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Housing market monitor

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Housing market at boiling point

- Price estimates again revised upwards due to higher realisations
- Lack of homes for sale hinders number of transactions, but less than previously anticipated
- End of decline in mortgage rates will allow overheated market to cool
- Pressure on next government to implement structural reforms grows.

We are again adjusting our housing market estimates. The continuing rise in prices means that this year's average will be higher than previously thought. For this year, we therefore expect prices to rise by 15%. Previously, we assumed a price increase of 12.5%. The upward revision of this year's price increase will be reflected in next year's average price increase, so that the estimate for 2022 will also increase from 5% to 10%.

The number of transactions is decreasing, but is higher than expected. That is why we are also adjusting our estimates of home purchases. This year transactions will decline by 5%, next year by 10%. Last report it was exactly the other way around. The net result is that the number of purchases will be slightly higher than expected this year, but next year will be more or less the same as last time: around 200,000.

Transactions are under pressure because there are very few homes left for sale. This makes it very difficult for buyers to find a suitable, affordable home. The lack of supply contributes to the sharp rise in house prices. Many buyers bid above the asking price, often with a generous margin. At EUR 402.000, the average purchase price is now EUR 153,000 above the level of five years ago.

Despite this increase, net housing costs as a percentage of net income remained relatively low. This is mainly due to the decline in mortgage interest rates. But this decline may be coming to an end. Due to increased inflation, interest rates on financial markets have risen. As a result, the costs of mortgage lenders are rising. So far, this has hardly translated into mortgage rates. But that has changed this week.

The slight increase in mortgage interest rates may coincide with new measures from The Hague. Last Budget Day, the cabinet released some money for the acceleration of the construction, but it did not take far-reaching measures. That would not have been appropriate given the caretaker status of the government. But a subsequent government cannot ignore the problems in the housing market. There is a chance that sacred cows will once again be sacrificed, for example with regard to the fiscal treatment of owner-occupied homes. It was the same with the previous Rutte governments.

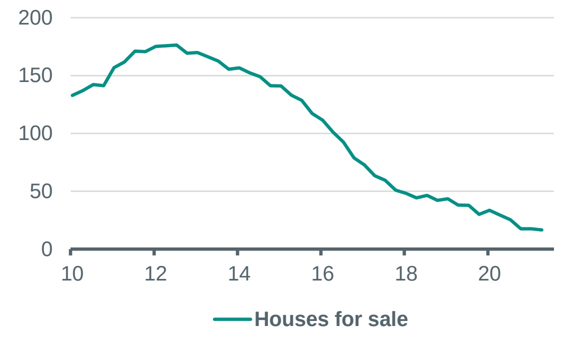
First buy then sell

The number of houses for sale continues to fall. According to broker association NVM, in the third quarter there were less than 17,000. Due to the lack of supply, buyers have to act immediately when they find something suitable. The homes sold by NVM affiliated brokers were for sale for an average of only 23 days. The effort it takes to find a new home does not encourage people to bring their own house on the market. Moreover, with the current price rise, it pays to postpone that moment. This pushes supply down even further.

With so many bidders on the market, many buyers feel compelled to bid above the asking price. According to the NVM, this happens in as many as eight out of ten home purchases, often with a generous margin. Against this background, it is logical for house prices to rise, but as fast as they are now does surprise. According to CBS Land Registry figures, house prices in August were 17.8% higher than a year ago, while the average annual price increase since 1995 has only been 5.1%. The recently published price figures of NVM, which are somewhat ahead of the figures from the Land Registry, point to a further increase in the coming months.

Number of houses for sale drops sharply

Number in thousands



Source: NVM

More and more buyers bid above the asking price

As a percentage of the number of transactions

Source: NVM

Price increase is even stronger than in other countries

Compared to other countries, where prices are also rising sharply, the price rise in the Netherlands is high. Price movements here are also more volatile than in other countries, with higher ups and downs. That is a disadvantage, because it contributes to the emergence of so-called unlucky and lucky generations with large differences in wealth accumulation that are not necessarily related to individual merit. In addition, it impedes mobility on the housing market, which hinders individual development opportunities and reduces the potential for economic growth. This fuels political discontent, as recently expressed in the housing protests.

House prices are also rising sharply in relation to average income and rental trends. However, these yardsticks do not provide an accurate picture of the affordability of owner-occupied housing. For that, fiscal aspects and interest rates also need to be taken into account. Calcasa has a measure that compares net housing costs with net income. Based on this, the housing market is, historically speaking, relatively affordable for those with an annuity-based loan (33.4% compared with the historic average of 33.9%) and relatively cheap for those with a grace period (13.8% compared with a historic average of 20.3%). Because of the repayment obligation introduced from 2013 onwards, the burden for first-time buyers with an annuity-based loan is significantly higher than for home owners with an interest-only mortgage.

There is not much variation in price rises between the various types of houses, price categories and construction years. There is more difference between the various Dutch provinces. In provinces with a lower average price level, such as Groningen, prices are currently rising fastest. But at EUR 276,000, the average house price there is still EUR 183,000 lower than in North Holland and EUR 90,000 below the national average. The price difference between the Randstad and the provinces outside it remains sizeable.

Difference in regional purchase prices has decreased

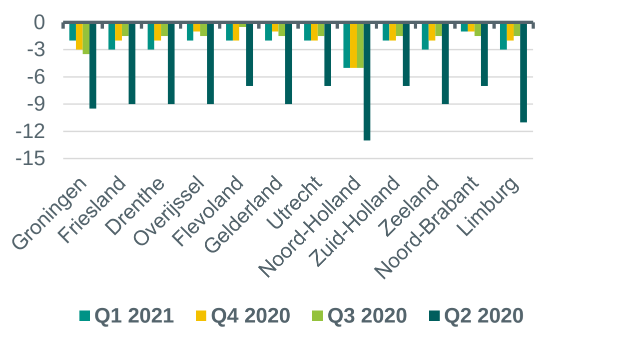
The catching up of the provinces outside the Randstad has not so much to do with the corona-enhanced trend of working more often from home and the related shift in housing preferences. Indeed, research by the Netherlands Environmental Assessment Agency (PBL) shows that although the proportion of people working from home has risen from 37% in 2013 to 41% in 2019 and 46% by the end of 2020, this has not led to large-scale relocations. As a possible reason for this, PBL argues that people regard working from home as temporary.

Furthermore, commuting gives an incomplete picture of how often and how far people travel. Japanese mobile phone data show that most transport movements are not so much related to work, but rather to all kinds of services that people consume. The distance to these services is then just as important a variable in the decision where to live as the travel time to work. This is also consistent with the PBL finding that people have begun to attach even greater importance to the social and physical quality of their living environment since Corona.

The main driver of regional relocation movements, according to OECD research, is GDP per capita. When that rises, the attractiveness of a region increases. Second in line is the price level. A higher price makes the region less attractive to newcomers. The development of unemployment also plays a role. If unemployment rises, the interest in moving to a region weakens. Looking at the Randstad, we can see that, compared to the other provinces, the economy suffered a relatively severely during the corona crisis, that unemployment rose more sharply and that house prices were much higher after years of rising prior to the crisis. The OECD's findings therefore also seem to apply to the Netherlands.

Effect of corona on GDP differs by region

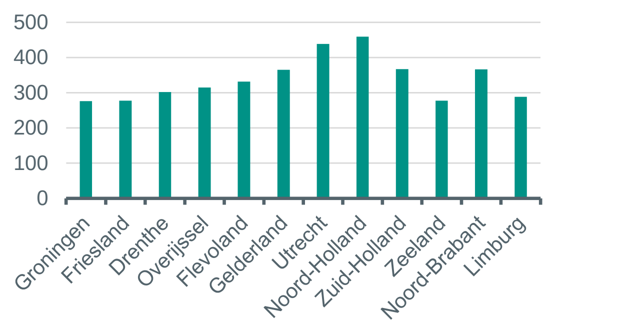
Percentage of GDP growth



Source: CBS

Provincial price levels vary widely

Average purchase price in thousands of euros



Source: CBS

That said, during periods of sharp price rises, buyers will have to compromise more on their housing preferences and increase their search scope in order to find a suitable home. This is particularly true for first-time buyers, who have less savings than those who are moving up the property ladder and are therefore more likely to run up against the limits of their financial capacity when buying a house. Research by the Land Registry shows that the average moving distance has increased by 27% for first-time buyers since 2013, while the moving distance for those who move on has only increased by 3%.

Fewer house purchases after a good start to the year

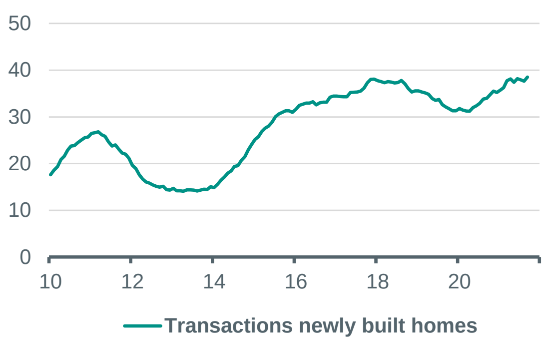
While house prices are rising faster and faster, transactions are on the decline. In the first few months of the year, the number of transactions was still at a record high, as first-time buyers had pushed home purchases beyond the year in order to benefit from the reduction in the transaction tax. But things have now taken a turn. The number of house purchases is declining. In the twelve months up until August, 243,000 existing homes were sold, compared to 251,000 in the twelve months up until April.

The situation is not much better for newly built houses. Here too, supply is limited and purchases are falling. At the start of the housing crisis, project developers brought forward the sale of new homes in order to reduce business risk. At the time, this led to an increase in the number of newly built house transactions. Now, with a lack of stock, the sales brought forward are actually causing a fall in the number of purchased houses.

The stock of new houses is unlikely to increase rapidly. The number of building permits issued is rising, but is still insufficient to meet the growing future demand for housing. Moreover, many construction projects have been delayed by the nitrogen and PFAS crisis, which still obstructs construction. Furthermore, the construction sector is facing production bottlenecks due to the lack of personnel and increased material costs.

Increase in new-build transactions stagnates

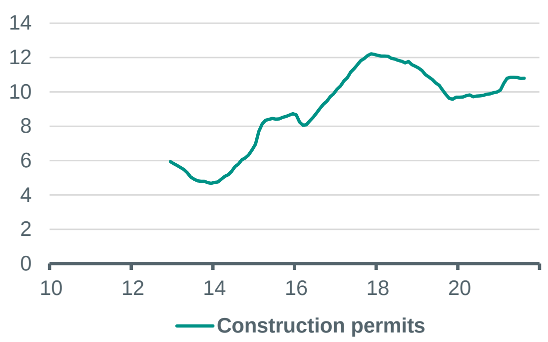
Number of last twelve months in thousands



Source: CBS

Improvement in the issuing of building permits

Number of last twelve months in thousands



Source: CBS

Government sets aside money to speed up housing construction

Fortunately, there are also bright spots in housing construction. In view of the current housing shortage and the continuing population growth, no less than 900,000 homes will have to be built by 2030. Experience shows that not all plans are realized and that 30% more plans are needed than the target. With plans for 960,000 homes, the planning capacity is now not far off the required number of 1,170,000. This hurdle has therefore almost been taken.

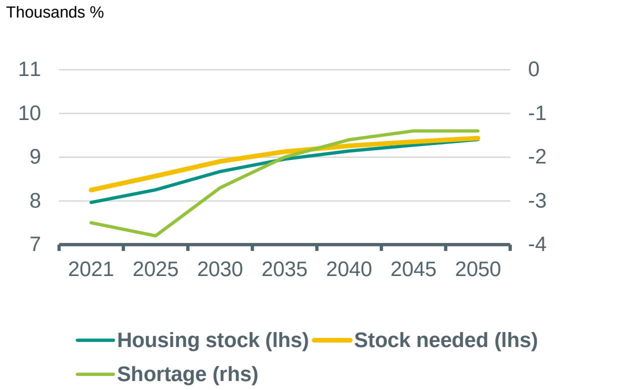
The task now is to accelerate the pace of construction beyond the earlier, too low target of 75,000 houses per annum. Last Budget Day, the Cabinet again earmarked funds to accelerate the pace of construction. It announced that it would be investing EUR 100 million annually over the next ten years. It also extended the scheme for building homes for vulnerable groups (homeless people, status holders, students) until 2025 annually EUR 10 million will be available.

However, housing construction is not just about money. Objections from local residents regularly result in construction being delayed. Inadequate communication is one of the reasons for the postponement and cancellation of housing projects. The participation of local residents therefore requires more attention. The government's so called 'flexpools', which support local and provincial authorities in the preliminary stages of the construction process, could help here.

Housing shortage is not the only explanation for the steep rise in prices

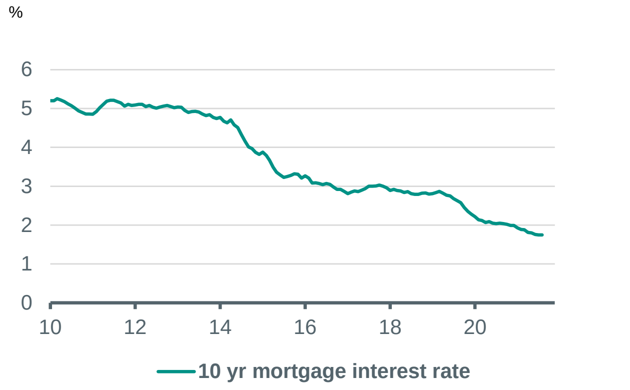
According to the most recent figures, the Netherlands is 279,000 homes short. Before the crisis, this figure was still 331,000. Despite this decline, prices have continued to rise. Without wishing to understate the problem of the housing shortage, this scarcity movement calls into question the oft-repeated suggestion that the price rise is due to the housing shortage. At the very least, other factors are at play.

Housing construction lagging behind demand



Source: Primos

Mortgage interest rates fell further



Source: DNB

One such factor is that, in the case of housing, many people regard recent price developments as a guide to future price trends. Unlike in consumer goods, where buyers expect periods of high prices to alternate with periods of low prices, many home buyers extrapolate recent price information into the future. If purchase prices rise, they count on a further increase. Hence, a rise in prices is a reason to strike quickly in order not to miss out on the ride of further price increases.

Buyers can borrow more thanks to lower mortgage rates

The question remains as to what caused the initial price impulse. In our opinion, it is the increased awareness of the problems in construction combined with the development of mortgage rates. Since the start of the corona crisis in March 2020, 10-year mortgage rates have fallen by 37 basis points to 1.75% in August. This allows buyers to take out more mortgage at the same monthly cost based on their income. Since the mortgage space is leading for many buyers in home purchases, this extra credit space is partly translating into house prices.

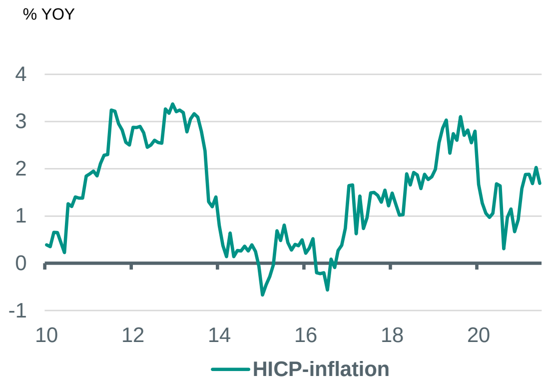
The fact that mortgage interest rates fell so sharply was due to the relatively favourable financing conditions on the capital markets. CDS spreads show that the risk premiums are manageable for banks. Investors' confidence is bolstered by the fact that few businesses failed and employment levels were maintained during corona, partly thanks to government support. The number of problematic loans and their write-offs remained limited during the corona crisis. As a result, the capital buffers that banks increased in the run-up to the corona crisis remained intact.

Another factor contributing to the favourable financing conditions is the low interest rate on government bonds. This is an important benchmark for the burden on banks and therefore for mortgage rates. In the period March 2020 August 2021, the 10-year interest rate on Dutch government bonds decreased by 10 basis points to -0.3%. Low inflation and the policies of central banks, which bought up debt on a large scale, contributed to this decline.

Rising inflation leads to rise in capital market interest rates

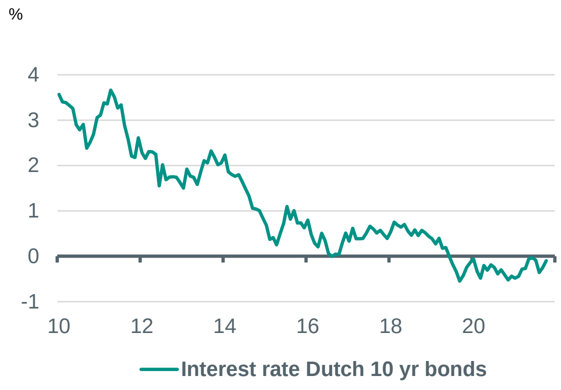
But interest rates on government bonds have actually risen in recent months. Investors are demanding higher interest rates because of the recent rise in inflation. With this in mind, they are anticipating a tighter monetary policy. Indeed, several central banks have already adjusted their policy (Norway) or are hinting at it (United States). The European Central Bank (ECB), on the other hand, is still cautious.

Inflation rises sharply, mainly due to energy



Source: Refinitiv

Higher inflation affects government interest rates



Source: Refinitiv

The ECB has doubts about whether inflation will remain high in the longer term. It sees the main factors behind the rise in inflation (higher energy prices, shortages of semiconductors and lack of offshore transport capacity) as temporary after-effects of the corona crisis. Once these are over, inflation will ease. The intention to include the cost of home ownership in the inflation measure from 2026 will also have little impact. This may make a difference for the Netherlands (inflation would be 0.5 percentage points higher according to this measure), but for the eurozone as a whole the decision makes less of a difference given the 0.2 percentage point higher outcome.

Apart from the doubts on the longer-term inflation outlook, the ECB has another reason to be cautious on monetary policy tightening. The ECB wants to avoid making the same mistake as during the financial crisis. At the time, it raised interest rates too early and had to reverse them soon after the euro crisis erupted.

Fierce competition keeps mortgage lenders from raising interest rates

Despite the signals that the ECB will wait with tightening monetary policy, capital market interest rates are also rising in the eurozone. The Dutch 10-year interest rate is now at 0.0%. Mortgage lenders have waited to pass on the resulting higher costs. Fierce competition and the threat of losing market share are deterring them from raising mortgage rates, all the more so since buyers are very sensitive to the interest rate offered when choosing a mortgage. More so than other mortgage-related costs, according to research in the United Kingdom.

But the question is, whether mortgage lenders will be able to keep this up for much longer. We assume that mortgage rates may rise slightly in the coming period. This is also because the Dutch Central Bank (DNB) recently decided that banks need to hold more capital from 2022 when they provide mortgages. DNB wanted to implement this measure earlier, but postponed implementation due to the corona crisis off. Now the economy is doing better and house prices are rising so fast, the moment is right according to DNB. The measure leads to a further increase in costs for mortgage lenders.

Government raises barriers for investors

The recent rise in interest rates in capital markets is also likely to affect investor appetite for rental housing. Indeed, higher interest rates erode returns on credit-financed residential investments. Their appetite is further affected by the series of government measures, such as the restriction on rent increases, the cap on the WOZ value in the housing valuation system. Furthermore, from next year municipalities may introduce buy-out protection in popular areas and there are plans for a landlord license. This should enable municipalities to keep out rogue landlords. Recent figures from DNB confirm that enthusiasm for real estate is waning. The volume of investments in commercial property in the Netherlands was disappointing this year: not EUR 21 billion as expected, but EUR 5 billion.

An end to the fall in interest rates could bring some calm to the now seriously heated housing market. What will also cool the market down are interventions in the tax treatment of owner-occupied homes. DNB and the International Monetary Fund recently called for this once again. On Budget Day, the government did not present any major reforms in this area. It only introduced a few legal changes to prevent unintentional restrictions on mortgage interest relief. More drastic measures would also not be appropriate for the caretaker status. A subsequent cabinet, however, could decide to do so.

Adjustment of forecast house prices and transactions

Against this background, we expect the market to become less heated in due course. The decline in the number of transactions will continue, in our view. The rise in prices will also gradually ease to a more normal level, which is in keeping with the slightly lower level of confidence in the housing market, as indicated by the Dutch Home Owners' Association's market indicator. Once again, we have to acknowledge that the downturn will come later than previously predicted. This means we have to raise our estimates again compared to last time. House prices will not rise by 12.5% this year but by 15% and next year by 10% rather than 5%. The number of transactions will not fall by 10% this year, but by 5%, and next year by 10% rather than 5%.