Economic stability in 2018

The Dutch economy has remained strong during 2018 with expected YoY growth of 3.1% for the year as a whole.

In Q1 2018, GDP growth was at 2.8% YoY, partly due to the stimulus of an increase in government investment in infrastructure, education and defence. Other key economic indicators are also favourable (see table on the right). In an international context, Dutch economic growth is outperforming that of neighbouring countries and many other European countries. Expected GDP growth in the Netherlands for 2018 is 3.1% while it is 1.4% in the UK, 2.3% in Germany and 2.0% in France. Due to the strong economic situation and positive outlook, the Dutch real estate market is thriving. However, this also has a downside as it has led to a shortage of supply in various segments of the occupier and investment markets.

How is this scarcity of supply affecting both these markets? And how sustainable is the current situation?

ECONOMIC PARAMETER	YOY GROWTH
EXPORTS	3.6%
UNEMPLOYMENT RATE	4.2%*
PRIVATE INVESTMENT	3.2%
GOVERNMENT INVESTMENT	1.4%

* CURRENT RATE, NOT YOY GROWTH

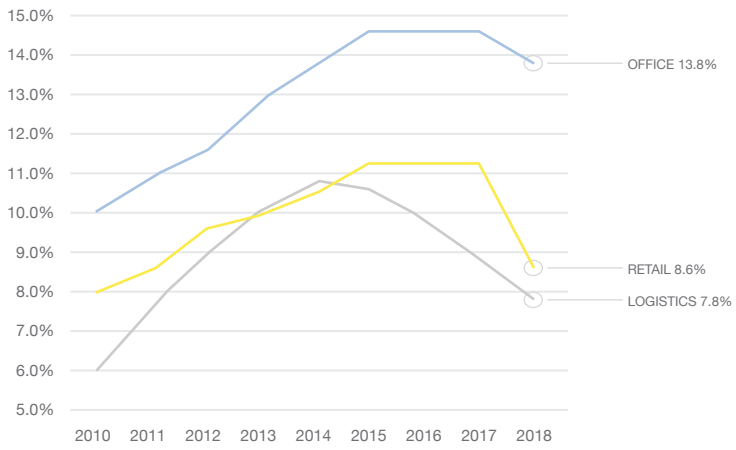
Falling vacancy rate leading to pressure in occupier market

The shortage of supply was evident in the occupier market in the take-up rate for Q1 2018, which was relatively low compared to the first quarter of 2017.

The total take-up in Q1 2018 was 1.8 million sq m while in Q1 2017 this figure was 2.4 million sq m (a fall of 25%). For the office, industrial and retail markets, take-up was 215,200 sq m, 718,700 sq m and 65,000 sq m respectively. Due to continuing demand, vacancy rates are dropping significantly in a range of segments. This is leading to increased pressure on the occupier market as new developments are limited.

The decrease in take-up is being caused mainly by a lack of available, good-quality real estate. This is preventing occupiers from moving from secondary locations to prime locations, especially in the four major cities. As a result, occupiers are widening their scope and locating outside these major cities and even outside the Randstad. In Q1 2018, around 26.8% of take-up was in the Randstad, compared to 39.6% in Q1 2016. Another result of the lack of available supply is rising rents, both for prime and secondary locations and cities. Examples in the office market include secondary locations in Amsterdam such as Sloterdijk and Zuidoost, which are experiencing rising rents after a period of stability.

GRAPH SHOWING VACANCY RATE PER SECTOR 2010 – 2018 YTD



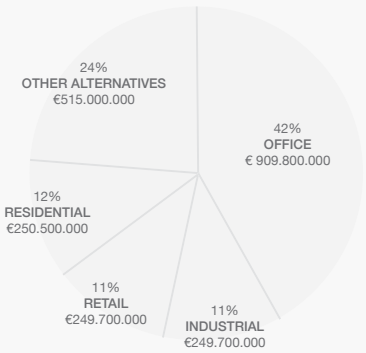
Investors are widening their horizons

The scarcity of supply can also be seen in the investment market. Just as occupiers are widening their horizons, so too are investors, who are looking for new opportunities in new locations and sectors. The investment volume within the Randstad now makes up 58% of the total investment volume, which is similar to the previous year. However, average purchase prices in the Randstad are much higher than in the rest of the country, which means that this view is somewhat distorted. When we look at the number of transactions, over 52% were outside of the Randstad. The number of transactions outside the Randstad has been growing steadily at 2% per annum over the last three years. Despite the shortage of supply, the first quarter of 2018 indicates that another strong year is likely, although not a record-breaking year. The total investment volume in Q1 2018 was almost €2.5 billion. Nearly all market segments saw a lower investment volume in Q1 2018 compared to Q1 2017, with the exception of the alternatives market which includes the residential market. The alternatives market, which in addition to residential properties includes assets like hotels, parking facilities and land, grew by 54%. The major driver in the investment market was the hotel sector, which in Q1 2018 recorded an investment volume of €284 million, twice that recorded in Q1 2017 (€114 million). This is remarkable, especially since 2017 was already a record-breaking year for the hotel sector. The fact that the alternatives market had such a strong start to 2018 indicates that investors are finding their way to other asset classes. Nevertheless, despite these changes, the office market remains dominant in the Dutch real estate market.

Another change within the investment market is cross-border activity. International capital remains dominant in the Dutch real estate market, but the allocation of this capital is undergoing a shift. One example is the industrial market which saw a share of 87% of foreign capital invested in Q1 2018, while this was below 80% in 2017 and below 75% in 2016.

Although the Dutch real estate market is in a relatively strong position, the relentless growth in the real estate market over the past few years has not gone unquestioned. Is the market overheating? And could we be looking at the same scenario as we did in the years 2006 and 2007?

TOTAL INVESTMENT VOLUME, DUTCH REAL ESTATE Q1 2018, PER SECTOR



The stability of the Dutch real estate market

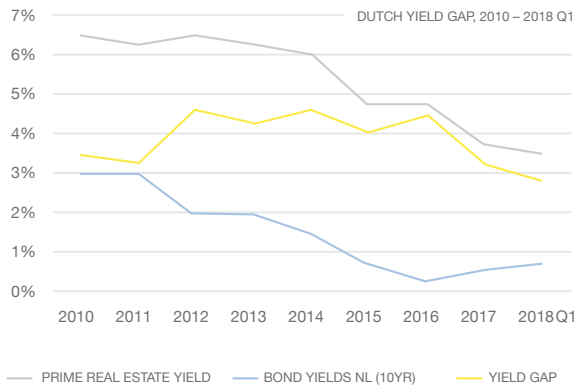
When the fundamental characteristics of the real estate market of 2006-2007 are compared with today's market, some structural differences become apparent. We identified three major differences that could tell us whether the outlook is positive and whether an economic slowdown may be approaching.

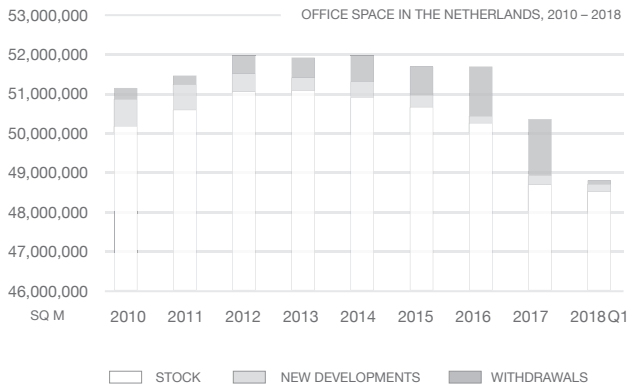
1. On-going yield gap
   Currently, the Netherlands is benefiting from a relatively low long-term interest rate of 0.69% in combination with a yield of 3.5% on prime real estate. This results in a yield gap of 2.8%. Compared to the situation in 2006-2007, this is significantly better because the long-term interest rate stood at 4% during those years, resulting in no yield gap at all. Even if interest rates should rise somewhat, there would continue to be a structural yield gap.

2. Ongoing inflow of capital from all over the world
   Because of the stable economic situation, foreign investors in particular see the Dutch market as attractive. In Q1 2018, around 64% of total investment was cross-border investment. The majority of the cross-border investment came from Germany, the UK and the US. The share of cross-border investment in Q1 2018 was the second highest share recorded in the past eight years, and the origin of that capital is also much more diverse now than it was ten years ago due to the increase in investments from Asia and the Middle East. This makes the inflow of capital into the Netherlands more stable than ever.

3. Smaller stock of real estate
   Particularly in the office market, about 4 million sq m has been withdrawn over the last five years and many more conversion and transformation projects are planned. In cities where less stock has been converted or withdrawn, vacancy rates remain high. In most cities, however, there is now a healthier balance between supply and demand. Renewed expansion of the real estate stock is unlikely since the government is now pursuing more restrictive policies.

Based on the three factors described above, the current market is more balanced than it was in 2006-2007. Even if the current economic situation were to deteriorate dramatically, we would be likely to see a soft landing for the real estate market because of these factors.





Outlook

The economic forecast for the Netherlands is better than that for most other European countries.

The economy is likely to continue growing, but it is not showing any signs of excessive growth which could lead to an economic downturn. Due to the positive outlook for the Dutch economy, there is scarcity in the occupier market and few new developments are being planned. Occupiers will find it difficult to move within Randstad and are therefore likely to look for options outside of the Randstad. This will lead to higher take-up levels and rising rents in both secondary locations as well as secondary cities. This is a positive trend for investors.

In the investment market, a similar shift will occur. Historical movements in the market have taught us that investors tend to follow the movements of the occupiers. In addition to investors considering new locations, they are also considering different asset classes than before. This trend is now actually reflected in significant investment volume growth in these alternative asset classes.

In times of prosperity and economic growth, the question always remains: are we reaching the peak and could an economic downturn be approaching? The answer certainly appears to be 'no', since no signs of any economic downturn can currently be detected. This means that certain markets can achieve further rental growth and yield compression. However, if the economy were to stop growing unexpectedly, the Dutch real estate market would be in a much better position than during previous periods of economic growth due to the substantial yield gap, the ongoing inflow of capital from all around the globe and the good balance between supply and demand due to the smaller stock of real estate.

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