Housing Market Monitor

Group Economics

Netherlands

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Bright outlook for 2017 and 2018

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- **Number of housing transactions hit new record in 2016**
- **Rising interest rates bring peak in sight**
- **Persistent housing shortages drive up prices**

The Dutch housing market continued its remarkably strong recovery in 2016. Housing sales hit record highs and prices soared. But there were marked regional differences. The recovery was mainly visible in the larger cities.

Multiple causes are fuelling the revival. The most eye-catching are low interest rates and insufficient construction activity. The economic upturn has also made home buyers more confident. Finally, pent-up demand remains as strong as ever. We expect these factors to continue propelling the housing market in the coming years. Additional impulses, effective from 1 January, are the less stringent mortgage income criteria for many households, the increased NHG mortgage guarantee limit and the expansion of the gift exemption.

Despite all these positives, the housing market will gradually lose momentum. Sales will peak first, after which the price increases will also start to slow. The weakening is partly due to the falling number of entrants into the market. First-time buyers will have a harder time finding suitable properties because of the elevated prices and stricter mortgage criteria, though some can benefit from the expanded gift exemption. Another factor dampening the transaction volume is the lack of suitable properties for sale. Finally, the housing market will become less affordable as mortgage rates start to rise.

Price and transaction estimates

	Transactions (% y-o-y)	Prices (% y-o-y)
2016	20	5
2017	5	5
2018	-5	3

Source: ABN AMRO Group Economics

What are the most recent developments in the housing market?
The housing market is gradually moving towards a seller's market. One tell-tale sign of this shift in power from buyers to sellers is the average selling price, which has been on the rise since the end of 2015.

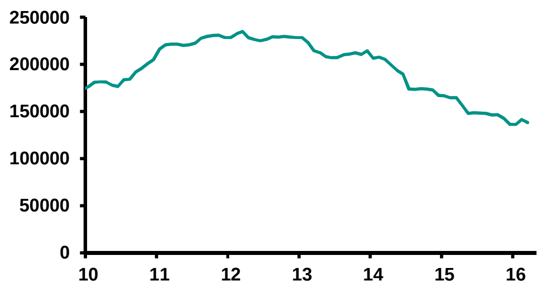
Sellers can ask more because of the higher valuation levels in the housing market. According to the Land Registry, prices in November were 6% higher than a year ago. Meanwhile, prices are 13% above the low point of 2013. The appreciation in value is broad-based across all provinces and types of housing. However, apartments and houses in the Randstad conurbation in the west are showing above-average increases. Prices of higher-end properties and pre-war housing are also rising relatively strongly.

Another sign that sellers are back in the ascendancy is the growing number of buyers bidding above the asking price. Calcasa estimates that one in five transactions now involves overbidding. Four years ago, this applied to at most one in twenty transactions. The shift is mainly visible in the larger cities. Amsterdam is clearly the hottest market of all, with buyers overbidding in three out of four transactions.

Stock for sale
Buyers also have less choice. According to the *huizenzoeker.nl* property website, there were only 138,000 properties for sale in November, almost 25,000 fewer than a year ago and 100,000 less than four years ago. The dwindling supply means that buyers have less time to decide. One quarter of the properties coming onto the market are sold within three months. A year ago, fewer than one fifth were sold within that timespan.

Shrinking supply restricts choice for buyers

Properties for sale (number)



Source: huizenzoeker.nl

One reason for the housing supply is that buyers are waiting longer before putting their house up for sale. Due to the housing market recovery and rising prices, they see buying first and selling later as less of a risk than before. In fact, in the cities with the hottest markets, selling first is actually becoming the bigger risk. Because sellers cannot be certain of finding a new home in time.

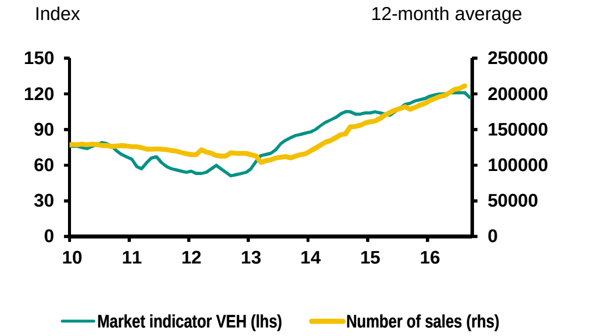
The main reason for the decrease in the housing supply, however, is the high number of transactions. Land Registry data show that 211,000 properties were sold in the twelve months until the end of November, 29,000 more than in the twelve months until the end of November 2015. So there is every chance that the number of sales in 2016 will break the 2006 record, when a total of 210,000 properties were sold. Home movers are the main driving force behind this growth. Between 2010 and 2014 first-time buyers accounted for the majority of sales. But not in the past two years. At present, their share has shrunk to only 40% of the transactions.

Pent-up demand is currently giving an extra boost to house sales. In recent years many people postponed buying a new home, partly because of the risk of negative equity. Thanks to the recent price increases, however, a growing number of homeowners are 'above water'. They can now set their sights on their next home. We expect pent-up demand to hold up for the time being, with home movers accounting for a steadily growing proportion of sales.

Sales move towards peak

Despite this pent-up demand, we think that the peak in sales will come into sight in the coming year. We see the rise in sales weakening in most provinces. One major cause is the insufficient supply of housing. This will hamper transactions and slow the pace of sales growth. Amsterdam, where sales actually dropped off in the third quarter, is an extreme case.

VEH Housing Market Indicator stabilises at record level



Source: VEH

The recent development in the housing market indicator of the Homeowners Association (VEH) confirms our expectation that sales will peak soon. This indicator, which shows a strong correlation with house sales, declined from a peak of 121 in November to 117 in December. This points towards a slowing of sales growth.

The VEH market indicator is still very high. This is mainly attributable to the optimism among current homeowners. They are benefiting from the higher house prices. Young first-time buyers and lower income households are less positive. The combination of higher house prices and stricter mortgage criteria is keeping them out of the market. If the number of new entrants drops, this will eventually affect the optimism of current homeowners.

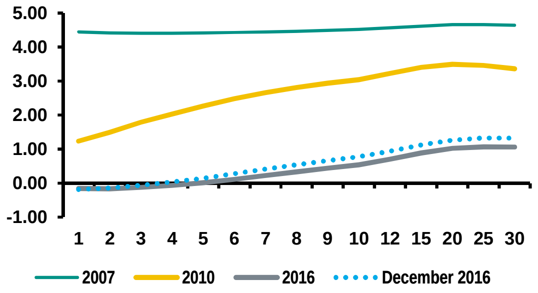
Why the strong price recovery?

The most important explanation for the sustained improvement in the housing market is the low interest rates. The average mortgage rate has fallen from 5.6% in 2008 to 2.4% in October. Interest rates have been depressed by the economic crisis and the ensuing low inflation. In a bid to turn the tide, the European Central Bank (ECB) cut its official rates, pushing short-term interest rates sharply lower. In addition, it embarked on a massive debt purchase programme, which also dampened long-term interest rates. Early in December, the ECB announced the extension of this programme until the end of 2017. This would seem to secure low interest rates for the time being.

In the United States, however, the central bank is moving in the opposite direction. After previously ending its asset purchase policy and implementing a single interest rate hike, the Federal Reserve recently raised its official rates again. And more of the same is expected. Reasons for upping interest rates are the accelerating US economy and rising inflation (which is partly due to firming commodity prices). The Fed wants to ward off an overly rapid rise in inflation. The chance of an inflationary spiral is growing, particularly if Donald Trump delivers on his campaign promises to introduce strong stimulus measures.

Swap rate edges higher at end of 2016

Swap rate for terms of 1 to 30 years



Source: Thomson Reuters Datastream, *year figures are averages

Rising interest rates in the US are also putting upward pressure on interest rates in the rest of the world. Most swap rates (the interest rate on loans between banks) have already risen, particularly the interest rates on longer-term swaps. We expect this development to continue, with mortgage rates slowly starting to creep upwards after a prolonged period of decline. All in all, however, mortgage rates are set to remain low. Interest rates will thus continue to keep the housing market affordable and underpin the price recovery, albeit to a lesser extent than before.

Bottlenecks

That said, two issues hanging over the market could still lead to higher mortgage rates. First of all, there is the debate about the capital buffers that banks are required to maintain under the Basel rules. Stricter buffer requirements threaten to inflate the costs of banks. Secondly, there are plans to curb the securitisation of loans. The European Parliament recently agreed to a proposal requiring banks that want to bundle and resell mortgages to keep a detailed mortgage database that is accessible to investors and regulators. In addition, banks are required to retain part of the loan and investors must disclose their interests to the regulator. These new cost-raising conditions could make mortgage lending more expensive for providers of capital. This, in turn, could lead to less competition and result in higher mortgage rates.

Economic recovery

Another explanation for the rising house prices is the economic recovery. After nine years, per capita GDP is finally back at its pre-crisis level. GDP growth is receiving a further boost from home investments. Other contributors are business investments, public spending and exports. But the biggest driver of GDP growth is currently the consumer. The upturn in consumption is partly attributable to the improved circumstances in the labour market. Employment is growing, unemployment is falling and disposable incomes are rising. This is strengthening consumer confidence and lowering the threshold for would-be home buyers.

New-builds or, more accurately, the shortage of new-builds is another reason for the surge in prices. Though construction investments are rising sharply and the order books of construction firms are full, the number of new-build completions continues to lag demand. Research institution ABF estimates that demand exceeded supply by 134,000 homes in 2015, which is equivalent to 1.8% of the existing housing stock. With new-build production continuing to undershoot demand, ABF sees this shortfall rising to 2.5% in 2018 before gradually decreasing again in the period thereafter. The shortage is particularly acute in the large cities which, as a result, have the highest square metre prices.

Continuing tightness, particularly in large cities

Housing shortage

	2015	2025		2015	2025
Amsterdam	4.2	5.2	Breda:	2.0	1.1
Utrecht:	3.0	3.7	Arnhem	2.0	2.4
Tilburg	3.0	1.6	Oss	1.8	0.3
Haarlem	2.7	2.7	The Hague	1.7	4.4
Nijmegen	2.5	1.4	Gouda	1.5	0.0
Amersfoort	2.4	2.9	Alkmaar	1.4	2.6
Leiden	2.2	-0.6	Lelystad	1.3	2.0
Den Bosch	2.1	-0.2	Roosendaal	1.3	-0.5
Eindhoven	2.1	1.7	Rotterdam	2.1	1.7

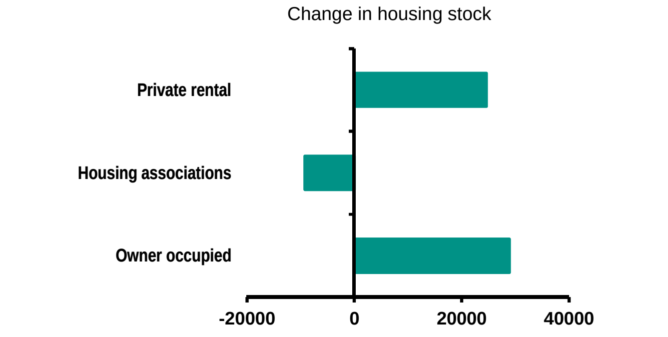
Source: ABF Research

An increase in construction output is needed to alleviate the tightness in the housing market and moderate the upward price trend. Key to achieving this, according to market parties, is a relaxation of the physical planning regulations. Supporting this claim, a recent report of the Economic Institute for Construction (EIB) asserts that many building plans are completed later than planned or abandoned altogether due to complicated decision-making and objection procedures.

Minister Blok is unwilling to comply with the market parties' appeal for regulatory changes. He says that physical planning is primarily the responsibility of the municipalities. In his view, the recent simplification of the municipal decision-making guideline ‘Sustainable Urbanisation Ladder’ already gives municipalities sufficient scope for stepping up building activity. Moreover, municipalities can also make use of expert government teams to accelerate their area development and office transformation initiatives.

Blok thus clearly places the ball in the court of the municipalities. Fortunately, they are not sitting still. Amsterdam recently announced plans to realise a further 20,000 homes in the region on top of the 40,000 already in the pipeline. It sees more compact and more high-rise construction as one way of bringing these plans to fruition. In addition, the capital wants to reduce the pressure on the housing market by sharing the residential burden with adjacent municipalities.

Housing association ownership falling due to new-builds



Source: **Statistics Netherlands (CBS)**

Regarding the construction of rented housing, there is good news for the municipalities. After years of deferring and cutting investments, housing associations are once again ready to do their bit. Combined with demolitions and sales from their existing stock, the total number of housing association homes is decreasing. However, with their replenished cash reserves, housing associations now have scope to invest in new-builds and make their existing housing more sustainable. According to the Aedes umbrella organisation, the housing associations are planning to build 26,000 homes in 2017, 3,000 more than in 2016 and 10,000 more than in 2015.

Private rental

A final explanation for the rising prices is the private rental market. For years, the private rental segment was depressed by the subsidies on owner-occupied and social rented housing. Now that the government is scaling down these subsidies while also tightening the mortgage criteria, people looking for their first home see renting as a more attractive option. This, combined with the government's measures to encourage more market-based rents, is making investors more interested in this segment, particularly now that low interest rates are forcing them to look for alternative investments. Based on the government's three-yearly WoON survey, the share of private rental in the total housing stock rose from 7% in 2009 to 10% in 2015.

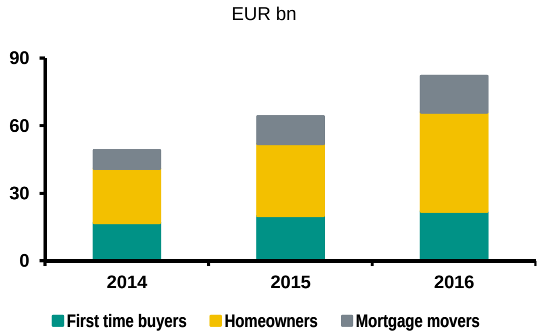
Besides institutional investors, individual investors are also showing more interest in private rental. The more flexible labour market means that a growing group of employed people are responsible for their own pension. For those with sufficient spare capital, buy-to-let is a good option for securing a steady flow of rental income. As a rule, they do not need to borrow as much as owner-occupiers to purchase a property and can therefore do deals more quickly. This puts them at an advantage in the large cities where the housing market is tight and buyers need to decide fast.

Increase in mortgage lending

The increased sales volume combined with higher house prices is giving an impulse to new mortgage business. In the twelve months until the end of November 2016, new mortgages worth EUR 79bn were taken out, EUR 16bn more than in the same month a year earlier. The increase in new business is being driven by the combination of more mortgages together with a higher average sum.

The growth in new mortgage business depends largely on the improved mobility in the housing market and the resulting increase in transaction volume. In addition, many homeowners are moving their mortgages in order to benefit from the low interest rates, a step aided by the fact that penalty interest is tax deductible. The growth in the number of people moving their mortgage is decelerating, however. This is because lenders are increasingly offering customers the option of interest rate averaging and because the mortgage rate differences between providers are narrowing. This makes switching to another provider less lucrative.

First-time buyers have smaller share in new mortgages



Source: IG&H

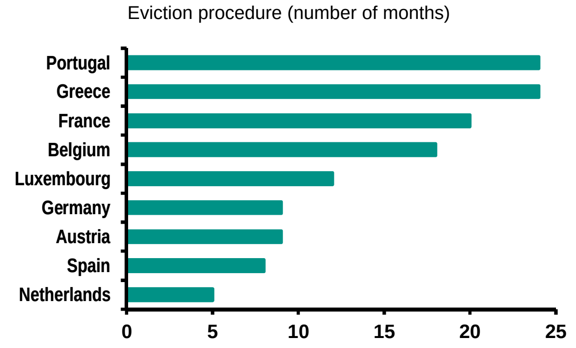
The expanding mortgage market is attracting a growing number of providers. Pension funds and insurers have become particularly active in recent years. According to the Dutch Central Bank (DNB), their share in the outstanding mortgage volume has jumped from 6% to12% in the past six years. Insurers have little scope for further growth. Their premium income is under pressure and mortgage loans already constitute a substantial 15% of their invested assets. Pension funds, by contrast, do still have room for expansion: only 2% of their invested assets is currently tied up in mortgages. The available resources are concentrated in the larger pension funds, which tend to have an international investment focus. Lack of a liquid secondary market and reputational risk explain their reluctance.

The main reason for entering the mortgage market is the current low interest rates. These are compelling pension funds and insurers to look for investments with higher returns. Mortgages are an attractive option, particularly as buyers prefer mortgages with long fixed-rate periods which perfectly matches the long-term funding sources of insurers and pension funds.

Limited risks

An additional advantage for entrants is that the risks on mortgages are limited. DNB research shows that, during the crisis, credit losses on the mortgage portfolios at the four large banks increased only marginally to no more than 0.2% per year. These low losses are due to the social security system which acts as a cushion against excessive loss of income in times of adversity. In addition, people in the Netherlands tend to have few debts other than their mortgage. Finally, banks enjoy relatively ample legal means to call in collateral whenever necessary.

Eviction procedures are comparatively quick



Source: Bover O. (2016), 'Diverging household debt patterns in the Eurozone: The role of institutions', Vox.org

New regulations have reduced the risks on mortgages even further. These days, most new mortgages are subject to annuity repayment obligations. And the mortgage criteria are stricter than before, both in terms of collateral value and income. The ongoing price recovery also provides additional assurance as more homeowners are now above water. Lastly, a growing number of homeowners are able to clear their mortgage arrears thanks to the improving labour market. According to the latest Dutch Credit Bureau Registration (BKR) data, 107,000 homeowners were in arrears in October, 5% less than a year ago.

NHG claims

This picture of receding risks is confirmed by the most recent National Mortgage Guarantee (NHG) data. In the third quarter, 12% of NHG-guaranteed homes had a market value below the NHG-guaranteed amount. By the end of 2015, this percentage had fallen to 18%. The number of loss claims is also falling, as is the average loss amount. In the first three quarters of 2016, the number of submitted loss claims was 21% lower than in the first three quarters of 2015. The average loss amount has declined by 12%.

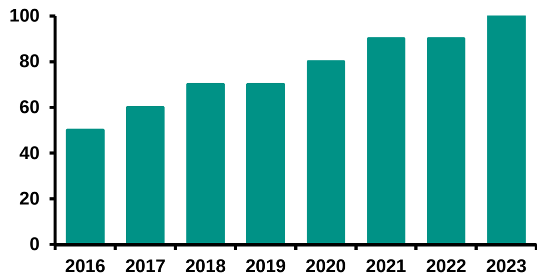
From 1 January, the NHG raised the maximum mortgage limit including additional purchasing costs from EUR 245,000 to EUR 247,500. The amount for energy-efficient homes will rise to almost EUR 260,000. Appreciating property values means that the number of buyers who are eligible for an NHG guarantee is steadily decreasing. In the first three quarters, the number of issued guarantees dropped by 13% compared to the same period last year. Now that NHG is raising the limit, more buyers can make use of the scheme, which is extremely popular among the target group. No less than three quarters of the eligible mortgages carry the NHG label. And the target group will grow even further now that self-employed people qualify sooner than before for a guarantee, namely after one year of independent employment instead of after three years.

Mortgage criteria

In addition, from 2017 home buyers can borrow more on the basis of their income. The National Institute for Family Finance Information (Nibud) has relaxed the income criteria for 2017, so that buyers can borrow more. It should be noted, however, that the more generous criteria only apply to mortgages with an interest rate above 2%. Below this limit (typically NHG mortgages and mortgages with a low *loan-to-value ratio*), the maximum loan amount is lower. From 2017 the second income counts for 60% instead of 50% in the mortgage calculation, enabling double-income households to borrow more. The plan for the coming years is to give the second income steadily more weight and to allow its full inclusion from 2023. Finally, home buyers can borrow a higher amount if they make their home more energy-efficient.

Second income to be given steadily more weight

Inclusion of 2nd income in mortgage calculation (%)



Source: Nibud (National Institute for Family Finance Information)

Note, incidentally, that by no means all home buyers make use of their maximum credit amount. According to the Nibud, 58% of all households who purchased a home since 2012 have a mortgage that is lower than four times their income. This means that the majority of households borrow less than is allowed on the basis of their income.

In contrast with the income criteria, the collateral requirement is to be tightened up. From 2017, buyers are only permitted to borrow 1% more than the value of the collateral, as opposed to 2% in 2016. In 2018 the *loan-to-value ratio* will be reduced by a further percentage point to 100%. That's as far as the current plans go, but the Financial Stability Committee is pressing for a further reduction to 90%.

This recommendation is backed by the European Systemic Risk Board (ESRB) of the ECB, which recently designated the Netherlands as a high-risk country in an international comparative report. The ESRB acknowledges that the government has implemented major reforms, that house valuations are broadly in line with structural price levels and that the banking sector runs little risk and has adequate capital buffers. Nevertheless, it still regards the outstanding mortgage debt as too high and the number of 'under water' properties as too large.

Reforms

Apart from a tightening of the LTV criteria, the ESRB also recommends an accelerated reduction of the mortgage interest relief scheme. The International Monetary Fund shares this view. In its recent country report on the Netherlands, the IMF urges the government to lower the marginal rate at which borrowers are allowed to deduct mortgage interest by 1 percentage point annually instead of the current half percentage point. The marginal rate in 2017 is 50%, half a per cent lower than in 2016.

In a recent report, the Netherlands Scientific Council for Government Policy (WRR) also presses for further adjustments to the mortgage interest relief scheme. In this report, the council is critical of the gift exemption which the cabinet will raise in 2017 to EUR 100,000 for homeowners under the age of 40. The council sees the taxation of inheritances and gifts as an efficient means of raising revenue which is undermined by exemptions. In addition, the council states that the timing of exemptions is important. Exemptions, it argues, can inflate prices in an overheated housing market. Finally, the council points to the risk of elderly people being tempted by the exemption to give gifts beyond their means.

The government took note of all these well-intentioned recommendations, but has not acted on them. It wants to safeguard the recovery in the housing market and has no appetite for additional measures at the present stage. With elections due in March, this is not the time for further changes. That is a job for the next cabinet.

What is the outlook for 2017 and 2018?

We are counting on more good results from the housing market in 2017. The volume of sales will be high again, and may even show a slight increase. But a rise similar to the one in 2016 is not on the cards. The lack of suitable properties will put a brake on the growth in transactions. In addition, the slight increase in interest rates will gradually dampen house sales. After rising a little bit further in 2017, sales will probably fall back in 2018.

Rising interest rates will also put prices under pressure, albeit at a later stage. In 2017, we expect the price increases to continue unabated, mainly due to the large shortage of suitable properties. Owing to insufficient new-build activity, this shortfall will only grow further. Nevertheless, prices will eventually hit a ceiling. As interest rates rise, the mortgage criteria will impose mounting constraints. The tightening of the criteria had little impact on prices in the past years because interest rates fell. This will change if interest rates rise. Hence our expectation that prices will increase less in 2018.

A note of caution is in order regarding these forecasts. As indicated, there are some uncertainties about the Basel rules and the impact of new securitisation regulations on mortgage lending. The coming months will hopefully provide more clarity on this issue. The upcoming elections in March add further uncertainty. What will the next cabinet look like? What will its stance be on the housing market? And what impact will this have on prices and sales? No clear-cut answers can be given to these questions as yet.

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