SPOTLIGHT
*Savills Research*

The Netherlands – Autumn 2019

# The residential paradox

savills

## Development of new property starting to stall as the housing market booms

**Question** At which locations is residential property development currently the least feasible? And which areas are promising locations to invest in, given the demand and supply fundamentals?

**Introduction** It seems paradoxical: the demand for housing in the Netherlands remains strong, supply is limited, house prices and rents continue to rise, and as a result an increasing number of (international) investors are looking for opportunities in the Dutch residential market. So far, so good: the investment climate for the Dutch residential sector seems healthy.

Normally, a situation of high demand and limited supply incentivises property developers to scale up the construction of new homes. However, at the moment this is not the case. Property development is actually becoming less viable in an increasing number of locations.

This is mainly due to a combination of construction costs, excessive land prices, and building requirements and regulations for new developments, which are pushing up construction costs and cutting returns. This is resulting in an increasing share of unviable new residential developments.

So, in light of the healthy investment climate combined with the increasing difficulties of property development, at which locations is residential property development currently the least feasible? And, feasibility aside, which areas are promising locations to invest in, given the demand and supply fundamentals?

This analysis reveals that the most attractive locations for residential investment are also the least feasible locations for residential property development, hence the great paradox.

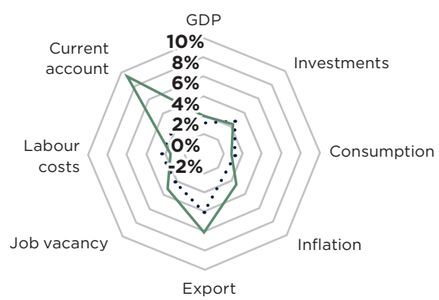
# Economic fundamentals remain stable

The basic demand for housing in the Netherlands is strong, and is being driven by demographic factors. The demand for housing can also be expected to remain strong in the long term (more on this later). In the short term, any possible weakening in the housing market will therefore likely be down to falling consumer confidence and an increasing risk of a more generalised economic slowdown. However, this risk does not appear imminent at the moment.

Although consumer confidence in the housing market and economic growth in the Netherlands are weakening slightly, the Dutch economy is still showing above average growth (+1.9% YoY – 2019 Q1) within the Eurozone, and unemployment remains very low (3.4% of the labour force). Mortgage interest rates also remain historically low (currently an average of 2.24% on new mortgages), as a result of which households can afford to pay more for their home.

**Performance on key economic indicators 19Q2** YoY % change

Key
— Netherlands
··· Eurozone




> "The most attractive locations for residential investment are also the least feasible locations for residential property development"





## POSSIBLE POLICY MEASURES

Other possible policies under consideration by the national government:

**Compulsory occupation** A requirement for home owners to reside in that home.

**Tax Exemption** Exemption of the property-transfer tax for first-time buyers. Investors, by contrast, may face higher property-transfer taxes.

**Limited LTV** A limit on the loan-to-value ratio applicable to buy-to-let mortgages.

**Taxes** A new method of taxing rental income from buy-to-let.

# Government housing policies

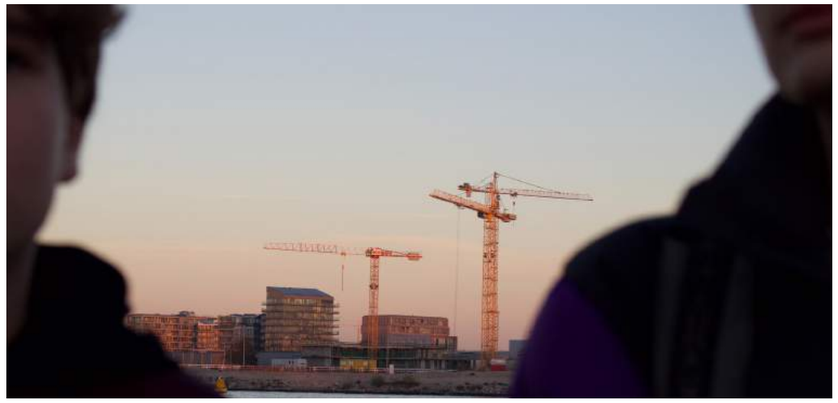
## Announced policy changes

As long as the mortgage interest rate and national policies on the loan-to-value ratio (LTV; currently at 100%) remain unchanged, there is no real reason to expect any sudden fall in the demand for housing and house price decreases. Currently, mortgage interest rate increases remain unlikely in the near future since the ECB has recently reinstated its quantitative easing programme and has again reduced the official interest rates.

The LTV will also remain at its current level, since the Dutch government currently has no plans to reduce the LTV. In other areas several changes to the national housing policy for the coming parliamentary session have recently been announced. Some of these policy changes could create more uncertainty in the market.

Still, most of these policies are favourable for investors in the residential market, such as:

1. €1 billion will be made available for the construction of affordable homes in areas with a severe housing shortage.
2. €1 billion will be made available as a tax reduction on the landlord levy. The amount will be made available in phases over ten years (flexibly – on average €100 million annually).
3. The exemption of temporary housing from the landlord levy.
4. Allowing higher rental price increases for people who continue living in a social housing house/flat when their income has in fact become too high to be eligible for social housing.



Future policy measures that are less favourable for investors include:

1. The future options for municipalities to cap rents for rental housing in the unregulated sector based on a percentage of the market value of homes as assessed by each municipality (the 'WOZ' value).
2. The influence that the market value (WOZ value) of homes can have on determining the maximum rent for social housing through the social housing points system (woningwaarderingsstelsel - WWS) which is used to determine the maximum permitted rent will be capped.

Currently the WOZ value determines about 15% to 45% of the rent of social housing in Amsterdam according to research conducted by RIGO.

3. Buy-to-let private investors will pay higher taxes due to a change to the tax on capital returns.

**€1 billion** made available for the construction of affordable homes in areas with a severe housing shortage.

The expectation is that the current housing shortage will ease somewhat from 2020 onwards, as the backlog in housing production is slowly made up after 2020.


**Y-Towers** (c) Team V, a visualisation by Zwartlicht

# Supply and demand

The current population of the Netherlands is estimated at 17.29 million (2018) people, and there are 7.94 million households.

Normally, each individual household requires its own home, and the number of households therefore serves as a good indicator for housing demand.

On the supply side, the national housing stock currently totals 7.81 million dwellings. Taking into account regional differences in oversupply and shortages, this means a current housing shortage of around 294,000 dwellings (3.8% of the Dutch housing stock). This shortage is due to very limited construction activity during the last economic recession, among other.

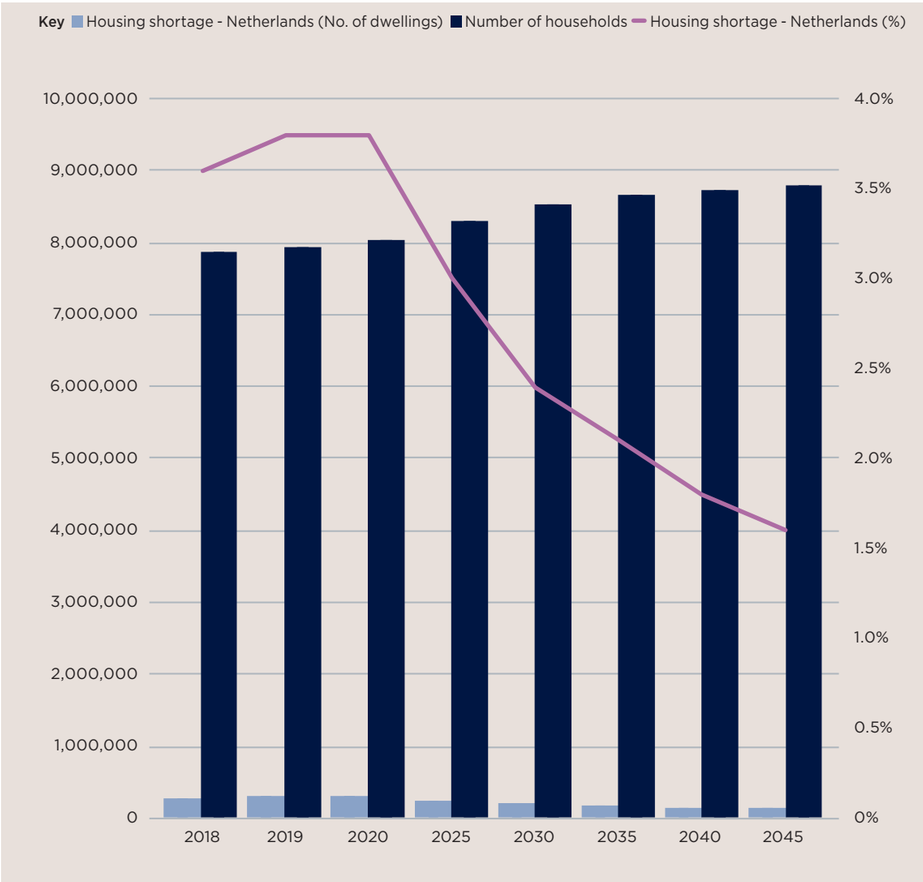
**The future demand for housing**
Based on national demographic forecasts, the future demand for housing has been estimated at approximately 672,000 homes in the period until 2030. When expected new-build is subtracted from future demand, there will be a housing shortage of 200,000 homes by 2030 (2.4% of the total housing stock). That shortfall is approximately 90,000 homes less than the current housing shortfall. The expectation is that the current housing shortage will ease somewhat from 2020 onwards, as the backlog in housing production is slowly made up after 2020. Of course, the housing shortage will only be reduced if the desired construction volume of approximately 75,000 homes per year is achieved. But is this realistic?

> **“The housing shortage will only be reduced if the desired construction volume of approximately 75,000 homes per year is achieved”**





**Current and future national housing shortage in the Netherland, in relative terms**
The housing shortage is expected to peak in 2020, after which it is expected to ease




**Source** PRIMOS (ABF)

Based on the current housing shortage and future demand for housing, the government is aiming for the construction of 75,000 dwellings annually until 2025 (excluding the average annual number of withdrawals of roughly 11,000). Currently this goal is not being met. In 2018, 73,500 dwellings were added to the housing stock: 66,000 homes through new developments and 7,500 through conversions. The goal is unlikely to be met this year too (66,000 homes are expected to be built this year). In the first quarter of 2019, only 12,500 construction permits were issued. This was the lowest number in three years and the fall was the greatest in regions with the most severe housing shortages. Moreover, Dutch municipalities have zoned new residential developments for only 300,000 dwellings in the period between 2019 and 2024, which is insufficient to achieve the national policy goal and accommodate the expected demand for housing. Developers currently hold enough land for an estimated 400,000 dwellings, but this is mainly suited to greenfield development, something that local governments are increasingly reluctant to support in order to protect open space in the countryside. A recent court ruling regarding the Dutch implementation of the EU Nitrates Directive has resulted in a planning crisis. This development can be expected to seriously delay the pipeline of new residential developments still further, creating added pressure on the housing market. The court ruling, however, mainly affects construction projects in the vicinity of Natura2000 protected nature areas, and the consequence of the court ruling for residential development in regions with the most severe housing shortages is still unclear.

## REGIONAL DIFFERENCES IN THE MISMATCH BETWEEN SUPPLY AND DEMAND ARE GROWING

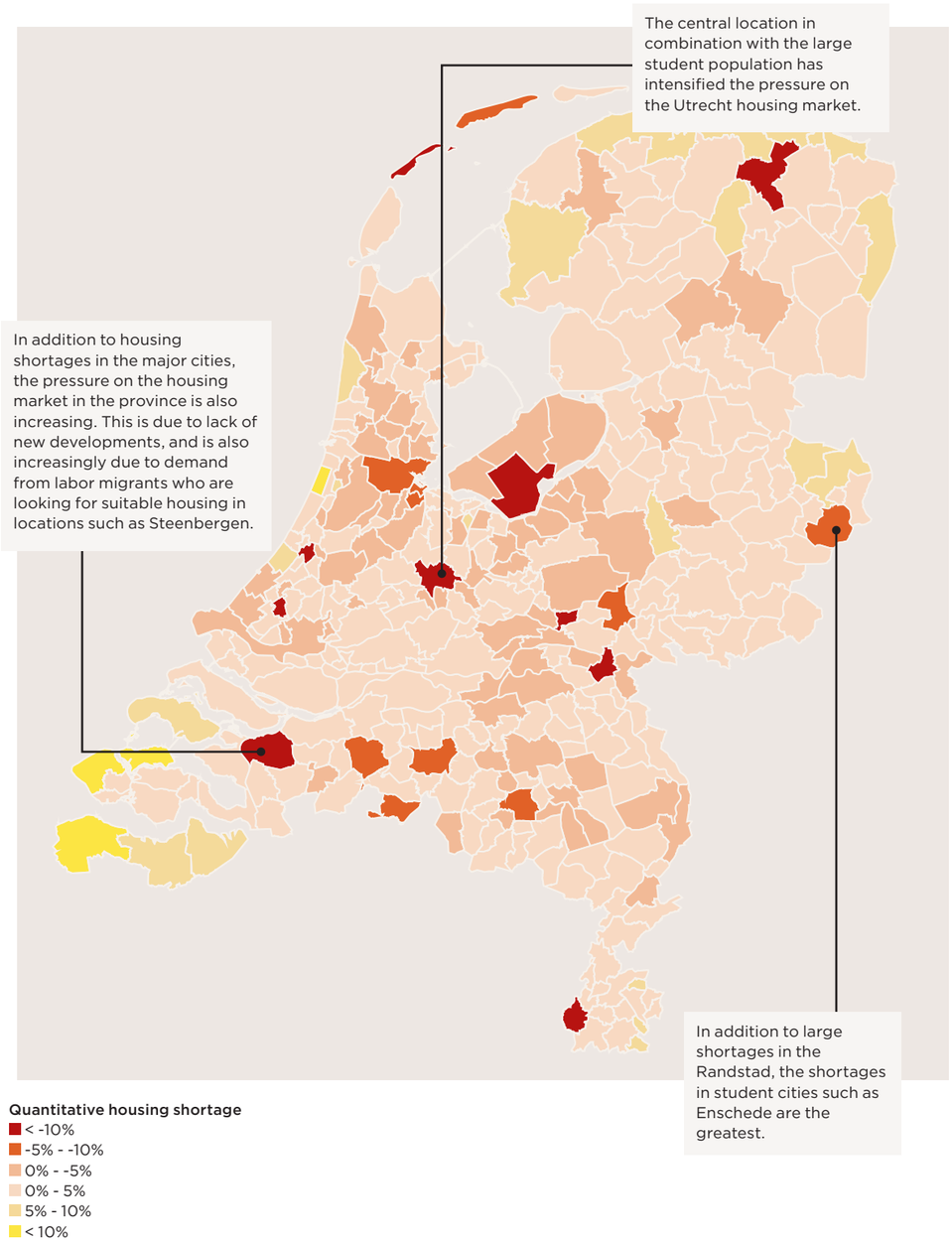
**Due to urbanisation and other demographic trends, some municipalities are facing more severe housing shortages, while other municipalities have an oversupply of housing. The map below shows that the largest quantitative housing shortages can be found in ‘student cities’ cities, which are home to major universities, such as Groningen, Nijmegen, Wageningen, Utrecht and Amsterdam. These cities are struggling to house their constantly growing and increasingly international student population. Currently (2018-2019 academic year), the national student population totals almost 748,000 (+2.4% YoY), of which 86,000 are international students (+12.2% YoY). Major housing shortages, in relative terms, can also be found in municipalities which house a large number of migrant workers, such as Zeewolde and Steenbergen. But even when these extremes are removed from the picture, it becomes clear that other larger or medium-sized Dutch cities which are not home to a large university (e.g. Breda, The Hague, Arnhem and Zwolle) are also contending with significant housing shortages.**

## QUALITATIVE MISMATCH

**In addition to a quantitative mismatch between supply and demand, there is also a qualitative mismatch in certain regions as a result of changing consumer preferences. This includes the increasing demand for smaller residential units due to the changing demographics of the Netherlands (the ageing population and an increasing number of single person households). Regions with no quantitative mismatch may therefore still face a qualitative mismatch, which is especially evident from the generalised shortage of care-assisted dwellings suitable for elderly persons in many regions.**

### Quantitative housing shortage in the Netherland in relative terms

Housing shortage as a percentage of local housing stock




**Source** Savills Research





# Price development and affordability

The shortfall in the Dutch housing market, in combination with the low mortgage interest rate, continues to result in upward pressure on house prices.

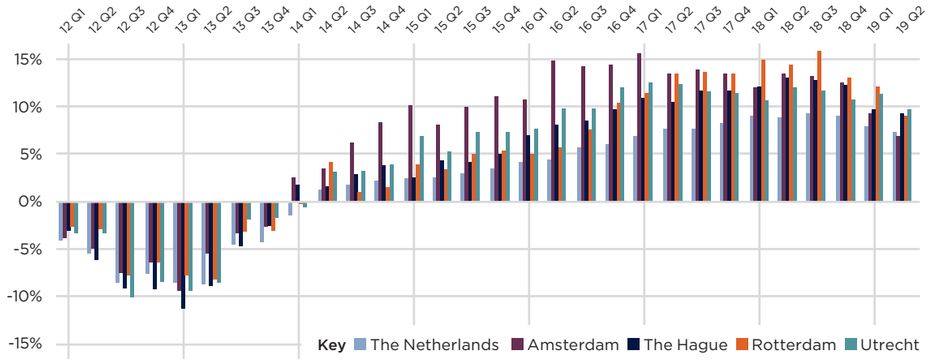
So far in 2019 (until August), around 140,000 homes were sold (-3% YoY). In this period, the average house price in the Netherlands increased to €316,000 which is almost 40% higher than the low point reached during the last recession (June 2013).

**House prices are becoming increasingly unaffordable**
The demand and supply mismatch and low interest rates are the two main reasons why house prices have been rising much faster than wages in recent years. This also means that affordability, in relative terms, is decreasing. In combination with falling consumer confidence in the housing market, this is now leading to some levelling off of price increases.

For an increasing number of homebuyers, current house prices are becoming increasingly unaffordable. This is especially evident among first-time buyers. Potential new entrants to the housing market are increasingly staying in their student homes for longer. As a result, the pressure on the rental sector has also increased, and rental prices in the unregulated sector are increasing significantly above inflation in the past few years.

### House price growth in the Netherlands is now levelling off, having peaked in 2018Q3

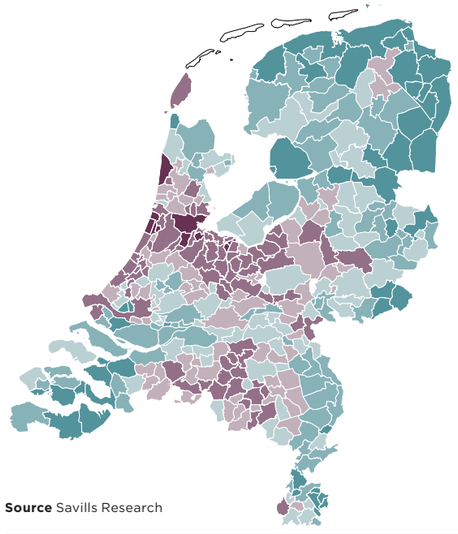
House price YoY percentage growth per quarter




**Source** CBS, Land Registry

### Relative affordability of housing in the Netherlands (2019)

Relationship between average annual household income and the average house price.




While incomes increased by approximately a half between 1990 and 2019, house prices have tripled.
In other words, in the 1990s people required four to five times the average annual income to buy a house of average price in the Netherlands. This has now increased to nine times the average annual household income in 2019. People with an annual median gross income of around €38,000 can finance about 4.5 times their own income (€180,000). This illustrates how housing has become less affordable in the Netherlands in recent years.

**Source** Savills Research

### Annual rent

increase by rental housing segment

**% YoY growth**

**2016**

0.3%
**Inflation (CPI based)**
1.9%
**Total rent increases**
2.2%
**Unregulated sector**
1.6%
**Regulated social housing sector**

**2017**

1.4%
**Inflation (CPI based)**
1.6%
**Total rent increases**
2.3%
**Unregulated sector**
1.1%
**Regulated social housing sector**

**2018**

1.7%
**Inflation (CPI based)**
2.3%
**Total rent increases**
3.1%
**Unregulated sector**
1.7%
**Regulated social housing sector**

**2019**

-
**Inflation (CPI based)**
2.5%
**Total rent increases**
3.3%
**Unregulated sector**
2%
**Regulated social housing sector**

Spotlight residential

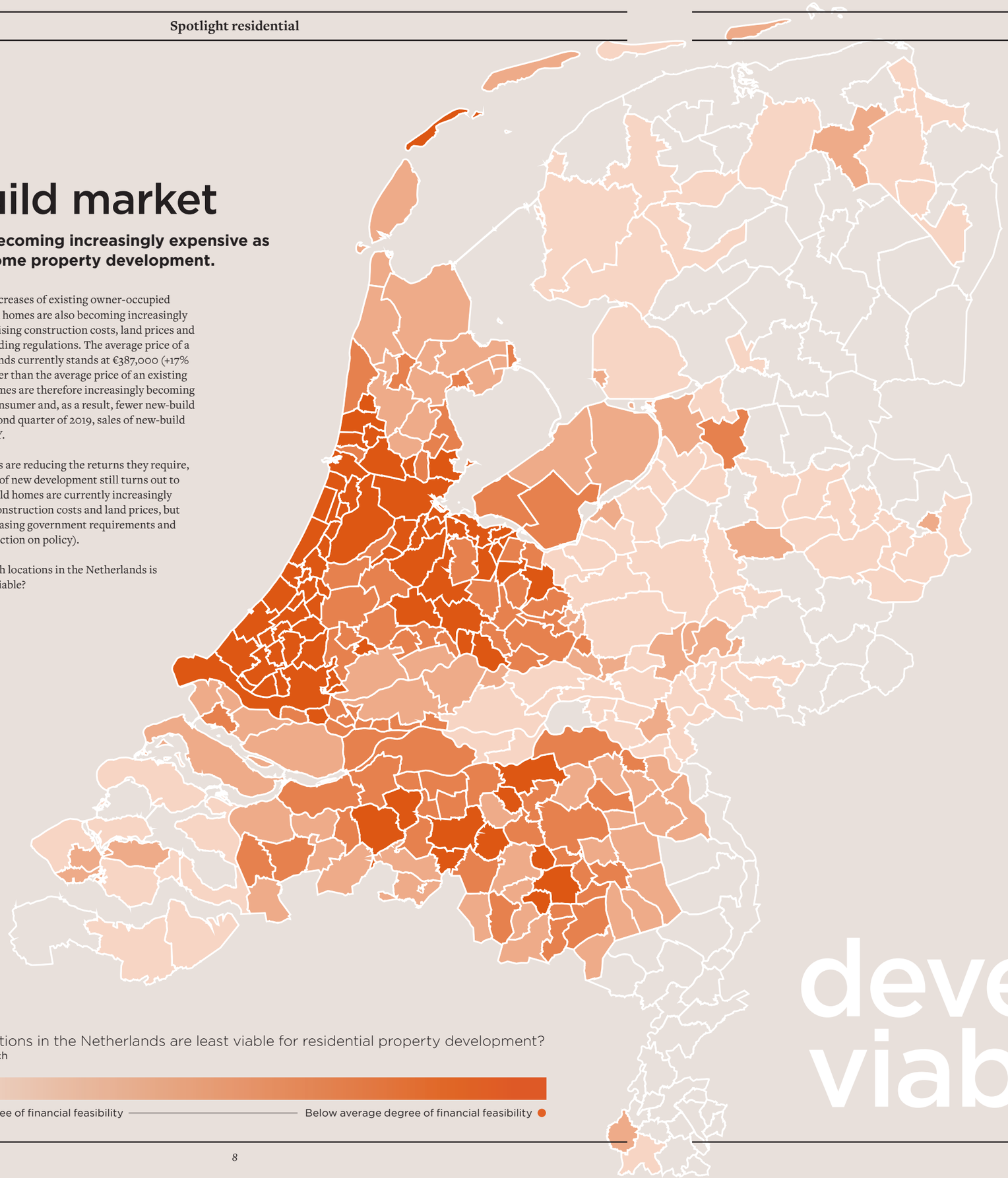
# New-build market

**New-build homes becoming increasingly expensive as a result of troublesome property development.**

In addition to the house price increases of existing owner-occupied homes that are rising, new-build homes are also becoming increasingly expensive as a result of rapidly rising construction costs, land prices and the cost of compliance with building regulations. The average price of a new-build home in the Netherlands currently stands at €387,000 (+17% YoY), which is significantly higher than the average price of an existing home (€316,000). New-build homes are therefore increasingly becoming too expensive for the average consumer and, as a result, fewer new-build homes are being sold. In the second quarter of 2019, sales of new-build homes fell by as much as 13% YoY.

In response, property developers are reducing the returns they require, but even so, an increasing share of new development still turns out to be financially unviable. New-build homes are currently increasingly expensive to build due to high construction costs and land prices, but above all due to the cost of increasing government requirements and regulations (also see previous section on policy).

This raises the question; in which locations in the Netherlands is residential new-build the least viable?



**Map** Which locations in the Netherlands are least viable for residential property development?
**Source** Savills Research

**Key** ○ Above average degree of financial feasibility ——— Below average degree of financial feasibility ●

> “The housing market is in danger of coming to a standstill: in areas where housing is desperately needed, project development has become increasingly difficult”

## Method

To answer the question where property development is least viable, Savills has produced a residential property development viability scan for developers.

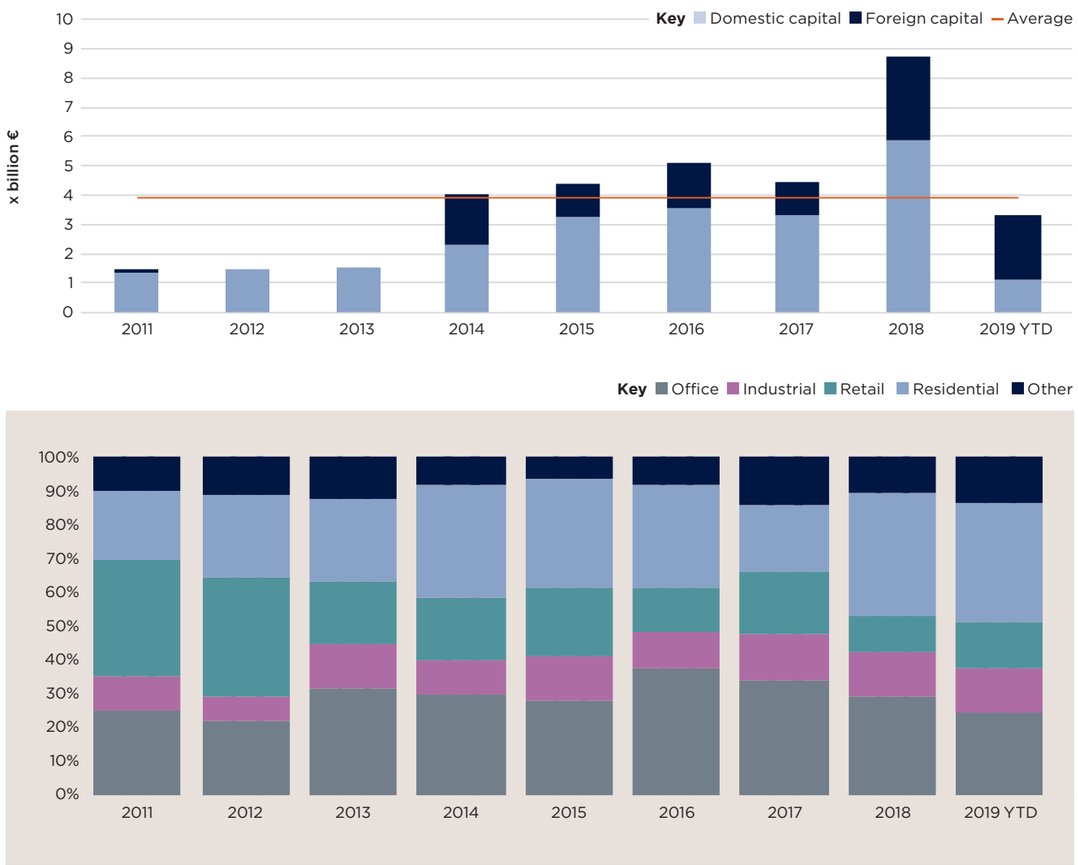
To highlight the average degree to which residential new-build has become unviable, we look at the relationship between construction costs, material costs, land prices, additional development costs and sales prices.

# property development viability scan

# Investment market

Rental prices that are outpacing inflation and shortages in the residential housing market are leading to increasing market opportunities for investors.

**Figure** Investment volumes in Dutch residential investment product




**Source** Savills Research

It is not just the pressure on the Dutch housing market which is responsible for stimulating interest among investors. In recent years, rents have also risen sharply (2.3% to 4.9%) and well above inflation every year, which is positive for investors' direct returns. This has led to rising investment volumes over the last couple of years.

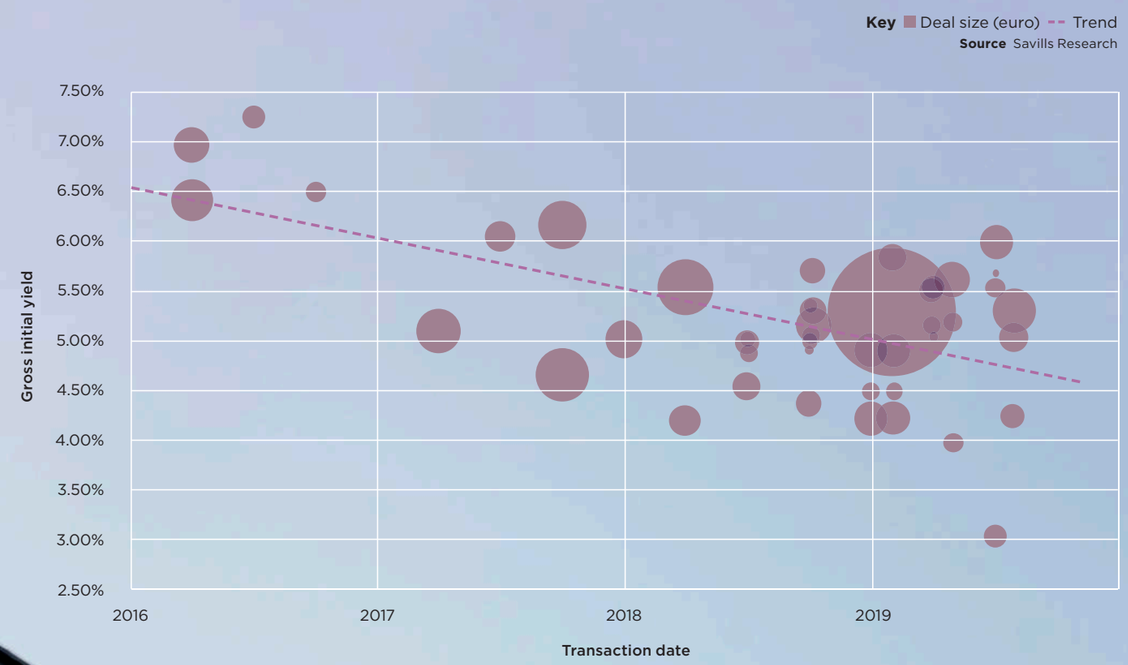
**Residential investment volumes**
After record-breaking residential investment volumes in 2018, caused by many large portfolio transactions, 2019 also started well for the residential investment market. The total investment volume in Dutch residential real estate reached €2.8 billion in the first half of 2019 (+3.9% YoY), of which a record-breaking 68% involved foreign capital. By far the largest transaction involved the purchase of the Vermeer portfolio of 9,544 units by Heimstaden for almost €1.4 billion.

> **"Investors are eager to enter the Dutch housing market. Because new construction is lagging behind, the pressure on existing residential investment product is increasing"**





**Graph** Prime yield compression of Dutch residential portfolios of varying size




Due to growing interest from investors, gross initial yields have also seen significant compression. Since 2014, yields have compressed by 160 basis points. At present, the sharpest gross initial yields for prime residential real estate have gone as low as 3%. These ever compressing prime initial yields increasingly match levels traditionally only achieved in prime commercial real estate.

This provides evidence of a market which has matured quickly in recent years. In the past, (foreign) investors were mainly interested in large residential portfolios. Currently, Dutch portfolios of various types and sizes are being traded for increasingly sharp, and ever compressing, prime initial yields.

# Update: Savills attractiveness scan

The Dutch residential market is booming, but due to urbanisation and demographic changes, local differences are becoming ever sharper.

To be able to compare the attractiveness of investment in residential rental product between local markets in the Netherlands, Savills has produced its residential attractiveness scan for investors. To highlight the attractiveness, we look at the relationship between supply and demand and the share of rental homes in the total housing stock.

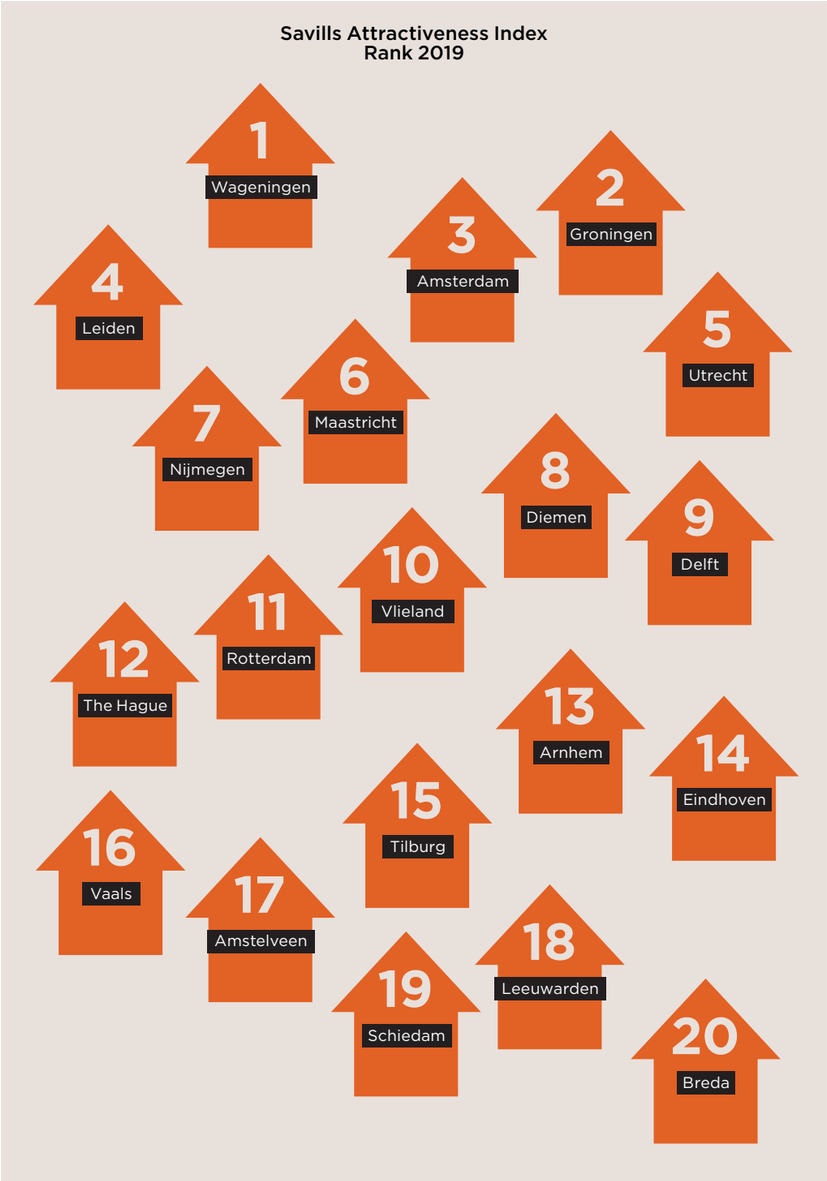
**The residential attractiveness scan**
Since the previous edition of the ranking, scarcity in the market and house prices have continued to increase sharply.

As a result, while previously market opportunities were largely confined to the big cities and their satellite towns, such as Amsterdam and Amstelveen, the ranking shows that market opportunities can now be found in locations increasingly further away from the G4 cities, such as in the big cities in Brabant, in the region of Arnhem and Nijmegen and even in cities such as Leeuwarden.

In this year's edition of the ranking, Wageningen takes the top spot. The other municipalities in the top three are Groningen and Amsterdam. The main reason for their high ranking is the significant mismatch between supply and demand in these areas, combined with a relatively large rental housing stock.

**The great paradox**
A comparison of the residential investment attractiveness scan with the residential property development viability scan reveals that many of the attractive residential investment locations are also the least viable locations in terms of property development, hence the great paradox.

**Figure** 2019 ranking Savills attractiveness scan – top 20




**Source** Savills Research





## Key findings

**1** In the short term, consumer confidence in the housing market and economic growth in the Netherlands are weakening slightly, but at present this does not seem to be causing an imminent risk for the weakening of the housing market. In the longer term, driven by demographic developments and a shortfall in housing production, and hence a shortage of supply, the fundamentals of the Dutch housing market remain strong.

**2** The most important risk factor currently concerns government policy. Several changes to the national housing policy for the coming parliamentary session have recently been announced, some of which could create more uncertainty in the market.

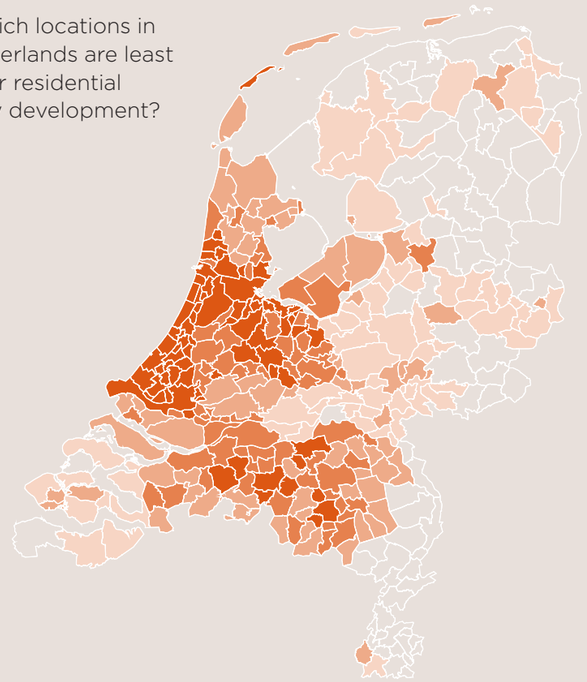
**3** Taking account of regional differences in oversupply and shortfalls, the current housing shortfall is 294,000 dwellings (3.8% of the Dutch housing stock), but regional differences are significant.

**4** The shortfall in the Dutch housing market combined with the low mortgage interest rate continues to result in upward pressure on house prices.

**5** House price increases have outpaced income growth, resulting in lower affordability in relative terms.

**6** Normally, a situation of high demand and limited supply incentivises property developers to scale up their construction activities. However, this is not currently occurring. Property development is becoming unviable in an increasing number of locations due to rapidly rising construction costs, land prices and the added cost of building regulations.

**Map** Which locations in the Netherlands are least viable for residential property development?



**Key** Above average degree of financial feasibility — Below average degree of financial feasibility

**Source** Savills Research

Outlook

# Development of new property starting to stall as the housing market booms

To highlight in which locations residential new-build has become unviable, Savills has produced a residential property development viability scan. The scan shows that property development is least viable in cities in Noord-Brabant and the Randstad, both in the cities and surrounding suburban towns.

Paradoxically, these are also the locations where market demand (housing shortages) is the strongest, and which thus, are the most attractive residential investment locations.

Although enough capital is available, the supply of current and future residential investment product will be limited due to decreasing viability. The extent and the increasing number of government building requirements and regulations (including the recent court ruling regarding the Dutch implementation of the EU Nitrates Directive) delay the pipeline of new residential developments still further. Hence, the residential paradox is here to stay.

**3.8%** **The current housing shortfall is 3.8% of the Dutch housing stock, but regional differences are significant.**





**Source** CBS, Ministerie van Binnenlandse Zaken en Koninkrijksrelaties, RaboResearch, PRIMOS (ABF), EIB, BAK, PDOK, VU, Savills Research

**Savills World Research**
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

**Bas Wilberts**
Head of Alternative Investments
+31 (0) 20 301 2011
b.wilberts@savills.nl

**Ronald Koemans**
Associate Alternative Investments
+31 (0) 20 237 9909
ronald.koemans@savills.nl

**Martijn Onderstal**
Co-Head of Valuation
+31 (0) 20 301 20 20
martijn.onderstal@savills.nl

**Jordy Kleemans**
Head of Research & Consultancy
+31 (0) 20 301 20 94
jordy.kleemans@savills.nl

Claude Debussylaan 48
1082 MD Amsterdam
+31 (0) 20 301 2055