

Dutch Residential Mortgage Market 2018-Q3 Quarterly Update

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Introducing our quarterly reports



Jasper Koops,
Portfolio Manager

In this quarterly report we discuss developments in the Dutch housing market and the broader economy. The quarter marked the 10-year anniversary of the bankruptcy filing of Lehman Brothers and the beginning of a credit crisis which resulted in a global recession. We use this opportunity to discuss how the Dutch housing market has been subject to regulatory changes which have decreased risks, increased consumer protection and increased lender competition in the mortgage market. As always, we welcome the opportunity to discuss the housing market or investing in Dutch mortgage loans with you.

Comment

During the past few years, an interesting trend has started to emerge. 5- and 10- year fixed rate periods used to get most of the market volume, but they have now been overtaken by the longer 20- and 30- year fixed rate periods.

This has happened as pension funds and insurance companies are playing an increasingly big role in the Dutch mortgage market and borrowers want to lock in historically low interest rates.

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Contact

Jasper Koops
Mortgage Team
Dynamic Credit Partners Europe

Frederik Roeskestraat 97D
1076 EC Amsterdam
The Netherlands

Desk: + 31 20 794 60 58
jkoops@dynamiccredit.com
www.dynamiccredit.com

Dutch Residential Mortgage Market 2018-Q3 Quarterly Update

1. Executive Summary

10 years after Lehman Brothers: a number of measures have been taken in order to reduce risks in the housing market. We comment on some of the most important changes.

Longer fixed rate periods are getting a bigger market share: the 10-year fixed rate period was clearly the main fixed rate period a few years ago. That is not the case anymore as the 20-year fixed rate period has gotten more popular. The 30-year fixed rate period is also quickly taking a larger piece of the pie.

House price increases accelerated: CBS reports that in 2018-Q3, house prices increased 2.7% QoQ, and 9.2% YoY. Rotterdam stood out with a 4.8% QoQ increase.

Decreasing number of property transfers: approximately 57,000 houses were transferred in 2018-Q3 in the Netherlands, a decrease of more than 7% compared to 2017-Q2. The decrease was evident in all provinces except for Zeeland which had a small increase of 5% YoY.

Monetary policy: the ECB decided to keep the interest rate on the main refinancing operations, the marginal lending facility, and the deposit facility unchanged at 0.00%, 0.25%, and -0.40% respectively. The Inflation estimates for the euro area for 2018 and 2019 were both unchanged at 1.7%. The GDP growth estimate for 2018 was lowered from 2.1% to 2.0% with 2019 lowered from 1.9% to 1.8%.

Mortgage interest rates remained largely flat: the average decrease, across all major risk classes and all major fixed rate periods, was 2 bps QoQ.

Swap rates increased significantly: the increase was quite steep, especially in September. Many lenders have increased rates in October, after the end of the third quarter.

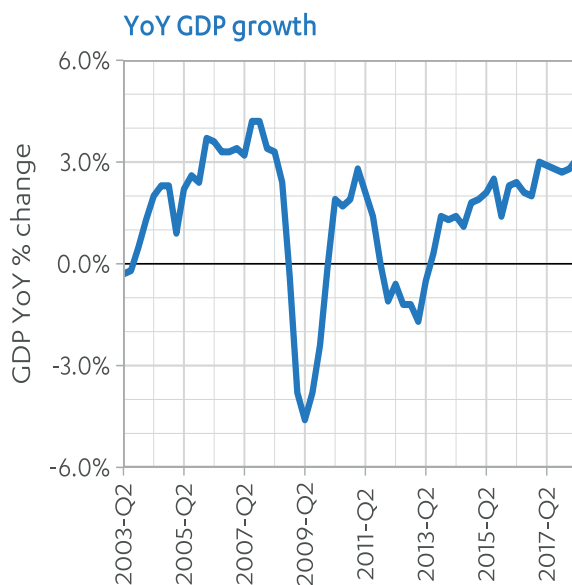
2. Market update

The following sections provide an update on the macroeconomic outlook, Dutch mortgage loan interest rates and spreads, the RMBS market, the Dutch mortgage loan and housing market, mortgage (related) regulation, and other relevant developments.

Macroeconomic update

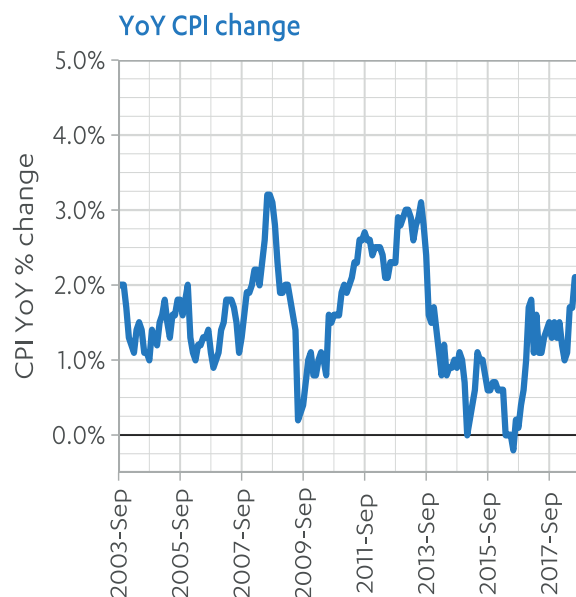
The most recent economic updates of the Central Bureau of Statistics (“CBS”) on key economic indicators generally indicated a strong economy with a GDP growth of 3.1% YoY in 2018-Q2 for the Netherlands (Figure 1) (2.8% in 2018-Q1). Headline inflation (CPI) was higher than 2% for the first time since September 2013 as it reached 2.1% YoY in July and August before dropping to 1.9% YoY in September compared to 1.7% YoY in June (Figure 2). The spike in inflation was mainly driven by increases in house rents which are annually raised in July. The average residential YoY rent increase increased from 1.6% in July 2017 to 2.3% in July 2018. Inflation increased at a slower pace in September than in August and July due to cheaper fares and the price development of petrol.

- Inflation higher than 2% for the first time in almost 5 years -



Source: Dynamic Credit, CBS

Figure 1: Dutch GDP growth. As of 2018-Q2

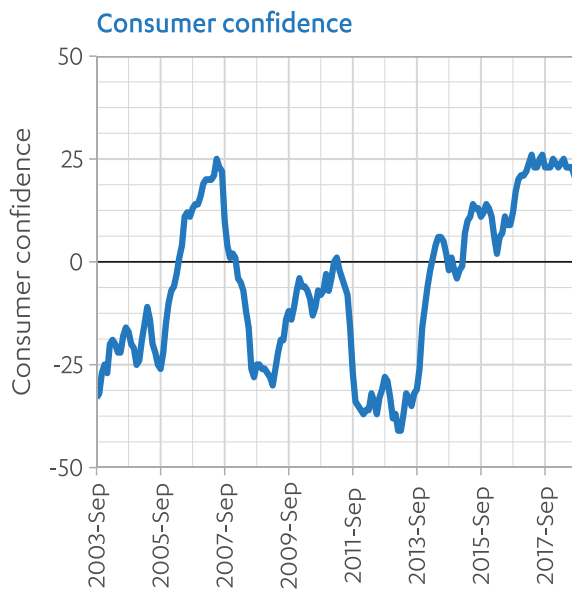


Source: Dynamic Credit, CBS

Figure 2: Dutch CPI change. As of September 2018

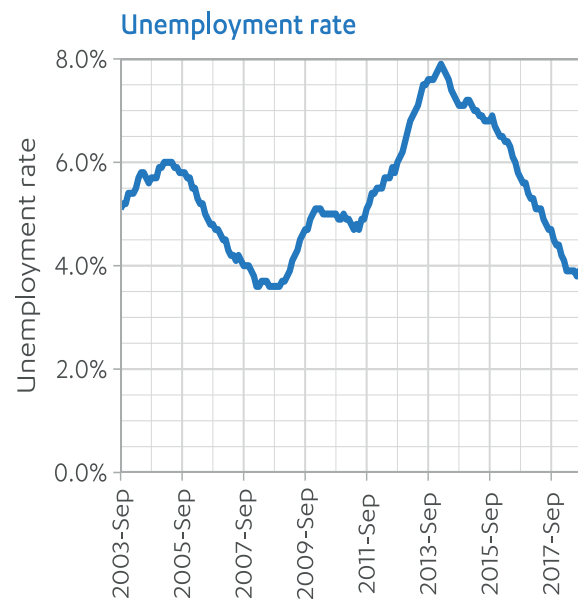
Dutch consumer confidence decreased from +23 in June 2018 to +19 in September 2018 (Figure 3). The willingness to buy was largely unchanged but decreased from +9 in June to +8 in September as consumers still think it is a good time to make large purchases. The most notable change was in consumers' confidence in the economic climate which went from +43 in June to +34 in September as consumers were less positive about the past as well as the next 12 months. The unemployment rate decreased from 3.9% in June 2018 to 3.7% in September 2018 (Figure 4).

The employed labor force increased by 22,000 per month on average during 2018-Q3, a slight increase compared to 2018-Q2 which had an average increase of 17,000 per month. The labor participation rate increased from 70.5% in 2018-Q2 to 70.8% in 2018-Q3. DNB reported in its last Economic Outlook on 14 June 2018 that the unemployment rate is expected to decrease even further and reach 3.5% in 2019.



Source: Dynamic Credit, CBS

Figure 3: Dutch consumer confidence. As of September 2018



Source: Dynamic Credit, CBS

Figure 4: Dutch unemployment rate. As of September 2018

Eigen Huis Market Indicator ¹

Vereniging Eigen Huis ("VEH") measures consumer confidence in the housing market every month. They do that based on questions about interest rates, prices, and the general market. Over the past 3 months, the index has increased from 104 in June 2018 to 105 in September 2018. The index was at 113 in September 2017. The indicator can take values ranging from 0 to 200, 100 indicating a neutral value. A higher value indicates a more positive sentiment.

VEH reports that the proportion of people who find it an unfavorable time to buy a house has increased from 20% one year ago to 40% as of 2018 Q3. The two main reasons are unaffordability and limited supply. VEH also note that more than 80% of the Dutch people believe that house prices will continue to increase while almost 50% of the people believe that interest rates will remain the same or increase.

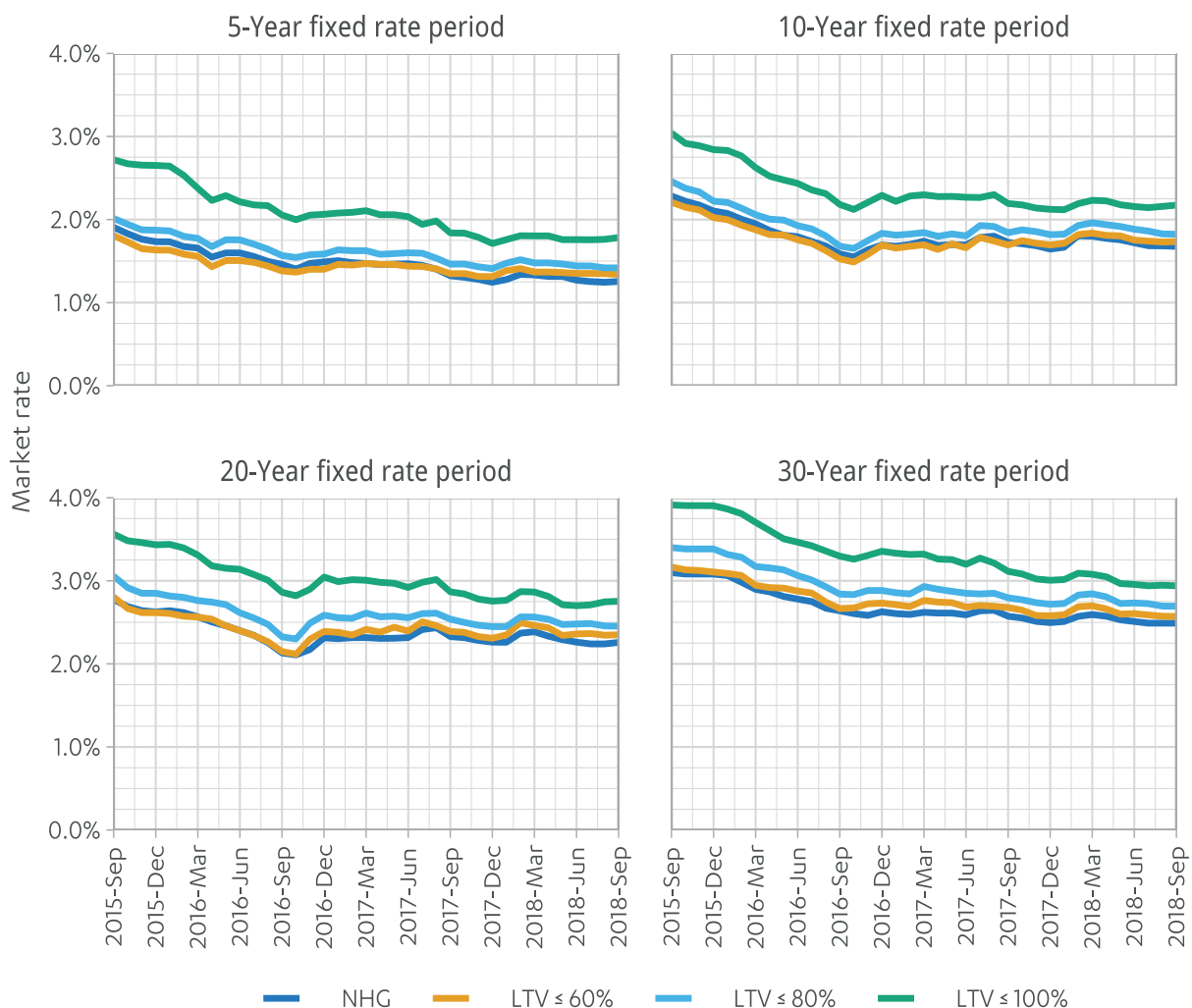
¹ [Eigen Huis Market Indicator 2018-Q3](#)

Interest rate developments

Across all major risk classes and all major fixed rate periods, the top six rates have decreased from the end of 2018-Q2 to the end of 2018-Q3 by 2 bps on average. However, the relatively popular 100% LTV classes generally had increasing rates except for the 30-year 100% LTV mortgage interest rate which decreased from 2.96% in 2018-Q2 to 2.94% at the end of 2018-Q3. The 20-year 100% LTV rate increased from 2.70% in 2018-Q2 to 2.75% at the end of 2018-Q3. We mentioned in our last quarterly report that several new mortgage providers have entered the market with a focus on the 30-year segment. For an overview of the evolution of mortgage rates, see Figure 5 below.

Mortgage rate developments

Average top 6 market rates



Source: Dynamic Credit, Hypotheekbond

Figure 5: Average top-6 mortgage rates (excluding action rates) for mortgage loans with different fixed rate periods for four risk classes.

For a breakdown of the rates, see Figure A5 to Figure A8 in the Appendix.

Spread developments¹

The table and graphs below show spreads over swaps for the 5-, 10-, 20- and 30-year fixed rate periods for NHG and various non-NHG mortgage loans. For a more detailed view of the rate decomposition and spread evolution throughout time, please see figure A1 to A4 in the Appendix.

The information in the table/graphs can be interpreted as a representative gross spread for newly originated Dutch residential mortgage loans over time.

Spread development for average of top 6 mortgage rates								
Fixed rate period	Risk class	2017-03-31	2017-06-30	2017-09-30	2017-12-31	2018-03-31	2018-06-30	2018-09-30
5-year	NHG	1.46%	1.37%	1.24%	1.08%	1.12%	1.14%	0.99%
	60% LTV (non-NHG)	1.46%	1.34%	1.27%	1.14%	1.16%	1.23%	1.07%
	80% LTV (non-NHG)	1.62%	1.50%	1.38%	1.24%	1.27%	1.32%	1.15%
	100% LTV (non-NHG)	2.11%	1.94%	1.76%	1.54%	1.59%	1.64%	1.52%
10-year	NHG	1.31%	1.12%	1.16%	1.04%	1.11%	1.12%	0.93%
	60% LTV (non-NHG)	1.23%	1.09%	1.11%	1.08%	1.15%	1.16%	0.99%
	80% LTV (non-NHG)	1.39%	1.23%	1.27%	1.21%	1.27%	1.29%	1.07%
	100% LTV (non-NHG)	1.88%	1.71%	1.63%	1.52%	1.55%	1.57%	1.43%
20-year	NHG	1.43%	1.29%	1.27%	1.24%	1.30%	1.24%	1.10%
	60% LTV (non-NHG)	1.52%	1.37%	1.33%	1.29%	1.37%	1.34%	1.19%
	80% LTV (non-NHG)	1.72%	1.54%	1.49%	1.43%	1.48%	1.47%	1.30%
	100% LTV (non-NHG)	2.15%	1.92%	1.84%	1.76%	1.80%	1.70%	1.61%
30-year	NHG	1.64%	1.47%	1.41%	1.38%	1.42%	1.41%	1.25%
	60% LTV (non-NHG)	1.79%	1.57%	1.53%	1.47%	1.53%	1.51%	1.34%
	80% LTV (non-NHG)	1.97%	1.75%	1.65%	1.62%	1.68%	1.64%	1.47%
	100% LTV (non-NHG)	2.38%	2.11%	1.98%	1.93%	1.94%	1.88%	1.72%

Table 1: Spread of the average top-6 mortgage rates (excluding action rates) over duration matched swap rates for four risk classes. Source: Dynamic Credit, Hypotheekbond

Key observations

- The average QoQ decrease in spread, across all major risk classes and all major fixed rate periods (Table 1) was 16 bps. The moves in spreads result from small decreases in mortgage rates and significant increases in swap rates on average.
- September was especially significant in terms of movements in swap rates as all swap rates increased by more than 10 bps during the month of September alone.
- The 10-year NHG and 10-year 100% LTV spreads are now lower than 1.0% and 1.5% respectively.
- The 30-year 100% LTV spread which now stands at 1.72% has gotten more competitive compared to other fixed-rate-period/risk-class buckets. The spread decreased by 26 bps YoY. This was more than that of other buckets. In comparison, the 30-year NHG spread only decreased by 16 bps YoY.

¹ The EUSWxV3 swap is used, which uses quarterly resets and the floating leg is 3-month EURIBOR.

Dutch RMBS market: Priced RMBS deals

A few new RMBS deals were closed during 2018-Q3

Date	Issuer	Series	Seller	Class	Euro Amount	Life	FXFL	Coupon	Spread	Benchmark	M	SP	F	DBR	Retained	Comments
2018-09-06	Storm BV	2018-II	Obvion	A	850.0	5	FL		60	3 Mo. Euribor	Aaa	AAA	AAA		N	EUR 904mm;
				B	19.4	5	FL		100	3 Mo. Euribor	Aa1	AA+	AA		Y	WA CLTV 74%;
				C	17.4	5	FL		200	3 Mo. Euribor	Aa2	AA	A		Y	WA Seasoning 74m;
				D	17.4	5	FL		400	3 Mo. Euribor	A2	A-	BBB+		Y	IO Loans 54.5%;
				E	9.0	5	FL		600	3 Mo. Euribor	Ba1				Y	Self-Employed 10.4%;
2018-07-13	Cartesian Residential Mortgages	3	Venn Partners	A	180.0	4.5	FL		35	3 Mo. Euribor	Aaa		AAA		N	EUR 200mm;
				B	5.0	5.4	FL		88	3 Mo. Euribor	Aa2		AA+		N	WA CLTV 96%;
				C	5.0	5.4	FL		130	3 Mo. Euribor	A2		A+		N	WA Seasoning 5m;
				D	4.0	5.4	FL		175	3 Mo. Euribor	Baa3		BBB-		N	831 Obligors;
				E	6.0										Y	IO Loans 31.3%;
				S	4.5										Y	Self Employed 12.6%;

Table 2: Priced Dutch RMBS Deals in 2018-Q3. Source: Dynamic Credit, JP Morgan

ABS comments

In 2018-Q3 only two Dutch RMBS deals were issued (Table 2). Obvion reached out to the securitization market for the fourth time this year, including notes with a total sum of EUR 913 million. However, all mezzanine and junior tranches worth EUR 63 million were retained. Dutch RMBS issuance YTD has increased to EUR 25.2 billion with EUR 6.8 billion being distributed (including buy-to-let). Obvion, an affiliate of Rabobank, who has already issued 44 prime mortgage-loan securitizations to date (39 in the Storm series) was the seller. The collateral consists of 4,552 first-lien mortgages from the Netherlands whereas the outstanding balance amounts to EUR 904 million. More than half of the portfolio consists of interest-only mortgage parts that are limited to a maximum of 50% in the Netherlands after the latest regulatory changes. The uncertainty surrounding EU regulations on STS and LCR made the marketing a bit more difficult. The AAA's printed at +28 basis points in the end (+28 refers to discount margin, the price was above par). Venn Partners priced their third deal in the Cartesian series. It was a small deal of only EUR 200 million. The portfolio consists of high LTV and a large proportion of interest only loan parts.

Buy-to-let

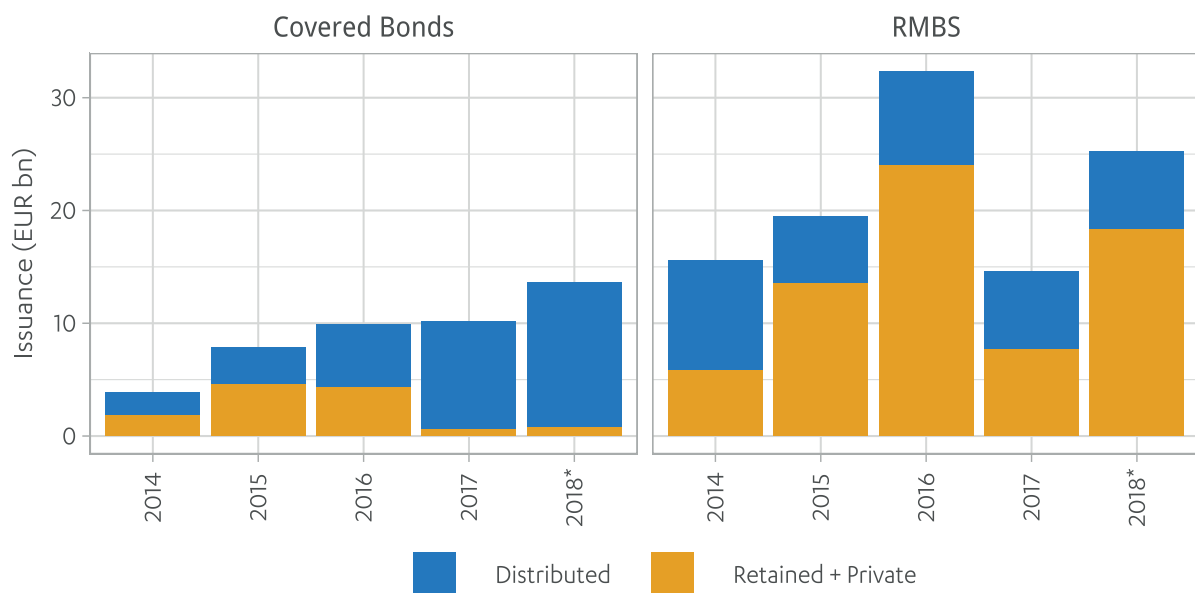
Close to RMBS issuances, a Dutch buy-to-let (BTL) deal by RNLB was closed in September 2018. The Dutch Property Finance 2018-I is a follow-up issuance to the debut which came to the market in August 2017. The notes sold to investors sum up to EUR 400 million, backed by an outstanding loan balance of EUR 527 million. The senior tranche has been rated AAA and priced with a spread of 63 bps over the 3-month Euribor. Although the deal is small compared to previous RMBS deals, it is noteworthy that only the two most junior tranches (face value of EUR 20 million) have been retained.

Covered bonds

The major banks in the Netherlands brought another EUR 1.2 bn of covered bond issuance to the market. The largest deals, by far, were issued by NIBC and Nationale Nederlanden, both with a face value of EUR 500 million. The NIBC and NN deals were priced with a spread of +15 and +14 bps by investors respectively. These deal amounts represent a steep slump not only from the high levels of the first two quarters in 2018 (EUR 4.25 billion and 7.5 billion). This perfectly underscores the relative market inactivity during the last months (Figure 6).

ABN AMRO, ING, Rabobank, De Volksbank, NN, and NIBC are the six financial institutions who currently issue covered bonds. The total outstanding amount of the top 6 issuers is EUR 50.4 billion.

Mortgage funding issuance

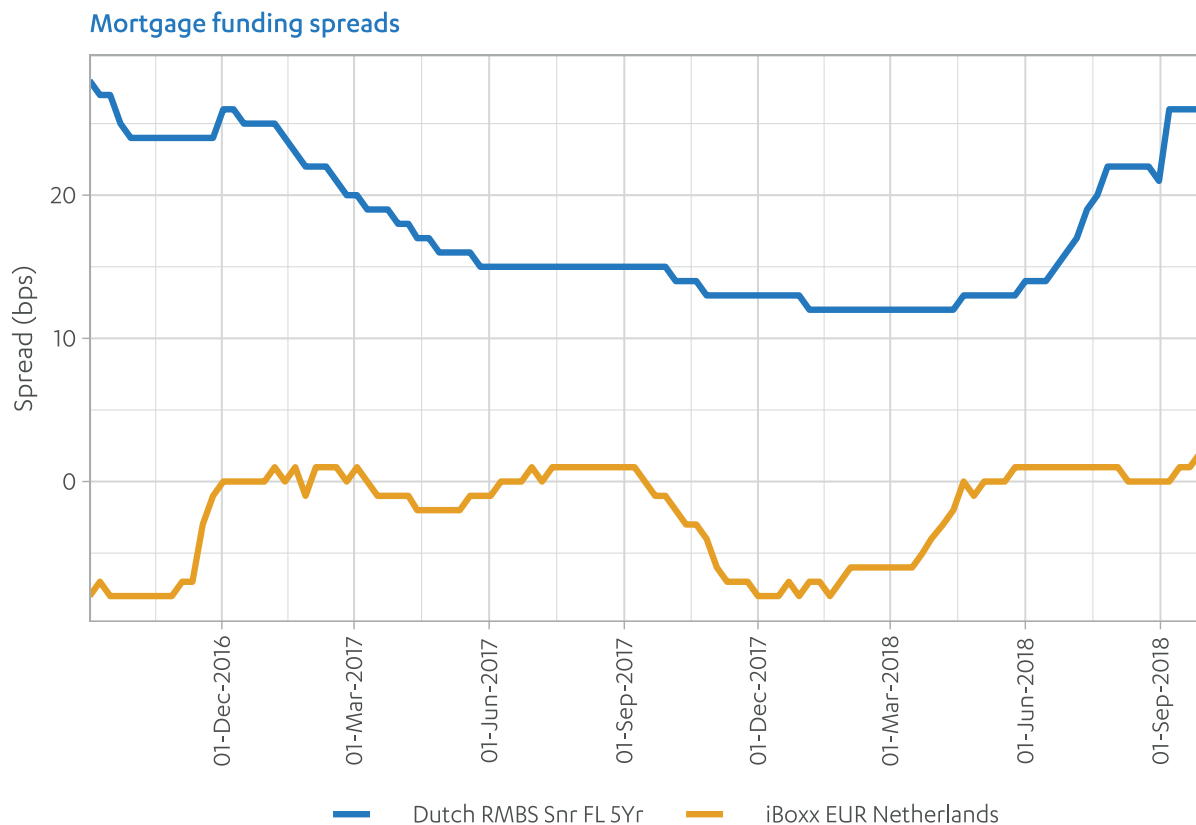


* Data up to Q3
Source: Dynamic Credit, JP Morgan

Figure 6: Issuance of Dutch RMBS and covered bonds.

Mortgage funding spreads

Spreads in the secondary ABS market continued the trend from the previous quarter as they also increased in the third quarter. Dutch RMBS senior notes have picked up to the current spread level of +26 bps. The realization that the loose monetary policy will end soon combined with increased market volatility, in general, were the main drivers. At the same, Dutch covered bonds hovered around 0 bps during the quarter (Figure 7).



Source: Dynamic Credit, JP Morgan

Figure 7: RMBS spread refers to indicative mid spread (discount margin) for representative generic RMBS bonds. iBoxx EUR Netherlands spread refers to spread versus mid swap rates. The data is as of 2018-Q3

Market entry/exit

Robuust Hypotheken

On 2 October 2018, Robuust Hypotheken entered the Dutch mortgage market. The label was launched by the Blauwtrust Group. Quion is the servicer and Connect Mortgage Distribution is responsible for distribution of Robuust Hypotheken mortgages. The mortgage loans are funded by Aegon.

Robuust's most competitive segments are the high LTV risk classes with a long fixed rate period.

NHG

The Dutch National Mortgage Guarantee (“NHG”) scheme, offered by the Dutch Homeownership Guarantee Fund (“Stichting Waarborgfonds Eigen Woning” or “WEW”), provides a safety net if borrowers run into problems meeting their payments due to circumstances beyond their control¹.

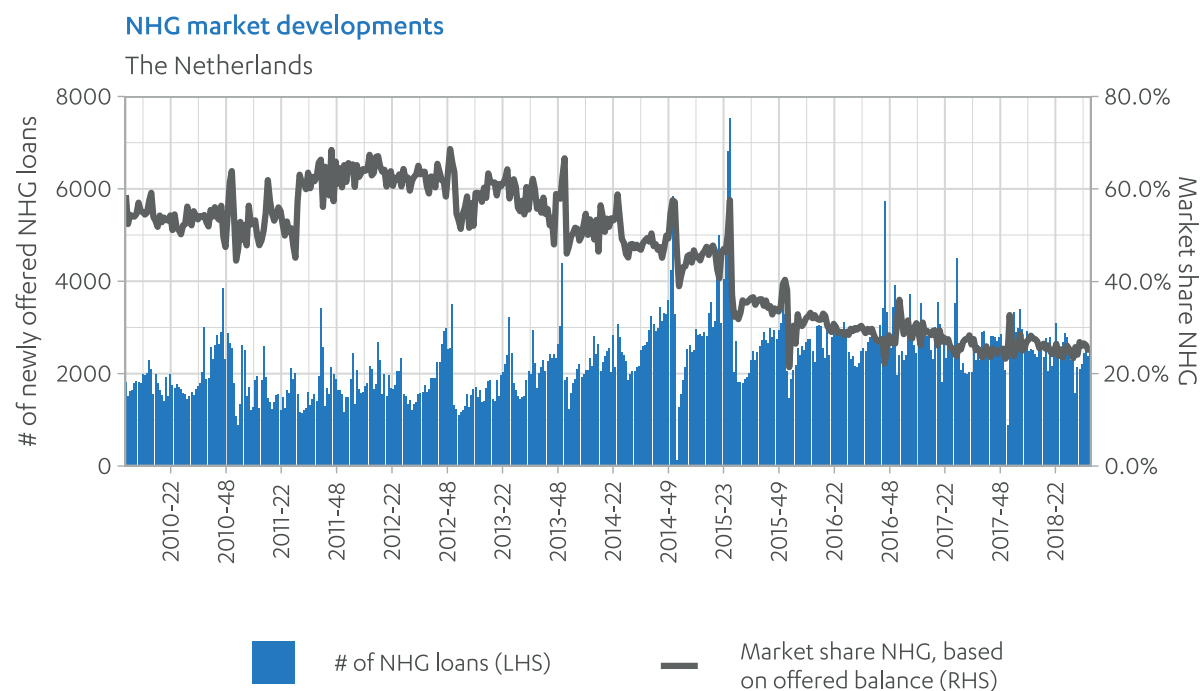
Higher NHG limit and lower premium in 2019

Because of the rapidly increasing house prices, NHG announced that the NHG limit will move to EUR 290,000 by the first of January 2019. The limit is currently set at EUR 265,000.

It was also announced that the NHG premium will be lowered from 1% to 0.9% in 2019.

New NHG Guarantees

Data from the Mortgage Data Network (“HDN”) shows that over 2018-Q3, 30,776 NHG loans with a total balance of EUR 5.6 bn were offered through its network. This corresponds to an NHG market share of 25.0% in terms of mortgage loans balance (Figure 8).



Source: Dynamic Credit, HDN

Figure 8: Number of new NHG guarantees and market share of NHG loans as a percentage of total originated balance through time. The y-axis refers to year and week number.

Loss declarations

The number of loss declarations submitted to WEW decreased from 1,175 in 2017-H1 to 652 in 2018-H1, a decrease of 45%. The NHG payout ratio of accepted declarations decreased from 95.2% in 2017-H1 to 93.4% in 2018-H1².

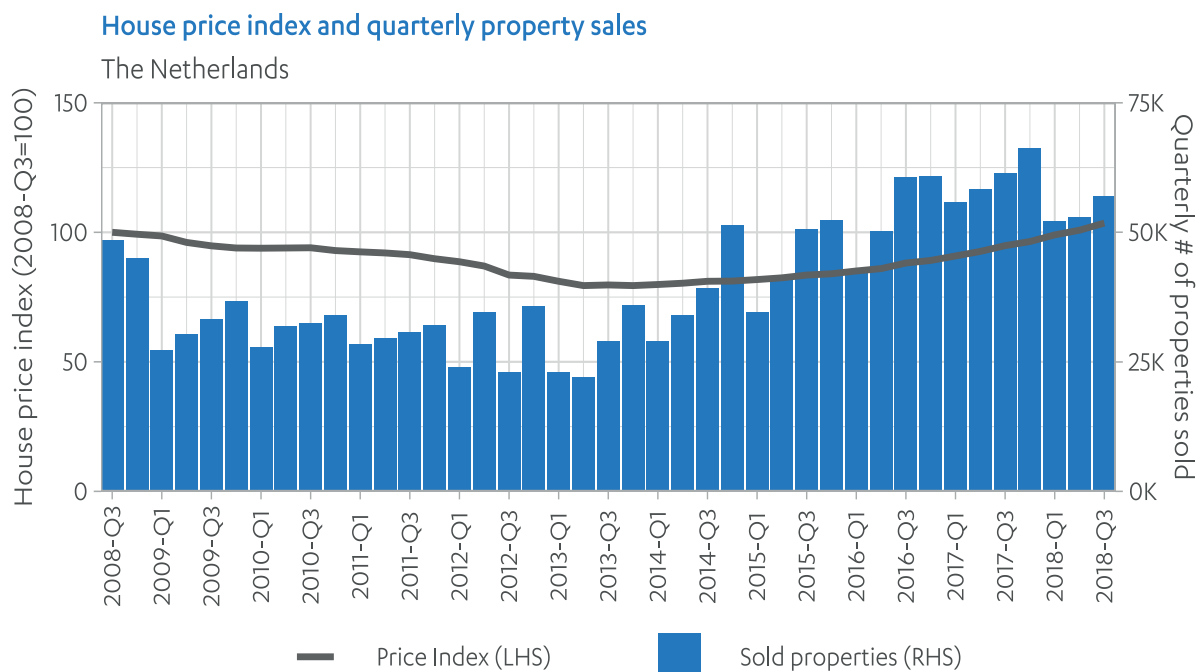
¹ <https://www.nhg.nl/english-summary/Professionals>

² [NHG - Quarterly report Q2-2018](#)

House prices and property sales

The CBS house price index increased 2.7% over the third quarter of 2018 and 9.2% YoY. During the third quarter of 2018, house prices increased 1.8% QoQ and 8.8% YoY.

Close to 57,000 properties were sold during 2018-Q3, an increase of 7.3% QoQ but also a 7.3% YoY decrease. The quarter thus continued the trend of 2018 as the previous two quarters also had a YoY decrease in the number of sold properties (Figure 9).



Source: Dynamic Credit, CBS

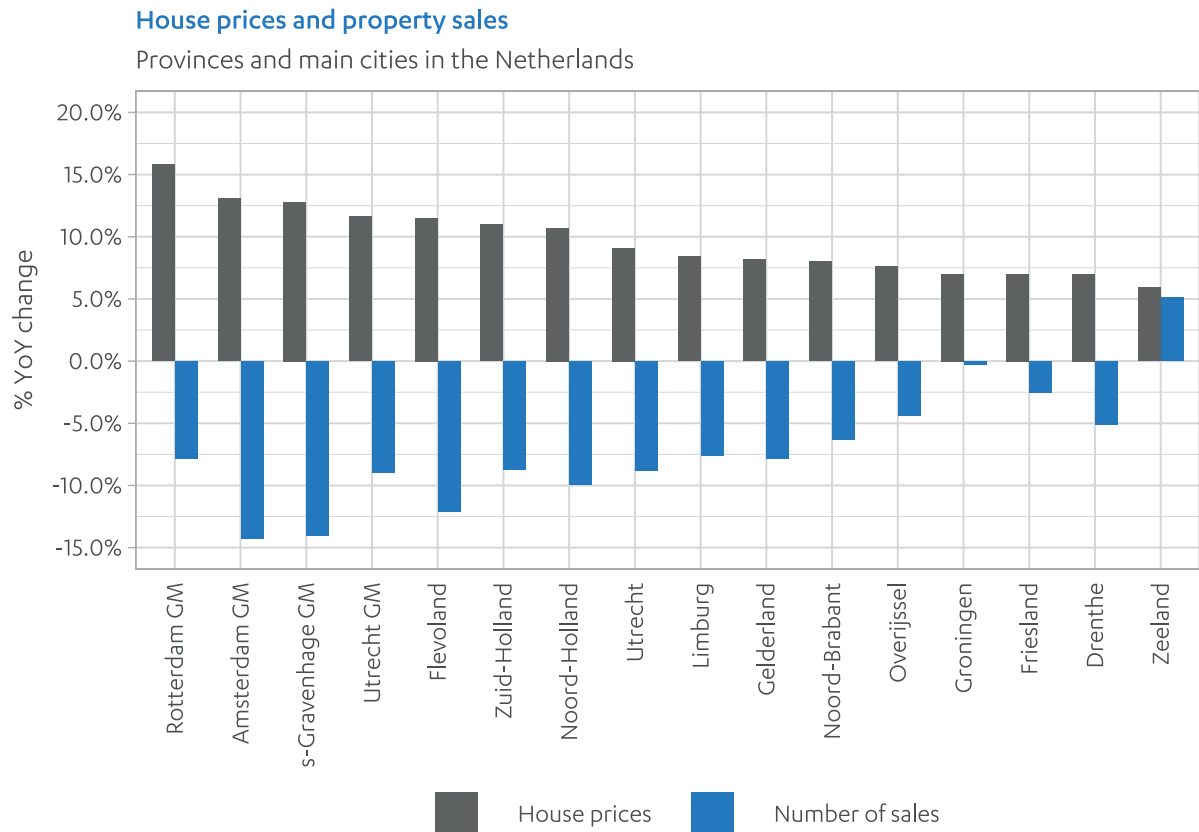
Figure 9: House Price Index of the Netherlands (2008-Q3=100) and quarterly property sales. The data ranges from 2008-Q3 up to and including 2018-Q3.

Regional differences

During 2018-Q3, price divergence between the big cities and the rest of the country continued to increase as Rotterdam, 's-Gravenhage, and Amsterdam all had larger QoQ and YoY house price increases than the national average. Most noteworthy, Rotterdam prices increased 4.8% QoQ. This was a much steeper increase than that of Amsterdam (3.6%) and the country overall (2.7%) (Figure 11). In contrast, prices in Utrecht municipality only increased 2.5% QoQ. On a provincial level, we also see that the provinces with the main 4 cities as well as Flevoland are increasing the fastest with Zeeland lagging behind in terms of YoY increases (Figure 10).

- Decreasing house sales everywhere except Zeeland -

Zeeland was the only province which had a YoY increase (5.1%) in the number of sold properties in 2018-Q3. Flevoland had steep YoY decreases with 12.1% fewer properties sold.



Source: Dynamic Credit, CBS

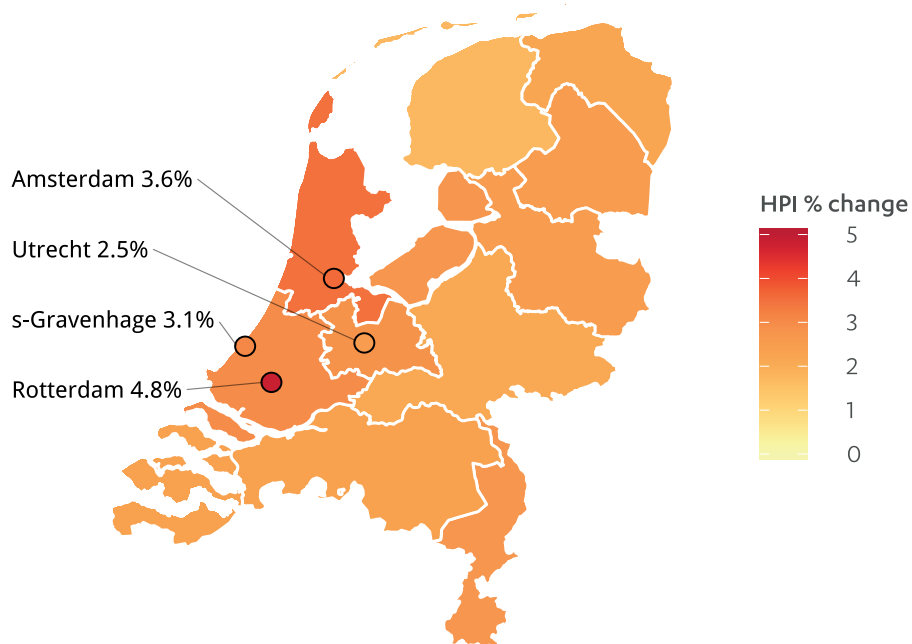
Figure 10: House price index and property sales in 2018-Q3 compared to 2017-Q3.

Figure 10 also suggests that there is a shortage of housing as prices increase steeply while transactions are decreasing. The housing shortage is already a prevalent problem in most Dutch provinces but Rabobank reported earlier this year¹ that housing shortages are expected to increase and all Dutch provinces are expected to have a shortage in 2020 except for Zeeland and Friesland. Furthermore, the shortages are expected to increase.

We reported in our 2018-Q1 report the decrease in property transactions. During the period 2012-2017, the market had increasing sales volumes but a decreasing number of properties for sale at any given moment. This was possible as properties were sold increasingly fast. This trend has changed in 2018 as supply is not able to keep up with demand from homebuyers thus leading to a tighter market.

¹ [Rabo Research - the size and forecast of the housing shortage](#)

House Price Index QoQ change



Source: Dynamic Credit, CBS

Figure 11: House price index changes in Dutch provinces and major municipalities in 2018-Q3.

Area	QoQ Price %	YoY Price %	QoQ Sold %	YoY Sold %
Drenthe	2.5	7.0	6.9	-5.1
Flevoland	2.7	11.5	3.7	-12.1
Friesland	1.7	7.0	14.5	-2.5
Gelderland	2.1	8.2	4.4	-7.8
Groningen	2.2	7.0	8.9	-0.3
Limburg	2.7	8.4	7.7	-7.6
Noord-Brabant	2.3	8.0	1.5	-6.3
Noord-Holland	3.5	10.7	9.7	-9.9
Overijssel	2.5	7.6	8.8	-4.4
Utrecht	2.8	9.1	11.0	-8.8
Zeeland	2.3	5.9	13.8	5.1
Zuid-Holland	3.0	11.0	9.0	-8.7
Amsterdam GM	3.6	13.1	10.5	-14.3
s-Gravenhage GM	3.1	12.8	13.4	-14.0
Rotterdam GM	4.8	15.8	12.8	-7.8
Utrecht GM	2.5	11.6	25.1	-9.0

Table 3: House prices and number of property sales changes in Dutch provinces and major municipalities 2018-Q3. Source: CBS.

10 years after Lehmann Brothers

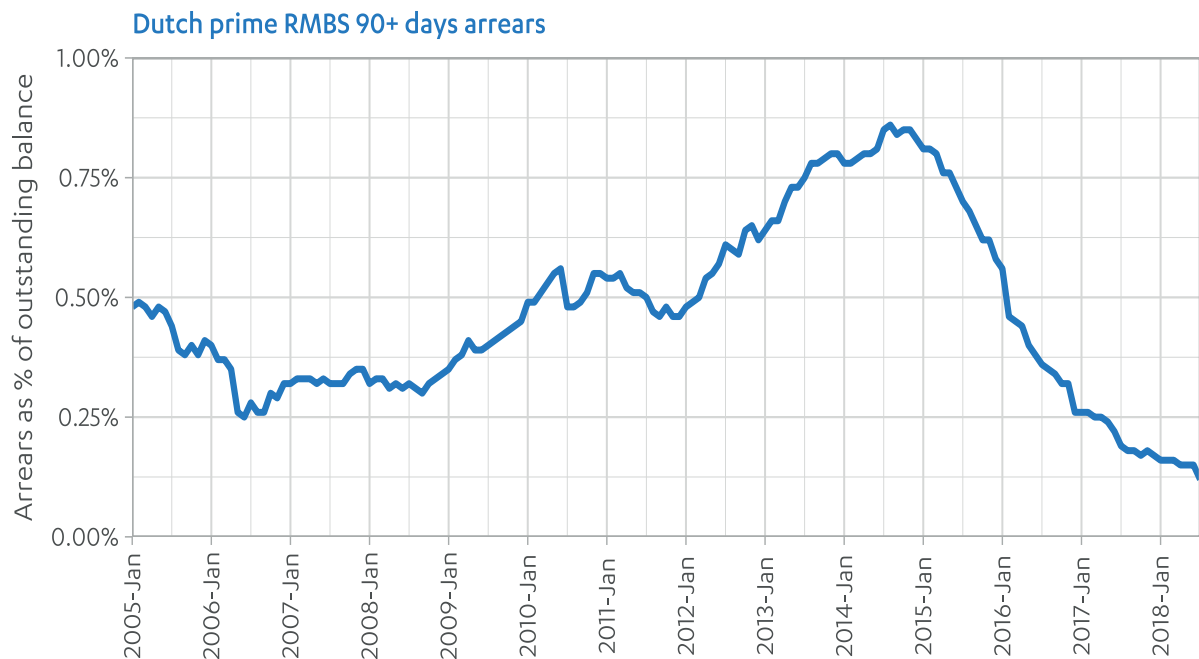
On 15 September 2008, US investment bank Lehmann Brothers filed for bankruptcy. Shortly after, a global recession started. The CBS wrote an article¹ on this which shows statistical developments in a number of categories before, during, and after the crisis.

Restricted lending by the banks

Dynamic Credit published an article² earlier this year on the development of Dutch residential mortgage lending through time. The article described how the aftermath of the crisis resulted in the nationalisation of ABN AMRO bank along with Fortis bank Nederland in 2008 and to capital injections for ING Groep, Aegon and SNS Reaal and subsequent nationalisation of SNS Reaal in 2013. To prevent these parties from gaining an unfair competitive advantage, the European Commission put restrictions in place on the pricing policies of these parties.

Resilient Dutch mortgage market

It should be noted that the Dutch prime market remained relatively resilient as 90+ days arrears remained below 1% throughout the crisis and post-crisis periods. The fact that arrears could remain at this relatively level in spite of unemployment reaching 8% (Figure 4), house prices dropping more than 20% (Figure 9) has been attributed to a strong payment morale and good unemployment benefits amongst others.



Source: Dynamic Credit, Fitch

Figure 13: Dutch prime RMBS 90+ days arrears.

1 [CBS - The Netherlands 10 years after Lehmann Brothers](#)

2 [Dynamic Credit - a selective history of Dutch residential mortgage lending](#)

A number of policy changes were made following the crisis. See Table 4 below for the key regulatory changes:

Year	Event
2007	<ul style="list-style-type: none"> • Introduction of household budget (NIBUD) standards into the Code of Conduct for Mortgage Finance (GHF) with the aim to limit excessive lending through capping the Loan to Income (LTI) ratio.
2011	<ul style="list-style-type: none"> • Stamp duty on residential dwellings reduced from 6% to 2%. • Interest only capped at 50% of property value. • Interest payment on residual debt remaining after property sale will remain tax deductible for a maximum of ten years.
2012	<ul style="list-style-type: none"> • Maximum LTV of 106% to be lowered by 1 percentage point per annum to 100% in 2018.
2013	<p>Self-regulating code of conduct for mortgage finance (GHF) partly replaced by ministerial regulation on mortgage financing:</p> <ul style="list-style-type: none"> • Inducement prohibition on fees paid by lenders to mortgage intermediaries. • Financial service providers are no longer allowed to pay or receive inducements for acting as an intermediary or adviser other than a fee from the borrower. • Maximum LTV was reduced from 106% to 105% and set to be reduced by 1% p.a. until 100% in 2018. • Reduction in interest rate tax deductibility: Used to be equal to the highest marginal tax bracket (52%) but starting from 2013 the maximum deduction is lowered by 0.5% per annum to 38.0% in 2042. • Newly originated mortgage loans have to be repaid in full in 30 years, at least on an annuity basis, in order to be eligible for tax deductibility of interest (linear amortization also eligible). <p>NHG: Only amortizing mortgage loans are eligible for NHG for borrowers who did not have mortgage debt prior to 2013.</p> <p>Single Rate Policy: Lenders not allowed to price discriminate. New borrowers should see same rate sheet as borrowers at rate reset.</p>
2014	<ul style="list-style-type: none"> • Maximum LTV was reduced from 105% to 104% and set to be reduced by 1% p.a. until 100% in 2018.
2015	<ul style="list-style-type: none"> • Interest payments on residual debt remaining after property sale will remain tax deductible for a maximum of fifteen years. • Maximum LTV was reduced from 104% to 103% and set to be reduced by 1% p.a. until 100% in 2018.
2016	<ul style="list-style-type: none"> • Maximum LTV was reduced from 103% to 102% and set to be reduced by 1% p.a. until 100% in 2018.
2017	<ul style="list-style-type: none"> • Increase of the proportion of the second borrower income that is taken into account for maximum debt-to-income percentage to 60% (from 50%). When the maximum DTI percentage has been determined, 100% of both incomes can be used to determine the final maximum loan amount. • Maximum LTV was reduced from 102% to 101% and set to be reduced by 1% p.a. until 100% in 2018.
2018	<ul style="list-style-type: none"> • Maximum LTV of 100% (or 106% in case of energy-saving measures). • Increase of the proportion of the second borrower income that is taken into account for maximum debt-to-income percentage to 70% (from 60%). When the maximum DTI percentage has been determined, 100% of both incomes can be used to determine the final maximum loan amount. • Maximum mortgage loan interest tax deductibility reduced by 0.5% to 49.5%. • Maximum mortgage loan interest tax deductibility might reduce faster starting in 2020. The yearly decrease will accelerate from 0.5% p.a. to 3% p.a. This would mean that the plan is achieved in 2023, almost 20 years faster than the previous plan of 2042.

Table 4: Dutch Mortgage Market Regulatory Changes.

See the following pages for more detailed comments.

Inducement prohibition¹

An inducement prohibition on fees paid by lenders to mortgage intermediaries was introduced in 2013. Financial service providers were no longer allowed to pay or receive inducements for acting as an intermediary or advisor other than a fee from the borrower.

When looking at data from 2009, it is clear that large commissions were paid to advisors for recommending certain labels and certain products. These commissions would typically range between 1% to 3% depending on the product and the label. The advisor would thus have a financial incentive to give biased advice. Furthermore, the commission would be a percentage of the loan amount which meant that the advisor would have an incentive to recommend as high a loan amount as possible.

It was noteworthy how non-complex products such as annuity and linear mortgages were typically not the best ones to recommend if the advisor wanted to maximize fees. More complex mortgages such as investment account products would be compensated much more favorably. The product was essentially an interest-only loan with an investment account which allowed a borrower to apply interest rate deductibility on the full interest-only loan. A return would be assumed for the account and the borrower would then deposit money into this account on a periodical basis such that the cash flows would resemble that of an annuity. There are at least two reasons why investment products were problematic:

- Firstly, borrowers would in many cases invest in funds that lacked transparency regarding fee structure. Fees were in many cases very high and not attractive for borrowers.
- Secondly, an investment account product was more risky than a normal amortizing loan as there was no guarantee that the investment account would accumulate in value as much as expected, especially not if a crash in the value of the investment portfolio was to occur.

The inducement prohibition has added a layer of protection to borrowers. The setup means that lenders have more incentive to compete on rates, product and customer service as opposed to kickbacks to the mortgage advisor.

Short-lived life of self-certified products

In 2007-2008, a trend was starting to emerge as mortgage providers started to offer products for which income was self-certified. These were products for which the borrower income was not verified by the lender. A number of labels later changed this to advisor-certified products. These were products where the borrower would determine income together with the mortgage advisor.

- Borrowers could determine their own income without income records -

These types of products were short-lived and stopped again in 2008-2009. Furthermore, they are no longer possible as industry regulation has been replaced by government regulation.

¹ Commission data from AFAB (an intermediary) in 2009.

Excessive use of the “explain clause” to get around the standards in the pre-crisis years^{1,2,3}

DNB published a paper in September 2009 on the risks in the mortgage market. They noted some undesired developments with regards to compliance with the Code of Conduct. This was based on a study from 2007 in which the quality of mortgage advice was researched. They found that during the first months of 2007, 28% of the applications fell under the *explain clause*. This clause was only meant to be used for exceptional cases as it would allow lending even in situations where the borrower deviated from the loan-to-income and loan-to-value rules set forth in the industry standard Code of Conduct.

- Excessive use of the “explain clause” was used in order to get around debt-to-income and loan-to-value requirements -

AFM did research on financial intermediaries in 2008. In their sample, insufficient reasons had been given in 92% of the cases where the “explain clause” had been used. In 8% of the cases, the clause was justified as the mediator could demonstrate that there were sufficient freely available own resources or that the salary would start increasing within a specific time limit to a level that was within the test standard. The AFM study thus clearly confirmed that the “explain clause” was being misused. It was used in order to get away with excessive lending.

The Code of Conduct prior to 2013 refers to the self-regulating Code of Conduct for mortgage financing GHF (“Gedragsscode Hypothecaire Financieringen”). GHF, an industry standard, is still in place today but was partially replaced by ministerial regulation on mortgage financing in 2013 when the “tijdelijke regeling hypothecair krediet” was introduced. There is also an “explain clause” in the ministerial regulation but it is much more restrictive. This is evidenced by a study by the Ministry of Interior and Kingdom which shows that only 3.5% of cases from 2015 and the first half of 2016 deviated from the regular financial requirements of the “tijdelijke regeling hypothecair krediet” and relied on the explain clause. The study shows quite some variation between lenders and mentions that several lenders do not allow the use of the explain clause at all. The study found that no lender made use of the explain clause in more than 6% of the cases.

Single Rate Policy⁴

Before the Single Rate Policy was introduced, customers were not protected at rate resets. Many market participants would take advantage of the fact that borrowers, to a large extent, just accept whatever they are given when the fixed rate period expires. Lenders would take advantage by offering significantly higher rates at rate reset than they would offer new borrowers. In November 2010 the TV show TROS Radar aired an episode of their show that focused on the loyal customer penalty at mortgage providers. The show got a lot of media attention and eventually, the Minister of Finance at the time responded with a letter saying that he would talk to his advisors and investigate the matter. This ultimately resulted in the introduction of the Single Rate Policy which meant that lenders could no longer discriminate between new and existing borrowers with the same risk profile.

1 [Risks in the mortgage market - Dutch National Bank 2009](#)

2 [Customization of mortgage lending - Ministry of Kingdom and Interior 2017](#)

3 [AFM - Research on financial intermediaries](#)

4 [Loyal customer penalty - TROS radar 2010](#)

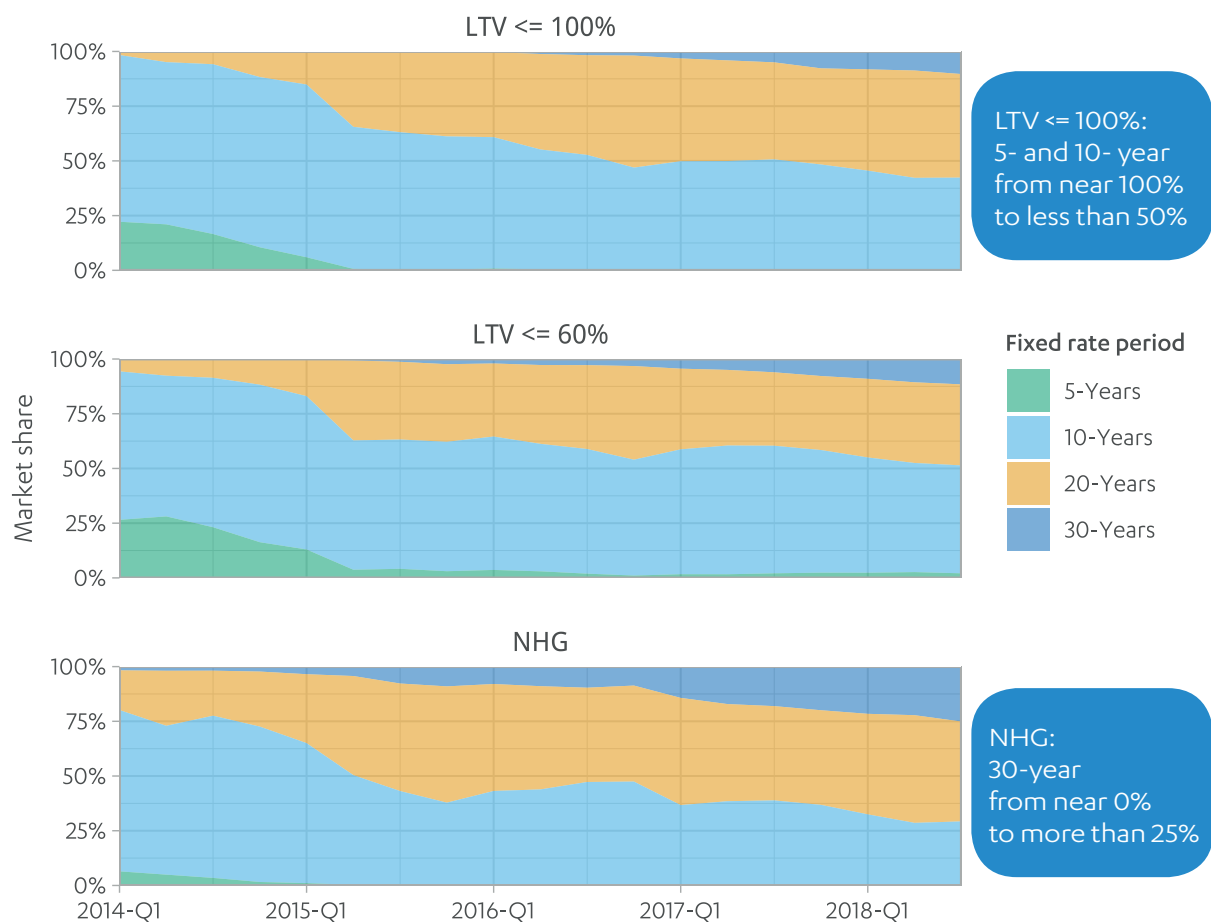
Mortgages gaining popularity with insurers

More and more consumers want to benefit from the current low-rate environment. Therefore, more people apply for a mortgage with a 20- or 30-year fixed rate period. At the same time another development is taking place where more insurance companies and pension funds are entering the Dutch mortgage market, attracted by the relatively attractive returns, regulation for insurance companies favouring whole loan portfolios to securitizations and several direct lending platforms providing access to whole loans. DNB reported that insurers have increased their exposure to Dutch mortgages in the period 2015-2017 with EUR 11.5 bn while reducing exposure to government bonds.

-Dutch insurers expanded their mortgage portfolio by EUR 11.5 Billion between 2015-2017 -

FD reported in 2016 that more pension funds were entering the Dutch mortgage market, pushing out banks in the process. These new market participants are seeking fixed income investments with a good risk/return profile that also matches the duration of their liabilities.

Evolution of market share per fixed rate period



Source: Dynamic Credit, HDN

Figure 14: Market share of different fixed rate periods. Market share is calculated using originated amount.

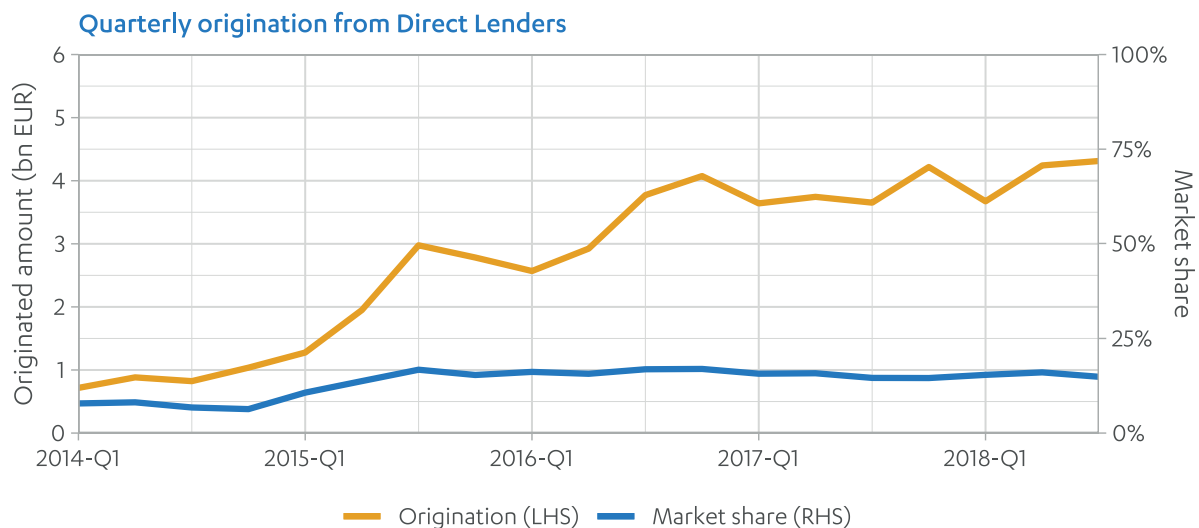
The combination of low rates and more competition in the long fixed rate period buckets caused the 20- and 30-year fixed rate period buckets to gain a large amount of market share as illustrated in Figure 14.

When looking at Figure 14 we notice the following developments:

- The 5-year fixed rate period used to have a market share of more than 20% in the non-NHG risk classes, but that market share has basically gone to 0, especially in the NHG and 100% LTV buckets. A change in regulation has had an impact such that loans with a fixed rate period of less than 10 years are now subject to an affordability test by the AFM benchmark rate which restricts the possible loan amount.
- The 10-year fixed rate period, which was by far the leading bucket in 2014, has also lost a large part of its market share to the 20- and 30-year fixed rate periods.
- In the NHG risk class, the 20-year fixed rate period has overtaken the 10-year fixed rate period thus becoming the leading fixed rate period in terms of market share. The major gain in market share for the 20-year fixed rate period took place in 2014-2015 across all risk classes.
- Especially interesting is the evolution of the 30-year fixed rate period. The 30-year fixed rate period was virtually non-existent four years ago but has seen a major growth in all risk classes over the past years. The NHG segment is leading the other risk classes in terms of market share for the 30-year fixed rate period. Currently, 25.1% of new NHG applications are for a 30-year fixed rate mortgage. The 60% LTV and 100% LTV buckets are following with a market share of 11.6% and 10.3% respectively.

Direct lenders changing the game

Insurers and pension funds have two ways of realizing exposure to the Dutch mortgage market. One is to set up their own mortgage label through which they originate mortgage loans. The second option is to originate mortgage loans through a direct lending firm, which is often the most efficient method. See Figure 15 below for the evolution of mortgage origination from Direct Lenders.



Source: Dynamic Credit, Kadaster

Figure 15: Market share of direct lenders in the Netherlands. Data up until 2018-Q3.

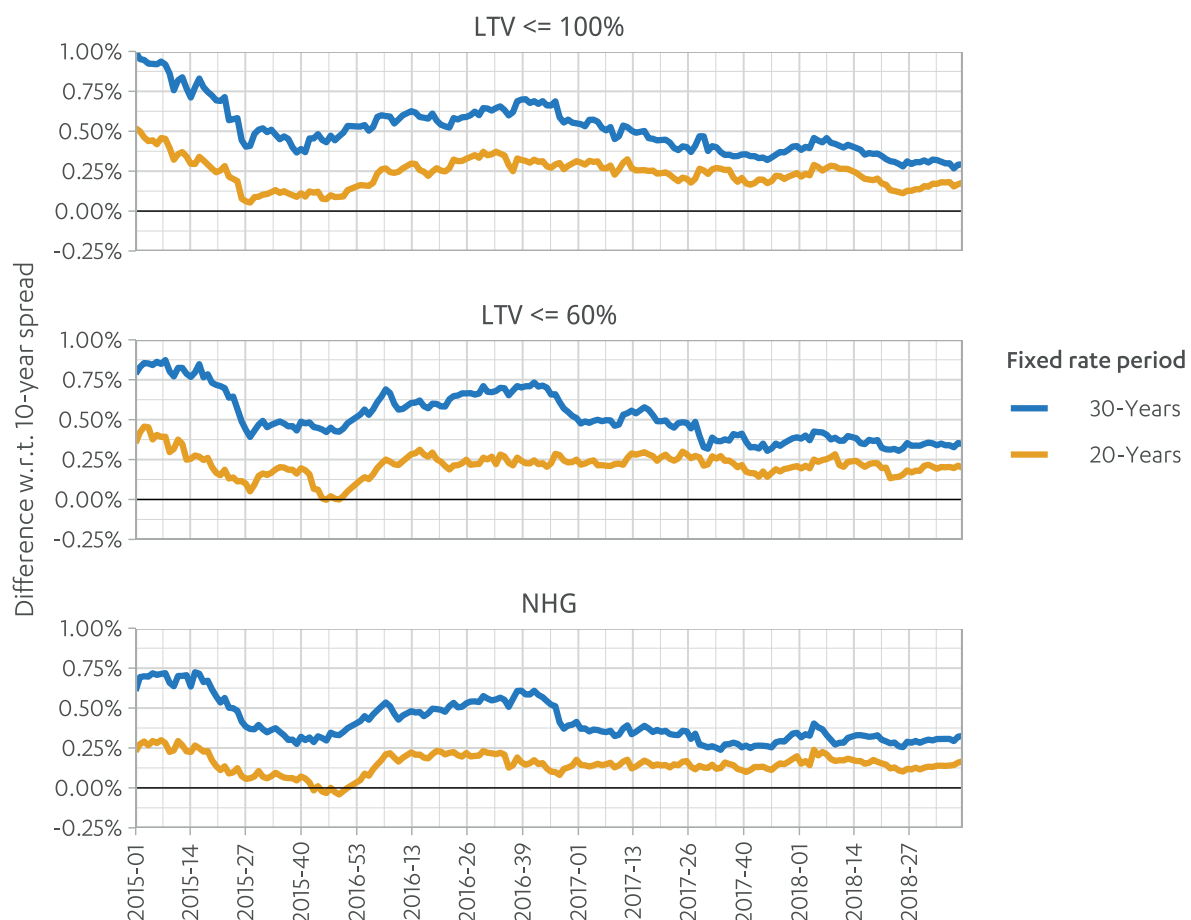
Origination volume under Direct Lenders has been growing since the start of 2014. The largest increase in volume took place around the end of 2014/beginning of 2015. This period of growth coincides with the increase in market share for the 20-year fixed rate period. The same pattern is observable in the mortgage rate spreads for the 20- and 30-year fixed rate periods.

Borrowers are benefitting

While pension funds and insurance companies benefit from a pick-up spread relative to alternatives such as government bonds, borrowers are also benefitting from this development. Figure 16 shows how spreads for 20- and 30-year fixed rate periods have improved relative to the 10-year fixed rate period. The 30-year fixed rate period has improved even more than the 20-year fixed rate period.

It should be noted that Figure 16 uses annuity spreads. We reported in our 2018-Q1 report that banks generally charge a large premium for interest only loans (ING charge a 30 bps premium for interest only for the 10-year fixed rate period) whereas direct lenders generally do not charge a premium.

Mortgage rate spread evolution with respect to 10-year fixed rate period spread



Source: Dynamic Credit, Hypotheekbond, Yahoo Finance

Figure 16: Difference between spreads levels of 20 and 30 year fixed rate annuities relative to spread levels for 10 year fixed rate period annuities. Data up until 2018-Q3. The y-axis shows year and week number.

3. Relevant news items

Prinjesdag 2018 (Prince's Day)

On 18 September 2018, King Willem-Alexander delivered his throne speech on Prince's Day in which he set out the main features of government policy for the coming parliamentary session. Overall, the economy is going well, but there are a number of interesting developments which will affect the Dutch economy and the Dutch housing market. Below is a summary of some of the changes that will have an impact going forward:

Energy taxes will increase. The increase in taxes is expected to cost the average household as much as € 150 extra per year. We wrote in our last quarterly report that a lot of Dutch households do not have very energy efficient homes and that significant potential remains for upgrades.

Increased VAT. The lower rate of value-added-tax will increase from 6% to 9%. Consumers will feel an impact when they go grocery shopping or to the cinema amongst others.

Income tax changes. 4 tax brackets will gradually be reduced to two tax brackets. From 2021 onwards, 37.05% will be paid on income up to € 68,600 and 49.5% will be paid on everything above that. The change will mean that middle income and high-income people pay lower income tax, but low-income people will pay a slightly higher tax.

Reduction of mortgage interest tax deduction accelerated. Maximum mortgage loan interest tax deductibility might reduce faster starting in 2020. This would mean that the plan is achieved in 2023, almost 20 years faster than the previous plan of 2042.

WOZ ("Waardering Onroerende Zaken") value increase: The WOZ value will increase again in 2019 by a value between 7.5% and 9.5%.

Notional Rental Value ("eigenwoningforfait") is reduced. This value is calculated based on the value of home value (WOZ). The tax is expected to decrease from 0.7% in 2018 by 0.05% p.a. over 4 years to 0.5% in 2023. In addition, "Wet-Hillen" is being abolished. "Wet-Hillen" was put in place to promote the repayment of mortgage debt in The Netherlands. In case the notional rental value would exceed the mortgage interest tax deductibility, a homeowner would not need to pay the notional rental value. From 2019 "Wet-Hillen" will be phased out over a period of 30 years.

Financial Markets Authority ("AFM") - Benchmark Rate

The benchmark rate, used to test the affordability of mortgage loans for mortgage loan applications with a fixed rate period shorter than 10 years, remains 5% for 2018-Q4.

Monetary policy

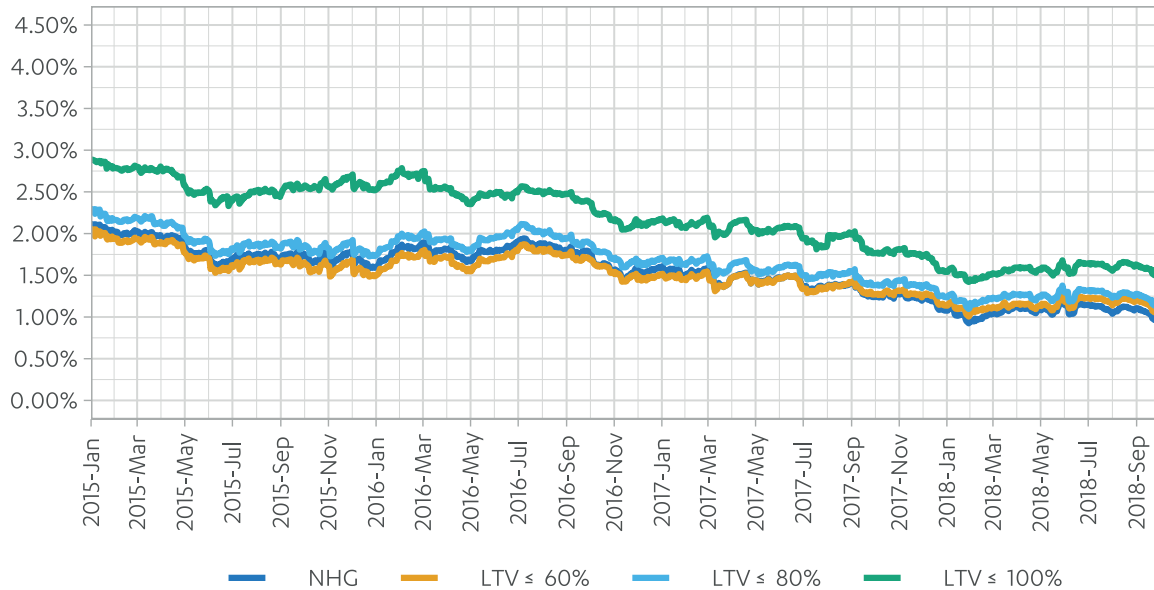
On 13 September 2018, the Governing Council of the European Central Bank met. The takeaways were:

- The Governing Council decided to keep the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively;
- It was confirmed that bond purchases will be halved to 15 billion euros per month starting in October 2018. Plans were announced to end bond purchases at the end of the year;
- The meeting occurred just a few days before the 10 year anniversary of the Lehmann Brothers collapse. Draghi commented on it and highlighted that banks are in better shape now;
- In terms of GDP growth, the estimates for 2018 and 2019 were downward adjusted to 2.0% (was 2.1%) and 1.8% (was 1.9%) respectively;
- The inflation estimates for 2018 and 2019 were unchanged at 1.7%;
- Draghi warned about rising protectionism and financial market volatility.

Appendix

Spread average top 6 per risk class

5-year fixed rate period

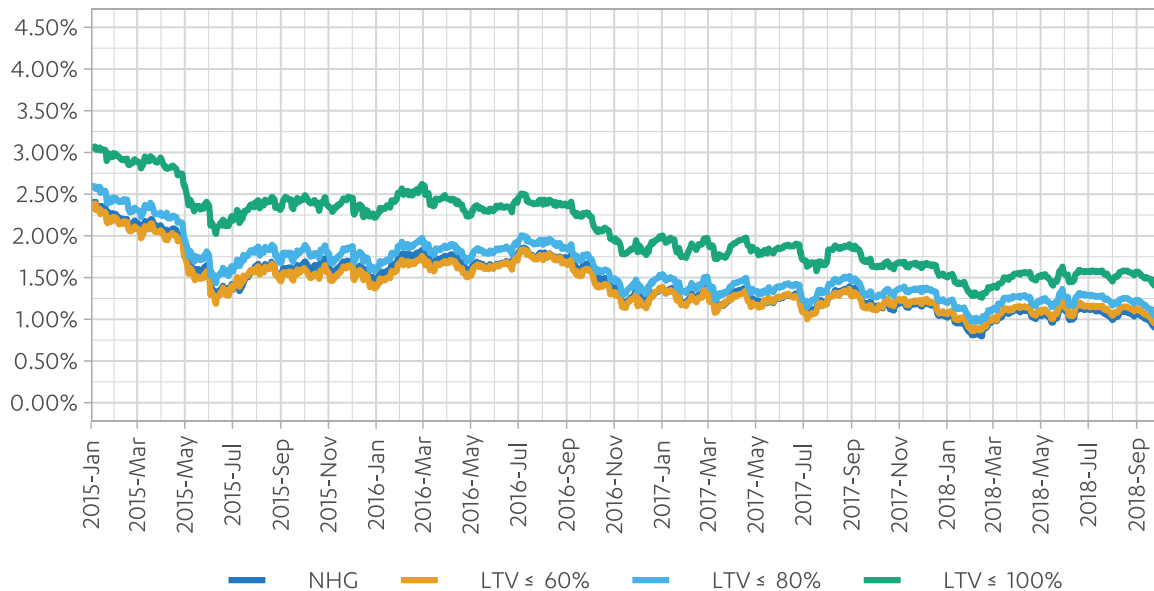


Source: Dynamic Credit, Hypotheekbond

Figure A1: Spread of the average top-6 price leader mortgage rates (excluding action rates) for mortgage loans with a 5-year fixed rate period for four risk classes.

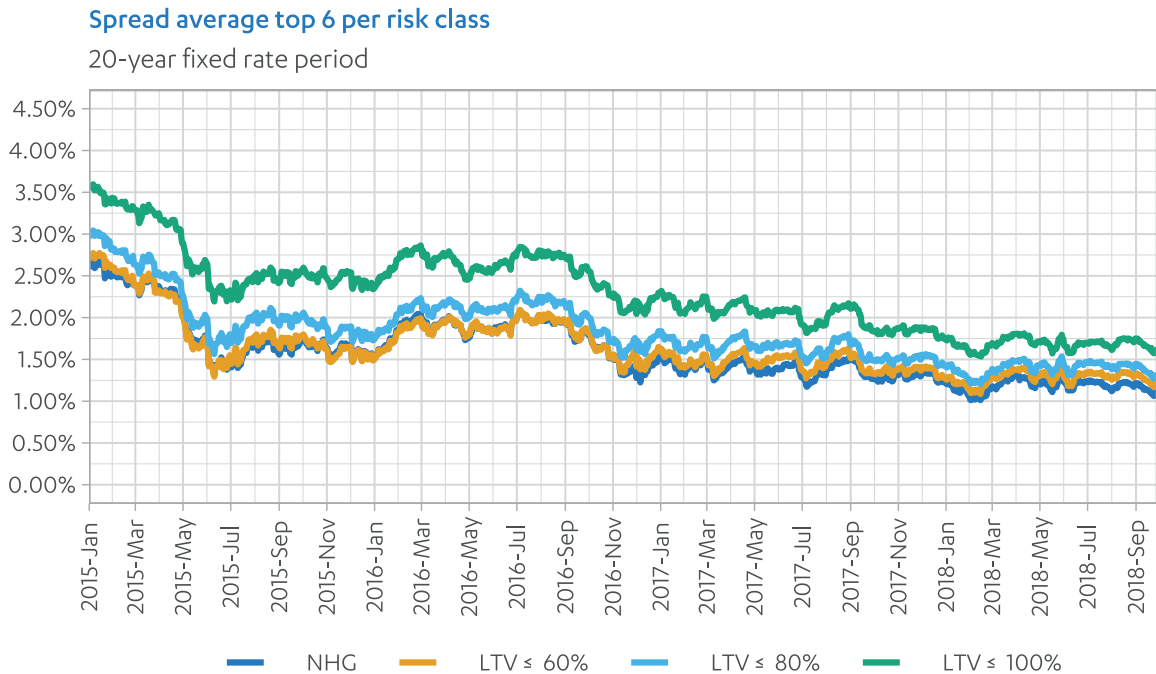
Spread average top 6 per risk class

10-year fixed rate period



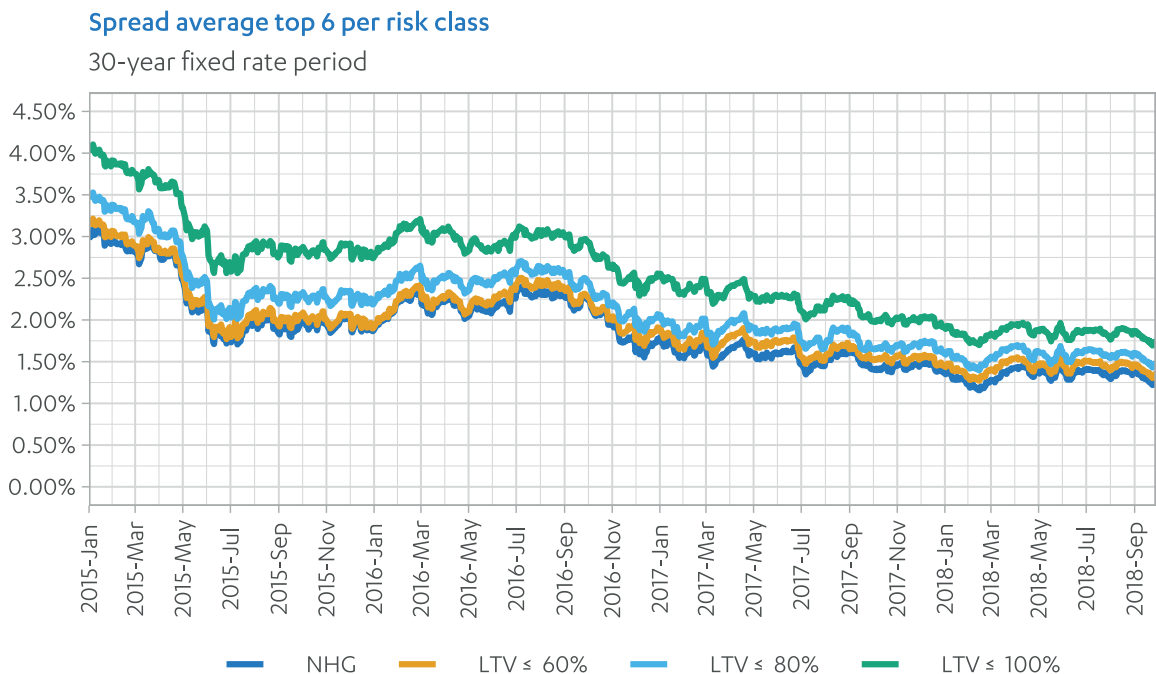
Source: Dynamic Credit, Hypotheekbond

Figure A2: Spread of the average top-6 price leader mortgage rates (excluding action rates) for mortgage loans with a 10-year fixed rate period for four risk classes.



Source: Dynamic Credit, Hypotheekbond

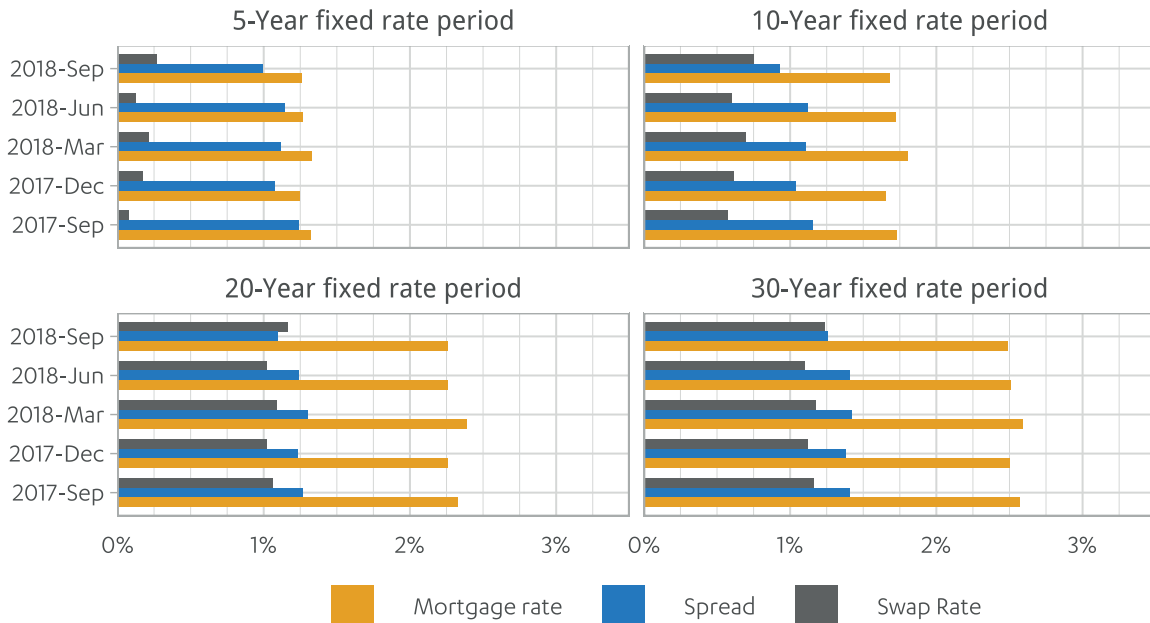
Figure A3: Spread of the average top-6 price leader mortgage rates (excluding action rates) for mortgage loans with a 20-year fixed rate period for four risk classes.



Source: Dynamic Credit, Hypotheekbond

Figure A4: Spread of the average top-6 price leader mortgage rates (excluding action rates) for mortgage loans with a 30-year fixed rate period for four risk classes.

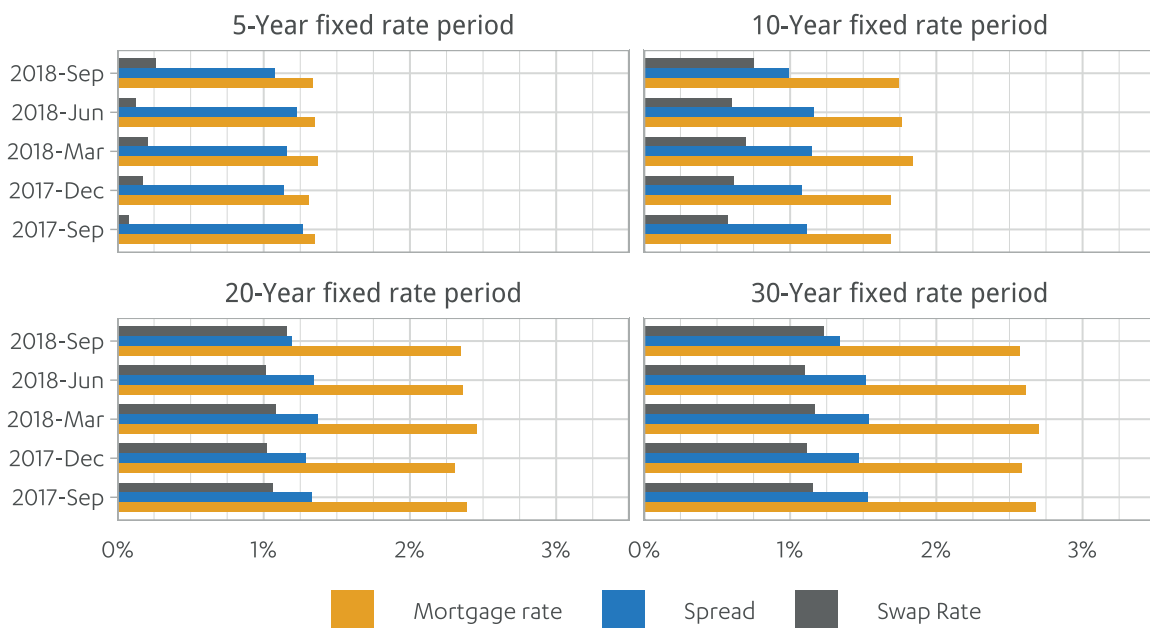
Mortgage rate decomposition for NHG mortgage loans



Source: Dynamic Credit, Hypotheekbond

Figure A5: Mortgage rate decomposition of the average top-6 price leaders (excluding action rates) for NHG mortgage loans with different fixed rate periods. End of month data has been used.

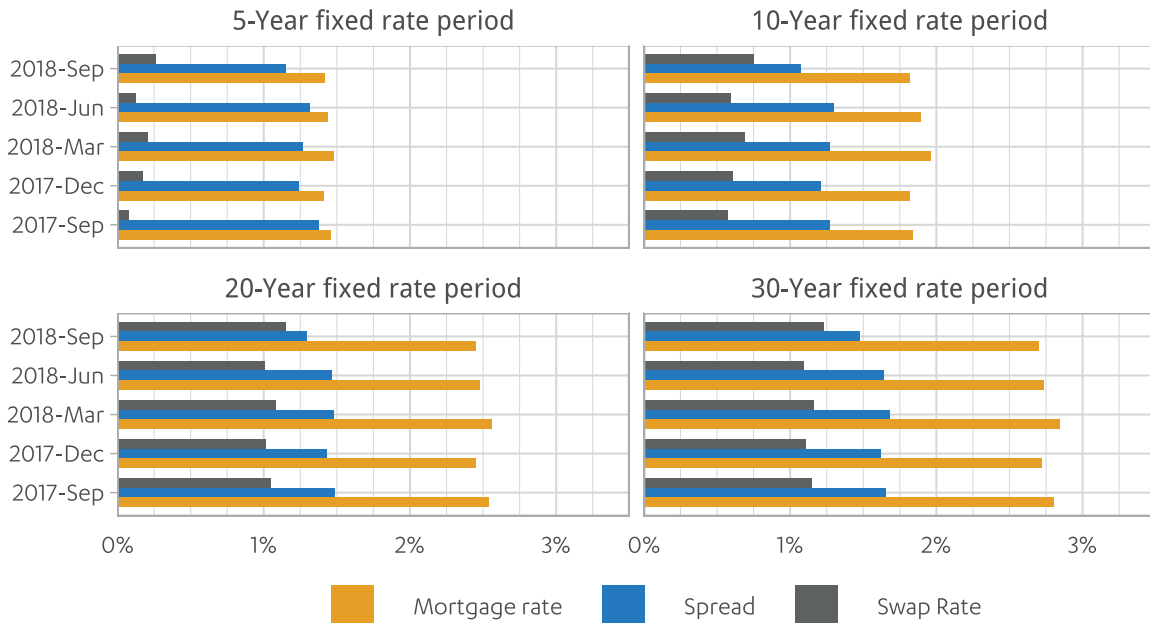
Mortgage rate decomposition for 60% LTV mortgage loans



Source: Dynamic Credit, Hypotheekbond

Figure A6: Mortgage rate decomposition of the average top-6 price leaders (excluding action rates) for 60% LTV mortgage loans with different fixed rate periods. End of month data has been used.

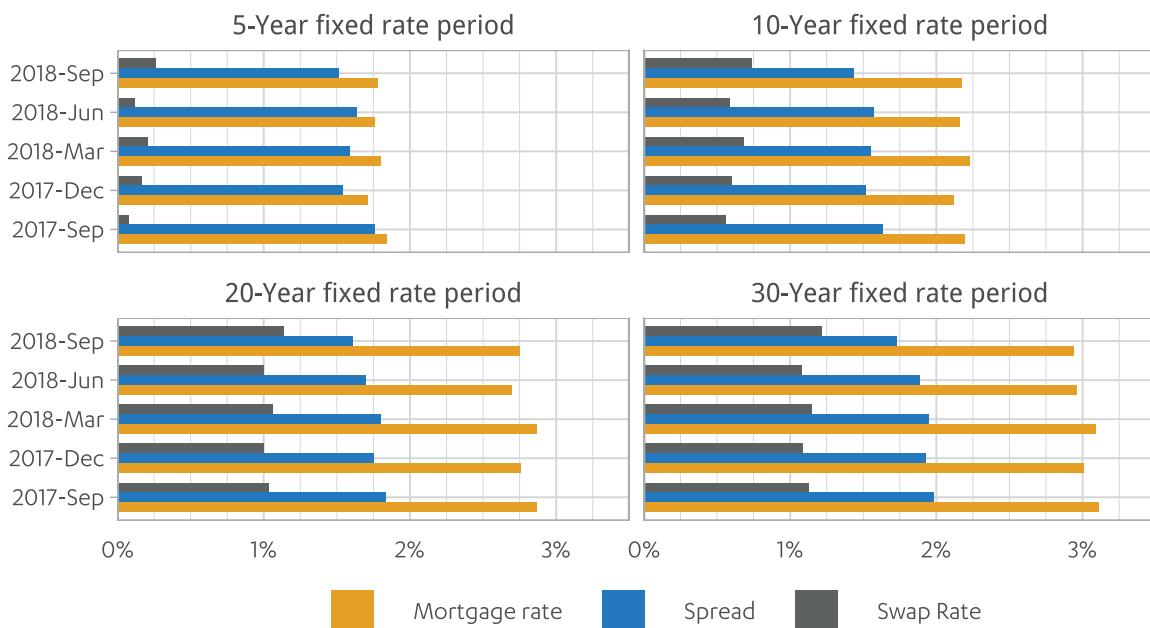
Mortgage rate decomposition for 80% LTV mortgage loans



Source: Dynamic Credit, Hypotheekbond

Figure A7: Mortgage rate decomposition of the average top-6 price leaders (excluding action rates) for 80% LTV mortgage loans with different fixed rate periods. End of month data has been used.

Mortgage rate decomposition for 100% LTV mortgage loans



Source: Dynamic Credit, Hypotheekbond

Figure A8: Mortgage rate decomposition of the average top-6 price leaders (excluding action rates) for 100% LTV mortgage loans with different fixed rate periods. End of month data has been used.

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NEW YORK

389 Fifth Avenue, Suite 809
New York, NY 10016
United States of America
Phone: +1 212 710 6608

AMSTERDAM

Frederik Roeskestraat 97D
1076 EC Amsterdam
The Netherlands
Phone: +31 20 770 4876

JAKARTA

Equity Tower, 35th Floor
Jalan Jend. Sudirman, Kav 52-53 (SCBD)
12190 Jakarta, Indonesia
Phone: +62 21 2939 8922

WWW.DYNAMICCREDIT.COM