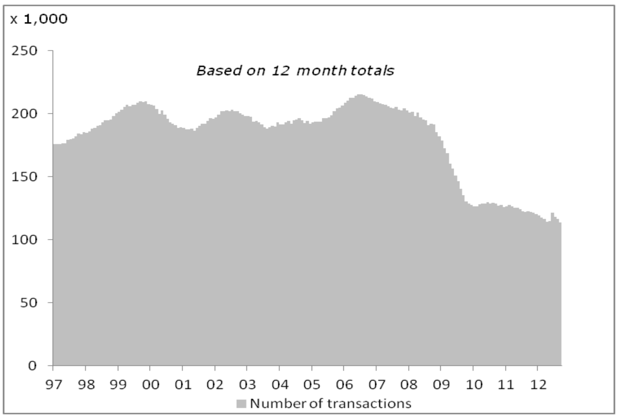


Source: NVM

Chart 3: Development house price index

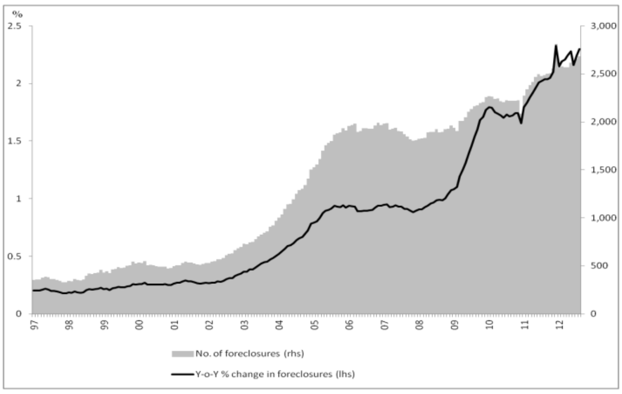
Source: Statistics Netherlands/State Registry

Chart 4: Number of house sale transactions



Source: Land Registry

Chart 5: Number of foreclosures



Source: Land Registry