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House price development in the Dutch mortgage market

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This analysis gives an overview of the recent development of the housing market in the Netherlands. It explains part of the house price growth observed since 2013 and provides an estimate of the house price growth of the coming years.

Executive Summary

Property prices in the Netherlands have increased in the past 9 years. This increase in property prices can mostly be attributed to a tight property market, increased interest from buy-to-let investors, fiscal stimulus and declining mortgage rates.

Since H2 2022, the house prices are under pressure because of sharply rising mortgage rates, less fiscal stimulus, less demand from buy-to-let investors and worsening buyer sentiment. However, the property market is still supported by a strong labor market, rising wages, and a structural shortage of new build properties - and by higher building prices, caused by inflation. Taking all these balancing effects into account, we expect house prices to decline by around 10% from the peak of 2022 into 2023. In the longer run we expect the housing shortage in the Netherlands to support house prices and that the current sentiment and interest rate changes will mostly be a shorter-term effect.

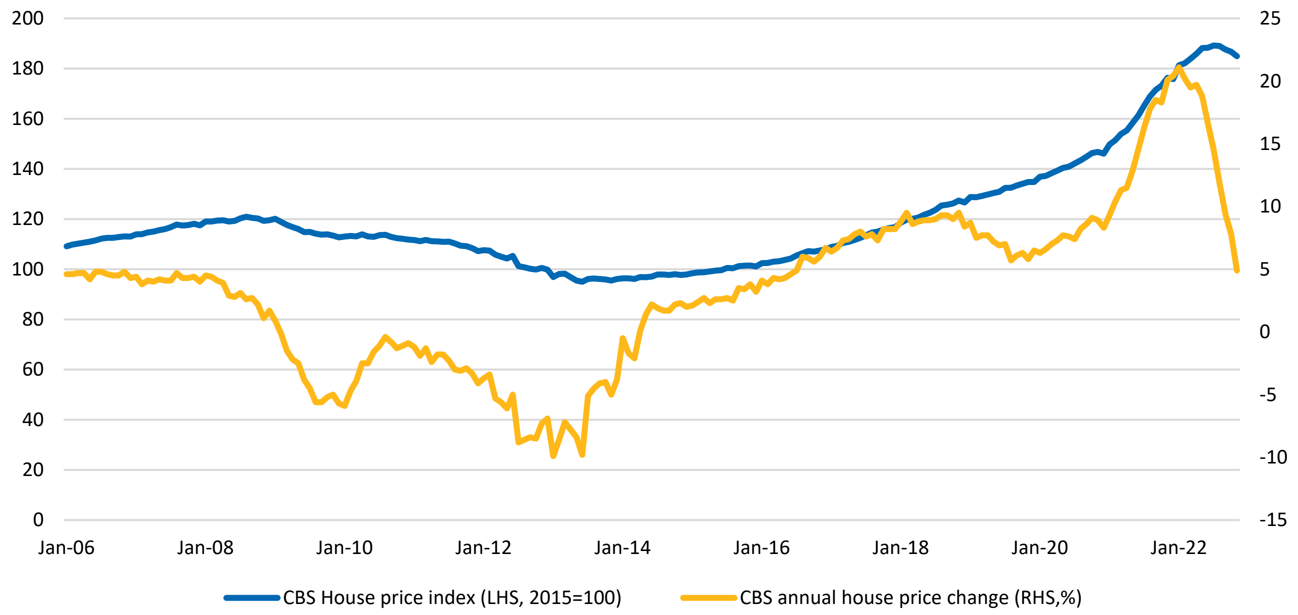
At the same time, we expect credit losses on our Dutch mortgage portfolios to remain very limited in the foreseeable future. Unemployment rate is still close to record lows and the growth of the Dutch economy appears resilient with 1.6% expected growth in 2023 according to CPB Netherlands Bureau for Economic Policy Analysis. Also, the Debt-Service-To-Income (DSTI) is conservatively low. And most borrowers have opted for long-term fixed-rate mortgages, making them less vulnerable to rising mortgage rates. Therefore, we believe that the probability of default on Dutch mortgages is still limited. Moreover, most borrowers have built up significant equity cushions in their properties, as the house prices increased significantly over the past decade, and additionally borrowers have partially paid off their (repayment) mortgage. This means that the Loan-to-values (LTVs) are generally low, and we therefore expect credit losses to be low as well on defaulting borrowers / mortgages

Recent developments

Since 2013 the Dutch housing market has been in a benign environment with year-over-year positive growth. In December 2022 property prices in the Netherlands increased 90% from the lows in June 2013[1]. The biggest increase was during 2021 (see Figure 1) when prices increased with more than 20%. Between the financial crisis and 2013, house prices declined with house prices in summer 2013 on average 21% below those in the summer of 2008.

[1] Statistics Netherlands (CBS)

Figure 1 House price development



Source: Statistics Netherlands (CBS), November 2022

The recent growth in property prices can partly be explained by the following reasons

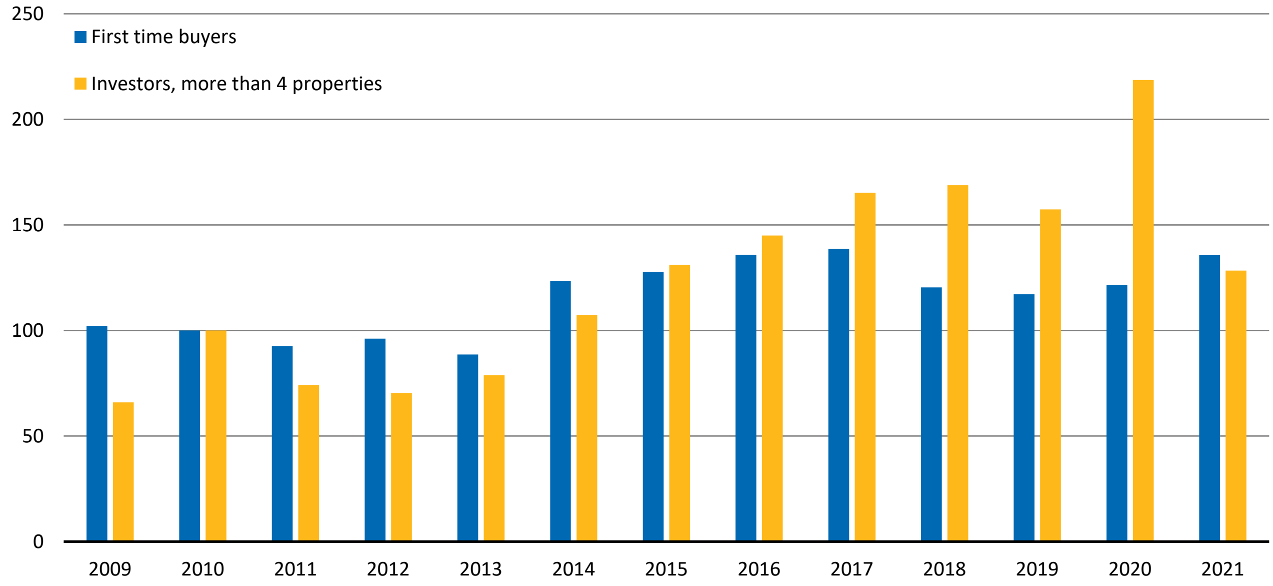
- Tight property market
- Fiscal stimulus for buyers
- Increased affordability due to lower interest rates

Tight property market

The Dutch property market is in imbalance. This imbalance increased over the past years through an increased demand for Dutch properties while the supply side lagged over the same period.

One of the reasons for the increased demand of housing is the increase in buy-to-let (BTL) investors active in the Dutch market. Figure 2 shows that in the years after 2013 the number of transactions by these investors more than doubled. The share of investors in the Dutch housing stock increased with almost 1.5%-point between 2017 and 2022 from 7.6% to 9.9%. This compares to an average annual 2.8%[1] turnover of total Dutch housing stock between 2017 and 2022. So BTL has been an influential driver of the total number of housing transactions during that period.

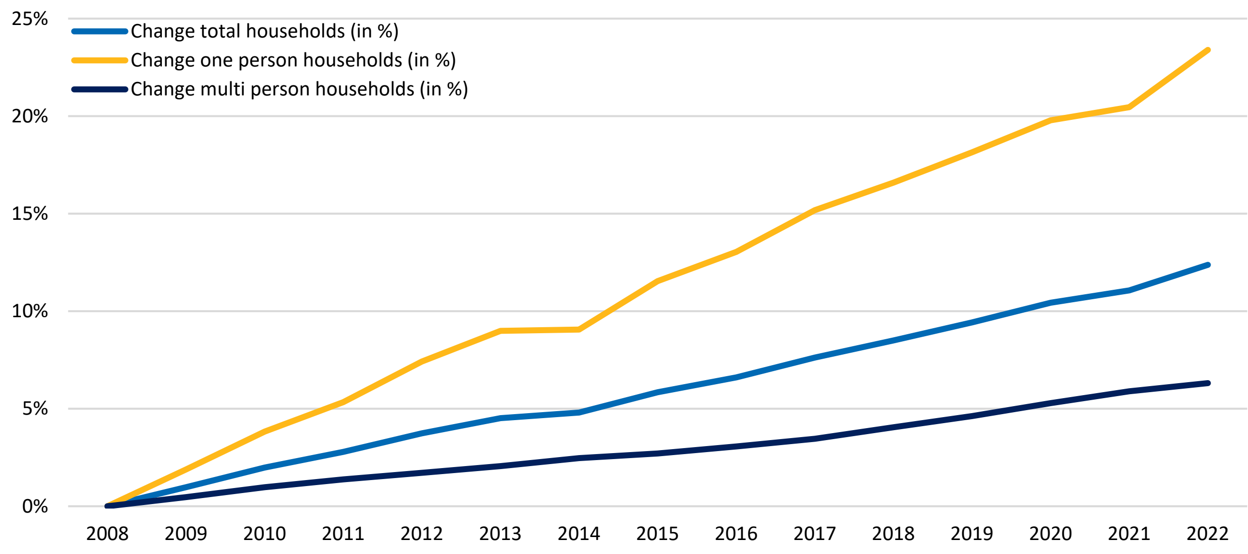
Figure 2 First time buyers compared to BTL (2010=100)



Source: Dutch land registry (Kadaster)

Another factor impacting the demand for properties is the multiyear trend of a growing Dutch population in combination with more people living by themselves. Between 2008 and 2022 the Dutch population has grown by about 1.2mln. In that period the ratio of one person households compared to multi-person households increased by almost 9% points. Figure 3 shows that the growth of one person households has been a key driver in the total number of households. In 2022 the average household consisted of about 2.13 persons, which is a 5% decrease from 2008. Combined with an increase in population this has led to a more than 12% increase in the number of households in the Netherlands over the last 14 years.

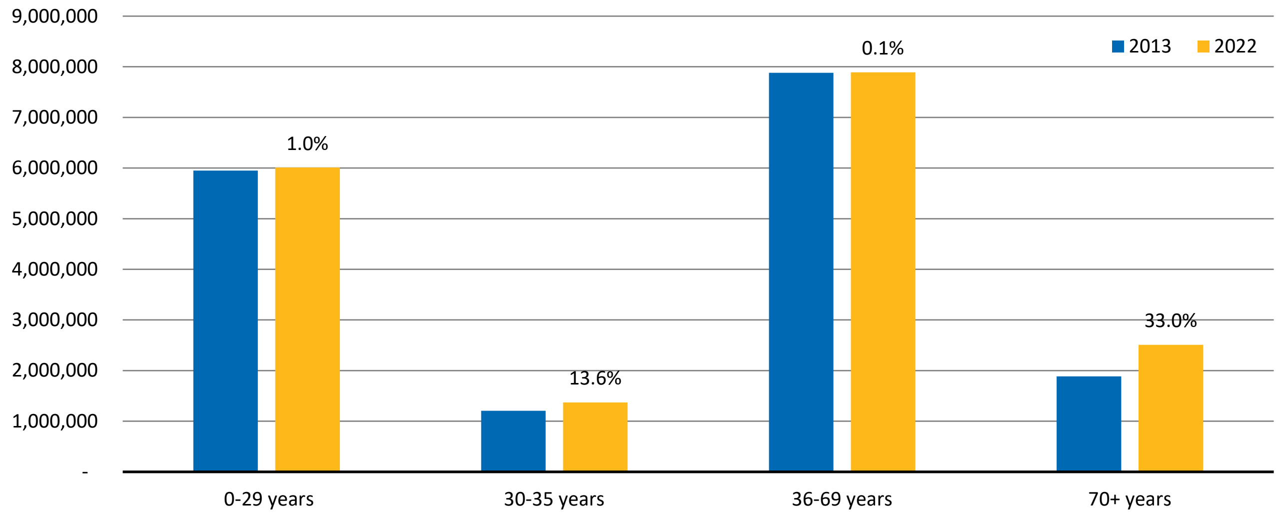
Figure 3 Growth of Dutch population and ratio of one person households over multi person households



Source: CBS

If we breakdown homeownership by age, we see the increased demand for properties is caused by a combination of young people looking for a home and an increase of elderly who choose to remain living on their own. From 2013 to 2022 there has been an increase in the number of young adults (home seeking) of ages 30 to 35 years while at the same time the number of elderly (age 70+ years) has also increased, see Figure 4.

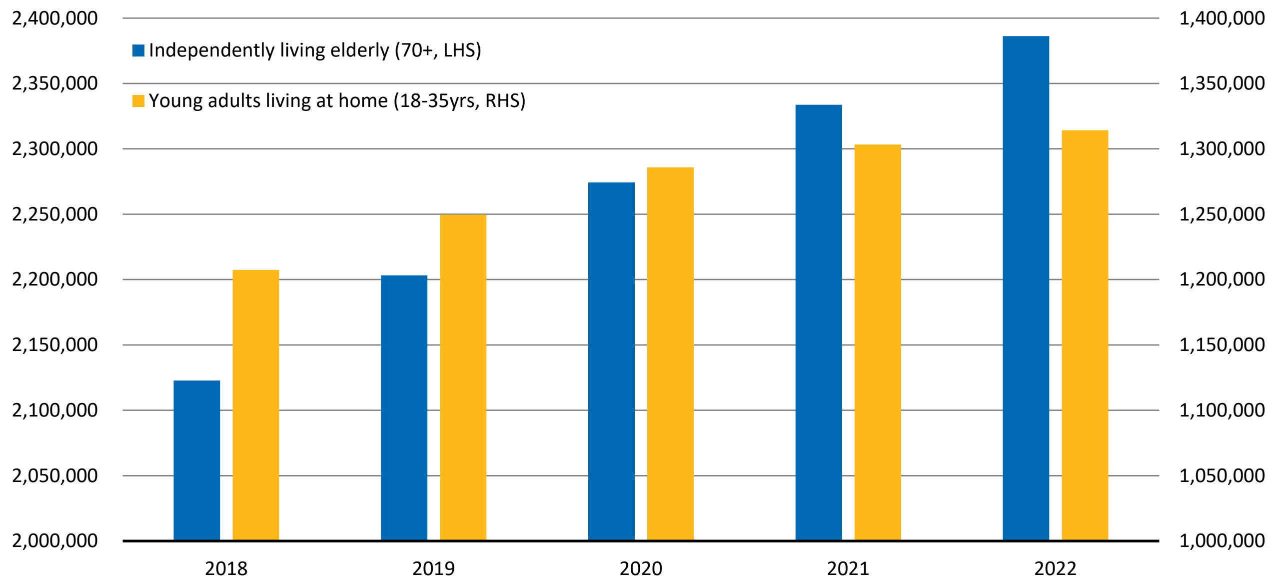
Figure 4 Population breakdown by age cohort



Source: CBS

In addition to the population increase observed in these age cohorts, elderly people tend to remain living on their own and not move on to retirement homes while the number of young adults remaining at their parental homes has increased. The number of elderly living on their own increased by more than 250,000 over the past 4 years alone and the number of young adults (ages 18 to 35 years) remaining at their parental homes increased with more than 100,000 persons over the past 4 years, see Figure 5. We believe this is a consequence of the unavailability of affordable homes for young adults.

Figure 5 Housing of sub populations



Source: CBS

On the supply side of housing the amount of newly built properties lags the estimated required amount needed. This shortage of housing is also recognized by the Dutch government. The Ministry of the Interior and Kingdom Relations (Ministerie van Binnenlandse Zaken en Koninkrijksrelaties) calculated that the housing shortage per 2021, equaled 315,000 properties and this is expected to increase further towards 2024[2].

To solve the imbalance of housing in The Netherlands it is estimated 100,000 new houses[3] need to be built every year until 2030. However, it is expected that no more than 70,000 houses can be built in 2023 and in 2024[4]. A variety of issues have posed a challenge to building more properties.

Recently the rise in interest rates puts pressure on the financing of new-builds and an increase in building costs compounds the affordability issue for homeowners.

The assignment of building locations used to be overseen at a regional level. However, this has not yielded the desired results in recent years, due to the restrictions around availability of suitable locations[5]. Municipalities and Provinces were less incentivized to build houses. This lack of focus has been compounded by a crisis around nitrogen deposition and PFAS rulings[6] which hampered the issuance of building permits for houses.

Fiscal Stimulus

Due to the rise in house prices over the past years, buying a house has become unaffordable for first-time buyers in the housing market. To support first-time buyers the government tried to help via tax benefits.

In 2017, the Dutch government (re)introduced the tax-free gift of EUR 100,000, if the gift was used for the purchase of a property. While this policy made purchasing a house relatively more affordable for a selective group of first-time buyers it further supported the house price development over the past years and left most other first-time buyers, who did not receive such benefits, behind.

Since 2021, home buyers below the age of 35 do not have to pay stamp duty for the purchase of a property with a value of less than EUR 440,000. For other buyers who use the property as a primary residence (owner-occupied buyers) the stamp duty on property transactions is 2%. Stamp duty is 10.4% for BTL investors. This measure was intended to increase home ownership and discourage BTL investments.

Increased affordability

Over the recent years borrowers were able to borrow increasingly more due to decreasing interest rates. In the Dutch mortgage market, the National Institute for Family Finance Information (NIBUD) states the maximum amount a borrower is allowed to spend on a mortgage depends on income and mortgage rates. This maximum debt-service to income (DSTI) ratio is given by the NIBUD, considering economic scenarios, certain fixed costs such as heating costs and developments in the fiscal regime.

As interest rates steadily declined from 5.4% in 2013 towards 1.8% per the beginning of 2022 borrowers had to spend less of debt servicing towards paying interest and were able to spend more on principal repayment. This led to an increase in the maximum loan amount for borrowers.

When the maximum loan amount during the summer of 2013 is compared to the beginning of 2022 (just before mortgage rates increased), the maximum loan amount increased by 30% to 46% for borrowers who earn between EUR 40,000 and EUR 80,000 annually (see Figure 6). Most of this increase in borrowing capacity can be attributed by the salary growth of 20%[7] observed between 2013 and 2022.

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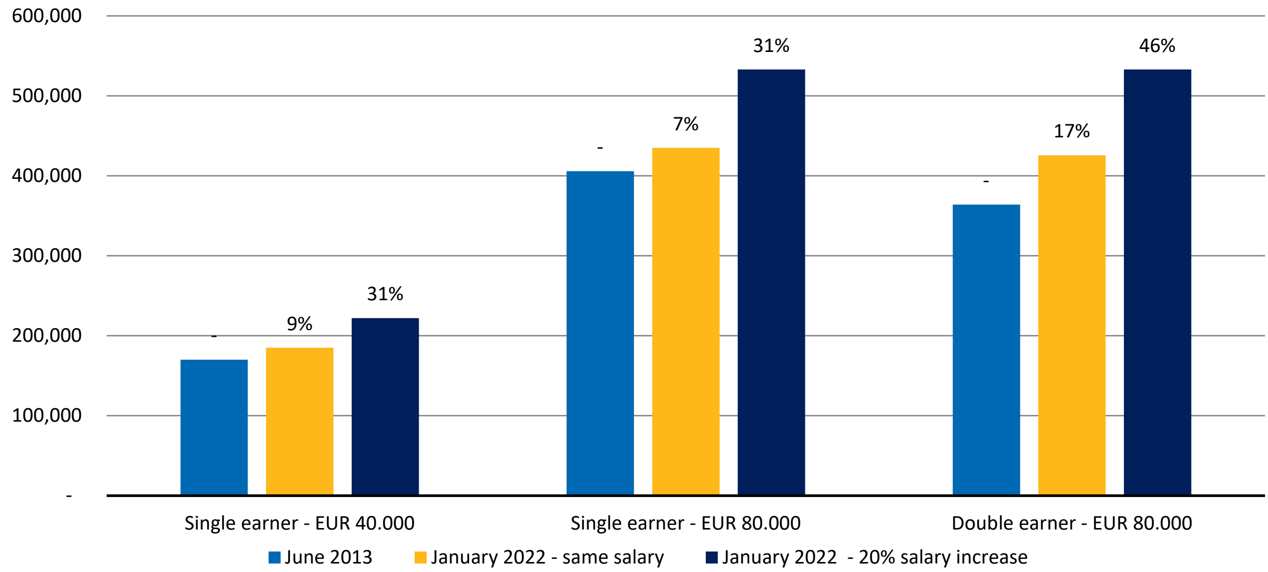
[2] Ministry of the Interior and Kingdom Relations (Ministerie van Binnenlandse Zaken en Koninkrijksrelaties)
[3] Aedes, Association of Housing Corporations
[4] NOS
[5] CPB Netherlands Bureau for Economic Policy Analysis (CPB)
[6] Economical Institute for Building (EIB)
[7] Statistics Netherlands (CBS) states an increase of contractual hourly wage costs of 20% between June 2013 and January 2022

Figure 6 Maximum loan amount development from 2013 to 2022



Source: NIBUD, Aegon Asset Managemen*t*

Future developments

Since halfway 2022 the sentiment on the Dutch property market has changed. The year ended with negative house price growth (month-over-month) over the last 5 months according to CBS, while the Dutch association of real estate agents (NVM) reported a negative house price growth year-over-year per the end of December of -6%. The NVM numbers typically lead CBS numbers by about 3 months.

How does the housing market now compare to the aftermath of the Global Financial Crisis (GFC)?

Nowadays the housing market is relatively less leveraged, and it is governed by much stricter underwriting criteria as set out in the Dutch Code of Conduct:

- In 2012 mortgage debt as a ratio of Dutch GDP was 105%. In Q3 2022 this had decreased to less than 85%
- There were no restrictions on the use of interest only loans. Since 2013 interest only loans cannot make up not more than 50% of the value of a property. Yet loans are underwritten conservatively: assuming a full repayment of the loan within 30 years
- There were few restrictions on LTVs. The LTV could be as high as 112% or even higher. This meant that many, often younger house owners were already 'underwater' when house prices decreased. Per 2018 LTVs have been capped at 100% or 106% in case a borrower has installed energy saving measures
- After the GFC a combination of higher unemployment, high household indebtedness (through mortgages) and tightening underwriting standards restricted the ability of borrowers to move house, pushing house prices down. This contrasts with the current situation where unemployment and household indebtedness are lower and underwriting standards are not expected to change significantly

Fiscal regime

The slowdown on the property market can partly by attributed towards changes in the Dutch fiscal regime. As stated earlier, the Dutch government introduced measures in recent years to support the property market. Also, more recently the government added measures for targeted support of owner-occupied buyers.

Whereas starters and homeowners who move house need to pay stamp duty of respectively 0% and 2%, other buyers of properties (like buy-to-let buyers) needed to pay 6% stamp duty as of 2021. This increased in steps to 10.4% in 2023. This had its effect whereas the number of transactions from BTL investors decreased with 41% in 2021 versus 2020 as observed in Figure 2. In addition, the Dutch government gave local authorities more powers to regulate access of BTL investors to the property market. In August 2022[8] over one third of the Dutch municipalities were planning to implement regulation such as a self-occupancy obligation (zelfbewoningsplicht). For example, in certain areas in Amsterdam a buyer of a house below a value of EUR 533,000 cannot rent out the property for 4 years. This makes BTL investments unattractive in such areas.

Also, the updated wealth tax regime negatively impacts BTL investments which have been funded with a loan. Due to a different (less positive) treatment of debt, buy to let investors are expected to pay more than 0.5% in taxes on their invested amount. This means for an investor with EUR 200,000 of mortgage debt on a EUR400,000 house the additional tax amount is more than EUR 2,000.

In addition to the higher tax burden, there is more discussion about the requirement of a minimum energy label on BTL properties, which should lead to additional capital expenditures for investors.

Consumer sentiment

A less tangible, but nonetheless powerful factor contributing to the slowdown of the housing market is a negative sentiment among Dutch consumers. Increased interest rates, high inflation and uncertainty of the economic situation makes consumers less confident.

Dutch consumer confidence stayed below -50 since July 2022[9], compared to a 20-year average of -9. The Dutch homeowner association (VEH) regularly reports consumer sentiment in the housing market. The indicator of VEH is at the lowest point since 2013 and this indicates that the willingness to buy is decreasing rapidly. Funda, one of the largest facilitators for real estate transactions in the Netherlands, also acknowledged that sentiment in the housing market is turning rapidly. They reported the number of contact requests between consumers and real estate agents decreased from 12 to 6 requests per property over 2022.

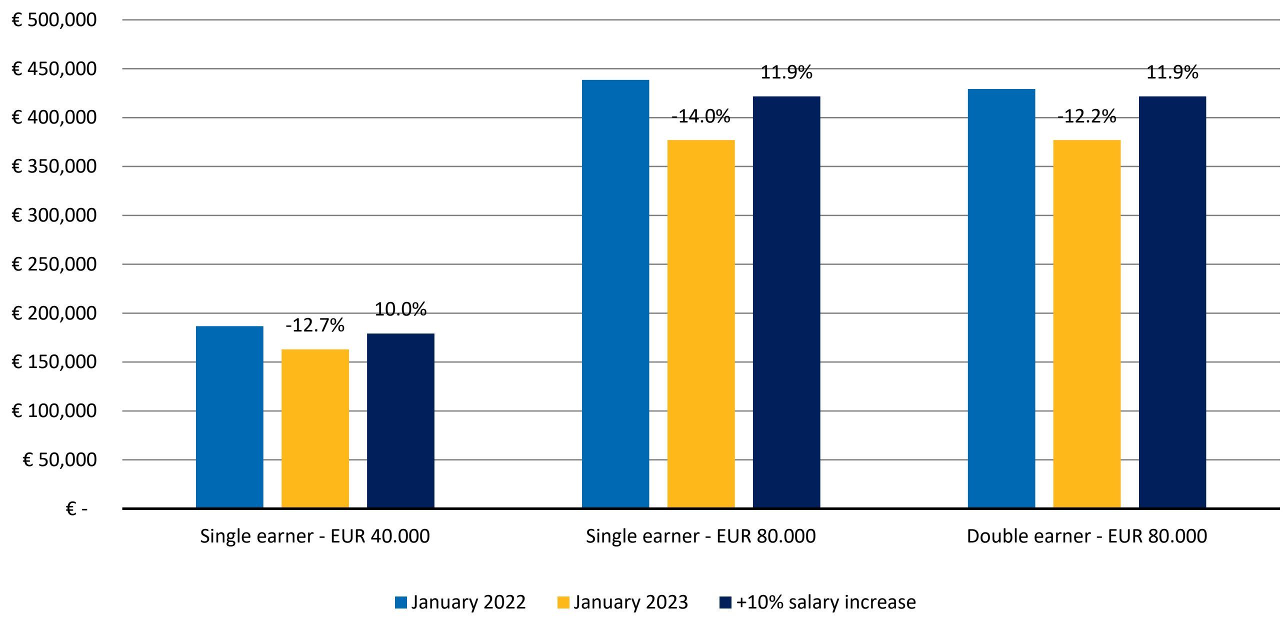
Affordability

Declining affordability can be linked to an anticipated decline of property prices, the way house prices increased between 2013 and 2022 could be attributed towards increased affordability of homeowners over that period. Over the past year increased mortgage rates and slightly more stringent NIBUD underwriting criteria had a negative effect on borrowers' affordability. At the same time there are some offsetting effects, which will support affordability. The second income, in 2022, only counted for 90% towards the calculation of the maximum debt servicing percentage of a borrower. In 2023 this percentage increased to 100%. Lastly, the expected annual wage growth will have a positive effect on borrowers' affordability.

Figure 7 shows the changes between January 2022 and January 2023 had a negative effect on a borrower's maximum loan amount of between 12% and 14%. For this calculation we assume no wage increase, a 3% mortgage rate increase and apply the underwriting criteria of the NIBUD for 2023. When a 10% wage increase is assumed - which is a bit more conservative than the average wage growth of 3.2%9 for 2022 combined with expected wage growth, of 5% for both 2023 and in 2024[10] – the negative affordability effect from higher mortgage rates is mostly offset.

[8] RTL Nieuws
[9] Statistics Netherlands (CBS)
[10] CPB Netherlands Bureau for Economic Policy Analysis (CPB)

Figure 7 Maximum loan amount development from 2022 to 2023



Source: NIBUD, Aegon Asset Management

Housing shortage

Taking into account the changes in fiscal regime, consumer sentiment and the impact on affordability, we believe that house prices will continue to see some headwinds. However, we don't expect the housing shortage, one important support factor for the large increase in property prices in the Netherlands, to be easily solved over the coming years.

- An aging population, combined with a tendency for elderly to remain living on their own and an increasing group of young adults looking for a house will continue to support the property market
- Stringent nitrogen and PFAS procedures and a shortage of suitable building locations in the Netherlands will continue to hamper new building projects
- Higher interest rates and a shortage in both the materials and builders will add to the increased costs of new building projects.

Conclusion

Taking all the above into consideration we see headwinds in the Dutch housing market. We think high mortgage rates and low consumer confidence as the most significant drivers of expected negative growth of property prices. Low unemployment and a deficit of available houses will continue to support property prices and therefore it is expected that the price correction on the property market will not be as deep and prolonged compared to the last correction of the property market between 2008 and 2013 (-21%). For the coming year we expect a cumulative house price decline around 10% compared to the peak in July 2022. Is it finally a good time for first-time home buyers?

Impact on mortgage investments

We believe any negative house price impact on Dutch mortgage investments is limited. Due to the reforms in the Dutch mortgage market since 2013, most of the newly originated loans are repaying loans with lower LTVs. As interest rates moved up their share has also increased. This means that the notional, and therefore the LTV, steadily declines year after year. Second, the increased property prices of the last years created low LTVs for mortgage portfolios today. The Dutch Central Bank (DNB) reported in its Financial Stability Report (Autumn 2022) that less than 5% of the Dutch homeowners have an LTV greater than 90% and roughly 5% of the homeowners will have an LTV above 90% in case of 10% house price shock. This means that high LTVs, even after a correction of the house prices, are rare in the current Dutch market and therefore potential losses given a default are limited. Third, historically low unemployment and a high number of job vacancies combined with an expectation that economic growth will continue into 2023 ensure a low probability of default on properties.

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