Housing Market Monitor

Group Economics
Netherlands

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Home sales growth decelerates

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- **Confidence in housing market slightly weaker**
- **Supply shortage dampens transaction growth in popular regions**
- **Tight housing market continues to drive prices higher**

Although confidence remains high, sentiment has faded somewhat in the past year. Since the peak late last year, optimism has weakened slightly – despite the sustained economic recovery. Enthusiasm is being tempered partly by the expectation that interest rates have bottomed out and are poised to rise, but above all by the growing housing shortage. The tightness in the housing market is reflected in the transaction pattern. Sales are rising sharply in the regions that previously lagged behind, but are under strong pressure in the regions where the stock of properties for sale is limited. Buyers are struggling to find a suitable home. We expect this trend to continue, with the transaction volume falling next year after four years of strong growth. New-build activity is failing to keep pace with demand, and will continue to do so in the coming years. The growing shortage is driving prices higher. So much so, that an increasing number of would-be buyers are finding it difficult to meet the mortgage criteria. First-time buyers are already on the sidelines. They have to save first before they can enter the market. Investors are accounting for a growing share of the number of transactions, indicating that personal savings and assets are playing an increasingly prominent role in the housing market. Apart from a minor adjustment to price developments this year in connection with the higher number of completions, we maintain our previous forecasts. We prefer to keep our powder dry until the new Dutch government is in place and has unveiled its plans. We are particularly curious to hear how it proposes to tackle the housing shortage.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2016	20.5	5.1
2017	15	7.5
2018	-5	5

Source: ABN AMRO Group Economics

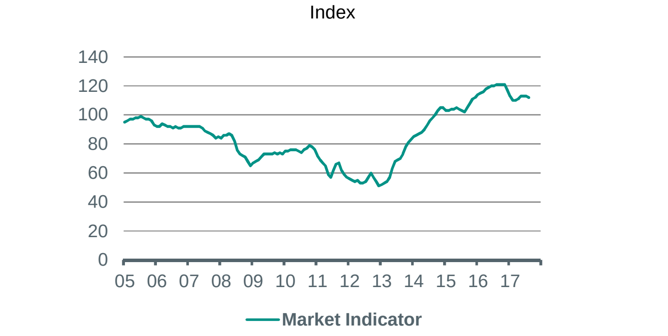
Why is confidence slightly weaker?

Confidence is high in the Dutch housing market. The Dutch Homeowner's Association (VEH) Market Indicator stood at 112 in August, well above the neutral value of 100 where optimistic and pessimistic respondents are in perfect balance.

This confidence is underpinned by the combination of low interest rates, a strong economy, better marketability of owner-occupied properties and the anticipation of further price increases. Thanks to low interest rates, the costs of home ownership are easier to bear. The Calcasa affordability index, which shows housing costs as a percentage of net household income, stands at 14.2%, nearly half the level in 2008.

However, confidence has weakened somewhat this year. In August 2016, the VEH Market Indicator was still at a peak value of 121. The decline to 112 is partly attributable to the shrinkage in supply. Owing to the constrained supply, respondents are taking a less positive view of the overall position for buyers. Added to this, more and more buyers anticipate rising interest rates in the future. As interest rates have a big impact on the maximum mortgage loan buyers can secure, the prospect of higher interest rates is dampening confidence.

Optimism about housing market weakens slightly



Source: Dutch Homeowners' Association

Substantial differences can also be seen between diverse groups. Older home movers are more confident than younger generations, probably because they already own a home and therefore benefit more from the recent price recovery. Added to this, flexible job contracts and limited savings make it more difficult for first-time buyers to take out a mortgage.

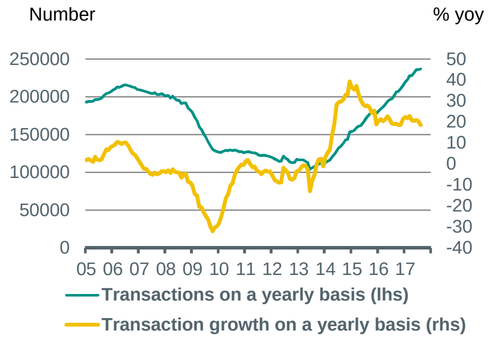
Respondents on high incomes are also more optimistic than lower-income respondents, one reason being that the mortgage criteria have been tightened more for the latter than the former. Another is that higher-income groups have so far gained more from the economic revival than the lower income groups.

Is the drop in confidence reflected in sales?

The most recent transaction data confirm that confidence in the housing market remains strong. In the 12 months until the end of April, no fewer than 237,000 properties were purchased, 35,000 more than last year. Pent-up demand from home movers who postponed their purchase to avoid negative equity, but no longer face this problem, is contributing to the acceleration.

The number of new-build transactions is also picking up, but not as quickly as sales of existing properties. In the first seven months of the year, 20,000 new-builds were sold, 4% more than in the same period last year. The increase for existing properties in this period was 19%. This is not due to a lack of interest in new-builds, but to the shortage of completions. An old problem thus reasserts itself: home construction in the Netherlands is notoriously slow to respond to changes in demand due to regulatory constraints. This is a major sticking point, particularly in view of the challenging construction targets.

Home transaction volume nears peak



Source: Statistics Netherlands (CBS), Land Registry

The revival in house transactions is gradually spreading from large cities to the peripheral areas and more remote regions. The recovery is visible in more and more provinces. The fastest increase in sales of existing homes can be seen in the provinces that initially lagged behind, such as Limburg and Overijssel. The number of transactions in the second quarter there jumped by more than 20% compared to the same quarter last year. In the provinces of Noord-Holland and Utrecht, the initial frontrunners, sales growth decelerated to no more than 3%.

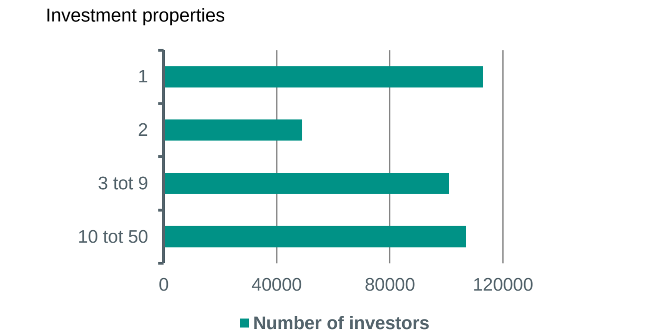
The main reason for the flagging transaction volume in the Randstad conurbation is limited supply. This is putting a brake on the number of transactions. Buyers have less choice, which is making it harder to find a suitable home. According to home search website *huizenzoeker.nl*, there were 95,000 existing houses up for sale in the Netherlands in August. The number in August 2016 was 136,000. The biggest drop occurred in the Randstad conurbation.

The stagnation of sales there caused the rise in the transaction volume to lose momentum compared to the start of the year. We expect this trend to continue. Whereas sales in the rest of the country are still rising, the number of transactions will decline in areas where the housing market is tight. As the Randstad conurbation accounts for a substantial share of the total number of sales, we foresee a slight decline in transaction volume next year after four years of strong growth.

What role do investors play in the housing market?
In recent years, a new group of buyers has become active in the housing market. Private investors are now involved in an estimated one in ten property purchases, so that more and more houses are ending up in their hands. A Land Registry survey shows that their share in the total housing stock increased from 2.6% in 2005 to 4.4% in 2016.

Private investors buy to let. Given the sustained price recovery and higher rents, this promises to yield a good return. This makes property an attractive alternative for investors, particularly given the low savings account rates and relatively high wealth tax. Another factor is that the more flexible labour market is leading to a growing group of self-employed people who are responsible for accruing their own pension and are opting to invest in rented housing.

Private investors are increasingly active



Source: Land Registry/*De Volkskrant*

Private investors favour properties in student cities with constant demand for temporary accommodation, low risk of vacancies and relatively high rents. Parents also see it as a way to provide their student-children with accommodation. Finally, investors are primarily interested in small cheap apartments, which used to be mainly the hunting ground for first-time buyers.

Private investors have the financial resources to make full or partial cash offers, which makes them less dependent on mortgage loans and enables them to waive the mortgage contingency. That way, they can act fast. Few first-time buyers have this advantage, unless their parents help out with a gift.

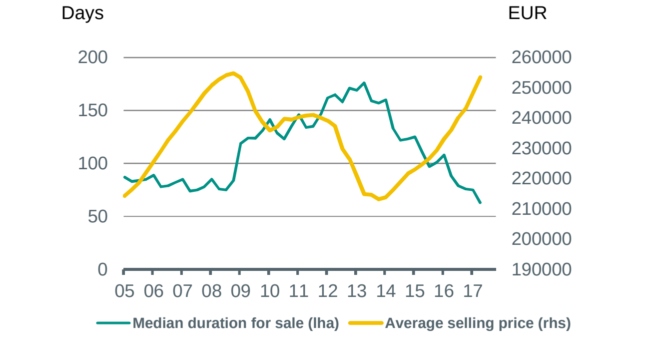
The greater importance of private investments and parental gifts means that personal wealth now plays a more prominent role in the housing market. Land Registry data confirm this picture. These show that the share of non-mortgage purchases climbed from 11% in 2006 to 17% in 2016.

The larger contribution from personal assets does not necessarily reduce the financial risk in the housing market. A bigger presence of private investors in the housing market can sometimes cause greater price volatility. Investors are prone to responding more impulsively to price swings than regular buyers, flocking into the market when the going is good but beating a hasty retreat as soon as the tide turns. However, as private investors are still very much a minority in the Dutch housing market, we believe that this risk is still minor.

Does tightness in the housing market inflate prices?

In today's tight market, buyers find themselves compelled to decide fast. According to the Dutch Association of Real Estate Brokers (NVM), houses took an average of 63 days to sell in the second quarter, over three weeks shorter than in the same quarter last year. Calcasa recently reported that less than one in ten homes is on the market for longer than two years. Three years ago, that number was twice as high.

Buyers must decide faster and pay more



Source: NVM and Statistics Netherlands (CBS)/Land Registry

The tightness in the housing market is reflected in the recent price appreciation. According to the Land Registry, prices in August were 7.9% higher than a year ago, an acceleration relative to the 6% price increase last August. The biggest rise in valuations is occurring in the EUR 250,000 to EUR 500,000 price range. Not coincidentally, this is the segment with the strongest home-mover activity and the highest increase in transaction volume in the past year.

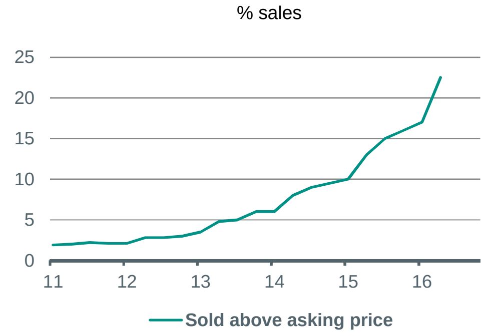
New-build prices are also rising rapidly. According to NVM, new-builds cost 16% more in the second quarter than a year ago. The faster appreciation of new-builds relative to existing properties is due to the changed composition of the new-build properties. Newly completed houses are tailored more to the wishes of home movers and are therefore bigger. In square-metre terms (i.e. adjusted for size), the price increase is considerably smaller at 9%.

With prices soaring upwards, sellers of existing properties feel increasingly free to raise their asking price. The average asking price in August was EUR 352,000, up 8.1% compared to last year. A year earlier, the increase in the asking price was 4.7%.

But putting properties on the market for too high a price is not a wise strategy. A study by the Amsterdam School of Real Estate shows that sellers increase their chance of a high transaction price if they start with a relatively low asking price. A low asking price attracts more interest from prospective buyers and may ultimately lead to a higher price through a bidding-up process.

That said, the increase in asking prices is not preventing buyers from overbidding one another. According to Calcasa, buyer offers now match or exceed the asking price in nearly three out of ten transactions. During the peak of 2007-2008, this only occurred in one out of ten transactions. Moreover, this time around, the overbidding phenomenon is not confined to Amsterdam and Utrecht, but is visible in many more places.

Buyers increasingly overbidding the asking price



Source: Dutch Association of Real Estate Brokers (NVM)

Owing to the high bids, the difference between the last asking price and the actual selling price has decreased. According to NVM, this difference had narrowed to a mere 1.5% in the second quarter. A year ago, this difference was nearly twice as big. The smaller gap reflects the shift in power from buyers to sellers.

Will interest rates continue to underpin the housing market?

As mentioned earlier, low mortgage rates are a major factor underpinning the recovery of the housing market. These low mortgage rates are largely attributable to the European Central Bank (ECB). First of all, the ECB slashed its official interest rates, which pushed down the interest rates on short-term loans. It then embarked on a massive debt purchasing programme, thereby sparking a sharp decline in long-term interest rates.

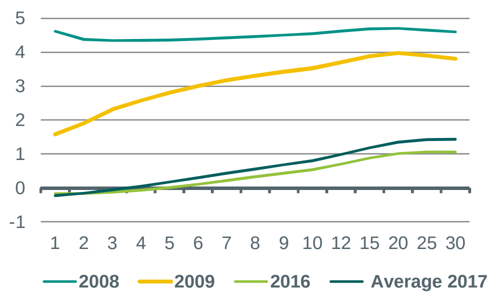
The ECB's objective is to kick-start economic growth and reignite inflation. Regarding the former, its policies appear to be working. The European economy is rebounding, GDP growth is rising and the labour market is recovering. Moreover, confidence indicators point to a further improvement. The Dutch economy is delivering an above-average performance. We estimate that the Dutch economy will grow by 3.1% this year, with unemployment working out at an average of 4.9% of the labour force. For the eurozone as a whole, we foresee 2.3% GDP growth and unemployment of 9.1%.

The second objective, higher inflation, is proving more elusive. At 1.5%, European inflation remains well below the ECB's target of 2%. Structural economic reforms, such as the more flexible labour market and international economic integration, are tempering prices. Added to this, the strong euro is also putting a brake on inflation by lowering the price of imported goods. Owing to the low inflation, the ECB is sticking to its measures, despite the economic recovery.

Nevertheless, we expect the ECB to announce the start of its policy normalisation process some time soon, probably including a reduction in the level of monthly asset purchases from early 2018. Long-term interest rates are likely to edge higher in the run-up to a less active asset purchase policy. For the Netherlands, we see the ten-year rate on government loans rising from 0.4% at year-end 2016 to 0.8% at year-end 2017 and 1.0% at year-end 2018.

Swap rates point to slight upturn in interest rates

Swap rate for terms of 1 to 30 years



Source: Datastream

This is lower than the 1.5% we initially estimated for the end of 2018. The long-term mortgage rate, which moves in step with ten-year interest rates, will therefore also increase less than we foresaw at the start of this year. Low interest rates will thus continue to support the housing market for longer than we assumed at that time.

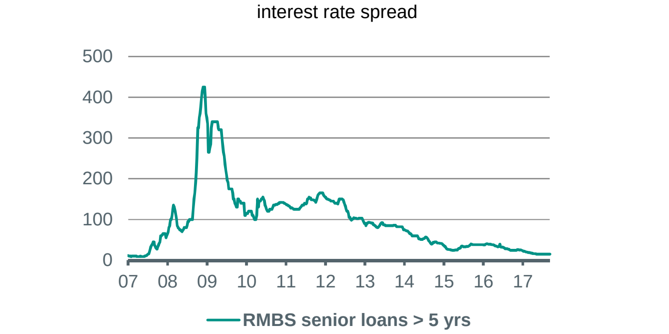
How is the housing market revival translating into new mortgage business?

Apart from the ECB's monetary policy, competition between mortgage providers is also keeping interest rates low. Insurers and pension funds are seizing a steadily growing share of the new mortgage business. Stiff competition is prompting banks to relax their acceptance criteria, as can be seen in the Bank Lending Survey of the Dutch Central Bank (DNB).

Banks also have more latitude to relax their acceptance criteria because of the reduction in credit risks (owing to fewer payment arrears thanks to the recovering labour market). An additional factor is the falling number of loss claims submitted to the Dutch Homeownership Guarantee Fund (WEW). As house prices continue to recover, fewer households face negative equity. Current valuations in the Dutch housing market are now only 5% off the peak of 2008. If this upward momentum is maintained, house prices will surpass that level in the course of next year.

Although fewer households are in arrears, series of bundled mortgage data show that both the number of mortgage borrowers requesting suspension of payments and losses on mortgages are still rising slightly. If the recent upturn in the housing market continues, it is only a matter of time before these aspects also show an improving trend. Judging by the low spreads, investors evidently consider these bundled mortgages a safe bet.

Investors perceive mortgage risk as low



Source: J.P.Morgan

New mortgage business is growing, driven by the sharp rise in transaction volumes and the sustained price recovery. In the 12 months until end of August, 343,000 mortgages were taken out for an average amount of EUR 280,000. Total new mortgage business stands at EUR 95bn, EUR 20bn more than in the year to August 2016.

Against the new mortgage business, there were also repayments, so that the outstanding mortgage amount grew significantly less rapidly. In the second quarter, the outstanding mortgage amount was EUR 669bn, EUR 7bn more than in the same quarter last year. Owing to stronger economic growth, mortgage volume as a percentage of GDP declined again from 96% to 93%, comparable to the level in 2005.

Any news on the political front?

The budget for 2018 presented on Budget Day by the caretaker government contained no surprises. With the days of its tenure numbered, this is not the time for the outgoing cabinet to launch new policies. That is a task for the incoming government. The policy changes set out in the budget have already been approved by Parliament.

The measures announced on Budget Day comprise a further reduction in the maximum mortgage that house buyers can borrow based on the value of their property. This loan-to-value ratio will be reduced by one percentage point to 100%. Because of this change, house buyers must in future finance all additional costs from their own funds. This is the last in the series of planned annual reductions. However, if the Financial Stability Committee has its way, the maximum LTV ratio will in future be reduced further to 90%.

Furthermore, the government confirmed in the 2018 budget that the maximum mortgage interest relief rate will be reduced from 50% to 49.5%. This is in line with the plan to bring down the maximum percentage in small steps to 38% in 2042. Whether this will actually happen, however, is open to question. Based on their election manifestos, the parties currently forming a new government have widely varying opinions on this matter. While centre-right VVD and Christian Democratic CDA want to stick to the current plans, progressive liberal party D66 and Christian Union Party are looking for a faster adjustment.

The cabinet also reiterated that mortgage interest on negative equity will no longer qualify for tax relief. Under this measure, which was introduced during the crisis, mortgage borrowers are eligible for tax relief on the interest paid on negative equity that is included in the new mortgage over a 15-year period. This only applies to negative equity incurred between 28 October 2012 and year-end 2017. Pointing to the regional differences in the housing market, various stakeholder groups want the measure extended. They fear that ending the measure would impede housing market mobility in regions where the price recovery has lagged behind and potential negative equity remains a problem.

Another issue on the political agenda is the income criteria for mortgages. The National Institute for Family Finance Information (Nibud) has advised giving the secondary income more weight in the calculation of the maximum mortgage amount. At the moment, 60% of the lower income of a double-income household can be added to calculate the maximum mortgage cost percentage. Finance Minister Jeroen Dijsselbloem has proposed to raise this to 70%. If the Lower House of Dutch Parliament approves this proposal, double-income households will be able to borrow more from 1 January 2018.

Finally, an adjustment to the Mortgage Loan Scheme has been announced. Under this scheme, the mortgage cost percentage for loans with a term shorter than ten years must be calculated on the basis of the reference rate rather than the current market rate. This means that house buyers can borrow less. However, if the loan is repaid in full, there is no question of an affordability risk for the consumer. For this reason, the current market rate can now also be used to determine the percentage for such short-term loans.

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