Housing Market Monitor

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Housing Market Monitor – Coronavirus halts boom

After years of rising prices and high transaction volumes, the housing market is currently taking a severe blow. The measures needed to contain the spread of the corona virus are pushing the economy into headlong retreat. Unemployment is climbing and disposable incomes are under pressure. Combined with an expected increase in mortgage rates, home ownership is becoming less affordable. The number of house purchases is set to slump, also because investors are stepping back from the market. Due to this fall-off in demand, the strong upward price trajectory witnessed until recently will stall and the average price level will start to fall. By how much is impossible to say at this stage.

The coronavirus not only poses a threat to public health, but also to the economy. The damage may well approximate, or even surpass, that inflicted by the credit crisis. The current crisis is first and foremost a health emergency. All efforts are focused on the prevention of infections. Radical containment measures are bringing production to a standstill all over the world. Fortunately, governments and central banks are coming to the rescue with massive support packages. The aim is to keep production structures intact, so that the economy can get back on track once the restrictions can be scaled down. A recession, however, is inevitable.

What was the situation before corona?

The economic backlash will hit the housing market which, until recently, was in such solid shape. After one and a half years of decline, the transaction volume had resumed the upward trend from mid-2019 onwards. In the twelve months until the end of February, no less than 221,000 pre-owned properties changed hands. The revival of the purchase volume was partly driven by the fall in mortgage rates: the average 10-year mortgage rate dropped from 2.8% in June 2019 to 2.4% in January 2020. With properties becoming more affordable, newly-confident buyers flocked back into the market in droves.

The buying frenzy was fanned further by reports that construction would continue to lag demand, pointing to even more pressing housing shortages (already 300,000 dwellings) in the future. The dwindling issuance of building permits and persistent builder shortages were already early harbingers of slackening output. When construction activity was dampened even more by restrictions to curb nitrogen emissions and the use of PFAS-polluted land, many potential buyers concluded that they needed to act fast in order not to miss the boat.

The relentless increase in purchase volumes squeezed supply even further. According to home search website *huizenzoeker.nl*, there were fewer than 50,000 properties up for sale in February, clearly signalling severe tightness in the Dutch housing market. This overheating propelled house prices to still higher levels. In February 2020, the average

house price was no less than 6.6% higher than in February 2019. The average price of pre-owned properties advanced in this period by EUR 22,000 to EUR 321,000. New-builds followed suit.

Interestingly, price momentum in the large cities was less buoyant, with Amsterdam even falling below the national average. A remarkable signal, because the housing market in the large cities is usually several steps ahead of the rest of the country, partly because their economic structure is more strongly oriented on foreign markets, which makes them more sensitive to the changing fortunes of the international economy. In 2019, the main global headwind was the US-China trade conflict. But since the start of this year, the coronavirus has emerged as an even more toxic threat, initially causing a relatively mild upset in the form of production problems in China before escalating into the current full-blown crisis.

Coronavirus: what are the consequences?

The question now is: how will the coronavirus crisis feed through in the housing market? This depends on various factors, both on the demand and the supply side. Particularly important on the demand side are economic growth, income prospects and household wealth levels. Other factors include the development of the rented segment, mortgage rates and the availability of credit. Finally, home preferences and population growth need to be taken into account. Regarding the supply side, we will look at construction activity.

Incomes under pressure

A recession this year is inevitable. After years of contending with a tight labour market, companies are suddenly forced to lay off staff. And can do so faster than before, because many employees are on flexible contracts. With unemployment on the rise, wage increases are now a distant prospect. Instead, short-time working and part-time unemployment benefit lie ahead. As well as undermining confidence, the worsening outlook for disposable incomes will reduce the maximum mortgage that potential house buyers can take out.

Added to this, disposable incomes may be squeezed further if healthcare premiums and pension contributions are raised, which is a real risk. A high infection rate, after all, will translate into greater demand for treatment and a corresponding increase in healthcare costs. The coronavirus will also add fuel to the pension contribution debate now that the investments of pension funds have lost value due to the crash. And with interest rates remaining low, pension funds must also make provisions for higher future obligations. The resulting decline in funding levels will force them to choose between increasing contributions, reducing pensions or a combination of the two.

Waning investor interest

The falling prices in the financial markets have also eaten into household wealth levels. Smaller financial buffers make it more difficult for potential buyers to buy a house. Added to this, the influx of private investors into the buy-to-let market that was prompted in recent years by low interest rates will dry up. Some of these investors will have seen part of their assets go up in smoke on the stock exchange and be less able to opt for this route. Others will prefer to return to the stock exchange to snap up equities at bargain prices, particularly as the rental market is losing its appeal amidst the expat exodus and wave of Airbnb cancellations.

Institutional investors may also abandon the rented market for similar reasons. If institutional investors invest less in new-build, housing associations will face growing pressure to expand their rental stock. And all the more so if more households become eligible for social housing after suffering a fall in income. Housing associations have steered clear of new construction projects in recent years, partly because of the Landlord Levy. But political support to reduce this tax was already growing and will probably receive a further impulse from the current malaise. Because one thing is clear: the Netherlands must not make the same mistake as during the credit crisis when poor policy decisions led to stagnation in house construction and severely aggravated the national housing shortage.

Mortgage rates on the rise

One key variable for the owner-occupied segment is the mortgage interest rate. As noted, central banks are pulling out all the stops to keep lending flowing. Banks are happy to cooperate. Keen for rehabilitation after the credit crisis, they want to be part of the solution. That said, banks clearly face larger risks in times of recession. The higher credit risk is already priced into the financial markets. Despite central bank policy, banks are therefore confronted with higher borrowing costs. Against this background, there is a growing risk that mortgage rates will not fall further, but may actually rise.

The risk of higher mortgage rates will grow if competition in the mortgage market decreases. This could happen if, as during the credit crisis, foreign lenders opt to concentrate on their home market or pension funds decide to invest less in mortgages. One mitigating factor in this context is that Dutch homeowners enjoy mortgage interest relief and are therefore less vulnerable to rising mortgage rates than their counterparts in other countries. In addition, most recent mortgages have long fixed-rate periods and are therefore protected against the higher rates for the time being. Moreover, even after the increase, mortgage rates are likely to remain historically low.

Changing home preferences

Whether the coronavirus crisis will bring about a change in home preferences is impossible to say at this stage. Will the lure of the large cities grow even greater or will people rediscover the attractions of the more peaceful periphery? That is anybody's guess. But one thing is certain: working from home has received a major boost from the crisis. And home-based working may well remain the new norm for many once the crisis has subsided. In that case, people will become more demanding regarding their facilities at home. More than ever, they will appreciate an extra room where they can work in peace and an outdoor space for some fresh air.

The position of the elderly in the housing market will also come under the microscope. The ideal of the participation society is for senior citizens to stay in their home for as long as possible. But the current circumstances suggest that this solution may not be ideal for everyone. Loneliness is an ever-present danger for the elderly, particularly when going outdoors is difficult, such as in the present situation. Even before the crisis, it was clear that the trend for seniors to stay in their home longer was creating bottlenecks in the housing market and slowing down the drive for more sustainable housing. These problems, combined with the ongoing ageing process, make it imperative that we review our approach to elderly housing.

Lower population growth

Next, the development in household numbers. The harsh reality is that the virus has already exacted a high death toll and that the number of victims is set to rise further. Earlier population forecasts must be revised down. But nobody knows by how much. Another factor driving the number of households is migration. Will the number of migrants expand further as labour markets continue to internationalise or has a job abroad lost its lustre? In the latter case, the number of households will fall short of earlier forecasts. One countervailing factor is the expected rise in the divorce rate as relationships succumb to the strain of staying at home together. On balance, we expect the number of households to be lower than anticipated before the coronavirus crisis. Demand for housing will therefore be slightly lower than thought.

Even so, the efforts to expand the housing stock must continue. Because less rapid growth in demand will by no means eliminate the current shortages. New-build construction was already a challenge before the corona crisis. And the current uncertainty is not making it any easier. Many foreign construction workers have returned home. Permit applications and participation procedures can now only take place online, which is also causing delays in building projects. The supply of construction materials may stagnate due to the multiple restrictions that have been put in place. Finally, the increased risks are making it harder to raise funding for construction projects. One bright spot is that the falling nitrogen emissions due to the reduction in aviation and road traffic may create more environmental leeway for housebuilding. But aviation

and road traffic are not the biggest contributors to nitrogen emissions, so any additional environmental leeway from this source will be limited.

Worsening market outlook

All in all, we cannot escape the conclusion that the outlook for the housing market has taken a serious turn for the worse. The containment measures are in themselves sufficient to push transaction volumes significantly below normal levels, notwithstanding all the initiatives of estate agents to organise online viewings. Only a small portion of the deferred purchases will be made up later, as confidence in the housing market will be dealt a severe blow. Reduced affordability (due to lower income growth and higher mortgage rates) and structurally lower demand will keep the market subdued for some time to come.

Given the uncertainty about the duration of the containment measures, there is little point in making forecasts for house prices and transaction volumes. The best we can do is indicate a general direction. A weakening of the housing market usually becomes visible in the first instance in transaction volumes, and only later in price levels. We are counting on a sharp decline in the number of house purchases this year and a slightly smaller fall next year. Average prices will still display a modest increase this year - mainly because last year's price rise will feed through in the average price for this year due to the carry-over effect. Next year however, house prices will fall.

As a result, some households will once again see their mortgages sink under water. But the number of underwater mortgages will probably rise less quickly than during the credit crisis. Firstly, because of the extremely sharp rise in house prices in recent years (7.5% in 2017, 9% in 2018, 7% in 2019), secondly because most house buyers have an annuity mortgage and are making repayments, and thirdly because loan-to-value ratios are lower than before the credit crisis. If house prices fall further in the coming years (e.g. because of a longer-than-foreseen economic decline), more homeowners will be confronted with an underwater mortgage.

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