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Housing Market Monitor

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Sharp price correction due to higher mortgage rates

- House prices are under pressure due to higher mortgage rates and deteriorating housing market sentiment
- The number of houses for sale is rising, as there are fewer transactions and homes come up for sale earlier
- The quality of the home is going to play a more important role in sales duration and selling price
- Problems in new construction hinder transactions but prop up house prices in the longer term
- More attention will be paid to natural boundaries: water and soil will become guiding factors in spatial planning

The housing market is in the doldrums. The latest data points to a sharp fall in house prices. House prices are falling because mortgage rates have risen sharply, while disposable income is under pressure due to high inflation. As a result, housing costs are rising relative to net income and housing affordability is deteriorating. We reckon mortgage rates will remain high and incomes will not rise fast enough to compensate. This means house prices will have to come down further to improve affordability. Reflecting investors' waning interest in home rentals, the subdued outlook for economic growth and recent sharp house price falls, we have revised our 2023 estimate downwards from -2.5% to -6%. In 2024, we believe house prices will continue to fall by 4%, mainly due to the so-called spillover effect. Thus, the main price adjustment already takes place this year.

We have also revised our estimates for the number of housing transactions downwards, from -1% to -5% in 2023. This is because buyers are waiting to see what happens when house prices fall. Next year, when the average price level is lower, interest in owner-occupied houses will grow again. We expect home purchases to increase by 2.5% in 2024. The increase will be modest, as it will be limited by the small number of new homes being completed. Because of the ongoing problems in new construction, the risk of the housing stock falling short of housing demand is growing. This means even more households will struggle to fulfil their housing needs. Given a lack of new constructions, mobility will stall and the number of transactions will remain low. Meanwhile, the shortage will underpin housing price levels.

The number of homes put up for sale is growing again. Sellers are bringing their homes to the market earlier because the sale takes more time. There is less interest among buyers and it takes longer for a property to find a new owner. Potential buyers are also becoming more critical. In a wider market, they attach more importance to the quality of the property and pay more attention to the energy label, for example. Other factors, such as the quality of the foundation, will also gradually receive more attention when buying a house. As yet, information on the foundation is often lacking, while the costs of foundation repair can be considerable. The same goes for water safety. This too will gradually receive more attention, as water and soil have become guiding factors in spatial planning in the Netherlands.

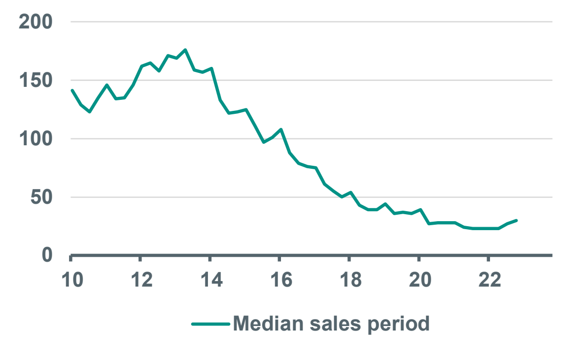
Stock of homes for sale grows again

The streets are changing. A few 'for sale' signs are hanging on facades again. In the fourth quarter of 2022, there were 35,000 houses on offer, according to the NVM, a whopping 19,000 more than in the fourth quarter of 2021 when a record low was reached. Compared to the historical average from 1995, which stands at 74,000, the current stock for sale is still limited. That said, the increase marks a turning point in the housing market. Until early 2022, it was still overheated due to a combination of low mortgage rates, labour market tightness and excess household savings. Since then, the situation has changed considerably.

The fact that more houses are for sale is because those who want to move on to the next property are putting their current home up for sale earlier. This is because buyers are no longer crowding around when a property comes on the market. Fewer viewers come by and bids are also less likely to exceed the asking price. As it is less certain that an attractive offer will be made and the sale may take longer, it is important to take more time for the sale. Therefore, there is a growing preference among move-up buyers to first find a buyer for the old house and only then purchase a property themselves. When house prices were still rising fast, the reverse was true.

It takes more time to sell the house

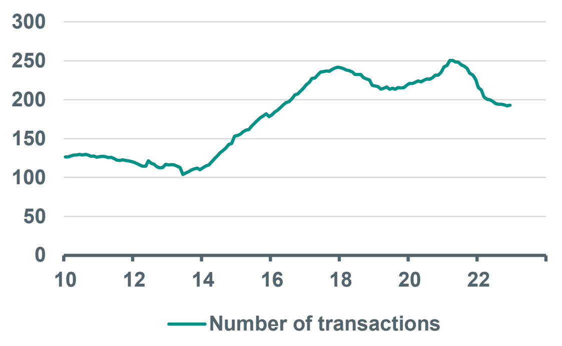
Number of days sold property has been on offer



Source: NVM

Number of transactions continues to decline

Thousands (rolling annual total)



Source: land registry

Another reason for the growth in the stock for sale is the falling number of transactions of existing homes, which declined by 33,000 to 193,000 year-on-year last year, according to CBS/Kadaster figures. The decline is visible across the country, as transactions are under pressure in all provinces. The drop in the number of transactions reflects the turnaround in sentiment. Whereas earlier it was the lack of supply that affected housing market confidence, it is now affordability. Affordability has worsened as house prices have risen sharply in recent years, especially during corona. The average purchase price rose from EUR 326,000 in early 2020 to EUR 427,000 in the fourth quarter of 2022. When mortgage rates are low, this is already a hefty amount, when mortgage rates are high, all the more so; especially when disposable income is under pressure from inflation, as it is now.

The number of transactions continues to decline due to ongoing problems in construction. The number of newly completed houses lags behind. There is no prospect of improvement as the number of building permits issued is falling. This suggests that the number of housing realisations will remain limited in the coming years. Lack of new construction will increasingly hamper mobility on the housing market. Indeed, new construction is an important first link in the moving chain. In 2020, households moving on to a new home left 60,000 existing homes behind. Of these, two-thirds became vacant for new residents.

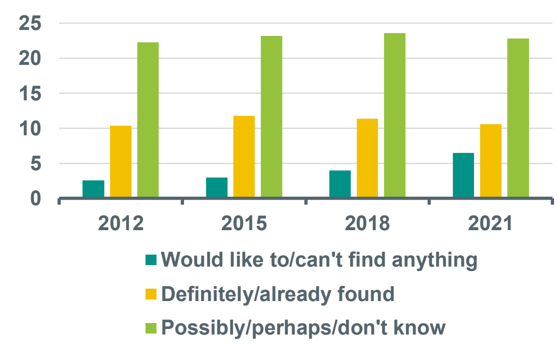
New construction projects already initiated are also starting to be delayed. The 70% pre-sale threshold remains increasingly out of reach. Buyers are dropping out because they can borrow less given the higher mortgage rates, have higher costs during construction, have doubts about selling their current home, or no longer consider it a good time to buy a home due to the threat of a price drop. If the 70% sales limit is not met, developers will have to revise their plans. This requires extra time, as once again a difficult puzzle has to be put in place. A puzzle within tight frameworks, because according to the national government's building brief, one-third of the total number of houses built should be senior housing and two-thirds should be affordable, while at the moment, houses are mainly built for higher income groups. More than half of the homes completed in 2018, 2019 and 2020 are occupied by households in the higher income brackets.

Strong price rise turns into price fall

That transactions are under pressure is also reflected in the moving figures. These also show a decline, especially for short-distance removals, which are mainly driven by changing wishes regarding the house and its surroundings. These are generally less urgent moves than those over longer distances between regions, which are driven more by study and work motives. Remarkably, the desire to move is actually growing strongly. In 2021, there were 900,000 people who wanted to move but could not; twice as many as in 2015.

The desire to move house gets stronger

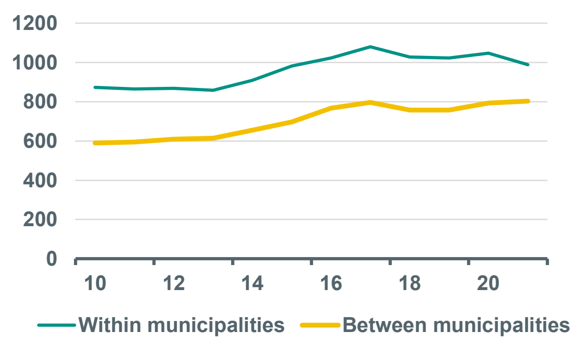
% respondents triennial WoON survey



Source: CBS

But the number of people that moves, is faltering

Number of people moved (in thousands)



Source: CBS

Unresolved moving desires are most common in the Randstad. There are also differences between various population groups. In particular, young people living at home with their parents and singles up to 40 have difficulty finding suitable housing. The cause is the lack of affordable housing. Only one in 20 of the homes sold in the first half of 2022 fitted the budget of single-income earners on a modal income who rely entirely on mortgage financing. Five years ago, the figure was one in five homes sold. At most, there are still affordable homes for sale in the border regions.

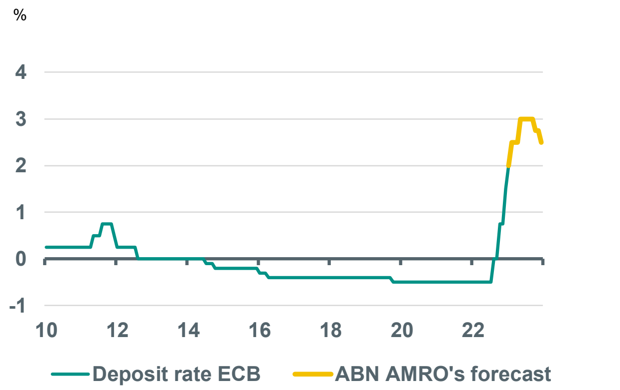
More and more people are thus sidelined in the housing market. Against this background, it makes sense that the market is turning. According to CBS/Land Registry figures, the average house price rise in 2022 was 13.6%. But in December, at 2.7% year-on-year, the price rise was much lower than in January, when it stood at 21.1%. Things accelerated from August onwards. That's when house prices started falling compared to the month before. And the end is not yet in sight. According to the NVM, house prices fell by 4.7% in the fourth quarter compared to the previous quarter. As NVM figures are slightly ahead of those of CBS/Cadaster, further price falls are likely.

Mortgage rates rise due to tightened monetary policy and risk-averse investors

The turnaround in the housing market is the result of the change in the economic situation. Over the past year, consumer prices rose sharply. First due to the combination of growing demand and lack of supply in the aftermath of corona. Then by the Russian invasion of Ukraine and the sharp rise in food and energy prices that followed. Eurozone inflation spiked above 10%. This created uncertainty among homebuyers and was also well above the European Central Bank's (ECB) 2% target. Inflation has since fallen back somewhat, but to maintain credibility, the ECB has little choice but to squeeze money supply and tighten monetary policy.

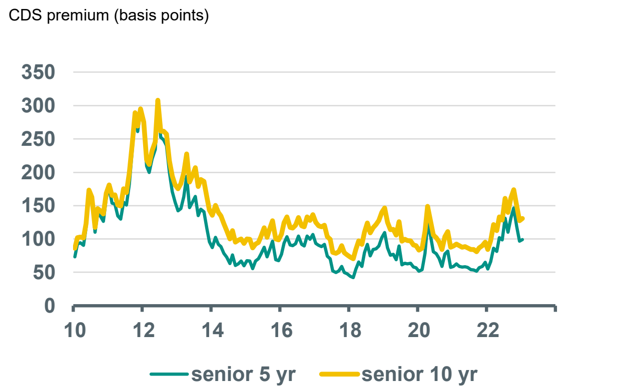
The ECB has raised the official interest rates at which commercial banks can deposit short-term money with the ECB. The deposit rate rose from -0.5% at the end of July to 2% in December. Statements from ECB representatives suggest that the ECB wants to raise interest rates further. We think the deposit rate will eventually reach 3% in May. The ECB also wants to swap the policy of quantitative easing for quantitative tightening. This means that the ECB will no longer buy but sell debt securities, so that it withdraws money from the economy instead of adding liquidity. This drives up long-term interest rates. The 10-year rate on Dutch government bonds, a key benchmark for long-term mortgage rates, rose from zero in January 2022 to 2.5% in January 2023. However, for the end of this year, we expect 10-year rates to fall to 1.8%.

ECB raises interest rates and is not done yet



Source: Refinitv, Economic Bureau ABN AMRO

Investors have become more risk averse



Source: Refinitiv

Apart from the ECB's tighter policy, mortgage rates are also pushed up by uncertainty in financial markets. Risk premiums that banks have to pay when they want to raise money for mortgages have risen. Indeed, investors are worried about the threat of war, shifts in international political relations and the resulting threats to world trade and the global economy. There are also concerns about the impact of changed monetary policy. There is a risk that the ECB could apply the brakes so hard that the economy falls into recession, unemployment rises and arrears and credit losses increase.

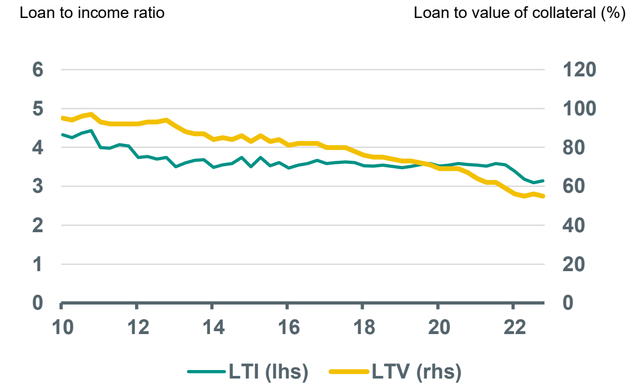
Higher government bond yields and increased risk premiums in financial markets are translating into higher mortgage rates and tighter credit terms. According to Van Bruggen Advisory Group, the average mortgage rate offered on 10-year fixed-rate loans rose from 1.1% in January 2022 to 4.1% in January 2023. Bank Lending Survey data shows that mortgage lenders are imposing stricter collateral requirements, which means homebuyers can borrow less based on their income and collateral value. According to HDN data, the average loan-to-value ratio at home purchase dropped from 80% in 2021 to 76% in 2022 and the average loan-to-income ratio decreased from 4.4 to 4.2.

Fewer mortgages granted; growing preference for shorter fixed-interest period

Mortgage production is falling as there are fewer housing transactions and lower loan amounts. Added to this, the rise in interest rates makes mortgage refinancing less attractive. Mortgage production is pushed down further as fewer homes are being remodelled due to increased construction costs. However, there is more demand for mortgages to make homes more sustainable. The main constraint here is the lack of professionals to carry out the preservation measures.

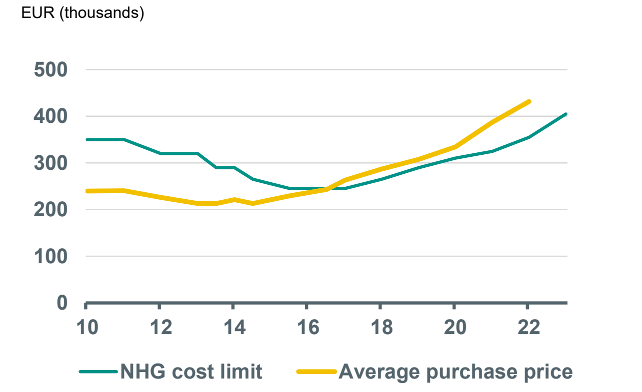
Due to increased mortgage rates, more people are opting for shorter fixed-interest periods. In early 2022, 20- to 30-year fixed was the norm. Now it is 10-year fixed. Until recently, even shorter fixed-interest periods were unpopular because they allowed borrowing much less. After all, the maximum amount of credit for shorter than 10-year fixed is not calculated on the basis of the prevailing market interest rate, but on the basis of the key interest rate currently set at 5% by the Financial Markets Authority (AFM). Now that the difference between the key rate and the market rate is small, this no longer constitutes an objection for some buyers. However, the AFM has indicated that it may raise the key rate. If that happens, it will become less interesting for them to choose an interest rate period shorter than 10 years.

Lower LTV & LTI ratios in mortgage applications



Source: HDN

NHG limit rises in line with higher purchase price



Source: NHG

Thanks to the EUR 50,000 increase in the NHG cost limit to EUR 405,000, more people will be able to use the NHG scheme again from this year. This scheme insures against the risk of residual debt in case of a forced house sale after job loss, divorce or deceased partner. On the other hand, NHG is paying closer attention to ground lease and discount constructions, where someone buys a house but not the land it stands on. These constructions have become popular in recent years, as they have allowed buyers to obtain homes that were otherwise out of their reach in terms of price. However, as these constructions can be complex and sometimes to the buyer's disadvantage, NHG is critical of them.

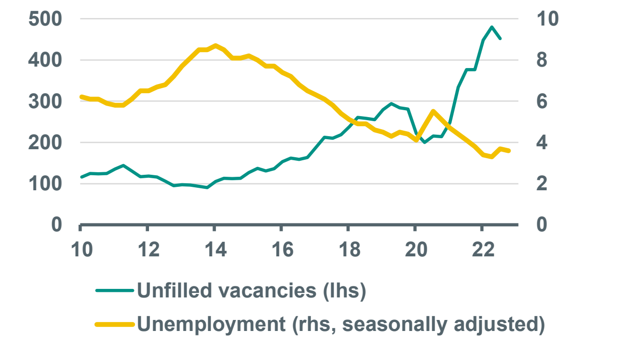
For most homeowners, the rise in mortgage rates need not translate directly into higher housing costs. This is because most of them have fixed their mortgage rates for a long period. Only a quarter of outstanding mortgages will have their interest rates reviewed in the next five years. However, for those whose fixed-interest period is ending, the increased mortgage interest rates may well pose a problem, especially as their energy costs have risen too.

Shock absorbers soften blow to housing market

Part of the rise in interest rates will be absorbed by the government through mortgage interest deductions. The amount the government will lose in tax revenue due to the deductions is likely to rise again. The total deductions for the owner-occupied home under the interest deduction and the Hillen scheme decreased by around EUR 10 bln to EUR 25 bln over the past decade, as mortgage interest rates fell, the maximum interest deduction rate was lowered in steps and the Hillen scheme was also cut. Now that the reduction in the maximum deduction rate has been completed and mortgage interest rates are rising again, the total deduction is expected to rise again.

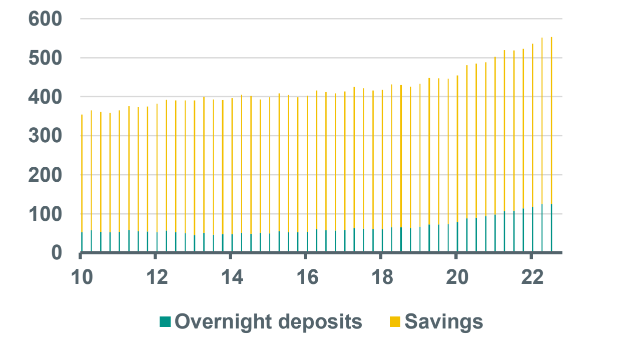
In addition, the tight labour market also acts as a shock absorber. Many employers are facing staff shortages. We think these will not disappear any time soon, unemployment will remain low and most people will keep their jobs. This will give households more security. What will also reassure them are the government's measures to bear higher energy costs. The price cap and energy surcharge shore up purchasing power. Finally, there are also the savings accumulated during and in the aftermath of corona. Thus, households have decent buffers to absorb any setbacks.

The labour market is unprecedentedly tight



Source: Refinitiv

Household savings continued to rise



Source: CBS

At the same time, investors are losing interest in residential rentals

Investor interest in rental housing is likely to decline. Earlier, investors flocked to rented houses, as low government bond yields made them an interesting investment alternative. Stable rental income rising with inflation and favourable tax treatment also contributed to the attraction of rental properties for investors. But the government is curbing rents. Moreover, landlords have to pay more taxes and housing valuations are under pressure due to increased interest rates. Therefore, investors are shifting their attention to other investment alternatives and putting less money into real estate. This was already clearly visible in publicly traded real estate funds last year. REITs took a hit worldwide. As investors withdrew their money, some funds were even forced to divest from real estate, pushing valuations down further.

In addition to this pressure on landlords to become more sustainable is increasing, while small landlords own relatively many homes with a poor energy label. From 2024, the government plans to deduct rent points from rental homes with a low energy label and award extra rent points to homes with a favourable energy label. If this proposal passes, landlords will be able to charge less rent for homes with an unfavourable label and more rent for homes with a favourable label. This should increase the incentive to make rental properties more sustainable. Currently, this is still too limited, as the financial benefit of a lower energy bill does not accrue to the landlord but to the tenant.

Investors' main focus is on current properties that are in high demand and rarely vacant. These are mainly flats in cities with high employment and educational institutions. There is also a lot of interest in these among first-time buyers. In that sense, first-time buyers will face less competition in their search for a suitable house to buy. Yet that search remains difficult, because at current income, interest rate and price levels, houses are still poorly affordable. On top of this, the government has cut back on the gift aid, making it less attractive for young people to receive gifts for house purchases.

Investing in home sustainability pays off

High energy prices have also increased interest in sustainability among homeowners. A first step in this is insulation. Investments in wall, roof and floor insulation soon pay off, even taking into account the so-called *rebound effect*, where people start using household appliances more and turn up their thermostat in response to lower energy bills. Empirical research shows that gas consumption drops by one-fifth on average after insulation. Against the cost at the time of purchase, wall insulation delivered the highest return of 18% in recent years, followed by roof insulation (15%) and floor insulation (11%). With recent high energy prices, the return comes in at even twice as high.

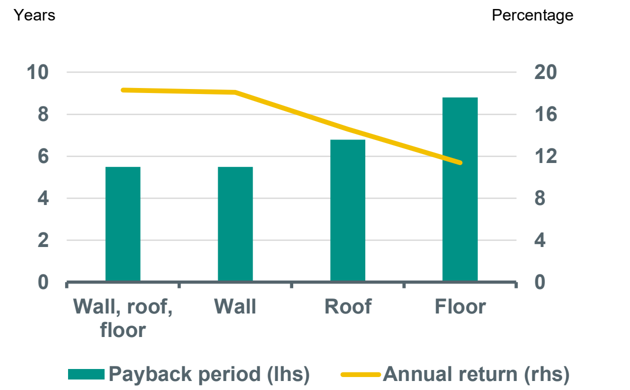
Value increases with energy label improvement

Change in house price after jump in energy label

Old label	New label							
	A-plus	A	B	C	D	E	f	G
A	2,9							
B	7,1	3,9						
C	10,3	7,1	3					
D	14,2	10,8	6,5	3,5				
E		14,5	10	6,8	3,2			
F			12,6	9,3	5,7	2,3	2,3	
G				11,6	7,8	4,4	4,4	2,1

Source: Brainbay, NVM

Attractive return on home insulation



Source: ESB

Investments in home sustainability also pay off in higher home values. Recent studies by both the NVM and the Land Registry show this. Homes with a green energy label yield more when sold and are also more easily sold. Many home owners with a poor energy label therefore want to invest in energy-saving measures. However, there is a difference between younger and older home owners. The interest in investing in home sustainability is stronger in the first group than in the second.

Against this background, the question is whether subsidising is the best way to speed up home insulation. Perhaps obstacles other than financial ones, such as the laborious decision-making process in Associations of Owners (VVE), are a bigger obstacle. The Netherlands has a total of 128,000 VVEs, which together manage a fifth of the housing stock. For sustainability and borrowing to invest in common building parts, a two-thirds majority or more is often required at VVEs. Attempts to make them more sustainable regularly fail because of this. Therefore, the government is looking at whether this threshold can be lowered.

Sustainability is about more than just energy label

Housing sustainability is gradually taking on broader connotations than energy consumption alone. Water has been given a much more central role in spatial planning and is becoming a guiding principle for where new housing can be built. Following the floods in Limburg, a report was also published on how to deal with the dangers of flooding and high water for the existing stock. One of its recommendations is to explore the possibilities of a so-called water label. Such a label should provide more transparency on the financial risks of flooding. As with the energy label, more public information for buyers will lead to greater price differences between homes safe for flooding and less safe.

That transparency and the availability of information affects the pricing of homes is also shown by research on foundation damage. It is estimated that around one million homes in the Netherlands could be affected. If the foundations have to be replaced, this will involve substantial repair costs of EUR 50,000 to EUR 100,000 per property. When the condition of the foundation is known, these repair costs are priced in. However, the discount for the buyer's effort to repair the foundation appears to be limited. But this may be due to the survey period. This is because the study was done with dates from January 2019 to June 2022, a period when the housing market was particularly tight and buyers had to make more concessions. The researchers therefore take into account that the discount buyers can negotiate may be higher when the housing supply becomes more plentiful again. This phenomenon can also be seen with the energy label. The influence of a poor energy label on sales duration and final sale price is smaller in regions with a relatively tight housing market.