ABN·AMRO

Housing Market Monitor

Group Economics

Netherlands

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More signs of cooling

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- **Optimism over housing market outlook is waning**
- **Supply of both pre-owned and new-build properties is limited**
- **Policymakers yet to adapt to stronger investor involvement**

Signals of cooling in the housing market are growing stronger. The optimism over the outlook has waned, prices are losing upward momentum and the transaction volume has been falling for some time. This cooling is taking place against the background of a weakening economy. GDP growth is slackening towards the structural rate of 1½%. With fewer jobs being added, unemployment may edge slightly higher in due course.

We maintain our forecast that house purchases will fall by 5% in 2019. Transactions are under pressure now that sustained price increases have eroded affordability. Moreover, there are few properties for sale and the catch-up demand from homeseekers who postponed their move during the crisis has been largely met. The moderation of the price increase to 6%, one percentage point above the historic average, that we previously forecast has also been left intact. Prices are receiving support from the low interest rates and lagging construction output. The number of new-build completions is trailing demand due to the lack of building locations and high construction costs.

The government is still struggling with the new role of investors. To protect first-time buyers and prevent excessive rent increases, it is brandishing measures that have alarmed investors. After the 1950s, the supply of private rented housing dried up due to favourable conditions for the social rented and owner-occupied segments. Recent years have brought a turnaround, however. Policymakers are worried about the renewed interest from investors. Both sides must learn to understand each other in order to work constructively together.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2018	-5	9
2019	-5	6
2020	-5	4

Source: ABN AMRO Group Economics

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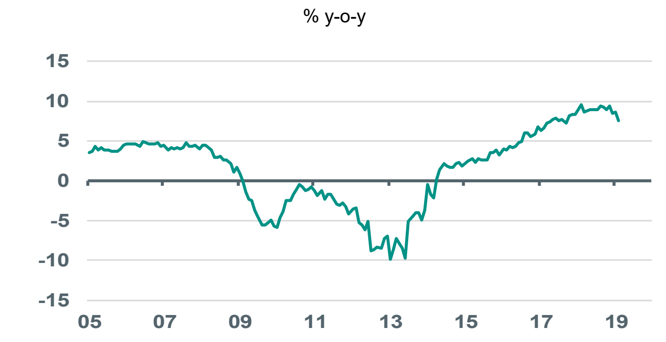
Optimism has gone

The optimistic mood in the housing market has waned. Two years ago the Homeowners' Association (VEH) Market Indicator was still at a record value of 121. Meanwhile, the confidence barometer has returned to the neutral level of 100. The optimists and pessimists are in balance. Respondents no longer see this as a good time to buy a property.

First of all, houses have become less affordable. Prices have risen faster than disposable income. Lack of supply is another reason they cite. There are too few suitable and good-value properties to make the right choice. Nor is there much hope of a speedy improvement. Half of the respondents expect a further deterioration in the housing market.

Price increase has peaked



Source: Land Registry

Price increases are gradually weakening

Despite the fading optimism, house prices are still climbing, albeit less quickly than before. In February the value of pre-owned housing was 7.5% higher than a year earlier. In December, the year-on-year increase was still 9.5%. The highest price increase concerned apartments and houses in the price segment up to EUR 150,000. The average purchase sum peaked in January at EUR 302,000. This was the first time the number exceeded EUR 300,000. A month later the amount had moved fractionally lower to EUR 298,000.

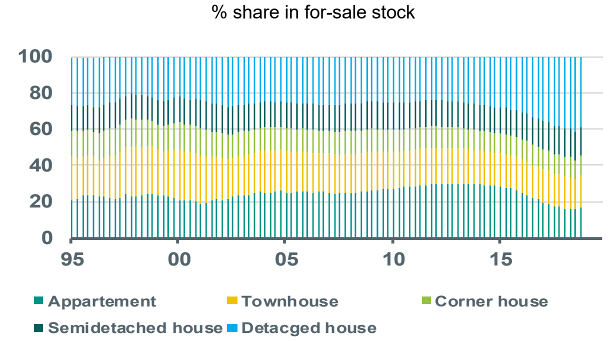
The average selling price for new-builds has already been above EUR 300,000 since the third quarter of 2017. As project developers are focusing on the more expensive segment for home movers instead of on first-time buyers and are building more in popular higher-priced regions, new-builds are rising even faster in price than pre-owned properties. In the third quarter, the average price increase amounted to no less than 17%, so that pre-owned and new-build prices jointly rose 10.3%. This makes the Dutch property market one of the front-runners in Europe.

For-sale stock is shrinking

Pre-owned asking prices are rising. According to home search website *huizenzoeker.nl* the average asking price in March was EUR 400,000, over 10% higher than a year ago. There is a gaping gap of EUR 100,000 between the average asking price and the average purchase price. Buyers are struggling to find a home to suit their needs and budget, particularly now that the for-sale stock has shrunk to less than 61,000. The number in 2012 was 230,000. Would-be home movers are not putting their property on the market until they have found an affordable alternative.

The supply-demand mismatch in the existing stock is also evident from the composition of the for-sale stock. The share of detached housing is relatively high, whereas the share of apartments is modest. A similar mismatch can be seen in the new-build segment. Despite more people registering for projects, the Dutch Association of Real Estate Agents (NVM) reports that it is taking longer and longer to reach the 70% pre-sale limit. Would-be buyers are put off by the high asking price.

Share of upmarket housing in for-sale stock is growing



Source: NVM

The transaction volume is gradually decreasing.

The lack of suitable supply is putting a brake on house purchases. In the twelve months until the end of February this year, 217,000 properties were sold, 9% less than in the twelve months until February 2018. The decline is noticeable in all provinces, but the strongest drop occurred in the Randstad conurbation which has the tightest housing market. In keeping with the changed composition of the housing supply, the transaction share of apartments has fallen, while that of detached housing has risen. Last year, the number of transactions with a purchase sum above EUR 1 million hit a new record, at 1,749.

The decrease in new-build transactions is 6%, slightly lower than for pre-owned housing. This drop is largely attributable to the shortfall in the number of completions. The government is targeting 75,000 home completions per year, considerably more than the 66,000 realised in 2018. The number of building permits issued last year was at the same level as the preceding year (70,000), suggesting that there is little prospect of a rapid improvement.

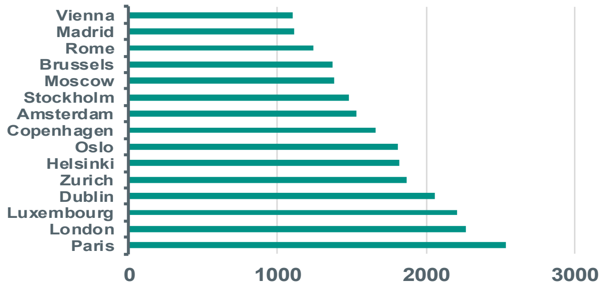
Rents are rising less fast despite tight supply

The rented segment is also tight. Those who cannot find a suitable property to buy must resort to rented housing. According to the NVM, the average private rent stood at EUR 1,050 per month in the second half of 2018, up 2.9% compared to the same period a year earlier. This increase is less high than in previous years, probably because rents in the popular cities rose less quickly.

In these cities, rents are already close to the limit that tenants are prepared to pay. This is also clear from the fact that landlords in the high price segment above EUR 2,500 per month are having to wait longer to find a tenant. However, rents are still reasonable by European standards, with Amsterdam ranking ninth in a survey of rental levels in fifteen European capital cities.

Rents in Amsterdam not exorbitant by international

Rental price per month in euros



Source: Pararius

Cap on social rent increases

Rent increases in the social segment have been reined in. The Social Rental Agreement concluded in December between tenant organisations and housing associations stipulates that the total rent increase of housing associations in the coming three years will not exceed inflation. The cabinet wants to make this arrangement law before 2020.

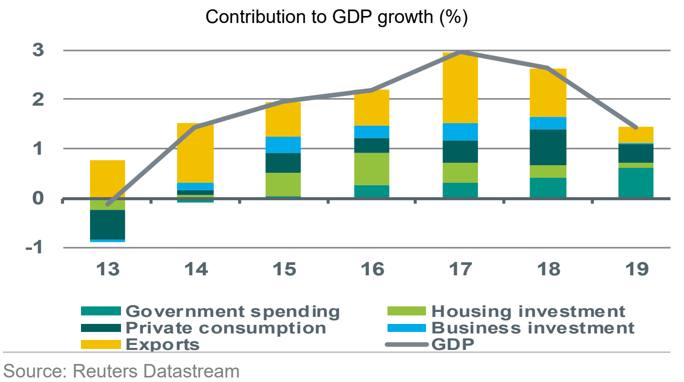
Another proposal is to make the municipal property tax valuation a less important factor in the Property Valuation System. Since 2015, this property tax valuation has played a role in determining the maximum rent for social housing. But due to the strong price increases, rents are threatening to rise so much that they no longer fall within the social segment. To prevent too many properties transferring to the private segment, the cabinet is considering limiting the share of the property tax valuation level to EUR 250,000. Investors oppose this measure because, if it is adopted, housing that became eligible for private rental due to the higher property tax valuation will revert to the social segment.

Stricter rules for the social segment

More rules in the social rented segment are set to be overhauled. The government wants the household composition to be a bigger factor in the allocation of social rented housing. This will benefit multiple-person households. Other proposals are faster rent increases for high-income occupants of social housing and a relaxation of the rules to allow elderly people who have a low income but high assets to qualify for a home that suits their residential and care needs.

Finally, the government wants to introduce heavier penalties for illegal rental of social housing, with the maximum penalty being raised from EUR 20,000 to EUR 83,000. The first infringement will attract a penalty of EUR 20,000. Repeat offences may be penalised more heavily. These adjustments are designed to ensure that social rented housing only goes to qualifying households, while also leading to shorter waiting times.

GDP growth weakening, mainly due to foreign trade



Source: Reuters Datastream

Economy has peaked

The falling transaction volume and weakening price increases are clear signals that the housing market is cooling. This is coinciding with signs that the economic cycle is beyond its peak. This year will see GDP growth slow for the second time in a row to 1.4%. The labour market is still doing well, but we expect jobs growth to gradually decrease, with unemployment starting to rise in due course. This means that disposable incomes, a key driver of house prices, will rise less quickly.

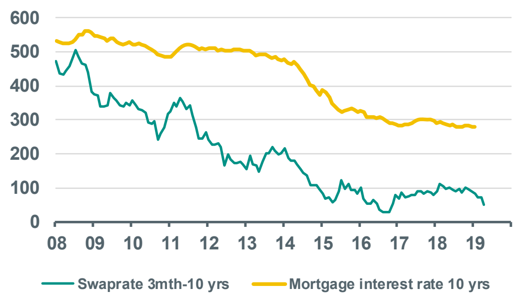
The principal cause of the weaker GDP growth is diminishing demand from abroad. Exports are suffering from flagging world trade. This is attributable to various factors, such as the tighter financing conditions in the US and China and the trade conflict between these two countries. There are also impediments closer to home, including Brexit, the Italian budget deficit, the yellow vest protests in France and, more temporarily, the stagnation of car production due to stricter environmental regulations.

Mortgage rates to remain low for now

In view of the weak economic forecasts and the persistently low inflation, the ECB has decided to push back the previously planned interest rate hikes. It has also announced additional liquidity for banks to keep up household and business lending and stimulate economic activity. The ECB is not alone in this stance. Its counterparts in China and the United States have announced further monetary relaxation to give the economy some breathing space. The prospect of an expansive monetary policy in the foreseeable future is dampening capital market rates.

The more extensive availability of money will also help banks to raise cheap funding. After a short-lived upturn, both the swap rates and CDS premiums recently fell again. Against the background of increased competition in the mortgage market, this strengthens the expectation that mortgage rates, which have been around 2.8% for a 10-year period since July, will remain low for the time being. This keeps an important pillar of housing affordability and rising house prices intact.

Mortgage rates to remain low for now



Source: Reuters Datastream

Capital buffers for mortgages may be increased

New bank funding regulations may have both a positive and a negative effect on mortgage rates. In recent months, Europe has made progress on the framework for *covered bonds*, an instrument to help banks raise mortgage funding. The European parliament is due to vote on the current proposal before the European parliament elections. The framework provides banks with more clarity about the use of *covered bonds*.

Against this, the Financial Stability Committee (FSC), a committee comprising representatives of De Nederlandsche Bank (DNB), the Authority for the Financial Markets and the Ministry of Finance, wants to examine whether it would not be better to replace the counter-cyclical capital buffer that obliges banks to maintain higher buffers when their lending grows too strongly with a higher specific buffer for mortgages. Such a change may exert upward pressure on mortgage rates.

Mortgage valuations under scrutiny

The FSC doubts the quality and independence of residential property appraisals. A DNB study into residential property appraisals in the 2012-2017 period indicates that the purchase price often serves as the basis for the appraisals: a third of the appraisals are equal to the purchase price[1]. In addition, the majority of appraisals exceed the purchase price, whereas undervaluations should normally occur just as often. On average, the appraisal sum was 5.3% higher than the purchase price.

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[1] Molen R. van der, R. Nijskens, The quality and independence of residential property appraisals, DNB, *Occasional Studies* Volume 17-1

According to the researchers, systematic overvaluations serve to drive up prices as high bids are rarely corrected by the appraisals. Moreover, the high appraisals can lead banks to underestimate the credit risks. In view of these risks, the government is looking at ways to improve the quality and independence of physical appraisals. In addition, it is exploring opportunities for a model-based appraisal method. This leaves less room for influencing the appraiser and is also cheaper. But it is less suitable for property-specific appraisals, for instance when a property is in a significantly better or worse state of repair than surrounding properties.

Mortgage interest relief under renewed fire

Recently the FSC insisted, not for the first or last time, on the need to curb mortgage interest relief even further. Less tax relief will lead to a lower mortgage debt. The Committee has received the backing of Maarten Camps, Secretary-General of the Ministry of Economic Affairs and Climate. He says that the steps taken so far are welcome, but not sufficient.

Camps thinks that mortgage interest relief undermines the stabilising effect of monetary policy. Due to this tax break, he says, the central bank's rate hikes and cuts to steer the economy are less noticeable in the wallets of households. Mortgage interest relief thus constrains the impact of the central bank's measures and leads to bigger economic ups and downs. A further argument, in his opinion, is that mortgage interest relief drives up prices.

Using pension savings for mortgage repayments is not a good idea

The Dutch mortgage debt is high by international standards. At the same time, households have sizeable pension assets. Employees are obliged to pay pension contributions, which leaves them with less money to buy a home. Surveys show that employees would like to use their pension savings to repay their mortgage, either by making a pension lump sum withdrawal or by opting for a temporary pension holiday.

Researchers of the Amsterdam School of Real Estate reject this idea.[2] They say that diverting pension contributions to mortgage repayments would not significantly improve the affordability of housing or the financial resilience of homeowners. Moreover, households would have less pension when they retire. One key reason why the advantages of this idea are limited is that pensions are only taxed when paid out, while mortgages are repaid with money that has already been taxed. Finally, the researchers point to the risk that housing prices could receive an extra upward impulse if pension savings are freed up to buy a home, particularly in markets where supply is slow to react.

Larger share of remortgagers in mortgage applications

Low mortgage rates are driving mortgage lending. According to Mortgage Data Network, which registers the majority of mortgage applications, there were 389,000 mortgage applications last year, 4% more than in the previous year. The increase in the number of mortgage applications is due to remortgagers. The number of

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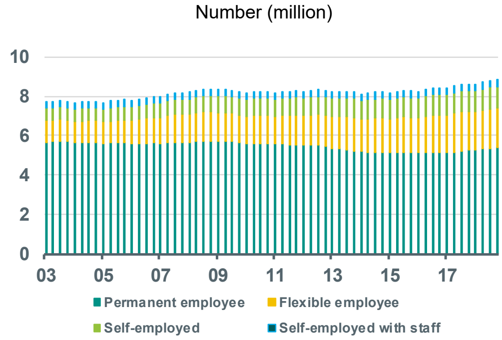
2 Schilder F.. S. van Hoogdalem, J. de Vries, J. Conijn, 'Aflossen of opbouwen: de mogelijke rol van pensioenpremies bij het versneld aflossen van de hypotheekschuld' Amsterdam School of Real Estate, *ASRE Research Paper* 2019-2, February 2019

applications relating to home purchases actually fell. While home movers submitted more applications, first-time buyers made considerably fewer applications.

The number of self-employed applications increased slightly in 2018. In recent years, it has become easier for people without fixed employment to take out a mortgage, so that their share in the applications is rising. The self-employed now account for about one tenth of the applications, which is more or less equal to their share in the labour force. This increase does entail a certain risk. ECB research shows that mortgage payment arrears are higher among people without fixed employment.[3]

Higher self-employed ratio due to more flexible labour



Source: Statistics Netherlands (CBS)

High sustainability ambitions

More than a quarter of the mortgage applications were accompanied by an energy label. This is presumably to benefit from the lower mortgage rate for energy-efficient homes and to qualify for energy saving finance. The FSC is keeping a close eye on this. It recently emphasised that financiers must make sure that home energy saving loans match the energy saving plans and that there are sufficient guarantees to ensure the savings will be achieved.

The cabinet is aiming to halve the CO2 emissions compared to 1990 by 2030. Radical measures are necessary to achieve this ambition. The built environment is responsible for about 40% of the total CO2 emissions, with homes accounting for half this figure. Sustainability measures are relatively difficult to carry out in pre-1950s housing, but a lot more straightforward for housing built between 1950 and 1995. These consist predominantly of terraced housing where large-scale insulation is quite simple to implement. Post-1995 housing, too, can be made more sustainable quite easily with solar panels and heat pumps.

3 Gaudencio J., A. Mazany A., C. Schwarz, 'The impact of lending standards on default rates of residential real estate loans' *Occasional Paper Series*, no 220, March 2019

Shorter payback period for energy saving measures

Not all measures are equally attractive from a financial perspective. It currently costs about EUR 75,000 to make a terraced house energy-efficient. That is too high to be profitable. The price needs to fall to EUR 45,000 to make the investment worthwhile. This will become possible when more energy-saving products are sold and economies of scale start to kick in.

Home energy saving: payback period and return

Investment	Payback period (years, indicative)	Return (indicative)
Floor insulation	9	6%
Roof insulation	8	6%
Wall insulation	4	9%
Double glazing	13	5%
Solar panels	8	4.5%
Heat pump to replace central heating (combined with solar panels)	Often never. Can be very long (>= 17 years)	Negative (or close to 0%)
Solar boiler for hot water	20	0%
Solar boiler for hot water & central heating	9	4.5%
Solar boiler for hot water & central heating plus heat pump	12	2.5%

Source: Financial Focus ABN AMRO[4]

The first sustainability step is to install insulation and buy solar panels. The payback period is short and the return relatively attractive. The final step is to achieve a well-insulated, energy-neutral home with floor heating. But based on current technologies and energy prices, this is often financially beyond reach. Heat pumps must become at least 40% cheaper to make the investment worthwhile, unless the price of gas increases significantly. However, a combination of various technologies, such as a solar hot water & central heating boiler plus, optionally, a heat pump and solar panels combined with the existing gas-fired boiler or an electric after heater can be good for the environment as well as your wallet.

New-build activity is lagging demand

There are various reasons why new-build output is lagging demand. First of all, prolonged building permit procedures are an important factor. Secondly, due to the increased labour and material costs, construction projects are being postponed and sometimes even cancelled. Thirdly, municipalities are refusing to lower their land prices now that rising construction costs are making residential development investments less profitable. Instead, many municipalities are actually setting additional conditions such as a minimum number of rented housing or a maximum selling price. This makes projects even more expensive and less profitable for developers. Fourthly, innovation is not the construction sector's strong point. And finally, there are factors beyond human

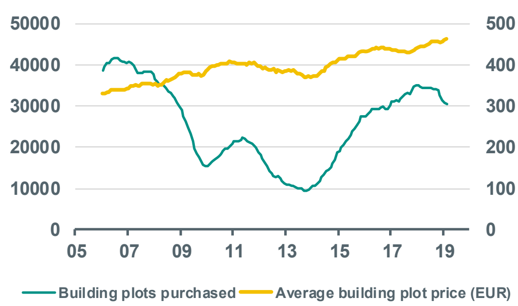
4 Bril M., 'CO2-reductie doelstelling vergt ingrijpen in uw huis', *Financial Focus 2019*, ABN AMRO Bank

control, such as the weather. Last summer, for instance, low river levels impeded the supply of construction materials.

To speed up the construction of homes, the cabinet is looking to make deals with the five large cities that have the worst shortages. These deals aim to accelerate the realisation of specific residential projects in the short term, create additional construction capacity and promote large-scale area development. Such deals were recently concluded with Groningen and Eindhoven, while Amsterdam, Utrecht, and the Rotterdam/Hague region are set to follow. In addition, the cabinet wants to accelerate the new-build process by making it easier to acquire land and change the planning permission. The Crisis and Recovery Act has been amended for this purpose.

Fewer land plots sold, prices are rising

Twelve-month moving average



Source: Land Registry

Lack of locations is holding back construction

One major problem is the shortage of new-build locations. Various parties are calling on central government to intervene. The government insists that this is a responsibility for local authorities. It has, however, formed an Expert Team to help municipalities overcome disputes about specific building locations. In addition, an Inner City Transformation Finance Facility comprising EUR 38 million has been set up for the extension of loans for the transformation of locations.

The government could also increase the number of building locations in other ways. The gap between the administrative plans for residential construction (measured by potential construction capacity) and the actual plans that are ready for implementation (measured by confirmed construction capacity) suggests that housing construction is still a low priority. Municipalities tend to cater more to the interests of their existing residents, while provincial authorities focus more on the protection of nature and the environment. With this in mind, the CPB Netherlands Bureau for Economic Policy Analysis has advised that the powers of provinces should be limited in order to give municipalities a free hand. In addition, municipalities should be given more financial incentives to develop residential construction locations.[5]

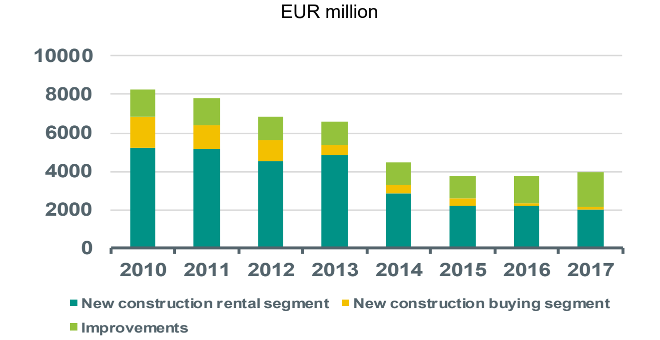
5 Michielsen T., S. Groot, J. Veenstra, 'Het bouwproces van nieuwe woningen' *CPB book*, March 2019

Housing associations in a tight spot

Housing associations used to play a prominent role in new-build construction. No longer. In the period 2010 to 2017 they more than halved their residential investments to less than EUR 4bn, causing their output to plummet from 36,600 to 15,400. Housing associations are required to concentrate on their core task and no longer see the construction of mid-market rental and owner-occupied housing as a priority. But social rental construction is also under pressure. The main reason is the lack of building locations. The new Housing Act sets stricter land acquisition rules for housing associations, which makes them more dependent on municipalities. Housing associations cannot set to work until the municipalities make concrete plans for the social rented segment.

Moreover, higher construction costs are making it more difficult to find profitable projects. Housing associations also sometimes contend with financial constraints. Rental increases are limited by law and the housing associations also have various tax obligations, including the Landlord Levy of EUR 1.7bn. As well as creaming off the profits, this levy depresses the value of the portfolio and its future profitability. The introduction of the Anti-Tax Avoidance Directive (ATAD) also costs the housing associations EUR 300 million annually. The cabinet's compensatory measures in the form of a discount on the Landlord Levy of EUR 100 million and a tax credit up to EUR 104 million for sustainability investments are insufficient to entirely offset this burden. Finally, the investment capacity is very unevenly distributed across housing associations. The cash-rich housing associations tend to operate in regions where investments are less necessary.

Strong decrease in housing association investments



Source: Conijn[6]

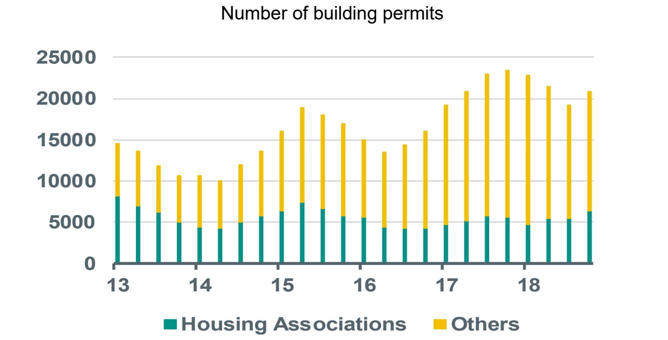
Investors taking over the baton

The share of rented housing offered by landlords other than housing associations has increased since 2012. This is mainly because more building permits have been awarded to institutional investors who have built lots of new rented housing. They have ample capital and are keen to expand their residential property portfolios. Research shows that investors are currently able to invest EUR 20bn. This money typically comes from pension funds, i.e. investors with a long-term horizon.[7]

6 Conijn J., 'Kennis is als een fata morgana', afscheidsrede UVA 17 January 2019
7 Wirtz S., J. van Hasenbroek, 'De woning(beleggings)markt in beeld 2019, Capital Value

These investors see opportunities in the rented segment because of the increased demand due to demographic growth, tighter mortgage criteria for first-time buyers and the more flexible labour market. Investors are not only interested in the large cities and the Randstad conurbation. Due to the steady decline in the initial returns in the cities, these investors are also setting their sights on other regions. They also increasingly include parties from abroad who are interested in the Dutch residential market because of the stable economic climate in the Netherlands.

Private investors are increasingly building rented



Source: Statistics Netherlands (CBS)

Investors are meeting resistance

Despite the important role they can play in growing the mid-market rental segment, investors are not always received with open arms. Municipalities set strict conditions for future rental prices and a minimum period for holding the rental property prior to resale. Some municipalities are considering introducing an occupancy obligation, so that only buyers are allowed to occupy new-build properties. Another measure is the 'mid-market rental emergency button'. To prevent extortionate rents, the government is considering allowing municipalities with severe shortages to temporarily cap the initial rent for private rented properties based on a percentage of the property tax value.

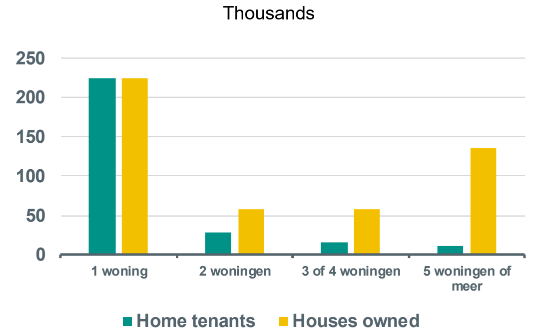
Institutional investors object to such measures, they argue that this creates uncertainty about future profitability and is causing construction plans to be called off. They also point out that the measures are unnecessary as they have only raised rents by 0.9% in real terms in recent years. To emphasise their good intentions, they cite a recent contract for the construction of 7,000 high-quality mid-market rented homes in the province of Utrecht which includes arrangements to limit the rent increases.

Negative buy-to-let image

One problem for institutional investors is that they are lumped together with individual investors who buy properties to let. There is considerable scepticism about the contribution of these buy-to-let investors to the housing market. The perception is that they squeeze out first-time buyers and hardly help to alleviate the housing shortage as they merely shift the problem from a shortage of rented housing to a shortage of owner-occupied housing. Another complaint is that they pull out of the market as soon as the tide turns and thus contribute to stronger price swings. The government has commissioned a study to obtain more detailed insight into the contribution of buy-to-let investors.

One measure for countering housing speculation is to increase the transfer tax for investors. The extra tax revenue could then be used to lower the transfer tax for first-time buyers. Various opposition parties are pressing for this measure to be implemented. The government, however, doubts whether it is practically feasible. In the first place, the terms 'first-time buyer' and 'investor' need to be clearly defined. Furthermore, it points to the danger of creative schemes to avoid the higher tax rates and the risk of landlords passing on the higher costs to their tenants.

280,000 private investors own 475,000 properties



Source: Statistics Netherlands (CBS)

Rules for accommodation platforms

Finally, the government wants to regulate tourist rentals via platforms such as Airbnb. Homeowners who offer their property as temporary accommodation must register with the municipality and post their registration number with each advert. In addition, hosts will be required to obtain a licence and report every rental, so that municipalities know which properties are being rented, how often and who is responsible. Municipalities can also impose and enforce restrictions, such as a maximum rental term. Moreover, the information they receive can be used to levy tourist tax, income tax and VAT.

The regulation of tourist home rentals will put a brake on house prices in some neighbourhoods. Recent research shows that Airbnb has caused house prices in Los Angeles to rise 3%.[8] The strongest effect is noticeable in popular tourist areas, where prices have sometimes shot up by as much as 40%. The outcomes cannot be translated directly to other tourist hotspots such as Amsterdam, where there were 2.1 million Airbnb overnight stays in total in 2017. The consequences for the surrounding area can be both positive and negative. An influx of tourists can lead to a different retail and hospitality mix and also cause additional nuisance in the neighbourhood. Moreover, the composition of the local population may change as residents can no longer afford the rent.

8 Koster H., J. van Ommeren, N. Volkshausen, 'Airbnb verhoogt woningprijzen en huren in Los Angeles', *ESB Jaargang 103* (47685), 20 December 2018

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