Private Rental Sector in the Netherlands

- The private rental sector is relatively small in the Netherlands. Generous tax incentives on owner-occupied housing and a relatively big presence of social housing associations have impeded the development of the private rental market.
- New government policy is aimed at increasing the deregulated segment of the Dutch housing market, mainly at the expense of the regulated segment in which the social housing associations are mainly active.
- Demand for rental housing in the deregulated sector is increasing, boosted by growing flexibility of the labour market, stricter mortgage underwriting standards and population ageing. Growth will likely be concentrated in the major urban areas and in the rental price bracket of EUR 750 – 900 per month.

Introduction

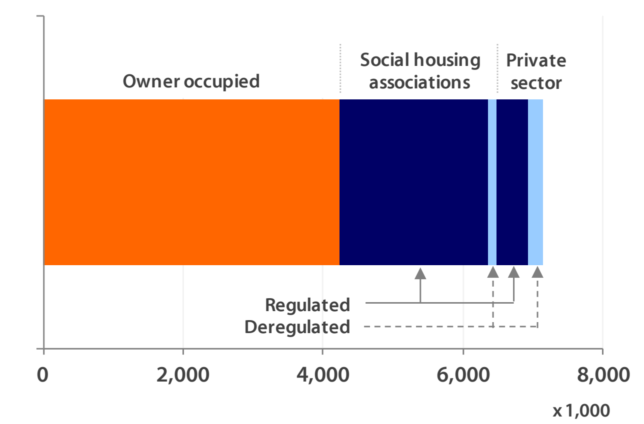
Despite very generous tax incentives on owner-occupied housing, the market for rental housing is relatively big in the Netherlands. In December last year we already gave an overview of the social housing sector in the Netherlands, which forms the lion's share of this market. In this publication we will take a closer look at the private rental sector.

Though this for-profit rental market is relatively small, in particular by international comparisons, it is likely that it will be subject to quite some growth in the next few years. Demand for rental units appears to be on the increase in the Netherlands, on the back of a more flexible labour market, as well as population ageing, increased urbanisation and tighter mortgage lending standards.

Overlapping definitions

Unfortunately, the definition of the private rental sector is not straightforward, because the not-for-profit social housing associations are also active outside their natural habitat (the low-income rental segment). At the same time, private investors are also letting houses in the regulated low-income rental segment. The figure below shows these overlaps more clearly.

Figure 1: Dutch housing stock



Sources: WoOn 2012, Rabobank

We therefore use a two-dimensional approach when looking to the Dutch housing market. On the one hand, a distinction can be made between the **regulated** and **deregulated** market segments. The threshold currently equals a monthly rent of **EUR 699.48**. Housing with rents below this threshold are in the regulated segment, which is often referred to as **social housing**. Fixed maximum rents and maximum rental increases apply only to the regulated segment. Houses with rents above the threshold, belong to the deregulated market. Lessors of these more expensive homes have greater freedom in determining the rents.

On the other hand, the rental market can be determined by the type of landlord. The not-for-profit **social housing associations** are by far the most important landlords in the rental market, and they are mostly active in the regulated segment. **Private landlords**, either (institutional) investors, or to a lesser extent private individuals (buy-to-let), are commercial for-profit landlords. Interestingly, these landlords have also more activity in the regulated segment, though they have relatively big shares in the deregulated segment as well. In this publication, we refer to private landlords when talking about the private rental sector.

Housing stock

A very large proportion of the rental housing stock is in the hands of social housing associations. The main reason for this is historical. After the Second World War, the Netherlands faced an enormous housing shortage. The Dutch government opted to finance house building, by regulating covenants and mainly delegating the construction to the social housing associations. Only once the housing shortage abated in the mid-1960s, did the central government gradually start to grant building licences for owner-occupied houses. From then on the government stimulated both home ownership and the social housing associations. Accordingly, the private rental sector was "squeezed out" and has remained relatively small since.

As the name suggests, social housing associations have a social function, and this goal is indeed ensured in Dutch law. Their primary task is to provide rental housing for lower income

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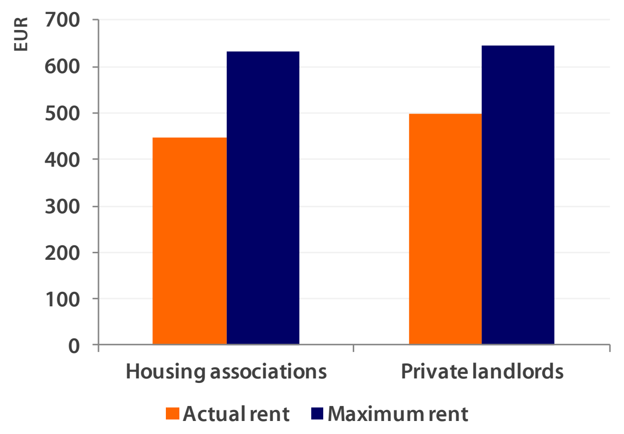
households[1]. If households are unable to pay the required rent, given their income level, they are entitled to receive rental allowance ("huurtoeslag"). However, they are only eligible for this subsidy if they live in a rental home with a maximum rent of EUR 699.48 – the liberalisation threshold.

The remainder of the Dutch stock of rental houses is owned by a large number of private landlords with small portfolios and only a limited number of institutional investors with large portfolios. The private lessors rent out approximately 510,000 units (of which 72% are under the liberalisation threshold) and the institutional investors own 150,000 rental properties (of which 56% are below the liberalisation threshold). The current trend is that private lessors want to sell off their social housing exposures, because the demand for more expensive properties is increasing, and particularly because there is little profit to be gained in the social sector any longer. This is due to the new landlord's levy in the social sector (see box on the right).

Private sector and social housing portfolios

Private lessors of social rental housing are required, just as the social housing associations, to comply with the rules regarding rent protection and maximum rent? in the regulated market. In the Netherlands, the maximum rent attached to a property is determined by a points system which is based on characteristics of the property and its surroundings[2]. There is, however a difference between the actual rent sought and this maximum rent permitted (Figure 2). Housing associations seek on average 72% of the maximum reasonable rent; private landlords 78%.

Figure 2: Average rents in the regulated segment



Sources: WoOn 2012, Rabobank

[1] As indicated on 16 September, the Dutch government aims to make this the only task over social housing associations. It wants to tighten the law on social housing further in order to accomplish this goal.

[2] In the future, the government wants the fiscal appraisal value ("WOZ") to be an additional input for determining the maximum rent.

Levy for social housing

The government imposes a levy on all landlords with 10 or more rental houses in the regulated segment. Over the coming years this levy will reach EUR 1.7 bn per annum (in aggregate) and will ultimately amount to one and a half month's rent per unit in this segment (0.231% of appraised value). The levy mostly acts a an extra tax to the social housing associations. Part of the levy may be paid from income from rents, which are now permitted to rise above inflation. Moreover, some rents are now also means-tested. The other part of the levy must also be paid from savings achieved within the organisation of the housing associations itself. According to the umbrella organization of the social housing associations, *Aedes*, this ought to be feasible, and the sector is aiming to reduce operational costs by 20%. That said, there is a widely held view that in the early years of this new measure in particular, the investment capability of the social housing associations will be severely diminished by the levy.

Private landlords, with more than 10 properties in the regulated segment also have to pay the levy related to any social housing in their portfolio.

According to the Dutch association of private property investors (*Vastgoedbelang*), their members derive only limited yields from social housing portfolios. In order to remain competitive in this segment, they are not able to charge the maximum rent. The market-based rent is lower, and additional rent increases would result in higher vacancy rates.

According to *Vastgoedbelang*, a private investor with a portfolio of 100 social units commanding an average monthly rent of EUR 414 with an appraisal value of EUR 263,000, achieves a gross direct yield of only 1.9% vis-à-vis the appraised value. These are lower yields than those achieved by the institutional investors in their (total) rental portfolios, which stand at around 5% gross (including capital gains) and 4% net (direct rental income). These figures do not include extraneous costs, like local taxes and property maintenance. If these costs are included, the new landlord's levy results in a negative yield on social housing exposures for private landlords. Expansion plans in this segment will be shelved, and projects that were already started, mothballed.

Government policy: less social housing

The Dutch government wants to create greater opportunities for institutional investors and other market participants in the deregulated segment of the rental market. On 11 April 2014, the Dutch housing minister proposed a task delineation for the social housing associations. He believes that the social housing associations have an unfair advantage in the market because they can operate at lower costs (partly thanks to government guarantees in their funding). Moreover, he has proposed a number of measures specifically aimed at improving the efficiency of the rental market.

Under these proposals, the liberalisation threshold of EUR 699.48 per month will be frozen for three years. By permitting annual rent increases above the rate of inflation, the social segment will automatically shrink and the deregulated segment will expand. This shift would also be positive for private landlords with social housing exposures. Due to the freeze of the threshold and ongoing rent increases, a larger part of their portfolios would move from the regulated to deregulated segment, resulting in a lower landlord's levy.

By freezing the threshold, the minister has given a signal that private lessors do not have to fear that their deregulated rental properties could suddenly morph into social housing following a minor raising of the threshold, with the consequence that they would be liable for the landlord's levy. Private landlords will also be offered the reassurance that newly built properties would remain deregulated for the first five years after construction.

The freeze of the liberalisation threshold requires a change in the law. This amendment will probably be implemented this year, together with the review of the Housing Act.

Selling regulations

Homes in the regulated rental segment may only be sold to third parties after they have first been offered for sale to the sitting tenants for a price not exceeding the unoccupied, unlet, valuation amount.

In the case of an entire complex, if it should arise that only some of the sitting tenants are willing or able to purchase their homes while there is a buyer who only wants to purchase the entire complex, then the housing minister will decide to whom the homes should be sold.

In the case of vacant properties, permission is in principle only given if the homes are sold for at least 90% of the valuation amount. If the properties are let out, then the minimum amount is 75%. If the properties are purchased by a private party, then this party must sign a declaration concerning social letting principles, which forms part of the sales agreement.

If rental properties are to be sold in the deregulated segment by social housing associations, in principle the minister only gives permission if the properties are sold for at least the market value. The minister has defined the market value as 90% of the fiscal appraisal value (WOZ).

Another measure aiming to reduce the size of the social housing market is a relaxation of selling requirements under which housing associations are permitted to offload part of their portfolio to private parties. These changes were applied on 1 October 2013.

As a rule, the minister first has to give approval for the sale, which has to take place on the basis of a public notification, for example via an advert in a national newspaper or via *Funda* (the Dutch equivalent of *Zoopla* in the UK). The rules vary for homes above and those below the liberalisation threshold, while vacant newly built properties for sale, irrespective of quality, are categorised as homes with a maximum rent above the liberalisation threshold.

More demand in deregulated sector

There are expectations and indeed signs of growing demand for rental properties in the deregulated market sector. According to market research by *Capital Value* and *ABF Research* there is mainly demand for social rental housing priced at around EUR 550 monthly on the one hand, and private sector rental properties with monthly rents of EUR 700-850 on the other hand. By 2020 a shortage of rental houses is expected, particularly in and around Amsterdam.

Demographic trends, such as population ageing and regional differences in the growth of the number of households are the reason for the above development. Older people appear to increasingly opt to live near facilities and services, thus boosting demand for city living. These 'new' older people enjoy better health for longer and are better off than was formerly the case. This has resulted in a change in living requirements. Surveys have shown that the increasing group of the over 55s with medium to higher incomes are happy to rent and to release equity from their owner-occupied homes for other purposes. Apparently they prefer to live in the city, close to all facilities.

Indeed, institutional investors focus mainly on properties in the Randstad urban conglomeration (Amsterdam, Utrecht, The Hague and Rotterdam) and on homes commanding rents from EUR 750 to EUR 1,000. Their second choice is areas in and around Leiden, Haarlem, Almere and Arnhem where rents of up to EUR 900 are sought. These are areas of high returns for investors, and incomes are relatively high and the number of households is rising.

However, we are slightly sceptical about these conclusions and wonder whether these elderly really freely choose to sell their homes in order to move to rental accommodation. These survey results could well be coloured by the recent crisis period.

In another trend, the number of single person households is set to increase during the coming decades, particularly in the west of the country and in urban areas. This growth can be attributed to increasing numbers of young people moving to cities to study and find jobs. They will be confronted with increased de-regulation on the labour market and more short-term job contracts. Accordingly, they will also seek flexibility on the housing market. In particular, young graduates (higher professional education or university) very quickly reach a household income of over EUR 38,000 and are therefore candidates for the purchase sector or the deregulated market rental sector. At the same time, the growth of temporary job contracts puts a brake on the demand for owner occupied housing. Although the income requirements (rent to income) set by private lessors are comparable to those of mortgage lending institutions (loan to income), it is much easier to rent a house than to obtain a mortgage loan for purchasing a dwelling, when holding a temporary job contract.

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