Housing Market Monitor

Group Economics

Netherlands

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Prices to rise further in 2018 and 2019

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- **Transaction volume peaked in 2017**
- **Shortage in housing market puts brake on future sales**
- **Economic revival feeding further price rises**

House prices soared in 2017 and are expected to continue advancing strongly. We think economic growth will receive an extra impulse from government policy in the years ahead. The resulting fall in unemployment alongside rising wages and disposable incomes will make owner-occupied housing more affordable, particularly with interest rates likely to stay low, as is now expected. We previously assumed slightly higher interest rates for the coming years. Against this backdrop, demand will remain vigorous. At the same time, the existing for-sale stock is shrinking and ill-matched to buyers' needs. Moreover, new build output is trailing behind demand. As a consequence, the housing market will become even tighter. We have therefore raised our price forecasts for 2018 and 2019 by one percentage point to increases of, respectively, 6% and 5%, after the 7.5% rise this year. The shortage in the housing market is putting a drag on transactions. Sales are already falling in areas with the tightest markets. In our opinion, the supply drought will become even more acute and spread to other regions. We continue to forecast a 5% decline in sales, both in 2018 and 2019. The decrease follows an estimated increase of 13.5% in 2017, slightly lower than our earlier estimate of 15%. The projected decline in sales means that the record of 244,000 transactions in 2017 will remain out of reach in the coming years.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2017	13.5	7.5
2018	-5	6
2019	-5	5

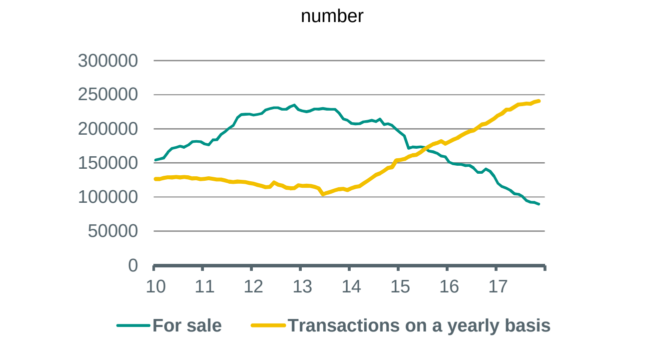
Source: ABN AMRO Economic Bureau

Sales losing momentum

Optimism about the housing market, the favourable economic outlook and low interest rates continue to drive up the transaction volume. Home movers account for the bulk of this increase. But the upward momentum is slackening. In the third quarter, a total of 61,400 homes changed hands, only 1% more than in the third quarter of 2016, which is a significantly smaller increase than the 16% recorded in the previous quarter. The weakening is noticeable in all provinces, but particularly in Noord-Holland and Utrecht where sales actually retreated. These provinces initially led the way in the transaction recovery, and are now the first to show signs of flagging.

One key reason for the deceleration in sales is the shortage of supply. Home search website *huizenzoeker.nl* estimates that fewer than 90,000 houses were on the market in November, compared to 138,000 a year ago. The biggest decline is taking place in the large cities, where supply almost halved in the past year. Sellers are hesitant to put their property on the market before having found a new home first. This is tricky, not just because of the shortage in numbers but also due to the mismatch between supply and demand. For instance, the share of detached and semi-detached housing in the for-sale stock has increased strongly, whereas people are mainly looking for apartments.

For-sale stock shrinking after rise in purchases



Source: huizenzoeker.nl and Statistics Netherlands (CBS)

Further price increases

The shrinking housing market has ensured buyers need to take action quickly to secure the home they want. In the third quarter, the average time on market for houses sold by members of the Dutch Association of Real Estate Agents and Appraisers (NVM) was less than two months. At the height of the crisis, in mid-2013, this was almost six months. In addition, buyers have to bid more to get the deal done. No less than 40% of properties are now selling for or above the asking price. The average gap between the asking and bidding price has narrowed from 6.8% in 2013 to 1.1% while sellers are upping their prices to cash in on the boom.

Tightness in the housing market is fuelling further price increases. In November, house prices were 8.2% higher than a year ago. The overall price level is now only 3.7% below the record set in August 2008. But the regional differences are marked. In the Randstad prices are back to their original levels, or even higher. But many other provinces still have a long way to go. Prices in the larger cities are also rising faster than elsewhere. And within the cities, the appetite for city centre housing is particularly strong. So, the prices for these - frequently pre-war - properties are showing the fastest acceleration.

Pull of the city

The sharp price increases in the larger Dutch cities are not an isolated phenomenon. The Bruegel Institute study entitled '*Spotting excessive regional house price growth and what to do about it*' identifies the same trend in other European countries. There too, it is particularly in the capital cities that valuations are going through the roof as house prices respond to the economic upswing. The remedy suggested by researchers is to set tighter mortgage criteria for regions where house prices are racing ahead of the national average. This approach was evidently successful in South Korea, where the maximum loan-to-income and loan-to-value depends on postcode. However, this system is contingent on a reliable postcode-based price series, which is not yet available in the Netherlands.

According to the Bruegel researchers, the sharp price increases are related to the pull of the city where there are abundant employment opportunities. This is due to the presence of companies in the growth sectors as these typically favour urban locations in order to benefit from the good infrastructure, knowledge institutions and the extensive pool of potential employees.

Strong population growth in cities

	Number	Population growth in 2016 (in %)		
	1 January	Natural growth	Migration	Total
Netherlands	16979120	0.1	0.5	0.6
Groningen	583721	0.0	0.0	0.0
Zeeland	381252	-0.1	0.2	0.1
Limburg	1116260	-0.2	0.3	0.1
Friesland	646040	0.0	0.2	0.1
Overijssel	1144280	0.1	0.2	0.3
N-Brabant	2498749	0.1	0.5	0.6
Gelderland	2035351	0.1	0.6	0.6
Drenthe	488629	-0.2	0.8	0.6
Z-Holland	3622303	0.3	0.5	0.8
Utrecht	1273613	0.4	0.5	0.9
N-Holland	2784854	0.2	0.6	0.9
Flevoland	404068	0.6	0.4	0.9
Rotterdam	629606	0.4	0.4	0.8
Eindhoven	224755	0.2	0.8	0.9
The Hague	519988	0.5	0.5	0.9
Utrecht	338967	0.9	0.3	1.2
Amsterdam	833624	0.7	0.7	1.4

Source: **Statistics Netherlands (CBS)**

National Statistics data confirm this trend for the Netherlands. Business activity has burgeoned at an above-average rate in the large cities. The rising number of business locations was mainly propelled by the proliferation of one-man businesses in the services sector. Densely-populated areas are the habitat of choice for these network-dependent operators. Young people in particular are gravitating towards the city, both from the provinces and abroad. The birth surpluses that come with a young demographic mean that the cities are also displaying natural population growth.

New builds lagging behind

The Bruegel study also pinpoints another factor that is driving up urban property prices in many countries: namely, the failure of new build production to keep pace with growing demand. The Netherlands is no exception. The construction of new homes is falling well behind demand. According to the calculations of ABF Research, the total housing shortage in the Netherlands amounted to 139,000 houses in 2016. This shortage will increase to 206,000 homes in 2020, before gradually starting to decline. The biggest shortages occur in the large cities.

Production needs to be stepped up fast, but this is hard to do – partly because of a shortage in construction workers. During the crisis, construction companies shed large numbers of staff to keep their head above water. Many laid-off employees have now found work in other sectors and few are keen to return. This is why extra effort needs to be expended in training new employees.

Persistent housing shortage in the Netherlands

Number in thousands

	2016	2020	2030	2040	2050
Desired housing stock	7780	8092	8515	8666	8715
Available stock	7641	7886	8354	8557	8683
Statistical shortage	139	206	161	109	32
Shortage (in percentages)	1.8	2.6	1.9	1.3	0.4

Source: ABF research

Another reason for the housing shortage is that very few building permits were issued during the crisis. What is more, lead times in the construction sector are currently very long, meaning there are not enough projects in the pipeline. Making up lost ground is not easy. The number of issued permits is rising, but not fast enough due to the plethora of planning restrictions. To ramp up construction, some say the central government should impose and enforce mandatory production goals on local government. Others argue for more autonomy at municipal level. In Germany and Switzerland, where municipal budgets depend on their ability to attract new residents, the housing supply is more flexible and responsive to changing demand[1].

1 http://www.demographia.com/dhi.pdf

Growing interest among investors

In addition to the pull of the city and the slow response of construction production, there is another phenomenon that is driving up prices in the Netherlands: namely, the return of the private investor. Traditionally, the Dutch housing market was dominated by homeowners and housing associations. Unlike owner-occupied and social housing, private rentals are unsubsidised, so that demand - and hence supply - in this sector is modest. This lack of interest in private rentals is strengthened by the fact that employees are obliged to surrender a large portion of their potential savings to pension funds. And these institutions prefer to invest in global markets in order to diversify their risks.

However, changes on all these fronts have put rented housing back on the investor radar. For one thing, the current cabinet is following the policy of the previous cabinet by continuing to reduce homeowner tax breaks. In addition, housing associations are now obliged to focus on lower income groups and social housing to promote fairer competition between landlords in the private sector.

Share of private rental in housing stock growing

Changes in housing stock in thousands

	Purchase	Private rental	Housing associations
Position as of 1 January 2014	4237	940	2274
New build additions	41	18	28
Other changes	19	36	-49
Position as of 1 January 2016	4297	994	2253

Source: Statistics Netherlands (CBS)

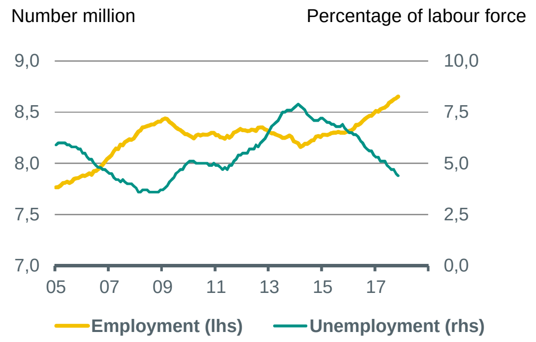
The move towards a more flexible labour market means employees are being given more responsibility for their own pension, so that savings are increasingly remaining in private hands. Unlike institutional investors, private individuals prefer to invest in rental properties close to home in familiar surroundings. However, a shift is noticeable here as well. With interest rates still stuck at ultra-low levels, institutional investors are also setting their sights on relatively safe residential investments. According to Capital Value, Dutch pension funds acquired no less than 17,000 properties in 2017, 35% more than in 2016. The amount involved was EUR 3.5 billion.

The return of the investor has contributed to price increases. Parliament has voiced criticism in this regard. However, it is unlikely the cabinet will intervene as investors don’t just drive up prices in the owner-occupied segment, they also increase the supply of rented housing. And it is precisely this segment that is currently in such high demand. An expansion of the private rented segment is desirable because many households on middle incomes are not entitled to social housing, but lack the means to buy their own home. Strong demand has led to sharp rental price increases. But according to the rented housing site, Pararius, tenants cannot be stretched much further. Pararius recently reported that rental prices in the large cities are already losing upward momentum as tenants are unwilling or unable to pay more.

Optimism about economy

Though soaring prices have created a more challenging environment for would-be buyers, housing remains historically affordable thanks to the low interest rates. Another helping factor is the recent rise in disposable incomes. International sentiment indicators show optimism in the global economy is running high. Business activities are being revived and companies are gaining confidence in the future and starting to invest again. This has led to a growth in GDP, global trade and the labour market. The Netherlands, in particular, is benefiting from this positive momentum and is among the leaders of the eurozone. This will not change anytime soon, as the government plans to increase spending in order to give economic activity a further boost.

Strong improvement in the labour market



Source: Thomson Reuters Datastream

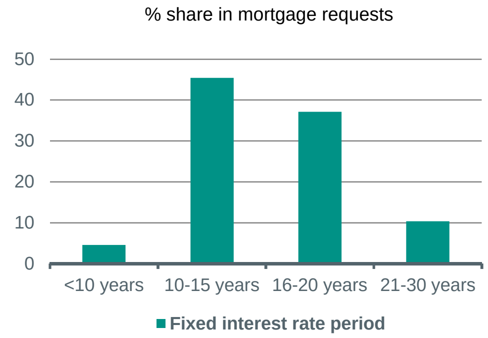
The European Central Bank (ECB) is also doing its bit. Despite the economic recovery, Frankfurt remains unsure about inflation and is therefore sticking to its expansive monetary policy. The ECB recently announced that its bond purchases would continue until the end of September 2018, albeit at the reduced rate of EUR 30 billion per month, which is half of the amount in 2017. Since starting its asset purchase programme, the ECB has already pumped approximately EUR 2,300 billion into the financial system. So at least EUR 270 billion more will be added in 2018. This strengthens our conviction that interest rates will remain low for the time being.

Interest rates set to remain low

The improved economic climate, rising house prices and persistently low interest rates are all contributing to the buoyant sentiment in the housing market. But the shortage of supply is tempering the optimism to a certain extent. The diminishing for-sale stock means that would-be buyers are increasingly struggling to find a property that suits their needs and budget. The benefits of low interest rates will also steadily peter out. Once the ECB casts light on how and when it intends to normalise its monetary policy, the prospect of rising interest rates will loom ever larger. More and more households are aware of this and are already counting on higher interest rates in the future.

However, most homeowners will not immediately be affected by a rise in mortgage rates. In recent years, many have opted for a fixed interest rate for long period of time, with new borrowers typically locking in rates for ten years or more. This is not just due to interest rates being very low, but is also because borrowers with a fixed-rate period of ten years or more can take out a higher mortgage relative to their income.

Mortgage applicants opting for long fixed-rate period



Source: HDN (mortgage data network)

First-time buyers will suffer from rising interest rates. Higher interest rates will reduce the amount they can borrow in proportion to their income, making it even harder to pay the current elevated prices and get a foot on the property ladder. They are less optimistic about the housing market than home movers as they are struggling to meet the bigger down payment under the tighter mortgage collateral criteria. In general, first-time buyers have had less opportunity to save and so their share in the transaction volume is shrinking. The current increase in sales is chiefly attributable to home movers.

Strong rise in new mortgage business

Strong transaction activity and soaring prices spurred new mortgage business in 2017. In the twelve months to the end of November, total new mortgage lending jumped to EUR 99 billion, much higher than the EUR 37 billion recorded in 2013.

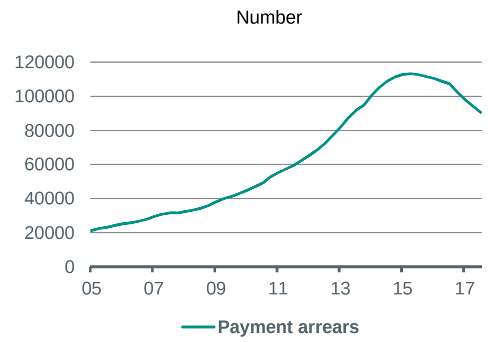
In line with their growing share in transactions, home movers are the main drivers of this increase. They are responsible for more than half of the new mortgage business, whereas first-time buyers are responsible for just over a quarter and remortgagers for about a fifth. Mortgage refinancing became popular due to low interest rates and the ability to deduct penalty interest from income tax. In the meantime, so many homeowners have revised their contract that the amount of remortgagers opting for new mortgage business may well start to decrease. Against this, however, more homeowners are opting to upgrade their home rather than move and are raising their mortgage to finance these improvements.

The outstanding mortgage amount remains limited, despite the high volume of new mortgage business. At the end of the second quarter, the total amount of outstanding mortgages was EUR 671 billion. That is EUR 6 billion or 1% more than a year earlier. This modest rise in the outstanding mortgage amount is partly attributable to higher voluntary repayments and the more generous gift tax exemption. Other factors are the rising average age of home buyers and the increased activity of private investors in the housing market. Older home buyers tend to make larger down payments when purchasing a house. The same applies to investors although, judging from the figures, less so than before.

Smaller NHG share

The share of mortgages with a NHG (National Mortgage Guarantee) in new mortgage business has decreased. Less than four out of ten buyers of existing and new build properties currently use this option, as opposed to seven out of ten in 2013. The decrease is mainly due to the reduced NHG limit, which means fewer properties qualify for the guarantee (particularly now that the average property value is rising). But the scheme remains popular among buyers of properties that are eligible for a NHG. According to the Dutch Homeownership Guarantee Fund (WEW), 69% of this group have opted for an NHG-guaranteed mortgage.

Fewer payment arrears thanks to recovery



Source: BKR Credit Registration Agency

The latest WEW quarterly report indicates the number of loss claims is continuing to fall. In the first three quarters of 2017, the number of claims shrank to 1700, which is more than one third less when compared to the same period last year. Due to the ongoing recovery in the housing market, the paid-out losses ran to only EUR 38 million, less than half last year's amount. The lower number of claims alongside the continuing inflow of premium income for new guarantees means that the guarantee capital has grown to more than EUR 1 billion. The capital ratio (i.e. guarantee capital as a proportion of guaranteed capital) is now 0.55% versus 0.5% at the start of the year. The housing market recovery is thus contributing to the financial health of the Guarantee Fund.

More stringent buffer requirements are being introduced to strengthen the financial resilience of banks. Dutch banks will be hit comparatively hard by the current proposals due to the relatively high loan-to-value ratio of their mortgages. Under the new Basel requirements, Dutch banks will jointly have to add an estimated EUR 14 billion to their capital buffers. Though less punitive than feared, the change will inevitably inflate the mortgage lending costs of banks. If passed on to the customer, these costs will translate into slightly higher mortgage rates. But that still lies in the future. The proposals must first be approved by the various European member states. And if they agree, the change will only become effective from 2022.

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