Group Economics | 09 July 2020

Housing Market Monitor

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Housing market: a tanker slowly changing course

- Latest housing market data positive, but impact of coronavirus not yet evident
- Prices this year +6%, next year -2%; transaction volume this year -5%, next year -10%
- Dampened housing market sentiment first sign of weaker outlook
- New reform proposals: majority will inhibit appreciation in property values over the long term

The latest data continue to paint a positive picture of the housing market, with strong price rises and high transaction volumes. This applies to pre-owned properties and new-builds alike. It is questionable, however, whether these figures give a true picture of what is actually happening in the market. The figures for pre-owned properties, for example, lag behind by several months.

A first sign that a change is underway is provided by the Confidence Indicator of the Homeowners' Association (VEH), which swung from mildly positive to slightly negative in May. A second sign is the rise in the number of properties for sale. More homeowners wanting to trade up are likely looking to sell their home first before buying another property.

The housing market is being supported by the low mortgage interest rates, which have been kept at that level mainly through the actions of the central banks. By intervening on an unprecedented scale they have helped to calm the financial markets. This ensures that mortgage lenders retain access to finance so that they can raise the funds to continue to provide credit.

The coronavirus crisis is nonetheless causing severe economic damage. Many businesses have been dealt a hard blow and the labour market is deteriorating. Unemployment is rising and the loss of jobs and incomes will have an adverse impact on the housing market. It seems inevitable that investors too will favour caution and step back from the market given the uncertain conditions.

With so much remaining unclear about how the coronavirus pandemic will develop, economic forecasts are subject to even more uncertainty than usual. Based on current assumptions, we expect the number of house purchases to decline by 5% this year and by 10% in 2021. House prices too will come under pressure, albeit it with some delay. While house prices are set to rise by a further 6% this year, we anticipate a 2% decline in 2021.

Various studies have recently been published on reform of the housing market and the tax system. If the next government implements the proposals discussed in these papers, including more government involvement in house construction and further adjustment of mortgage interest relief, this will curtail increases in property values in the coming ten years.

Latest data remain positive

The latest housing market data from CBS/Kadaster continue to paint a very positive picture of the housing market, with sustained strong house price growth, In May, pre-owned properties were on average 7.7% more expensive than a year ago. At EUR 333,000, the average purchase price was EUR 30,000 higher than in the previous year. Properties in the lower price segments in particular increased in value. Apartments once again recorded higher price increases than single-family homes. In addition, older properties are rising more in price than newer dwellings. This is likely due to their more central location and the closeness of amenities.

The transaction volume also remains high. In the first five months of the year, more than 89,000 pre-owned properties changed hands, 4,500 more than in the same period last year. It is questionable, however, whether these figures are entirely up to date and accurately reflect the most recent developments since, being based on transfers conducted through a civil-law notary, they tend to lag behind several months. The recently published figures for May are therefore more likely to relate to February, just before the onset of the coronavirus crisis, than May itself. We need to be patient a while longer, therefore, before the figures for the lockdown period are released.

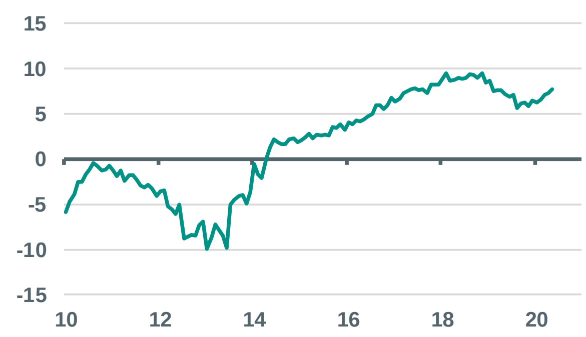
The volume of housing transactions still high

No. of transactions during previous twelve months (x 1000)

Source: CBS/Kadaster

House prices also continue to rise

Price index (% change YoY)



Source: CBS/Kadaster

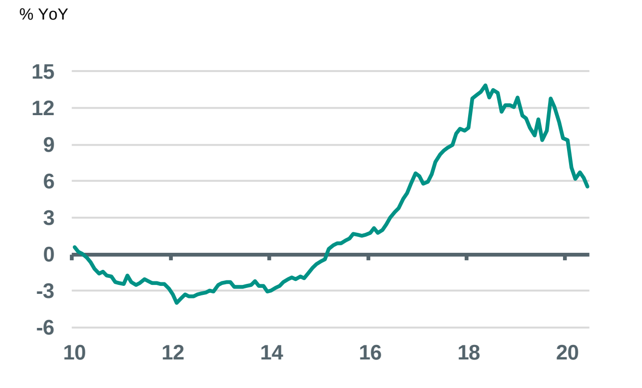
Estate agents are the parties closest to the market. The Dutch Association of Real Estate Agents (NVM) retains its positive outlook. According to the NVM, there is little cause for concern and purchase volumes remain at the same level as previous months. This continued buoyancy is backed up by the numbers of mortgage applications. Mortgage data network HDN, which registers 80% of applications, reports a sharp rise in mortgage applications. There is a difficulty, however, in that figures for mortgage applications are artificially inflated to a significant degree due to the fact that many homeowners have refinanced their mortgage in anticipation of a possible interest rate rise. At the same time, the number of applications for house purchases rose by 15% in the second quarter compared to the same quarter in 2019. This is a substantial increase, albeit less pronounced than the 20% increase in the first quarter.

The sustained level of transactions during lockdown has surprised us. In our previous Monitor we assumed that the physical restrictions would inhibit house viewings and purchases and that concerns about the economy would make people more cautious. We believe there are five possible explanations for why things turned out differently. Firstly, estate agents have been inventive in finding ways of minimising the negative impact of the lockdown. Secondly, buyers saw their opportunity to finally make a move without having to fend off rivals. Thirdly, buyers acted fast in order not to miss the boat, in anticipation of a possible rise in interest rates. Fourthly, government measures have softened the financial blow: a total of 114,000 businesses and organisations employing 1.9 million people and 350,000 self-employed individuals have received income support. Fifthly, buyers thought that coronavirus would be only a short-lived problem with limited negative impact on the economy.

The latest reports provide increasingly fewer reasons to believe that the coronavirus crisis will have a modest impact on the economy. The longer-than-expected length of the lockdown has prompted us also to revise downwards our forecasts for the Netherlands in the meantime. Furthermore, the risk of a second wave of infections cannot be excluded, the international economy has been hit even harder than feared and there is a growing danger that businesses and families will economise in order to offset financial setbacks. Many businesses and families are experiencing difficulties. We expect the government to gradually scale back the level of income support it provides, and fear that the economy will contract by more than 5% this year and that unemployment will peak at more than 7% during the course of next year.

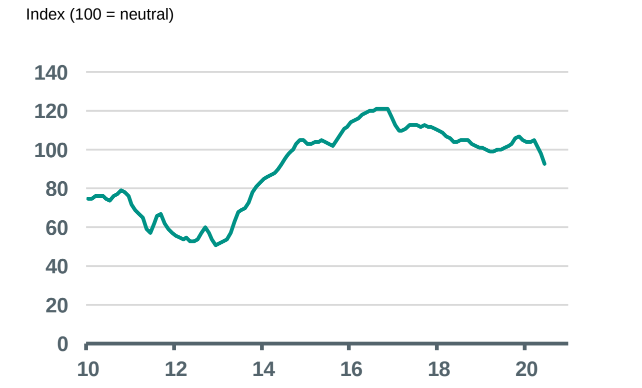
Trend toward 'buy first then sell' points to shift in the market
Given this bleak outlook, it is inevitable that the housing market too will be affected by the crisis. The first cautious signs of this impact are already visible. Estate agents point to the increased number of properties put up for sale as the leading change brought about by the lockdown. Still, reports on the number of properties for sale are rather contradictory. According to data from home search website *huizenzoeker.nl*, the number of properties on the market has remained more or less stable in the past few months. Calcasa, on the other hand, echoes the reports of the NVM that this number has increased, from 73,000 at the end of the first quarter to 93,000 in May.

Asking price rise of properties for sale slowing



Source: Huizenzoeker.nl

Turnaround in housing market sentiment



Source: Dutch Homeowners' Association (VEH)

If more properties are indeed for sale, this could in theory lead to a further increase in purchase volumes. In recent years, prospective buyers had great difficulty finding a suitable property due to the lack of supply. There were few houses for sale, and those that were on the market were generally in the higher price segment. This led many home hunters to shelve their plans. If more properties were to come on to the market again that would lead to a greater range of supply and boost the buying chances of those who previously became disillusioned and gave up.

We doubt, however, whether the number of house purchases will increase if there are more properties for sale. We believe that the increase in the for-sale stock is more likely to be a sign of a shift in the market. Markets swing from a seller's to a buyer's market in this way when there is an estimation that the number of properties for sale will increase and that prices will rise less quickly, or will possibly go down. More homeowners who are looking to trade up to a new property are then anxious about owning two houses. In order to avoid the costs of maintaining two homes for an extended period, they prefer to first put their house up for sale before buying a new property. The greater the uncertainty, the larger this group is.

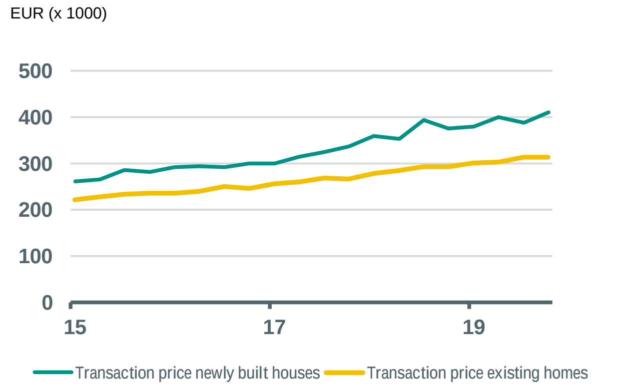
The recent dampening of housing market sentiment is an indicator of growing uncertainty. In the past few years confidence was high amongst prospective buyers. The continuing fall in mortgage interest rates and the steadily growing housing shortage contributed to optimism. In June, however, the Confidence Indicator of the Homeowners' Association (VEH) stood at 93, 11 points down from two months earlier and 7 points below the neutral value of 100. Optimism about the housing market has therefore shifted to pessimism. Compared with the consumer confidence indicator, which mirrors movements in the economy to a far closer degree, the dampening of housing market sentiment remains modest.

It is worth noting that there was already a cautious sign of a shift in the market even before the onset of the coronavirus crisis. Price rises in Amsterdam have been below the national average for some time, for instance. During the housing market recovery of recent years, the capital was several steps ahead of the rest of the country. This is probably the case once again, only this time in the opposite direction.

New-build remains in demand

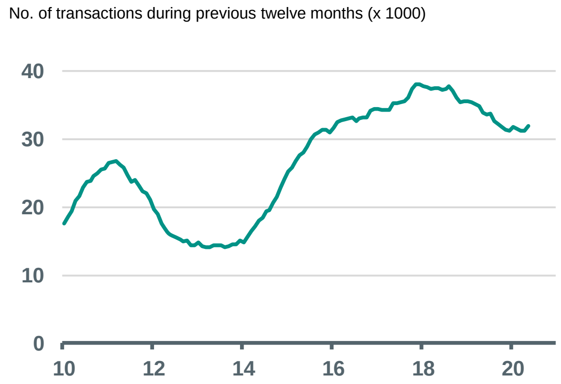
As in the resale market, the number of new-build transactions also has held up well. According to NVB Construction, slightly more new-build properties were sold in the first five months of the year than in the same period in 2019. No up-to-date information is available on the price level of new-builds.

New-build prices rise faster than resale



Source: CBS/Kadaster

New-build transaction volume remains solid



Source: NVB Construction

We assume that new-build prices continue to rise faster than resale prices. This difference in price increase between new-build and pre-owned properties is largely attributable to the changing composition of new properties coming onto the market. In recent years, home-building has increased in popular regions and towns and cities where the price of land is higher. In addition, property developers are focusing more on larger properties in the higher price segment. Add in the fact that recently completed houses boast higher energy performance, it becomes evident that, when adjusted for these factors, the price of new properties has advanced at much the same rate as pre-owned properties.

Brief upsurge in numbers of first-time buyers

Mortgage website De Hypotheker recently highlighted an increase in the number of first-time buyers in the period March to May. That is remarkable, considering the fact that the number of first-time buyers remained more or less stable in recent years while the overall volume of house purchases increased sharply. As a result, the proportion of first-time buyers fell from 50% in 2012 to 30% at the end of 2019. The proportion of first-time buyers also declined in the towns and cities popular amongst young people, driven in part by tightened mortgage rules. Buyers have to stump up additional cash and therefore need to set money aside in order to meet larger deposit requirements when buying a property. As a result, the average age of first-time buyers is rising and increasingly first-time buyers are opting to buy a house together.

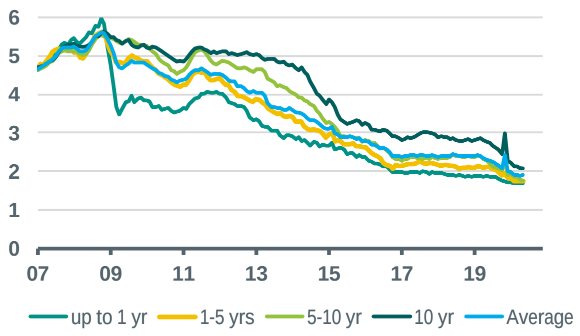
Our working assumption is that the increased volume of purchases by first-time buyers is temporary, a brief upsurge possibly fed by the belief that the crisis will be short-lived and provide an opportunity finally to get a foot on the ladder. The hope that the coronavirus crisis would be merely a minor dip has meanwhile dissipated. The economic backlash will particularly hit young people primarily, as, lacking permanent employment, they will be the first to lose their jobs. Weakened income perspective reduces their chances of buying a property. Added to this, the difficulties they will experience in changing jobs will weigh on their plans to move.

Massive support measures help to mitigate initial impact

The economy contracted by 1.5% in the first three months of this year, compared with the final quarter of 2019. Activity is expected to have decreased even further in the second quarter. The government's support measures have limited the adverse effects for homeowners to some extent. By the end of May, 19,000 households had requested a mortgage payment break from their lender. This is a modest number compared to other countries.

Fall in mortgage rates on new originations

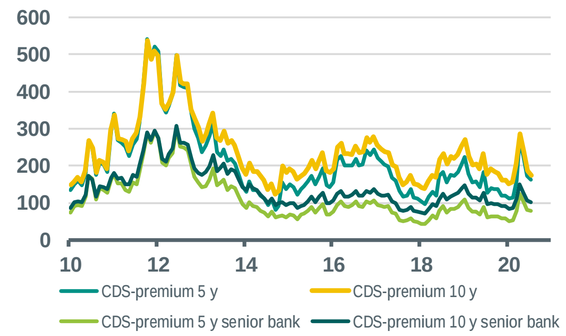
% per fixed-rate period



Source: Dutch Central Bank (DNB)

Increase in bank insurance costs short-lived

Basis points



Source: Thomson Reuters Datastream

The income support measures implemented by the government have therefore helped to mitigate the initial impact. Lower buffer requirements for banks introduced by regulators have also aided the housing market. This ensured that lending continued to flow and prevented any sharp rise in mortgage rates. Central bank action has been even more important in moderating mortgage rates. They pulled out all the stops to keep enough cash in circulation to ensure continued funding for public authorities, companies and banks.

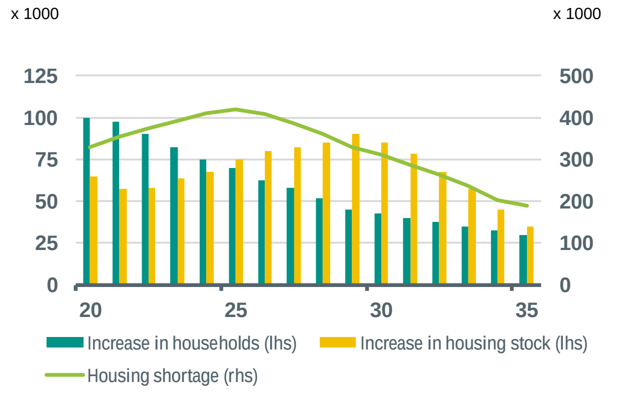
Thanks to central bank interventions, mortgage rates have risen less sharply than we anticipated a quarter ago. In fact, DNB data show that the average interest rate for new originations of mortgages with a term to maturity of 10 years or more has even decreased. However, the lag in these figures, just as in the figures for house prices and transactions, makes it difficult interpreting them. Furthermore, the high proportion of mortgage refinances in new mortgage loan production may also have contributed to the decrease. Thanks to the steep increase in house prices of the past few years, this group has accumulated considerable equity and is therefore well placed to refinance a new mortgage at a favourable rate. On the other hand, there is a shift in preference to longer fixed-rate periods. The lower difference in interest rate compared to loans with a fixed-rate period of 10 years has led many mortgage borrowers currently to take out a mortgage with a fixed-rate period of 20 years. The interest on these loans is only slightly higher than on a 10-year fixed rate mortgage.

Mortgage rates will not necessarily remain sustainably low. Firstly, the recovery in the international financial markets is fragile. Considerable uncertainty remains, not just about coronavirus, but also about the Brexit negotiations, the ongoing tensions between China and the US and budgetary solidarity between EU Member States. Secondly, it is doubtful whether central banks are able or willing to continue playing such a prominent role on the financial markets in the long term. If the governments of the eurozone countries were to cooperate more in budgetary matters, the European Central Bank (ECB) would not need to feature so prominently in tackling financial problems. Thirdly, the economic downturn is exacerbating the credit risks in the mortgage portfolios of mortgage lenders. This will in time lead to a higher risk premium on new mortgage originations. For the time being, however, low mortgage rates continue to contribute to the affordability of housing and to support price levels.

Severe housing shortage holds up price levels

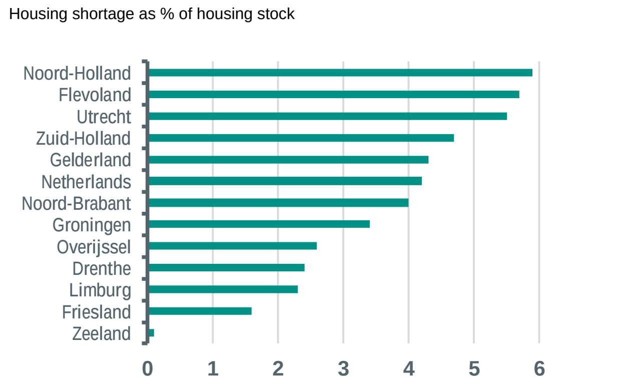
The persistent housing shortage continues to hold up price levels. Over the past ten years, the population of the Netherlands increased by 834,000 to 17.4 million. One-fifth of this is due to natural increase, and four-fifths to immigration. The Netherlands is popular with foreign workers and students. Whether they will continue to come if the problems around coronavirus persist for a long time is uncertain. In April, more people left the Netherlands than arrived. Despite this, the latest population forecasts have once again been revised upwards, to 18.8 million in 2035.

Housing shortage continues to increase



Source: Primos

Large regional differences remain



Source: Primos

Population growth will be high in Amsterdam and The Hague in particular. Owing to the relatively young population, the natural increase in the Randstad conurbation is markedly higher than in other parts of the country. Combined with migration from abroad, this will propel stronger population growth in these urban areas. It is notable that internal migration to the Randstad has been reversed, with, on balance, slightly more people now leaving the Randstad for other parts of the country than are moving to the Randstad.

According to the latest estimates, the Netherlands currently has a housing shortage of 331,000 homes. This is 16,000 more than was previously supposed. Although the number of new homes completed rose in recent years from 45,000 in 2016 to 77,000 in 2019, the expansion of the housing stock is still less than what is needed. The problem of nitrogen emissions, the lack of construction land and the coronavirus crisis threaten to lead to a construction backlog on the number of new homes completed in the coming years also. The housing shortage is expected to increase to 419,000 dwellings in 2025. This figure is not expected to fall until after 2025, when construction will once again surpass the growth in the number of households. Compared with the available housing stock, the housing shortage will increase from 4.2% in 2020 to peak at 5.1% in 2025, before falling to 3.7% in 2030 and 2.1% in 2035.

Roughly 727,000 new homes will need to be created in the coming decade. Given that approximately 12,000 homes are withdrawn from the housing stock each year, the average annual construction target is therefore 85,000 homes, 10,000 more than the government previously assumed. In order to meet this figure, it is essential that enough building plans are put forward. Past experience has shown that plans are often delayed, and are sometimes dropped entirely. There therefore need to be many more construction plans on paper than there are new homes actually needing to be built. Fortunately, this is now the case for most housing developments.

In addition to enough building plans, money is also needed to meet the challenging construction target. If the Netherlands is serious about the target of building as many homes as possible within urban areas, money will have to be made available for relocating businesses, remediating the soil of derelict sites and for investing in infrastructure to make developments accessible. The government is taking steps to meeting this need by bringing forward the EUR 1 billion building impulse in response to the coronavirus crisis. It has learned from the previous crisis that construction activity cannot be allowed to stagnate as it can take years before it picks up again.

Coronavirus highlights importance of investments in public space

The figure of EUR 1 billion is probably just the start. Experts warn that animal habitats are shrinking due to temperate and tropical deforestation, increasingly the likelihood of more frequent pandemics. This means that we need to think again about how we design and manage our cities, just as in the nineteenth century. Back then it was discovered that lack of hygiene was a major cause of the repeated cholera outbreaks, prompting investments around the world in drinking water networks and improved living conditions. These insights helped to bring about the 1901 Housing Act in the Netherlands. This piece of public housing legislation resulted in the creation of many housing associations.

The coronavirus crisis should prompt renewed investment in living conditions. Partly in improved accommodation, since suitable outdoor space or an extra room is far from a luxury during lockdown. Investments are also needed in public infrastructure, as more space in the streets for pedestrians and public green areas ensure residential environments remain liveable. Good liveability is important for continuing to benefit from the economic advantages of cities. Urban agglomerations provide space for the specialisation of labour, offer opportunities for sharing knowledge and learning from one another, help to bring together supply and demand more easily and create possibilities for jointly sharing high-quality services and facilities.

History shows that pandemics have a negative impact on house prices, but that this effect is only temporary. Price decreases are linked to the decline in population growth. As coronavirus is less lethal than the plague, for example, mortality will be relatively low. At the same time, reduced migration from abroad can still have the effect of slowing population growth. Price decreases also reflect the slowdown in the economy. Investors especially favour caution, and step back from the market in uncertain times. In the current situation also, investors face some difficult choices. This is reflected in the increased number of rental properties advertised on rental website Pararius due to the decline in rentals via Airbnb, for instance, and the exodus of expats and international students. Rents in the liberalised rental sector are falling in various towns and cities.

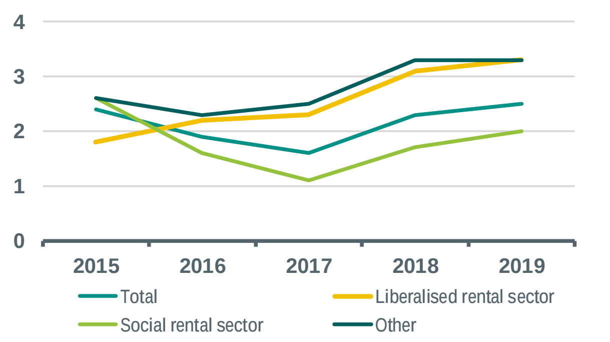
Investor restrictions

Investors additionally face changes to laws and regulations. Government plans to lower the transfer tax for first-time buyers and raise it for investors have been shelved. The plans proved to be neither workable nor to further the intended objective (more opportunities for first-time buyers) The government has also decided against the so-called 'panic button', which was intended to prevent the rents for social housing that was absorbed in the liberalised rental sector from rising too quickly to above the maximum mid-market rental price of EUR 1,000. Instead, the government envisages the introduction of a more transparent manner for setting initial rents.

The government also wants to extend the length of temporary rental contracts from two to three years and give local authorities the power to introduce a buy-up protection for affordable owner-occupied housing when investors that buy up properties on a buy-to-let basis charge excessively high rents. It further proposes that the property tax value (WOZ-waarde) should in future count for no more than 33% when determining the number of housing points. This will result in some rental homes in the large cities, where property tax values have risen sharply due to increased house prices, possibly returning to the social rental sector from the liberalised sector. Finally, the government intends to cap annual rent increases in the liberalised sector at the rate of inflation plus 2.5%. Average rent increases were below this level in recent years.

Average rent rise remains moderate

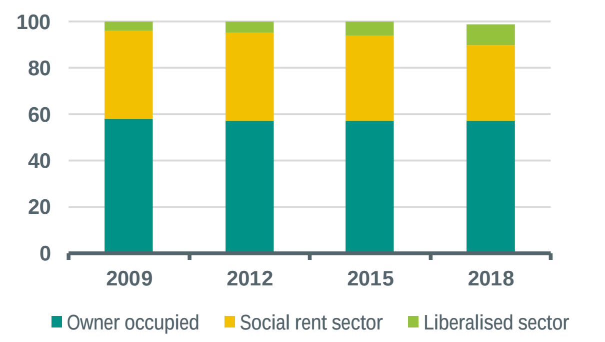
Rent rise including one-off increase (% YoY)



Source: CBS/Kadaster

Liberalised rental sector still modest in size

% share of stock



Source: Woon 2018

Further, the Senate has called on the government to impose a rent freeze in the social sector to help out tenants in financial difficulties due to the coronavirus crisis. Investors and housing associations oppose the move, arguing that a freeze would affect their returns and make rental property investments less attractive. Furthermore, they claim, it ignores their own efforts to limit rent increases and find a "tailor-made solution" for tenants who are in financial problems. Interior minister Kajsa Ollongren agrees, and has twice ignored the Senate's motion. The Senate responded by tabling a motion of censure against Ollongren. The significance of this motion, which is rare in parliamentary history, and its practical implications are unclear.

New reform ideas moderate increase in property values

In the run-up to next year's elections, think tanks of the government and related bodies are studying plans for reform of the housing market. They are proposing greater involvement by central government as a solution for reducing the housing shortage. This would represent a break with the practices of recent decades, which have seen a transfer of responsibilities for spatial planning and housing construction from central government to local authorities and provinces. To prevent excessive price swings, they also recommend a further tightening of mortgage rules and curtailment of mortgage interest relief.

The reports that have been published on a review of the tax system also come up with the latter proposal. They contain various suggestions for levies on real estate. Broadly speaking, it is proposed that real estate should be more heavily taxed. One of the underlying ideas is that this will allow taxes on labour to be cut. From the viewpoint of economic theory, a strong case can be made for shifting taxes away from labour to capital/property, since this entails fewer distortions. Nevertheless, heavier taxation of real estate affects price levels. Should a future government implement the proposed ideas, which promises to be a major political challenge, this would inhibit the appreciation in property values over the long term.