Housing Market Monitor

Ongoing improvement in second half

Group Economics

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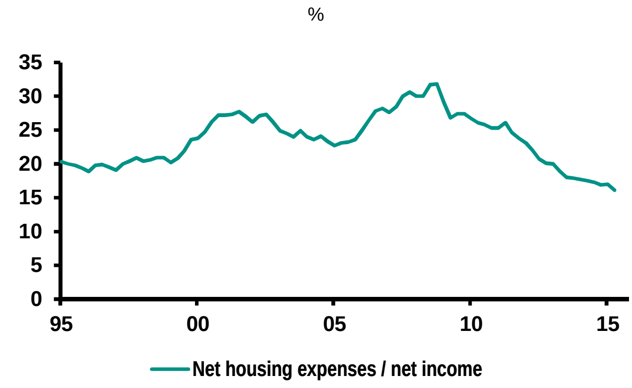
- Low interest rates and economic revival place firm foundations under housing market recovery
- Municipal land policy impedes expansion of mid-market rented segment
- Easier access to mortgages for flexible workers

Why the strong confidence in the housing market?

Dutch consumers remain upbeat about the outlook for the housing market. Despite edging fractionally lower in the past three months, the mood indicator of the Homeowners' Association (VEH) remains high at 102. This strong confidence is being fuelled by the growing optimism about the Dutch economy and the increasing affordability of housing.

The economy is doing well. Apart from foreign trade, domestic spending is now also contributing to GDP growth. Another encouraging sign is that companies are starting to invest again, as is reflected in the rising level of employment and improving wages. Moreover, the tax reduction announced by the government is also putting more money in people's pockets. The net result is an increase in disposable incomes. This is giving a major boost to both consumer confidence and housing market sentiment, even though some doubt has crept in since the recent turbulence in the financial markets.

Housing steadily more affordable



Source: Calcasa, NB repayments are not included in net housing costs

The sustained improvement in the affordability of housing is due to the low mortgage rates which, in turn, stem from the ECB's expansionary monetary policy. After cutting its short-term rate, 'Frankfurt' also embarked on a large-scale bond-buying programme in March. This has pushed long-term interest rates even lower. The ECB policy gives banks access to cheaper funding, which enables them to offer lower mortgage rates.

Intensifying competition from new entrants in the mortgage market is putting further pressure on mortgage interest rates. The mortgage market is attractive for investors as mortgages yield a higher return than government bonds. Moreover, Dutch mortgages have a good track record for being relatively safe. Even during the crisis, the number of defaults remained within bounds. Additionally, the Dutch Budget Memorandum shows that the proportion of households with an 'underwater mortgage' decreased from a third in the first quarter of 2013 to a quarter in the first quarter of this year.

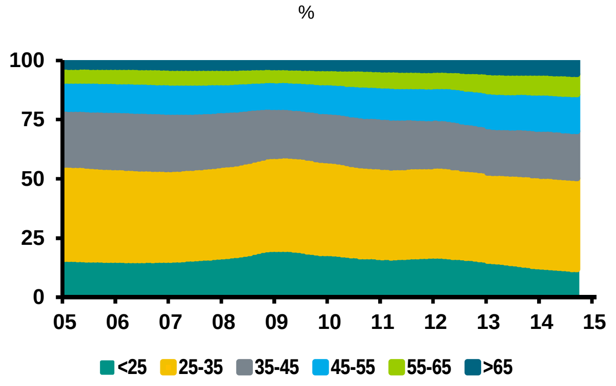
Not so long ago the planned creation of a National Mortgage Institution seemed to provide scope for a further fall in mortgage rates. But this plan has run aground owing to the failure to produce a viable concept consistent with the conditions of the European Commission.

Is the new-found confidence translating into increased sales and prices?

The strong confidence in the housing market is visible in the number of housing transactions. In the first eight months of the year, existing house sales jumped 23% compared to the same period in 2014. The surge in sales peaked in June due to the lowering of the threshold for the National Mortgage Guarantee (NHG) and the introduction of stricter income criteria of the National Institute for Family Finance Information (Nibud) effective from July. However, in the months thereafter the transaction volume remained higher than in the equivalent months last year. Potential buyers sat on the fence for a long time, but a growing number are now making their move. This pent-up demand is giving an extra impulse to the transaction volume.

The transaction upturn is broad-based, with sales rising in all provinces. In terms of price class, too, the revival is acquiring firmer foundations. During the crisis, buyers focused mainly on the cheaper price classes, but the share in sales of the other price classes is now also growing. Against this, younger buyers are having more difficulty buying a home than older purchasers. The share of buyers under 45 is falling. This is largely attributable to the under-25s, many of whom are postponing their home purchase plans because of the stricter financing conditions.

Young people have smaller share in house sales



Source: Land Registry

Due to the gathering transaction momentum, fewer houses are on the market. In September the for-sale housing stock numbered only 166,000 properties, 40,000 less than a year ago. Additionally, houses are changing hands faster. According to the Dutch Association of Real Estate Brokers (NVM), the properties sold in the second quarter were on the market for 112 days on average, 21 days less than in the same quarter a year ago. The current housing supply is also selling faster: within an average of 338 days versus 402 days last year. The average, incidentally, is significantly inflated by the stock of hard-to-sell properties. According to Calcasa, over a quarter of the housing supply has been on the market longer than three years.

The contracting supply is reflected in the uplift in prices. In August the average year-on-year price increase was 2.5%. The upward price momentum is not only visible in the Randstad conurbation, but also in other parts of the country. Prices are on the rise in all provinces, with Noord-Holland and Utrecht as the clear front-runners. That said, prices in some regions are under pressure – notably in Groningen where earthquakes have caused considerable damage to properties.

Initially, the price recovery barely fed through into higher asking prices. On the contrary: sellers continued to lower their prices in order to secure a quicker sale. Their number is shrinking, however. Since the start of this year, the average asking price has actually started to rise again, albeit less quickly than the average transaction price. The difference between the average asking and transaction price is therefore steadily narrowing.

According to the latest NVM figures, the difference between the last asking and offered price in the second quarter was 4.1% on average, as opposed to 4.8% in the same quarter of 2014. This means that buyers and sellers are coming together faster. In some popular neighbourhoods of the large cities – and chiefly Amsterdam – buyers are no longer underbidding the asking price, but are actually overbidding. This, however, is the exception rather than the rule.

Is only the Dutch housing market staging a revival?

The housing market in the rest of the eurozone is also on the mend – witness an ECB report which states that house prices have been rebounding in a string of countries since the start of 2013. This recovery follows a prolonged period of depressed prices. The revival is particularly visible in countries that experienced a pre-crisis housing boom, but were then hard hit by the financial meltdown. Ireland is one salient example. But other countries where the housing market suffered less from the crisis, such as Germany and Austria, are also enjoying rising prices.

The report claims that the current recovery in the European housing market is more balanced than the temporary upturn in 2009-2010. The reason is that this time round it is not confined to the urban areas (where prices usually respond faster to changing market conditions) but extends to other areas as well. Also heartening is the fact that prices are at a more balanced level. The European house price/income ratio is now just above the long-term average. And, with interest rates at record lows, housing is currently even more affordable than the historic average.

'Frankfurt' is confident that the economic uplift will continue to drive the housing recovery, but admits that the outcomes will vary from one country to another. These variations are due to differences in the tax treatment of home ownership and the diversity of mortgage lending rules. Another factor is that in some countries the housing supply responds more quickly to changes in demand. This is because some governments issue building permits and release building land more readily than others.

In our view, these structural differences have a bearing on the effectiveness of the ECB policy. The ECB's measures have a different impact on property valuations in each member state. For this reason, they are not equally useful as an economic policy instrument in every country. This situation will only change when the member states harmonise their housing and mortgage market policies.

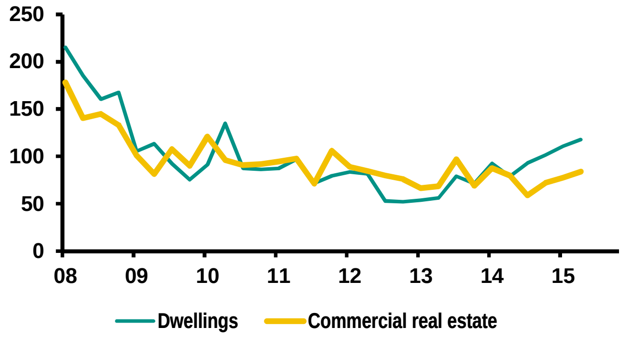
The disparity between countries partly explains the earlier recommendation of the Financial Stability Committee to steadily reduce the maximum mortgage in the Netherlands to 90% of the property value, a percentage that is more in line with international practice. However, the current government has chosen to disregard this recommendation. Its priority is to maintain calm on the housing market, so any further LTV reduction will be a matter for future cabinets. The government recently also rejected a proposal of the Netherlands Bureau for Economic Policy Analysis (CPB) to transfer owner-occupied property to Box 3 (wealth tax) for income tax purposes. In a recent report the CPB concludes that Dutch tax revenue from capital income is low by European standards. One reason it cites is that home ownership is taxed differently from other free savings.

Is the construction industry responding to the housing upturn?

The construction of new housing has been gathering pace since mid-2013. According to the Dutch Builders' Association (NVB), just under 20,000 new-build homes were sold in the first eight months of this year, up almost 50% on last year. If sustained, this will lead to a year-end total of 30,000 – which is a tremendous improvement but still significantly less than the pre-crisis figure of 40,000.

Architects are drawing new-builds again

Construction sum for new assignments (index 2010=100)



Source: **Statistics Netherlands (CBS)**

The pick-up in construction activity will probably be mostly in evidence within the square of Amsterdam, Zwolle, Eindhoven and Rotterdam. A study commissioned by the Ministry of the Interior and Kingdom Relations shows that social activity is becoming increasingly concentrated within this square. This is the epicentre of social, economic and cultural exchange between diverse urban regions, with Amsterdam, Utrecht and Den Bosch emerging as pivotal hubs in these networks.

The resurgence of new-build construction is vital for the Dutch economy. After putting a brake on economic growth for many years, the construction sector is once again making a positive contribution as the new-build segment gathers steam. This trend is expected to continue. Construction activity has long lagged behind demand. So it's no surprise that architects are now receiving more new-build assignments. The growing number of issued building permits also confirms this upturn in activity. In the first seven months of the year, 34,000 permits were issued, 15,000 more than in the same period last year.

The construction sector's contribution to GDP growth, incidentally, is rising less quickly because of the flat performance in the non-residential sector. Investments in infrastructure are under pressure. The construction of offices and shops is also stagnating due to the high vacancy rates. One suitable option is to transform surplus retail and office space into homes. A study of Deloitte claims that a third of vacant office space could be converted into residential space, leading to the creation of 25,000 new homes.

Next year the construction sector's contribution to the economy will probably be smaller than this year. The reason is that the temporary VAT reduction on conversions was reversed in July. This temporarily lower rate was introduced to help construction companies weather the crisis. With the economic revival now under way, the government sees no need to continue the measure. The expectation is that clients will have brought their conversions forward to benefit from the tax break before it was too late. Construction companies, however, say they have little evidence of this so far.

Is rented housing also being built?

The pick-up in the owner-occupied segment has consequences for the rented segment. During the crisis homeowners regularly opted to rent out their property in the absence of buyers. Due to the rising transaction volume, this is now happening less often. According to the rented housing website *Pararius.nl*, more owner-occupied properties have been withdrawn from the rented segment than added since 2013.

Nevertheless, demand for rented housing remains buoyant. One factor feeding the popularity of renting is the shift towards a more flexible labour market and the tighter financing conditions for buyers. According to VGM and NVM, about 9,000 rental transactions took place in the second quarter, 6% more than last year.

Demand is particularly strong in the mid-market rented segment up to EUR 1,000. Frans Schilder and Johan Conijn of the *Amsterdam School of Real Estate* estimate the supply in this segment at about 440,000 homes in 2012 and calculate that in the same year there were about 1.6 million households with a middle income of EUR 35,000 to EUR 53,000. So there is a yawning gap between potential demand and supply. According to the researchers, the biggest tension in the market can be found in urban regions in Noord-Holland, Utrecht, Gelderland and Brabant.

However, the expansion to the mid-market rented segment is slow to take off. In the past years private investors have taken over substantial rented housing portfolios from housing associations. But they seem less interested in building new rented housing. This is also clear from the number of issued permits for new-build rented housing. Activity here is picking up, but not nearly as quickly as in the owner-occupied segment. Only 33% of the issued permits are now for rented housing, versus 44% two years ago.

Evidently, investing in new rented housing is a difficult proposition. Rented homes are worth less than comparable owner-occupied properties. This stems from the favourable tax regime for owner-occupiers. The difference in valuation level makes it more attractive for municipalities to release land for owner-occupied housing rather than rented housing, because the proceeds from land for owner-occupied homes are higher.

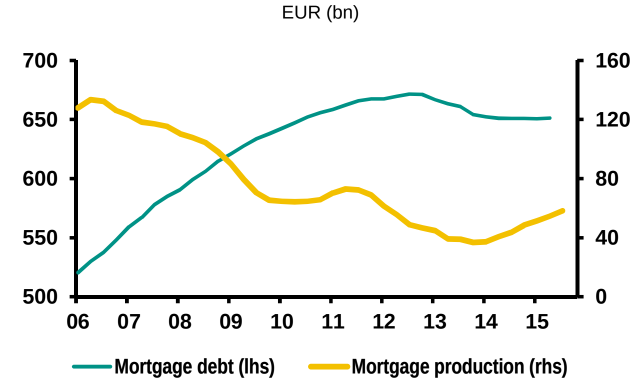
If municipalities want to expand their mid-market rented housing stock, they must make the same concessions as for social housing and accept a lower land price. However, due to the losses on land portfolios and their tight budgets, the municipalities can ill afford to do this. Investors are therefore staying on the sidelines and private investments in new mid-market rented housing remain lacklustre.

Is the revival already leading to a higher mortgage volume?

The increase in house sales is driving up the volume of new mortgages. Additionally, the average amount of mortgage contracts is increasing, so that the new mortgage volume is also steadily rising. In the twelve months until the end of August, the total value of new mortgages was EUR 58bn versus EUR 43bn last August. Due to the sharp decline in long-term interest rates, mortgagors are showing a strong preference for loans with long fixed-rate terms. In addition, remortgagers are also accounting for a growing share of new mortgages, albeit from a low initial base.

At first the increase in new mortgages did not translate into a higher mortgage volume. There was a strong tendency to make extra mortgage repayments. This was due to various factors such as the low interest rates on savings, the risk of high negative equity and the temporary expansion of the gift exemption up to EUR 100,000. Another factor was that, in contrast with existing house sales, no repayments take place upon the sale of new-build homes. It follows that when there are few new-build transactions, as has been the case in recent years, mortgage repayments are relatively high compared to the new mortgage volume.

Mortgage volume edges higher on new mortgage



Source: Statistics Netherlands (CBS), Land Registry

Meanwhile, however, the mortgage volume is edging higher again. In the second quarter this volume rose 0.1% compared to the previous quarter to EUR 651bn. The renewed increase after nine quarters of decline is due to the recovery of new-build sales. Moreover, the temporary expansion of the gift tax exemption was terminated at the end of last year, causing the take-up of the scheme to peak in December. The revival of the housing market will lead to a further increase in new mortgage volume. The recently announced reintroduction of the expanded gift tax exemption in 2017 will have little effect on this. This time around, the expanded gift tax exemption will be permanent, but only applicable to recipients under 40.

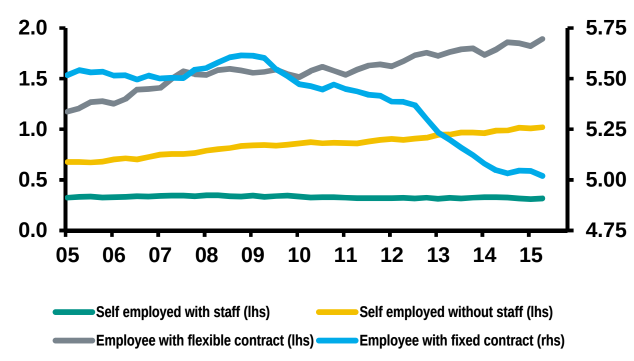
Can flexible workers get a mortgage?

The Dutch labour market is rapidly becoming more flexible. Since the onset of the crisis, the number of employees on an indefinite contract has shrunk by 600,000. At the same time, the number of flexible and self-employed workers has grown by, respectively, 280,000 and 180,000. More than one third of the current labour force is on a flexible contract or self-employed. The shift is particularly visible among young people. Over half of those under 35 have a flexible contract.

The reasons for the popularity of temporary contracts are diverse. Companies use them to absorb fluctuations in work load and to respond more quickly to changes in demand. In addition, the future is uncertain and flexible contracts impose fewer obligations. The diverse types of contract offer different ways of reacting to contingencies. Employers tend to hire temporary workers to manage peaks in work load or to replace employees on sick leave. They make use of payrollers to avoid administrative red tape. And they enlist the services of self-employed people when they need specialised knowledge.

Share of flexible workers has increased sharply

Millions of employees



Source: **Statistics Netherlands (CBS)**

Society is calling upon mortgage lenders to react to these changes in the labour market and to make it easier for flexible workers to get a mortgage. Their response has been to relax the mortgage conditions for employees on a flexible contract. Flexible workers are now eligible for a mortgage if they can present income details for the past three years, and this period has even been reduced from three to one year for self-employed persons.

In a further move several mortgage lenders, including ABN AMRO Bank, recently announced an experiment. Until now, the employer's statement of intent was decisive in determining the maximum mortgage amount. Acceptance was based on the applicant's current income and income history. The experiment involves including the applicant's future prospects in the acceptance process. These prospects will be assessed on the basis of a statement of prospects and a labour market scan.
Staffing firm Randstad will issue the statement of prospects based on objective employee characteristics, the experiences with the employee and a personal interview.

The labour market scan looks at a job seeker's chances of finding a new job and his or her earning capacity in the coming five years. The employability score, which takes on board such aspects as role, sector, level of training, age and region, determines the eligibility for a mortgage. The applicant is only eligible if the score indicates that the demand for jobs in his labour market segment is at least equal to the supply of jobs.

The experiment is a logical response to recent regulatory changes, which have made the distinction between permanent and flexible contracts less clear-cut. Due to the growing share of flexible labour contracts, the government felt compelled to reduce the differences between permanent and flexible working. The Work and (Job) Security Act (*Wet werk en zekerheid*) was introduced for this purpose. Effective from 1 July, flexible workers enjoy more safeguards and are entitled to a permanent contract after only two instead of three years. Since that same date, the procedure for dismissing permanent employees has also been made faster and less costly for employers. Finally, the maximum duration of unemployment benefit is being reduced in steps.

Conclusion

The recovery in the housing market is taking hold. Prices and sales are both continuing to rise. Low interest rates and the economic revival provide an important foundation for the current improvement. Additionally, after years of postponement, pent-up demand is now kicking in and the millstone of negative equity is being lifted from homeowners' shoulders as prices continue to recover. All in all, there are plenty of reasons to be optimistic about the outlook for the housing market. In view of the stronger-than-expected increase in sales so far, we are raising our transaction estimate for this year from 10% to 15%. Our price growth forecast has been left unchanged at 3%. We have also left our forecasts for 2016 as they were.

Price and transaction estimates

	Transactions (% y-o-y)	Prices (% y-o-y)
2014	39.4	0.9
2015	15	3
2016	5	3

Source: Group Economics