ABN·AMRO

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Housing market monitor

Philip Bokeloh
Tel.: 020 383 2657 / philip.bokeloh@nl.abnamro.com

Housing market is heated

- We have again raised our price estimates for the housing market significantly
- Buyers take more risk to increase their chances of home purchase
- Low interest rates are the main driver of the buying spree
- Our estimates for the number of transactions remain unchanged

We are raising our housing market forecasts. The recent house price figures and more favourable expectations regarding future economic development give cause to revise our forecasts upwards. We now expect house price growth of 12.5% this year and 5% next year. Previously, we assumed a price increase of 7.5% and 2.5% respectively. The estimates for the number of transactions remain unchanged. For this year, we are taking a decline of 10% into account. Next year, the number of house purchases will decline by a further 5%.

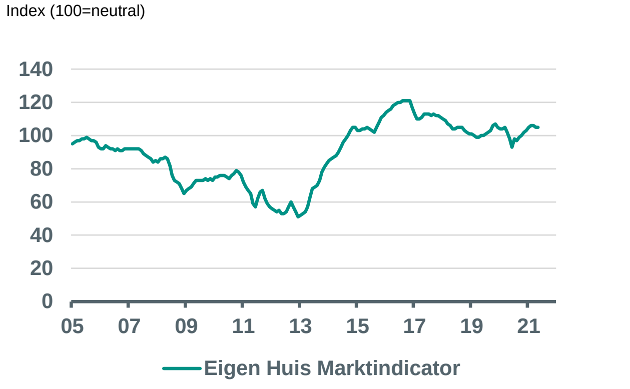
The housing market is heating up. The prices of existing homes are rising sharply, even in the four major cities where the market seemed to be cooling down a little during the corona crisis. In May, the price index for the Netherlands as a whole was almost 13% above last year's level. Adjusted for inflation, the price level is now 6.5% above the previous price peak in 2008. There are also other signs of heating up. For example, there are still very few houses for sale. According to brokerage association NVM, there were only 15,500 houses on offer in the second quarter, the lowest number since the series began. In the past, the average number was five times higher. The homes that come up for sale also find a new owner very quickly. The houses that changed hands in the first quarter were on average for only three and a half weeks, whereas the historical average is more than eleven weeks.

Under current market conditions, buyers have little time to think about what could be the biggest financial decision of their lives. With prices rising all the time, buyers fear that they will be left out of the housing market for good and are in a hurry to purchase their homes. To increase their chances of a successful offer, they take more risks. They outbid the asking price, sometimes by a wide margin. According to the NVM, the final purchase price is now at or above the asking price in eight out of ten transactions. They try to outbid other interested parties by competing on the conditions of sale and by dropping all kinds of sales restrictions. They also try to extend their financial scope. They do this by taking out higher mortgages in proportion to their income, by opting for interest-only mortgages and renouncing the right to deduct mortgage interest, or by separating building and land, selling the land to investors and renting it back on a long lease. Investors interested in fixed-interest securities are interested in this type of financial construction.

Sentiment remains positive, especially among those wanting to sell

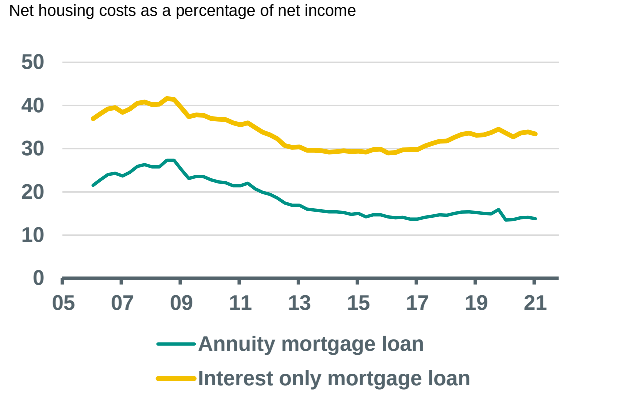
Confidence in the housing market has recovered smoothly after a decline at the start of the corona crisis. According to the indicators of the Home Owners Association (Vereniging Eigen Huis) and the Dutch Association of Real Estate Brokers (NVM), sentiment has been consistently positive in recent months. What is remarkable, however, is the underlying dynamic. The favourable sentiment on the housing market is increasingly based on the assessment of the possibilities of selling a house, something that comes as little surprise given the increased price level and short sale times. Those surveyed are less optimistic about the possibilities of buying a house. Interest rates may be low, but house prices are thus high that the limits of income mortgage standards are beginning to bite. Moreover, due to the limited supply, buyers have little to choose from and find it difficult to buy with so much competition on the market.

Confidence in the housing market stabilises



Source: Dutch Home Owners Association

Low interest rate supports affordability



Source: Calcasa

Despite the limited number of houses on offer, many transactions are still taking place. In the first five months of this year, 102,000 existing homes were purchased, according to CBS/Kadaster. That is 10,000 more than in the same period of 2017, the year in which a record number of homes were bought. In that respect, the market works very efficiently: buyers and sellers find each other particularly easily. The increase in purchases has been driven, among other things, by the relaxed lending conditions from the beginning of this year. The second income now counts for 90% when determining the mortgage amount buyers can borrow. In 2015, this was still 33%. In addition, there have been relaxations for those with educational loans. But more relaxed borrowing conditions are not the main cause of the sharp rise in home purchases.

Policy changes push up purchases

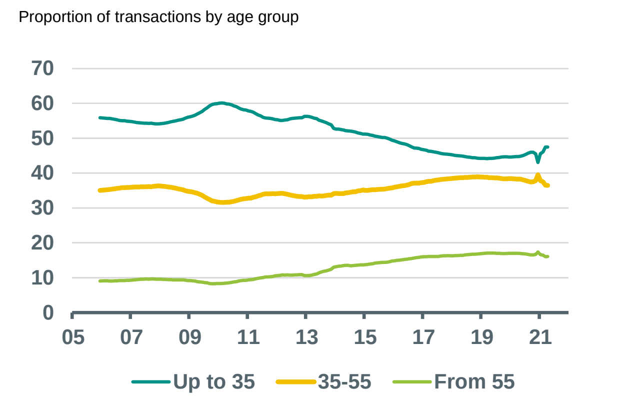
The increase in house purchases is mainly due to the change in the transfer tax rate for first-time buyers up to the age of 35 at the beginning of this year. The tax rate was lowered from 2% to 0%. With this in mind, many first-time buyers pushed their purchases beyond the turn of the year, as can be seen from the sharp increase in the number of transactions by buyers in the 25 to 35 years age bracket at the beginning of this year. At the same time, the introduction of the EUR 400,000 limit on 1 April caused many first-time buyers interested in houses above EUR 400,000 to bring forward their purchases. As a result, many homes over EUR 400,000 were purchased in March. This can be seen, amongst other things, from the short-lived jump in average purchase price from EUR 369,000 in February to EUR 407,000 in March. In April, according to CBS/Land Registry, the average purchase price was EUR 363,000 again.

The fact that the housing market took such a flight during the corona crisis is probably also due to the shift in housing preferences. The importance of a comfortable home has increased as people spend more time at home. If all goes well, the strict home rule will soon be a thing of the past. But even if all restrictions can be loosened permanently, it is likely that many will continue to work from home in the future, at least for a few days of the week. Employers and employees have embraced home working in a short period of time. After all, the technological support for working from home proved its worth during the crisis.

Economy holds up stronger than expected

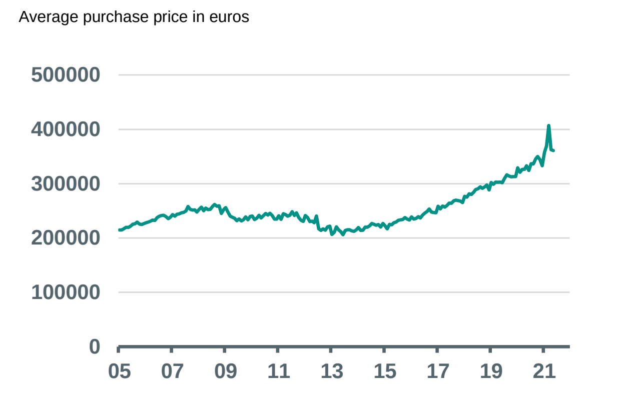
What also helps the housing market is that the economy is holding up much better than expected. During the second lockdown period, the economy fell less sharply than during the first lockdown period, as consumers and businesses adjusted to the new situation in a very short time. Furthermore, the extensive government support measures have worked. This safety net has taken the edge off the crisis and sustained confidence in the future. The unprecedented speed of development and distribution of vaccines is now doing the rest. Restrictions are being reversed and the economy is reopening. On balance, the economic damage is much less than feared. The labour market has also remained better intact than anticipated. Unemployment is not expected to rise as much as previously predicted.

Especially starters active early this year



Source: CBS/Land Registry

Introduction of limit leads to price spike in March



Source: CBS/Land Registry

Furthermore, many households were able to save during the corona crisis. In the absence of opportunities to spend, their savings buffers increased. It is estimated that households set aside an additional EUR 44 billion. Some of this will find its way back into the economy through catch-up spending. But the amount involved will be modest. Indeed, much of the spending missed during corona will not lead to catch-up demand. Furthermore, most of the savings have ended up with high income groups. This group usually consumes only part of its income. We therefore assume that most of the additional savings will flow into wealth accumulation and will be put into housing, among other things. This includes debt repayment, home improvements and investments in rental properties.

Ample interest from buy-to-let investors

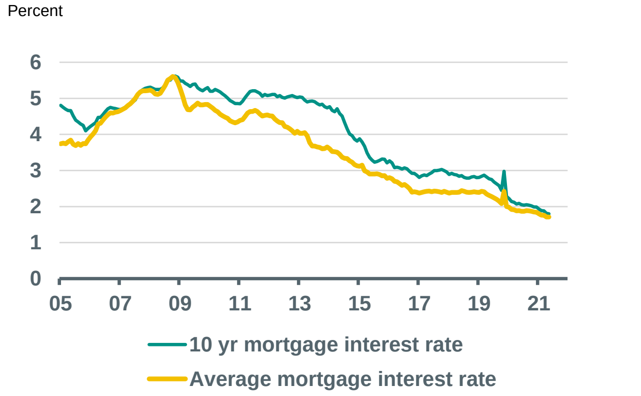
Investors' interest in rental properties has increased in recent years. The government stimulated this by offering more possibilities for temporary rental contracts, by making the liberalisation of social housing easier and by restricting the freedom of movement of housing corporations, all in accordance with the advice of international bodies, such as the OECD, which recently drew attention to its recommendations for the housing market once again, but this time found little response as opinions have changed in The Hague. Politicians have become are more critical towards investors. The chances that this will only be temporary are limited given the fall of the Swedish cabinet, which stumbled over proposals to liberalise the rental market.

Examples of the government's more critical stance towards investors are the introduction of the so-called self-tenancy obligation, the curbed rent increases and the increase in the transfer tax rate for investors. Yet it is questionable whether investors will be deterred by the recent measures. Low inflation and central bank policies have caused savings rates to fall sharply. This means that investors are looking for higher yielding alternatives for their savings such as residential investments.

Global impact of monetary policy

The interest in residential investments is further fuelled by the European Central Bank's (ECB) TLTRO programme. Through this programme, the ECB lends money to banks at a reduced rate on the condition that they use it to lend to families and businesses. The term of the ECB loan is limited to a maximum of four years. Furthermore, the ECB does not allow banks to grant mortgages with the TLTRO funds. After all, the ECB has already set up a *covered bond* programme of EUR 292 billion for this purpose. Real estate financing, including loans for the purchase of existing rental housing, is permitted though. This comprises enormous amounts. So far, European banks have borrowed a total of EUR 2,200 billion from the ECB via the TLTRO programme. Even if only a limited chunk of this goes to rental housing, the LTRO programme is contributing to higher valuations on the European housing market.

Mortgage rates have fallen sharply in recent years



Source: Refinitiv

Government interest rates briefly higher, decline

Source: Refinitiv

The Dutch Central Bank (DNB) is concerned about the situation on the housing market. Together with the IMF and the OECD, it is calling for a gradual reduction of the tax advantages of owner-occupied homes and an increase in the supply of housing. DNB is trying to curb mortgage lending by requiring banks to hold higher capital buffers. In 2019, DNB announced a lower limit for banks' risk weighting, but postponed its introduction when the corona crisis erupted. Now DNB wants to implement the lower limit, so banks will have to set aside more capital for mortgage loans starting next year. In addition, DNB has left the door ajar for the countercyclical capital buffer, an extra buffer whenever required by the economic situation. Larger capital buffers provide more financial security, but at the same time increase the cost of lending and make banks less keen to provide mortgages.

The situation on the Dutch housing market is not unique. In other countries, too, house prices are rising sharply under the influence of low interest rates, albeit less sharply than in the Netherlands where valuations have traditionally shown more pronounced gains. One explanation for the latter is that the supply of houses in the Netherlands responds slowly to changes in demand. The number of new homes completed lags behind the demand, partly because of the strict regulations on spatial planning and the multi-layered administrative structure, which slows down decision-making on new construction. As a result, the Netherlands is faced with a substantial shortage of housing. Last year, this shortage fell slightly from 330,000 to 280,000 homes due to reduced migration, but as soon as international passenger traffic picks up, the shortage is likely to increase again.

Housing construction still struggling for the time being

It is estimated that 900,000 new homes will have to be built in the next ten years. A difficult task, especially if the construction of new homes is hampered by nitrogen emissions that are too high for the preservation of biodiversity. Now, the first thing to do is to determine the location for all those new dwellings. This job seems to be finished as the most recent estimates signal there is sufficient 'hard' planning capacity now. However, it is unclear whether the assessment of all the 'hard' plans takes sufficient account of climate change and the costs of making locations climate-proof. It would be wise to check the planning capacity once again, as the damage in built-up areas due to flooding, heat and drought could, according to the climate damage estimator, amount to EUR 124 billion in 2050. As climate change will continue beyond 2050, this probably underestimates the total costs of ill-considered building areas.

Now that there is gradually more clarity about where houses can be built, more attention can be paid to the next step: approving building plans, granting permits and preparing land for building. For this, however, the municipalities need financial resources. Unfortunately, these are still lacking. In recent years, the State has outsourced all kinds of tasks to municipalities, but has not offered any financial compensation for this. Many municipalities are now strapped for cash and have to cut back on their spending. Partly for this reason, there is insufficient capacity to convert the 'hard' planning capacity into building projects. If the Netherlands really wants to realise its construction ambition, money will have to be made available to municipalities and their spatial planning departments. Money is a hot issue anyway. For instance, the realisation of the 14 large-scale housing areas will require an additional EUR 20 billion for investments in infrastructure.

Conclusion

The support measures of governments and central banks are working. The economy is in better shape than expected, unemployment has risen only slightly and interest rates are very low. In combination with stimulating measures, such as the lower transfer tax for first-time buyers and the wider borrowing conditions for second earners, this is leading to very strong house price increases. The number of transactions is also high. Nevertheless, we consider it likely that the number of transactions will fall. This is because the supply of houses for sale is small, because there are few opportunities to move because of the lagging housing construction and because the buying boom of coronasummer 2020 will probably not materialise this year. A harbinger of this is the HDN mortgage applications. These are on the rise, but not because of more house purchases but because of an increase in refinancings, for instance for renovations. We also anticipate a gradual weakening of price growth. This is because the positive effect of the interest rate decline on house prices is gradually diminishing and interest rates may rise in the longer term, partly as a result of the higher capital requirements for banks. In addition, the next cabinet may restrict the tax benefits of the owner-occupied home, in accordance with the recommendations of agencies such as DNB, IMF and OECD.