Commentary

The Dutch Housing Shortage and the Growing Buy-to-Let Market

DBRS Morningstar
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Contents

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Despite property prices in the Netherlands increasing sharply in the years since the great financial crisis of 2008–09 and the European debt crisis of 2012, the Netherlands is undergoing a housing shortage. Fast growth in house prices raises concerns about how sustained the upward trend can be; however, a combination of high land prices, population growth, construction costs, strict building regulations, the general economic outlook, limited supply of new housing stock, limited availability of suitable land to build houses, and the adoption of new government and local authority measures point to the prevention of overheating in the Dutch buy-to-let (BTL) housing market, thereby reducing the risk of an overall house price correction.

DBRS Morningstar believes that the Dutch government is taking appropriate steps to resolve the housing shortage in difficult circumstances and that construction will continue to increase to meet demand. Key points covered in the commentary are:

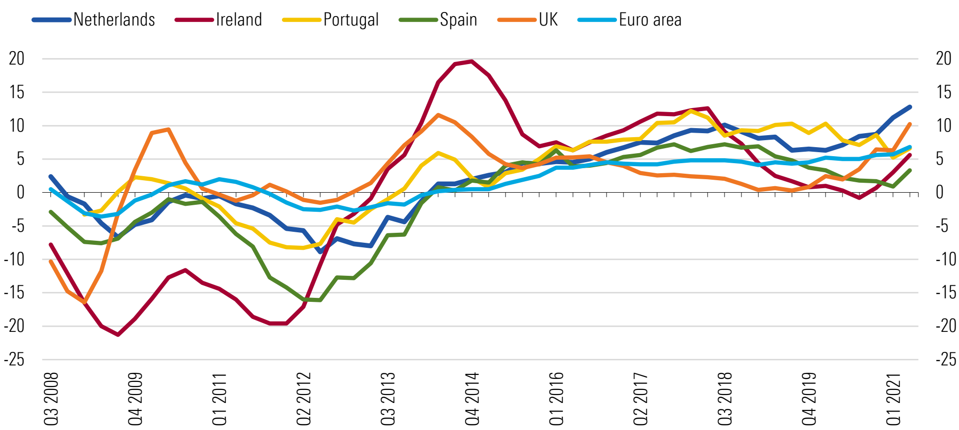
- The current status of the Dutch housing market and reasons behind it;
- The growing BTL lending market;
- Recent Dutch initiatives to protect tenants (less rental growth) and housing stock from too many investors and their potential impacts; and
- To date, DBRS Morningstar has received several queries to rate Dutch BTL transactions, the credit analysis for which is covered by DBRS Morningstar's proprietary model (the Insight Model).

European Housing Context

Major European residential housing markets showed no signs of cooling off during the Coronavirus Disease (COVID-19) pandemic-induced recession. Contrary to general market expectations, almost all European house price indices exhibited year-over-year (YOY) increases. In this context, Dutch house prices are now among the fastest growing, posting a 12.8% YOY increase in Q2 2021. This growth is above the euro-area average and the highest among major European countries with a continuing upward trend (see Exhibit 1). In some markets, general fiscal and monetary interventions may have masked some underlying chronic supply issues in the housing market that further propelled property prices higher, a trend more evident in the Netherlands than any other major European economies.

In our view, perhaps the most significant factor in house price rises in the Netherlands is sustained low interest rates and the effect they have had on people's ability to borrow more. Mortgage interest rates have fallen to around 2% currently from an average of 7% in 1995. In practice, this means that borrowers have access to larger loans for a similar monthly instalment, which allows them to pay more for the same property.

Exhibit 1 European House Prices (Year-over-Year, %), Selected Countries



Source: Eurostat,Nationwide (UK) and DBRS Morningstar.

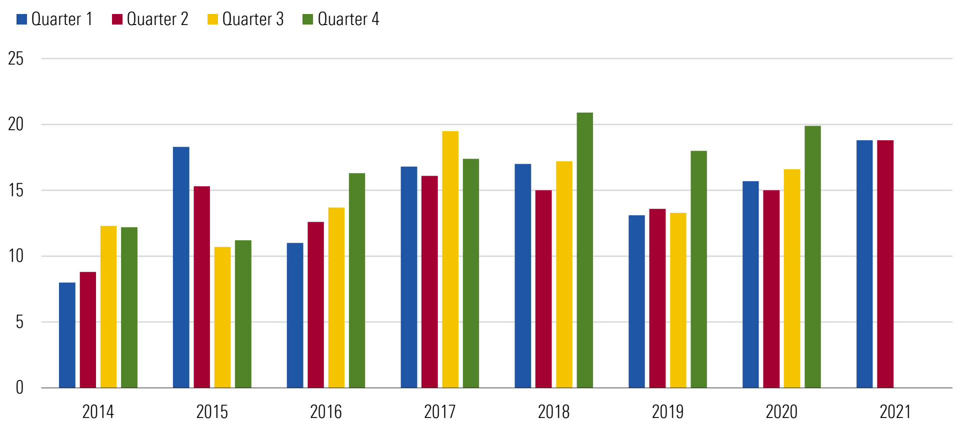
Shortage in Housing Supply

According to the State of the Housing Market report presented to Dutch parliament in 2020, 845,000 homes would need to be built by 2030 for the Netherlands to have enough housing for its growing population. The Netherlands currently has a shortage of 331,000 homes. Although the Dutch government is assessing measures to accelerate supply, this shortage is expected to persist for the next 30 years. The construction of new-build homes has not been keeping pace with the numbers required to curtail the housing shortage. To combat this, there have been calls to increase new-build rates to 100,000 new homes per year.

Building a new home in the Netherlands requires a building permit. While the number of building permits issued has been increasing since late 2020, the number of permits issued is still roughly similar to those in 2017 and 2018[1]. In the 12 months ending June 2021, approximately 74,000 housing permits were issued. The rate of granting permits will need to increase to around 25,000 per quarter to meet the demand of building 100,000 new homes per year. Even if this increase happened immediately, the effects would take time to manifest with the average time between the issuance of permits and the completion of construction at approximately two years[2].

1. And 2 Centraal Bureau voor de Statistiek (CBS) 2021, "Turnover in construction more than 9 percent higher in the second quarter of 2021", 19 August 2021.

Exhibit 2 Building Permits Issued by Quarter Since 2014



Source: CBS. 2021 figures are provisional.

Almost 19,000 building permits were issued in the second quarter of 2021, representing a 25% increase over the same period in 2020. This is the sixth consecutive quarter in which the number of permits has increased compared with the same period in the previous year.

A major factor in why the number of permits issued reduced in 2019 is the nitrogen crisis, which stems from the Dutch supreme court's abolition of the Nitrogen Approach Programme (the Programme) in 2019. The Programme was abolished as it was found to be noncompliant with European Union (EU) regulation surrounding nitrogen emissions. The Programme was designed such that new projects would compensate for nitrogen emissions caused by construction work at a later date. However, the Dutch supreme court found the Programme to be in breach of regulations and ruled that nitrogen emissions must be reduced before new projects could start. The ruling brought many construction projects to a halt throughout 2019 and 2020. Following protests from both the construction industry and farmers, however, the regulations were rescinded in December 2020 and construction projects were allowed to resume, resulting in a slight uptick in the number of permits issued. The Dutch government has taken several other steps to tackle nitrogen emissions, such as reducing motorway speed limits.

According to the World Bank, the Netherlands is the second most densely populated country (518 people per square kilometre (sq. km)) in the EU (112 people per sq. km), only behind Malta (1,642 people per sq. km). Of the Dutch land mass, 54% is used for agriculture and around 6% is used for residential buildings.

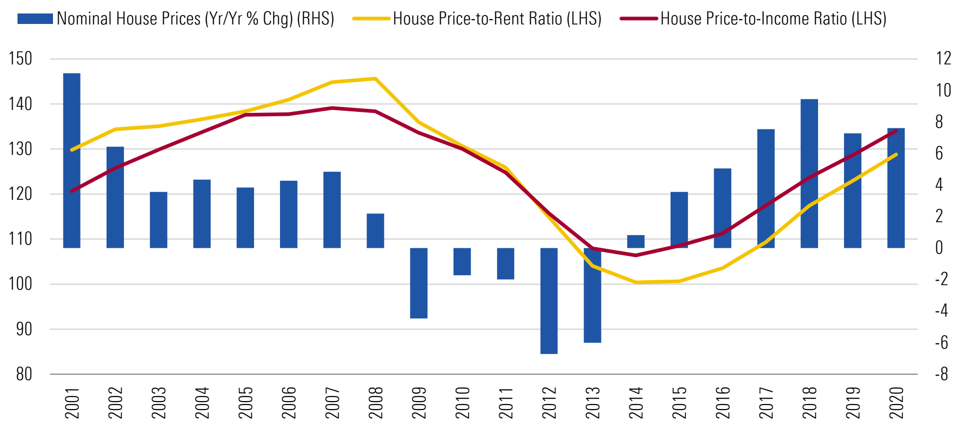
At the most recent Dutch budget meeting, the government announced that it would be investing EUR 100 million on an annual basis over the next 10 years to accelerate the pace of construction. The government also established a scheme to build homes for vulnerable groups, which has been extended for 10 year, and another EUR 10 million per annum will be available for this[3]. These government initiatives should hopefully contribute to meeting the country's housing demands.

3 Expat Housing Network, "Budget Day 2021: Key Points For the Dutch Housing Market", 22 September 2021.

Rise of Dutch BTL

The housing shortage has caused Dutch property prices to increase sharply, with an average purchase price of EUR 402,000, which is EUR 153,000 above the average purchase price five years ago. The lack of housing has driven many buyers to bid above the asking price to secure a property.

Exhibit 3 Dutch House Price Ratios (Long-Term Average =100) and Nominal House Price YOY % Change



Source: OECD, Haver, and DBRS Morningstar.

The high property prices, combined with consistently stringent underwriting criteria across lenders have made it increasingly difficult for people to buy properties, especially first-time buyers. Price-to-rent and -income ratios are rising, as a sign that renting is preferred for many would-be-buyers, as affordability measures continue to face pressure (see Exhibit 3). Both price-to-rent and price-to-income ratios are above their long-term average of 100, but under their previous peaks of 2007, which signals that the market is heating up. However, strict supply, demand dynamic, and further tightness in the housing market could mean that price growth might not slow. As such, in our view, an imminent correction is not expected.

The decreased ability to get on the housing ladder, in conjunction with the shortage of properties and a new generation keen on retaining flexibility by renting, is fuelling the structural demand for rental properties, both in major cities and suburban areas. Regulated rent could be an option for Dutch citizens, but it is only available for fewer low-income households. According to Centraal Bureau voor de Statistiek (CBS), nearly 70% of all rental homes in the Netherlands are social housing, which are subject to strict regulated rent mechanisms.

The increasing demand for rental properties has in turn led to a greater demand for BTL mortgages within the private rental sector in the Dutch market. BTL markets tend to exist in economies where housing is viewed as an investable asset class. Stable above-market yields in what has otherwise been a very low-rate environment, the 'safe-haven' perception associated with real estate, readily available mortgage leverage, and – commonly – tax incentives have been among the key investment motivations in residential property.

After the financial crisis in 2008–09, Dutch lenders ceased offering investment mortgages. The first bank to reintroduce BTL mortgages to the Dutch market was NIBC Bank N.V. (NIBC) in 2015 when conditions were more receptive and, until recent years, the Dutch BTL lending market has been dominated by NIBC. With the BTL lending market valued at around EUR 200 billion, lenders and investors have recognised an opportunity. DBRS Morningstar noticed an increasing number of smaller BTL lenders, which tend to work mainly with warehouse lenders who provide funding lines prior to securitisation, coming to market.

BTL lending in the Netherlands is not regulated as regular mortgage lending is, but lenders have largely followed the residential mortgage code of conduct with the view that BTL lending regulation will follow. DBRS Morningstar views this to be a prudent approach by lenders in setting their criteria.

Because the Dutch BTL market is a small but competitive space, we have noticed that lenders have had broadly similar underwriting criteria and lending rates. With this in mind, speed and quality of service are key to generating new business. To achieve this, new lenders often partner with experienced third-party underwriters and servicers with already-established systems and staff. DBRS Morningstar observed that, once a lender has become established in the market, internal recruitment for underwriters tends to take place with underwriting services slowly moving in house. Servicing, however, tends to remain with third-party servicers.

Recent Changes Affecting Dutch BTL

Due to the tight housing supply and the difficulty that many first-time buyers face to afford properties, the Dutch government implemented a new transfer tax regime designed to increase the chances for first-time buyers to enter the real estate market.

On 1 January 2021, the property transfer tax ("stamp duty") on residential properties that are not bought as primary residences increased to 8% from 2%; as such, BTL properties have been taxed with a stamp-duty levy of 8% and this will continue. For owner-occupants, stamp duty remained at 2%, except for first-time buyers under 35 years of age, who are not subject to a stamp-duty charge if the first property is worth less than EUR 400,000. The introduction of this tax saw a surge in BTL purchases at the end of 2020 followed by a slowdown in Q1 2021.

Exhibit 4 Property Transfer Tax Rates (%)

	2020	2021
Residential first-time home buyers (18-35 years)	2	0
Residential (i.e., the buyer will use it as residence)	2	2
Investors in residential real estate	2	8
Commercial real estate	6	8

The Dutch government has introduced additional measures that could dampen the appetite of private property investors. For example, the government implemented a cap on rent increases of inflation plus 1% on 1 May 2021 for private-sector sitting tenants. Such caps do not currently apply to new tenants, but only to existing tenants in the private sector. This new restriction applies for the next three years, with a maximum rent increase of 2.4% allowed this year. Previously, the market drove rent increases; however, data from CBS shows that, thus far in 2021, the average rent increase is 0.3% compared with an inflation rate last year of 1.3%, which falls well within the new rent cap[4].

The new regulation minimises exuberant rent increases for existing tenants, but it could also indirectly encourage a higher turnover of tenants with landlords potentially reluctant to renew expiring leases in order to achieve a higher rent from a new tenant. According to data from CBS, the five-year running average for rental increases is just over 7% for new tenants.

The maximum annual rent increase limits in the private sector has done little to abate the spiralling cost of rental properties versus tenant incomes (see Exhibit 3). Despite the quiet early months of 2021 and the subsequent introduction of rental increase rules, however, the BTL market has picked up and is growing at similar historical rates. One reason for this could be that the reward of long-term yields outweighs the costs of these measures.

Impending Changes in the Market

This may soon change with the anticipated introduction of a new law 1 January 2022, which will give local councils powers to ban investors from purchasing properties considered to be in the low- to mid-price segment. This is known as a purchase protection scheme and it is up to each council to decide what constitutes a low- to mid-priced property. One-third of all houses sold in the four big cities—Amsterdam, Rotterdam, The Hague, and Utrecht—last year were sold to investors and, at the end of October 2021, Kadaster—the Dutch Land Registry and national mapping agency—said that private investors own almost 18% of housing in the big cities. This has prompted first-time buyers to take greater financial risks or prevented them from entering the real estate market at all. The purchase protection scheme is designed to allow first-time buyers more and better opportunities to purchase properties.

The purchase protection scheme will mean that any houses that are purchased cannot be rented out for the first four years, but there are exceptions—houses that have already been rented out may continue to be rented out, and renting to family members or to others if the owner is moving overseas temporarily will continue to be allowed. The government introduced a version of this law earlier in 2021, but it only applied to new-build properties whereas the new law applies to all properties going forward.

Amsterdam is anticipated to be the first city to introduce the purchase protection scheme with a final proposal submitted to the city council in February 2022 for a decision. The city has set its definition of a low- to mid-priced property as anything less than EUR 512,000. Other Dutch cities, such as Tilberg, Utrecht, The Hague, and Rotterdam, are expected to follow Amsterdam's lead in implementing the new measure. Among these cities, only Tilberg has set its definition of a mid-priced property—a WOZ (property) value of up to EUR 325,000 or the maximum national mortgage guarantee amount.

4. CBS, "Smallest rent increase since 1960", 6 September 2021.

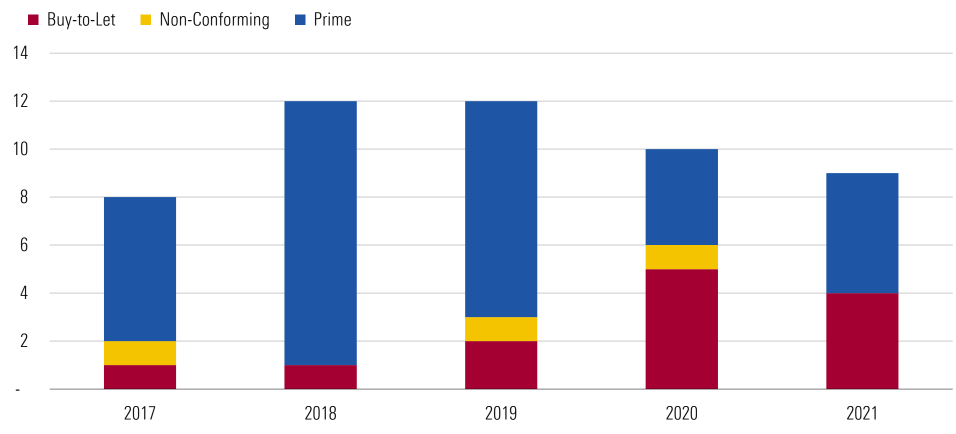
In our view, a potential consequence of cities implementing this new law is that investors will simply opt for more expensive properties that are not covered by the law or focus more on the periphery of cities with restrictions. For people looking to rent, the scheme may lead to a shortage of affordable rental properties, particularly if investors have purchased more expensive properties to let. Subsequently, if a shortage of affordable rental properties in cities arises, then renters may look to move outside cities where more affordable rental properties are available. The overall effect of this may be that the BTL market shifts away from a city-centric to a more suburban market.

As of now, the BTL market is showing signs of sustained growth , despite the recently introduced government measures of increased property transfer tax and rent increase caps. DBRS Morningstar believes that it remains to be seen if the new purchase protection scheme coming into effect in January 2022 will have a significant impact in curbing the demand of the BTL market.

Dutch BTL RMBS

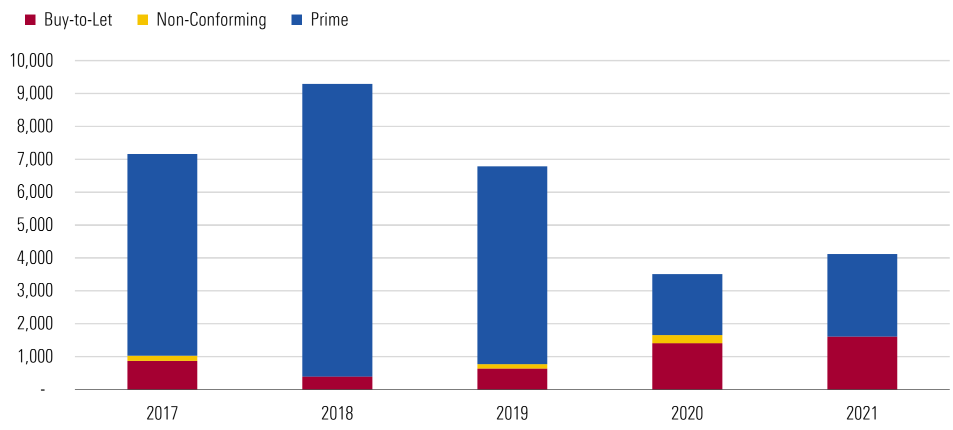
The Dutch residential mortgage-backed security (RMBS) market has traditionally consisted of owner-occupied prime residential mortgages. The securitisation of BTL mortgages started in the Netherlands in 2017 with issuances of EUR 0.8 billion and continued in 2018 with issuances of EUR 0.4 billion. Total securitisation of BTL mortgages since 2017 increased to EUR 4.9 billion during 2021, reflecting both the growth of the private rental market and the interest of international institutional investors in the Dutch housing market. Securitised BTL mortgage loans have been originated by a small number of lenders, several of which entered the mortgage lending market in 2020. Given the recent flurry of activity in the BTL market prior to the property transfer tax changes, we expect more transactions coming to the market in the form of BTL RMBS securitisations.

Exhibit 5 Distributed Dutch RMBS Number of Deals, 2017 to Q3 2021



Source: Concept ABS, DBRS Morningstar.

Exhibit 6 Distributed Dutch RMBS Issuance Volume (EUR Millions), 2017 to Q3 2021



Source: Concept ABS, DBRS Morningstar.

The analysis of Dutch BTL residential mortgage Loans is covered by DBRS Morningstar's proprietary Insight Model used for credit analysis. For typical Dutch BTL pools, DBRS Morningstar sees the expected loss for the AAA (sf) rating category of between 7% and 10%. Further information about the Insight Model is available in the DBRS Morningstar *European RMBS Insight Methodology* and *European RMBS Insight: Dutch Addendum*.

Conclusion

DBRS Morningstar believes that the Dutch government is taking appropriate steps to resolve the housing shortage in difficult circumstances and that construction will continue to increase to meet demand. The BTL market has shown strong growth in recent years, despite the recently introduced government measures of increased property transfer tax and rent increase caps. However, it remains to be seen if the new purchase protection scheme coming into effect in January 2022, along with other national and local government measures, will have a significant impact on cooling off the BTL market.

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