Group Economics | 10 January 2020

Housing Market Monitor

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Acute housing shortage due to construction problems

- **Nitrogen and PFAS crisis undermining confidence in construction sector**
- **Environmental issues put annual construction target in jeopardy**
- **Persisting housing shortage creates housing market bottleneck**

The environment is increasingly imposing itself on the construction sector. The government has taken temporary measures to keep construction activity moving, but a definite solution to the PFAS and nitrogen crisis remains elusive. This is causing uncertainty among construction firms. At the end of 2017 confidence in the sector was still at a record high. But that optimism has almost entirely gone. Despite well-filled order portfolios and signs of a cautious upturn in building permit issuance, we expect output to contract in 2020.

If that happens, the government's aim to add 75,000 dwellings annually to the stock will again be in jeopardy. The target was achieved in 2018 for the first time, and this feat will probably be repeated in 2019. The high number of transformations helped to meet the objective. In 2018 13,000 dwellings were added through the conversion of offices, schools and shops.

The construction target of 75,000 dwellings has been set to bridge the gap between supply and demand. The supply of housing is failing to keep pace with demand, which continues to grow due to rising prosperity and demographic developments. According to the latest Statistics Netherlands (CBS) forecasts, the population will grow from 17.4 million today to 19 million in 2039.

Meanwhile, the gap between supply and demand has swollen to 300,000 dwellings. Making up this shortfall will become even more difficult if more dwellings become eligible for demolition than is currently estimated. The current projection is that 60,000 dwellings will need to be demolished between now and the end of 2030. A more recent estimate, however, puts the figure at almost 140,000 dwellings. If the latter number is correct, the annual construction target will need to be revised up.

The persisting housing shortage is fuelling house prices and creating a bottleneck in the housing market. Households are struggling to find a suitable home, leading to a suboptimal distribution of the housing stock. Elderly people, for instance would like to move to a smaller home near shops and a medical centre, preferably in their familiar neighbourhood. Those that fail to find a home to suit these needs have no option but to stay put. This, in turn, makes it more difficult for young families to move up to a larger home. A quantitative housing shortage (more households than homes) can thus lead to a qualitative shortage (housing mismatch).

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Negative evaluations of tax rules for homeowners

- **Multiple changes make tax compliance difficult for homeowners**
- **Best way to tackle problem: accelerate limitation of mortgage interest relief**
- **Evaluation outcomes: a job for the next government**

The tax treatment of home ownership continues to fuel debate. The Ministry of Finance commissioned an evaluation of the home ownership tax rules, with a particular focus on the changes implemented since 2001 to counter the side effects of mortgage interest relief (limits on mortgage interest relief for people moving home with positive home equity, the "Hillen" property tax set-off, increased property tax rate for expensive properties and a reduction of the maximum interest relief).

The evaluations show that all adjustments (except the "Hillen" set-off) are more or less having the envisaged effect. But administering these schemes leads to higher costs. Moreover, the changes have made it very difficult for homeowners with a mortgage to comply with the tax rules, particularly in the event of a big change in their personal circumstances such as divorce or a decision to live together. Professional advisers also struggle to make head or tail of the rules. And in complicated cases, even the tax authorities find it hard to check and enforce compliance.

The evaluation reports mention various measures to alleviate the problems, but stress that only a thorough overhaul can achieve a long-term solution for home ownership taxation. The existing tax rules are designed to stimulate home ownership, which is something that society wants. But this system comes at a high price and actually erodes the prosperity of society at large. The evaluations therefore advocate the accelerated introduction of restrictions on tax-financed home ownership. Options include removing home ownership from the tax sphere (abolition of mortgage interest relief and property tax) or shifting home ownership from the income tax to the wealth tax sphere.

The recommendation to accelerate the adjustment of mortgage interest relief and property tax corresponds with earlier suggestions of international institutions such as the IMF, the OECD and the European Commission, recommendations of national institutions such as DNB and the CPB Netherlands Bureau for Economic Policy Analysis, and proposals in the recent authoritative publication *Ontwerp voor een beter belastingstelsel* of Bas Jacobs and Sijbren Cnossen. The current cabinet has taken note of the evaluation outcomes, but sees this as a job for the next government.

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Tightness continues, price increases easing

- **Less support for housing market from economy**
- **Continuing fall in mortgage rates supports house prices**
- **Limited supply puts brake on house purchases**

House price forecasts revised up

Early in 2019, we lowered our price estimate from 7% to 6%. The reasons were the reduced confidence in the housing market and the weakening economic outlook amidst international tensions. With hindsight, we should have left our forecast unchanged, because prices rose 6.9% on average in the first eleven months of 2019. The price increase for full-year 2019, therefore, will be closer to 7% than 6%. This higher percentage has to do with the central banks' policy U-turn. They have returned to monetary accommodation in response to the slowing economy and persisting low inflation. As a result, mortgage rates decreased, confidence in the housing market improved and house prices climbed further. We think that the low interest rates will continue to drive up house prices in 2020. Moreover, the higher-than-expected price increase in 2019 will feed through in the price increase of 2020. This is why our estimate for 2020 has been raised from 3% to 4%. For 2021 we foresee an increase of 3%.

Regarding the transaction volume, we forecast a decline of 5% in early 2019. The lack of properties for sale, significantly elevated prices and lower catch-up demand all pointed in this direction. In the course of the year, however, transaction levels turned out slightly higher than we thought due to the lower-than-forecast mortgage rates. In October this prompted us to raise our transaction estimate from a decline to a stabilisation. Whether that was a wise decision remains to be seen. December can be unpredictable in terms of transaction volumes. For 2020 we again expect the number of transactions to fall 5%. Partly because all the aforementioned transaction-inhibiting factors remain in place. And partly because house construction is stagnating due to environmental issues. The sustained shortage of housing is creating a housing market bottleneck. Assuming a solution is found for the problems in the construction sector, the number of transactions can stabilise in 2021.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2019	0	7 (6)
2020	-5	4 (3)
2021	0	3

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

Economic growth slowing, lower house price increases

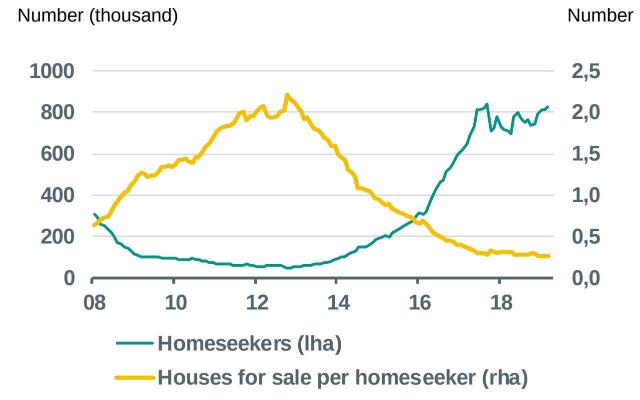
Dutch economic growth is set to weaken this year to less than 1%. The deceleration in world trade is putting a brake on GDP growth. Moreover, the economy is contending with the constraints of stricter environmental requirements. Investments in various sectors are under pressure due to stricter standards for nitrogen emissions and the use of land polluted with PFAS, a group of toxic chemicals. The economy will therefore provide less support to the housing market.

House prices have risen sharply in recent years, but the upward momentum is tailing off. In November prices were 5.8% higher than in the same month last year, when the price increase was still at a record high of 9.5%. The easing trend can best be seen in the large cities. In Amsterdam, for instance, prices rose 3.8% year on year during the third quarter of last year. In the same quarter a year earlier, the increase was still 13.1%. House prices in the four large cities are now rising less quickly than in the rest of the country. Previously, the reverse applied.

On balance, house prices have now been advancing upwards for six years in a row. They are now 42% higher than at the low point of June 2013 and over 11% higher than before the crisis. Adjusted for inflation, the comparison looks less buoyant. Viewed in that light, prices are still 7% below the pre-crisis level.

One side-effect of the appreciation in property values, according to Statistics Netherlands (CBS), is a reduction in wealth inequality. Less affluent homeowners, whose wealth consists largely of their home, have benefited more from the price recovery than rich households who tend to own a broader spectrum of assets.

Many homeseekers, chances of success low



Source: ABN AMRO Bank estimate based on huizenzoeker.nl and CBS data

Less transactions due to tight supply

Price increases are partly driven by a lack of supply. According to home search website *huizenzoeker.nl*, there were only 56,000 properties for sale in November, 15,000 less than a year ago. What a difference with November 2012, when there were still 234,000 properties for sale. The biggest lack of supply is in the low price segment. The offerings for low-income households are extremely scarce. They are therefore confronted with the highest price increases.

This is putting a brake on the number of transactions. In the twelve months until the end of November 2019, 215,000 houses were sold, 10,000 less than in the same period of 2018. The decline is even sharper with apartments than with houses. The number of purchased apartments decreased 7.2%, while the number of purchased houses dropped 3.4%.

New-build prices are rising even faster than resale prices. In the second quarter, the price increase worked out at 16% year-on-year, versus 7.2% for resales. As with resale properties, supply is extremely constrained and the number of transactions is falling. According to NVB Construction, year-to-date new-build sales ran to 31,300 until end of November 2019, 2,700 less than in the previous year.

Mortgage rates may fall even further

In view of the weakening economy, various central banks returned to monetary accommodation in 2019. Both the European and US central bank lowered their official rates. In view of the persisting low inflation, we expect another reduction in rates in 2020. If inflation continues to undershoot the central bank targets for longer, the future inflation outlook will fall further. Low inflation will then threaten to take on a permanent character, something that central banks want to prevent.

To stem the tide, central banks will take additional measures. We expect the European Central Bank and the Federal Reserve to cut their policy rates in the first half of 2020. On top of this, the European Central Bank will raise the amount of its monthly bond-buying programme. These adjustments will push money and capital market rates even lower. Mortgage rates may therefore fall even further.

But not by much. First of all, because interest rates on government loans will decrease less quickly than in 2019 - for the simple reason that there is little downward room. Secondly, because fierce competition has already forced providers to pass on part of the reduction in interest rates. Thirdly, because DNB (the Dutch central bank) is requiring banks to maintain higher capital buffers for mortgages. This has raised the costs of the mortgages they provide. The capital buffers are designed to protect banks against the consequences of a house price correction and an economic downturn.

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Construction costs driving up new-build prices

- **New-build prices rise 16% year-on-year in second quarter**
- **Composition of home-ownership completions is changing**
- **Construction costs up due to smaller projects, scarcity and stricter regulations**

New-build prices are rising even faster than the prices of resale properties. In the second quarter, the price increase came to 16% year-on-year, versus 7.2% for resale properties. As in the resale market, supply is extremely constrained and the number of transactions is falling.

Tight supply is not the only factor driving up new-build prices. Another is the changing composition of home-ownership completions. More dwellings are being built in the regions where demand is strong and the average price level high. In addition, project developers are tending to build larger (and therefore more expensive) dwellings to generate more attractive margins.

Yet another factor concerns the construction costs. These are rising because projects are smaller in scale than before. The preference for small-scale construction projects can be seen both among project developers and policy-makers. Since the crisis, project developers have become more conscious of possible financial risks. Small projects allow them to respond flexibly to changing market conditions. Policy-makers, for their part, are no longer championing the construction of large-scale residential estates. They have turned their attention to small inner urban developments. The focus on smaller projects does come at a price in the form of missed economies of scale. One advantage, on the other hand, is that the preliminary investments in, for instance, road infrastructure are usually lower.

A further cost-inflating factor concerns the high land, wage and materials costs. Construction land in popular residential regions is scarce. This is reflected in higher prices for building plots. Moreover, construction firms are struggling to find suitable staff and employees are demanding higher wages. In addition, limited capacity at suppliers is leading to a shortage of construction materials and higher materials costs.

A final problem lies in the introduction of stricter building regulations. Environment and energy standards, for instance, are becoming evermore stringent. From 1 July 2020 all new-builds must comply with the BENG (Almost Energy Neutral) standard. The resulting energy savings will save costs in the future, but require substantial upfront investments today. This translates into a higher price for new-builds.

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Sustainability remains a big challenge

- **Housing market bottleneck is impeding sustainability**
- **Important role for municipalities in transition strategy**
- **Individual tailored approach and upscaling are key to successful transition**

The lack of properties for sale has created a bottleneck in the housing market. That is bad news for the efforts to make the housing stock more sustainable. Moving house, after all, is an excellent time to make major improvements to a property. Other appropriate occasions are conversions, normal maintenance and appliance replacements (e.g. when the boiler breaks down). Relatively simple improvements, such as the installation of a high performance boiler and high performance glazing, have already been implemented in many homes. Even so, 3 million dwellings still have an energy label of C or lower, so the sustainability challenge remains a huge task.

Municipalities have been given a crucial role to play in the sustainability drive. Together with residents and other stakeholders, they must draw up transition vision documents outlining which neighbourhoods are to leave the gas grid in the period until 2030 and what sustainable alternative will be installed. Once this has been cleared up, it will be easier for homeowners to make well-considered sustainability choices for their home. These transition vision documents must be completed by the end of 2021. In addition, municipalities will help homeowners who are not included in a neighbourhood-specific plan to take energy saving measures.

However, the policy in the first instance is to avoid forcing sustainability measures upon homeowners. The government is also aware of the strong differences between residents in terms of resources, motives, and preferences. The package of sustainability measures must therefore be highly diverse in order to facilitate an individual tailored approach. Finally, the government insists that the transition must be affordable for everyone and that more and more homeowners must be able to earn back the sustainability costs via a lower energy bill. Sustainability interventions will become cost-effective more quickly if the costs can be reduced through upscaling and innovations.

Various subsidy schemes are also in place to help dampen the costs of sustainability. The SEEH (Homeowner Energy Saving Subsidy), for instance, offers a contribution of about 20% to homeowners who take at least two insulation measures. At the end of 2020 this scheme will merge into the ISDE (Sustainable Energy Investment Subsidy) which already provides for a comparable reimbursement for the purchase of solar boilers and heat pumps. The climate agreement provides for an extension of the ISDE to 2030, with EUR 100 million being made available each year. The solar panel set-off scheme makes it possible to set off the proceeds from solar feed-in against the home energy bill. A total of EUR 2.6 billion is being made available for this scheme until end of 2030.

In addition, attractive and accessible sustainability financing schemes will be created. These include the Heating Fund, a revolving fund that can ultimately grow to EUR 1 billion. The Heating Fund will extend loans up to EUR 25,000 per house or apartment for insulation measures and solar panels. Homeowners can enter into Heating Fund loans for terms of up to fifteen years. The maximum term for homeowner associations is thirty years. The interest rate on the loans will be comparable with the interest on NHG loans.

Furthermore, the cabinet is seeking to relax certain mortgage rules. One proposal is to scrap the knowledge and experience test for homeowners who want to raise their mortgage on an execution-only basis. The intention is to get more providers to offer mortgage increases for sustainability investments and lower the associated costs. Finally, the cabinet is looking at the option of facilitating property-specific finance through a change in the law. With this type of loan, the remaining mortgage costs are transferred to the new owner when the property is sold. One disadvantage of property-specific loans is that the homeowner is not eligible for mortgage interest relief.

As things stand, policymakers are focusing mainly on first-time buyers and mid-income households. The most recent initiative concerns the adjustment of the NHG (National Mortgage Guarantee) Scheme. The NHG qualifying limit will be raised by EUR 20,000 to EUR 310,000 to keep it in line with rising house prices. Moreover, on 1 January the NHG premium will be lowered from 0.9% of the mortgage loan to 0.7%, making the insurance cheaper for house buyers. Due to this lower premium, the capital of the Dutch Homeownership Guarantee Fund (WEW) will grow less quickly, an effect that is reinforced by the fact that the government is also demanding a higher price for the guarantee it provides to WEW.

Another initiative for first-time buyers and mid-income households is aimed at stimulating social housing ownership. This concerns the provision of cheap dwellings to buyers who leave a social rented home, subject to the obligation to remain in the home and not resell it for a specified period. In future, the maximum price for social housing included in municipal land use plans will be the NHG limit of EUR 310,000. The previous limit was EUR 200,000. Whether these relaxed conditions will result in a sharp increase in social housing ownership remains to be seen. In practice, municipalities struggle to enforce the conditions for social housing ownership and prefer other instruments to stimulate affordable housing for first-time buyers and mid-income households.