Dutch residential mortgage market

Compared to other mortgage markets in Europe, the Dutch residential mortgage market is typified by a range of relatively complex mortgage loan products[[1]](#footnote-1). Generous tax incentives have resulted in various loan structures. Most of these structures share the common characteristic of bullet repayment of principal at maturity. Historic practices and culture have also shaped the Dutch residential mortgage market in quite a unique way[[2]](#footnote-2).

Most mortgage loan products reflect the tax deductibility of mortgage loan interest and enable borrowers to defer repayment of principal so as to have maximum tax deductibility. This is evidenced by relatively high LTV values and the extensive use of interest-only mortgage loans (which only need to be redeemed at maturity)[[3]](#footnote-3). 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.

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. More focus on transparency and financial predictability have resulted in simpler mortgage loan products in recent years.

Dutch mortgage loans predominantly carry fixed rates of interest that are typically set for a term between 5 and 15 years. Rate term fixings differ by vintage however. Historically low mortgage 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). Compared to countries where floating mortgage rates are the norm, Dutch mortgage borrowers are relatively well-insulated against interest rate fluctuations[[4]](#footnote-4).

Even though Dutch house prices have declined since 2008, the principal amount outstanding of Dutch mortgage loans has continued to increase until the fourth quarter of 2012. Since then the aggregate outstanding mortgage debt of Dutch households has slightly decreased. 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.

**Tax deductibility and regulation**

Prior to 2001, all interest payments on mortgage loans were deductible in full from taxable income. As from January 2001, tax deductibility was made conditional 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 highest marginal tax rate was reduced from 60 per cent. to 52 per cent. in 2001. 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 these limitations that came into force in 2001, tax deductibility of mortgage loan interest payments has been further restricted for borrowers that relocate to a new house and refinance their mortgage loan as from 1 January 2004. Under this 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. Other housing related taxes partially unwind the benefits, but even despite restrictions implied in the past, tax relief on mortgage loans is still substantial. More meaningful restrictions to tax deductibility have been imposed per 1 January 2013 (see recent regulatory changes).

Underwriting standards follow from the Code of Conduct for Mortgage Lending, which is the industry standard. Since 1 August 2011, the requirements for mortgage lending have been tightened by the Financial Markets Authority (*AFM*). This has resulted in a revised Code of Conduct for Mortgage Lending (*Gedragscode Hypothecaire Financieringen*). It limits the risks of over-crediting. Under those tightened requirements, the principal amount of a mortgage loan may not exceed 103 per cent. of the market value of the mortgaged property plus transfer tax (2 per cent.). In addition, only a maximum of 50 per cent. 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.[[5]](#footnote-5) 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 led to additional borrowing capacity[[6]](#footnote-6).

**Recent regulatory changes**

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 tax relief (the linear option is also possible). Tax benefits for mortgage loans, of which the underlying property was bought before 1 January 2013, have remained unchanged. Grandfathering of these tax benefits is possible in case of refinancing and/or relocation. However, any such mortgage loans will again be tested against the Code of Conduct for Mortgage Lending, with the most important condition being that no more than 50 per cent. of the mortgage loan may be repaid on an interest-only basis.

As from 2014, the maximum interest deductibility for mortgage loans for tax purposes will decrease annually at a rate of 0.5 percent-point from the main income tax rate of 52 per cent. down to 38 per cent. in 2042.

In addition, the maximum LTV will be gradually lowered to 100 per cent. in 2018, by 1 per cent. per annum (2015: max LTV: 103 per cent. including transfer tax). This guideline has been inserted in special underwriting legislation, which has become effective per 1 January 2013. This new legislation overrules the Code of Conduct for Mortgage Lending currently.

The transfer tax (stamp duty) was temporarily lowered from 6 per cent. to 2 per cent. on 1 July 2011. With effect from 15 June 2012, it will remain permanently at 2 per cent.

Finally, interest paid on any outstanding debt from a mortgage loan remaining after the sale of a home (negative equity financing) can be deducted for tax purposes for a period of up to 15 years. This measure will be in place for negative equity financings entered into before 2018.

**Recent developments in the housing market[[7]](#footnote-7)**

The Dutch housing market has shown clears signs of recovery since the second half of 2013. On a quarterly basis, existing house prices (PBK-index) stayed flat in the fourth quarter of 2014, though the annual price increase equalled 2.1%. Since the recovery on the housing market started in the third quarter of 2013, house prices have increased by 2.2%. Compared to the peak in the third quarter of 2008, house prices are still 18.8% lower.

In the fourth quarter of 2014, considerably more houses changed hands than in previous quarters. The Land Registry registered a total of 51,314 transactions, which was the highest number since 2008. In particular December 2014 was good, but the number of sales in this month has been affected by the expiration of a temporary exemption in the gift tax framework. Forward looking indicators, such as the sales figures by the Dutch association of real estate agents (NVM), suggest an ongoing recovery of the Dutch housing market in 2015, though sales momentum is likely to decrease somewhat.

**Forced sales**

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[[8]](#footnote-8). 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 forced sales was therefore limited compared to the number of owner-occupied houses.

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. The number of forced sales 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 recorded 1,863 forced sales in 2013. In 2014 the number of forced sales amounted to 2,178. Recent numbers on forced sales could be distorted by the fact that originators increasingly attempt to circumvent such sales, for example by selling the property in the normal market using an estate agent.

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[[9]](#footnote-9).

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 forced sales 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 sales is 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[[10]](#footnote-10) 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 forced sales per year since 2005 therefore corresponds to approximately 0.1 per cent. of the total number of residential mortgage loans outstanding.

Chart 1: Total mortgage debt Chart 2: Transactions and prices

 

*Source: Dutch Central Bank Source: Statistics Netherlands*

Chart 3: Price index development Chart 4: Interest rate on new mortgages



*Source: Statistics Netherlands Source: Dutch Central Bank*

Chart 5: Volume of new mortgages by term Chart 6: Confidence bodes for more sales

 

 *Source: Dutch Central Bank Source: Delft University OTB, Rabobank*

1. Due to new regulation, borrowers have been restricted to annuity or linear mortgage loans since January 2013 if they want to make use of tax deductibility. See paragraph “Recent regulatory changes” below [↑](#footnote-ref-1)
2. Rabo Credit Research, Dutch RMBS: a Primer (2013) [↑](#footnote-ref-2)
3. Dutch Association of Insurers, Dutch Insurance Industry in Figures (2012) [↑](#footnote-ref-3)
4. Maarten van der Molen en Hans Stegeman, “De ongekende stabiliteit van de Nederlandse woningmarkt” (2011) [↑](#footnote-ref-4)
5. 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 [↑](#footnote-ref-5)
6. M.T. van der Molen, “Aanschaffen woning is makkelijker” (2012) [↑](#footnote-ref-6)
7. Rabobank Economic Research Department, Dutch Housing Market Quarterly, August 2014 [↑](#footnote-ref-7)
8. Comparison of S&P 90+ day delinquency data [↑](#footnote-ref-8)
9. Standard & Poor's, Mortgage lending business supports some European banking systems (2010) [↑](#footnote-ref-9)
10. Dutch Central Bank, statistics, households, table T11.1 [↑](#footnote-ref-10)