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FUND IN FOCUS: DMFCO dents Dutch banks' dominance of mortgage market with pension funds' help.

London, 2nd March 2017

The Dutch mortgage market is changing fast, with a few new entrants gaining a foothold in only a short period of time. Among this new breed of mortgage originators, **DMFCO** stands out. The firm, created in 2013, has managed to achieve sizeable volumes - c.€250m-€300m of new mortgages originated every month - with a very simple business model. Dutch pension funds invest in DMFCO, which then originates mortgages under the **MUNT Hypotheken** label.

According to a Rabobank report, MUNT was the seventh largest Dutch mortgage originator in 2016, with a market share of 5.1%, up from 4.8% in 2015, in a market still largely dominated by the country's banks. But MUNT ranked above mortgage lenders such as Obvion (3.2%) and Achmea (2.4%) - these two entities, which regularly tap the RMBS market for funding, lost market share during that period.

"We combine the roles of asset manager and mortgage lender. Institutional investors were finding Dutch mortgages attractive as an asset class, but did not have the infrastructure to get involved in this market," said Marieke Hut, director of business development at DMFCO and prior to this responsible for NIBC's securitisations and structured finance transactions, including many Dutch RMBS transactions.

"While pension funds see the risk/reward of mortgages as compelling, they want one entity to take care of all the different tasks that mortgage lending involves," she added. DMFCO provides this technical infrastructure, deals with regulatory requirements matters and assumes the duty of care responsibilities.

"Basically pension funds are entitled to the mortgage rate through an investment in the whole loan," she said. The return is c.200bps over swap per annum.

The harsh regulatory environment and cheaper funding alternatives are often cited as the chief causes for the woes of some Dutch banks and for the decline in Dutch RMBS issuance. Rabobank, in particular, is looking to reduce its balance sheet. Compared with banks, insurers and pension funds are less dependent on external finance because they issue mortgages as an investment of the pension or as insurance premiums paid by their members, noted Rabobank economists in their Dutch Housing Market Quarterly, dated 14 February.

In their outlook for 2017, Deutsche Bank analysts forecast that the Dutch RMBS would again be "cannibalized by Solvency II and cheaper covered bond product". But at least Solvency II - which applies to insurance companies - has nothing to do with the rise of DMFCO. The firm targets pension funds, which fall under a different regulatory regime.

Origination though IFAs

DMFCO started with €1.8bn provided by three Dutch pension funds; three more funds then invested €2.4bn at the beginning of 2015. A further five Dutch pension funds have since joined in, bringing to total committed funds to c.€8.8bn. The mortgages are extended via a network of c.1,700 independent financial advisers (IFAs). The fact that such a wide network of intermediaries pre-existed made it much easier for DMFCO to break into mortgage lending.

"We invest the funds provided by the pension funds within 12 months. As soon as we have the commitments we start sending offers to Dutch consumers via IFAs. We have about €3.5bn to invest every year and until now, we have invested all the funds available - and until now we have recorded no default either," said Ms. Hut.

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The MUNT loans have a duration of around eight years - the legal maturity is 30 years. This is longer than the WALs that Dutch RMBS typically offer - between three and five years.

"We started right at the end of the financial crisis, when banks were reluctant to extend mortgages - or to the least, not at competitive rates. This was the right timing because IFAs were happy to have new mortgages to offer, particularly mortgages with consumer-friendly features", Ms. Hut said.

Among the selling points of MUNT's mortgages, Ms. Hut cites clear acceptance criteria and quick approval. "When we started lending in 2014, we opted for very simple mortgages, with no small print. It is very basic, with no borrowers with a BKR registration. This means that the approval process is very fast: now an application can be processed and be approved in three days."

"In terms of pricing, we are between number five and 20, but for the most common mortgages this is just a 10bps differential. Our interest rate is very attractive for longer tenors, which match the longer-term obligations of the pension funds that provide the funding. Banks are much less interested in lending beyond 10 years and this is reflected in their offering," she noted.

A strong asset class in a solid market

The Dutch house market is in good shape, with prices up 6.4% in January compared with the previous year, and standing 15% above the lows hit in 2013. The lack of residential construction activity is also putting upward pressure on house prices. In a recent report on the European housing and mortgage markets (dated 16 February), Fitch Ratings forecast for an increase of 3% in prices for the Netherlands and the strongest growth (10%) in new mortgage lending among European core markets as non-banks compete to lend. Fitch also pointed to "exceptionally low" arrears in the Dutch market due to "supportive fundamentals but also servicing innovations to detect and remedy borrower distress more quickly".

"The credit risk is very small. The Dutch house market withheld the recent crisis very well. Moreover, since the financial crisis, the lending criteria have become more stringent too as regulators have introduced new criteria such as LTV caps." Ms. Hut pointed out.

Strong fundamentals, the increase in the number of housing transactions and growing house prices provide DMFCO with a robust backdrop, even if the outcome of the upcoming elections looks uncertain. Several market participants wonder, however, what the firm's strategy might be once all the cash it has received from pension funds is invested. DMFCO officials are unconcerned, seeing their presence in the Dutch mortgage business as long-term, rather than a swoop in a post-crisis market.

"There is a big funding gap in the Dutch mortgage market. Banks are reluctant to increase their mortgage book, but the volume of the mortgage debt is expected to increase in the coming years. This is where we see an opportunity for us," said Ms. Hut.

The firm could in theory seek to attract money from insurance companies, but the current focus is on pension funds. In the future DMFCO may seek out foreign investors looking to gain exposure to the Dutch market, but currently there is no need. For now, "Dutch pensions are providing enough funding," she said.

FACT SHEET
Dutch Mortgage Funding Company (DMFCO) is an independent asset manager, licensed by the Dutch Financial Markets Authority (AFM) to offer and broker mortgage loans. It is also licensed under the Alternative Investment Fund Managers Directive (AIFM).

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DMFCO manages the Dutch Mortgage Fund (NHF), a fund that invests new mortgages originated via its label MUNT Hypotheken. The mortgages are offered via a network of c.1,700 independent professional intermediaries.

DMFCO was founded in 2013 and based in The Hague, Netherlands. MUNT mortgages have been originated since then end of 2014. DMFCO has c.€8.8bn of funds committed by Dutch pension funds (from 11 entities in total). The funds are all invested - in the form of new mortgages - within 12 months.

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