Solid as a rock

The acceleration in economic growth has come to an end.

Dutch institutions like the CPB ('Centraal Planbureau', a Dutch economic research institution) and the DNB ('De Nederlandsche Bank') have adjusted their economic growth prognosis for the Netherlands slightly downward due to a relatively slow start to 2018. They predict that the acceleration in economic growth has come to an end. However, this does not mean an economic downturn in the Netherlands and growth is forecast to continue, even if at a lower level. The exceptional growth rates of 2017 could not have been sustained for long, as this could have led to overheating of the economy. It looks like economic indicators will continue to show healthy growth, with an expected economic growth of 2.9% in 2018 and 2.7% in 2019. Other economic parameters will also continue to reflect this favourable situation.

The effect of continuing economic growth is that both occupiers and investors are being attracted to the Dutch real estate market. This is being reflected in falling vacancy rates and relatively high investment volumes. Due to the favourable economic situation and positive outlook, the Dutch real estate market is thriving. However, this also has a downside for investors as it has led to a shortage of supply, with decreasing yields and rising prices as a result. In view of rising price levels, are there still opportunities for making good returns? And what will the trend for next year be?

ECONOMIC INDICATOR	YOY GROWTH
GDP	2.9%
EXPORTS	2.9%
UNEMPLOYMENT RATE	3.7%*
PRIVATE INVESTMENT	2.2%
GOVERNMENT INVESTMENT	1.2%

* CURRENT RATE, NOT YOY GROWTH

Rising rents will be the trend

Take-up in 2018 so far (August) has been approximately 4.9 million sq m, which is slightly lower than the volume for the same period in 2017.

The decrease in take-up has been occurring since 2016 and is caused by a lack of availability at the higher end of the market. This prevents occupiers moving up from their current locations, thus limiting the number of relocations. Despite the lack of supply, demand from occupiers remains strong due to the stable economic situation. In general, scarcity leads to upward pressure on rental prices.

A study by Savills into the correlation between vacancy rates and rental prices reveals a negative correlation, confirming this link. In other words, when the vacancy rate decreases, there is rental growth. In markets where the scarcity of supply is particularly acute, such as the Randstad, this correlation is stronger and thus results in stronger rental growth. A closer look reveals that rents are often affected by a change in the vacancy rate with a lag of between one and two years.

Vacancy rates, which have a significant impact on rent levels, are expected to continue to decrease. This is partly being caused by continuing high demand from occupiers and a dwindling stock due to conversion to other functions. Another important factor is the lack of new development to increase, or even stabilise, the total volume of office stock. Many regional governments are still pursuing a restrictive policy. For example, the province of Utrecht has recently announced a limit on the number of new office developments. As a result we have already seen substantial rental growth in offices in the Randstad of around 4.6% in 2017. For the office market (in Amsterdam) this figure was as high as 5.5%.

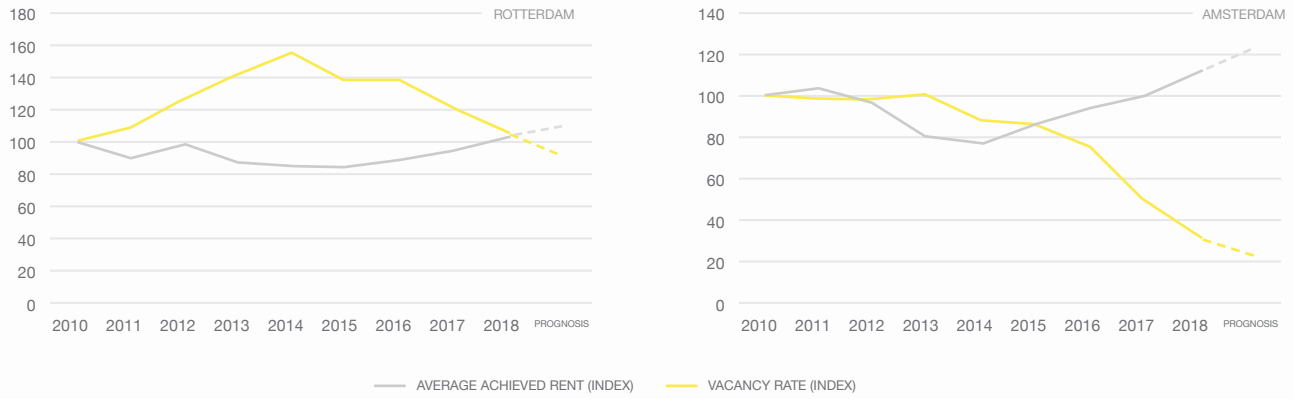
Can we expect this rental growth to continue in the years to come? And what might the potential for rental growth in the Netherlands be, taking into account historically low vacancy rates in some cities?

In the study mentioned previously, a comparison was made between different sectors and submarkets. A correlation was detected for the market as a whole. Rents correlated more strongly with vacancy in the Randstad area compared with other areas. This means that in regions with greater scarcity, rents respond more strongly to any fall in the vacancy rate. With a structural decrease in the vacancy rate, rents in the Randstad for example rose by 13.5% while the average rents achieved in Amsterdam increased by 29.7%. The same principle applies in Rotterdam, where the average rent achieved rose by 12.0%. It is worth noting that a similar effect occurs in Rotterdam, but with a lag. Rotterdam is currently in the same position as Amsterdam found itself in 2015: at the start of a period of rental growth as the vacancy rate falls steadily.

With no signs of any decrease in demand and an absence of new developments, Savills forecasts rental growth for the next two years of 4 to 6% per annum in Amsterdam, on the basis of the principles described. A wider analysis shows a prediction of rental growth of 3 to 5% for the office market in the Randstad area.

A similar picture emerges for other sectors, especially for segments of the market experiencing scarcity (such as the industrial market in Rotterdam). In addition to the office market, we expect rental growth to occur in the residential and industrial markets as well. For the retail market as a whole, rental growth is unlikely because supply remains plentiful.

GRAPH: POSITIVE FUTURE OUTLOOK FOR THE AMSTERDAM AND ROTTERDAM OFFICE MARKETS (INDEX 2010=100)



Some alternatives are no longer alternatives

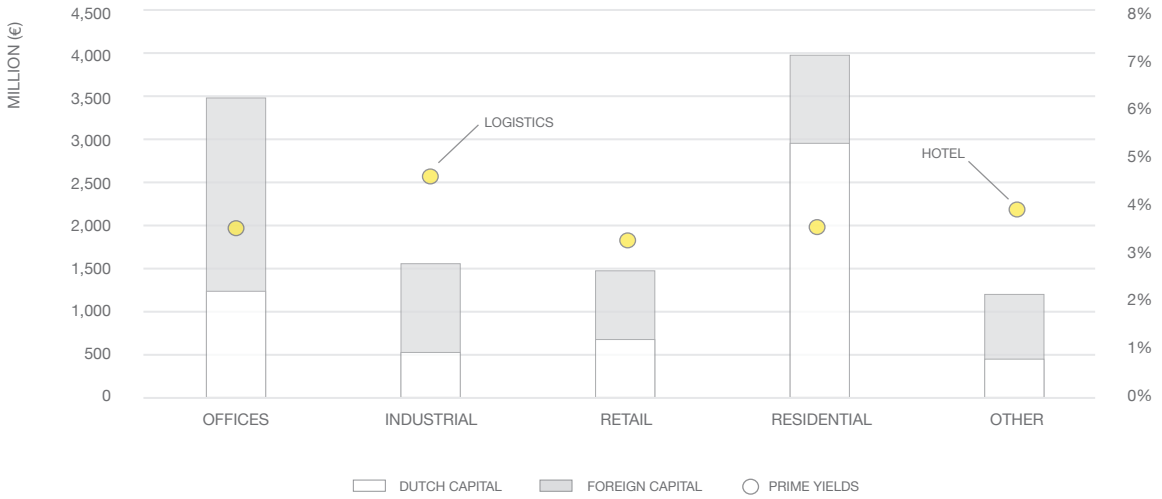
The Dutch investment market has displayed some changes with regard to the allocation of capital.

The office market, which had for many years seen the largest share of the total investment volume in Dutch real estate, has been surpassed by the residential market in 2018. This shift is being driven mainly by a shortage of supply in the office market. Currently, €3.5 billion has been invested in offices and €4.0 billion in residential real estate. The retail market has had a relatively slow six months in the first half of 2018, compared with 2017. The investment volume for retail in 2018 (nearly €1.5 billion) has so far reached one-third of the total investment volume for 2017 (€4.5 billion). The industrial market has continued on the same trajectory as in 2017 and currently has an investment volume of €1.6 billion. The main driver for industrial real estate continues to be the logistics market, which accounted for €1.0 billion of the total volume of industrial investment. In the 'other' category, the main driver is the hotel market. The hotel market currently stands at an investment volume of €501 million.

Another shift in the investment market is the share of foreign capital. In 2017, the share of cross-border investment stood at nearly 66% while in 2018, this share has only reached 49%. This relatively low share of cross-border investment can be explained by the high share of Dutch investment in the residential market. The higher share of domestic investment in the residential sector has been caused by several portfolio purchases, in particular a portfolio purchase made by Vesteda for €1.5 billion.

Prime yields in the Netherlands have been compressed significantly in 2017 and 2018. This compression can be interpreted as a price correction for Dutch real estate in comparison to other mature economies such as the UK and Germany. The graph shows the current prime yield for each real estate market.

GRAPH: INVESTMENT MARKET IN AN OVERVIEW



Outlook

The Dutch economy seems to be balancing out towards a healthy, sustainable growth rate.

Although the peak in growth has passed, more stable growth will reduce the likelihood of any sudden economic downturn in the years to come. The economic forecasts issued by various institutions are having a positive effect on the real estate market.

Although demand for Dutch real estate is high among occupiers, the scarcity of prime product will likely result in the overall take-up volume being lower in 2018 than it was in 2017. Current scarcity will put rental prices on an upward trend, with prime locations in the larger cities benefiting from this in particular. For Amsterdam, Savills forecasts rental growth potential of 5% annually for the next two years. Rental growth will also be achieved in other cities, especially in the Randstad area, but to a lesser extent. With so much rental growth potential, the peak of the cycle is not yet in sight.

Encouraged by potential growth, investors will remain interested in Dutch real estate, which will push the overall volume of investment upwards. However, the investment volume for 2018 is unlikely to reach the total investment volume for 2017. Savills expects the investment volume to reach approximately €20 billion in 2018, with the share of cross-border investment rising towards a similar level as in 2017. Yield compression for the remaining part of 2018 is likely to be limited as investment has bottomed out somewhat over the last few quarters.

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