DUTCH RESIDENTIAL MORTGAGE MARKET

Compared to other mortgage markets in Europe, the Dutch residential mortgage market is typified by a range of mortgage loan products[1] and a high degree of competition between mortgage lenders. The latter has recently been questioned by consumer organisations. In their view margins have become too high due to government interference. Banks who received government support were restricted in the sense that they are not allowed to be a price leader. The Dutch competition authority concluded in 2011 that this was not the case.[2] Due to new complaints by consumer organisations, and the argument that the approach chosen in the research was not sufficient, a new evaluation is currently conducted. Historic practices, culture and most importantly tax legislation (especially those pertaining to the deductibility of mortgage interest) have also shaped the Dutch residential mortgage market in quite a unique way.

Dutch mortgage loans predominantly carry fixed rates of interest that are typically set for a period of between 5 and 10 years. The historically low mortgage loan interest rates in the last decade provided an incentive for households to refinance their mortgage loans with a long-term fixed interest rate (up to as much as 30 years, which gives people almost life-long certainty).[3] Dutch mortgage borrowers are therefore relatively well-insulated against interest rate fluctuations.[4]

Even though Dutch house prices have declined since 2008, the principal amount outstanding of Dutch mortgage loans has continued to increase until the second quarter of 2011. Since then the aggregate outstanding mortgage debt of Dutch households is stabilising (Chart 1)[5]. The Dutch mortgage market is still supported by a gradual increase in the levels of owner-occupation and an environment of low mortgage loan interest rates.

In the period prior to the credit crisis increased competition and deregulation of the Dutch financial markets resulted in the development of tailor-made mortgage loans consisting of different loan parts and features, including mortgage loans involving investment risks for borrowers. The relatively risky mortgage loan products have since the start of the credit crisis in 2007 lost their attraction and are nowadays no longer provided.[6]

Tax deductibility and regulation

The mortgage loan products that were and still are offered by lenders reflect the tax deductibility of mortgage loan interest (which was deductible in full until 2001, see next paragraph) and enable borrowers to defer repayment of principal so as to have maximum tax deductibility. This is evidenced by relatively high loan to foreclosure values and the extensive use of interest-only mortgage loans (which need only be redeemed at maturity). For borrowers who want to redeem their mortgage loan without losing tax deductibility, alternative products such as ‘bank saving mortgage loans’ were introduced. The main feature of a bank savings mortgage loan is that the borrower opens a deposit account which accrues interest at the same interest rate that the borrower pays on the associated mortgage loan. At maturity, the bank savings are used to redeem the mortgage loan.

As from January 2001, mortgage loan interest tax deductibility is restricted in three ways. Firstly, deductibility applies only to mortgage loans on the borrower’s primary residence (and not to secondary homes such as holiday homes). Secondly, deductibility is only allowed for a period of up to 30 years. Lastly, the top tax rate has been reduced from 60% to 52%. However, these tax changes did not have a significant impact on the rate of mortgage loan origination, mainly because of the ongoing decrease of mortgage interest rates at that time.

On top of the limitations that came into force in 2001, tax deductibility of mortgage loan interest payments has been further restricted as from 1 January 2004 for borrowers that relocate to a new house and refinance their

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1 Due to new regulation households who opt for a new mortgage loan are since January 2013 restricted in their choice if they want to make use of tax deductibility. See paragraph “Recent changes in regulation” below
2 NMA, Sectorstudie Hypotheekmarkt, 30 May 2011
3 Dutch Central Bank, statistiek, statistieken DNB, financiële markten, rentes, T1.2.2 (31 October 2012)
4 Maarten van der Molen en Hans Stegeman, 2011, De ongekende stabiliteit van de Nederlandse woningmarkt, 7 May 2011
5 Dutch Central Bank, statistiek, statistieken DNB, huishoudens T11.1 (31 October 2012)
6 Boonstra and Treur (2012) “Reactie op: Hollands hoge hypotheekrentes” ESB, 12 October 2012

mortgage loan. Under the new tax regulation (*Bijleenregeling*), tax deductibility in respect of interest on the mortgage loan pertaining to the new house is available only for that part of the mortgage loan that equals the purchase price of the new house less the realised net profit on the old house.

Since 1 August 2011, the requirements for mortgage lending have been tightened by the Financial Markets Authority (*AFM*) leading to a revised Code of Conduct for Mortgage Lending (*Gedragscode Hypothecaire Financieringen*), to limit the risks of over-crediting. Under those tightened requirements, the principal amount of a mortgage loan may not exceed 104% of the market value of the mortgaged property plus transfer tax. In addition, only a maximum of 50% of the market value of the mortgaged property may be financed by way of an interest-only mortgage loan. In addition, the revised Code of Conduct provides less leeway for exceptions using the 'explain' clause.[7] Consequence is that banks are less willing to deviate from the rules set by the revised Code of Conduct. This will make it more difficult for especially first-time buyers to raise financing as they used to be overrepresented as borrowers of mortgage loans subject to an explain clause. In practice, expected income rises of first-time buyers were frequently included, which lead to additional borrowing capacity.[8]

Recent changes in regulation

Mortgage loans taken out for houses purchased after 1 January 2013 have to be repaid in full in 30 years and at least on an annuity basis in order to be eligible for mortgage interest relief (the linear option is also possible). Household with a pre-1 January 2013 mortgage loan that purchase a house after 1 January 2013 are permitted to keep the existing (more favourable) mortgage loan after it has moved to another house (while keeping the favourable tax relief). However, any such mortgage loan will again be tested against the Code of Conduct for Mortgage Lending (*GHF*), with the most important condition being that no more than 50% of the mortgage loan may be repaid on an interest-only basis. Finally, an increasing rate of deemed income a property generates (*huurwaardeforfait*) implies a reducing net tax benefit as a result of interest deductions.

The coalition agreement for the new government as presented on 29 October 2012, includes measures pursuant to which, as from 2014, the maximum interest deductibility for mortgage loans for tax purposes will decrease annually at a rate of 0.5 per cent. from the income tax rate of 52 per cent. down to 38 per cent. Furthermore, the maximum loan-to-value (mortgage loan versus the market value of the house) will be gradually lowered to 100%. The transfer tax that was already temporarily lowered from 6% to 2% on 1 July 2011 with effect from 15 June 2011, will remain at 2%.[9] In addition, interest paid on any outstanding debt from a mortgage loan remaining after the sale of a home can be deducted for up to ten (10) years. This measure will be in place from 2013 up to and including 2017. It is likely that the impact on the house price level will be negative[10], but the extent is uncertain and depends amongst other things on the overall confidence level and the real disposable income development.

In February 2013 the Dutch cabinet came with additional measures for the housing market. Most important feature for the owner-occupied sector is that a second mortgage loan may be used to pay part of the redemption of the annuity mortgage loan. As a consequence, the monthly expenses of the mortgage loan are lower. However, the total costs will increase as after 30-years the mortgage is not fully repaid. There are a few restrictions on the second mortgage: 1) it is not eligible for tax deductibility and 2) it may not exceed 50% of the original market value of the house.

Recent trend in house prices and transactions[11]

The housing market recorded a good fourth quarter in 2012. Prices stabilised and house sales rose considerably. The main reason was that buyers had a strong incentive to sign a provisional sale agreement before 1 January 2013 in order to remain eligible for tax deductibility under the old regime (interest-only repayments of up to 50% of the market value of a house and various options for mortgage loan redemption).

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[7] Under the "explain" clause it is in exceptional cases possible to deviate from the loan-to-income and loan-to-value rules set forth in the Code of Conduct

[8] M.T. van der Molen, 2012, Aanschaffen woning is makkelijker, January 2012

[9] Rijksoverheid, 2012, Stabiliteitsprogramma Nederland, april 2012 actualisatie

[10] CPB, 2012, Analyse economische effecten financieel kader Regeerakkoord, 29 October 2012

[11] Rabobank Economic Research Department - Dutch Housing Market Quarterly August 2012

The additional demand in the non-rental sector led to a better bargaining position for sellers. Consequently the selling price declined much less rapidly than had been the case in preceding quarters. In the end, prices dropped in the fourth quarter by only 0.7% on a quarterly basis – and 7.0 on a yearly basis (Chart 3). At least as important was the rise in the number of provisional sale agreements and the number of house transfers. On balance, an estimated 33,000 provisional sale agreements were signed, and 35,704 houses changed hands (Chart 4) - 10,000 more than might have been expected on the basis of the number of provisional sale agreements signed in the third quarter.[12]

Foreclosures

The number of arrears and involuntary sales of residential property by public auction ("forced sale") in the Netherlands is traditionally very low compared to international standards.[13] Especially in the second half of the 1990s, when the demand for residential property was exceptionally strong, house sales by auction, even in the event of a forced sale, almost never occurred or were required. Moreover, the 1990s were characterised by very good employment conditions and a continuing reduction of mortgage interest rates. In the years before 2001, the total number of foreclosures was therefore limited compared to the number of owner-occupied houses.[14]

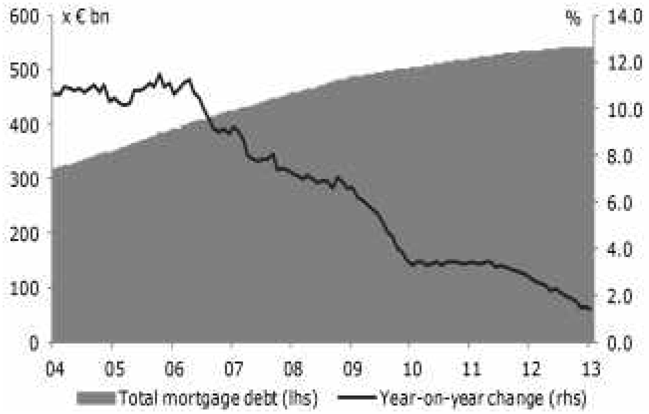
The relatively prolonged economic downturn from 2001 to 2005 led to a significant rise in the amount of mortgage loan payment arrears and correspondingly forced house sales (Chart 5). The number of foreclosures in the Netherlands reported by the Land Registry (*Kadaster*) rose from 695 in 2002 to about 2,000 forced sales from 2005 onwards. This increase was mainly the result of a structural change in the Dutch mortgage loan market during the nineties: instead of selling single income mortgage loans only, lenders were allowed to issue double income mortgage loans. The subsequent credit crisis and the related upswing in unemployment led to a rise of the number of forced sales. The Land Registry (*Kadaster*) recorded 2,488 forced sales in 2012. In the fourth quarter of 2012 the number of foreclosures amounted to 669, compared to 891 in the same period in 2011(Chart 5). Recent research confirms that the number of households in payment difficulties in the Netherlands is low from an international perspective and that problems mainly have 'external' causes such as divorce or unemployment as opposed to excessively high mortgage debt.[15]

The proportion of forced sales is of such size that it is unlikely to have a significant impact on house prices. The Dutch housing market is characterised by a large discrepancy between demand and supply, which mitigates the negative effect of the economic recession on house prices. In the unforeseen case that the number of foreclosures were to increase significantly, this could have a negative effect on house prices. Decreasing house prices could in turn increase loss levels should a borrower default on his mortgage loan payment obligations.

Even though in a relative sense the increase over the last years is substantial, the absolute number of forced[16] sales is obviously still small compared to the total number of residential mortgage loans outstanding. There is no precise data of the number of residential mortgage loans outstanding in the Netherlands. However, based on the published total amount of residential mortgage debt outstanding[17] and the current average mortgage loan principal amount it is estimated that the total number of residential mortgage loans outstanding in the Netherlands exceeds 3 million. A total of approximately 2,500 foreclosures per year since 2005 therefore corresponds to approximately 0.1% of the total number of residential mortgage loans outstanding.

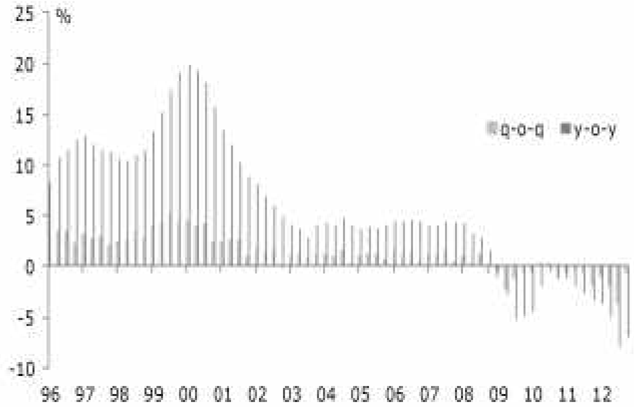
[12] Statistics Netherlands, cijfers, cijfers per thema, bouwen en wonen, verkochte woningen (31 October 2012)
[13] Comparision of S&P 90+ day delinquency data,
[14] Kadaster and CBS, cijfers, cijfers per thema, bouwen en wonen, verkochte woningen (31 October 2012)
[15] Standard & Poor's, 2010, Mortgage lending business supports some European banking systems
[16] Kadaster
[17] Dutch Central Bank, statistiek, statistieken DNB, huishoudens T11.1 (31 October 2012)

Chart 1: Total mortgage debt



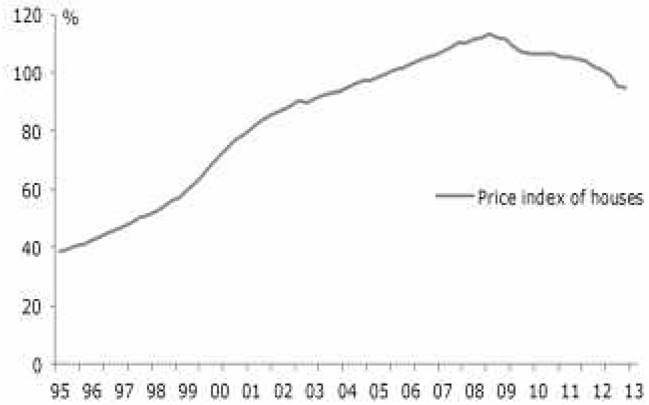
Source: Dutch Central Bank

Chart 2: Dutch property price development



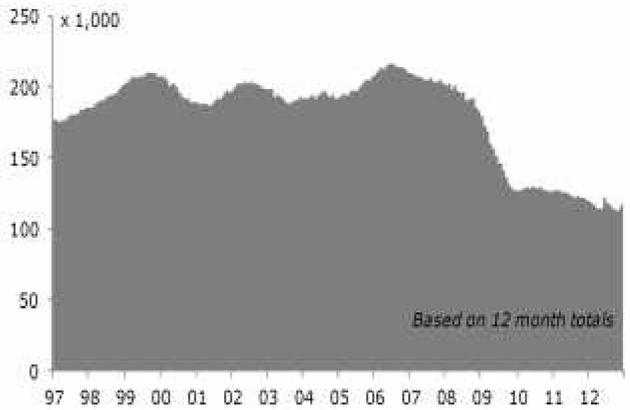
Source: Statistics Netherlands

Chart 3: Development house price index



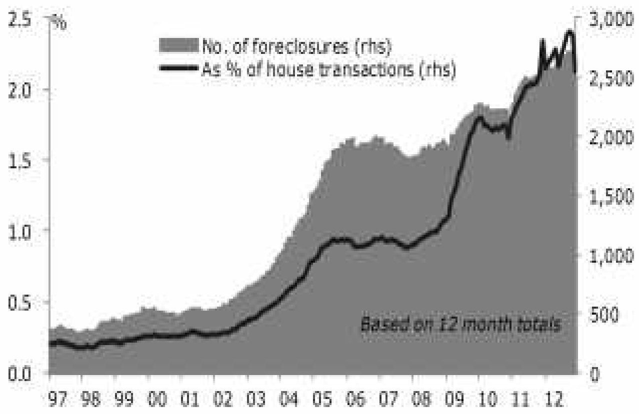
Source: Statistics Netherlands

Chart 4: Number of house sale transactions



Source: Statistics Netherlands

Chart 5: Number of foreclosures



Source: Land Registry, Statistics Netherlands