ABN·AMRO

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Housing market monitor

Philip Bokeloh
Tel.: 020 383 2657 / philip.bokeloh@nl.abnamro.com

Growing uncertainty after Russian invasion

- House prices continue to rise, but less sharply than before
- Lower confidence heralds further decline in housing transactions
- Mortgage rates rise again after years of decline, but remain historically low
- High energy prices emphasise the importance of home sustainability

We are sticking to our previously issued price estimates. We expect house prices to rise 12.5% this year and 5% next year. Last year, prices rose by 15.2%. The reason for the weakening is the affordability of the housing market. This is worsening due to the sharp rise in house values and because real incomes are under pressure due to high inflation. Furthermore, affordability is tempered by mortgage interest rates. Mortgage rates are rising due to stubbornly high inflation and the monetary authorities' policy reaction. Central Banks are trying to curb inflation by accelerating the tightening of monetary policy. In addition, mortgage rates are rising due to higher risk premiums on financial markets. Since the Russian invasion of Ukraine, the financing costs for mortgage lenders have increased.

However, we have revised the estimates of the number of transactions downwards: for 2022 from -10% to -15% and for 2023 from +5% to 0%. The war in Ukraine is causing unrest, also among potential house buyers. That confidence was already under pressure because there are few houses for sale. Due to the lack of affordable housing, many potential buyers give up and abandon their search. The flow on the housing market could improve if more new houses were realised. That is also the government's aim. But as yet, there is little prospect of a strong increase in housebuilding. With the rising cost of materials, the lack of personnel and the high cost of land, the number of obstacles seems to be increasing rather than decreasing. In addition, the environment, the climate and public health present challenges. This creates doubts about whether all the planned housing construction can actually be realised.

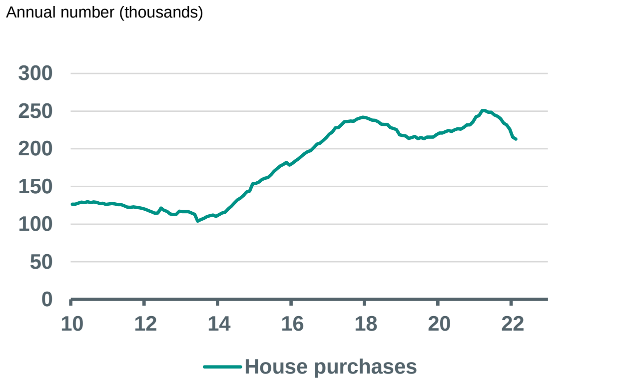
In addition to new buildings, making the existing housing stock sustainable also requires a great deal of attention. The recent sharp increase in energy costs underlines the need to reduce the consumption of natural gas. This requires better insulation of homes. The majority of homes currently have too low an energy label, causing energy to be wasted. Depending on the year of construction, the façade, floor, roof and windows need to be improved. In the future, the remaining energy consumption will have to rely on energy sources other than natural gas. The main alternatives are an electric water pump (powered by wind and solar energy), a connection to the heat network (if necessary, supplemented by an electric water pump) and green gas (e.g. produced from VGF waste, manure and sludge). This energy transition requires money, manpower and organisation.

Gradually fewer transactions

The number of house purchases is declining. In the first two months of the year, 28,000 existing homes were bought, 13,000 fewer than in the first two months of last year. The decline is mainly due to the fact that at the beginning of last year, many houses were bought in connection with the newly reduced transfer tax rate for first-time buyers. But apart from this, the number of transactions is also under pressure. The annual number of transactions fell to 213,000 in February, while last April still saw a record 251,000 transactions.

The trend towards fewer transactions of existing residential properties is visible throughout the country. House purchases are under pressure in all provinces, although it should be noted that the pressure is slightly less in the Randstad, so that the transaction share of the Randstad is slowly returning to its historical average. One explanation is that the Randstad economy suffered relatively much from the corona crisis. Now that the corona crisis is fading into the background, its impact on the Randstad housing market is also diminishing.

The number of house purchases is falling



Source: CBS/Land Registry

Stock of houses for sale is historically low

Source: NVM

An important reason for the decline in house purchases is that there are few houses for sale. In the fourth quarter, fewer than 16,000 houses were on offer at NVM affiliated brokers, whereas the historical average is 78,000. Based on the scarcity indicator, which compares the stock of houses for sale with the number of house transactions, buyers' choice is constrained to just 1.3 houses. With such a modest supply, the chances of a house hunter finding a suitable home are very limited.

Another reason for the decline in the number of transactions is the lack of circulation. One driver of this is the supply of new homes. Anyone who moves into a new house leaves behind an existing house, which becomes available to the next buyer, and so on. The more homes that are added, the smoother the flow. But sales of new homes continue to lag behind. In January, there were 38,000 transactions on an annual basis, 2,500 more than in January last year, but still too little to meet the growing demand.

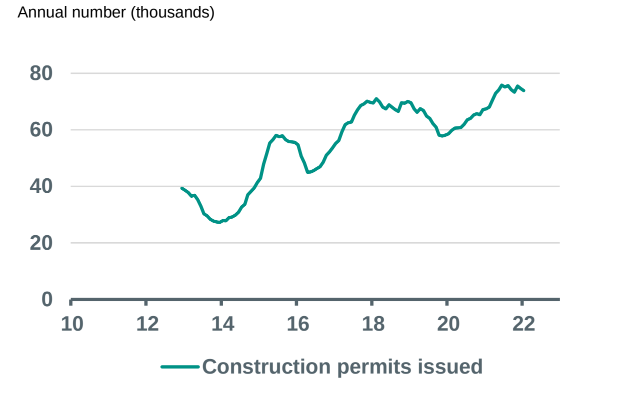
Residential construction hampered by series of disruptions

The question is whether more new-builds will be able to get the flow going again in the short term. The government has set the bar high for the number of homes to be delivered and is spending a lot of money to realise its target, which it has increased to 100,000 homes annually. However, objection procedures continue to be an obstacle to the realisation of new homes, as does the shortage of issued permits, the number of which remains at less than 75,000 annually. In addition, construction costs are rising due to the lack of building materials, personnel and land, while the ambition is to build homes in the affordable segment.

Shortly after the warning from the Delta Commissioner that many of the current housing plans are concentrated in areas that are vulnerable to climate change, the Council for the Environment and Infrastructure sounded the alarm about the highly vulnerable nature in the Netherlands. The Council calls for more account to be taken of nature in the design of residential areas, new housing developments and renovation of existing housing. Nature-inclusive construction is the motto. This goes beyond the reduction of nitrogen emissions, another issue that hangs over the construction sector like a sword of Damocles.

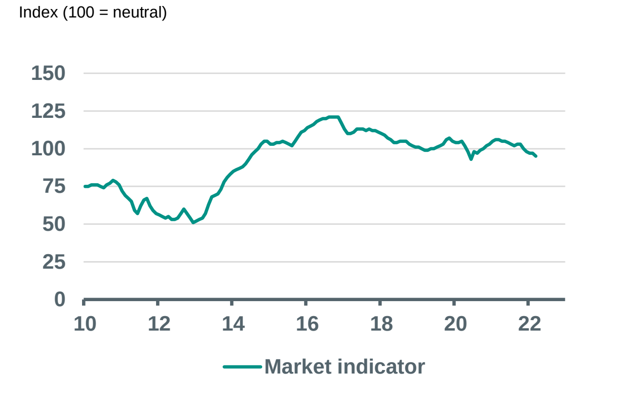
Then there is public health. The health risks resulting from the PFAS crisis were already playing tricks on the construction industry. Now there is also noise pollution. Given the World Health Organisation's limits on noise pollution from aircraft, the plans for the construction of 150,000 homes around Schiphol could be jeopardised. With all these obstacles, there is little chance that the construction of new homes in the short term will give a solid impulse to the total number of transactions.

Stagnation in the number of building permits



Source: CBS

Slight optimism turns to pessimism



Source: Dutch Home Owners Association

Sentiment on housing market deteriorates

The number of transactions is also held back by the lower confidence in the housing market. The Dutch Home Owners' Association's market indicator now stands at 95. In March last year, this index was eleven points higher at 106. The index has been below the neutral value of 100 since December, which means that the number of pessimistic respondents has now outnumbered the number of optimistic respondents.

Sentiment towards the housing market is deteriorating partly because buyers are giving up hope of finding a suitable home. They have missed the boat so often that they are adjusting their housing preferences. They settle for a smaller home, shift their search to another location, or give up the search altogether. Given the limited supply of homes for sale and the competition from other interested parties, the chances of success are indeed slim.

The war in Ukraine may further erode confidence. The economy has barely recovered from the corona crisis and the next crisis is already looming. This creates uncertainty about the future and is bad for housing market sentiment. Consumer confidence has fallen below the low point of the corona crisis in response to the outbreak. This does not necessarily mean that confidence in the housing market will fall as sharply, but it will certainly affect housing market sentiment.

Affordability less favourable than before

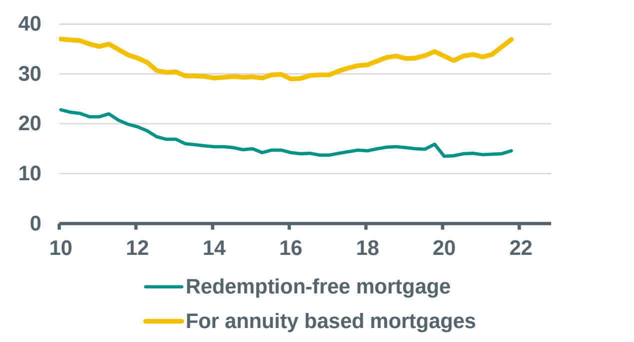
Housing market sentiment is also tempered by declining affordability. Net housing costs are currently rising faster than net income, especially for those who make an annuity payment on their mortgage. Their net housing costs have risen by 3 percentage points to 37% of net income. The net cost of living is also rising for those with interest-only mortgages. Compared to last year, net costs are half a percentage point higher at 15% of net income.

Several reasons can be identified for the deterioration in affordability. First of all, real incomes are under pressure, despite the fact that many people are finding jobs and employees can make higher wage demands because of the tight labour market. The reason for the downward pressure on real incomes is rising inflation. As a result of continuing price increases, families have less money at the end of the month. It is likely that, for this reason, the Nibud income standards will be adjusted downwards from next year onwards and homebuyers will be able to borrow less on the basis of the same income. The result is likely to be weaker house price growth.

Affordability is also declining because of higher mortgage rates. Mortgage rates are another important variable in calculating how much people can borrow based on their income. In recent years, people have been able to borrow more and more as mortgage rates fell. But that period has come to an end. Mortgage rates went up slightly in January. And there is no end in sight to the rise because of persistently high inflation, the related tighter monetary policy of central banks and the increased risk premiums on financial markets since the Russian invasion.

Affordability worsens

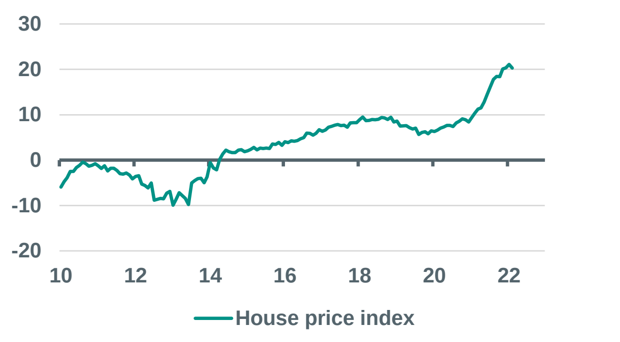
Net housing costs as a percentage of net income



Source: Calcasa

House prices rise very sharply

Percentage change (year-on-year)



Source: CBS/Land Registry

Until recently very strong price increases

Finally, the affordability of the housing market is deteriorating due to the ongoing house price increases. The tension on the housing market is reflected in prices. Many buyers are forced to bid at or above the asking price. Four out of five buyers do so, with the result that the price offered in a typical transaction is some 9% above the asking price. The price index of existing homes based on CBS Land Registry figures was 20% higher in February than in the same month last year. Surrounding countries are also recording sharp price rises, but the Netherlands takes the prize. The housing market is clearly overheated.

Due to the price increases, the average purchase price of existing homes rose to EUR 419,000 in February. That is considerably higher than the NHG cost limit of EUR 355,000. This difference explains why the NHG guarantee scheme is currently less popular among homebuyers. Over the past ten years, an NHG insurance policy was taken out for about half of the transactions involving existing and new homes. Today, this is less than a quarter, while the cost of an NHG guarantee scheme has fallen. The NHG premium has been gradually reduced from 1% of the mortgage amount in 2018 to 0.6% in 2022.

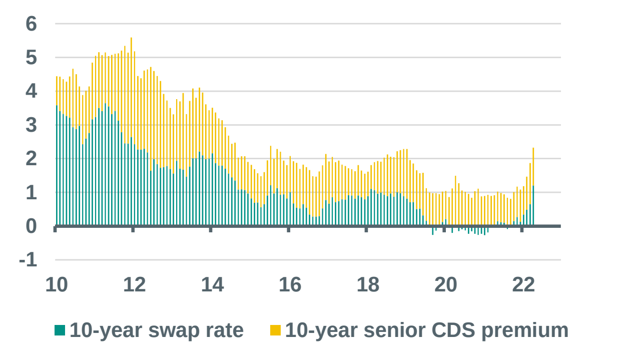
We expect the rise in prices to level off gradually this year. The Russian invasion is creating uncertainty about the future, causing households to delay major financial decisions, such as buying a home. Growing uncertainty about the possible impact of the war on the labour market, which will be exacerbated by the loss of corona support measures and the collapse of some companies, is leading some potential buyers to hold off and postpone buying a house.

Rising interest rates will curb price growth

In addition, mortgage rates are rising. In January, the average interest rate on new 10-year mortgage contracts rose by 4 basis points to 1.77%. We assume that the increase marks a turning point. The rise in mortgage rates will dampen the propensity to buy, as borrowing becomes more expensive and buyers can borrow less on the basis of their income if interest rates are higher. The latter is also the case for applicants with private lease commitments. As mortgage lenders weigh these obligations more heavily in their credit assessments, mortgage applicants can borrow less money. Since October last year, it is no longer possible to conceal student debt when applying for a mortgage.

Costs for mortgage lenders are rising

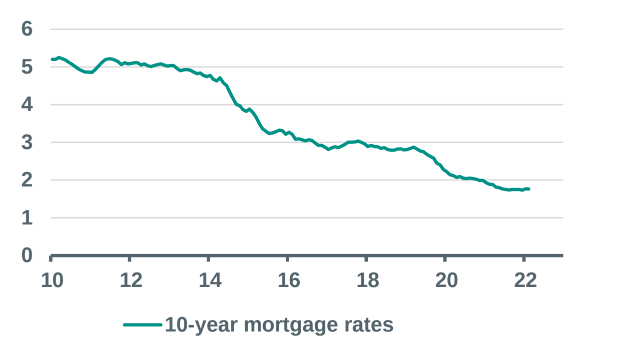
Interest and risk premiums (in percent)



Source: Refinitiv

Mortgage rates past record low

Percent



Source: DNB

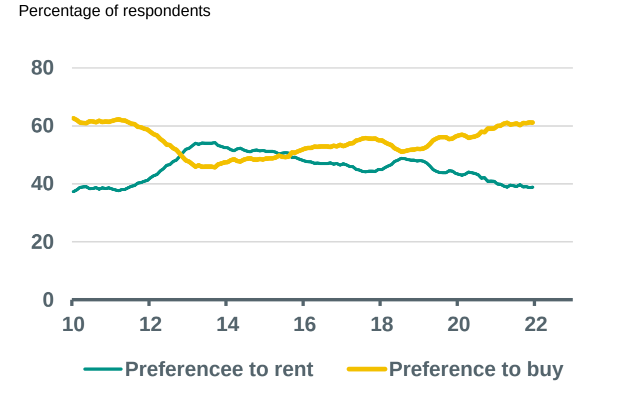
The rise in interest rates will affect the behaviour of investors. Due to the low yield on government bonds, more and more investors shifted their attention in recent years to alternative investments, such as rental housing. With central banks less active in debt purchases and rising interest rates, some investors will return to this originally favoured safe investment option: government bonds. Less investor interest in rental housing may translate into weaker house price growth

Declining investor interest in rental properties may also be the result of government policy. The new cabinet has decided to tax investments in rental properties more heavily, to introduce buy-out protection and to limit the rent increase by capping the contribution of the WOZ value to the number of rental points. With these measures, the government wants to give first-time buyers more opportunities and protect existing tenants. A side effect, however, is that investments in new rental homes are discouraged, so that finding a rental home will become more difficult in the future.

The desire to regulate investors more strictly is also heard internationally. Since the credit crisis, investment companies, backed by money from pension funds and others, have expanded their rental housing portfolios considerably. But the transparency of these often internationally operating companies leaves much to be desired. It is not always clear where the money comes from, how these companies are organised, how they deal with tenants and whether they can threaten the stability of the financial system. That is why there are calls for the EU to keep a closer eye on their activities.

Finally, the reduction and subsequent abolition of the so-called jubilee bonus will also lead to a less sharp price increase. The gift exemption from parents to children aged 18 to 40 for the purchase of an owner-occupied home will drop to EUR 27,231 next year. If it is up to the Cabinet, the exemption will be abolished entirely in 2024. This will mean the end of a popular, but also criticised tax measure for the housing market. The jubilee bonus would mainly benefit wealthy families and drive up prices in a housing stock that responds slowly to demand.

Buying a home is preferable to renting



Source: Dutch Home Owners Association

Higher inflation makes real interest rates even

Source: CBS

Price drop not in sight

We do not foresee a decline in house prices. Given the recent price increases, the spill-over effect is large and the average price increase will be high, even if prices stabilise at the current level. Another reason why we take a sustained price rise into account is that house prices rarely fall. Declines are usually limited to periods of severe economic recession and a sharp contraction in lending. This is not the case for the time being.

In addition to the nominal interest rate, the inflation-adjusted real interest rate is also important for the development of house prices. With today's high inflation, real interest rates are negative, which is an incentive to borrow money and invest it in fixed assets such as homes. Furthermore, the alternative to buying, renting, is expensive because the rent is linked to inflation. Against this background, buying remains attractive. This is also evident from the underlying statistics of the Home Owners' Association's Market Indicator. These show that the majority of respondents still prefer a house to a rented one.

Finally, the shortage of housing is also underpinning the price level. This shortage is likely to remain intact with construction faltering due to high commodity prices, and will even increase if the war in Ukraine leads to an influx of refugees. The United Nations estimates that 4 million people will be cast adrift by the war. How many of them will eventually end up in the Netherlands is uncertain. First estimates vary from 15,000 to 240,000 people. The longer the war lasts, the greater the chance that refugees will settle permanently.

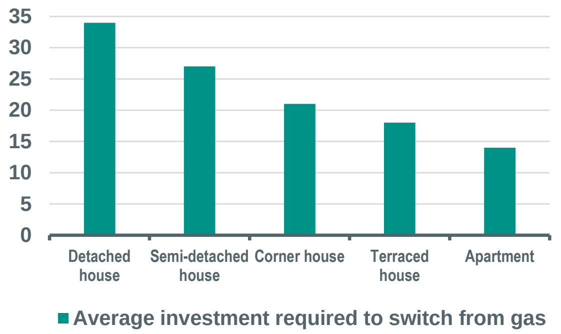
Energy crisis highlights importance of sustainability

An important lesson from Russia's invasion of Ukraine is that Europe depends for its energy supply on a regime that poses a threat to international law and stability. Our dependence on fossil fuels is costly, as the recent report of the International Panel on Climate Change states that the climate is changing at an unprecedented rate due to man-made CO_2 emissions. This is damaging the atmosphere and the oceans and causing extreme weather conditions.

Against this background, it is important to accelerate the process of making the economy more sustainable. This includes a task for the built environment, which is responsible for one-eighth of the CO2 emissions in the Netherlands. The focus will then be on homes, because Dutch households are responsible for 70% of CO2 emissions in the built environment. New-build homes already meet strict standards, but because the number of additions is too small to make a difference, improvement must come mainly from the existing stock. There is still a long way to go, because 70% have energy label C or lower.

Costs of preservation vary per type of house

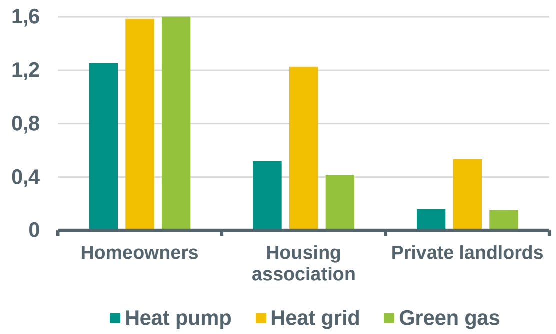
Amount in thousands of euro



Source: DNB

Alternative energy sources to property

Number of dwellings (in millions)



Source: Land Registry

Insulation yields the highest returns. Depending on the year of construction, the facade, floor, roof and windows should be tackled first. This is followed by modifications to accommodate the remaining energy consumption. Natural gas can be exchanged for green gas, a water pump or the heat network. In the longer term, hydrogen may also come into the picture. Which alternative is preferred depends on external factors. According to the Land Registry, heat networks will be preferred in densely built-up, urban areas and green gas and heat pumps in rural areas. The sooner municipalities provide clarity on their sustainability strategy, the sooner homeowners can assess which interventions are optimal for them. The chosen alternative to natural gas determines how well the house must be insulated.

The investment required to switch an average home off the gas is approximately EUR 20,000. However, the final amount can vary greatly depending on the type of dwelling, all the more so because the chosen conservation strategy will influence the final investment costs. With green gas, the old central heating boiler can continue to be used, for example. For the time being, many homeowners have preferred to finance the sustainability measures from their own savings. With today's high energy costs, however, this may change as investments pay off more quickly. There is also room for this within the current lending standards, all the more so because many homeowners have the necessary surplus value.