Dutch residential mortgage market

The Dutch residential mortgage debt stock is relatively sizeable, especially when compared to other European countries. Since the 1990s, the mortgage debt stock of Dutch households has grown considerably, mainly on the back of mortgage lending on the basis of two incomes in a household, the introduction of tax-efficient product structures such as mortgage loans with deferred principal repayment vehicles and interest-only mortgage loans, financial deregulation and increased competition among originators. Moreover, Loan-to-Value (LTV) ratios have been relatively high, as the Dutch tax system implicitly discouraged amortisation, due to the tax deductibility of mortgage interest payments. After a brief decline between 2012 and 2015, mortgage debt reached a new peak of EUR 861.5 billion in Q1 2024[1]. This represents a rise of EUR 19.6 billion compared to Q1 2023.

Tax system
The Dutch tax system plays an important role in the Dutch mortgage market, as it allows for partial deductibility of mortgage interest payments from taxable income. Historically, this has resulted in various deferred amortisation mortgage products, most importantly the use of interest-only loan parts.

Since 1 January 2013, all new mortgage loans have to be repaid in full in 30 years, at least on an annuity basis, in order to be eligible for tax relief (linear mortgage loans are also eligible). The tax benefits on mortgage loans, of which the underlying property was bought before 1 January 2013, have remained unchanged and are grandfathered, even in case of refinancing and relocation. As such, new mortgage originations still include older loan products, including interest-only. However, any additional loan on top of the borrower's grandfathered product structure, has to meet the mandatory full redemption standards to allow for tax deductibility.

A second reform imposed in 2013 was to reduce the tax deductibility by gradually lowering the maximum deduction percentage. As a result, the highest tax rate against which the mortgage interest may be deducted is 36.93% (equal to the lowest income tax bracket) in 2023. No further reductions are currently planned.

There are several housing-related taxes which are linked to the fiscal appraisal value ("WOZ") of the house, both imposed on the national and local level. Moreover, a transfer tax of 2% is due when a house is acquired for owner-occupation. From 2021, house buyers aged between 18 and 35 years will no longer pay any transfer tax. Currently, this exemption only applies to houses sold for 440,000 euros or less and can only be applied once. For 2023, a transfer tax of 10.4% is due upon transfer of houses which are not owner-occupied (compared to 8% in 2022).

Although these taxes partially unwind the benefits of tax deductibility of interest payments, and several restrictions to this tax deductibility have been applied, tax relief on mortgage loans is still substantial.

Loan products
The Dutch residential mortgage market is characterised by a wide range of mortgage loan products. In general, three types of mortgage loans can be distinguished.

Firstly, the "classical" Dutch mortgage product is an annuity loan. Secondly, there is a relatively big presence of interest-only mortgage loans in the Dutch market. Full interest-only mortgage loans were popular in the late nineties and in the early years of this century. Mortgage loans including an interest-only loan part were the norm until 2013, and even today, grandfathering of older tax benefits still results in a considerable amount of interest-only loan originations.

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[1] Statistics Netherlands, household data. The total amount of mortgages outstanding reported has also increased including historic data due to a benchmark revision.

Thirdly, there is still a big stock of mortgage products including deferred principal repayment vehicles. In such products, capital is accumulated over time (in a tax-friendly manner) in a linked account in order to take care of a bullet principal repayment at maturity of the loan. The principal repayment vehicle is either an insurance product or a bank savings account. The latter structure has been allowed from 2008 and was very popular until 2013. Mortgage loan products with insurance-linked principal repayment vehicles used to be the norm prior to 2008 and there is a wide range of products present in this segment of the market. Most structures combine a life-insurance product with capital accumulation and can be relatively complex. In general, however, the capital accumulation either occurs through a savings-like product (with guaranteed returns), or an investment-based product (with non-guaranteed returns).

A typical Dutch mortgage loan consists of multiple loan parts, e.g. a bank savings loan part that is combined with an interest-only loan part. Newer mortgage loans, in particular those for first-time buyers after 2013, are full annuity and often consists of only one loan part. Nonetheless, tax grandfathering of older mortgage loan product structures still results in the origination of mortgage loans including multiple loan parts.

Most interest rates on Dutch mortgage loans are not fixed for the full duration of the loan, but they are typically fixed for a period between five and 15 years. Rate term fixings differ by vintage, however. In recent years, there was a strong bias to longer term fixings (20-30 years) but since Q2 2022 10 year fixings have rapidly increased in popularity as the sharply increased mortgage rates drove borrowers to seek lower mortgage payments by going for shorter fixings. Most borrowers remain subject to interest rate risk, but compared to countries in which floating rates are the norm, Dutch mortgage borrowers are relatively well-insulated against interest rate fluctuations.

Underwriting criteria
Most of the Dutch underwriting standards follow from special underwriting legislation ("Tijdelijke regeling hypothecair krediet"). This law has been present since 2013 and strictly regulates maximum LTV and Loan-to-Income (LTI) ratios. The current maximum LTV is 100% or 106% when financing energy saving measures. The new government has indicated not to lower the maximum LTV further. LTI limits are set according to a fixed table including references to gross income of the borrower and mortgage interest rates. This table is updated annually by the consumer budget advisory organisation "NIBUD" and ensures that income after (gross) mortgage servicing costs is still sufficient to cover normal costs of living.

Prior to the underwriting legislation, the underwriting criteria followed from the Code of Conduct for Mortgage Lending. Although the Code of Conduct is currently largely overruled by the underwriting legislation, it is still in force. The major restriction it currently regulates, in addition to the criteria in the underwriting legislation, is the cap of interest-only loan parts to 50% of the market value of the residence. This cap was introduced in 2011 and is in principle applicable to all new mortgage contracts. A mortgage lender may however diverge from the cap limitation if certain conditions have been met.

Recent developments in the Dutch housing market
The housing market recovery continued unabated this spring. In April, existing homes for sale were, for the first time, more expensive than at the July 2022 price peak. While houses in May last year – at the market's low point – were still 6.2 percent cheaper than at the previous peak, the price level is now already 0.8 percent higher. Year-on-year, the existing home price index rose 7.5 percent in April. Between April 2023 and April 2024, the average home sold became more than EUR 30,000 more expensive. The cooling down of the housing market and the subsequent recovery has thus lasted less than two years. The recovery is a lot faster this time than after previous periods with a cooling housing market, and house prices have also fallen less sharply. Since 2008, house prices have fallen 21 percent, until 2018, when a new price record was set. After 1978, house prices fell by 35 percent, and it took even longer to wait for a new price record: this came in 1993.

It illustrates how quickly demand has recovered, after potential buyers initially shied away due to rapidly rising mortgage rates. Rapidly rising incomes soon eased the pain of higher mortgage rates, with interest rates falling slightly again in the latter part of 2023. Meanwhile, potential homebuyers with one or two times the modal income are estimated to be able to borrow more again than in early 2022, when interest rates were historically low. High wage growth, together with new construction that structurally lags behind demand, are the main explanations for the rapidly recovering housing market this time.

The development of interest rates has been an important driver of house price development over the past decade. For mortgage interest rates, the development of interest rates on long-term loans – the capital market rate – is particularly important. This rate determines the financing costs of mortgage lenders.
In the period up to 2022, capital market interest rates the 10-year swap rate fell to historically low levels. As a result, house prices rose sharply. Due to the low interest rates, the monthly costs of buying a house for the same purchase price decreased, and households could borrow more and more for the same income. The result: homebuyers started bidding more and more for homes, causing house prices to rise sharply. Starting in 2022, the opposite happened. While the 10-year swap rate was still 0.3 percent in early 2022, it was 3.1 percent a year later, and as high as 3.5 percent at the peak in October 2023. due to the effect on mortgage rates, the monthly costs of owner-occupied homes increased and homebuyers' borrowing capacity declined. After the interest rate hike in 2022, a household with a twice-modal income could borrow more than EUR 30,000 less than at the beginning of that year. It ushered in a period of falling house prices. Meanwhile, at 2.8 percent, the 10-year swap rate is already much lower than at its peak in the fall of 2023, but still substantially higher than before interest rates began to rise.

How the housing market develops is determined not only by fundamental factors such as interest rates and the available housing stock, but also by market sentiment. People's confidence in the housing market is on the rise this year. Here, expectations about interest rates play a big role. Many people think that mortgage rates will stabilize or even decline in the coming period. The expectation that house prices will continue to rise reinforces this sentiment. Confidence in the housing market is now about the same as the average score over the past 20 years. However, there is no real sunny mood yet, due to the poor affordability of owner-occupied homes and what housing consumers consider to be unfavourable economic conditions.

Sales of existing homes for sale have been slowly but surely picking up since the beginning of this year Between May 2023 and April 2024, 189,280 homes changed hands. That's slightly more than in the same period a year earlier. And we haven't seen such a sales plus in quite some time.
On average, over 184,000 homes changed hands each year from 1995 through 2023. But today, the Dutch housing stock does have a lot more owner-occupied houses than, say, in the 1990s. From that perspective, the number of transactions can indeed be called modest.

The fact that relatively few existing homes are being sold is not because of a lack of demand, but because few homes are coming up for sale. Currently there are about 30,000 homes for sale by NVM brokers, and that is about a third less than at the peak in the last quarter of 2022. The number of transactions is not as low as you might expect based on the number of homes for sale, though. And that's partly due to the fact that houses are simply selling very quickly. In the first quarter, homes changed hands on average within 34 days, and that's well below the long-term average of 84 days.
For now, homebuyers will continue to suffer from the lack of supply. This is partly due to the lack of new construction. At the same time, we are seeing some positive market developments. The dip in permits seems to be behind us. Also, sales of new-build homes have picked up recently.
Moreover, a large number of to be constructed homes are in the pipeline. As of March, as many as 184,000 houses were in the pipeline. Those houses have already been licensed or construction has already started. Interestingly, despite the dip in building permits, the number of homes for which a building permit has already been granted but construction has not yet started increased. This means that

the rate at which building permits are granted has declined less sharply than the rate at which construction of new homes has started. For the short term, that means fewer completed homes, but it also means that there are many projects whose construction can start quickly when the market rebounds.

Although the number of houses for which construction has already started has declined slightly, there are still many more houses in the pipeline today than a few years ago; in early 2020, for example, the pipeline counter stood at 153,000 houses

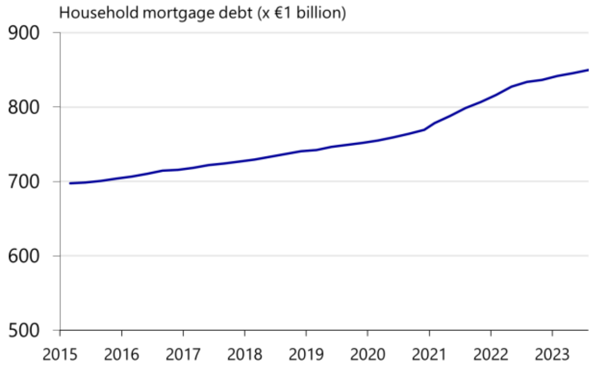
At the same time, all these positive new construction signals do not mean that we will see many more for sale signs in front of existing homes any time soon. Because even though more new homes are now being sold, it will take quite some time before those new homes are built. And therefore also before homeowners start putting their homes up for sale because they have bought a new home.

Forced sales
Compared to other jurisdictions, performance statistics of Dutch mortgage loans show relatively low arrears and loss rates[2]. The most important reason for default is relationship termination, although the increase in unemployment following the economic downturn post financial crisis was increasingly also a reason for payment problems. The ultimate attempt to loss recovery to a defaulted mortgage borrower is the forced sale of the underlying property.

For a long time, mortgage servicers opted to perform this forced sale by an auction process. The advantage of this auction process is the high speed of execution, but the drawback is a discount on the selling price. The Land Registry recorded 56 forced sales by auction in Q1 2024 (0.13% of total number of sales in those months).

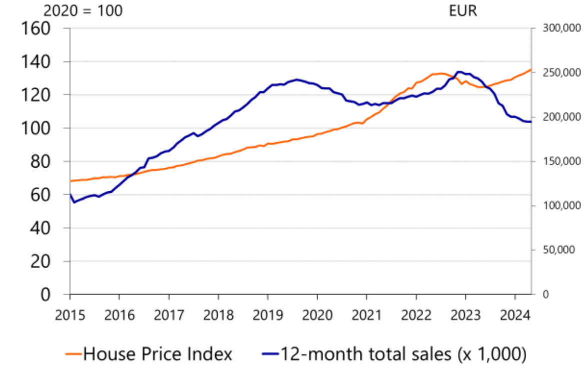
[2] Comparison of Moody's RMBS index delinquency data.

Chart 1: Total mortgage debt



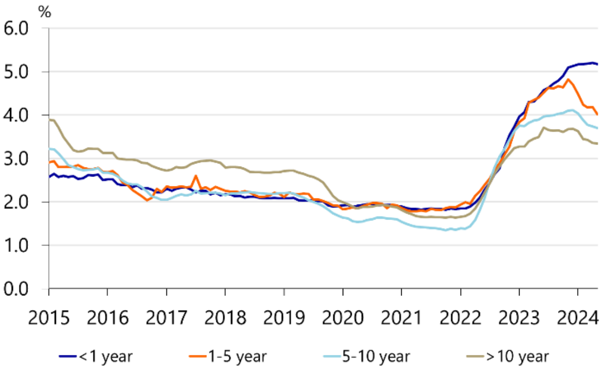
Sources: Statistics Netherlands, Rabobank

Chart 2: Sales



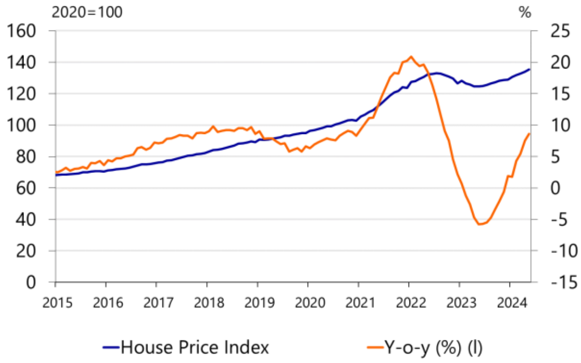
Sources: Dutch Land Registry (Kadaster), Statistics Netherlands (CBS)

Chart 3: Price index development



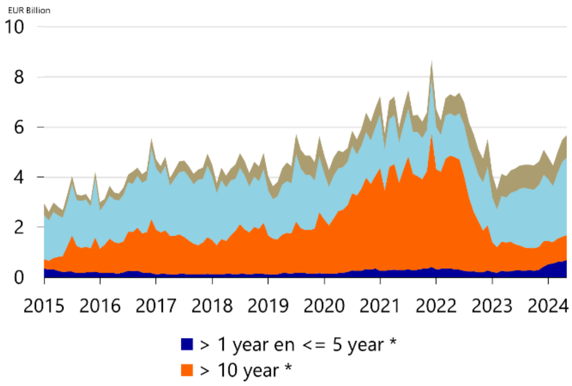
Sources: Statistics Netherlands, Rabobank

Chart 4: Interest rate on new mortgage loans



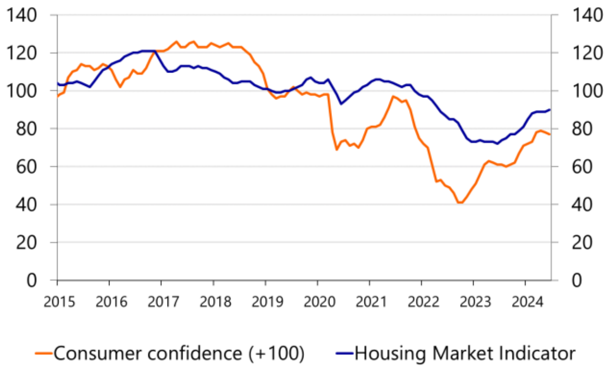
Source: Dutch Central Bank

Chart 5: New mortgages by interest type



Source: Dutch Central Bank

Chart 6: Confidence



Sources: Statistics Netherlands, OTB TU Delft and VEH