ABN·AMRO

Housing Market Monitor

Group Economics

Netherlands

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House price forecast 2020 lowered

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- **Growth slowdown impeding housing market…**
- **…, but central banks acting as counterweight with rate cuts**

The worst tensions in the housing market lie behind us. In 2016 optimism reached a record level. In 2017 the number of transactions peaked. In 2018 prices increased at their fastest rate. After a period of decline, the number of properties for sale has stabilised since the start of this year. Properties are also taking a little longer to sell. The housing market remains tight, but is cautiously entering calmer waters.

We assume that the transaction rate and price increases will gradually return to a normal level. But the economy is a risk. Growth is faltering now that world trade is weakening amidst escalating international tensions. Exports are under pressure and the mounting unrest has made households and businesses less positive about the future. The economic growth deceleration is taking its toll on the housing market.

Fortunately, the central banks are standing by to cut their key policy rates and buy up more bonds if necessary. Mortgage rates will therefore stay low for longer (and possibly even fall slightly), giving the housing market some welcome support. Against this backdrop, we have left our housing market forecasts largely unchanged. Only our price forecast for next year has been slightly reduced from 4% to 3%. However, if the international unrest increases and the economy weakens further, these central bank measures will not be enough and we will need to make further downward revisions.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2018	-5	9
2019	-5	6
2020	-5	3 (4)

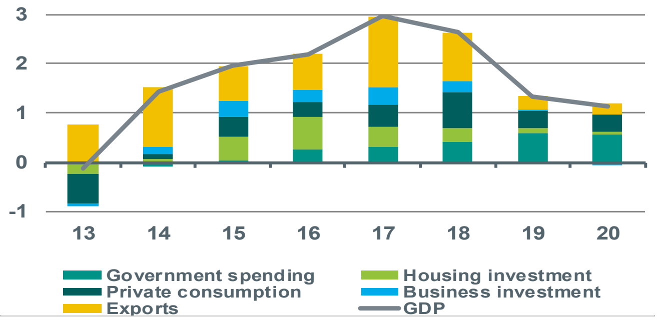
Source: ABN AMRO Group Economics

Whereas house prices previously drove the economy…

The Dutch economy responds strongly to the housing market. The GDP acceleration in recent years was largely fuelled by the revival in the housing market. According to DNB (Dutch central bank), a quarter of economic growth since the start of 2013 is attributable to the recovery in the housing market. The upturn in house prices made it less necessary for households to put money aside for extra mortgage repayments. Buoyed by the reviving property prices and lower interest charges, households became more confident about the future and started to move house again, which led to higher expenditures. The brighter outlook also encouraged businesses to invest more. This applied in particular to the construction sector. Emerging from the severe slump, new-build completions regained traction, with economic activity quickening in its slipstream.

Economic growth slowing, mainly due to lower exports

Contribution to GDP growth in percentage points



Source: Statistics Netherlands (CBS)

…, the economy is now threatening to dampen house price increases

But the roles are now reversed, with the cooling economy threatening to pour cold water on the housing market. The root problem lies abroad. Exports are under pressure amidst weakening world trade. One cause is the US-China trade conflict. Another is the uncertainty in Europe. May's departure has made a hard Brexit more rather than less likely. Italy's public finances are in poor shape. And political discontent is on the rise in Germany and France. This uncertainty is undermining business confidence, as is reflected in the sentiment indicators.

The less favourable sales outlook abroad has made businesses more prudent about investing. Unfortunately, domestic spending is also growing less rapidly than before and cannot act as a counterweight. Last year, consumption advanced vigorously thanks to strong income growth. This year, incomes are rising less quickly, because fewer jobs are being added. An additional factor is that the VAT increase has pushed up prices and the higher cost of living for households has wiped out much of the pay rise in real terms.

Business and consumer confidence has fallen significantly. This suggests that the economy will grow at a slower pace. The risk of a further deceleration will increase if the US-China trade conflict hardens. Trump's threat to hit Mexico with higher tariffs unless it stems the flow of migrants and his warmongering stance on Iran show that economic stability is not his top priority. In response to all these global disputes, we have revised down our forecasts for the Dutch economy. GDP growth will be clearly lower, falling in our projections from 2.5% in 2018 to 1.3% in 2019 and 1.1% in 2020.

Central banks take countermeasures

The central banks share our concerns about the economy. They too have adjusted their forecasts - not just for GDP growth but also for inflation. The danger of deflation continues to lurk, prompting a radical change of course by the Federal Reserve and European Central Bank (ECB). Last year, they still hinted at monetary tightening. Today, the rhetoric has turned to rate cuts and debt purchases.

In view of this policy U-turn, we have reduced our interest rate forecasts. We now expect the ECB to cut its official interest rates even further. The resulting decrease in rates on short-term loans will also push down interest rates on long-term loans. And this effect will be even stronger if the ECB, as we expect, also resumes its debt purchasing. We have therefore lowered our forecasts for 10-year government loans from +0.3% to -0.45% for end-of 2019 and from +0.6% to -0.25% for end-of 2020.

10-year rates down after policy change announcement

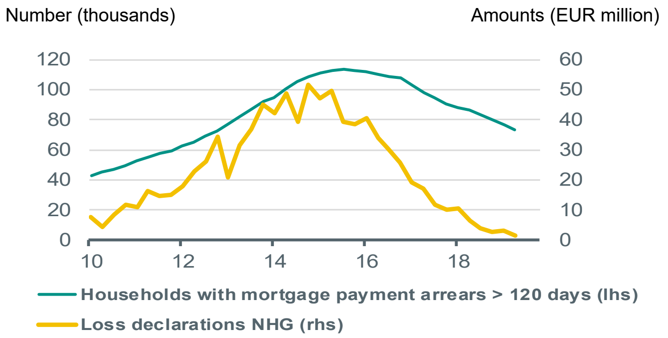
Source: Thomson Reuters Datastream

Mortgage rates are therefore also likely to fall. But not by as much as the rates on Dutch government loans. In times of turbulence, investors like to park their cash in government bonds. They accept a low interest rate, because the Dutch government is perceived as a safe haven. Now they are even prepared to pay - rather than receive - interest. By contrast, with investments that are considered less safe, they can demand higher premiums. The upshot is that lower government rates are no guarantee that banks can access much cheaper money.

Another reason why mortgage rates will probably not fall in exact proportion to government bond rates is that DNB is eyeing the need for higher capital buffer requirements for banks. Whilst acknowledging that lending growth is below trend, DNB has not ruled out raising the countercyclical capital buffer or bringing forward the new Basel requirements. This would raise the financing costs for banks, leaving less scope for lowering mortgage rates.

According to DNB, higher capital buffers are necessary because banks have relaxed their lending conditions while house prices are continuing to rise. DNB opposes the looser lending conditions, but banks say their more lenient stance is justified as the reduction in mortgage arrears and losses has led to lower mortgage risks.

Less mortgage arrears and losses



Source: BKR (Credit Registration Agency) and NHG (National Mortgage Guarantee)

DNB is also critical of the criteria that banks use to determine how much money mortgage applicants can borrow based on their income. These criteria have been set by the National Institute for Family Finance Information (Nibud). Incomes are set to rise next year because of tax changes and cuts. If the Nibud criteria remain unchanged, some households will be able to borrow up to 10% more. To prevent this, DNB is urging the Nibud to adjust its criteria.

Housing market beyond its peak

According to Statistics Netherlands (CBS)/Land Registry figures, house prices were 7.2% higher in May relative to the previous year. The number of transactions in that month was 8.1% higher than in May 2018. Closer analysis, however, shows that the housing market, like the economy, is starting to cool. The recent price increase, for instance, is lower than the peak of 9.5% in November last year and the transaction rate, measured over a longer period, is declining.

In the twelve months until the end of May, 216,000 properties in total changed owners - 8% less than the 236,000 properties sold in the twelve months until the end of May 2018. In 2017 the number of purchases reached a record high because many buyers who had bided their time during the crisis now decided to make their move. When the reservoir of catch-up purchases grew smaller, so did the number of transactions.

In addition to diminished catch-up demand, the lack of properties for sale is also depressing the transaction rate. According to home search website *huizenzoeker.nl*, there were only 62,000 houses on the market in June - 19% less than in June last year. During the crisis, that number peaked at 235,000 houses in November 2012. However, the for-sale stock is no longer shrinking, and is even growing again in the Randstad conurbation. The Randstad kick-started the recovery and, now that the market is turning, appears to be setting the trend again.

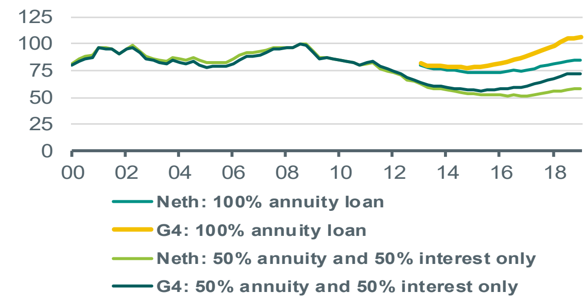
The meagre supply of properties for sale means that buyers have little choice. And the fact that what's on offer does not always match their preferences makes their search even harder. When buyers find a suitable home, they need to act fast. Homes sold by members of the Dutch Association of Real Estate Agents (NVM) in the first quarter were on the market for 45 days on average - significantly shorter than the historical average of 83 days. Many houses are also being sold above the asking price. This applied to 34% of the transactions, well above the historical average of 13%. But here too, there are signals that the market is turning, because in the previous quarter the average selling time was even shorter and even more homes were sold above the asking price.

Conditions still tight

The property market may no longer be boiling over, with prices amongst the most ebullient in Europe, but conditions remain tight. Due to the sustained price increases, net housing costs have risen slightly faster than net income since early 2017. Affordability is being squeezed, particularly in the major cities. Conditions are especially challenging for first-time buyers who must agree to repay their mortgage in full to qualify for mortgage interest relief.

Major four cities are less affordable

Housing costs versus income (Index Q3 2008=100)



Source: DNB

DNB calculations show that first-time buyers now face higher financing costs than if they had bought a house in 2009 with an interest-only loan under the mortgage interest relief available at that time. So it is hardly surprising that more first-time buyers are opting for high loan-to-income or loan-to-value mortgages.

Pressure on affordability and limited availability of properties for sale are dampening confidence in the housing market. In April the reading on the Confidence Indicator of the Homeowners' Association (VEH) was 99 - the same as in March when, for the first time in years, the indicator dived below 100 (the threshold marking the difference between optimism and pessimism on the housing market). The number of respondents that see this as a good time to buy has fallen to 16% - a far cry from the 63% measured in mid-2016. That said, the majority of respondents would still rather buy than rent.

New initiatives to stimulate new-build construction

The turnaround in confidence suggests that transactions will continue to decrease and prices to moderate. However, the shortage of housing does place a floor under prices. The construction of new homes is still failing to keep pace with demand. There are fewer homes than households. The latest estimates put the housing shortage at 294,000. And sustained population growth means that demand will only rise further - by a projected 585,000 until the end of 2030. The growing demand is unlikely to be met in the coming years, leading to an even bigger gap between the number of households and the number of houses.

Lack of supply is impeding new home purchases

Number of sold new-builds

Source: NVB Construction

The minister has called upon all parties involved in the construction sector to develop feasible plans for the rapid delivery of large quantities of houses. One of the instruments that the cabinet has deployed to accelerate construction consists of housing deals. After earlier deals for Groningen and Eindhoven, it recently managed to reach agreements with the Southern Randstad and the Utrecht region. National Government, provinces and the municipalities concerned have agreed to accelerate both the release of new construction sites and the realisation of existing construction plans. Extra money and manpower will be freed up for this purpose. In addition, parties have been given latitude to temporarily depart from restrictive rules and regulations if necessary. Finally, the housing deals contain arrangements about affordability, accessibility and livability.

However, setbacks continue to bedevil new-build construction. Only recently, for instance, there was a report that some municipalities had split construction sites into small plots and sold these to various owners at relatively high prices. It will not be easy to get all these owners thinking along the same lines and agreeing to sell their land at a reasonable price for new project development. This fragmentation of land impedes the realisation of new-build homes.

Due to the limited number of issued building permits, new-build completions - and, hence, new-build sales - are also lagging behind. Data from NVB Construction show that 34,000 properties were sold in the twelve months until the end of May 2019, 6% less than in the twelve months until the end of May 2018. This despite the fact that demand is strong. Against this backdrop, it is no surprise that new-build house prices are rising fast. In the fourth quarter of 2018, the average purchase price was EUR

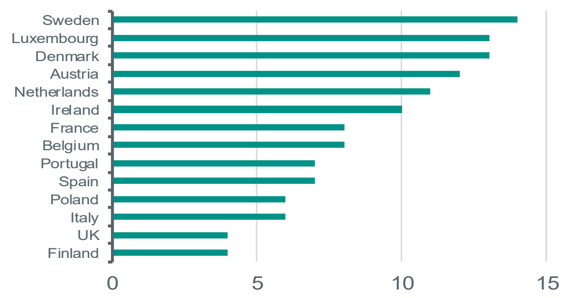
382,000, 13% higher than a year ago when the price was still EUR 338,000. And prices are receiving an extra impulse due to the fact that a relatively large number of new-builds are in the higher price segment.

Rental segment also tight

Tightness is also in evidence in the rental segment. Prices in the private rental segment are rising steadily, though less quickly than before. According to housing platform Pararius, rents rose in the first quarter by 4.9% compared to the same quarter last year - the first increase below 5% in three and a half years. The highest rent increases occurred in Rotterdam, Utrecht and Eindhoven and in several peripheral municipalities. According to the government's national housing survey (WoOn), the average housing costs for tenants as a percentage of disposable income is 38% on average. Ten years ago, that number was 33%.

Tenants are relatively well protected

Rent Regulation Indicator (0-16)



Source: World Bank

Whilst housing costs have increased, it is also true that the quality of Dutch rental housing is high compared with other countries and tenants are relatively well-protected. Good tenant protection can also benefit the landlord. In the first place the tenant turnover rate - and hence the vacancy rate - is lower. Secondly, longstanding tenants tend to take better care of the property, leading to lower maintenance costs.

The WoOn survey shows that the estimated return on rented property (exclusive of service charges) is 5.7% of the property tax value for private landlords, 5.9% for institutional investors and 5% for housing associations. Cheaper housing yields the highest returns for all types of landlords. However, these houses typically have a low energy label, so the need to invest in energy-saving measures may lead to a lower return in the longer term.

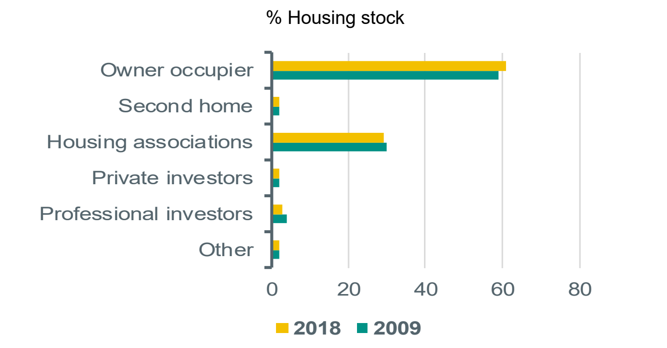
Government is monitoring the role of investors in the housing market

Due to the ultra-low interest rates, investors are increasingly interested in the housing market. This increased involvement of investors has attracted criticism from wider society. So the government is keeping a finger on the pulse. It wants to prevent exorbitant rents and is studying measures to protect tenants against bad landlords. Possible instruments could be a cap on the number of WOZ (property tax value) points awarded in the housing valuation system and an ‘emergency button’ enabling municipalities to temporarily limit initial mid-market rents. The government is also considering a ban on buy-to-let for existing housing in certain neighbourhoods, a tax on rental income and differentiated transfer tax rates for first-time buyers and investors.

Another option is to give tenants in the private segment the same protection as tenants in the social segment. This would entail a statutory cap on rental increases and the right to refer disputes with the landlord to the National Rental Committee for binding decisions. A recent press release of IVBN (Association of Institutional Property Investors) shows that professional landlords are receptive to ideas of this nature. The institutional investors say they are willing to double the pace of new-build construction, but only if municipalities do their bit by charging reasonable land prices.

Whether these measures are useful and necessary will depend on the outcomes of a series of studies into the role of investors. Two of these were recently published by the Land Registry. The first concerned ownership ratios in the housing market. This showed that home ownership increased from 59% in 2009 to 61% in 2018, a remarkable outcome given that owner-occupied accounted for only 57% of new-builds in the 2010-2017 period. The main reason why home ownership still rose was that housing associations sold part of their rental housing stock. Due to the sale of rental housing and their relatively small contribution to new-build output, housing associations saw their share in the housing stock shrink from 30% in 2009 to 29% in 2018.

Shifts in ownership ratios in the housing market



Source: Land Registry

The most important new-build contribution came from professional investors, who accounted for 9% of output. Despite this, their share in the housing stock decreased from 4% to 3% because they also sold properties. In view of the large amount of available capital for investments, professional investors can continue to play a major role in housing production in the years ahead. The share of private investors in the housing stock rose in the 2009-2018 period from 2% to 3%. This was because they purchased existing housing. Their contribution to new-build was a relatively modest 2%.

This first Land Registry report thus leads to the conclusion that, despite their relatively large contribution to new-build output, institutional investors now own a smaller share of the housing stock. Private investors did manage to expand their share, not so much by building new houses as by buying existing housing. The share of private investors rose from 2% of house purchases in 2009 to 5% in 2018. They tended to concentrate on the student cities, where their share in transactions climbed from 5% to 10%.

A second report of the Land Registry seeks to answer the question whether the growing presence of private investors is crowding out first-time buyers. To this end, the Land Registry compared the transactions of first-time buyers and private investors in student cities and looked at whether they were active in the same segment. Evidence that the two groups were looking for the same type of houses and a comparable floor space was found in only four of the twelve cities (Amsterdam, Delft, Utrecht and Wageningen). So there may be a crowding-out effect in these cities. But whether this is really the case is by no means certain, as first-time buyers account for a relatively large share of home purchases in Amsterdam and Utrecht.

We eagerly await the findings of the upcoming publications about the role of private investors. The outcomes will determine the government's future policy and the measures that will be announced on Budget Day for the housing market as a whole and the rented segment in particular.

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