Coalition agreement: the housing market

First we had the Spring Agreement, and now we have a coalition agreement. In addition to decisions about all kinds of other areas[1], measures have been taken for the further reform of the housing market. We will look at these measures below and consider their possible effects.

The Spring Agreement

The Spring Agreement contained preliminary proposals for housing market reform. The proposed measures will be adopted by the second Rutte cabinet without any changes. For instance, it was decided that new mortgages taken out after 1 January 2013 would be subject to annuity redemption over a maximum of 30 years in order to be eligible for tax relief on the interest paid. Other important measures stipulated that a maximum loan-to-value ratio of 100% for new mortgages will be phased in over the next six years (it currently stands at 106%), and that the reduction of transfer tax (stamp duty) to 2% will be made permanent.

In the social rental sector, rents are to be increased by 1 percentage point plus inflation, for household incomes between € 33,000 and € 43,000. Earlier it had been decided that rents could be raised by five percentage points plus inflation for households with an income of over € 43,000.

Measures from the coalition agreement

The coalition agreement between the VVD (liberals) and the PvdA (labour) expands further on the Spring Agreement. First, it has been decided that from 2014 the maximum rate at which mortgage interest can be deducted for tax purposes will be reduced incrementally by 0.5%-point every year to 38% by 2041. This means there will be a gradual change during the next twenty years only for households that deduct mortgage interest at the highest rate. Secondly, households will be able to deduct interest paid on residual debt temporarily and under specific conditions for a maximum of five years. This measure will be effective between 2013 and 2017. Thirdly, the favourable borrowing facility for first-time buyers from the Dutch Housing Foundation is to be expanded.

In the rental sector, the maximum rent increase is to be made income-dependent. For households with an income of up to € 33,000, rents may be put up by 1.5 percentage points, plus inflation. An extra percentage point applies to incomes up to € 43,000, and 6.5 percentage points plus inflation for incomes over € 43,000. For all income brackets, this represents an increase of 1.5 percentage points vis à vis the Spring Agreement.

Lower income households will be compensated for the rent hikes by a rise in their rent allowance. In addition, the complex method of determining the maximum rent will be considerably simplified by basing it on 4.5% of the official valuation (WOZ). The additional rental income generated will be partly creamed off by the government. In the long term, this measure will thus yield € 1.2 billion annually in government revenue.

Appraisal of the Spring Agreement

There have been three major criticisms of the Spring Agreement:

- a distinction between new and existing mortgages;
- the limited incentive for households to pay off an existing mortgage

[1] Belt, R. & D. Piljic (2012), Bruggenbouwers aan de slag [Bridge builders in action] Themabericht Rabobank [Rabobank Special Report] 2012/28

- the lack of an integrated approach to all sectors of the housing market

Coalition Agreement partly on the right path...

Some of the above criticism has also been levelled at the coalition agreement. However, most of what it contains has been accepted. The coalition agreement has gone further in meeting demand for an integrated approach by tackling so-called “scheefwonen”. This is when households remain in social housing, even though their income has exceeded the original threshold for eligibility. While important measures have been taken to combat this, their effect will only be felt in the longer term. The planned rent increases are too low to turn this unfair situation around in the near term. Importantly, however, the measures show that a major taboo for the Labour Party (PvdA) has been removed. In the longer term, the measures taken in the rental sector will lead to a better functioning housing market. There are three main reasons for this. Firstly, households in the social rental sector will, in the future, be more motivated to move to a house that better suits their living requirements, as their rent subsidy is reduced. This will lead to a reduction in the waiting lists for social housing. Secondly, it will lead to greater levelling of the playing field between the social and private rental sectors and the owner-occupied sector. It will become more attractive for private parties to offer rental accommodation. Thirdly, mobility on the housing market will increase, thanks to lower transaction costs in both the rental and non-rental sectors.

With the reduction of the rate at which mortgage interest may be deducted for tax purposes, households with an existing mortgage will have a somewhat greater incentive to pay off their mortgage. However, this incentive is insufficiently strong to have an effect in the short term. The reductions are very gradual and are spread out over a very long period. On the positive side, however, this measure will in itself not have a disruptive impact on the housing market. Less positive is the fact that the process will be very drawn out and that the subject is therefore unlikely to be off the political agenda definitively. Furthermore, the measure has no effect on households whose highest marginal tax rate is 42%.

....but doesn’t fully resolve problems

A distinction between new and existing cases remains in place. Mortgages taken out before 1 January 2013 are not subject to compulsory redemption, even if the householders move house. And if both existing and new cases are fully paid off within 30 years, there is still a discrepancy. This is because existing mortgages can be paid off within 30 years by means of a savings deposit mortgage. New cases, by contrast, have to be redeemed by means of an annuity scheme. For the latter group, the costs of full redemption will be some 15% higher.

The consequence of this discrepancy is that there will be no level playing field for a thirty year period between existing and new mortgage holders on the housing market. First time buyers in particular, who play an important part in movement on the property ladder, will be at a relative disadvantage on account of these measures for the next three decades. Besides, there may be question marks over the legality of this unequal treatment.[2] It is highly likely that the legal viability of the measures will be tested in court.

There are also unresolved difficulties in relation to how the measure is to be implemented. There are questions over what is to happen with freehold leases, as these are not subject to redemption. And what will happen in the

[2] CPB (Netherlands Bureau for Economic Policy Analysis), Analyse economische effecten financieel kader Regeerakkoord [Analysis of the economic effects of the fiscal content of the Coalition Agreement], 29 October, 2012.

case of payment arrears? Will households then lose their entitlement to mortgage interest relief, if they fail to comply with the conditions? This would only compound the problems asso-associated with being in arrears. And banks would lose some of their scope for jointly seeking a solution. Finally, the two-tier system will oblige banks to have two different sets of advice for customers over a thirty year period.

Effects on house prices

The Spring Agreement will lead to a one-off permanent drop in house prices. The estimated drop ranges from 4%[3] to 9%[4]. The measures contained in the coalition agreement will cause an additional incidental price decline of some 3%. However, this is not to say that prices will fall by a further 3%.[5] Uncertainty in recent months about the future of mortgage interest relief has put downward pressure on house prices. If confidence is restored through the coalition agreement, this could compensate for some of the additional price decline. However, it is doubtful whether confidence will in fact increase. If the two-tier regime for existing and new mortgages remains in place, leading to ongoing lower house sales, then this is bad news for the economy.

Even if the additional effects of the housing market reforms on house prices are limited, this does not mean that the decline in house prices will have come to an end. There is still a considerable overhang of houses on the market. And purchasing power is set to dwindle through factors such as austerity measures, which means households will have less money to spend on buying a house.

Effects on sales

It was hoped that clarity about the future of mortgage interest relief would boost house purchases. And this is likely to be the case, temporarily at least, until 1 January 2013. Potential buyers who wish to avail of the current, more favourable fiscal conditions, will be quick to close the deal on time. However, the likelihood that the coalition agreement will lead to a long-term increase in demand for non-rental housing is limited. Firstly, this is because of doubts about the legal viability of the proposed regime. Secondly, the very gradual reduction of the tax bracket at which mortgage interest is eligible for reduction means it is likely the government will tighten this measure, stepping up the pace of compulsory mortgage redemption, should its financial situation deteriorate.

Conclusion

The coalition agreement contains measures that go some way towards addressing the criticism levelled at the Spring Agreement. For instance, the lack of incentive for current mortgage holders to pay off their mortgage has been addressed in some cases. Furthermore, the plans contain measures to bridge the gap between the rental and non-rental sectors, which will lead to an improvement in the functioning of the housing market. An important point of criticism remains, however, in that new mortgage holders will be at a disadvantage compared to existing cases. This will lead to inequality for the next thirty years between those who happened to take out a mortgage before the deadline of 1 January 2013 and those who bought a house after that date. For this reason, it is worth considering a reversal of the proposed separate regime for new cases –

[3] CPB (Netherlands Bureau for Economic Policy Analysis), Analyse van de in het Begrotingsakkoord 2013 opgenomen hervorming van de woningmarkt (conform Juniraming 2012) [Analysis of the housing market reforms contained in the 2013 Budget Agreement (in accordance with the June 2012 estimates).

[4] DNB (Netherlands Central Bank) 2012, De verwachte effecten van de woningmarktmaatregelen uit het Begrotingsakkoord 2013 [The expected effects of the housing market measures contained in the 2013 Budget Agreement], 12 July 2012

[5] CPB (Netherlands Bureau for Economic Policy Analysis), Analyse economische effecten financieel kader Regeerakkoord [Regeerakkoord [Analysis of the economic effects of the fiscal content of the Coalition Agreement], 29 October, 2012.

especially in view of the minor consequences for the budget. Instead a system

should be implemented in which existing and new cases are treated equally and incentives to redeem mortgage are increased.

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