Housing Market Monitor

Group Economics
The Netherlands

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Next government's plans still guesswork

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- **House sales and prices continue to rise**
- **Dip in confidence indicators signals slowdown**
- **Divergent housing market plans of coalition candidates**

The housing market is on a roll. The transaction volume has accelerated to 222,000 annualised, an all-time record high. The boom is also more broadly based than before. Initially, Noord-Holland and Utrecht were the main drivers, but other provinces are now catching up. House prices are also on the rise. In February, prices were 6.7% higher than a year ago. Thanks to the sustained upward momentum, prices are now 15% higher than at their low point in 2013.

The strong sales momentum is causing contraction of supply, so buyers have less choice. And with houses changing hands faster, they also have less time to decide. The buyer's market seems to be making way for a seller's market. Added to this, the chances of mortgage rates turning the corner and rising again are growing. Tight supply, combined with the prospect of higher interest rates, is tempering sentiment in the housing market. The indicator of the Dutch Homeowners' Association (VEH) has flagged somewhat in recent months, but remains high.

The most recent housing market data are a bit better than thought, but not enough to upgrade our forecasts just yet. Transactions and prices are heading for a 5% rise this year. We now eagerly await the next government's plans. The housing market was not a big issue during the elections. However, analysis of the various coalition candidates' plans for the housing market reveals that quite a few differences need to be bridged.

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

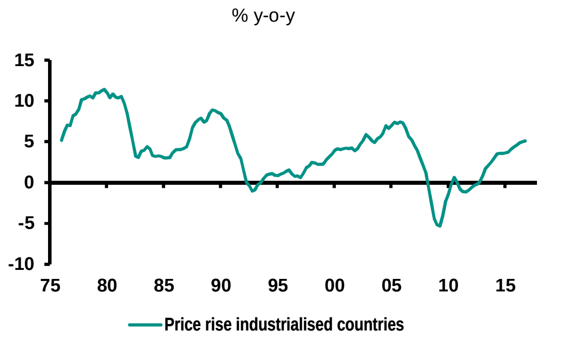
Worldwide rise in house prices

House prices in industrialised countries are on the rise. According to the Federal Reserve Bank of Dallas, average prices advanced nearly 6% y-o-y in Q4 2016 versus just over 5% a year earlier. The strongest rises are sees in the Anglo-Saxon countries. Canada is leading the pack with an increase of no less than 17.5%. The Scandinavian countries, by contrast, are losing some of their lustre.

The overall picture in the eurozone is brightening, but remains downright bleak in Italy. As in Japan, prices there are falling, albeit less than before. The Netherlands' score is above average. With a price rise of 6.8%, it has moved up to eleventh spot in the rankings, eight places higher than a year ago. Given the further price acceleration in the past months, the Netherlands may well climb even higher when the next monitor is published.

International housing markets are benefiting from the low mortgage rates. These are largely attributable to the expansive central bank policies. Central banks are trying to fan inflation through low interest rates and large-scale bond purchases.

International house price recovery



Source: Dallas Fed

The monetary stimulus policies are beginning to pay off. Confidence indicators around the world are high, pointing to stronger GDP growth and increased inflationary pressure. The prospect of more inflation has prompted the US Federal Reserve to continue the normalisation of its policy. After previously ending its bond purchase programmes, the Federal Reserve raised its official interest rate on 15 March by 25 basis points for the second time.

Europe is not yet ready for monetary tightening. Inflation rose in February to 2%, the target value of the European Central Bank (ECB), but this made little impression on ECB president Mario Draghi because detailed analysis shows that it is mainly energy and unprocessed food that have become more expensive. Core inflation, which strips out these volatile price components, is still low at 0.7%. In March, inflation had already slipped back to 1.5%.

In addition, whereas businesses may be upbeat, households are a lot more cautious. With wage growth still sluggish, their spending is only rising at a modest pace, so it may be a while before inflation reaches a structurally higher level. The ECB is pursuing an extended but slightly less active asset-buying policy. Starting from April, its monthly bond purchases have been reduced to EUR 60bn, EUR 20bn less than before. We see the ECB gradually lowering this amount in 2018, while waiting until September 2018 before raising interest rates.

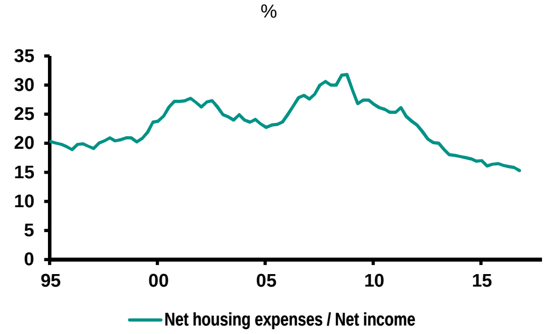
The ECB policy, alongside increased competition, has driven Dutch interest rates on new mortgage contracts down from 2.8% in early 2016 to 2.4% at the start of this year. House buyers are also benefiting from the economic recovery and the upturn in the job market. Real disposable household incomes increased by 1.4% last year. The combination of low interest rates and rising incomes is making owner-occupied properties more affordable. More people can now consider buying their own home.

Small dip in confidence

The optimism regarding the housing market is evident from strong consumer confidence. The indicator of the Dutch Homeowners' Association was 110 in March, which is high, but not as high as in recent months. In November, the indicator was still 121.

The recent drop reflects a growing awareness among house buyers that mortgage rates may start rising again now that the Fed is hiking US rates and the ECB is paving the way for less monetary accommodation.

Sustained improvement in housing market affordability



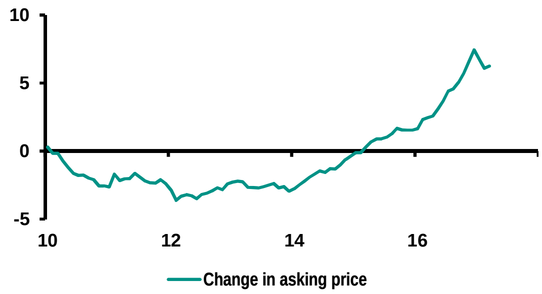
Source: Calcasa

The shift towards a sellers' market is also tempering sentiment. The housing supply is shrinking. Home search website *huizenzoeker.nl* puts the number of properties for sale in March at 113,000 – a lot less than the 148,000 available properties in the same month a year earlier. So buyers have less choice and have to decide faster. According to the Dutch Association of Real Estate Brokers (NVM), the average selling period for properties sold in the fourth quarter was 78 days, almost 100 days less than at the height of the crisis.

Moreover, buyers must now submit higher bids to stand any chance of success. The difference between asking and selling prices has shrunk to 2.2% according to the NVM, which is just as small as during the housing boom in 1999. Clearly, sellers can now put a higher price tag on their property. In March, the average asking price was 6.2% higher than a year earlier. So asking prices are currently rising almost just as fast as transaction prices. If this trend continues and asking prices start to outpace transaction prices, the number of transactions will decelerate.

Newly confident sellers are raising their prices

% y-o-y



Source: huizenzoeker.nl

One issue that is bad for confidence is the ground lease debate in Amsterdam. The City is looking to revise the ground lease system. It wants to fix the annual charge that homeowners pay for the right to use city-owned land under their property. In the future, the annual ground lease will be adjusted by no more than inflation. In the current system, the ground lease charge is reviewed upon the expiry of the ground lease period. The new system is designed to give homeowners more certainty about their future costs and thus improve their access to credit. Moreover, the City wants to offer homeowners the option of redeeming the ground rent in perpetuity.

So far, so good. Unfortunately, the new calculation method leads to much higher ground lease than homeowners had bargained for. According to a Dutch Homeowners' Association survey, homeowners had counted on an average amount of EUR 37,000 for perpetual redemption, whereas the City's calculation tool quotes EUR 112,000 on average. Vehement protests have persuaded the City to reconsider the calculation method. But whether the new proposal will offer homeowners a better deal remains to be seen. The confusion surrounding the ground lease issue has created an air of uncertainty in the city that trail-blazed the recent housing recovery. Accounting for just under 7% of total transactions, Amsterdam has been responsible for over one-fifth of the national price increase in the past three years.

Broad-based regional sales revival

House sales continue to gain momentum. January and February saw 34,300 transactions in total, 12,500 more than in the same two months of 2016. The slight relaxation in income criteria effective from 1 January may add to the momentum. A larger portion of a second income can now be included in the calculation of the maximum mortgage amount. Against this, households buying on the basis of one income can borrow less. In addition, the maximum loan-to-value amount has been reduced from 102% to 101%. Finally, the highest marginal rate for mortgage interest relief has been cut by a further half percent to 50%.

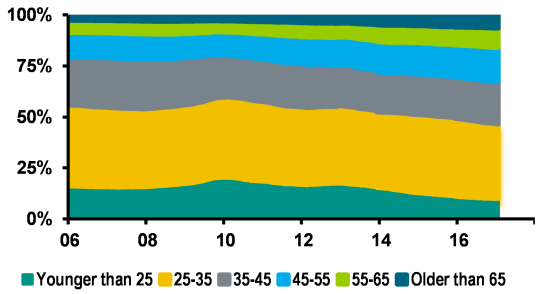
The transaction volume in the 12 months until February was 222,000, higher than the pre-crisis level. Compared to 2008, the strongest sales growth has occurred in the provinces of Noord-Holland and Utrecht. These provinces, and the cities of Amsterdam and Utrecht in particular, were initially the driving force behind the surge in sales. But in the final quarter of 2016, sales fell back in these regions amid faltering supply, while

Rotterdam has started to advance strongly. As a result, transactions in Noord-Holland and Utrecht are now lagging behind and other provinces are starting to catch up. House sales in Flevoland, Gelderland and Overijssel, for instance, were over a quarter higher in 2016 than in 2015. So the housing market recovery is more broadly based.

Other shifts are visible as well. More properties in the 200,000-plus price segment are being sold for instance. This is partly because prices have risen, so that fewer properties are available in the cheaper segment. Another reason is the rising share of home movers, who tend to focus on more expensive homes than first-time buyers. The improved mobility in the market is partly due to the fact that fewer homeowners are 'underwater'. Thanks to higher property values, only one in six households with a mortgage have negative equity versus one in three in 2013.

Share of older age groups in house transactions is rising

Share in house sales



Source: **Statistics Netherlands (CBS)**

By contrast, the elevated price levels are keeping first-time buyers off the property ladder. Their share in the transaction volume is falling. The more stringent income criteria and the need to save before you buy raises extra barriers for young people and less well-off households. With this in mind, it is hardly surprising that the average age of house buyers has risen from 35 in 1995 to 39 in 2016.

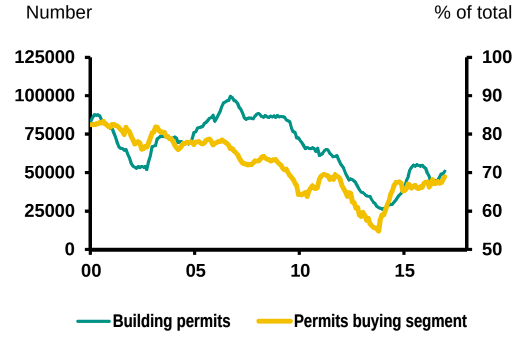
The greater difficulty that first-time buyers are experiencing in entering the market is also reflected in the number of applications for first-time buyer loans at the Social Housing Incentive Fund (SVn). The number of applications fell sharply after the State withdrew from the scheme and several municipalities stopped extending the loans in 2015. And the decline is continuing, even though sufficient funding remains available. In the fourth quarter, the SVn received 700 applications, 50 percent less than a year ago and a third less than in the previous quarter.

New-build construction lags demand

The market for new-build housing is also picking up. According to the industry organisation for builders and developers, new-build sales jumped 3,000 to 33,000 in 2016. That is still lower than before the crisis when 40,000 new-builds were sold. More and more new-builds are being allocated by drawing lots, so this difference is evidently not due to a lack of demand. The cause, rather, is a lack of supply. New-build construction is lagging demand, leading to a steadily smaller sales portfolio. According to NVM, only 13,900 new-build homes were available for sale at the end of 2016, 30%

less than at the end of 2015. The greatest fall in the portfolio concerned apartments in the Randstad conurbation.

More building permits issued after temporary dip



Source: **Statistics Netherlands (CBS)**

There are various reasons for this construction shortfall. The crisis caused severe stagnation in the building sector, forcing municipalities and construction firms to make major cuts. The reduced planning capacity is now delaying the development of new construction sites and developments. This problem is aggravated by the current focus on city centre locations, where construction is complicated and land prices are high. As a result, the housing shortage dating from the crisis years is increasing rather than decreasing.

Fortunately, the tide is beginning to turn. After a temporary dip, the issuance of building permits has picked up since mid-2016. Architects are also receiving more new commissions and the order portfolios of construction firms are growing steadily. These improvements are partly because municipalities with the most acute shortages are seeking to accelerate construction projects. Even so, the gap between supply and demand for new-build housing will not be closed any time soon.

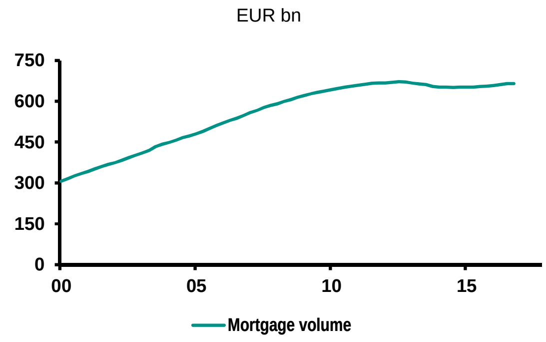
Home movers fuelling new mortgage business

The revival in the housing market is fuelling new mortgage business. In the 12 months until February, 320,000 mortgages were extended for an average amount of EUR 271,000. Total new mortgage business came to EUR 85.3bn, EUR 18bn more than in the 12 months until the end of February 2016.

The increase in new mortgage business is mainly attributable to home movers. According to data of IG&H, their share in new business rose last year from 50% to 54%. The share of first-time buyers dropped from 31% to 27%, while the share of remortgagers remained unchanged at 19%. Owing to the low interest rates and the tax relief for penalty interest, remortgaging is an attractive option. However, many households have now switched their mortgage, so the share of remortgagers in total mortgage business will probably shrink again.

On balance, the outstanding mortgage amount advanced in 2016 by EUR 4bn to EUR 664bn, which is 95% of GDP. The outstanding amount is rising less quickly than new mortgage business due to higher repayments. Besides the growing share of annuity mortgages, this is also because low savings rates make it more attractive for homeowners to repay their mortgage rather than save.

Repayments dampen growth in outstanding mortgage



Source: **Statistics Netherlands (CBS)**

And the repayment trend may gather further steam this year following the expansion of the gift tax exemption. Moreover, the tax rules for repayments on savings-linked and investment-based mortgages have been relaxed. Households are no longer required to pay premiums over a 15- to 20-year period before being allowed to access their accrued savings and investments. From 1 April, they can use these balances to make repayments on their old savings- or investment-based mortgage, irrespective of the length of the premium-paying period. After doing so, they can also switch over to a different type of mortgage. However, a mortgage switch is by no means always beneficial, so consumers should seek advice before taking this step.

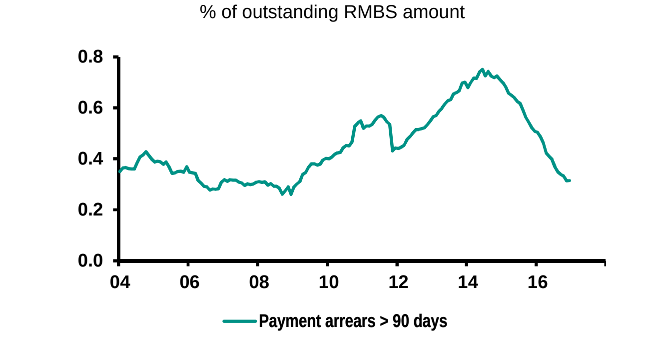
More and more households are opting for a long fixed-rate period when they take out a mortgage. According to the Dutch Central Bank (DNB), contracts with fixed-rate periods longer than ten years now account for 22% of new mortgages. Only 13% concerns contracts with a fixed-rate term shorter than one year. Historically, these averages are 14% and 23% respectively. The shift to longer terms is attributable to the sharply lower interest rates for long fixed-rate periods. In addition, the availability of long-term loans has increased, partly because pension funds and insurers are more active in the mortgage market.

In recent years, mortgage lenders have started to pay more attention to the self-employed. This group has grown strongly due to the more flexible labour market, but until recently they had limited access to mortgage loans. Lenders have now relaxed their guidelines and are focusing more on income security than on job security. Thanks to the more lenient lending conditions, more self-employed people are applying for mortgages. According to Hypotheek Data Netwerk, self-employed applications rose last year to 30,000, representing about 8% of the total.

Mortgage credit risks recede further

As house prices recover and the labour market improves on the back of the economic revival, households with a mortgage now have more financial leeway. According to Moody's, loan arrears are shrinking, but investors are sustaining slightly higher losses on their mortgage-backed investments. Now that the housing market is picking up, providers feel the time is ripe to wind up loss-making mortgages. Compared with other countries, however, the losses are highly limited.

Payment arrears back to pre-crisis level



Source: Moody's

National Mortgage Guarantee (NHG) data confirm that credit risks are receding. The number of loss claims declined in 2016 by 22% to 3,500. The average amount paid out by the Guarantee Fund decreased by 14% to EUR 34,000. The total paid-out amount fell by 36% to EUR 101 million. Owing to the steady reduction in the maximum NHG limit in recent years, fewer transactions are eligible for the scheme. Accordingly, the NHG share in transactions in existing and new-build housing has dropped from 76% in 2012 to 48% in 2016. Even so, the guarantee remains attractive for the target group: three quarters of eligible buyers still use the NHG guarantee.

The limited number of foreclosure auctions underlines that the credit risks for lenders are limited. In the 12 months until the end of February, foreclosures accounted for fewer than 2,000 properties, i.e. 0.7% of total sales of existing properties. In 2012, the percentage was still 2.3%. This needs to be qualified, however. With foreclosure sales fetching up to 40% less than regular sales, lenders have a strong incentive to solve payment problems in other ways.

Divergent political plans for housing market

The housing market was not a big election issue. Political parties paid little or no attention to this theme in their campaigns. The elections are now behind us and the coalition formation talks have begun. So this seems a good time to take a closer look at the coalition candidates' plans for the owner-occupied segment.

The centre-right VVD wants to maintain the current mortgage interest relief reduction schedule and scrap property transfer tax for first-time buyers. It also wants to create the option of 35-year mortgages for under-35s. Mortgage relief will then be available in the first five years on a fully interest-only basis, but will be conditional on annuity repayments in the remaining 30 years. Finally, the party wants to create more room for parents to make tax-free gifts for home purchases.

The Christian Democrats (CDA) want to maintain mortgage interest relief, but propose a flat tax rate of 35% for deductible items. The same, but lower, relief rate would thus apply to everyone. Other plans include a tax bonus for accelerated mortgage repayments, a tax-efficient save-to-buy scheme, and a larger gift exemption.

The liberal progressive D66 party, by contrast, wants further restrictions on the tax breaks for home buyers. The marginal tax rate for mortgage relief is to be reduced by 1% annually instead of the current half percentage point. And the percentage is to be lowered to 30% in 2035 rather than 38% in 2042. Owner-occupied properties can then be moved from the income tax sphere (Box 1) to the wealth tax sphere (Box 3), which has a comparable tax rate. D66 also wants to do away with property transfer tax for first-time buyers.

The Green Party (GroenLinks) wants to cap the mortgage amount that is eligible for interest relief at EUR 1 million for existing mortgages and EUR 0.5 million for new mortgages. Mortgage interest relief is also to be reduced at a faster pace and entirely abolished in 2025. Owner-occupied properties are to be gradually transferred to the wealth tax sphere (Box 3), with an exemption being granted for an amount equal to the average home value. GroenLinks also wants to gradually reduce property transfer tax and the notional rental income tax for owner-occupiers. Finally, home purchase grants are to be introduced for first-time buyers.

The Christian Union Party (ChristenUnie) also proposes a cap on the mortgage amount that is eligible for mortgage relief: initially a maximum of EUR 750,000, subsequently falling in gradual steps to EUR 500,000. In addition, it plans to reduce the mortgage interest relief rate to 30% over a 15-year period. Finally, it wants to help first-time buyers by exempting them from property transfer tax and creating more scope for tax-free gifts.

The political parties are less clear about the mortgage criteria. VVD is the most explicit. It wants to relax the criteria (notably for first-time buyers, flexiworkers and self-employed persons) by allowing banks to base the maximum mortgage amount partly on career prospects. In addition, it wants to give buyers more scope for financing the costs of buying and improving their home via the mortgage. CDA also wants less stringent mortgage criteria for first-time buyers.

On balance, the parties agree that first-time buyers need a helping hand. Several, for instance, want to scrap property transfer tax for first-time buyers. Broad support also exists for an expansion of the gift tax exemption. But it is unclear whether there is sufficient support for relaxing mortgage criteria, as not all parties express a view on this matter. The main point of disagreement is mortgage interest relief. Finding a consensus on this issue will probably be the most challenging task.