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Housing market monitor

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Low interest rates push up house prices

- House purchases postponed to beginning of 2021 due to lower transfer tax rate
- Tax adjustment boosts valuations; house price rise to record highs
- First time buyers hardly benefit from the tax change due to the continuing price increase
- DNB urges next government to curtail tax relief for owner-occupied homes
- Construction key to calming the heated housing market

We have again revised our estimates for the housing market upwards. For this year, we assume an average house price increase of 7.5%. Earlier, we assumed an increase of 5%. For next year, we expect an increase of 2.5% instead of 1%. The estimates for the number of transactions will remain unchanged for the time being. Transaction figures for the first two months of the year were indeed high. However, we think that this is temporary, as first-time buyers up to the age of 35 postponed their purchases due to the lower property transfer tax rate as of 1 January. This year, house purchases will fall by 10%, next year by 5%.

The number of transactions will fall as unemployment is expected to rise. If the government withdraws its support measures when the economy reopens, companies will restructure and job losses will follow. A weaker income outlook will affect the housing market, first through a decrease in transactions and then through weaker price growth. In addition to the expected deterioration of the labour market, there is another reason to expect a decline in the number of transactions: the lack of new construction. Partly because of the protracted nitrogen crisis relatively few building permits have been issued in recent years. The limited flow to new-build homes is slowing down transactions on existing homes.

The lack of new builds contributes to higher valuations on the housing market, especially when demand is strong as it is now. The demand for homes has increased because the pandemic has underlined the importance of housing, because the government has made adjustments, including lowering the transfer tax rate, but above all because the low mortgage interest rate has pushed down mortgage costs and thus contributed to better affordability.

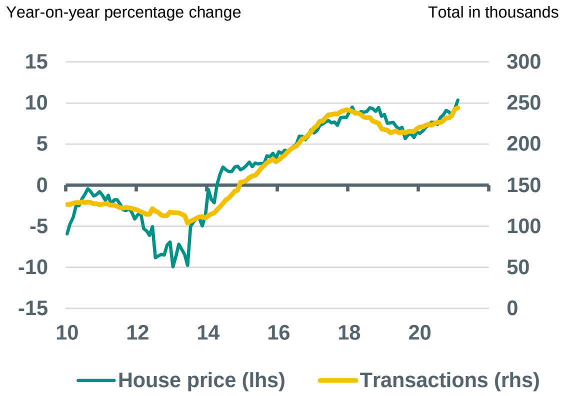
In recent months, government interest rates have threatened to rise on the back of higher inflation. But the ECB brought this rise in interest rates to a halt by buying up even more securities. The ECB's decisive action reinforces our expectation that mortgage rates will remain low for the time being. But the beneficial effect of low interest rates will diminish if they do not fall further. Therefore, and because we do not exclude that the next cabinet heeds the call of, among others, the Dutch Central Bank (DNB) to adjust the tax benefits of home ownership, we expect a somewhat lower price increase next year.

Growing optimism among home sellers

Confidence in the housing market continues to grow. In March, the Home Owners' Association's market indicator rose to 106, well above the neutral level of 100. Last June, at the end of the first corona wave, the indicator dipped to 93. These support measures ensured that incomes remained intact and that mortgage rates continued to fall. In combination with a tight housing supply, this contributed to a further rise in house prices. In February, the average purchase price of EUR 370,000 was almost EUR 50,000 higher than in February 2020.

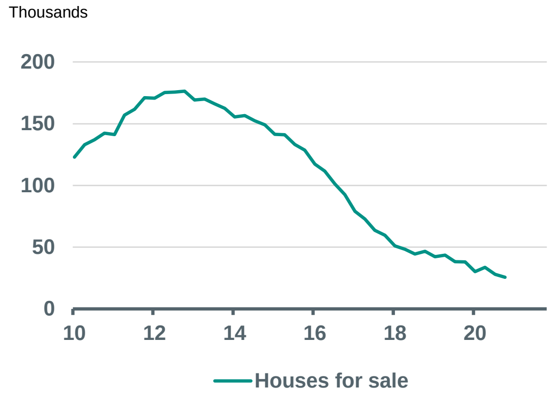
The continued rise in house prices is reinforcing housing market sentiment. According to the Funda index, the growing value of home ownership is contributing to optimism among sellers. On the other hand, those who want to buy a home face diminishing chances of purchasing a home as house prices continue to rise. The continuing rise in prices and the scarcity of houses on offer make potential buyers fearful of missing out and cause them to lose hope of success. For the time being, the effect of the first group, the sellers, is dominating, so that overall confidence is rising.

House prices and home purchases on the rise



Source: Land Registry

Number of houses for sale down further



Source: NVM

Strongest price increase in twenty years

In February, the price index of existing homes was 10.4% higher than in February last year. In order to achieve a similar sharp increase, we have to go back twenty years. Not only in a historical sense are house prices rising fast, also compared to other countries. According to figures from the DallasFed, house prices worldwide rose by an average of 4.2% year-on-year in the third quarter of 2020. In the Netherlands, the percentage was almost twice as high at 8.1. This is not a new phenomenon. Historically, Dutch house prices show larger fluctuations, both upwards and downwards. This is because the construction of new homes reacts slowly to changes in demand.

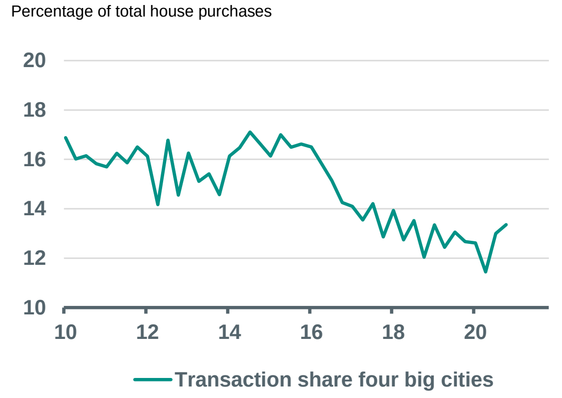
What is also striking is that the price increase of apartments no longer outstrips that of the other types of housing, but is below it. This is probably due to the fact that apartments are mainly found in the four major cities. After years of being above the national average, the price increase in the four major cities has been below the national average since the third quarter of 2019. Possible reasons for this are that fewer and fewer people can afford a home in the big cities and that the big cities are proportionally suffering more from the economic downturn due to corona.

More interest in living outside the city

Another explanation for the lower house price increase in the large cities is that interest in living outside the city is increasing. Estate agents signal a growing interest in houses in villages and outside the Randstad conurbation. Land registry figures confirm that when house owners in the four major cities move, they more often opt for a house outside the city. In 2020, for example, this applied to five out of ten Amsterdam homeowners moving. In 2010, this was only the case for three. People moving house are also moving further afield. The average distance is 44 kilometres. That is 7 kilometres further than in 2015.

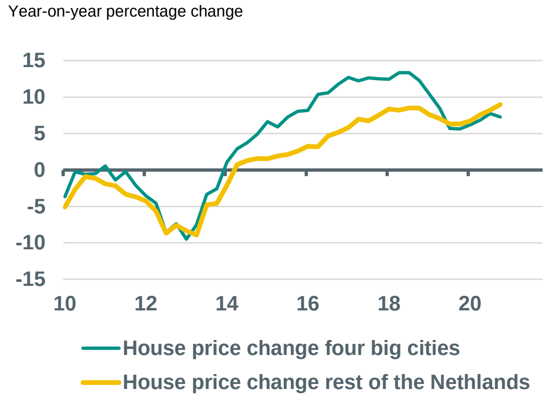
Will the expectations of the 1990s still be fulfilled? Back then, people were expected to leave the city because the Internet made it possible to work remotely. But the opposite happened. The emerging knowledge economy actually increased the need for mutual contact, which made people want to live closer to each other. The current pandemic is breaking this trend. The high population density is a source of risk for contagion. The facilities that make living in a city attractive are no longer accessible due to the lockdown. And *social distancing* forces people to work from home as much as possible.

Share of four large cities in transactions down



Source: Land Registry

G4 price rise below that of rest of the Netherlands



Source: Land Registry

In our opinion, these factors are largely temporary. The 'market' also seems to assume this. Research shows that rents in the densely populated American city centres are under more pressure than house prices. Because the focus with renting is more short-term and with house prices is more long-term, the 'market' therefore assumes a renewed popularity of the city as soon as immunity improves and facilities are accessible. On the other hand, two or three days at the office will probably become the new normal. Living close to work therefore loses some of its allure, which may lead to a little more dispersion.

Investors active in run-up to transfer tax increase

Recent transaction figures have already signalled some recovery in the popularity of the four big cities. In the second quarter of 2020, purchases there fell to 6,300 and the share in transactions dropped to 11.4%, a low point. Then, in the fourth quarter, there were 8,900 purchases and the share of the four big cities grew to 13.4%. The recovery may also be due to private landlords. They bought more houses in the fourth quarter because of the increase in transfer tax for investors on 1 January. Traditionally, they focused mainly on the four major cities, where they accounted for no less than 40% of purchases, according to the Land Registry.

Private investors now play a more active role in the Dutch housing market. Over the past ten years, they have been involved in 15% of all purchases. However, because they regularly traded among themselves and also regularly sold homes, their share in the housing stock grew less rapidly. In the period 2017-2020, it rose from 7.5% to 8.4%. It is noteworthy that the share of smaller private and medium-sized professional landlords in particular increased, while that of really large landlords with more than 500 dwellings remained the same at 2.1%.

Large landlords are often backed up by institutional investors which also invest in new buildings. The housing market could do with more new-build rental housing in the mid-segment, but unfortunately it is not getting off the ground. Investors complain that they are unable to get a foothold with municipalities, which are said to be charging too high a price for land and threaten to make the same mistake as during the previous crisis by considering a construction freeze for reasons of cost-cutting. They are also displeased with the rental restrictions announced by the government, which they say are damaging returns. Finally, the Verhuurderheffing (landlord tax) and the higher transfer tax are pushing up costs. The private landlords argue that the series of measures is an obstacle to the construction of new houses and to making them more sustainable.

Slightly higher share of young people in housing transactions

The smaller private landlords focus mainly on existing housing. Their tend to prefer houses in neighbourhoods where young starters also want to live. This sometimes makes it difficult for younger buyers to get into the market, especially as they cannot take home any surplus value from a previous home. The proportion of transactions involving buyers up to the age of 35 has been steadily falling in recent years, but has shown some improvement since 2019. In the first months of 2021, there was an extra boost because the government scrapped the transfer tax for first-time buyers. Since 1 April, however, the restriction that the house may not be more expensive than EUR 400,000 has applied. This will give an extra impulse to house purchases in the first quarter.

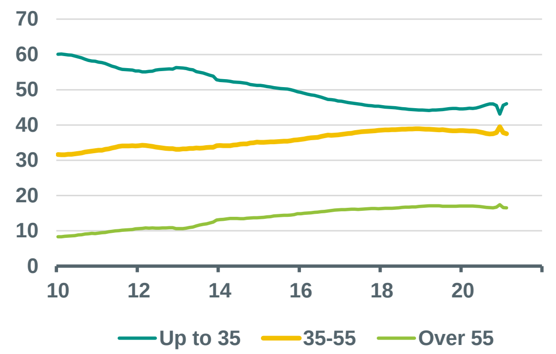
Growing share of investors in dwelling stock

Percentage of dwelling stock

Source: Land Registry

Lower share of young people in home buying

Percentage of home purchases by age group



Source: Land Registry

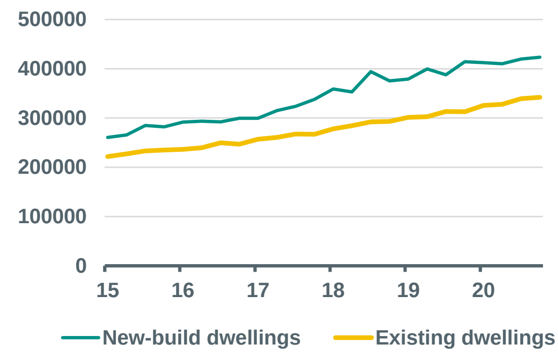
It is uncertain whether the scrapped transfer tax will really make a difference for first-time buyers in the longer term. In January and February, house prices rose by 2.5% and 1.1% respectively compared to the previous month. This increase is difficult to see in isolation from the easing of restrictions that took effect on 1 January. In addition to the adjustment of the transfer tax for first-time buyers, the NHG threshold and the maximum mortgage for couples based on their income, and for those with student debt, were also raised. The price increases prove that relaxing the rules in an already heated market helps sitting owners rather than first-time buyers.

The Netherlands is not the only country where young people have difficulty accessing the housing market. For example, Over eight out of ten Americans born in the 1940s had their own home by the age of 35. Among Americans born in the 1980s, the ratio is much lower, at most six out of ten. The picture is not much different in European countries. Important causes of the decline are the larger income differences and the flexibilisation of the labour market. Without a permanent job contract, taking out a mortgage is more difficult. The Netherlands is an exception in that respect. Thanks to adjustments, mortgage lenders have been able to deal more flexibly with applicants without a permanent job contract for a number of years now.

Reduced access to owner-occupied housing has consequences for the accumulation of wealth. Because younger generations buy their own homes at a later stage, they build up fewer home equity than earlier generations. This gap is also not fully compensated by other forms of wealth accumulation. Younger generations are therefore financially less well off. The current crisis does not make things any better. Young people have become more unhappy. This is shown in the United Nations WorldHappinessReport. Many young people work on a flex basis and are employed in hard hit sectors. The increased uncertainty affects their mental health.

Relatively high increase in the price of new builds

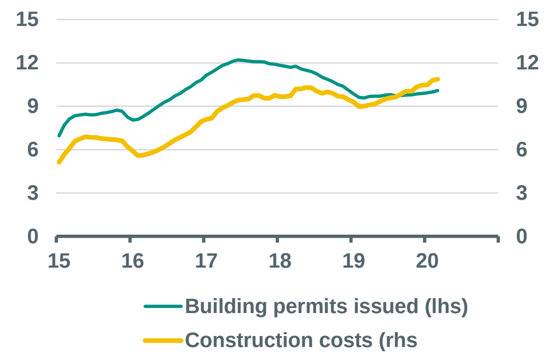
Purchase price in thousands of euros



Source: CBS

Fewer building permits due to nitrogen crisis

Thousands billion



Source: CBS

Lack of new construction props up price levels

The way forward for young people (and other people looking for housing) is to build more houses. But unfortunately that is easier said than done. Given the limited number of building permits that have been issued and the ongoing problems with nitrogen, the number of homes built will also be disappointing in the coming years. Despite all efforts to transform offices and shops into homes, the housing shortage is expected to increase. The shortage of newly completed homes is threatening the flow through to new-builds. The reduced flow to new-builds also dampens the number of transactions for existing homes.

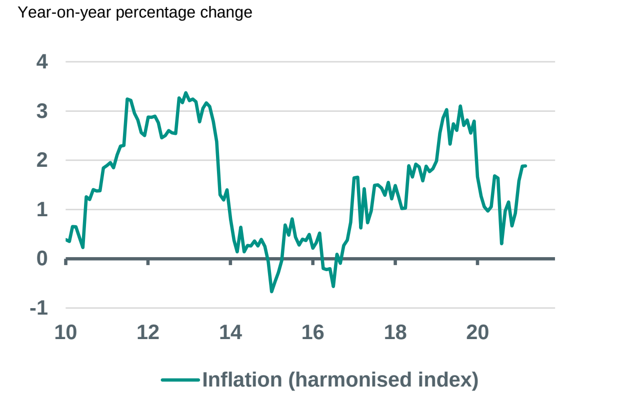
The ongoing housing shortage is pushing up price levels. On the other hand, disposable incomes will grow less fast in the coming years. If the government withdraws support measures for businesses, reorganisations will follow and unemployment will rise. We expect unemployment to rise from 3.6% today to 5.5% by the end of 2022. With the threat of job losses, the prospects for wage growth are moderate. Moreover, compensation in the form of government tax cuts is not on the cards due to the deterioration in public finances. The pressure on disposable incomes encumbers the affordability of the housing market and thus puts a lid on further house price developments.

Low mortgage rates gradually provide less support

Besides disposable income, house prices will also receive less support from mortgage interest rates. These have been falling steadily in recent years, so that mortgage interest charges have been steadily falling and the affordability of owner-occupied homes has been improving. But it remains to be seen whether mortgage rates will fall any further. In fact, it cannot be ruled out that they will rise again in the long run. In recent months, the interest rate on government issued loans, an important indicator for mortgage interest rates, has been creeping up slightly.

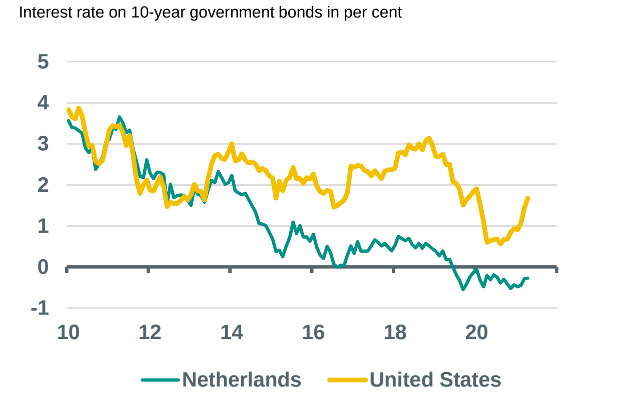
The rise in government bond yields is due to renewed inflationary fears. The prices of consumer goods and services are rising because of higher oil prices, higher international freight tariffs due to logistical problems and shortages of computer chips. In addition, Germany has reversed some temporary tax cuts and the US government has launched a very large spending programme. Financial markets fear that this will lead to a sustained increase in inflation. That is why investors are demanding higher interest rates.

Inflation up sharply due to temporary factors



Source: Refinitiv

Capital market interest rates on the rise,



Source: Refinitiv

The rise in interest rates has occurred mainly in the US, where inflation fears are stronger than in the eurozone, partly because the stimulus measures of the US government are much more extensive than in Europe and there is less overcapacity in the economy. On top of that, the ECB wants to prevent interest rates from rising. In the ECB's view, the rise in interest rates poses a threat to economic recovery. That is why the ECB recently decided to buy even more debt in order to curb the rise in interest rates. The interest rate on 10-year loans issued by the Dutch government now stands at -0.3%, 20 basis points higher than at the beginning of this year, while the interest rate in the US rose by 90 basis points to 1.7%.

We assume that the ECB will stick to its policy. There is also room for this, because we think that the factors behind the rise in inflation are temporary, which means that the upward pressure on interest rates will eventually disappear. As a result, and because of the fierce competition on the mortgage market, mortgage rates will remain low for the time being. In the short term, the combination of low mortgage interest rates and temporarily higher inflation could boost house prices, as real mortgage interest rates (i.e. nominal mortgage interest rates corrected for inflation) will be negative. In the longer term, when inflation subsides and nominal mortgage rates stop falling, the stimulating effect of mortgage rates on house prices will disappear.

Calls for further reforms

A final factor that may affect affordability is the tax treatment of owner-occupied homes. DNB and the European Commission, among others, are urging adjustments because tax relief leads to distortions, both of the economy and of the housing market. The role of the DNB is limited to signalling. The European Commission actually has carrots and sticks for the next government. In order to gain access to the resources of the European Recovery Fund, the Member States must implement reforms, a condition that the Netherlands itself introduced when the Recovery Fund was established. One of the reforms that the European Commission is now demanding from the Netherlands in exchange for funding is reform of the housing market.

It is uncertain what the next cabinet will look like and what measures it has in store for the housing market. In several respects, such as greater control over housing construction, the proposals of the various parties are in line with one another. However, the most likely future coalition partners, D66 and VVD, hold diverging views on the tax benefits of owner-occupied homes. According to the party programmes, D66 is in favour of adjustment, whereas the VVD is not. What happens, therefore, will ultimately depend on which parties join. On the right side of the political spectrum, the position of the CDA is unclear. On the left flank, there is a preference for adaptation. Whatever happens, it is important that the tax system surrounding the owner-occupied home is simplified. The current regulation is too complex to comply with by home owners or even to enforce by the tax authorities.