Sharp cooling of housing market due to higher interest rates and economic turnaround

Dutch Housing Market Quarterly
Nic Vrieselaar and Carola de Groot

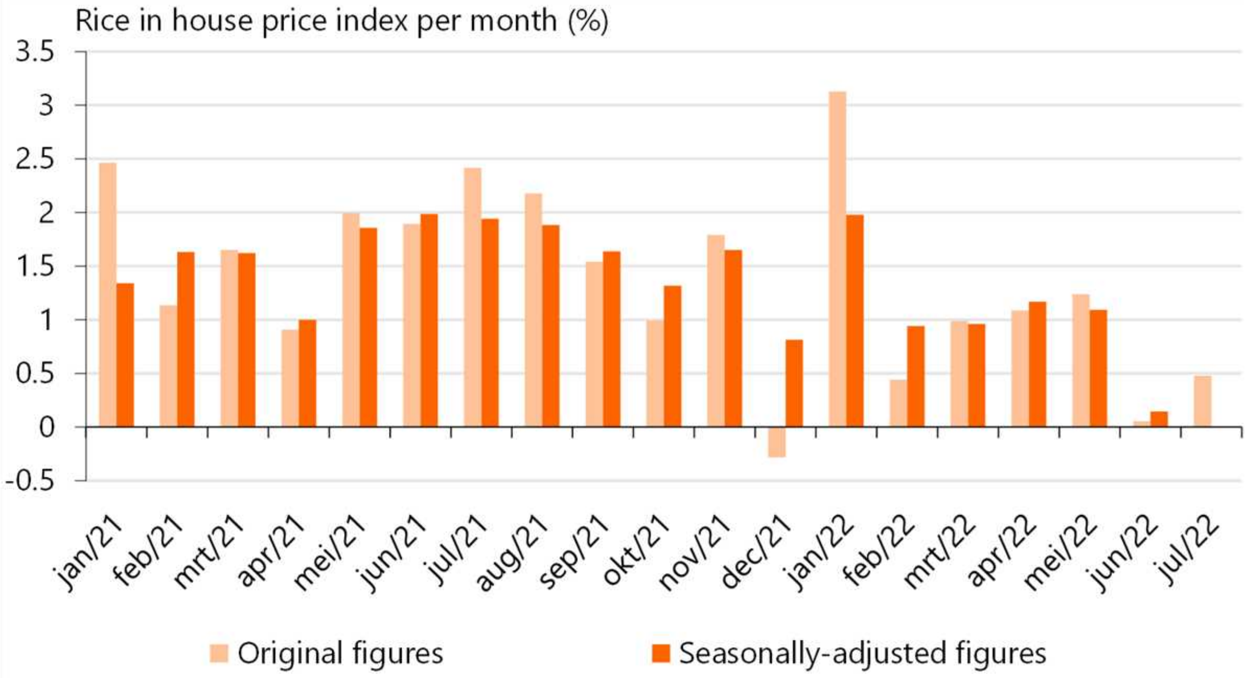
- **Existing owner-occupied homes are expected to be 15.2 percent more expensive on average this year than in 2021. For 2023, we assume a modest growth of 3.0 percent**
- **High interest rates and macroeconomic uncertainty are depressing demand for owner-occupied homes. This seems to be causing unrest among homeowners with plans to sell: more homeowners are putting their homes up for sale**
- **As a result, we anticipate a sharp weakening of house price growth, with a limited decline in house prices during 2023 as well**
- **Our house price estimate is slightly lower than in our June Quarterly Report. This is mainly because the interest rate picture has been revised upward. We also expect the unemployment rate to rise a bit more sharply. Both developments are depressing demand for owner-occupied homes**
- **We expect 189,000 homes to change hands this year; about 16 percent less than in 2021. With increasing supply, we expect the decline in sales to end later this year and next. For 2023, we assume 197,000 transactions**

Housing Market Cooled Considerably

Higher mortgage rates end price records

The pace at which house prices are rising has slowed considerably in recent months. Adjusted for seasonal effects (prices tend to rise a bit faster in the summer than in the winter), there was even stagnation in June and July (see Figure 1).

Figure 1: All stretched out?

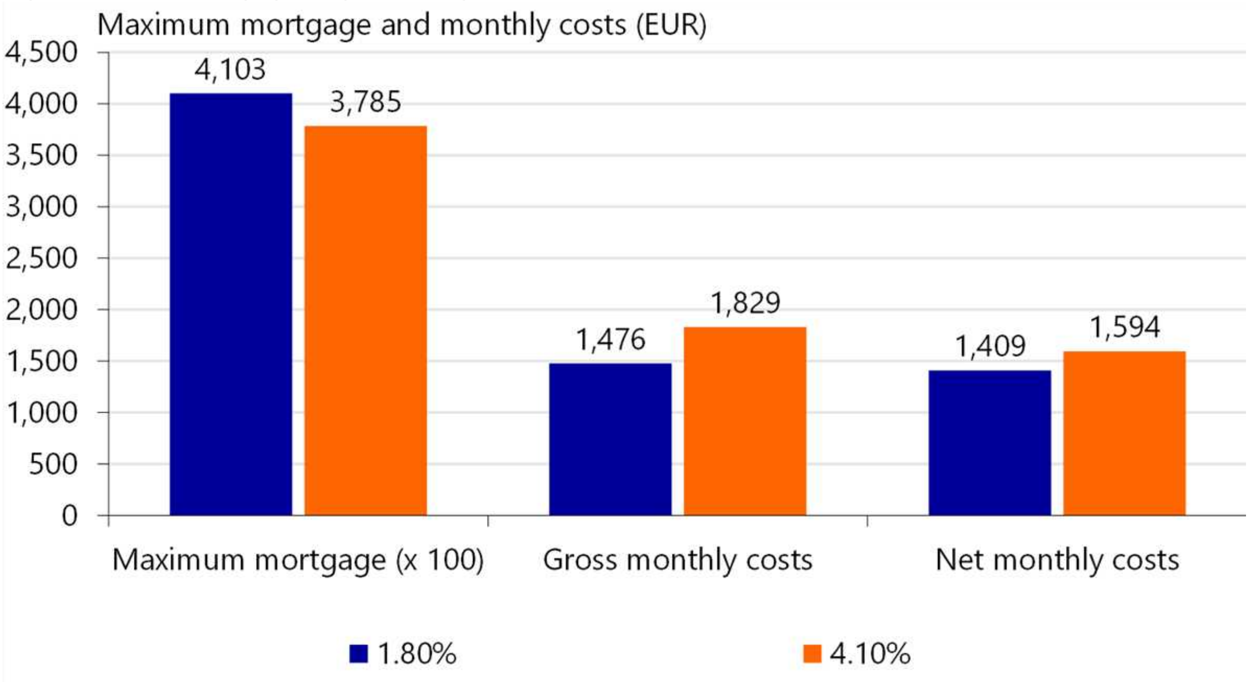


Source: CBS, Kadaster, RaboResearch

The levelling off of house price increases is related to higher mortgage interest rates, the energy crisis and the less favorable economic outlook. These developments not only depress the demand for owner-occupied homes, but by shifting sentiment probably also cause more people to put their homes up for sale. This results in more choice. As a result, potential buyers are less likely to have to compete with each other, which reduces the pressure on house prices.

Until recently, a 20-year fixed rate was the most popular choice. That interest rate more than doubled this year to about 4.10 percent. That means buyers can borrow less for a home. For a couple with two mode annual incomes, the maximum mortgage is almost EUR 32,000 lower. The monthly costs are also considerably higher (Figure 2). To be able to borrow more and keep the costs down, more homebuyers are opting for a shorter fixed-interest period. But this only partly cushions the decline in the maximum mortgage. Borrowing less also means being able to bid less. And that has repercussions on house price development.

Figure 2: Less mortgage, higher charges



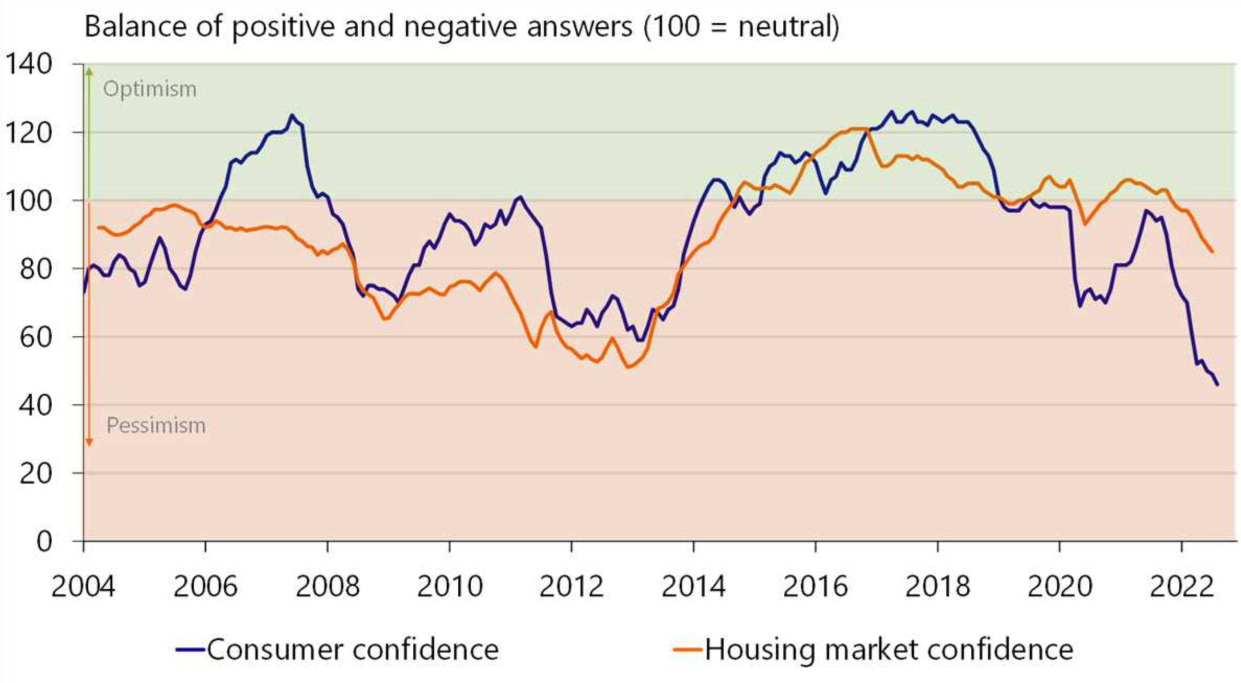
Note: The charges are based on the average monthly charges over the entire 30-year term for a 1-part annuity mortgage.

Source: Nibud financing burden standards 2022, Homefinance.nl

More people negative

According to the Eigen Huis Market Indicator, increased mortgage interest rates and expectations about them are depressing confidence in the owner-occupied housing market. Meanwhile, more people are negative than positive about current housing market conditions (see Figure 3). The demand for owner-occupied houses is likely to be further depressed by the rocketing energy prices and uncertainty about households' future energy costs. More and more households will feel the increased energy prices in their wallets as soon as fixed energy contracts expire and are switched to variable contracts with higher tariffs.

Figure 3: Confidence crumbling a bit



Source: CBS, Home Ownership Association/OTB TU Delft

With all the developments, it is likely that a portion of potential homebuyers are throwing in the towel. It is therefore not surprising that the purchase intention in a monthly barometer of housing website Funda is at its lowest point since the start of measurements in November 2020. Do-it-yourself real estate agent Makelaarsland also notes that the number of bids and viewings declined further in July. In the months of May, June and July there were an average of seven viewings per home. In the same period a year earlier, there were twelve.

More 'For Sale' signs

Sentiment has not only changed among buyers. Homeowners with plans to sell also seem to be getting restless: according to the aforementioned Funda barometer, the intention to sell rose sharply in the second quarter. In early September, more than twice as many houses were available on Funda than a year ago. This may partly be due to homeowners who have bought a new house and want to sell their current house early, because they fear that it may be more difficult to sell their house (for a certain amount) at a later date.

The sales strategy of first-time buyers looking for an existing home may also be tilting somewhat, with them betting on selling their own home first - and being sure of the sale proceeds - before buying their next home. Still, there does not seem to be an ample housing market yet: in historical perspective, there are still few houses for sale, and the increase in housing supply does not seem to have continued in recent weeks. Moreover, the rapid selling time implies that there is still a lot of demand for owner-occupied homes.

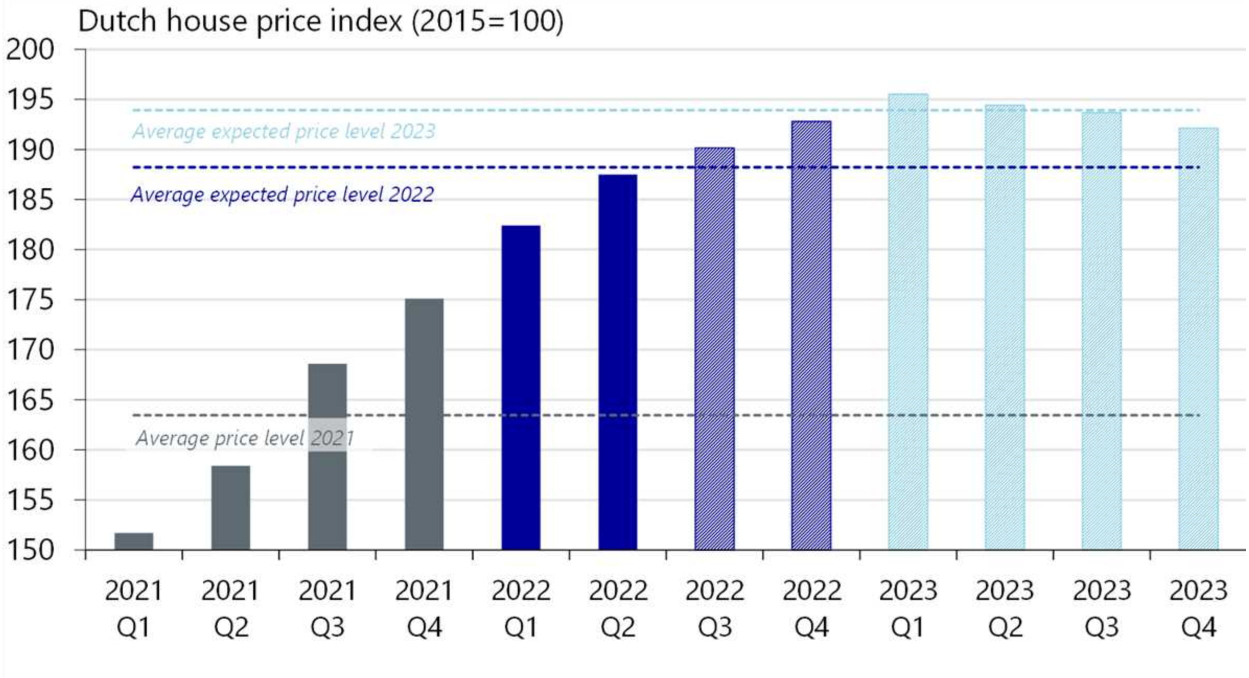
House Prices to Fall Slightly

Cooling continues

We expect the pace of house price growth to continue to slow, reversing to a limited decline during 2023. For 2022, we anticipate an average house price increase of 15.2 percent. This growth is still very high due to a spillover effect from last year and increases in the first half of the year. The bulk of that 15.2 percent has therefore already been realized. In fact, if house prices for the rest of 2022 remain at July's price level, the year-on-year growth rate would already be 14.5 percent this year. House prices will therefore rise only very slightly during the rest of this year. Even 2023 is expected to start with rising house prices, but this will gradually change to a modest decline. For all of 2023, we anticipate house price growth averaging 3.0 percent (see Figure 4).

Compared to our previous estimate, we have again revised our forecast slightly downward. It is true that the Dutch economy grew strongly in the second quarter and the share of people in paid employment is at record levels. Nevertheless, the macroeconomic picture has deteriorated slightly from three months ago and we expect unemployment to rise a little further. In addition, compared to our previous estimate, we assume that capital market interest rates - and therefore presumably mortgage rates - will remain high for longer. Capital market interest rates have risen sharply again in recent weeks, partly because of even higher inflation. In the previous Quarterly Report on the Housing Market we already took a higher interest rate into account in a risk scenario, which could cause house prices to fall because it would make buying a house less attractive. This would make owner-occupied houses less attractive, both for first-time buyers and for investors.

Figure 4: Prices already substantially higher than average in 2021



Source: CBS, Kadaster RaboResearch

New housing market crisis on the horizon?

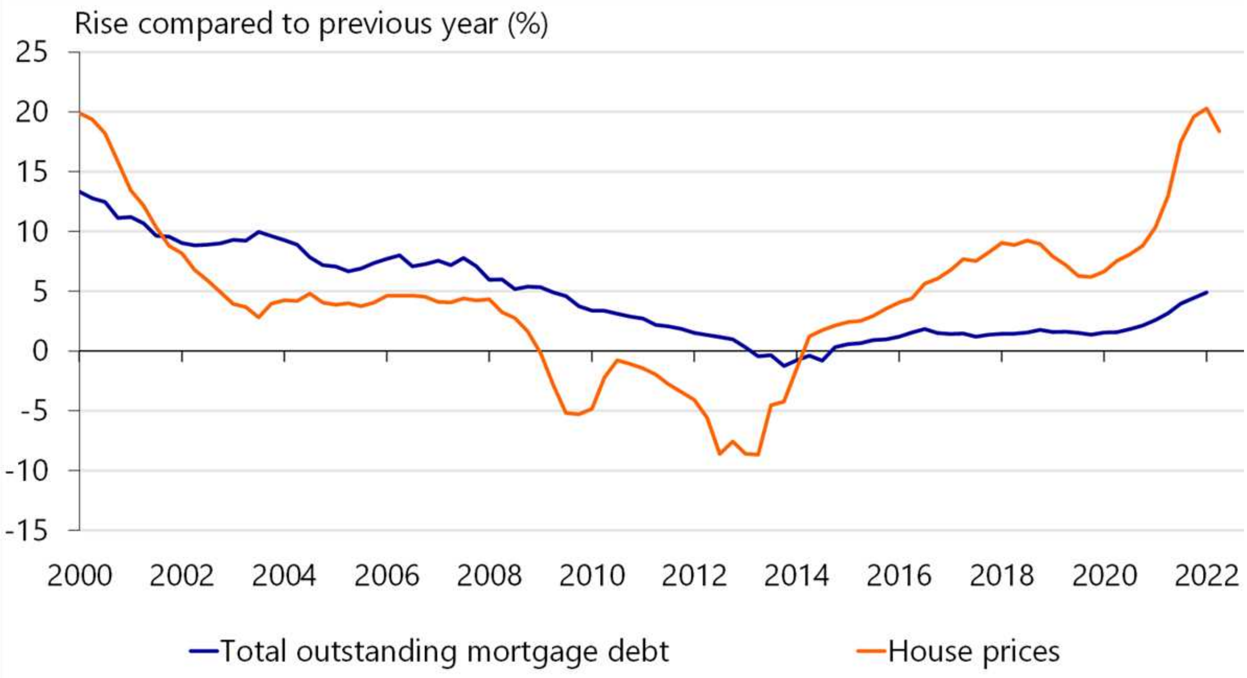
After almost a decade of rising house prices, we believe we will again face falling house prices in the coming years, which raises the question of whether we can expect another housing market crisis like the one between 2008 and 2013. Due to an accumulation of economic and financial factors, house prices fell for years on end, by a total of more than 21 percent. In our view, a comparison with that period is flawed, partly because the borrowing and repayment behavior of homebuyers and homeowners is currently less risky than it was before 2008.

Less risky lending

In the decades leading up to the housing market crisis of 2008-2013, lending was widespread, with so-called top mortgages being provided well-above the market value of homes through customization. It was also a time when (fully) redemption-free mortgages became commonplace. Homebuyers could also co-finance the purchase costs. The extent of mortgage debt proved toxic when house prices started to fall in 2008. The mortgage on the house was higher than the value of the house. When selling, the seller would be left with a residual debt. Homeowners suffer from 'loss aversion': rather than take their losses, they postpone selling their home when house prices fall. In households where residual debt arises after sale, this effect is likely to be even stronger. Continuing to keep prices high further depressed the demand for owner-occupied homes, which actually reinforced the downward spiral in house prices.

Although homebuyers in recent years have again been looking for the extremes of what is still a responsible loan (more repayment-free, borrowing more in relation to income and the value of the house), mortgage lending is now more cautious than in the years prior to 2008. Thanks to the strong rise in house prices, combined with mortgage repayments, many homeowners now have (a lot of) excess value. Even 25- to 35-year old homeowners on average had some EUR 70,000 in surplus value in 2020, according to CBS figures. And that figure is from before the extreme price increases of the last year. Moreover, total mortgage debt has risen much less rapidly than house prices (see Figure 5). In the event of a drop in prices, houses are therefore less likely to be worth less than the value of the mortgage. This is expected to dampen the drop in demand from first-time buyers and may limit a downward spiral driven by loss aversion.

Figure 5: House price growth no longer hand-in-hand with debt



Source: CBS

Tighter market and support measures
Unlike in 2008, the housing market also seems tighter now. For example, new construction production at that time was at a higher level of about 85,000 homes, where production now is no more than about 70,000 homes per year. This strengthened the supply of existing owner-occupied homes. Moreover, the selling time in the first half of 2008 was around 88 days, while it was less than 24 days in the first half of this year. So, in this respect, the owner-occupied housing market has to come from further afield before buyers take control again. This may dampen the anticipated house price decline. Also, the (planned) purchasing power measures to reduce the impact of the energy crisis may limit the expected price decline.

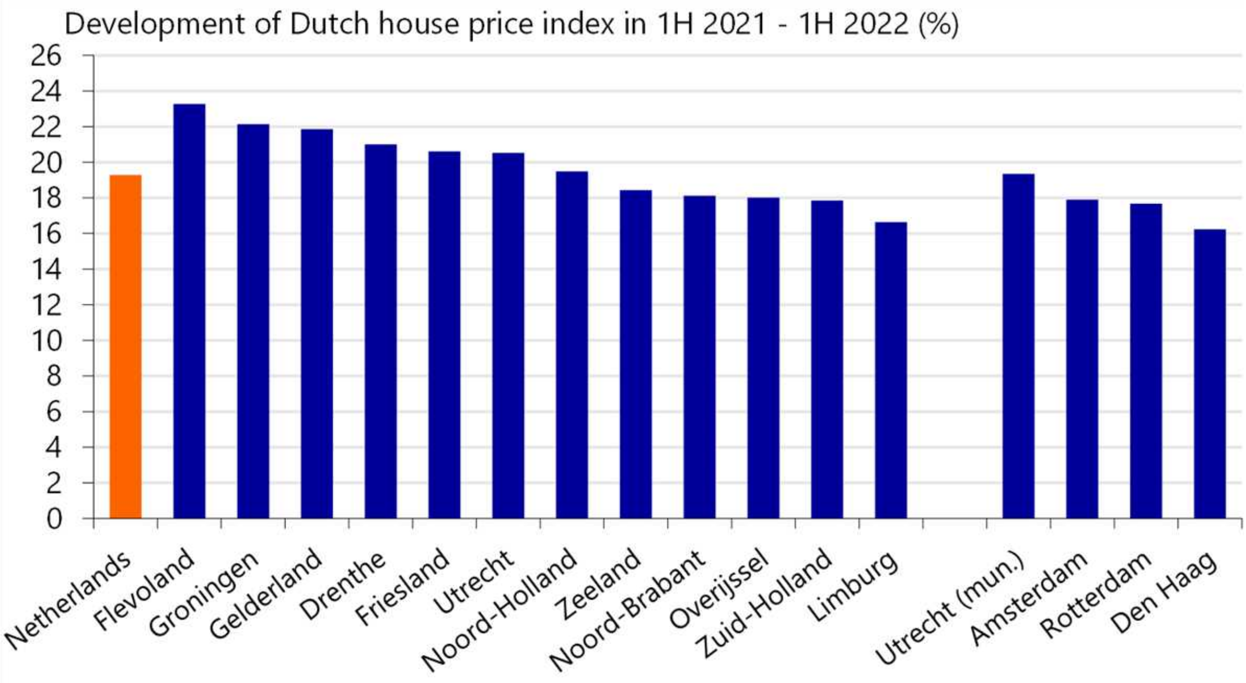
Risk of downward spiral
At the same time, a self-reinforcing effect cannot be ruled out. There is a risk that more and more potential homebuyers will put their desire to buy on hold because they expect houses to become cheaper. This may, as mentioned earlier, prompt sellers to adopt a different strategy, whereby they first want to sell their current house (at a profit) before buying another. As a result, the number of homes for sale may increase rapidly in a

short period of time, while the number of sales plummets. The anticipated decline in house prices may therefore ultimately be stronger than we expect on the basis of purely economic factors. The housing market is and will remain a confidence market.

Flevoland Still in the Lead

In all the house price violence of recent months, houses in Flevoland have increased in value the most. In the first half of 2022, houses there were on average 23.3 percent more expensive than in the first six months of 2021 (see Figure 6). The higher house price growth that has characterized the youngest province for some time can be explained in part by the fact that larger houses became more popular during the corona pandemic. Such houses are abundant in Flevoland. And they are less expensive there compared to other provinces. Gelderland and the three northern provinces also saw existing owner-occupied houses rise in price faster than average.

Figure 6: Flevoland in the lead again

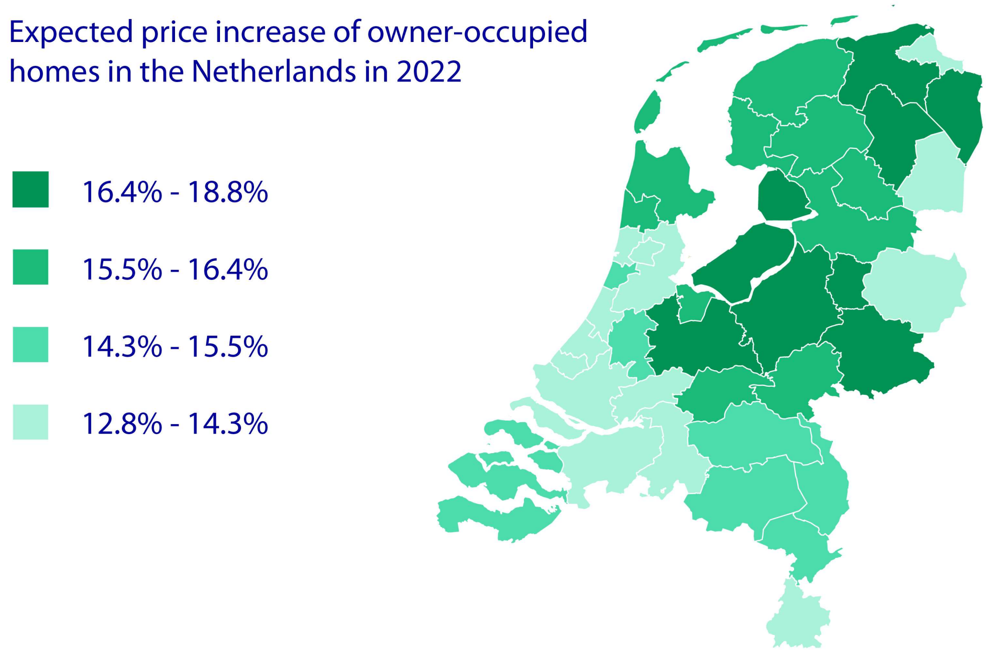


Source: CBS, Kadaster, RaboResearch

Regional house price forecast

In 2022, we foresee the strongest house price increase in the regions in the middle and north of the country (see Figure 7). We expect Flevoland to retain its leading position and homebuyers there to pay on average 19 percent more for an existing owner-occupied home this year than in 2021. East Groningen and 'Other' Groningen can also probably count on an average house price increase of about 18 percent. In South Limburg, prices are expected to rise the least, although the anticipated growth of almost 13 percent can still be called substantial.

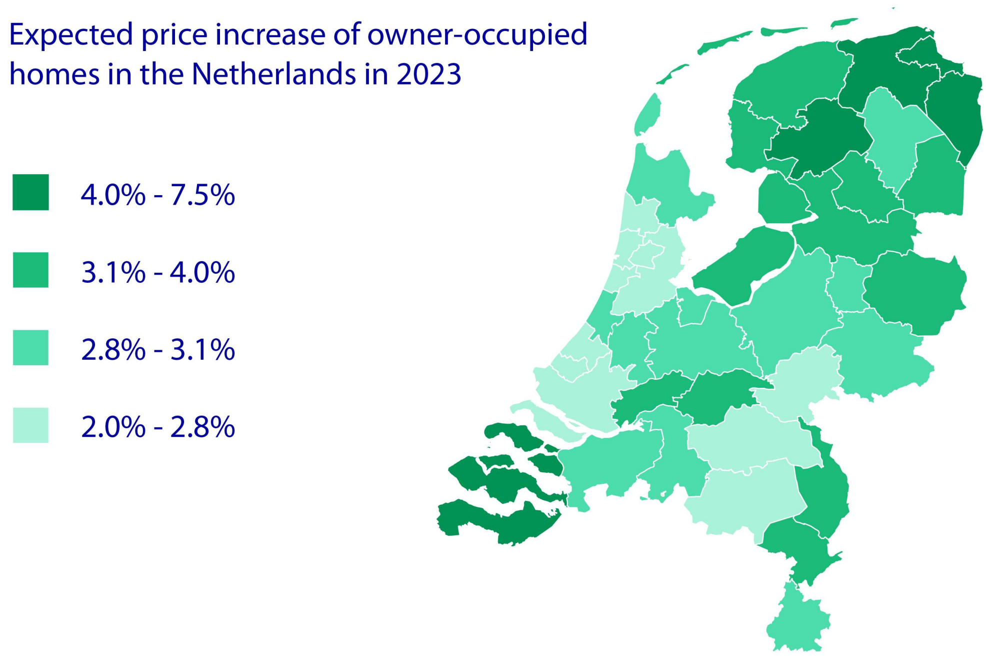
Figure 7: Central and North in the lead



Source: RaboResearch

In line with the national house price estimate, house price growth will drop sharply in all regions next year (see Figure 8). Flevoland will probably no longer be in the lead. The strongest average house price growth is expected in Zeeuws-Vlaanderen and 'Other'-Zeeland: more than 7 percent. And that is significantly more than in other regions, as in 34 of the 40 regions, house price growth does not exceed 4 percent in our estimate. The expectation for Zeeland may be related to the fact that in that province it took longer for the price recovery to kick in after the low point of the housing market crisis between 2008 and 2013. From this perspective, Zeeland may have some catching up to do.

Figure 8: In all regions, price growth slows down



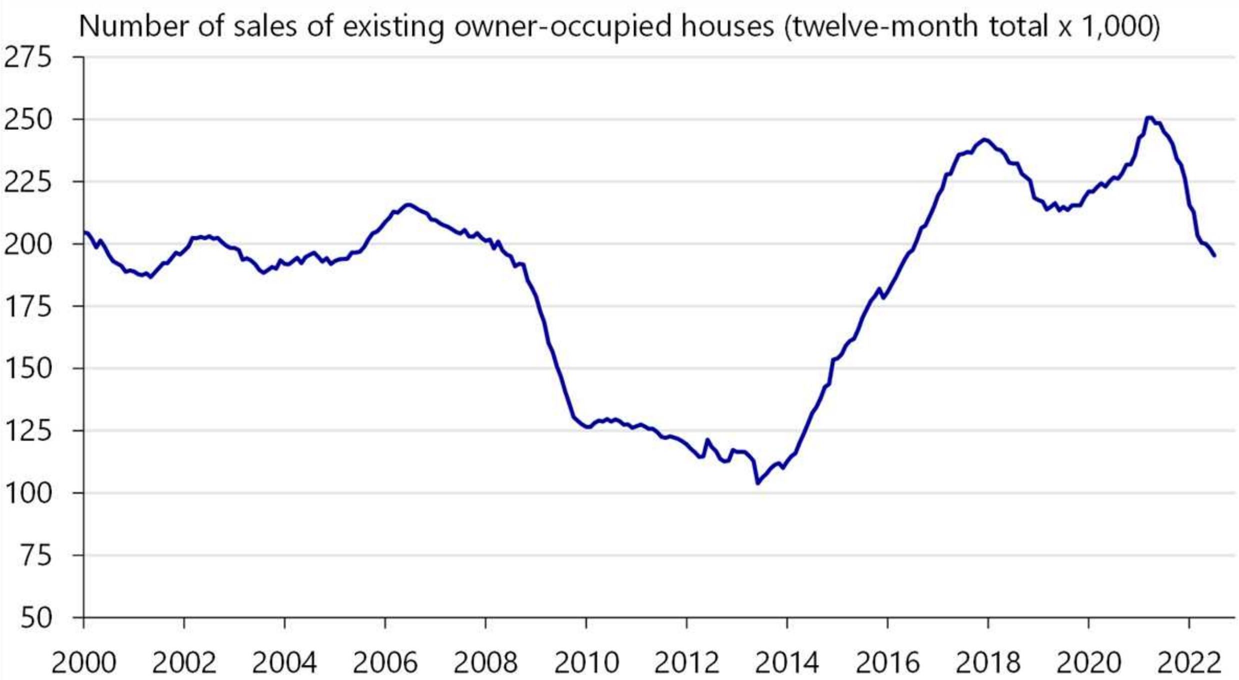
Source: RaboResearch

Transaction decline not yet halted

The number of sales declined further in recent months (see Figure 9) to just over 47,000 houses in the second quarter - over 10 percent less than a year earlier. The drop was particularly substantial in Overijssel, Drenthe and Limburg: in these three provinces, more than 15 percent fewer houses were sold than twelve months previously (see Figure 10). In the first quarter of the year, the number of sales was also considerably lower than a year ago, partly because there were a lot of house transfers between January and March last year. This was due to the exemption from transfer tax for first-time buyers and those up to 35 years of age. All in all, the number of sales in the first seven months of 2022 was more than 22 percent below the level of 2021.

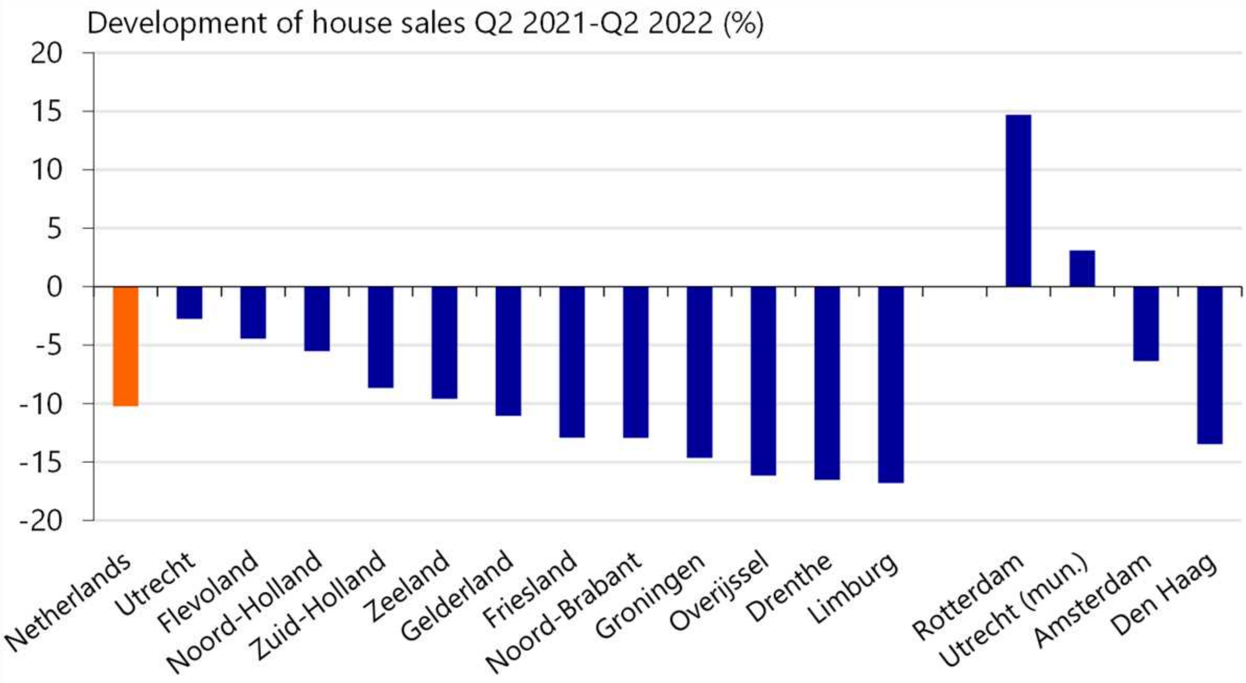
The fact that the number of sales declined further in the second quarter is related to the limited supply of housing at the end of last year and the beginning of this year. As a result, in the first two quarters of this year, few houses changed hands at the notary. The average time between signing the sales contract and the final transfer of ownership is around three months (see "Current housing market trends delayed in official statistics").

Figure 9: Decline not yet halted



Source: CBS, Land Registry

Figure 10: More sold only in Rotterdam and Utrecht

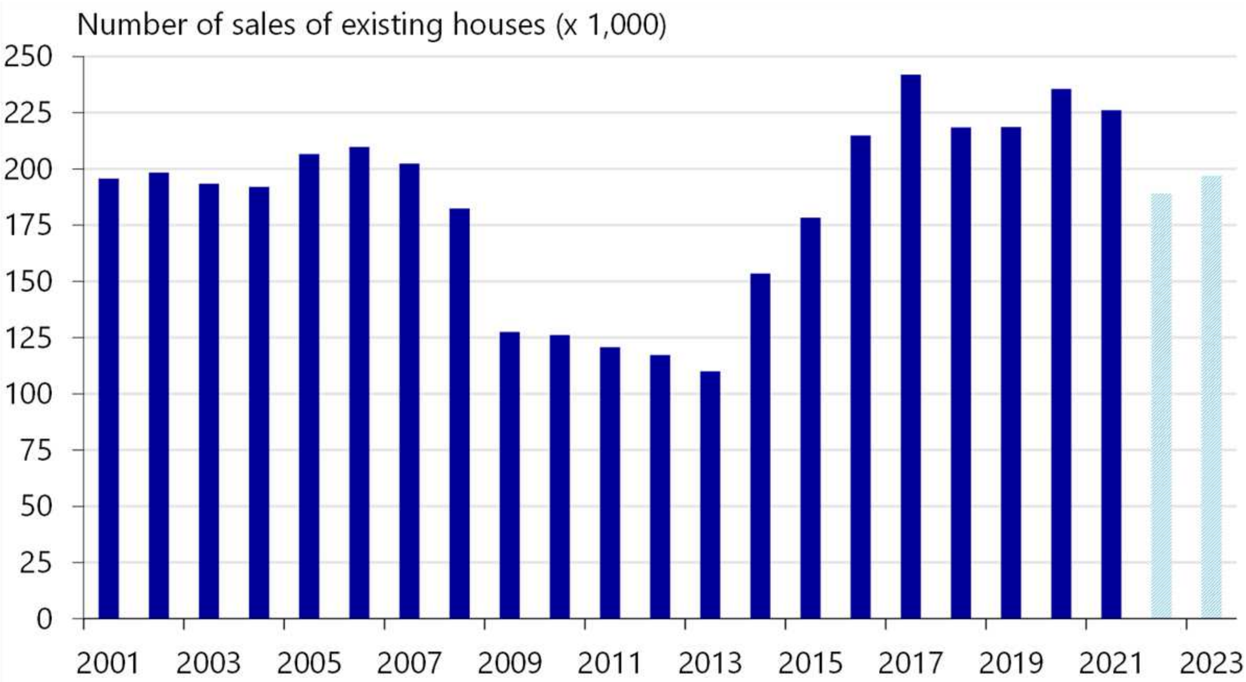


Source: CBS, Land Registry

Sales stabilize as expected

We expect a total of 189,000 existing homes to change hands this year, 37,000 fewer than last year. In the first seven months of this year, the counter was already 30,000 houses lower than in the same period last year. At that time, record numbers of owner-occupied homes changed hands after exemption from transfer tax for first-time buyers and those under 35 years of age.

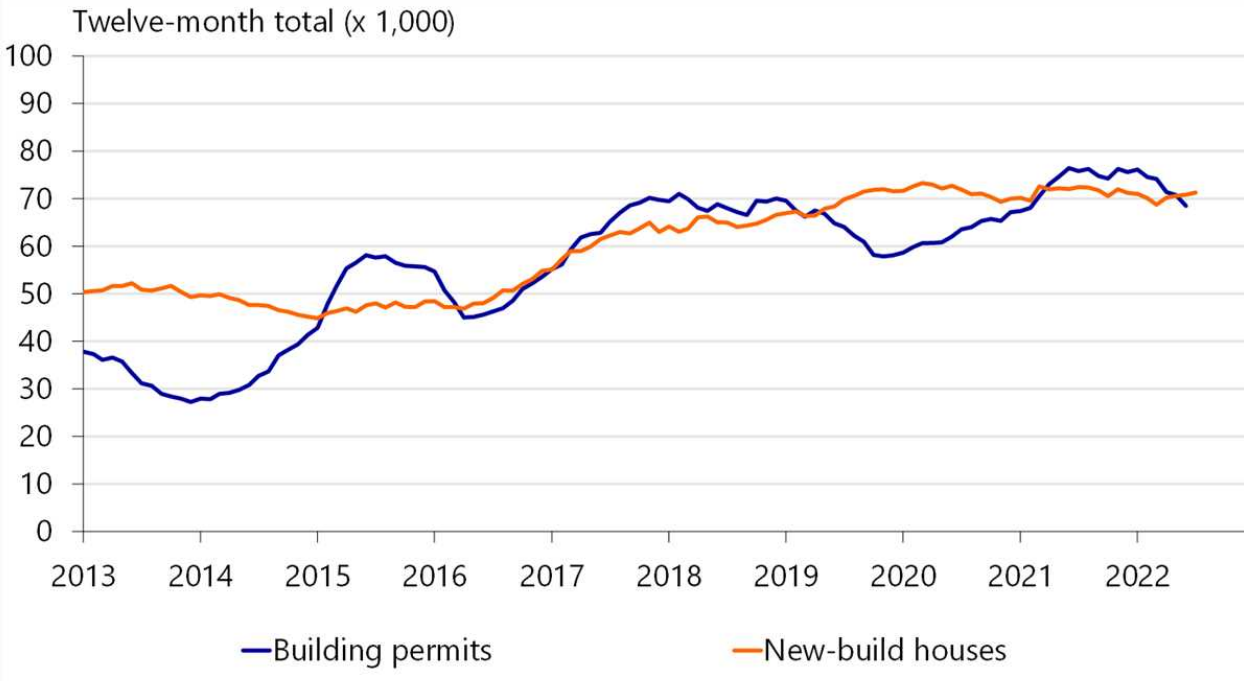
Figure 11: Sharply lower sales



Source: CBS, Kadaster RaboResearch

We expect the year-on-year drop to be less than expected for the rest of the year. Not only were many more houses put up for sale on Funda in the past six months, the past few months have also seen a limited rise in the number of houses with the status 'sold subject to conditions'. Yet we do not expect sales to take off just yet. For 2023, we expect only a limited increase to about 197,000 sales (see Figure 11). This is because increased mortgage interest rates, energy prices and construction costs have made a house unattainable for even more people. In addition, we expect fewer new homes to be completed in the coming years, which means there will probably be fewer people selling their existing house in order to move to a newly-built one. The number of new homes completed seems to be stagnating at around 70,000 per year, while the number of building permits issued has been falling for months in a row (see Figure 12).

Figure 12: Increase does not continue



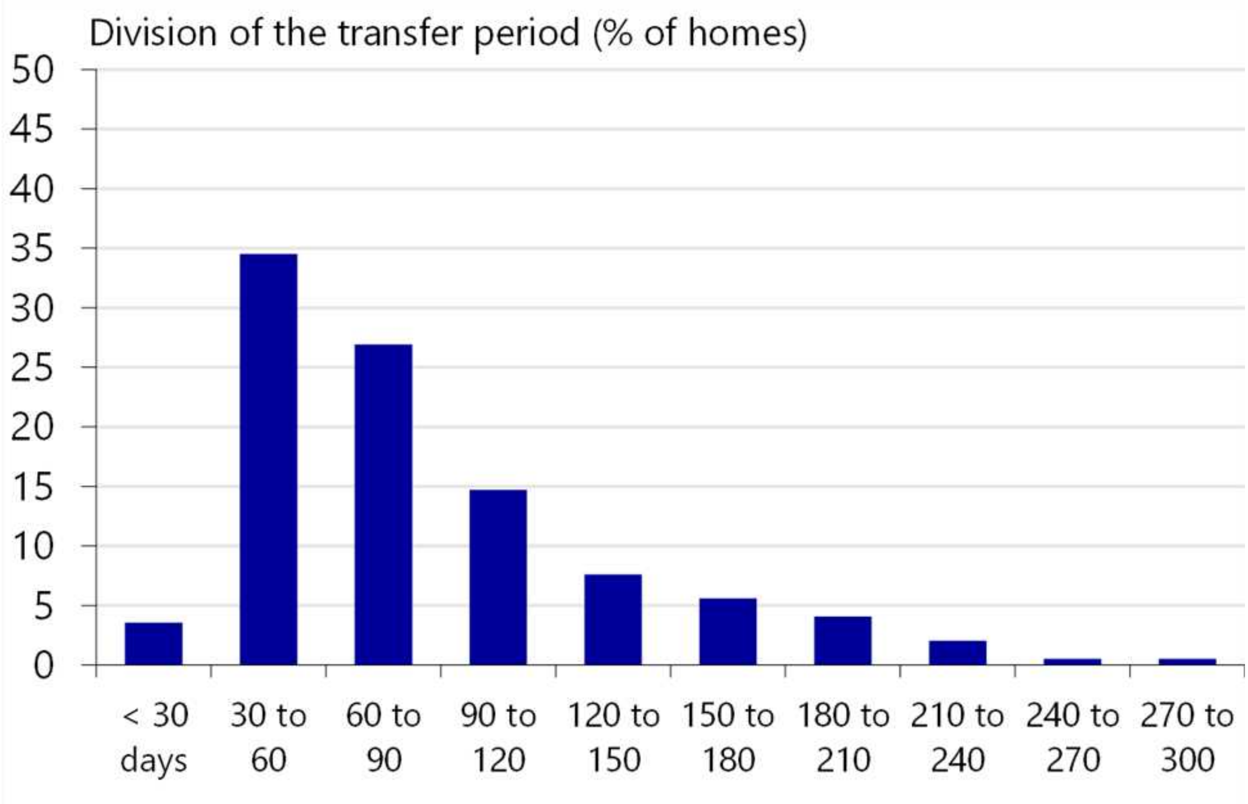
Source: CBS

Current housing market trends shown in official statistics with a delay

The official housing market statistics from the CBS and the Land Registry deal with the very last step in the buying process: the moment the new owners receive the keys. The viewing of the house, determining a final offer and signing the purchase contract often take place several months earlier. This means that the CBS figures for July are not about housing market conditions in that month, but about those of a few months ago.

To get a rough picture of this, we drew a random sample of 250 houses (approx. 1.5 percent) that changed hands in July 2022 from microdata from the Land Registry. We compared the date of registration with the Land Registry and the date of sale on the Funda website.

Figure 13: Actual exchange usually within three months



Source: Funda.nl, Kadaster, RaboResearch

We were able to do so for 197 houses (78.8 percent). The houses for which we were unable to find out the date of sale are owner-occupied houses both in urban areas and in rural areas, and both expensive and less expensive houses. We therefore assume that the absence of a sales advertisement is not related to the transfer date, but depends on the casual policy of the selling agent or that these houses were sold privately.

86 days between sale and transfer

On average, there were just under three months (86 days) between the time a house was listed on Funda as sold, and the day the new owner was registered with the Land Registry. But Figure 13 also shows that for 35 percent of the houses in July, the transfer took longer than three months. For just over 7 percent, there was even six months or more between the sale date and actual transfer. In any case, we suspect that the average of 86 days underestimates the actual transfer period by a few days, in part because real estate agents will wait to update the Funda ad until the statutory three-day cooling-off period has expired.

The relatively large spread of the transfer period means that it takes at least two to three months before developments in mortgage rates, economic conditions, buyer sentiment - and more recently, the energy crisis - become visible in the statistics of CBS and the Land Registry.

Author(s)

Nic Vrieselaar

RaboResearch Netherlands,
Economics and Sustainability

Nic.Vrieselaar@rabobank.nl

Carola de Groot

RaboResearch Netherlands,
Economics and Sustainability

Carola.de.Groot@rabobank.nl