9 January 2019

Housing market is slowly calming down

Philip Bokeloh
Economist
Tel. +31 (0) 20 383 2657
philip.bokeloh @nl.abnamro.com

- **Tight housing supply is constraining purchases and fuelling prices**
- **Housing market sentiment is weakening, but still positive**
- **Growing economic uncertainty is dampening outlook**

In 2019 house prices will increase less than in 2018. The downturn in housing market sentiment points to a deceleration to 6%. Our earlier forecast for 2019 was 7%. However, due to the more subdued GDP growth outlook amidst mounting economic uncertainty and the ensuing stock market corrections, we have reduced our price projection by one percentage point to 6% for 2019, slowing to 4% for 2020. This puts the price increase slightly above the historical average. Contributing factors to this sustained buoyancy are the persistent low mortgage rates and the prospect of continuing tight supply in the years ahead.

One signal of the weakening price momentum was the falling number of transactions in 2018. This decline is clearly related to the elevated prices, which have impacted on affordability and reduced the urgency to buy. There is also less pent up demand. The majority of those who postponed their house purchase plans during the crisis have now moved. Another drag on transaction volumes is the lack of properties for sale. This is partly due to home movers preferring to buy before putting their existing home up for sale. We expect this cautious stance to steadily diminish, leading to more properties coming onto the market. Nevertheless, we still see a further decline in transactions in the period ahead.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2018	-5	9
2019	-5	6 (7)
2020	-5	4

Source: ABN AMRO Group Economics

How did the housing market fare in 2018?

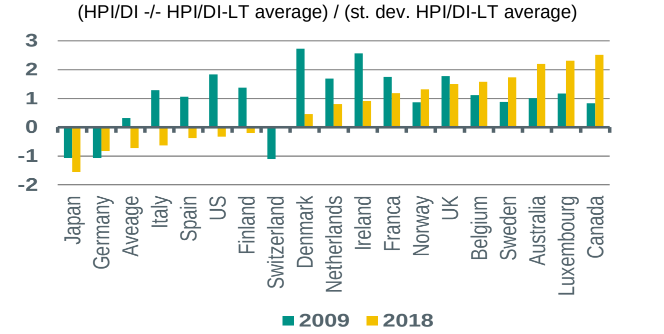
Buyers are less confident in the housing market

The Homeowners' Association (VEH) Market Indicator, a barometer for sentiment in the housing market, is cooling. The current reading is 102, just above the neutral value of 100. Buyers, in other words, are still optimistic, but considerably less so than in 2016 when the indicator hit a record level at 121. One major cause of the flatter mood is the lack of housing for sale. As a result, buyers have less choice and purchases are taking place with more difficulty. Another is that the soaring prices have made housing less affordable and harder to finance.

House prices continue to soar

According to Statistics Netherlands/Land Registry data, house prices had advanced by 9.3% y-o-y in September. The increase in the lower segment was particularly marked. Such a rapid rise in prices is not exceptional. The historical data series, starting in 1995, shows that prices rose more than 9% in a quarter of the cases. That said, it has been a long time since prices accelerated this sharply. We have to go back to 2001 to see a similar increase. After five years of sustained price increases, the price level is almost a third higher than during the low point in 2013. By now, prices are also 4% above the peak of 2008. However, adjusted for inflation, prices are still 10% below that level. And in disposable income terms, the current price level is also still lower than at that time.

Decline in price level versus disposable income



Source: Federal Reserve Bank Dallas

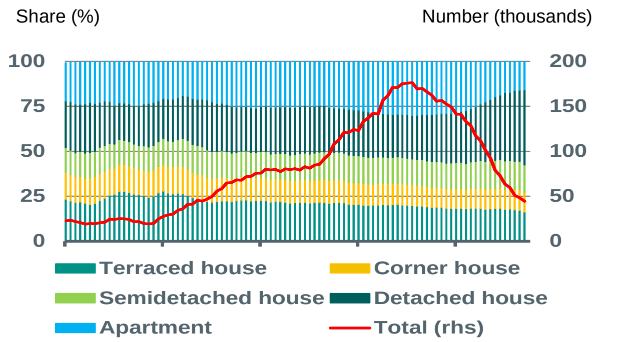
Faster than in neighbouring countries

International comparison shows that the price increase is relatively high. According to Eurostat, the only countries within the European Union where prices are rising faster are Ireland, Hungary, Portugal and Slovenia. The price increases in neighbouring countries - Belgium, Germany, France and the United Kingdom - are significantly lower and are even starting to weaken. This may be a harbinger of things to come for the Netherlands. IMF research reveals a growing international convergence between house prices, particularly in the larger cities. The IMF attributes this phenomenon to the prolonged period of house price increases that was triggered by ultra-low global interest rates, growing buy-to-let activity, and high net worth individuals who invest in foreign real estate for wealth preservation reasons.

Knock-on impact of Amsterdam on prices in other cities

Large differences exist between the regions in the Netherlands. Compared to the low point, prices in Amsterdam have risen the fastest. Due to the global relationship between large cities mentioned above, the capital has its own dynamics. In addition, the explosion in tourism and the related advent of Airbnb has given prices an extra boost. The price increases are rippling through to the rest of the country. A recent survey of the Dutch central bank (DNB) shows that the price surge in the capital is now spreading to surrounding areas, particularly nearby regions such as Utrecht, Haarlem and Gooi en Vechtstreek.[1] Homeowners in Amsterdam are cashing in on the sky-high prices and using their excess equity to buy a new property outside the city. In addition to Amsterdam, the Veluwe, various parts of Noord-Brabant, the Bollenstreek and Utrecht are having a relatively strong effect on prices in surrounding areas.

Shift in composition of properties for sale



Source: Dutch Association of Real Estate Agents

Purchases under pressure due to supply constraints

While house prices are still climbing, the transaction volume is losing pace. In the twelve months until the end of September, 228,000 properties were sold, 4% less than in September last year. The transaction rate is slackening because of the limited number of houses on the market. In terms of composition, there is also a mismatch between supply and demand. More than half of the properties for sale now consist of detached and semi-detached housing and a relatively large share of the transactions is taking place in this segment, whereas normally apartments account for the bulk of transactions. Due to the lack of suitable supply, buyers must move fast when they see a property that meets their wishes. The average selling period for properties is now only six weeks.

And because pent up demand is trailing off

Another reason for the slowing transaction volume is the smaller contribution from pent up demand. The crisis plunged a large group of homeowners 'under water'. Prices sank so far that moving was hardly an option for them. Selling a home at a loss and being left with negative equity is tough to swallow. And it also limits your borrowing capacity for your next home. As prices started to recover, more and more people were freed from the shackles of negative equity and started to act on their long-coveted plans to move home. This gave an extra impulse to demand, fuelling transaction

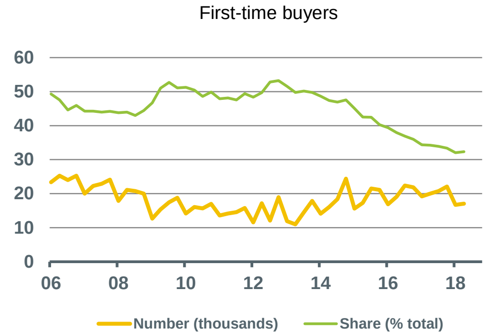
[1] Van Dijk D., Mesters G., *'Amsterdam bepalend voor woningprijzen'*, *ESB* 15 November 2018

volumes to a record level. In the meantime, few homeowners are under water and the pent up demand that arose from the removal of this obstacle is also dwindling.

Share of first-time buyers in transactions is shrinking

First-time buyers were not burdened with the negative equity problem during the crisis. As a result, their share in transactions grew to more than half of the home purchases. When prices started to recover in 2013, home movers began to re-enter the market and the share of first-time buyers decreased. In the second quarter of 2018, they only accounted for one third of the purchases. That is not to say that the actual number of first-time buyers shrank. In an accelerating market, their number actually increased from 60,000 in 2012 to 82,000 in 2017. Now transactions are under pressure, particularly among first-time buyers. While home mover purchases fell 5% in the first half of 2018 relative to the same period last year, first-time buyer purchases declined by14%. Unlike home movers, first-time buyers have no home equity to contribute. They are also confronted with high financing costs due to the obligation to make repayments from the outset. An additional drawback for first-time buyers is the competition from buy-to-let investors who are active in the same segment.

More first-time buyers, but lower transaction share



Source: Statistics Netherlands (CBS)

New-build reflects market for pre-owned homes

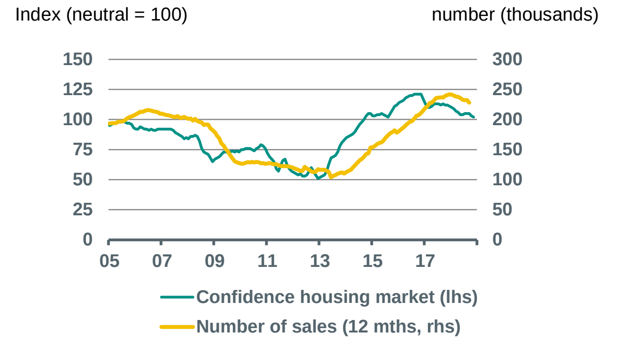
New-build prices are also rising, and even faster than pre-owned prices. This is because a relatively large share of new-builds belongs to a higher price segment than in the past. As with pre-owned housing, the supply of new-builds is limited. A shortage of construction capacity, a lack of construction plans, project finance constraints and setbacks in the development phase are holding construction back. The slight decline in issued building permits this year suggests that this situation is unlikely to improve in the near future. Particularly as the options for residential transformation are decreasing as fewer suitable office, retail and industrial properties are becoming available. If new-build supply slows, the transaction volume will also stagnate. In the year until the end of November 2018, 31,000 new-builds were sold, 2,700 less than in the same period of 2017.

Where are transaction volumes and prices heading in 2019?

Transaction volumes will decline further

Lack of supply is an important cause of the falling transaction volumes. This supply bottleneck is exacerbated by the fact that sellers are waiting longer before putting their house on the market. They want to find a new home first in order to avoid being left without a home after selling their existing property. And they also hope to benefit from further price increases. Because in a rising market, the longer you wait the higher the price your property will fetch. If confidence in the upward price momentum begins to flag and the future starts to look more uncertain, there will be less inclination to postpone the sale, more properties will come onto the market and the chances of a successful transaction will grow. We expect to see sellers putting their home up for sale faster. Nevertheless, transactions will probably continue to slow, partly because of a further weakening of pent up demand and partly because of the waning optimism in the housing market. Given the shaky economic outlook, sentiment is more likely to deteriorate than improve.

Housing market sentiment signals decline in sales



Source: Homeowners' Association and Statistics Netherlands

Prices continue to rise, but less quickly than before

We expect the price increases to slow slightly. Several factors that influence house prices, both on the demand and supply side, underpin this expectation. These are discussed below. Traditional economic thinking focused mainly on demand factors, but in recent decades supply factors have also been taken on board.

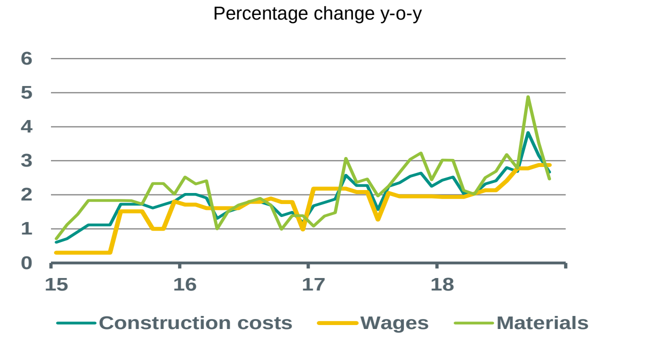
Supply: available development sites and spatial planning

We have mentioned the lack of new-build completions. The supply of new-builds is largely determined by the number of available suitable development sites. A DNB study indicates that house prices rise faster in municipalities with limited development opportunities than in municipalities where construction land is relatively plentiful.[2] The smaller the share of vacant land in the overall municipal area, the higher the price increase. This stands to reason, as supply in these municipalities can hardly respond to an increase in demand. The outcome of the study emphasises the importance of investing in development sites. But municipalities are too passive in this respect. A TU Delft study shows that municipalities are investing too little in land development.[3] Their

[2] Oztürk B., Van Dijk D., Van Hoenselaar F., *'Aanbodbeperkingen hebben effect op huizenprijzen', ESB* 15 November 2018
[3] Korthals Altes W., *'Financiële gegevens bouwgrondexploitatie gemeenten: cijfers tot en met 3e kwartaal 2018'*, OTB TU Delft 2018

spending on the acquisition and preparation of land for residential construction is lower than in the 2010-2013 period. This despite the higher revenues. The new Environment and Planning Act gives some cause for hope. This creates more room for effective spatial planning, so that more development sites can become available in due course. Meanwhile, however, supply constraints continue to push up prices.

Higher construction material and labour costs



Source: Statistics Netherlands (CBS)

Supply: construction costs

The number of new-build completions is small compared to the housing stock. As a result, the prices of pre-owned housing are only determined to a limited extent by the construction costs. In fact, the reverse applies: pre-owned housing is driving the price of new-builds. This is also evident from the way in which most municipalities set their land prices, which is an important component of the construction costs. They usually do this by deducting the VAT, a reasonable profit margin and the construction costs from the selling price. A survey by Stec Groep shows that municipalities will only raise the land prices to a limited extent next year due to the higher construction costs.[4] The construction costs are rising because of labour and material shortages. In addition, stricter construction requirements have been introduced, including environmental regulations. The extra efforts that builders must make to use materials economically and build according to circular principles will only pay themselves back in the longer term. The rise in construction costs underlines the importance of innovation.

Demand: population growth

As noted, apart from supply factors, demand factors also play a role. One key determinant of demand is population growth. According to ABF Research, the number of inhabitants has increased by 776,000 in the past decade. The coming decade will see the population grow by an estimated 664,000 people. But there are big regional differences. Whereas the number of inhabitants will expand rapidly in the western and central regions, there are also regions where the population is shrinking. As households are becoming smaller, the number of households will increase faster than the population. In 2030 there will be 8.3 million independent households versus 7.7 million in 2018. This implies that the housing requirement is set to grow by 591,000. According to the forecasts, the housing shortage will decrease from 3.2% to 2.6%.

[4] De Leve E., Geuting E., Lenteferink L., *'Benchmark Gemeentelijke Grondprijzen 2018-2019'*, Stec Groep 2018

Housing shortage in the various municipalities

Housing shortage	2017		2030	
	Number	%	Number	%
Municipality of Groningen	5,000	4.9	4,500	4.0
Amsterdam Metropolitan Area	61,000	5.4	54,500	4.2
Amersfoort Region	5,500	3.3	5,000	2.7
The Hague Region	22,000	4.3	31,500	5.6
Eindhoven Region	12,000	3.5	6,500	1.7
Rotterdam Region	16,000	2.7	19,000	3.0
Utrecht Region	18,500	5.7	21,000	5.6
Total shortage in regions with supply-demand tensions	140,000	4.4	141,500	4.0
Rest of Netherlands	102,500	2.3	221,000	1.6
Total Netherlands	242,500	3.2	222,500	2.6

Source: ABF Research

Demand: household preferences

The differences in population growth between the regions have to do with the shifting preferences of households which, in turn, are related to economic, social, cultural and technological changes. Due to the knowledge economy, people want to be in places where it is easy to physically meet in order to exchange information. Urban concentrations are ideal for this purpose. Furthermore, the demise of the single breadwinner model is going hand in hand with a growing preference for urban areas where both partners can find work. Added to this, the multiple cultural offerings of cities also hold a strong appeal. Traffic congestion, of course, is a less attractive aspect of urban conglomerations. Good infrastructure and mobility are therefore key to facilitate urban growth. A recent study into the historical development of London shows that without modern transport technology, this metropolitan area would have had far fewer inhabitants.[5] Whether people will want to live in or outside cities in the future will also depend on the self-driving car. If this innovation takes off, homes in the green peripheral municipalities may become more popular. If not, people will probably gravitate towards public transport hubs in the city.[6]

Demand: recent price movements

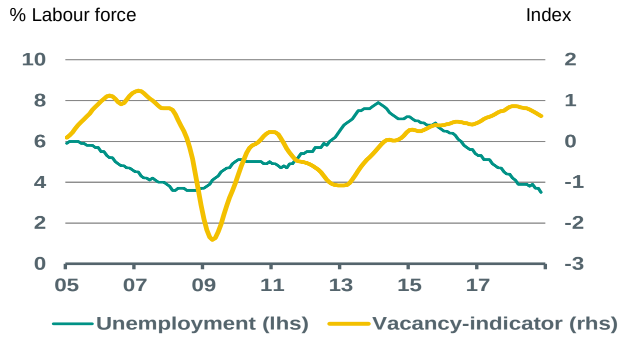
Another factor influencing demand is the recent price movement. People are inclined to base their future expectations on their experiences in the past. This also applies to house prices. They extrapolate yesterday's price movements to tomorrow. If house prices fall, confidence in the housing market is undermined and people lower their expectations. And when prices rise, the reverse happens. The rising prices in the past years have been self-reinforcing. Realising that the crisis was behind us, people increasingly felt the time was ripe to buy. Now that prices are back to their original level, supply is limited and uncertainty about the economy is growing, the urgency to buy is receding and the self-reinforcing upward price effect will automatically disappear.

[5] Heblich S., Redding S., Sturm D., *'The making of the modern metropolis: Evidence from Londen' vox.org* 13 October 2018
[6] Gelauff G., Ossokina I., Teulings C., *'Zelfrijdend vervoer leidt tot trek naar de Randstad en meer welvaart' ESB* 15 November 2018

Demand: the state of the economy

After years of economic acceleration, expectations were high at the start of 2018 that GDP would continue to surge upwards. US stimulus measures were expected to sustain buoyant growth. In the event, growth in the Netherlands appears to have decelerated from 3% to 2½%. The trade conflict between China and the United States depressed sentiment. In addition, many central banks of emerging economies found themselves compelled to follow the Fed's rate increases in the US, leading to tighter global monetary conditions. Another damper on GDP was the growing political uncertainty about Brexit, the Italian budget and, more recently, the yellow vest protests in France and Angela Merkel's succession in Germany. We foresee a further weakening of growth in the Netherlands to 2% in 2019 and 1.7% in 2020. The economy's contribution to the house price movement will thus be less positive than in recent years.

Labour market situation has improved



Source: Statistics Netherlands (CBS)

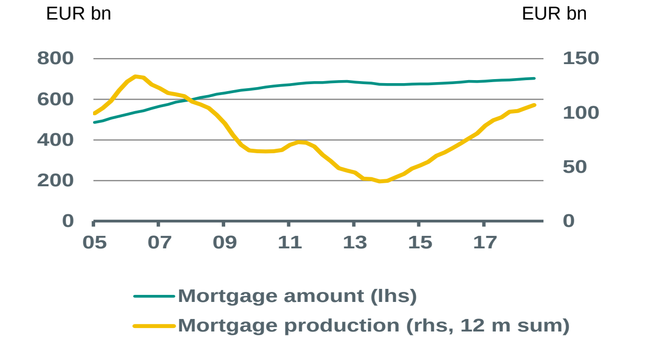
Demand: disposable income

The state of the economy has consequences for the labour market. Higher GDP growth typically leads to more employment, less unemployment and higher disposable incomes. This usually happens with a time lag. In 2018 unemployment decreased from 4.9% to 3.8%. Employment advanced and there were more vacancies, but by no means all were filled. The increased tension is leading to extra wage growth, albeit to a modest extent. Recent outcomes of the collective bargaining talks suggest that wages will rise slightly faster next year. As well as the tightness in the labour market, this has to do with the inflationary effect of the VAT increase effective from 2019. Growing disposable incomes will thus continue to have a positive impact on house prices for the time being. In the longer term, however, the expected weakening in economic activity will put a brake on house prices.

Demand: financial wealth

Buyers finance the purchase of their home partly from their own funds. Clearly, therefore, cash-rich buyers have an advantage in the property market. Dutch people are relatively affluent compared to people abroad. This is mainly because they traditionally save a lot due to the compulsory pension saving system. However, these compulsory savings are tied up in pension investments and are therefore not readily accessible. As their freely available capital is a bit lower than in surrounding countries, their net financial wealth plays a less prominent role in the house price movement. That said, the recent price falls in international financial markets will probably have a negative effect on housing market sentiment.

Higher mortgage production doesn't lead to more lending



Source: Land Registry and Statistics Netherlands (CBS)

Demand: mortgage lending

Looking at the Netherlands, we see that mortgage activity has increased in recent years, but partly due to remortgaging which is unrelated to house purchases. The change in the outstanding mortgage amount therefore provides more insight. Since 2013, this has increased by EUR 30bn to EUR 702bn. Even if we add the EUR 75bn of extra repayments to this amount, it is unlikely that mortgage lending has been the driving factor behind the price increases. The increase in the mortgage amount including extra repayments came to 15%, while valuations rose by more than 30% in that period. Note, however, that lending to professional investors has been left out of consideration as the amount of these loans is not known. The above data exclusively concern mortgages to natural persons.

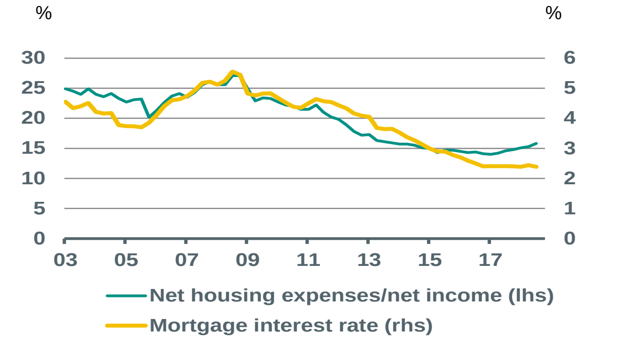
Demand: mortgage conditions

To obtain an accurate picture of mortgage lending in the future, we need to look at the lending conditions. The amount that house buyers are allowed to borrow based on the value of the collateral has been reduced in phases to 100%, which is still a high percentage by international standards. Various supervisory authorities are pressing for a further reduction and want to oblige buyers to make an even bigger down payment. The government is reluctant to do this, as it would raise the barrier for first-time buyers. The government, by contrast, would prefer to lower the barrier for this group. To this end, the qualifying limit for guaranteed NHG mortgages will be raised in 2019 by EUR 25,000 to EUR 290,000 and the premium will be reduced from 1% to 0.9%. The income criteria will also be relaxed. The National Institute for Family Finance Information (Nibud) thinks that the measures proposed by the government will enable households to bear higher housing costs. In addition, it wants to give buyers more financial room for measures to make their home more sustainable. This is against the grain of the financial market supervisors, the Netherlands Authority for the Financial Markets (AFM) and DNB. They disagree with the Nibud calculation system and want assurances about the expected cost savings from sustainability measures. They are concerned about the relaxation of the lending criteria, especially as the housing market is overheated.

Demand: interest rates

The sharp fall in interest rates in recent years has had a twofold impact on house prices. First of all, it made housing more affordable. Thanks to the lower financing costs, buyers are getting a cheaper deal and can offer more for the same property. In addition, it has drawn investors to the property market. Due to the extremely modest earnings on savings accounts, they are looking for more lucrative investment alternatives, including rented housing. The inflow of buy-to-let investors is giving house prices further upward momentum. Meanwhile, valuations have risen to such an extent that some investors with a high-risk profile are pulling out of the market. The rental income on their residential portfolio no longer matches up to the return they hope to generate with other investments.

Lower mortgage rates pushing down housing costs



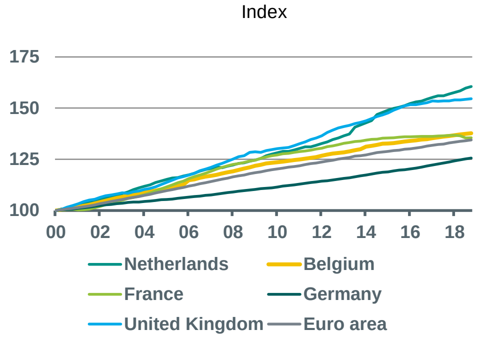
Source: DNB and Calcasa

The big question is: will interest rates stay low? We think they will. The low interest rates have to do with structural factors, such as the aversion among governments to pursue a fiscal stimulus policy, the growing saving propensity due to the ageing population and the lower productivity growth which makes investing less attractive. These structural factors will remain in place for the time being. In addition, the low interest rates stem from the ECB, which has slashed the official rates and has driven down the long rates through its extensive bond-buying programmes. The aim was to promote the economic recovery and achieve higher inflation. With inflation still low in the eurozone, we assume that the ECB will continue to pursue an expansive monetary policy. The ECB's asset purchase programme was discontinued effective from January, but the first official rate increases will not happen any time soon. In this light, we think that mortgage rates will remain low for the time being and continue to contribute to valuations in the housing market.

Demand: taxes

Taxes are another important factor in the net housing costs. Dutch homeowners are allowed to deduct mortgage interest for income tax purposes. This makes buying more attractive and has a price-increasing effect. As is known, the government is seeking to limit the tax relief on mortgage interest. In 2019 the highest marginal rate at which homeowners are allowed to deduct interest will be cut by a further half percentage point, from 49.5% to 49%. Homeowners will be compensated for this in the form of a lower 'eigenwoningforfait' (tax on imputed rental income). Furthermore, the government will start phasing out the Hillen arrangement (a discount on the imputed rental income for homeowners with no or low mortgage interest costs), while the gift tax exemption will be increased from EUR 100,800 to EUR 102,010. Finally, there is also the property tax. According to the Homeowners' Association, this is set to rise by 2.2%, which is less than the expected increase in inflation. On average, homeowners will pay EUR 289 in property tax. These tax measures have already been priced into home valuations and are unlikely to have any effect on future price movements.

Rents have increased relatively quickly



Source: OECD

Demand: the rented segment

The alternative to buying is renting. If rented housing is expensive or hard to come by, buying becomes attractive. Rents in the Netherlands have risen relatively quickly. According to landlord website Pararius, rents for new-build housing in the private sector were on average 5.3% higher in the third quarter than in the previous year. The same ripple effect as with owner-occupied housing can be seen here, with rents now also climbing outside the large cities. In the social housing segment, housing associations have agreed to bring rents back into line with inflation after years of above-inflation increases. Extra increases are only permitted if necessary to finance new-build development and if tenants and municipalities agree. Despite the strong demand, the construction of social and private rented housing still falls well short of what is needed. Housing associations point in this connection to the Landlord Levy, an extra tax which, they say, prevents them from investing more. Professional investors complain about the regulatory straitjacket that puts them off investing in rented new-build development. This suggests that the tightness in the rented market is set to persist.