Rabobank

Dutch Housing Market Quarterly

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Economic Research Department

Contents

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Summary and conclusions

- As in previous years, there were no major price changes in the first quarter of the year. According to the Netherlands Association of Real Estate Brokers (NVM), the sale price of an average house is currently € 240,000. This represents an increase of € 12,000 compared to a year ago, or +5.3%. The highest price rises in the first quarter of 2007 were found in mid-terrace houses (+ 1.4%).

- Although the number of sales transactions dropped from August 2006, the 12-month average remained at a high level of 207,503 houses sold. Mid-terrace houses were sold the most, although the percentage of detached houses in total sales is increasing.

- During the first quarter the number of enforced sales dropped by over 9% compared to last year. In relation to the total of transactions, the percentage has remained stable for nearly 2 years at 0.9%. Thus the number of enforced sales remains at a (very) low level.

- New housing output increased last year by 8.0% to 72,382 housing units. 2001 was the last year in which this level was achieved. Interestingly, the production of homes in the rental sector is growing faster then that of houses for owner-occupier sale. The number of building permits issued in 2006 rose by 15.8% with the 12-month total of permits for rental homes continuing to rise, whereas those for purchase homes have dropped since September 2006. Despite the rise in new housing output since 2006, on aggregate production remains low, particularly from an historical perspective. The new Cabinet intends to drive up production further to an annual output of over 80,000 houses. However, it remains to be seen whether this is realistic and attainable.

- The affordability of purchasing a house remains problematic. The financing burden is expected to rise further in 2007 and 2008. Both rising house prices and increasing interest rates are to blame for this. However, on the positive side for affordability, incomes are expected to grow, although this will not fully compensate for the financing burden. On balance, affordability will deteriorate, if to a lesser extent than last year.

- The outstanding mortgage debt has shown an unbroken rising trend for many years. Internationally speaking, too, the debt is high. Government policy, favourable market conditions and taking advantage of specific market circumstances are the underlying reasons. The combination of these factors is unique to and characteristic of the Dutch housing market, and encourages people to finance a house purchase with borrowed funds.

- The outlook for the Dutch housing market is moderately positive. **We expect that house prices in 2007 and 2008 will rise by an average of about 4¼% and 3¼%.** Demand for houses is supported by the positive economic climate. Nonetheless, interest rates may rise, but the fundamental shortage of houses and the limited flexibility of supply support the expected price development.

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Europe strong enough despite US growth dip

GDP growth in the US is likely to slow owing to the turnaround in the housing market. However, Europe will manage to withstand the downward pressure. Despite the strong euro, high consumption levels will keep Europe buoyant.

The **US economy** remains a hard nut to crack. Over two thirds of Americans own their own home, yet even the correction in the housing market has not yet hurt aggregate demand. Remarkably, consumption volume rose in 2006 by 3.2%. This was despite the fact that stagnating house prices reduce the possibility for financing spending with a top-up mortgage, as had become commonplace in recent years.

American consumers are, however, finding support from favourable developments in other quarters. A low unemployment rate, averaging 4.6% in 2006 combined with rising wages create a healthy base for growth in consumption. In addition, share prices rose by 12% in 2006, which dampened the negative wealth effects from the housing market. Furthermore, petrol prices dropped during the second half of last year, leaving Americans with more cash to spend on other products.

The developments outlined above do not mean that all danger is past. In contrast to shares, the value of a house is not immediately clear, which means that any loss of value only becomes evident after some time. Furthermore, the wealth effects are greater for houses than for securities. This is because more people own a house and their house occupies a greater share of the wealth. It is currently not clear how many people may be in trouble after taking out a high-risk mortgage. In addition, people regard changes in housing market prices as more long-term than stock market fluctuations, which they perceive to be more volatile. It is therefore likely that consumption growth will drop back, with the result that GDP growth will moderate to 2.2%. Because house prices have since stabilised, the danger of a long-term slowdown is limited. In our view, the US economy will rebound in 2008.

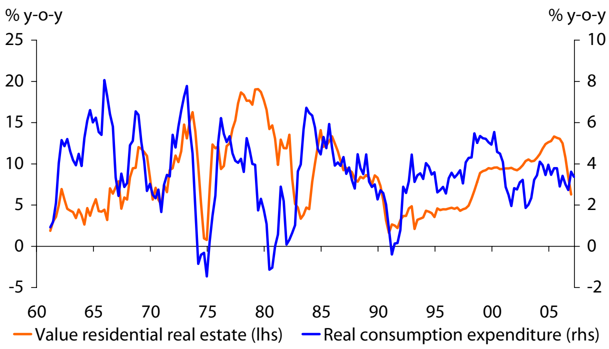
The growth dip may temper the fears of the US central bank (the Fed) regarding inflation. The Fed believes that inflation is currently too high and it fears that a tight labour market will add further grist to the mill. Therefore, a slight rise in unemployment caused by the growth dip will allow the Fed the scope to reduce interest rates in two instalments of 25 basis points (bps). We anticipate a first interest rate cut around the turn of the year. This will also impact on capital market interest rates, which will dip slightly.

Tabel 1: Key International figures

Real GDP % growth	**2006**	**2007**	**2008**
United States	3.3	2.2	3.1
Eurozone	2.8	2.6	2.2
Japan	2.2	2.5	1.8
% rates	**4 June**	**+ 3M ***	**+ 12M ***
3-month $ libor	5.36	5.40	4.90
3-month euribor	4.13	4.40	4.40
10 year swap rate	5.54	5.40	5.50
10 year swap rate	4.71	4.60	4.70
euro exchange rate	**4 June**	**+ 3M ***	**+ 12M ***
US dollar	1.35	1.33	1.27
Japanese yen	164	160	140

Source: Ecowin, Rabobank International

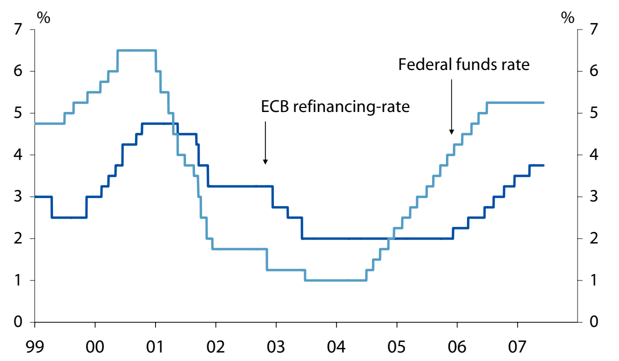
Figure 1: Housing market wealth effects not yet visible



Source: Ecowin

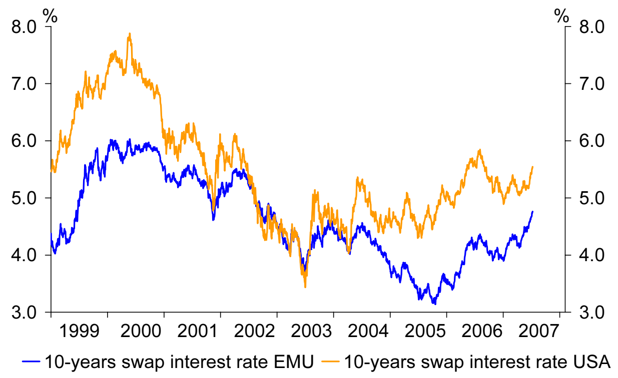
In the meantime, the growth dip in the US will put pressure on the exports of other countries. Nonetheless, it would appear that Europe is strong enough to withstand this pressure.
The strength of the economy in the **Eurozone** is currently not only based on exports. The euro has appreciated vis à vis the yuan, the dollar and the yen. European export growth is therefore expected to fall back in 2008 and will not rebound until demand from the US for imports is restored.
Within Europe, there are large discrepancies in the competitiveness of the individual countries. In Italy, rising wages have eroded competitiveness in recent years, whereas France has been able to maintain its position. German competitiveness has improved greatly thanks to a wage restraint policy and ongoing improvement in productivity. Consequently, Germany has succeeded in regaining its position as the export engine of Europe. Unfortunately this has not yet translated into consumption growth in Germany, despite declining unemployment, improving wage growth and increasing consumer confidence. Even the prospect of an imminent rise in VAT in 2007 was scarcely able to induce German consumers to spend money in advance in late 2006.
Fortunately, the Italians and the French are showing more spending readiness. Although higher wage rises have not been good for competitiveness, they have contributed to stronger purchasing power. Accordingly European economic recovery is being carried forward by Italian and French consumption on the one hand and German export growth on the other.
It is more likely that German consumers will follow the example of their other European counterparts than vice versa. These three countries each have rapidly declining unemployment and adequate wage development, which form a solid basis for consumption growth. We therefore expect that the consumption-dampening effects of the German VAT increase will be short-lived. Based on the prospect of a positive contribution from the German consumer in particular, we predict that the Eurozone will produce steady growth of 2.2% both this year and next year.
Partly because of the strong euro, inflation in the Eurozone remains relatively low. Nonetheless, the European Central Bank has been increasing interest rates since late 2005. The Bank fears that the strong monetary growth of recent years will rapidly lead to high inflation if the economy expands further. In view of our expectation of continuing economic growth and declining unemployment, it is likely that the ECB will raise interest rates again in September. This, combined with further economic growth may contribute in the long term to higher capital market rates.

Figure 2: Money market interest rates



Source: Ecowin

Figure 3: Capital market interest rates



Source: Ecowin

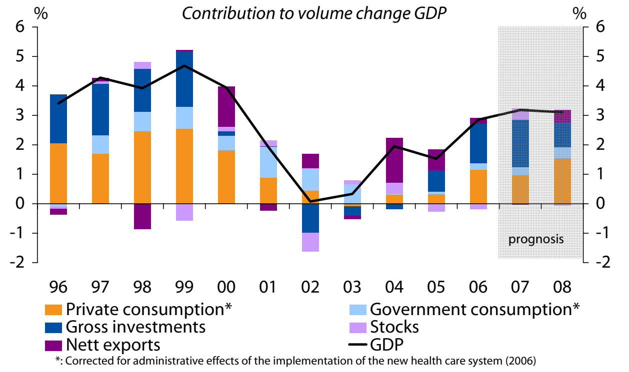
Summer-time for the Dutch economy

Dutch export growth has been fuelled in recent years by strong global economic expansion. In 2006 private consumption finally took off as well. This contributed to an economic growth rate last year of 2.9%. Although investment recovery has picked up, it remains slightly below par from an historical perspective. There is room for a further rise this year. A greater rise in investments would contribute to a healthy growth in volume of GDP by 3¼% in 2007. In 2008 the economy may slow down slightly to 3%. These are sunny prospects for the Dutch economy. However, this is not without the risk of overheating; in 2008, further tightening of the labour market is likely to become evident in the shape of higher inflation.

In recent years, exports have been the only driving force behind the Dutch economy. Since 2004 the average annual export growth has been an impressive 7%. World economic growth is likely to slow somewhat in 2007. This may lead to a lower increase in export volume, particularly to the United States. Nonetheless, the general outlook for the export sector is favourable. We don't expect the growth dampening in the US to be severe, while at the same time demand from Asia may increase further. The expected drop in Dutch export growth will therefore be modest - slipping from 7.6% last year to 6½% this year. Next year, export growth will slow down slightly under the influence of slower growth in Europe. Although the export sector no longer has to drive total economic growth in the Netherlands, it remains an important driving force for the time being.

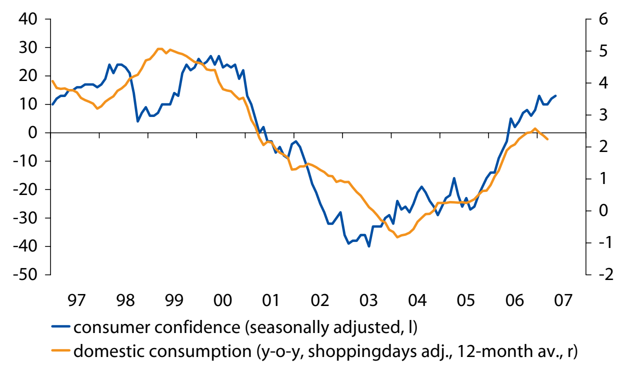
Last year Dutch consumers finally found that circumstances permitted significantly greater spending. This broadened the base for economic growth, so that it is no longer merely export-driven. The externally driven economic upswing led to a drop in unemployment and a turnaround in wage development. The government also played its part in improving purchasing power. With the approaching elections, there was room for much-promised goodies after years of denial, following the implementation of the major reforms. Consequently, consumer spending rose in real terms by a healthy 2.4% last year (corrected for the administrative effects of the new health care system). This favourable scenario for consumption is likely to continue this and next year.

Figure 4: Economic recovery broadly based



Source: Statistics Netherlands

Figure 5: Consumer confidence and consumption



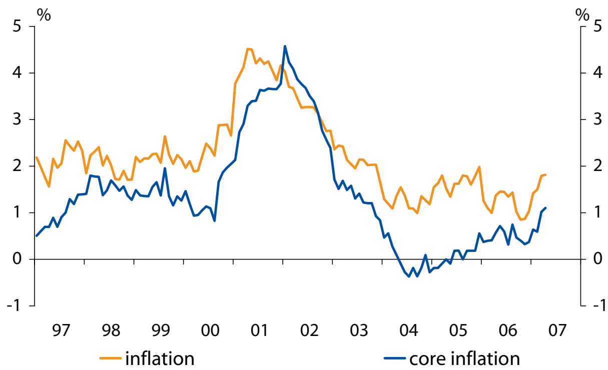
Source: Statistics Netherlands

Nor does there appear to be any reason to assume that government policy might throw a spanner in the works. The new cabinet has declared that unlike earlier governments, it intends to involve the social partners in government policy and thus avoid social unrest. The decision to keep the tax relief for mortgages and to maintain current rental policy will go a long way towards dispelling uncertainty. During the past winter, consumer spending figures were pushed down by lower gas consumption. This unexpected bonus for the consumer may translate into greater spending on other items later this year and next year. Real consumption therefore should reach 2% this year, followed by a sizeable rise to 3¼% in 2008.

Corporate Investment also grew in 2006. To date, however, this rise is still only moderate in comparison to earlier periods of investment recovery. Therefore we expect that there is room for further investment growth in the Netherlands this year, for instance in the area of machinery and equipment. There may also be a further increase in corporate investment in construction and residential construction. However, in this respect, the upward potential is limited by a labour shortage in the construction industry. The 7¾% climb in investment volume that we expect this year, may be followed by a more moderate rise of 4% in 2008.

It is entirely possible that the economy may begin to feel its limits from as early as next year. This could lead to rising wages and inflation. Unemployment has dropped sharply from 6.5% of the work force in 2005 to 5.5% in 2006. Thanks to further economic improvement in 2007 we consider it likely that unemployment will drop further to an average level of 4¾% in 2007 and 4¼% in 2008. At this level, some sectors may experience a shortage of qualified staff, which may lead to more generous CAO agreements and higher inflation. Tightness in the labour market not only results in higher inflation, but also leads to capacity problems. In our view therefore, economic growth in 2008 will remain robust at 3%, after which it may drop to a more moderate level. In the light of imminent shortages on the labour market, there is an urgent need for measures to increase the labour supply by encouraging labour market participation.

Figure 6: Inflation still low, but rising



Source: Statistics Netherlands, Rabobank

Tabel 2: Key economic figures for the Netherlands

year-on-year %	2005	2006	*2007*	*2008*
Gross domestic product	1.5	2.9	*3¼*	*3*
Private consumption	0.7	2,4*	*2*	*3¼*
Government expenditures	0.3	1,2*	*1*	*1½*
Gross fixed capital formation	3.6	6.7	*7¾*	*4*
Exports of goods and services	5.5	7.4	*6½*	*6*
Imports of goods and services	5.1	7.9	*7*	*6*
Consumer price index	1.7	1.1	2	*2½*
Unemployment (% labour force)	6.5	5.5	*4¾*	*4¼*
Public budget (% GDP)	-0.3	0.5	*-½*	*0*
Current account (% GDP)	7.1	7.2	*6¾*	*7*

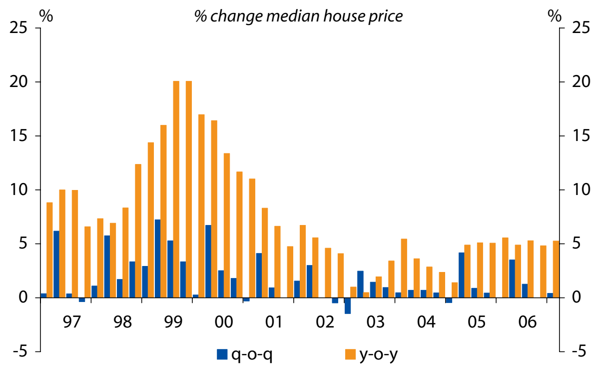
* Corrected for administrative effects of the implementation of the new health care system (2006)

Prices of second-hand housing still rising

Housing market price development

In the first quarter of 2007 there were no great changes in house prices (figure 7) which is in line with previous years. In the first quarter, prices generally only rise marginally and sometimes may even drop slightly. According to the Netherlands Association of Real Estate Brokers (NVM), an average house in the Netherlands currently costs € 240,000, which is € 1,000 more than at the end of 2006. Compared to the first quarter of 2006, however, the difference is greater and amounts to € 12,000: a price increase of 5.3%. The NVM bases these figures on (provisional) sales contracts from estate agents who are members of the NVM. The Dutch Land Registry also monitors developments on the housing market. Unlike the NVM, the Land Registry registers all transactions involving house sales in the Netherlands and bases its data on information from the contracts processed at the notary's office. This means each of these organisations has a different time of registration. Furthermore, the Land Registry data provide an arithmetical average of all house prices in a given period, whereas the NVM data refer to the median house price. Because of these differences, there may be discrepancies in the prices recorded by both organizations. For the first quarter of 2007 the Land Registry records a price rise of 2.6%, amounting to € 244,056.

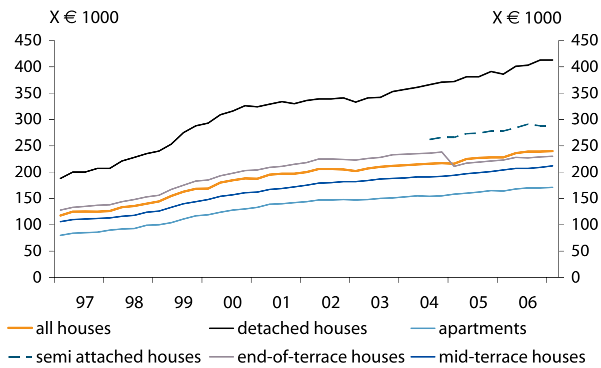
Figure 7: Price development of second-hand houses



Source: NVM

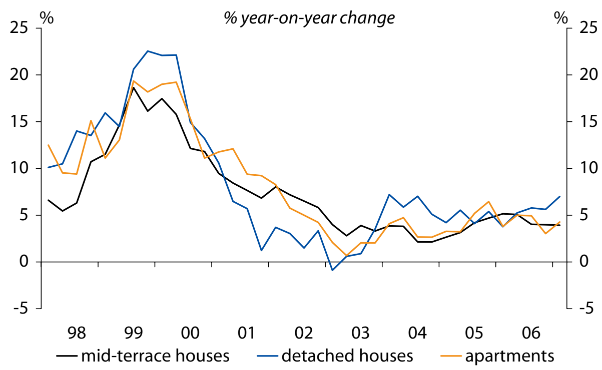
If we distinguish between the various types of houses, then there is scarcely any difference in the price development per house type. Taking a 10 year period, we see that detached houses rose slightly more rapidly than the other house types, although this difference did not take place in the past two years. According to NVM data, mid-terrace houses rose most during the first quarter of 2007, increasing by 1.4%. This was followed by apartments (0.6%) and end-of-terrace houses (0.4%), while the prices for detached and semi-detached houses remained unchanged during this period.

Figure 8: Absolute price development by house type



Source: NVM

Figure 9: Percentage price change by house type



Source: NVM

Sales Transactions

In the first quarter of this year, the Land Registry recorded 45,255 sales transactions in the second-hand housing market. This represents a drop in volume of 4.4% compared to the first quarter of 2006. The slowdown in the number of sales transactions that commenced in August 2006 thus continues. At the same time the 12-month average remained at a high level, totalling over 207,503 transactions (figure 10). Certainly from an historical perspective, a relatively high number of houses are currently changing hands.

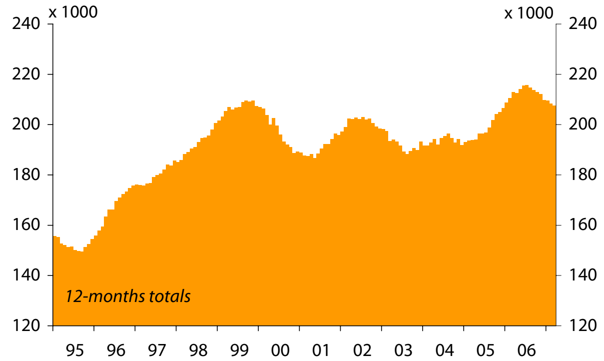
Of the various house types, mid-terrace houses are sold most often. Although the supply of detached houses is relatively limited, the share of these houses in total sales is rising. Demand for houses is being fuelled by the positive economic climate and favourable developments on the labour market. Tightening of the labour market may push up wages, which especially benefits sales of the more expensive houses. This is counterbalanced by the fact that capital market interest rates have risen since their lowest point in the autumn of 2005, and are pushing up the costs of mortgage debt.

Enforced Sales

During the first quarter of 2007, the Land Registry recorded 466 enforced house sales. This is over 9% less than in the same period last year, when 514 enforced sales were registered. In March 2007 the year-on-year change showed a drop in compulsory sales for the first time since March 2001 (figure 11). This reflects the fact that during the past 12 months there were fewer enforced sales than in the 12 months previously. Thanks to this development, the 12-month average has dropped to 160 enforced sales per month, which is comparable to the summer months of 2006.

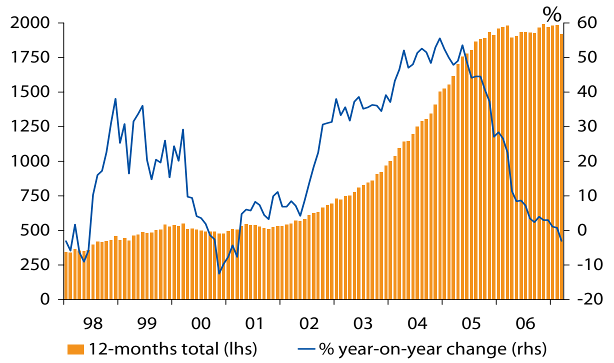
The percentage of compulsory sales within total sales has been 0.9% for almost two years. Although this ratio did rise (marginally) between July 2006 and February 2007, since March 2007 there has been a break in this gradual upward trend. Accordingly, the number of enforced house sales remains at a very low level in the Netherlands. For 2007 as a whole, we expect a drop in the number of obligatory sales for the first time since 2000.

Figure 10: Volume of transactions in existing housing supply



Source: Land Registry

Figure 11: Enforced Sales



Source: Land Registry, Rabobank

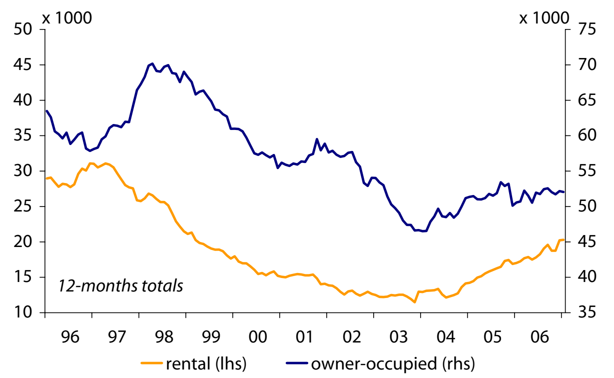
New construction rising slowly

Data from Statistics Netherlands (CBS) show that new construction output exceeded expecations in December last year. The total number of completed new housing units amounted to 72,382, which is 5,366 more than in 2005 and represents an increase of 8.0%. While our last quarterly report quoted a drop in new housing output, we can now report a reverse in the trend; the 12-month average for December and January indicates over 72,3000 homes. We have to look back as far as late 2001 to find similar numbers. Taking the rental sector and owner-occupier sector separately, the production in both sectors has registered a rise. Remarkably, of the two segments, the production of houses for the rental sector is rising at a far more rapid pace. For 2006 the production of houses for rental amounted to 19.6%, compared to 4.1% for owner-occupier houses.

Also important for the housing market sector is the number of building permits issued. For 2006 a total of 96,447 licences were issued, according to Statistics Netherlands. This amounts to 15.8% more than in 2005 and it has been nearly ten years since this many building permits were issued in one year. Disappointingly, however, the number of construction licences issued in January 2007 was over 20% below the same month in 2006. Interestingly, the trend for owner-occupier house permits has been declining since September 2006, whereas that for rental homes continues to rise.

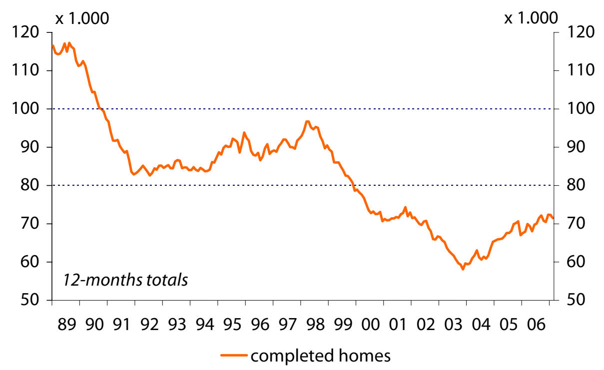
The growth in new construction output requires some qualification, however. For a number of decades, now, the Netherlands has been struggling with a housing shortage problem. For many years, the answer was sought in heavy investment in new housing construction. However at a maximum rate of less than 73,000 new houses per year, this production has been historically very low since 2000. By comparison, in the late 1980s over 100,000 new houses were being generated annually; and during the entire next decade the output remained above 80,000 houses annually (figure 13). Moreover, the present housing output clearly lags behind the cabinets goal of 80,000 new housing units annually. On a positive note, however, the new cabinet has declared its intention to invest in the construction of new homes for both the rental and purchase market. The coalition agreement states that housing output will be increased to an annual level of between 80,000 and 100,000 houses. However, the question remains whether this aspiration can become reality. Capacity problems and manpower shortages in the Dutch construction sector, combined with strict legislation make it difficult to realise the desired significant increase in construction volume. In addition, demand for new office space is rebounding, which means the limited building capacity will be divided between housing and utility construction in 2007.

Figure 12: Completed housing construction by home ownership



Source: Statistics Netherlands

Figure 13: Completed housing construction



Source: Statistics Netherlands

Affordability remains low

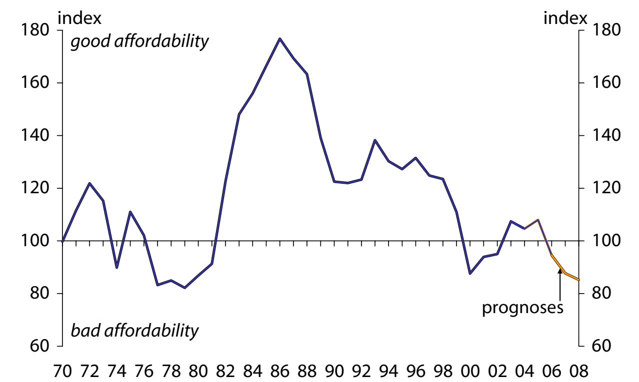
The Rabobank affordability index is a measure of the affordability of purchasing an average house for a household with an average income in the Netherlands. A distinction is made between affordability for first-time buyers (110% financing) and those who want to trade up (70% financing). If the affordability index is 100, this means that for an average household income and an average priced house, the gross monthly burden is 30% of gross income. If the affordability index exceeds 100, then the gross monthly burden is less than 30% of gross income, and vice versa.

After a decade during which home ownership was relatively cheap, the affordability of owning one's own home deteriorated rapidly during the second half of the 1990s. The rapid growth of house prices was mainly to blame for this. During the first half of this decade, there was a slight improvement in the affordability of home ownership thanks to declining interest rates an the more moderate development of house prices. In the autumn of 2005, capital market interest rates reached their lowest level, and since then house prices have risen again. Both these developments have increased the financing burden of home ownership. As against this, the economy in the Netherlands picked up after a dip, and unemployment has since dropped. Consequently more people were in paid employment and household incomes expanded. However, these positive income effects have not been sufficient to withstand the higher financing burden, which means that on balance, the Rabobank affordability index registered a decline in affordability.

For next year we expect a continued deterioration in the affordability of house prices. Although household disposable income is likely to rise, and interest rates are expected to rise slower than in 2007, this will not be enough to offset the expected rise in house prices. However, the decline in the index will be of a smaller scale than in the previous years.

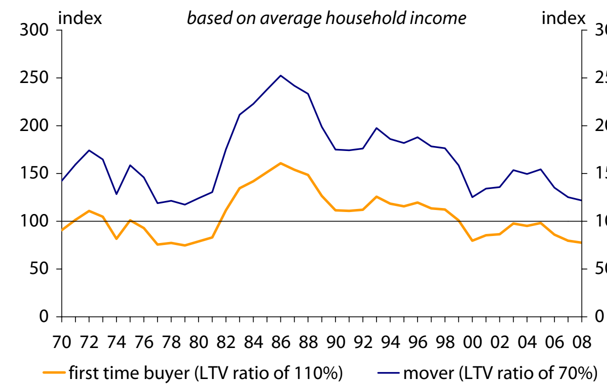
As in recent years, the current price levels remain problematic for aspiring first time buyers on the housing market, even for those in receipt of an average household income of € 45,000 (1.5 x modal income in 2007). Without a supplementary source of capital, this group has to resort to the cheaper segments of the housing market, such as houses of poorer quality, houses with a smaller square footage and/or situated in less desirable areas.

Figure 14: Rabobank affordability index



Source: CPB, Land Registry, Ecowin, Rabobank

Figure 15: Affordability index by buyer type



Source: CPB, Land Registry, Ecowin, Rabobank

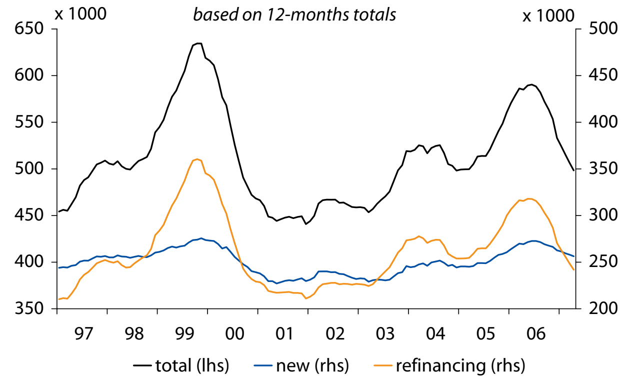
Fewer refinancing mortgages

In the first quarter of 2007, a total of 108,497 new mortgages were issued. This represents a drop of 14.5% compared to the previous quarter and is 19.7% less than in the same quarter a year earlier. The total mortgage debt issued during the first quarter amounted to € 25.5 billion. This is also lower than the previous quarter (-12.8%) and the corresponding period a year earlier (-11.8%). However, the drop in terms of amount is greater than in number of mortgages, which means that the average amount per mortgage loan has increased.

An important reason for the decline in newly issued mortgages can be found in the rising capital market interest rates. This has had the effect of reducing the number of refinancing mortgages in particular (figure 16). In March 2007 there was a year-on-year drop of 21.4% in refinancing mortgage loans. A large percentage of home owners have already refinanced their mortgage, and for those who have not, current higher interest rates may be acting as a deterrent. Consequently, the 12-month production of new mortgages from February 2007 has been higher than the number of refinancings. This is a first since the spring of 2003. Although the number of new mortgages issued declines as well, this trend is less sharp. The output of new mortgage loans is much less volatile than of refinancings and is in keeping with the current decline in the number of transactions on the housing market.

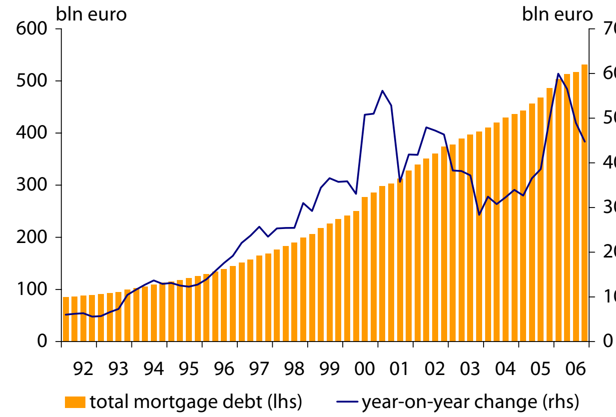
Net mortgage credit issued continued its rising trend in the first quarter of 2007. The Dutch Central Bank (DNB) registered an increase of € 14 billion, of the total mortgage debt, bringing the total amount outstanding with Dutch mortgage lenders to € 531 billion at the end of 2006. For the whole of 2006, this is an increase of € 45 billion, which corresponds to a rise of 9.2%. However, the net increase is smaller than in the previous quarter and has dropped since the historic peak in the first quarter of 2006. The rising mortgage debt is discussed in more detail elsewhere in this quarterly report.

Figure 16: Volume development of mortgage output



Source: Land Registry, Rabobank

Figure 17: Outstanding mortgage debt



Source: DNB, Rabobank

Effects of rising mortgage debt remain limited

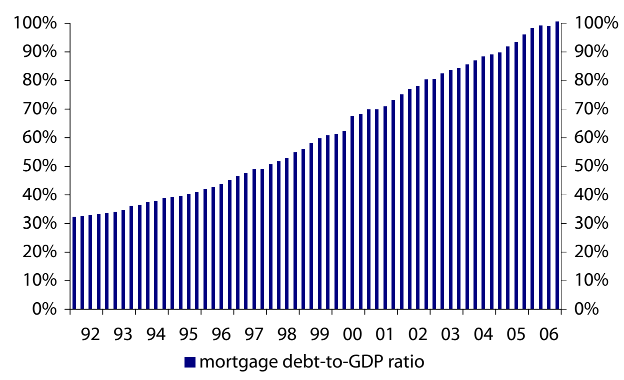
Outstanding mortgage debt has shown an uninterrupted rising trend for many years. It would appear that it takes about five years for the total outstanding debt to double. In the first quarter of 1995 the outstanding debt reported by DNB totalled € 115 billion. By early 2000 this had already increased to € 242 billion (+ 110%) and during the first five years of this decade, the outstanding debt has doubled again to 486 billion euro. Since that date it has risen further to 531 billion euro. In a relative sense too, the debt is increasing, for instance in relation to GDP. This opens the question as to whether this situation is sustainable in the long term. We will therefore examine the processes that form the basis for these developments and discuss whether the effects for the Dutch housing market are negative or not.

Relatively high debt quota for the Netherlands

Data from the European Mortgage Federation (EMF) show that the Netherlands has a high outstanding debt-to-GDP ratio (figure 18). In 2005 the ratio was 97.1%; this percentage was not reached by any of the 24 other EU member states at the time. Besides, there are considerable differences between the EU countries in this respect. The ratios found in the more recent member states from Eastern Europe are generally lower. The financial markets in these countries are less highly developed than in other EU countries. Nor are the conditions on the national housing markets the same. This is clear from the supply and demand situation in different countries and regions, as well as national government policies that can have direct or indirect impact on the housing market. Specifically, government policy at national level that intervenes directly in the supply and demand process can have major consequences for the choices made by prospective house buyers. These factors can result in considerable differences between the EU member states. In the Netherlands too, the housing market is influenced by government interventions. The preferences of Dutch consumers also play a role.

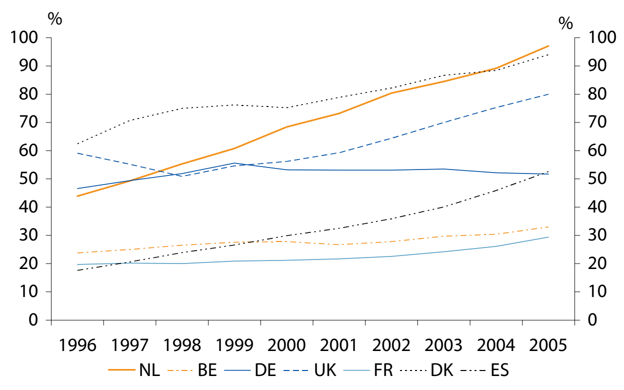
Remarkably, the mortgage debt-to-GDP ratio in the Netherlands has undergone a period of steady, strong growth from 43.9% in 1996 to almost 100% in 2005. More recent central bank figures show that this ratio grew at a less rapid pace in 2006 than in 2005. The figures also show that since the first quarter of 2006, the ratio has exceeded 100% for the first time. The reason for the rise in the ratio can be explained by the fact that growth rate of outstanding debt has outstripped the growth rate of GDP by a factor of between two and three.

Figure 18: Outstanding mortgage debt rising



Source: DNB, Rabobank

Figure 19: Mortgage debt-to-GDP ratio



Source: EMF

Forces behind the rising mortgage debt

A number of factors can explain the strong rise of the Dutch mortgage debt, including government policy, favourable market conditions, and market participants taking advantage of specific circumstances. A number of these developments can also be found in other countries, but the combination of factors is unique to and characteristic of the housing market in the Netherlands. Specifically, for decades, the Dutch government has been stimulating home ownership, by which the home-ownership-ratio has risen from 28% in 1950 to 55% in 2006. All the same, this ratio is still relatively low from an international perspective, and falls well behind the European average of 65%. Paradoxically, this is also a consequence of the intensive policy and involvement of the Dutch government in the area of social housing.
One of the most recent government interventions in the housing market is the introduction of starter loans in many Dutch municipalities. These loans are aimed at helping first-time-buyers to get on the property ladder, even though this is not (really) within their financial scope.
In addition, partly thanks to government measures, the financing options of households were expanded substantially in the mid 1990s. Partly to promote equal gender opportunity, mortgages from then on started to be issued on the basis of two incomes. Consequently, many Dutch households were able to raise their mortgage borrowings. In addition, increased participation of women in the workforce means that the number of dual income households is rising.
For more than 100 years, Dutch governments have been promoting home ownership with a tax system that benefits home owners, provided the owners use the house as their main residence. Although this tax advantage was curtailed somewhat in recent years by various measures, the changes have not affected the stimulating effects for the housing market. It remains lucrative for people to finance their own home with borrowed funds.

Added to the above, favourable market conditions have contributed to the rise in mortgage debt. Specifically, capital market interest rates have dropped during the past decade, reaching their lowest point in the autumn of 2005. Although interest rates have risen since then, the long-term interest rate remains at a historically low level. This situation has prompted many home-owners to refinance their house, often increasing the amount of the mortgage loan.
At the same time, these favourable and expanded financing possibilities for house-buyers have pushed house prices up further. Many people therefore have to dig deep into their pockets to purchase a house. Due to the limited flexibility on the supply side, the favourable conditions for a house purchase are effectively priced into the current market. As a consequence, mortgage loans simply rise in tandem with house prices.

The effects outlined above are reinforced because the market takes advantage of certain developments. Specifically, innovative mortgage products are regularly launched with a view to expanding the financing scope of house-buyers. One example is the emergence of mortgages based on savings or investment accounts. Instead of making repayments, capital is accumulated alongside the loan. The ultimate aim of these products is for the debt to be (partly) repaid at the end of the loan term, with the accumulated savings. The increased use of interest-only mortgages has also pushed up the maximum mortgage amount, since this product does not involve repayments.

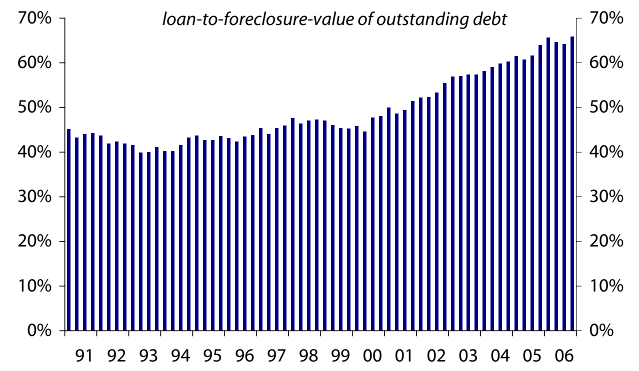
Rapid rise in LTV

It is clear from the loan-to-foreclosure-value of outstanding mortgage debt in the Netherlands, that Dutch house-buyers borrow a relatively high amount to finance the purchase of their own home. This ratio, which links the outstanding mortgage debt to the house value, has risen during this decade from about 45% in 2000 to approximately 65% in 2006 (figure 20). Internationally too, this ratio is high, which is also true for the LTV of new mortgages (figure 21).
There are various reasons for the increase of this ratio in the Netherlands. These include both numerator and denominator effects. The numerator effect consists in the rapidly rising total mortgage debt (figure 21), which contributes substantially to the growth of the LTV. Importantly also, Dutch house prices have risen at a less rapid pace during this decade than in the preceding period. Consequently the (surplus) value of houses has risen less rapidly, with the result that the rise of the LTV-denominator was limited. Now that house prices are rising again and increased by almost 5% in 2006, the LTV for 2006 stabilised at around 65%. This percentage will look considerably lower if we take account of the capital that Dutch households are accumulating in mortgages based on savings and investment accounts and other pawned capital.

High debt quota no direct threat to the housing market

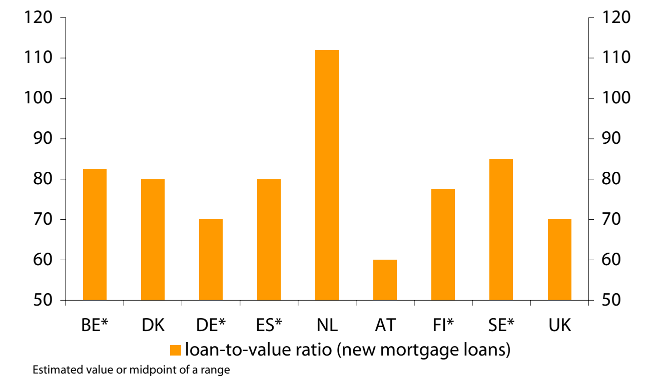
The rising level of mortgage debt and related ratios do not pose a direct threat to the Dutch housing market. The emergence of innovative mortgage products as well as government interventions have expanded the financing scope of house-buyers in recent years. In addition, the introduction of legislation for additional debt ("bijleenregeling") has made it less attractive to make redemptions. As long as current government policy on home ownership remains unchanged, the risks of the rising mortgage debt remain limited. Notwithstanding the interest rate risk. The historically low level of capital market interest rates has made relatively high mortgages possible. In the meantime, these interest rates have risen somewhat, though many Dutch households have not been affected because their loans are fixed for relatively long periods. Finally, the fundamental shortage on the housing market in the Netherlands must not be overlooked. For decades the supply of housing has lagged well behind demand. This generates upward pressure on house prices and consequently on new mortgages. Despite the rise in mortgage debt, the number of enforced sales in the Netherlands is relatively low, amounting to less than 1% of total transactions. Altogether, these are favourable conditions for price development, further stimulating mortgage borrowing to finance home purchase.

Figure 20: LTV development in the Netherlands



Source: DNB, Statistics Netherlands, NVM, Rabobank

Figure 21: LTV, international developments



Source: ECB

Housing market outlook

Developments on the Dutch housing market are stable. House prices have been rising by about 5% for two years now. There was even a slight rise in the usually stagnant first quarter, compared to last year when house prices remained unchanged. Although the 12 month total of house sales has declined since the summer of 2006, the level of transactions remains historically very high. The first quarter of 2007 also saw a drop of over 9% in the number of enforced house sales, compared to the same period last year.

The prospects for the Dutch housing market are moderately positive. Economic growth is stabilising at around the 2.9% achieved in 2006. The outlook for 2007 and 2008 are favourable, with an expected real increase in GDP for both years of about 3%. Consumer spending is also expected to grow in 2007 by about 2% and a further increase is expected for 2008 of some 3.2%. Compared to the fourth quarter of 2006 consumer confidence has risen further, and since April all the sub-indicators of consumer confidence are positive. In particular the sub-indicator of spending readiness has shown an improvement. This indicator is composed on the basis of estimates of the financial situation in the past 12 months and the coming 12 months together, with a sub series for large purchases.

The labour market is also playing its part in the positive outlook for the Dutch housing market. There are more people in paid employment and unemployment is declining. This has an upward effect on the demand for houses. Additionally, some segments of the labour market are already showing signs of tightness, which will create scope for wage increases. These developments will combine to increase disposable income. Furthermore, we expect that new housing output in 2007 will again lag behind the targets set by the Ministry of Housing, Spatial Planning and the Environment (VROM).

Less positive prospects are also looming, however. Interest rates have gone up significantly in recent times, particularly when compared to the lowest level in the autumn of 2005. This increases the burden of a mortgage. House prices have also risen, which means house-buyers have to pay more for a home than was the case a number of years ago. Consequently the financing burden has increased. For 2007 and 2008 a further rise is expected, both for house prices and for interest rates, although the latter is expected to rise at a slower pace each year and will be lower than in 2006.

The above developments have a combined effect on the affordability of home ownership. We do not expect the positive income effects to fully compensate for the rising financial burden of owning a home. This means that the affordability of purchasing a house will deteriorate. However, we do anticipate that this downward trend will be less sharp in the years ahead, both for first time buyers and for those trading up in the market.

As a consequence of the on balance somewhat poorer affordability of home ownership, combined with an acceleration in supply, we expect that the rise in house prices will level off somewhat. Altogether for 2007 and 2008 we predict a nominal rise in the average house price by 4¼% and 3¼% respectively.

Key figures

House Prices

Year-on-year change (%)	2005	2006	2007 [a]	2008 [a]
NVM (median house price)	5.1	4.8	4¼	3¼
Land Registry (average house price)	4.7	5.9	-	-

Totals

x 1000	2005	2006	2007 [a]	2008 [a]
Sales transactions	207	210	205	200
Newly built homes	67	72	75	80

Totals

	2005	2006	2007	2008
Enforced Sales	1,911	1,968	-	-

Key economic data

	2005	2006	2007 [a]	2008 [a]
GDP (growth, %)	1.5	2.9	3¼	3
Inflation (%)	1.7	1.1	2	2½
Unemployment (x 1000)	483	413	355	320

Rabobank affordability index

x 1000	2005	2006	2007 [a]	2008 [a]
Affordability index [b]	108	95	88	85

Interest rates [c]

Level (%)	10 May 2007	+3m [d]	+12m [d]
3-month Eurozone	4.05	4.38	4.38
10-year Euroswap	4.51	4.35	4.60
Mortgage interest rate, 5-10 year fixed	4.59 [e]		

[a] Rabobank outlook

[b] The Rabobank affordability index is calculated based on the average property price (Dutch Land Registry Office – *Kadaster*) and average household income (Statistics Netherlands). An annuity mortgage is used with a duration of 30 years and a forced sale value of 80 percent of the market value, and a monthly expense quota of 30 percent. An affordability index greater than 100 indicates that the average house is reasonably affordable. An affordability index below 100 indicates that an average property is not reasonably affordable without injecting personal capital.

[c] Forecasts by Financial Markets Research, Rabobank International

[d] Outlook for +3 and +12 months respectively

[e] January 2007 monthly average, DNB

Colophon

The Dutch Housing Market Quarterly is a publication of the Economic Research Department (KEO) of Rabobank Nederland. The vision presented in this publication has been based on data from sources we consider to be reliable. Among others, these include Ecowin, Land Registry, NVM, DNB and Statistics Netherlands. The key figures of the (inter)national outlook are updated at 7 June 2007.

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