

Dutch residential mortgage market

The Dutch residential mortgage debt stock is relatively sizeable, especially when compared to other European countries. Since the 1990s, the mortgage debt stock of Dutch households has grown considerably, mainly on the back of mortgage lending on the basis of two incomes in a household, the introduction of tax-efficient product structures such as mortgage loans with deferred principal repayment vehicles and interest-only mortgage loans, financial deregulation and increased competition among originators. Moreover, Loan-to-Value (LTV) ratios have been relatively high, as the Dutch tax system implicitly discouraged amortisation, due to the tax deductibility of mortgage interest payments. After a brief decline between 2012 and 2015, mortgage debt reached a new peak of EUR 823.3 billion in Q3 2023¹. This represents a rise of EUR 12.3 billion compared to Q3 2022.

Tax system

The Dutch tax system plays an important role in the Dutch mortgage market, as it allows for partial deductibility of mortgage interest payments from taxable income. Historically, this has resulted in various deferred amortisation mortgage products, most importantly the use of interest-only loan parts.

Since 1 January 2013, all new mortgage loans have to be repaid in full in 30 years, at least on an annuity basis, in order to be eligible for tax relief (linear mortgage loans are also eligible). The tax benefits on mortgage loans, of which the underlying property was bought before 1 January 2013, have remained unchanged and are grandfathered, even in case of refinancing and relocation. As such, new mortgage originations still include older loan products, including interest-only. However, any additional loan on top of the borrower's grandfathered product structure, has to meet the mandatory full redemption standards to allow for tax deductibility.

A second reform imposed in 2013 was to reduce the tax deductibility by gradually lowering the maximum deduction percentage. As a result, the highest tax rate against which the mortgage interest may be deducted is 36.93% (equal to the lowest income tax bracket) in 2023. No further reductions are currently planned.

There are several housing-related taxes which are linked to the fiscal appraisal value ("WOZ") of the house, both imposed on the national and local level. Moreover, a transfer tax of 2% is due when a house is acquired for owner-occupation. From 2021, house buyers aged between 18 and 35 years will no longer pay any transfer tax. Currently, this exemption only applies to houses sold for 440,000 euros or less and can only be applied once. For 2023, a transfer tax of 10.4% is due upon transfer of houses which are not owner-occupied (compared to 8% in 2022).

Although these taxes partially unwind the benefits of tax deductibility of interest payments, and several restrictions to this tax deductibility have been applied, tax relief on mortgage loans is still substantial.

Loan products

The Dutch residential mortgage market is characterised by a wide range of mortgage loan products. In general, three types of mortgage loans can be distinguished.

Firstly, the "classical" Dutch mortgage product is an annuity loan. Secondly, there is a relatively big presence of interest-only mortgage loans in the Dutch market. Full interest-only mortgage loans were popular in the late nineties and in the early years of this century. Mortgage loans including an interest-only loan part were the norm until 2013, and even today, grandfathering of older tax benefits still results in a considerable amount of interest-only loan originations.

¹ Statistics Netherlands, household data.

Thirdly, there is still a big stock of mortgage products including deferred principal repayment vehicles. In such products, capital is accumulated over time (in a tax-friendly manner) in a linked account in order to take care of a bullet principal repayment at maturity of the loan. The principal repayment vehicle is either an insurance product or a bank savings account. The latter structure has been allowed from 2008 and was very popular until 2013. Mortgage loan products with insurance-linked principal repayment vehicles used to be the norm prior to 2008 and there is a wide range of products present in this segment of the market. Most structures combine a life-insurance product with capital accumulation and can be relatively complex. In general, however, the capital accumulation either occurs through a savings-like product (with guaranteed returns), or an investment-based product (with non-guaranteed returns).

A typical Dutch mortgage loan consists of multiple loan parts, e.g. a bank savings loan part that is combined with an interest-only loan part. Newer mortgage loans, in particular those for first-time buyers after 2013, are full annuity and often consists of only one loan part. Nonetheless, tax grandfathering of older mortgage loan product structures still results in the origination of mortgage loans including multiple loan parts.

Most interest rates on Dutch mortgage loans are not fixed for the full duration of the loan, but they are typically fixed for a period between five and 15 years. Rate term fixings differ by vintage, however. In recent years, there was a strong bias to longer term fixings (20-30 years) but since Q2 2022 10 year fixings have rapidly increased in popularity as the sharply increased mortgage rates drove borrowers to seek lower mortgage payments by going for shorter fixings. Most borrowers remain subject to interest rate risk, but compared to countries in which floating rates are the norm, Dutch mortgage borrowers are relatively well-insulated against interest rate fluctuations.

Underwriting criteria

Most of the Dutch underwriting standards follow from special underwriting legislation (“Tijdelijke regeling hypothecair krediet”). This law has been present since 2013 and strictly regulates maximum LTV and Loan-to-Income (LTI) ratios. The current maximum LTV is 100% or 106% when financing energy saving measures. The new government has indicated not to lower the maximum LTV further. LTI limits are set according to a fixed table including references to gross income of the borrower and mortgage interest rates. This table is updated annually by the consumer budget advisory organisation “NIBUD” and ensures that income after (gross) mortgage servicing costs is still sufficient to cover normal costs of living.

Prior to the underwriting legislation, the underwriting criteria followed from the Code of Conduct for Mortgage Lending. Although the Code of Conduct is currently largely overruled by the underwriting legislation, it is still in force. The major restriction it currently regulates, in addition to the criteria in the underwriting legislation, is the cap of interest-only loan parts to 50% of the market value of the residence. This cap was introduced in 2011 and is in principle applicable to all new mortgage contracts. A mortgage lender may however diverge from the cap limitation if certain conditions have been met.

Recent developments in the Dutch housing market

After a year of declining prices, house prices started rising again in the summer of 2023 (see Chart 3). In May of this year, existing owner-occupied homes were still 6.2% cheaper than at the market peak in 2022. But by November – the most recent month for which figures are available – the difference had shrunk to minus 3.2%.

The fact that house prices are on the rise again has everything to do with the rapidly improving affordability this year. As a result, the demand for owner-occupied houses is now clearly picking up again. Market parties have seen the number of viewings per house increase in recent months. At the same time, there are still few houses for sale and the trend is declining, and that puts upward pressure on house prices. Due to the decline in new construction, this trend is likely to continue in the coming years. Less new construction means more scarcity.

Nearly 147,600 existing owner-occupied houses changed hands in the first ten months of this year, down roughly 6% from a year earlier. Although the sharpest drop in sales seems to be behind us – sales fell particularly sharply between mid-2021 and mid-2022 – the number of transactions is still on a slow but steady decline. The relatively low number of existing owner-occupied homes being sold is not so much related to prospective homebuyers dropping out (because demand is picking up), but more to the lack of supply. On average, there were some 21% fewer houses for sale in the Netherlands in November than in the same month last year. Real estate brokers association NVM attributes this to the fact that fewer people put their homes up for sale. Presumably this is also because it is often no longer possible for people to move up on the property ladder taking advantage of a lower interest rate when moving house in order to live in a larger or more attractive home for the same monthly cost.

Despite the significant impact of rising interest rates on affordability and on confidence and expectations about the owner-occupied housing market, fears for a major market correction have not materialized. Moreover, since the summer, we have seen the housing market rebound more and more clearly. The development of fundamentals may well explain this. In fact, the real net mortgage cost of the average owner-occupied home (if fully financed by a mortgage) is now back to where it was at the end of 2021. The net real disposable incomes of households are a few percent higher than at the end of 2021, due to increased wages and more hours worked, and borrowing space has also recovered. The fact that we are now seeing price increases for owner-occupied homes at similar levels of affordability and borrowing space – despite the decline in the housing market – is an important indication that homes are not overvalued. The fact that the market does not appear to be overvalued, despite high price levels, is inextricably linked to the very tight housing market.

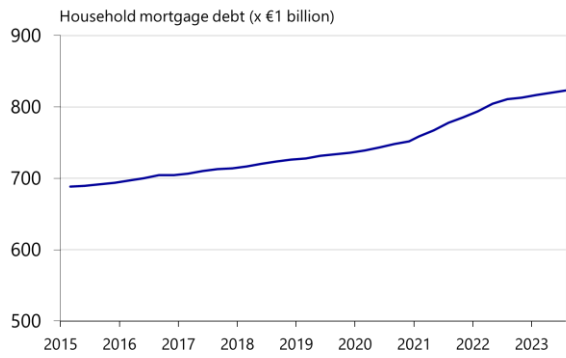
Forced sales

Compared to other jurisdictions, performance statistics of Dutch mortgage loans show relatively low arrears and loss rates². The most important reason for default is relationship termination, although the increase in unemployment following the economic downturn post financial crisis was increasingly also a reason for payment problems. The ultimate attempt to loss recovery to a defaulted mortgage borrower is the forced sale of the underlying property.

For a long time, mortgage servicers opted to perform this forced sale by an auction process. The advantage of this auction process is the high speed of execution, but the drawback is a discount on the selling price. The Land Registry recorded 46 forced sales by auction in the October and November 2023 (0.147% of total number of sales in those months).

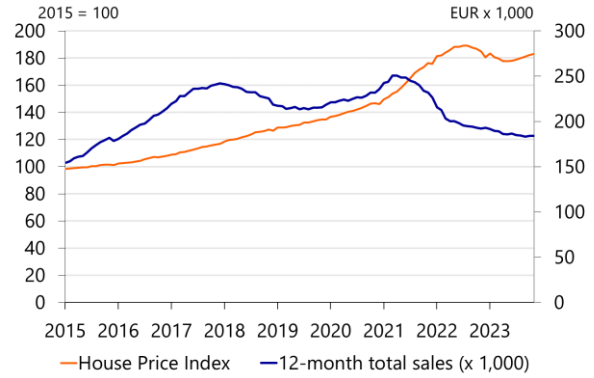
² Comparison of Moody's RMBS index delinquency data.

Chart 1: Total mortgage debt



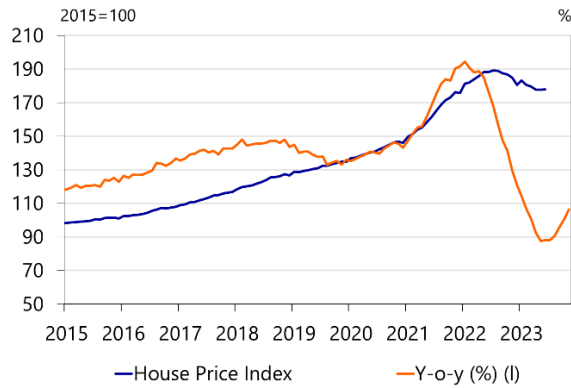
Sources: Statistics Netherlands, Rabobank

Chart 2: Sales



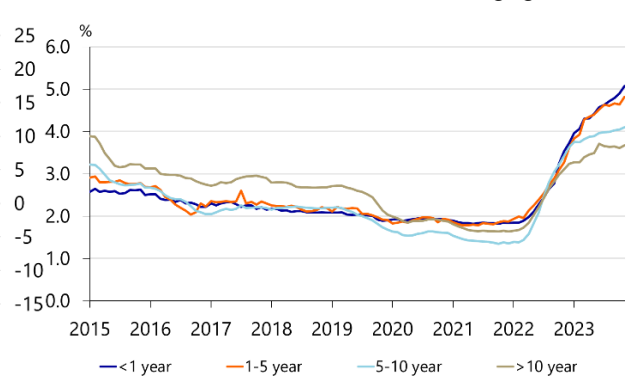
Sources: Dutch Land Registry (Kadaster), Statistics Netherlands (CBS)

Chart 3: Price index development



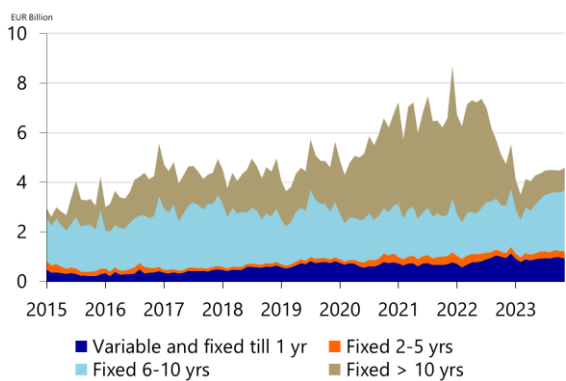
Sources: Statistics Netherlands, Rabobank

Chart 4: Interest rate on new mortgage loans



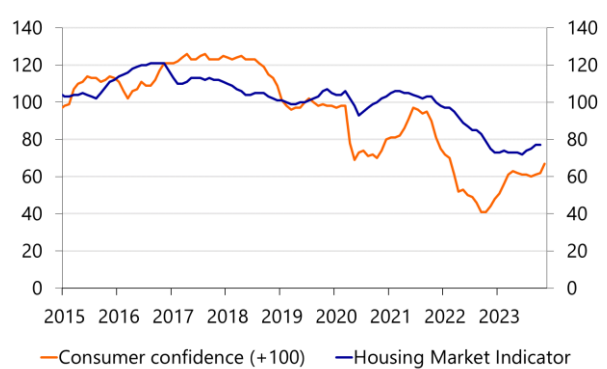
Source: Dutch Central Bank

Chart 5: New mortgages by interest type



Source: Dutch Central Bank

Chart 6: Confidence



Sources: Statistics Netherlands, OTB TU Delft and VEH