ABN·AMRO

Housing Market Monitor

Group Economics

Netherlands

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Low interest rates drive housing market

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- **Falling interest rates support house prices and transactions**
- **Cabinet frees up cash for housebuilding**
- **Impact of nitrogen decision on housebuilding still unclear**

The latest housing market data slightly exceeded our expectations. The annualised transaction volume has more or less stabilised since early 2019. Prices too have advanced a bit more strongly than foreseen. These better-than-anticipated figures have led us to slightly raise our transaction estimates for this year, namely from a 5% decline to a stabilisation.

One major cause of the brighter picture is the low interest rates. Central banks have changed course and are back in expansive mode. As a result, interest rates are trending down again. Mortgage rates are also lower, making houses more affordable. Buyers are becoming more confident, as is reflected in the recent housing market data.

The central banks changed their course amid concerns about the deteriorating economic situation. The US-China trade war, the unrest in the Middle East and the persistent Brexit threat are all contributing to the darkening outlook. The economic weakening will also temper the housing market. That is one reason why we have maintained our forecasts for next year.

Another is the uncertainty about the impact of the nitrogen decision on construction. On Budget Day the government announced plans to set aside funds for the construction of new houses. But whether this is sufficient to meet the target of 75,000 dwellings a year remains to be seen, particularly against the background of the nitrogen decision. If the target is not met, mobility in the property market will come under even more pressure and there will be fewer transactions. In addition, the growing shortage of housing may lead to higher price increases than currently estimated.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2018	-5	9
2019	0 (-5)	6
2020	-5	3

Source: ABN AMRO Group Economics (earlier estimate in brackets)

Prices still rising

The average purchase price of existing properties increased in the second quarter to EUR 303,000. But there are large regional differences. A house in the province of Groningen costs EUR 213,000 on average, which is a lot lower than in Noord-Holland where the average purchase price is EUR 388,000. Since 2008 the average purchase price in the Randstad conurbation has risen significantly faster than in the rest of the country.

Price level sharply higher than in 2008

Average purchase price in thousands of euros

	Q2 2008	Q2 2019
Noord-Holland	297	388
Utrecht	299	367
Noord-Brabant	275	307
Netherlands	254	303
Zuid-Holland	237	301
Gelderland	266	292
Flevoland	217	263
Overijssel	222	255
Limburg	207	241
Zeeland	204	239
Drenthe	217	237
Friesland	204	233
Groningen	186	213

Source: Statistics Netherlands (CBS)

The higher valuations in the Randstad are mainly down to the sustained price surge in the large cities. The price increases there have gradually rippled out, initially to the surrounding municipalities and later to the rest of the country. Based on the most recent figures, house prices in the four large cities are still rising faster than the national average. But the difference is getting smaller.

In fact, the current price increase in Amsterdam is actually below the national average. This corresponds with earlier research of the IMF, which found that international housing markets are moving more in tandem than before, particularly in the capital cities. Data of the Dallas Fed indicate that house price increases are starting to flatten around the world.

The moderating trend that already started abroad in 2017 has also been visible in the Netherlands since late last year. In August 2018 prices still rose 9.4%, as opposed to only 5.7% this year. All in all, the price increase is currently slightly higher than we foresaw earlier this year. This raises the chance that the full-year price rise for 2019 will be fractionally higher than our estimate of 6%.

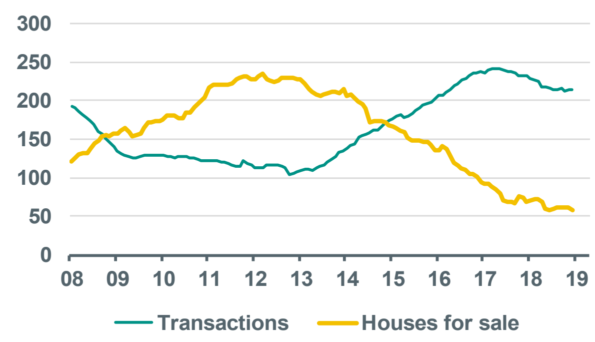
Similarly, the number of transactions is also somewhat better than expected. 214,000 properties were purchased in the twelve months until end of August 2019, 8% less than in the twelve months until end of August 2018. This decrease, however, is mainly attributable to the sharp decline at the end of last year. Since January the number of purchases has more or less stabilised.

Little choice

All in all, the housing market is extremely tight. The for-sale stock continues to shrink, albeit less quickly than before. Based on data of home search website huizenzoeker.nl, there were only 57,000 properties on the market in August. Many of these properties are in the higher price segment. The average asking price was EUR 418,000 in August. The property offerings for single people on an average income are very limited. An analysis carried out by mortgage website De Hypotheker shows that only one in twenty homes on offer have an asking price below their maximum mortgage.

Lack of supply dampens the transaction volume

Number in thousands



Source: CBS and huizenzoeker.nl

The ratio between the number of houses for sale and the number of transactions is historically low, which points to a shortage. Based on this measure, the greatest scarcity exists in the Randstad. The situation in Zeeland, Limburg and Drenthe is less acute. Due to the shortage, houses that come up for sale soon find a new owner. Data of the Dutch Association of Real Estate Agents (NVM) confirm that the selling time is very short. The average selling time for houses sold by NVM members in the second quarter was 38 days, 6 days less than in the previous quarter and 44 days less than the historic average.

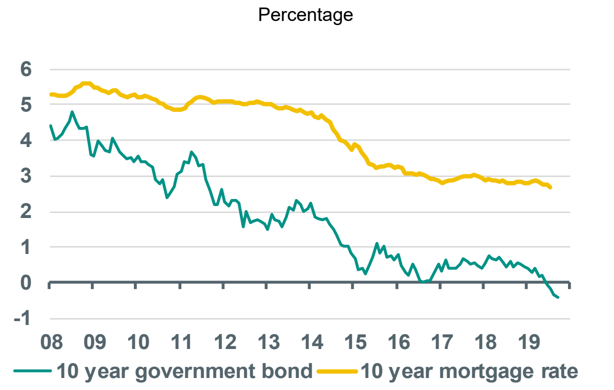
Due to the sustained tightness, buyers often need to bid above the asking price to stand a chance of getting a home. According to the NVM, this was the case for 39% of the transactions in the second quarter, three times as much as the historic average of 13%. Now that overbidding has become common practice, the purchase price currently exceeds the asking price by 0.5% on average. This has never occurred before, which underlines the exceptional nature of the current situation. Buyers who bid above the asking price cannot get a mortgage for the excess amount. This means they must contribute more of their own money to buy their home.

Confidence slightly better, but fragile

Lack of supply leaves buyers with little choice. As a result, confidence in the housing market has faded steadily in recent years. In March the Confidence Indicator of the Homeowners' Association (VEH) pointed to some pessimism for the first time since 2014. But the indicator has been marginally positive again since May.

The improvement is related to the changing trend in interest rates. Yields on government bonds have been falling since late last year. A 10-year Dutch government loan currently fetches -0.4%, one percentage point less than a year ago. The favourable conditions in the financial markets also mean that banks have access to cheaper funding. Mortgage rates are continuing to fall. In July the average interest rate on a 10-year mortgage loan was 2.7%, 10 basis points lower than in the same month last year. And a further drop is expected.

Capital market rates point to falling mortgage rates



Source: Reuters Datastream

This outlook is good for buyer confidence. Low interest rates make housing more affordable. Since the start of this year, net housing costs have been falling relative to net income. This improvement comes after two years of deterioration. Apart from the low interest rates, the improved affordability is also attributable to the higher incomes as a result of the strong labour market and to the tax cuts introduced by the government.

The low interest rates are primarily due to the central banks. Both the ECB and the Fed recently lowered their official rates. The ECB, for its part, also decided to resume its bond-buying programme. The reason for these expansive measures is the low inflation. Inflation in the eurozone is 1%, well below the ECB's target rate of around 2%.

Moreover, inflation is likely to remain subdued due to the worsening economic outlook amidst the festering US-China trade conflict. International trade is suffering from this conflict and industry in particular is feeling the pinch. The German economy, which is heavily dependent on industry, is threatening to slide into recession. Other major concerns are the prospect of a hard Brexit, the weak Italian public finances, the unrest in the Middle East and the protests in Hong Kong. Added to this, there is a growing awareness that the environmental problems will compel a major economic rethink. All these uncertainties are causing businesses to put off investments and households to pull back on spending, leading to less economic growth. Central banks are trying to counter the downward spiral by cutting interest rates.

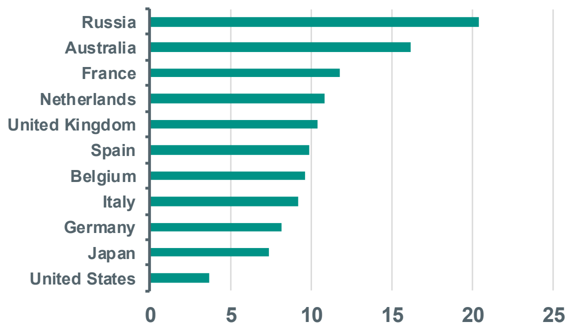
As things stand, the Dutch economy is still performing relatively well. But it is unlikely that our highly trade-dependent economy can escape the effects of these international headwinds. We therefore expect to see growth weakening further, resulting in rising unemployment. The economic growth deceleration will have an adverse impact on the housing market.

Modest risk of price correction

History shows that an economic decline can be the prelude for a price correction. But how great is this danger in the current circumstances? In a qualitative analysis made last year, the CPB Netherlands Bureau for Economic Policy Analysis concluded that the Dutch housing market is tight, but not on the verge of a bubble. The IMF found the same in a slightly earlier study[1]. Based on a regression analysis, the IMF concluded that housing market valuations are relatively high, but not excessive.

Price level in the Netherlands high, but not excessive

The price of a dwelling of 100 m2 versus average annual income 2016



Source: vox.org

This conclusion can be distilled again from a more recent publication. A paper entitled *'Assessing house prices: Insights from a dataset of price level estimates'* makes a cross-country comparison by calculating the average price of a dwelling of 100 square metres for forty different countries. After adjusting the calculated price for differences in purchasing power, the researchers set the result against the average yearly income. It transpired that the house price to yearly income ratio varies strongly between countries: from 4 times yearly income in the United States to 20 times in Russia. Most countries, however, fluctuate around a value of 10 times yearly income.

Based on a historical analysis, the researchers then looked at which price-to-income ratio the risk of a price correction started to increase. They concluded that there is a concrete risk of a correction as soon as the ratio rises above 10. With a ratio of eleven, the Netherlands would, at first sight, seem to be slowly moving towards the danger zone. But it is crucial to note here that the method used by the researchers fails to

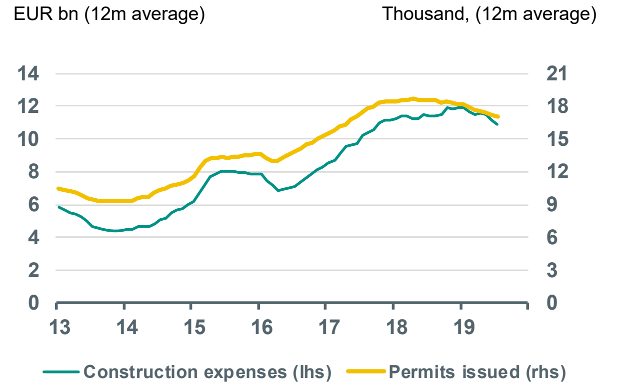
[1] Geng N., 'Fundamental Drivers of House Prices in the Netherlands? A cross-country analysis', IMF Country Report 18/131, IMF, May 2018

include two price-supporting factors that are extremely important in the Dutch context, namely the friendly tax regime for homeowners and the scarcity of new-build dwellings.

Housebuilding lags behind

According to the latest calculations, the housing shortage has risen to 300,000 dwellings. The need for extra homes is particularly acute in the Randstad. And all the more so given that demand for housing will keep rising as a result of the expected demographic development. The population will continue to grow in the coming years, while households are becoming smaller. An added problem is that supply and demand are not always well-matched. The quality of the average home in the Netherlands may be better than abroad, but it's still not good enough.

Fewer permits, lower expenditures on housebuilding



Source: Statistics Netherlands (CBS)

Clearly, more new-build construction is needed. But getting projects off the ground is a struggle. The target of 75,000 additional dwellings per year turns out to be very ambitious. In 2018 66,000 new dwellings were built, with an estimated 7,500 dwellings being added via redevelopment. Measured by the limited number of issued permits (a good indicator for future construction activity), the situation is unlikely to get better any time soon. The number of issued permits has stagnated since 2018, and has even started to fall in recent months. The decline stems from the limited availability of construction sites and a lack of capacity in the sector.

The for-sale stock is shrinking due to the lagging output. The transaction volume is contracting partly as a result of this. Another factor impeding transactions is the high price level. In the first quarter, the average new-build purchase sum was EUR 381,000, over EUR 80,000 higher than the average purchase sum of existing houses. The supply of properties for buyers on an average income has virtually dried up. Neprom estimates that only one in ten new dwellings are within their reach. Whilst it is true that new-builds tend to be more expensive than existing houses (partly because they offer greater comfort), the difference now is very large indeed.

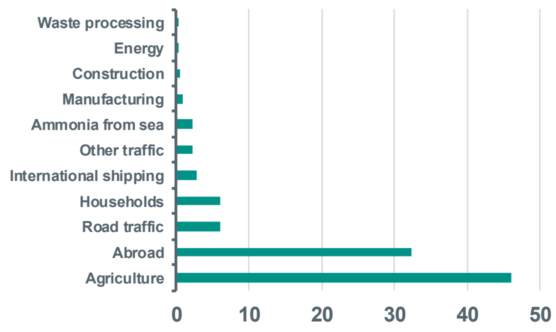
One important cause of the growing price difference is that construction firms are increasingly focusing on the higher price segment. They do this to cover the greater costs of staff, materials and land. Cost-inflating factors include higher wages due to the tight labour market, extra investments to meet the obligation to build gas-free housing and the high prices for construction land charged by municipalities. Moreover, many municipalities also attach strict conditions to the sale of construction sites. Construction firms, for instance, are required to include sufficient social and mid-market rentals in their projects. The builders hope to make up the resulting costs by building more expensive owner-occupied housing. But this also means it takes them longer to sell their dwellings and meet the 70% presale requirement. As a consequence, projects run into delays, causing the construction costs to rise even further.

Even more delays after nitrogen ruling

After the Council of State's nitrogen ruling in May, construction projects threaten to run into further delays and some may even be called off. European regulations prescribe restrictions for nitrogen emissions in the vicinity of 118 nature areas in order to protect biodiversity and soil quality. Without compensatory measures, activities that produce net nitrogen emissions are not permitted. For years the government turned a blind eye to emissions that were not directly compensated. A promise to offset the impact at some time in the future via the Integrated Approach to Nitrogen (PAS) was sufficient. However, having established that these PAS promises are not always kept, the Council of State has now decided to scrap the PAS deferral option.

Direct acidic emissions from construction are limited

N-depositions by sector



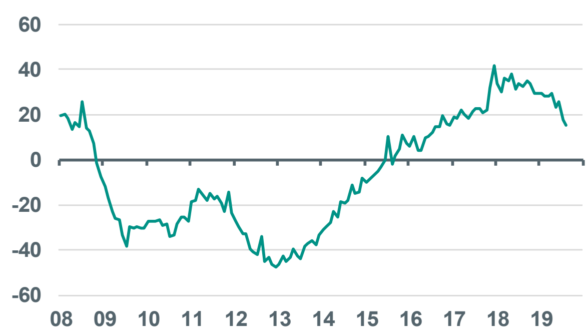
Source: Remkes Committee

The ruling's exact consequences for the sector are still unclear. Not all housebuilding projects will necessarily be put on hold. The so-called ADC test offers a loophole. Based on this test, permission can be obtained if there are no *alternatives*, if there are *compelling reasons in the public interest* and if the initiators take *compensatory measures*. Regarding *alternatives*: construction land is perennially scarce. Regarding the *public interest*: scarcity of social housing is an acute problem in specific areas. And regarding *compensatory measures*: the construction sector must negotiate appropriate measures with other nitrogen-emitting sectors.

Government frees up cash for housebuilding
Due to the persistent shortages, the government has made housebuilding a key priority. According to the cabinet, its previous measures do not go far enough to guarantee affordable new-builds for homeseekers. Unfortunately, despite the multi-stakeholder partnerships in the mid-market rental segment, the recent housing deals with five regions, the expert teams that are helping municipalities to kick-start projects and the short-term start-up loans for the redevelopment of commercial and industrial sites, many problems remain to be solved.

Construction firms less optimistic

Index



Source: Reuters Datastream

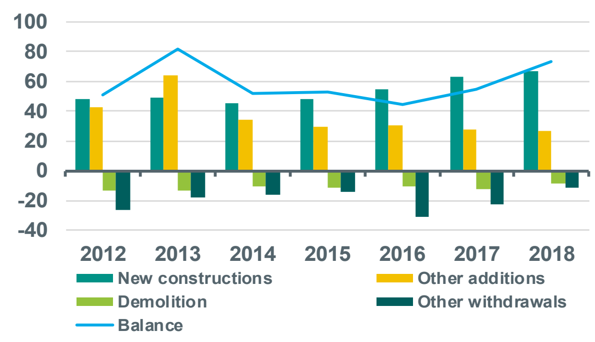
To break the impasse, the cabinet announced additional measures for the housing market on Budget Day. The package includes a special construction fund of EUR 1bn in total. The aim of the fund is to encourage municipalities with a shortage of homes to provide and prepare new-build locations (complete with residential infrastructure) in order to enable the accelerated construction of new homes. Starting from 2020, EUR 250m will be released annually for this purpose. Municipalities can also use this money for measures to offset nitrogen emissions. Conditions will be set to ensure that the construction fund mainly benefits people on low and mid-incomes.

We think that the construction fund is a good idea. Commercial parties and housing associations complain about a lack of construction land. And the land that becomes available is often too expensive. This new government funding can pave the way for progress. And that is badly needed, particularly in the light of the recent nitrogen ruling. It should be noted, however, that if the government wants more building land to be released, it also needs to look at a better distribution of responsibilities between municipalities and provinces. This could lead to shorter procedures.

We are less enamoured with the cabinet's plans to encourage housing associations to build more dwellings. Last year, the housing associations constructed 13,000 new homes, while the ambition was 34,000. The cabinet has set aside EUR 1bn in total for housing associations that build social and mid-market rentals in regions of scarcity. Over the next ten years these housing associations can receive a discount on the Landlord Levy of EUR 100m per year on average. This, however, is a paltry sum compared to the Landlord Levy of EUR 1.7bn. What is more, the Landlord Levy will probably turn out even higher as the levy is linked to the steadily rising property tax value of their housing portfolio. Finally, the housing associations also face a bigger corporation tax bill now that the European ATAD Directive limits the amount of interest they are allowed to deduct. This will cost them hundreds of millions a year.

Flexible housing brings new-build ambition closer

Number (thousand)



Source: Statistics Netherlands (CBS)

More promising in our view is the government's plan to give housing associations a discount on the Landlord Levy if they construct energy-efficient homes for life (known as "flexible housing") for vulnerable groups such as students, homeless people and others with an urgent housing requirement. These new flexible homes will be exempt from the Landlord Levy for a maximum of 15 years. As a further stimulus to build this type of housing, municipalities will receive assistance from a team of housebuilding experts and will also benefit from special arrangements made for this purpose in the municipal housing deals. In this way, the government is seeking to build 15,000 flexible dwellings per year. Achieving this target would be a major step towards attaining the ambition of adding 75,000 dwellings per year to the housing stock.

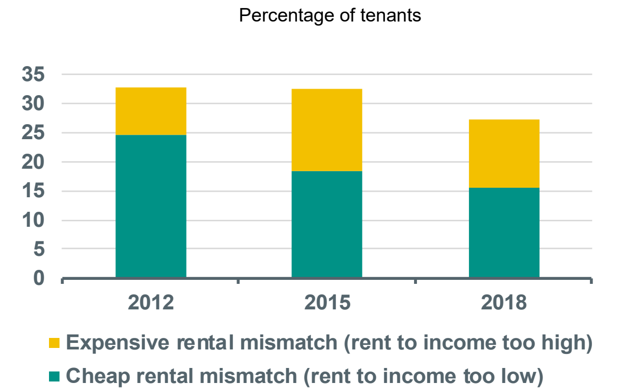
In addition, the construction of 15,000 flexible housing would also alleviate the shortage of rooms in student cities. Traditionally, the lack of student accommodation is most acutely felt at the beginning of the academic year. That's when there is an influx of new students looking for a place to live without a corresponding outflow of graduates. A structural increase in student housing would divert students from the first-time buyer and single-household market. The cabinet is mainly looking to encourage the construction of shared housing units as these are more affordable and appropriate for students. Investors, however, are not interested in this type of housing because of the lower return. This lower return is due to the different rules for calculating the rent and determining the entitlement to housing benefit.

More targeted approach to social rentals

The cabinet is taking further measures to improve the distribution of affordable rentals. First of all, the income threshold for social rentals will be made dependent on the household composition. At present, there is a uniform threshold of EUR 38,000. In future, the threshold will be EUR 35,000 for single-person households and EUR 42,000 for multiple-person households. Access to social rentals will thus be brought more into line with the household's income.

In addition, the cabinet wants to link social rents more closely to income and tackle the problem of rental mismatches. Landlords are allowed to raise the monthly rent for tenants with a high middle income by up to EUR 50 per month. The maximum monthly increase for tenants on high incomes is EUR 100 per month. The increases are permitted until the maximum rental price based on the housing valuation system has been reached. Landlords are allowed to use the resulting extra revenue in order to grant lower-income tenants a temporary rent discount.

Rental mismatches are less common



Source: Statistics Netherlands (CBS)

Finally, the cabinet is giving housing associations more freedom to target rented housing at young tenants and families and to promote diversity in neighbourhoods. At present, housing associations can freely allocate 10% of their available dwellings. This percentage will be raised to 15%, provided housing associations agree on clear allocation rules with municipalities and tenants. Furthermore, housing associations will be given more options to switch dwellings between their social (DAEB) and private (non-DAEB) portfolios.

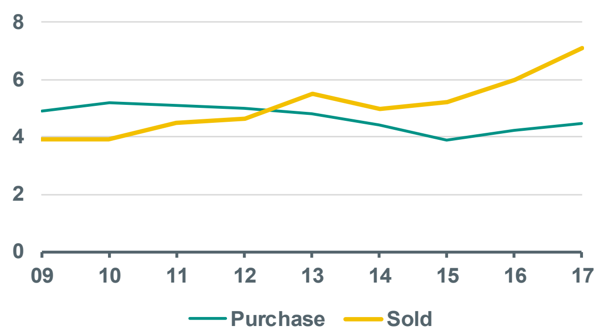
Cabinet set to clamp down on investors

The government wants to prevent too many social rentals being transferred to the privatised segment. Social rents are based on the number of points that a dwelling is assigned according to diverse criteria, including the property tax value. Once a certain number of points is reached, the dwelling is eligible for privatisation. Due to the sustained price increases and steadily rising property tax values, a growing number of dwellings falls within this category. To keep more dwellings within the social segment, the government wants to limit the weighting of the property tax value, so that it only accounts for a third of the points total. The measure is a setback for investors hoping to take advantage of the increased property tax value to transfer social rentals to the privatised segment.

Private investors in housing will also be hit by new tax measures. If the proposed changes go ahead, they will be required to pay more wealth tax (Box 3). At present, the tax rates rise according to the size of the assets. From 2022, taxation will be based on the composition of the assets, making a distinction between savings (with a modest imputed return of 0.09%) and investments in securities and housing (with an imputed return of 5.33%). In addition, the possibility to set off debts against assets is to be abolished. Instead of being allowed to eliminate debts against assets, investors will only be permitted to deduct an imputed debit interest rate of 3.03% from the imputed return of 5.33%. The upshot is that investors will be charged EUR 760 in tax on a property worth EUR 100,000 that is financed with a mortgage of EUR 100,000.[2] In the current system, the levy is still zero as the property value and the debt cancel each other out.

More active role for private investors

Share of transactions of existing dwellings



Source: Land Registry

In addition to these tax measures, the government is also contemplating other steps, such as an owner occupation obligation. Municipalities will be given the power to compel owners to live in their existing home, so that they have more control over the ownership ratios in neighbourhoods. This measure will make it more difficult for investors to purchase buy-to-let properties. And the scope for buy-to-let activity will be restricted even further if the proposed curbs on loans for housing investors go ahead. The cabinet wants to cap the loan-to-value amount that investors can borrow for buy-to-let properties. Less credit for investors will improve the chances of first-time buyers, put a brake on price increases and promote financial stability.

Tenants the losers?

A final measure under consideration concerns the introduction of differentiated transfer tax rates. The rate for investors may be raised to 6%, but abolished for first-time buyers. The practical feasibility of this measure is currently being studied. How, for instance, can the tax department determine whether someone is a first-time buyer or not? And what if investors come up with ploys to dodge the tax?

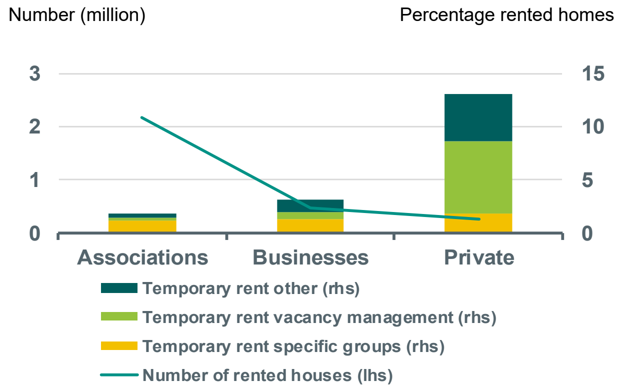
All these changes are mainly designed to discourage speculative investors. This group, which buys houses in the hope of further price increases, effectively transfers dwellings

2 A net imputed return of 2.3% (5.33% minus 3.03%) will be taxed at a rate of 33%. On balance the levy will be 0.76%

from the owner-occupied to the rented segment and makes little or no contribution to the expansion of the housing stock. However, the cabinet is keen to accommodate investors with a long-term horizon. They, after all, provide the capital that is necessary for new-build development. Unfortunately, though the aforementioned measures mainly affect speculative investors, they also impact on long-term investors.

Another risk is that landlords may pass on the higher costs to tenants, so that the measures will effectively drive up rents. They can do this because of the shortage of rented properties. In addition, since 2016 landlords are allowed to make use of temporary rental contracts, which has considerably strengthened their position towards tenants. Tenants who hope to renew their contract will be less inclined to complain about poor maintenance or high service charges and will also be more willing to accept rent increases.

Temporary contract popular among private landlords



Source: Statistics Netherlands (CBS)

Extra sustainability measures

To counter the risks of extreme weather conditions, the cabinet has freed up EUR 10 million for regional projects aimed at creating gas-free neighbourhoods and collecting and draining off rainwater. Furthermore, extra funding has been earmarked for a special project within which 100,000 rented homes are to be insulated and made gas-free between now and 2022. Starting from 2020, the tax on gas will also be gradually raised, while the tax on electricity will be reduced. In addition to all these sustainable energy measures, the government had already announced before Budget Day that the homeowners subsidy for energy-saving measures would be reopened from September. Under this scheme, homeowners can claim a refund for one fifth of the costs incurred to insulate their home. The maximum subsidy is EUR 10,000. The total available amount is EUR 84 million.