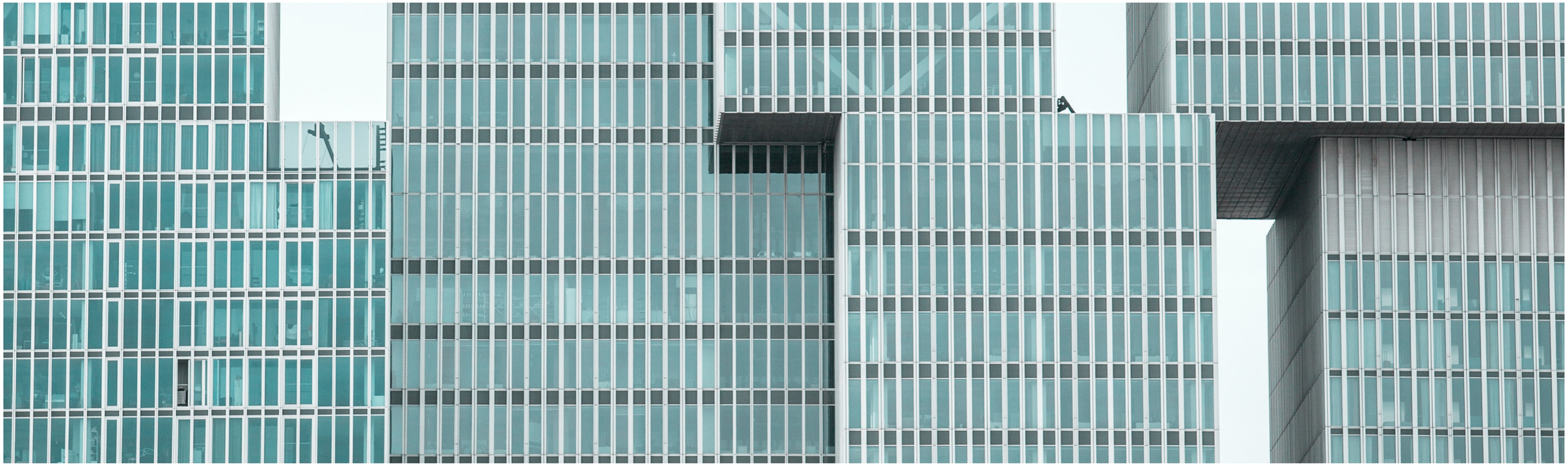
savills

Rotterdam

A **closer look** reveals more than the **first impression**



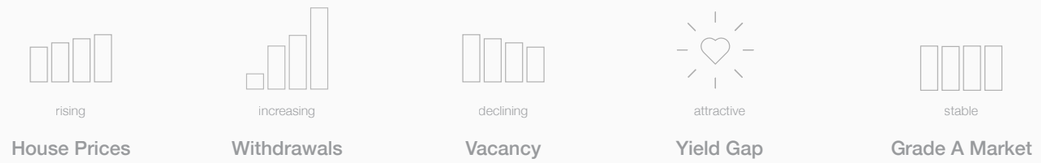
Introduction

The Dutch economy has seen a spectacular growth in recent years.

The real estate market in turn is profiting from this upswing. Occupiers have become more active, which has improved the outlook among real estate investors as well. The occupier market has become more dynamic in many Dutch cities, where vacancy rates have dropped while rents have increased, although some cities form an exception to this trend. Even though the geographical distances between cities and subareas are small in the Netherlands, local real estate markets can differ significantly. The city of Rotterdam is a prime example of this phenomenon.

Rotterdam is located in the Randstad, only 65 kilometres from Amsterdam, 22 kilometres from The Hague and 55 kilometres from Utrecht. Despite this close proximity to other cities, Rotterdam has its own DNA. The vacancy rate is one of the biggest differences in Rotterdam's real estate market compared to other large Dutch cities. Rotterdam currently has a vacancy rate of 15.1%, while the vacancy rate in cities such as Amsterdam, The Hague and Utrecht is running at half that rate. What is even more remarkable is that, despite this high vacancy rate, Rotterdam's investment market has been more active than that of The Hague (€1.1 billion in the last two years) or Utrecht (€0.9 billion in the last two years). In 2016 and 2017, office investment volumes in Rotterdam were €1.6 billion in total, with a share of over 70% purchased by foreign investors.

The investment market has continued performing well in 2018. The question is therefore: What makes Rotterdam appealing to investors, taking into account the relatively high vacancy rate?



What makes Rotterdam appealing to investors, taking into account the relatively high vacancy rate?

Population

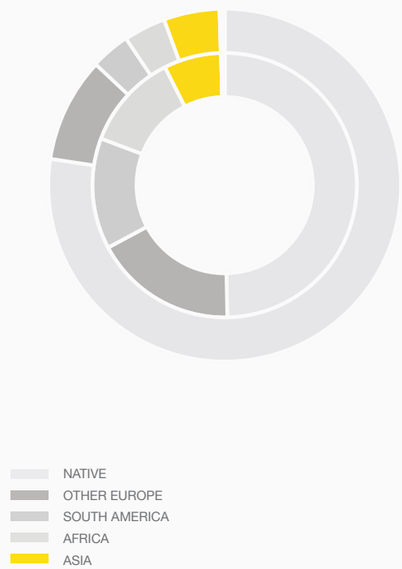
The city of Rotterdam lies within the metropolitan region called the 'Randstad'.

This area is home to over 7.1 million people, making it one of largest conurbations in Europe. The Randstad is the economic engine of the Netherlands, as it includes the four largest cities in the Netherlands: Amsterdam, Rotterdam, The Hague and Utrecht, in addition to Schiphol Airport and the Port of Rotterdam.

Rotterdam is the second largest city in the Netherlands. The city itself has 638,800 residents divided among 317,400 households. People of roughly 170 different nationalities call Rotterdam home. Native Dutch residents make up only 23% of the population in Rotterdam, whereas this figure is approximately 50% for the Netherlands as a whole The population of this multicultural city is expected to grow by 13% by 2040, which is more than double the growth forecast for the entire country.

Average household income in Rotterdam is €31,000 per year, which is relatively low compared to average household income in the Netherlands, which stands at €36,200 per year. Despite this lower average income, there is a clear distinction between wealthy and poor neighbourhoods in Rotterdam. On the south side of the River Maas, the average income is significantly lower (€27,300 to €28,800), compared to the northern part of the city where average incomes can be as high as €55,400 (specifically in the district of Kralingen Oost).

ROTTERDAM: A MULTICULTURAL CITY



Economy

Rotterdam is home to over 47,500 companies, of which 1,200 are international firms.

Unilever, Shell and Coca-Cola are just a few examples of leading global corporations that have established a substantial office presence in the city. The working population in Rotterdam numbers 358,000.

The Port of Rotterdam is vital to the Dutch economy: exports make up about 32% of annual GDP in the Netherlands. Port companies employ approximately 180,000 people, about half of all jobs in Rotterdam. Historically, Rotterdam has long been the epicentre of the Netherlands' famous shipping industry. The Port of Rotterdam is the largest in Europe, providing excellent access to its hinterland via rail, road, inland shipping and pipelines. The huge demand for workers in the Port of Rotterdam brought a no-nonsense culture and mentality to this working-class city by attracting employees from other cities and countries. The dominant economic forces of trade and distribution have shaped the city's character, making it an appealing place for companies to establish a head office here. This in turn gives rise to a need for a full array of supportive services. Companies providing such services to the trade and distribution industries are eager to profit from the high concentration of such firms in Rotterdam.

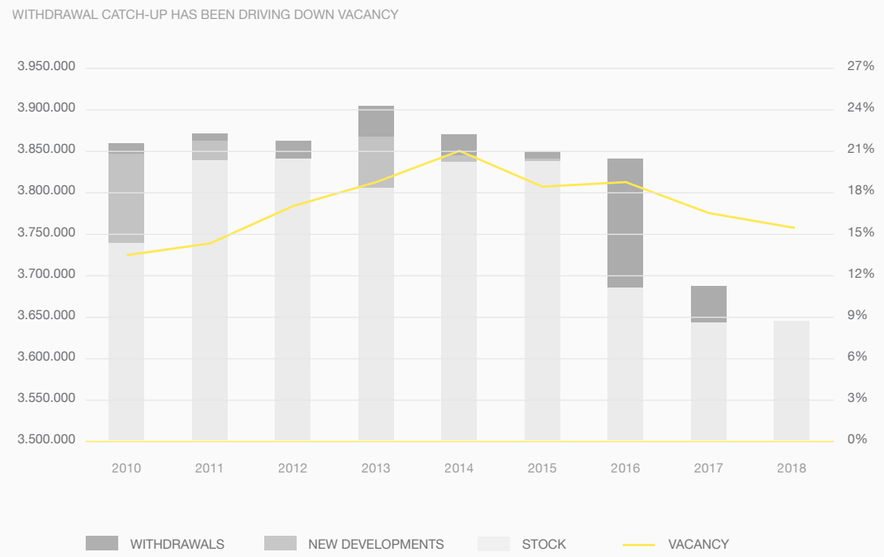
The current economic upswing in the Netherlands is causing unemployment rates to fall. This trend can also be seen in Rotterdam, where the unemployment rate currently stands at 4.3% compared to 5.4% last year. This is indicative of the healthy economic climate in the city.

Rotterdam's 'fundamentals' differ greatly from other large cities. The population is highly multicultural, with large differences between very low incomes and very high incomes. Rotterdam's economy is primarily focused on trade and distribution rather than on business services as in other larger cities. This means that Rotterdam reacts differently to economic changes. These differences can also be seen in the city's property market.

The port of Rotterdam

The Port of Rotterdam is currently the largest in Europe and the tenth largest worldwide. This has not always been the case, however. It was not even the biggest port in the Netherlands until the late nineteenth century. Rotterdam's port originated in the Middle Ages, when it developed into a vital port for the fishing industry. During the colonial era, Amsterdam's easy accessibility made it the centre of colonial trade. Unlike the Port of Amsterdam, the Port of Rotterdam was nearly totally destroyed during World War II.

A period of heavy investment followed which greatly improved not only accessibility to the sea, but also the connection to the hinterland of Europe. These investments enabled the port to grow significantly. Currently, the port is still growing and it is handling more freight than ever before. As this growth continues, new companies are attracted to the port, especially to Maasvlakte 2, which is still in development. This high demand has resulted in rezoning of certain areas of Maasvlakte 2 to provide more space for these companies.



Office stock & supply

Office stock in Rotterdam grew significantly until 2014.

Currently, the market comprises 3.6 million sq m, which makes it the third largest office market in the Netherlands (after Amsterdam and The Hague). The extensive growth of office stock led to increasing vacancy rates as supply exceeded demand. Following the peak vacancy rate of more than 20% in 2014, vacancy has been steadily dropping and currently stands at 15.1%. Rotterdam has a relatively high vacancy rate compared to the Dutch average (13.8%) and to other large cities such as Amsterdam (6.7%), The Hague (8.3%) and Utrecht (8.1%). This high vacancy rate can be partly explained by the relatively old stock. Around 34.2% of current stock is older than 40 years. In Amsterdam, The Hague and Utrecht, this percentage is much lower (21.5%, 29.3% and 19.1% respectively). Furthermore, only 7.4% of the stock in Rotterdam is new, i.e. built in the last 10 years. In Amsterdam and Utrecht, the share of stock younger than ten years is 11.7% and 13.4% respectively. In The Hague, the share of new buildings is fairly limited at just 4.4%.

Rotterdam's office stock peaked in 2014 at over 3.8 million sq m. Since 2016, large quantities of office space have been withdrawn from the stock in order to reduce vacancy. Withdrawals started earlier in Amsterdam (2010) and The Hague (2013). In Rotterdam, approximately 5% has been withdrawn from stock since the 2014 peak, compared to over 7% of stock in Amsterdam and over 10% of stock in The Hague. The Utrecht office market, which has historically a shortage of prime properties in its central business district, is totally different and is therefore not suitable for comparison here. The large withdrawals that took place in Rotterdam in 2016 and 2017 were the result of municipal policy enacted based on 2015 calculations.

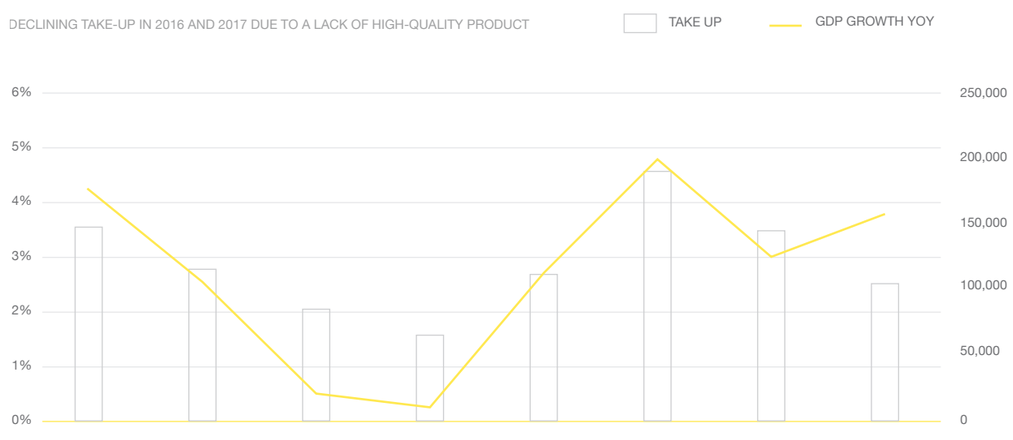
Notwithstanding the catch-up in 2016, it is expected many more withdrawals will take place in the years ahead. On the one hand, the municipality will continue to encourage office space withdrawals. On the other hand, residential conversions will be more profitable due to rising housing prices. Rotterdam's housing prices showed a more substantial increase in the last quarter compared to prices in Amsterdam. This fact clearly indicates that the residential market is catching up. In addition to the aforementioned conversions, the pipeline for new office buildings in Rotterdam is relatively limited. This is mainly due to the municipality's restrictive policies.

> "Rotterdam's office stock peaked in 2014 at over 3.8 million sq m making it the third largest office market in the Netherlands, after Amsterdam and The Hague."

Occupier market

Take-up in Rotterdam has a cyclical pattern that follows the trend of the overall Dutch economic cycle.

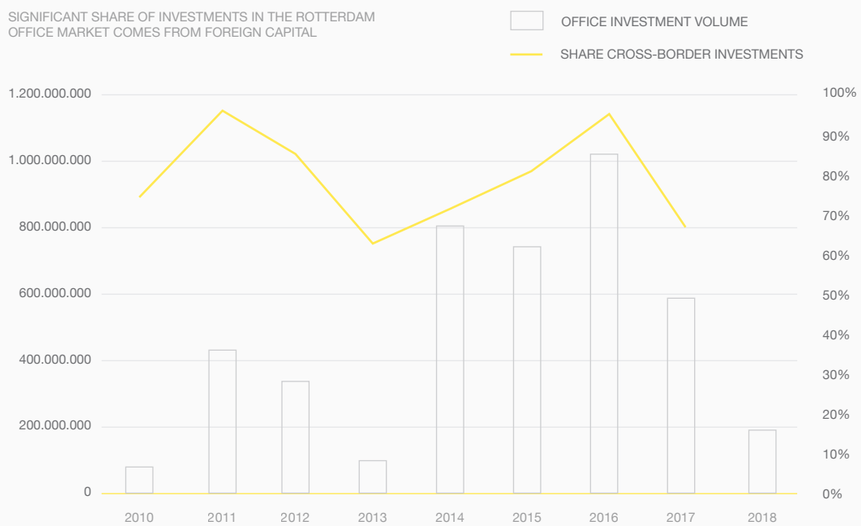
This is represented by the decrease in take up from 2010 until 2013, which was the period of an economic downturn, and the increase afterward until 2015. The year 2017 formed a breach in this trend as the Dutch economy showed strong growth of over 3% while take up decreased. This decrease was seen in all four of the major Dutch cities, and was caused by a lack of high-quality buildings and the decreasing vacancy rates in prime and secondary locations. Even though Rotterdam stands out with its high vacancy rate, trends among occupiers are similar in Amsterdam and Utrecht where lease renewals are a frequent occurrence. Moreover, the decline in take-up between 2016 and 2017 was similar in many other large cities.



Office Market Rents

Average rent levels in Rotterdam have remained relatively stable due to the lack of pressure on the occupier market.

Currently, prime rents stand at €220 per sq m per year. These rents are showing an upward trend while incentives are decreasing. It should be noted, however, that rent increases in Rotterdam are restricted to prime office locations, while secondary locations in other cities are also showing signs of rising rents.



Investment market

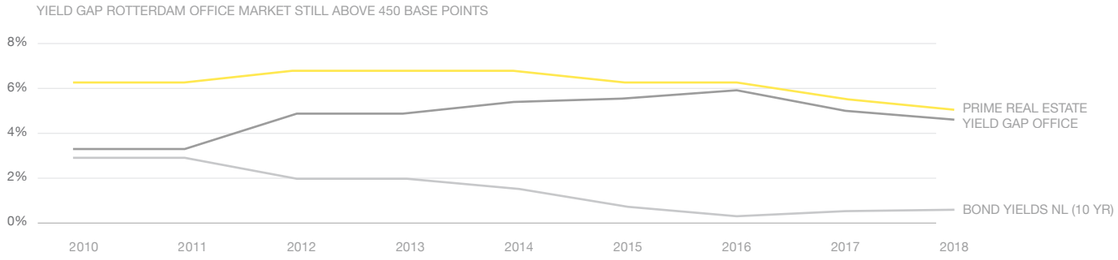
The office investment volume in Rotterdam has increased in recent years.

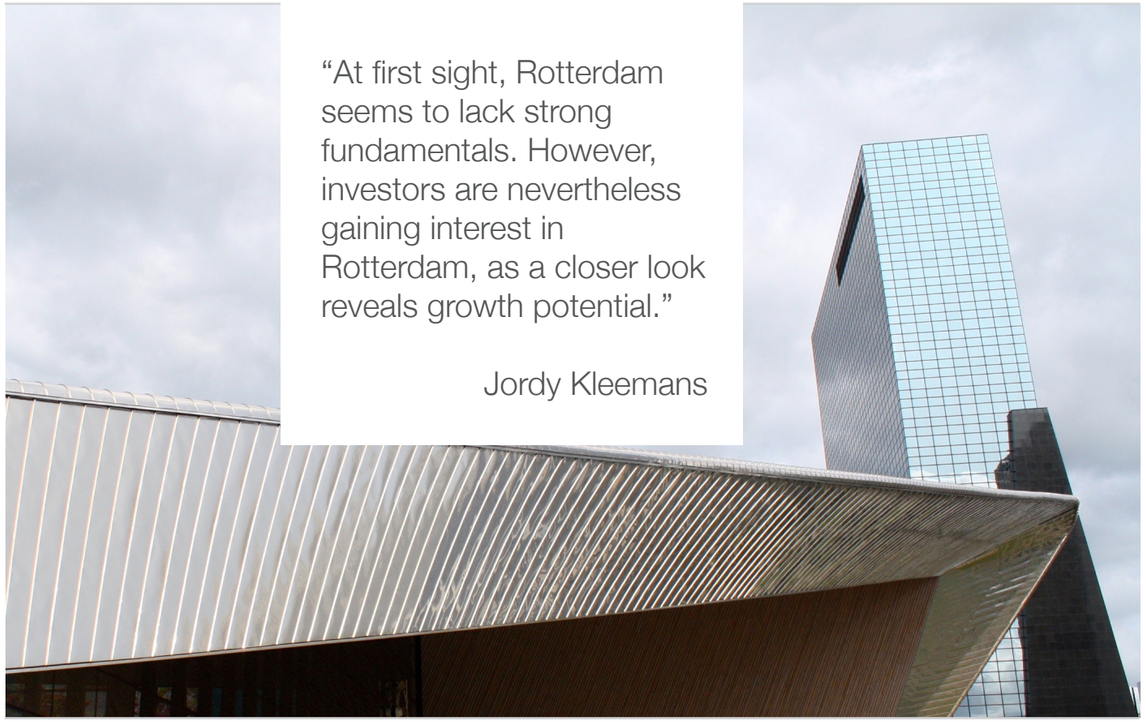
This is mainly due to the strong economic recovery. The 2016' investment volume peak is noteworthy. This was the year of the second largest single asset deal ever done in the Netherlands. This deal involved Amundi's purchase of 'De Rotterdam' for €352 million. In 2017, the investment volume decreased compared to the previous year. However, volume continued to hover around the 8-year average. Significant investment transactions in 2017 included Marathon's purchase of the World Port Centre for €105.2 million, and Deutsche Bank's acquisition of Blaak 31 for €75.6 million.

Foreign capital has been a significant factor in investment volume in the Dutch office market for many years now. This is also the case in Rotterdam, where, in the past 8 years, cross-border investments made up more than 60% of the investment market, even peaking in 2016 with a share of 94.6%. In 2017, the share of cross-border investment stood at 65.1%. Of this share, German capital was responsible for 32.1%, followed by US capital at 22.5% of the total investment volume in that year.

The steep increase in investment volume is what makes Rotterdam different from the other large cities in the Netherlands. Other cities have shown more gradual growth in investment volume as the economic recovery has continued. It is noteworthy that the sudden growth seen in Rotterdam is not being driven specifically by foreign capital, for the share of cross-border investments has increased only slightly since 2014. Domestic investors seem to be warming to the city, too. The increased investors' interest has pushed yields in Rotterdam down to 5.0%, compared to 7.0% in 2014. This compression happened following years of relatively stable yields. In view of the current, extensive period of exceptionally low long-term interest rates, Rotterdam offers investors a substantial yield gap of 4.5%, while the yield gap in Amsterdam is only 3.0%. This explains Rotterdam's ongoing appeal to office space investors.

The office market in Rotterdam stands out with its relatively high vacancy rate compared to the other large Dutch cities. In combination with a decrease in take-up and investment volume in 2017, the fundamentals do not seem to be particularly strong. Still, investors are warming to Rotterdam. The question then arises: What is causing the increased appetite for investing in Rotterdam?





"At first sight, Rotterdam seems to lack strong fundamentals. However, investors are nevertheless gaining interest in Rotterdam, as a closer look reveals growth potential."

Jordy Kleemans

A closer look at the office market

The Dutch real estate market is characterised by large differences between cities and subareas.

In Amsterdam for example, the South Axis and Riekerpolder business districts are separated by just a five-minute car ride. But prime rents in the South Axis district are €200 per sq m per year higher than in the Riekerpolder district. Such striking differences between subareas exist in Rotterdam as well. This is mainly due to the different characteristics of the office locations. A further analysis of the Rotterdam office market can elucidate the opportunities and risks, and thus the locations that carry an appeal for investors.

The appeal and success of an office location is determined by the occupiers' demand, and this is reflected in the amount of interest shown by investors. In Rotterdam, the CBD, Kop van Zuid and Alexandrium office locations were good for more than 70% of total take-up and 85% of total investment volume in the past three years. This indicates that these are Rotterdam's most appealing office locations.

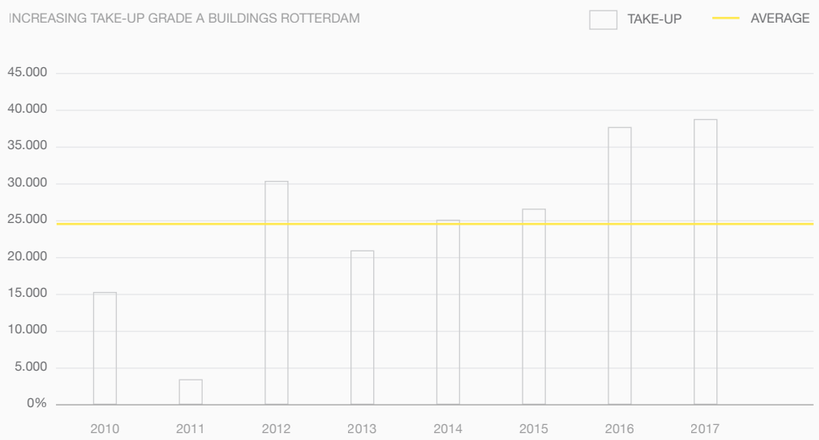
Taking a closer look at these three office locations reveals remarkable differences. CBD is by far the largest office location within Rotterdam. It is located near the city's central railway station and convenient to city centre shopping and other amenities. Withdrawals are being planned and executed with an eye to mixing functions and reducing the vacancy rate. It is noteworthy that withdrawals are mainly focused on the CBD district.

Together with CBD, Kop van Zuid dominates the skyline of Rotterdam. This fairly new and well-planned office location has the lowest vacancy rate (5.8%) in the city and is easily accessible by metro and by car. Alexandrium is an office location with a relatively high vacancy rate (18.7%). It is currently undergoing a process of reinvention and renewal. This process involves withdrawals, redevelopments and structural improvements to the public space in order to reduce the vacancy rate. This office location is also easily accessible by train, metro and car.

While some of these office locations still have a relatively high vacancy rate, investors have been specifically interested in these three areas for years. This is because quality in Rotterdam not only varies by location, but even on a building-by-building level. The distinction is made between Grade A, B and C buildings. Grade A buildings can be qualified by building year, time since the last renovation, micro location within the office location and level of finishing. Based on these factors and the expert opinion of Savills, Grade A buildings in Rotterdam have been identified. Grade B can be qualified as relatively outdated office buildings at lesser locations compared to Grade A buildings.

"Due to expected conversions stimulated by rising housing prices, the vacancy rate will drop significantly in the years to come."

Clive Pritchard



A closer look at the office market - continued

The fundamentals of the Rotterdam office market improve when restricted to Grade A buildings.

The stock of Grade A buildings in Rotterdam comprises approximately 920,000 sq m, which is 25.3% of the total office stock. This stock had a supply of 73,355 sq m at the start of 2018, which corresponds to a vacancy rate of 8%. This is significantly lower than the overall vacancy rate for office stock in Rotterdam (15.1%).

The take-up volumes of Grade A buildings in Rotterdam also show a different picture. Whereas the take-up in the total Rotterdam office market saw a decrease in 2016 and 2017, Grade A buildings showed a strong increase compared to 2015. This indicates a rising demand for high quality offices in the city.

The differences between Grade A buildings and the remaining stock also become apparent when looking at the rents achieved. In the past five years, the average rents in Grade A buildings stood at €190 per sq m per year, while the average rent stood at €140 per sq m per year in the remaining stock in the CBD, Kop van Zuid and Alexandrium locations. This indicates that, on average, rents are 35% higher in Grade A buildings.

The majority of the investment volume in Rotterdam (85.5%) is concentrated in the three prime office locations mentioned above. In these locations, approximately half of investments were done in Grade A buildings.

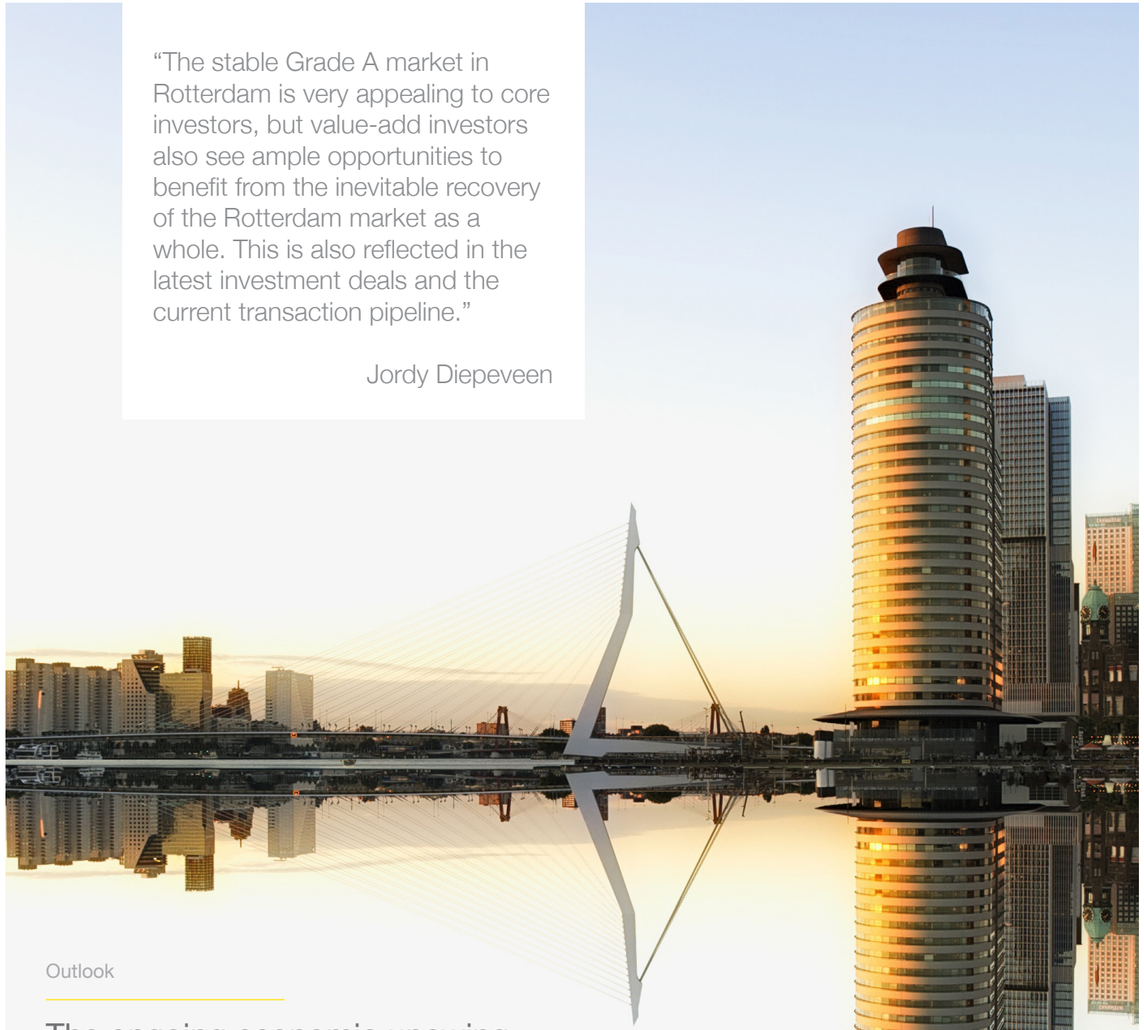
This indicates that, next to the core investors, value-add investors apparently still see good opportunities to turn around non-Grade A properties in Rotterdam. They want to take advantage of the spin-off generated from interest in the Grade A segment.
The question asked at the beginning was:What makes Rotterdam appealing to investors, taking into account the relatively high vacancy rate? The answer to this question is that Rotterdam's demographics and business climate give it a different dynamic.

The office market in Rotterdam is therefore reacting differently than other cities to the current economic upswing. While office markets elsewhere are showing strong fundamentals, Rotterdam seems to be lagging behind. However, when narrowing the focus to the various subareas, micro locations and buildings, Rotterdam still provides realistic investment opportunities. On a wider scope, and in view of the expected conversions, Rotterdam will become a more attractive investment location in the near future.

"Approximately half of investments in the three prime office locations were done in Grade A buildings."

"The stable Grade A market in Rotterdam is very appealing to core investors, but value-add investors also see ample opportunities to benefit from the inevitable recovery of the Rotterdam market as a whole. This is also reflected in the latest investment deals and the current transaction pipeline."

Jordy Diepeveen



Outlook

The ongoing economic upswing and the expected decline in the vacancy rate (due to conversions) are putting pressure on the occupier market for Grade A buildings.

Savills expects this pressure to result in an increase in take-up, for there is still plenty of supply. Moreover, continued urbanisation in the Netherlands will attract more residents and companies.

A substantial number of conversions are expected due to the strong increase in housing prices and the policies currently being pursued by the municipality. This will result in a tighter occupiers market and higher rents for prime office locations, specifically Grade A buildings. The market for Grade A buildings is significantly better compared to the total office market in Rotterdam, meaning owners and investors must upgrade their properties in order to compete.

Savills expects that owners will systematically improve their stock, which will strengthen the fundamentals of the Rotterdam office market as a whole. This will be accompanied by future withdrawals designed to reduce the high vacancy rate.

Over the course of time, the office market will show structural improvements that will be beneficial to occupiers, and investors will be drawn to the improved dynamics in Rotterdam. This will fuel the investment volume in 2018 both in Grade A buildings and in other buildings at prime office locations.The current yield gap of 4.5% in Rotterdam makes the city an attractive environment for investment in office properties. Savills expects yields in Rotterdam to contract further due to the likelihood of continued low interest rates.

Sources: CBS, Bak, Municipality of Rotterdam, Savills Research

Office stock development

The office stock in Rotterdam is comparatively old and withdrawals are a somewhat recent phenomenon, resulting in a relatively high vacancy rate (15.1%). In the years to come, however, more residential conversions will take place due to rising housing prices.

Take-up and rents

Take-up has been decreasing over the last two years, and rents have remained stable at €220 per sq m per year at prime locations.

Investment volume and yields

The investment market has been remarkably strong in Rotterdam, despite the relatively high vacancy rate. Compared to other large Dutch cities, Rotterdam has been able to attract as much or even more capital. This is mainly due to the attractive yield gap in Rotterdam. Prime yields currently stand at 5.0%.

Grade A buildings significantly better

The Grade A buildings show significantly better fundamentals compared to Rotterdam as a whole. Vacancy decreased to 8% in 2017, and both take-up and investment volume grew in recent years.

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