Housing Market Monitor

Group Economics

Netherlands

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New-build gap not yet closed

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- **Lack of housing continues to push up prices …**
- **... and puts a brake on house purchases**
- **New construction picking up, but not enough to close the gap**

The transaction volume continues to decline. The deceleration was initially confined to the Randstad conurbation, but is now also visible in the other provinces. One important reason for the drop is the substantial housing shortage. The number of properties for sale is falling. So buyers have less and less choice. We expect purchases to decrease further.

The lack of housing continues to drive up valuations. In August the price index for pre-owned housing rose 9.3% yoy. The average price level is now 3.7% above the pre-crisis level. But there are large regional differences. Due to the higher-than-expected outcome in August, we have slightly raised our estimate for this year. We expect prices to continue climbing, but at a steadily slower pace.

New construction is adding to the housing supply, but stills falls well short of demand. Government has largely devolved the responsibility for achieving the house construction target to municipal level. Boosting house construction is therefore a key priority in the recent municipal coalition agreements.

In addition, the agreements outline initiatives to promote housing mobility. Making the housing stock more sustainable is also high on the municipal agenda. As this subject is still in its infancy, the municipalities have welcomed the new Crisis and Recovery Act which gives them more scope to experiment.

Price and transaction forecasts

	Transactions (% yoy)	Prices (% yoy)
2017	12.6	7.6
2018	-5	9 (8.5)
2019	-5	7

Source: ABN AMRO Group Economics

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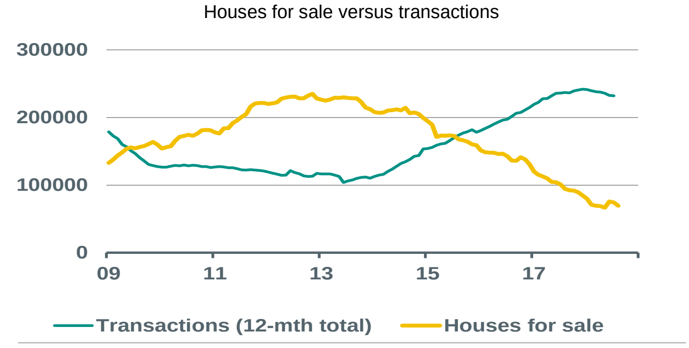
House purchases fall due to supply constraints

Despite high demand, the house transaction volume is weakening. In the twelve months until the end of August, 232,000 properties were purchased, 10,000 less than the peak in December last year. Historically, the number of transactions remains high.

The decline in the number of purchases is mainly attributable to the Randstad conurbation, where transactions have been under pressure for some time, particularly in the large cities. But the flagging momentum is now visible everywhere. In the second quarter, the house purchase volume was down on last year in virtually all provinces. The only exception was Groningen, which showed a tiny increase in transactions.

Limited choice for house buyers



Source: Statistics Netherlands (CBS), Land Registry

The reason for the slowdown in purchases is the limited supply. Buyers have little choice and are struggling to find a suitable home. According to home search website *huizenzoeker.nl*, there were only 70,000 properties for sale in August, 25,000 less than a year ago. The situation is the most acute in the Randstad conurbation and the larger cities.

Number of young buyers is shrinking

The strongest decline in purchases is among younger buyers. The transaction volume among the group up to 45 fell in the twelve months until the end of June 2018 by 2.9% compared to the previous year. The purchases of the group older than 45 only decreased by 1.3%. The shift in transactions between generations has been going on for a while. Younger buyers now only account for two thirds of total transactions, as opposed to three quarters previously.

The larger proportion of older buyers in the number of transactions partly reflects the ageing population: seniors account for a steadily growing share of the population. Another factor is that today's seniors are more affluent than earlier generations and more likely to own their own home.

But these are not the only causes of the shift. Due to the more stringent mortgage criteria, it has become harder for young people to buy a home. They have not yet had sufficient time to put aside the necessary savings.[1] An added difficulty is that more

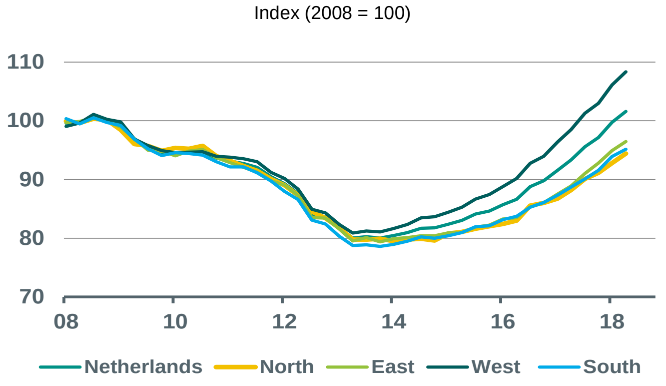
[1] According to figures of HDN, the average first-time buyer deposit was EUR 39,000 in the second quarter of 2018 while the average purchase price was EUR 280,000.

young people are on flexible employment contracts, which could make it harder to obtain a mortgage. Finally, young people of today tend to borrow more for their studies. A large student debt limits the mortgage amount they can borrow.

What you ask is what you get

Tightness in the housing market is fuelling prices. In August house prices rose by no less than 9.3% yoy. The price level is now 3.7% above the pre-crisis peak, with the average purchase sum running at EUR 294,000. The sharpest rises are in the lower price segments. Apart from first-time buyers, many investors are also active in this segment. They contribute their own funds and are less dependent on credit, which means they can close deals quickly.

Prices at record level, but with regional differences



Source: Statistics Netherlands (CBS), Land Registry

The tight market is compelling buyers to act fast and bid high. In the second quarter, homes sold by members of the Dutch Association of Real Estate Agents (NVM) were only on the market for 45 days on average. Detached properties took a little longer to sell, but the other types were sold within about a month. In about half of the transactions, the buyers offered the asking price or more. The difference between the last asking price and the actual selling price has shrunk to virtually zero. All of which confirms that the current market is a typical seller's market.

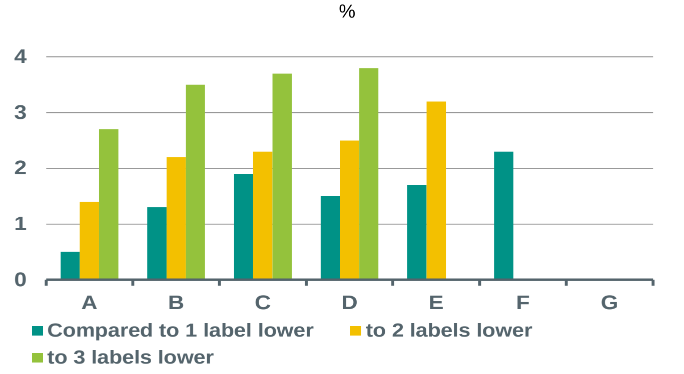
Their increased bargaining power is enabling sellers to up their asking price. According to home search website *huizenzoeker.nl*, the average asking price for pre-owned homes was EUR 382,000 in August, more than12% higher than a year ago. But the upward momentum has weakened slightly in recent months. The reasons can only be guessed at. Growing concerns about the international economy may be a factor.

Energy performance influences price level

The situation regarding the energy-efficiency requirements for homes has become clearer in recent years. In 2015, all existing properties were issued with a provisional one-star energy performance certificate (EPC) based on generic data. An owner who has made improvements to his home can request a provisional upgrade to a higher band (second star). The EPC only becomes definite after an expert energy audit. This can be done at a distance on the basis of photos, in which case the EPC rating is upgraded with a third star. An on-site audit provides more assurance regarding the performance and can result in a fourth star.

To conclude a transaction, home sellers must now be able to provide an EPC. Data from Calcasa indicate that a definite EPC is now handed over for 85% of the transactions. Further analysis shows that the EPC rating influences the transaction price. The higher the rating, the higher the selling price. Calcasa has compared transactions of properties with a similar location, type and construction year but a different EPC rating and has concluded that the selling price per square metre is on average 2% higher for a one-star difference, 2.8% for a two-star difference and 3.6% for a three-star difference.

Effect of EPC rating on house prices



Source: Calcasa

The above figures indicate that home energy improvements make a lot of sense. Apart from being greener, more comfortable and cheaper (lower energy bill), improved energy efficiency also enhances the value of the property. Despite all these advantages, homeowners are still slow to embrace sustainability. A recent survey by IG&H shows that half of homeowners are willing to make energy upgrades, but only an eighth have actually taken concrete steps in this direction. Funding is often the stumbling block. But many owners also lack information about the available types of improvements, the financial consequences and how to get the work done.

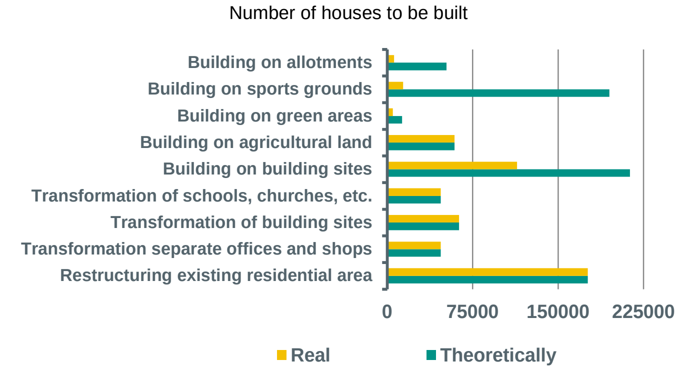
New-builds show same trends as pre-owned properties

New-build prices are rising even faster than pre-owned prices. This is largely due to the changing composition of sold new-builds. During the crisis, the new-build housing stock was largely aimed at first-time buyers. The properties that are currently coming onto the market are primarily targeted at home movers. One new phenomenon is that new-build properties are increasingly being sold in a bidding process. Formerly this only happened with pre-owned properties. Another is that a growing number of older buyers are moving into new-builds. Previously this mainly concerned young families.

New-build sales are showing a similar trend to pre-owned properties. Here too, the number of transactions is falling: 36,000 homes were sold in the twelve months until the end of July, 500 less than in December. The decline is mainly because of the shortfall of completions and the shrinking stock. Demand, by contrast, is huge. New-builds that come onto the market are rapidly snapped up. So there is an urgent need to build more new homes.

It is estimated that an extra 1 million new-builds are required between now and 2035. Over half of these must be realised before 2025. According to the current forecasts, a quarter of the target is needed to replace properties that are ripe for demolition. If even more homes need to be demolished to achieve the CO_2 reduction objective, the house construction target may have to be raised even further. A substantial portion of the new housing must be built in existing urban areas. A spatial feasibility analysis carried out by Van den Brink Management for Neprom indicated that most urban new-build development will take place on sites where homes must be demolished first.

Where can new urban housing be built?



Source: Neprom

Labour and material shortages impede new-build development

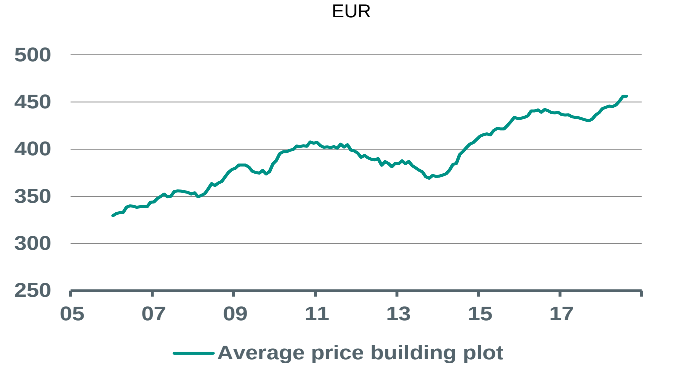
Boosting new-build construction is far from easy, as is clear from the faltering growth in the number of completions. Labour shortages are a big obstacle. In the period 2009-2016, 30,000 newly trained workers flowed into the sector, while 90,000 left: natural wastage accounts for two thirds of the departures, one third moved to a different sector.

Another stumbling block is the shortage of construction materials. One in fourteen construction firms contended with this problem in the third quarter. During the crisis, many suppliers went bankrupt, causing a substantial loss of production capacity that cannot be made up in the short term. Combined with the sharp increase in demand, this is leading to a shortage of construction materials. Projects are being delayed because of, for instance, a lack of cement or construction piles.

Two other factors may thwart the efforts to speed up construction. One threat in the short term is the ban on connecting new-build housing to the gas grid from 1 July. Exemptions are only possible if the building permit was applied for before that date or if a local exception is made. A longer-term threat concerns the fact that the number of issued building permits is barely rising. This increases the danger that the projected housing stock expansion of 75,000 homes annually will remain beyond reach.

Who must take the initiative: municipalities or developers and builders?
One constant drag on construction is the lack of building land and the rising price of building plots. Before the onset of the crisis, many municipalities invested in building land. When the value of the land fell during the crisis, they had to make large write-downs on these investments. This experience has made municipalities cautious about investing again in building land and preparing it for construction. Their preference for an arm's length approach received support in 2015 from the Council for Financial Relations which advised that the purchase and development of land should be left to project developers,

Prices of building plots continue to rise



Source: Land Registry

Whether the lack of municipal involvement will benefit house construction in the long term remains to be seen. In a comparison between the housing market in Great Britain and Germany, John Muellbauer[2] points out that, unlike the German government, the British government does not cap and cream off the profits when a change of land use permission is granted. Due to the substantial profits that are to be made on this practice, land speculation - preferably funded with borrowed capital - is a much more important activity for British construction companies. In view of the financial risks, management devotes a relatively large amount of its attention to the building land portfolio at the expense of the actual construction activities.

Moreover, due to their dependence on the profits on their land portfolio, construction companies have an incentive to postpone the construction of new homes. By way of evidence, Muellbauer notes that the number of building permits leading to the actual construction of housing is much lower in Great Britain than in Germany. Interestingly, Dutch municipalities were also accused in the past of creating artificial scarcity to drive up land prices. That said, the analysis of the situation in the countries around us suggests that it is undesirable for municipalities not to be involved in the purchase and preparation of building land - all the more so as governments are better able to bear the associated risks than market parties.

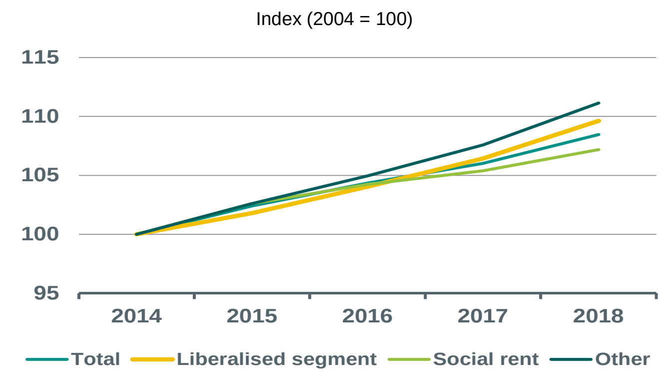
Municipal initiatives for the housing market
National government has taken various initiatives to speed up house construction. After signing a National Housing Agenda with construction-related parties, which sets

[2] 'Housing, debt and the economy: a tale of two countries', J. Muellbauer, *National Institute Economic Review*, No 245, August 2018.

out the national housing ambitions in terms of numbers, quality and living environment, the government received a positive recommendation from the Council of State about the proposal to amend the Crisis and Recovery Act. The amendment, which is to take effect on 1 January 2019, shortens and simplifies the house construction and sustainability procedures. Ultimately, the responsibility for the implementation is being largely devolved to local government.

Judging by the coalition agreements concluded so far at municipal level, increasing house construction and improving the utilisation of the existing housing stock are mainly perceived as pressing issues in the municipalities where the housing market is overheated, i.e. the larger municipalities in the west of the country. They are seeking to make arrangements with developers, investors and housing associations in both the social and liberalised segment, while devoting specific attention to the mid-market segment. Measures to improve the use of the housing stock include the appointment of mobility agents and financial incentives for home movers. In addition, pilots are being planned where the rental amount evolves with the household's income and composition. Finally, municipalities are seeking to make arrangements with landlords to tackle rental mismatches (high income/low rent or low income/high rent).

Rental movements since reforms in 2013



Source: Statistics Netherlands (CBS)

In areas where the housing market is less overheated, the focus is often on qualitative objectives, such as sustainability. Regarding sustainability, most municipalities are seeking to cooperate with relevant partners. They also stress the need for affordability and are particularly keen to ensure that low-income households benefit from investments in sustainability. The municipality of Zutphen has launched an interesting initiative to make the listed buildings in its historical town centre more sustainable. Many municipalities, for their part, are setting the right example by making their own buildings more sustainable, while some are also considering the creation of special funds to finance the energy transition.

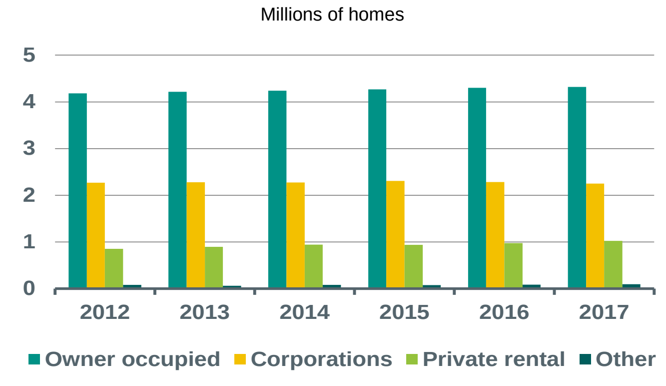
Next hurdle: making municipal coalitions work

The coalition agreements at municipal level are a good first step. But *the proof of the pudding is in the eating*. Achieving the set objectives will be an uphill struggle. Because different parties have different interests.

In a fairly recent case, for instance, the court ruled that the Tax Department must pay a tenant compensation for passing on his income details to the landlord without permission. Based on this information, the rent was increased in accordance with the income-dependent rental increase. The Minister of Finance has lodged an appeal but if the ruling is upheld, many tenants in similar circumstances can probably also demand compensation. Moreover, it would also mean that some municipal plans to promote mobility in the rental segment can be consigned to the dustbin.

Another example concerns the reactions to the construction plans for Amsterdam, where over a tenth of the national house construction target must be met. Using CBRE as their mouthpiece, private investors are protesting against the requirement to keep houses in the mid-market segment for perpetuity. They argue that linking the annual mid-market rental increases to the social rental increases would create a new form of social housing, but without offering investors the compensation of a lower land price. And that, they say, would come on top of the higher construction costs they already face due to the more stringent sustainability criteria. The investors, therefore, will kick off the negotiations with the municipality about the plans to meet the Amsterdam housing construction target with the claim that profitable investing in new-build housing is impossible if the current conditions remain intact.

Private rental accounts for growing share of housing



Source: Statistics Netherlands (CBS)

House of Representatives questions buy-to-let

The government believes that market parties can play an important role in the expansion of the rented housing stock. There has already been a marked rise in private investor activity. The number of privately rented housing increased between 2012 and 2017 by 56,000 to 1,065,000 homes. Based on Land Registry data, about a third of these are in the hands of private investors with 3 to 50 houses. As a result, 'small investors' own about one in twenty of the total stock of rented homes; that's twice as much as a decade ago.[3]

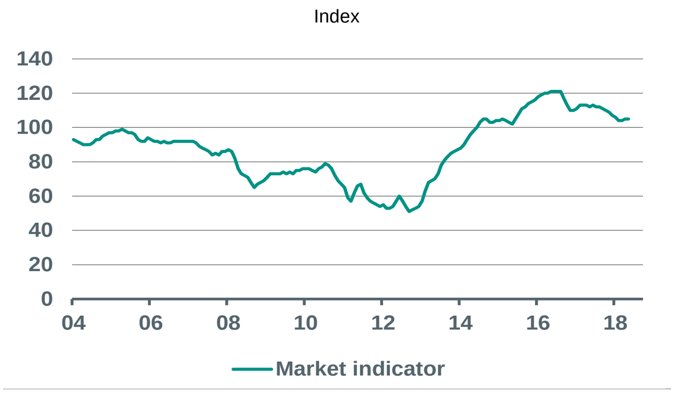
The emergence of the 'small investor' is a source of concern for some parliamentarians, who see a risk of rogue landlords taking advantage of vulnerable tenants. However, the law provides for adequate means to counter poor behaviour by landlords. Another objection is that private rental often leads to properties being left

[3] *Verdringt de particuliere verhuurder de starter van de woningmarkt*, Vries, P. de, Land Registry 2017, September 2017.

vacant. But in such situations, too, the law can step in. Amsterdam, for instance, imposes fines on homeowners who allow homes to remain vacant for long periods without reporting this to the municipality.[4] A more valid objection may be that buy-to-let investors are crowding out first-time buyers. But, as yet, there is no scientific proof to back this up. A Land Registry study from 2017 indicated that this may be a problem in Amsterdam, but nowhere else. Amsterdam is the only city where landlords paid more for comparable housing than first-time buyers.

Findings in the US, however, have increased the urgency for further research into the influence of private investors on prices. Recent studies have dispelled the widely-held notion that mortgage loans to low-income households precipitated the US credit crisis. New evidence shows that most mortgage losses stemmed from *buy-to-let* speculators who were gambling on rising house prices and, prior to the crisis, used their relatively good credit scores to take out large loans in order to maximise their profits.[5] Evidently, spiralling prices mainly occurred in the regions where these aggressive speculators were investing, and not in the regions where *subprime* mortgages were extended. With hindsight, it was this small group of overly optimistic investors who continued to buy properties when most people were already wary of overheating that was largely to blame for the price bubble in the US.[6]

Respondents less optimistic about housing market



Source: Homeowners' Association

Confidence in housing market under slight pressure

Confidence in the Dutch housing market is receding, but remains fairly high. In August, the Homeowners' Association (VEH) Market Indicator was 7 points lower than a year ago and 16 points lower than two years ago. Even so, the current reading of 105 is still above the neutral value of 100, where the numbers of optimistic and pessimistic respondents are equal.

One key reason for the drop in confidence is the housing supply. Due to the diminishing number of properties for sale, buyers have less choice than before. Added to this, more respondents are counting on a possible interest rate rise. In this event,

[4] *Particuliere woningbeleggers en toegankelijkheid van de woningmarkt: de casus Amsterdam*, E. Buitelaar, F. Schilder, Memorandum for the Amsterdam municipal council hearing/expert meeting, January 2018.
[5] *Mortgage default during the Great Recession came from real estate investors, not subprime holders*, S. Albanesi et al., October 2017, Vox.org.
[6] *Credit supply and housing speculation*, A. Mian, A. Sufi, August 2018, Vox.org.

buyers will be able to borrow less based on their income due to the more stringent mortgage criteria.

As things stand, interest rates are low. As a result, housing is still relatively affordable despite the elevated property values. Low interest rates - combined with the optimistic economic mood, the ease of selling properties and the expectation that house prices will continue to rise - are helping to prop up confidence.

More recently, the different target groups have converged regarding their assessment of the housing market. Whereas the weakening of confidence was initially noticed among first-time buyers, it can now also be seen among home movers. Rising prices are in principle good for home movers: the more profit they make on their existing property, the more they can spend on their next home. However, due to the lack of supply, home movers are also limited in their choice. And they too are feeling the strain of the relentless price increases. Home movers, like first-time buyers, are starting to borrow more in proportion to their income.

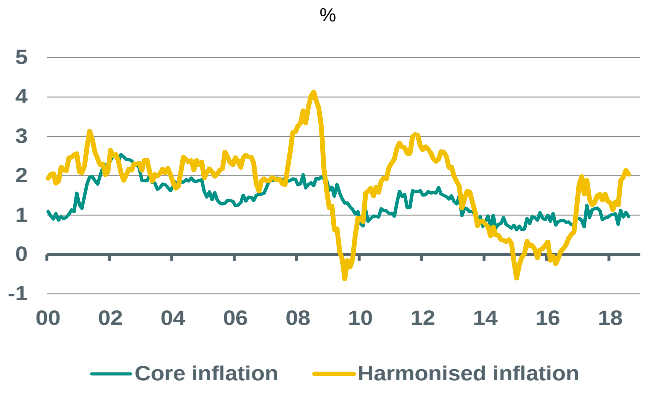
Another surprising finding is that households on low incomes are now more positive than households on high incomes. This is probably because they are beginning to feel the financial benefits of the recovery. Nevertheless, the tighter mortgage criteria and the high prices are definitely making it difficult for lower income groups to buy a new home.

ECB is sticking to low interest rates

Interest rates are a strong driver of the housing market. The current low rates are largely due to the central bank's policy. As things stand, rates are likely to remain low for a while, both at the short and long end of the spectrum.

To start with, the European Central Bank (ECB) is in no hurry to hike rates. Whilst inflation may have risen above its 2% target, underlying inflationary pressure is still limited. Core inflation, which omits volatile price components such as oil and food, has long been around 1%. According to the most recent reports from Frankfurt, an increase in interest rates will not be considered until autumn 2019 at the earliest.

Inflation still low, so ECB in no hurry to hike rates



Source: Thomson Reuters Datastream

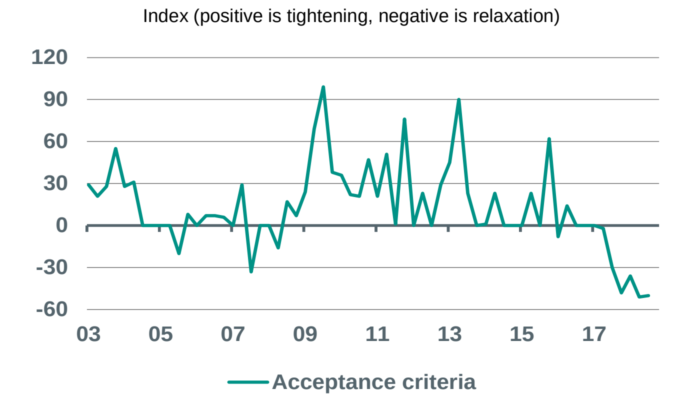
Capital market rates will also remain at a low level for the time being. The ECB is going to stop its large-scale bond-buying at the end of this year, but this has made little impression on investors so far. Due to the doubts about Italy, the unrest about Turkey and Argentina and the threat of a trade war, they remain interested in perceived safe government bonds. This is keeping capital market rates under downward pressure. We assume that the international concerns will slowly recede to the background, allowing the 10-year rate on Dutch government bonds to rise from 0.5% now to 0.9% at the end of next year. Historically, that is still very low.

Mortgage rates remain ultra-low for now

In other words, capital market rates will only rise very slowly. But the prospect of central bank monetary normalisation is pushing bank funding costs slightly higher. The swap curve, for instance, has shifted slightly upwards in the past two years.

This has not led to higher mortgage rates so far. In fact, these have declined further. New entrants are compelling banks to accept lower margins. This increased competition is also prompting banks to relax their acceptance criteria, as can be seen in the *Bank Lending Survey* of the Dutch Central Bank (DNB).

Banks continue to relax credit conditions



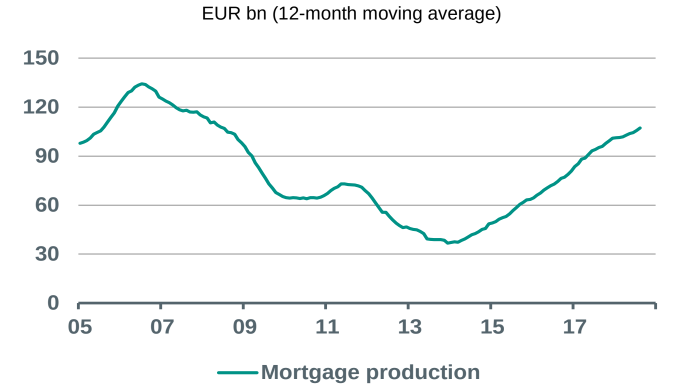
Source: DNB

In addition, banks have also absorbed their higher costs of funding by cutting costs through internal process automation and product standardisation. And, of course, they are also benefiting from the strong economy. The number of borrowers in arrears is decreasing. Thanks to the improving labour market, more people are able to meet their financial commitments. The losses on mortgage portfolios are also falling. Due to the rising house prices, the number of households with negative equity is steadily diminishing. The most recent estimate put this number at 200,000 households, as opposed to 1.3 million at the height of the crisis.

Sustained increase in new mortgage business

New mortgage business is not yet suffering from the lower number of transactions. In fact, the number of extended mortgages continues to rise. The reason is that more people are remortgaging to benefit from the low interest rates. Their share in the lending volume is expanding. Initially this mainly took place at the expense of the share of first-time buyers, but the share of home movers is now also under pressure.

Growth in new mortgage business is weakening slightly



Source: Land Registry

According to the Land Registry, 357,000 mortgages were taken out for an average amount of EUR 302,000 in the twelve months until the end of August. Total new mortgage business thus came to EUR 107bn, up EUR 12bn on a year ago. Statistics Netherlands currently puts the total outstanding mortgage amount at EUR 701bn, EUR 9bn more than last year.

According to HDN figures, most of the new mortgage business concerns loans with long fixed-rate periods. The ultra-low capital rates make it attractive to lock in rates for a long period. Now that repayments are mandatory to qualify for mortgage rate relief, annuity loans are the most widely chosen mortgage type. Interest-only loans are mainly popular among remortgagers.

NHG sets trend with mortgage renewal

The NHG guarantee scheme remains popular. There are now over 1.4 million outstanding guarantees covering a total capital of EUR 200bn. Most house buyers with a loan below the EUR 265,000 limit opt for an NHG guarantee. However, due to the sustained price increases in the housing market, fewer and fewer purchases fall within this limit. For this reason, the Dutch Homeownership Guarantee Fund (WEW) has raised the limit for 2019 to EUR 290,000. And the limit for borrowers who want to make energy saving improvements is 6% higher at EUR 307,400.

In addition, the WEW has introduced an 'entrepreneur's income statement'. This enables all entrepreneurs who have been active for more than a year to take out an NHG-guaranteed mortgage. The previous requirement was three years. This new statement for entrepreneurs replaces the previous 'self-employed person's income statement'. By making these adjustments, the WEW has decided to look more at the applicant's earning capacity than at the nature of the employment or type of employment contract.

The WEW wants to offer specific personalised solutions to help certain target groups buy a home. Its policies regularly set the standard for other credit providers. In our previous publication, for instance, we reported that the WEW wanted to use more relaxed criteria for their assessment of seniors. ABN AMRO recently adopted these same criteria. The more relaxed criteria will make it easier for seniors to move to a different (smaller) house which, in turn, will improve the mobility in the housing market.

Growing need for senior housing

According to CBS data, senior households are satisfied with their housing. Nine out of ten want to continue living in their current address. Those who want to move cite health reasons or the desire to live closer to family. But moving house can be difficult in practice. A Land Registry study shows that one third of homeowners aged 60 to 75 want to move but are unable to find a suitable house. Those who are successful tend to exchange their current home for a smaller and cheaper alternative, such as a rented apartment.

According to the NVM, many of the houses being vacated by baby boomers were built in the 1970s. These are typically large higher-end properties situated outside the city that require investment in maintenance and refurbishment. Such properties are particularly attractive for DIYers.

The ageing population means that the number of seniors will grow steadily. A quarter of the 7.9 million households in the Netherlands is currently older than 65. Forecasts of ABF research say that in 2030, one third of the 8.4 million households will be over 65. The number of less mobile people is therefore also set to increase. It is estimated that 152,000 stairless homes, 84,000 adapted homes and 68,000 clustered homes with extra facilities for seniors will be required. New-builds will account for a portion of these, but the majority must be realised by adapting the existing stock.

Budget Day: few new measures

The Government Budget that was recently presented on Budget Day contained no surprises for homeowners. The only exception concerned the abolition of tax relief for listed buildings effective from 2019. Owners of listed buildings will no longer be allowed to deduct 80% of their maintenance costs from tax. The government wants to bring in a grant scheme to replace the tax relief for listed buildings, which cost EUR 67 million in 2018. Prime minister Rutte's second government previously came up with a similar proposal, but withdrew it again.

The reason for the change is that the tax department cannot determine whether the maintenance has been properly carried out or whether the occupant has used the tax rebate for a legitimate purpose. Evidently, a grant scheme will make it easier to check whether these criteria have been met. Owners of listed buildings are unhappy with the change. Understandably so. Because unlike tax relief, grant funds tend to be finite. Moreover, with a grant scheme, owners are less certain of qualifying. Finally, they fear the onerous paperwork that tends to come with grants.