The Netherlands – Spring 2020

MARKET IN MINUTES

Savills Research

COVID-19: First effects already visible, asset reallocation ahead

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ALL KEY ECONOMIC INDICATORS WERE ON "GREEN" WHEN THE NEW DECADE STARTED

Table Key macroeconomic indicators (2019Q4)

	Netherlands	Eurozone
Unemployment rate	3.2%	7.4%
Investment rate of non-financial corporations	5.3%	1.3%
Household consumption	1.5%	1.5%

The COVID-19 pandemic has brought an abrupt end to this situation, forcing governments to take drastic measures in order to slow down the spread of the virus. At the same time, monetary, economic and fiscal stimulus packages have rapidly been put in place in order to balance protecting public health with economic interests, including in the Netherlands (€20 billion of spending in total for only three months). In financial terms, the Netherlands is better-placed to provide such a stimulus package, since its budget deficit had already been reduced through severe restrictions on public spending over the last five years. The current restrictions on economic activity are bound to impact adversely on the Dutch economy. The economic impact of COVID-19 is difficult to predict and will depend on the duration of the national lockdown and the restrictions imposed in the world's other major economies.

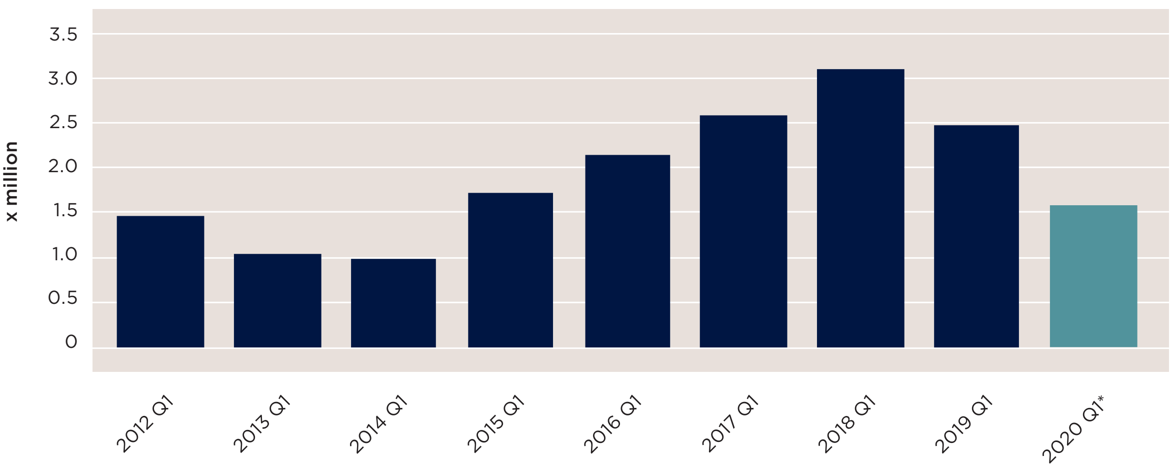
The Dutch Central Planning Bureau (CPB) has therefore published a best-case scenario, a baseline scenario and a worst-case scenario.So have the restrictions and the stimulus package already triggered changes in the Dutch real estate market in the first quarter of 2020?

Occupier market responds to governmental measures

The economic support package of the Dutch government has not been enough to sustain the same level of leasing activity in the occupier market as before the COVID-19 outbreak. For instance, the Dutch office market had flourished over the last five years as a result of demand from expanding businesses. As a result, vacancy has been reduced to zero in prime office locations. Currently, COVID-19 is changing the dynamics in the office market.

Figure Take-up in first quarter of the year, 2012-2020

*2020Q1 based on current figures and estimates



Office leasing has seen a sharp drop since the lockdown started (-50%), mainly due to businesses postponing major decisions. Businesses are currently shifting their focus from relocation to reorganisation. Some leases are still due to expire, of course, and the cost of office space is more likely to play a role as businesses seek to reduce costs. Despite the falling demand, it is clear that employees will need more office space per employee due to social-distancing measures. This factor will limit the expected fall in demand for office space, for the time being at least. Vacancy rates are therefore expected to remain relatively stable in major cities such as Amsterdam and Rotterdam. Due to the relatively tight market, office rents will stabilise in 2020, but increasing incentives are expected as occupiers seek to reduce costs in negotiations regarding new leases and renewals.

Debt as % of GDP (2019Q4)

49.3% Netherlands

135% Italy

98.1% France

59.8% Germany

74.9% Austria

85.5% United Kingdom

84.2% EU average

Source Eurostat

A best-case scenario, a baseline scenario and a worst-case scenario Dutch Central Planning Bureau

Best-case scenario	-1.2% of GDP in '20	lockdown between March - June '20
Baseline scenario	-5% of GDP in '20	lockdown between March - September '20
Worst-case scenario	-7.7% of GDP in '20	lockdown between March '20 - March '21

Leasing activity in the logistics occupier market had already begun to slow somewhat, even prior to COVID-19. This slowdown was due to the limited number of new developments as a result of the nitrogen-pollution issue. This was leading to a lack of supply for occupiers. Business decisions are also being postponed in the logistics sector, which is causing a further slowdown in leasing activity.

Remarkably, there is a sharp difference between types of occupiers. On the one hand, online retailers and supermarkets are flourishing, while third-party logistics are currently seeing falling revenues. Different types of tenants are being affected by the crisis in different ways, in financial terms. This applies less to multi-let light industrial due to the spread of tenants within locations and buildings. Generally speaking, the impact of the current market conditions on vacancy rates in the industrial sector is not yet visible. Although rental growth will be limited this year, it is expected that the market in logistics hotspots, in particular, will remain tight over the next year due to record low vacancy rates and relatively limited new supply.

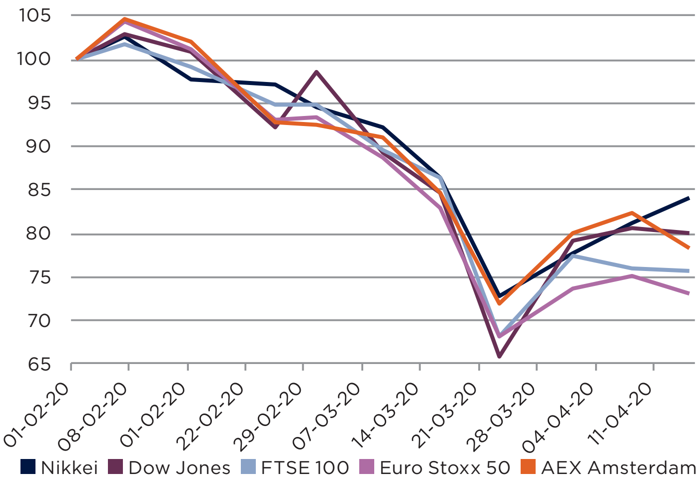
The effects of the COVID-19 crisis on the residential market are expected to be very limited. The current housing shortage (294,000 dwellings, or 3.8% of the Dutch housing stock) and demographic developments mean that demand is relatively resilient. The hospitality and retail sectors will be hit more severely due to the collapse of international tourism, the behavioural shift to e-commerce (which was already underway), and a major fall in the number of visitors to brick-and-mortar shops.Normally, a slowdown in the occupier market is triggered almost immediately when the investment markets fall. So what is occurring right now?

INVESTMENT MARKET REACTING LESS STRONGLY

The Dutch real estate market has been attracting domestic and international investors for several years. This has led to record-breaking investment volumes in recent years, with an annual average of €19.7 billion being invested in 2015-2019, compared to an annual average of only €7.8 billion in 2010-2014. The COVID-19 pandemic is changing the dynamics in the Dutch real estate market, although that impact varies significantly depending on the asset class and investment style. So far, lending banks are less active on loan origination. Generally, lenders are risk-averse, which is impacting the conditions of LTV and the margin negatively. Core-investment deals are more resilient to risk, while value-add and opportunistic real estate deals are currently more sensitive to risk. We therefore expect to see an effect on pricing in opportunistic and value-add real estate which has been acquired by leveraged investors, due to the increased risk in these asset classes. By contrast, core-buyers tend to require little or moderate leverage and are not restricted by debt. As a consequence, the impact on prices in core-real estate is expected to be less visible.

The robustness of the investment market differs significantly between sectors and styles due to the differences in the occupier market fundamentals. In short, over the next few quarters, the investment volumes and risk-return profiles for residential, core logistics and core-office are expected to remain relatively stable compared to other submarkets. One example of a very recent core real estate transaction was the purchase of the Amber residential portfolio by Heimstaden for €375 million. This proves that there is still an appetite for core real estate among investors. Nevertheless, investors are currently postponing or even abandoning opportunistic real estate transactions, which means that the pool of active buyers is smaller. The number of these types of deals in the pipeline is falling and this will affect investment volume numbers in the second half of 2020.

Figure Stock markets lost more than 30% in one month



Source Bloomberg

REAL ESTATE IN THE WIDER GLOBAL CONTEXT

Despite COVID-19, the pressure to invest in real estate remains high due to continued monetary easing and ultra-low interest rates. Real estate still holds some advantages for investors and is a relativity resilient asset class compared to shares for instance. The financial markets have been hit hard by uncertainty among investors. The Dow Jones Index lost 10% of its value on 12 March alone, the sharpest fall since the stock market crash of October 1987. The volatility of shares in financial markets is likely to continue due to economic uncertainty. However, the impact of pricing on real estate assets (particularly core assets) is expected to be less volatile, based on historical financial figures.

OUTLOOK ON A NEW REALITY

Several conclusions can be drawn based on the current developments in the Dutch real estate market. Firstly, asset classes which were already facing challenges prior COVID-19 will suffer more in the months to come. Continuing polarisation between core real estate and value-add real estate is therefore expected in the Dutch real estate investment market. Secondly, equity buyers are expected to be more active than leveraged investors, due to the current risk-averse stance of lending banks towards leveraged investors. Thirdly, the effect on pricing in core real estate will be less severe than in value-add real estate. Due to this 'new' reality, a reallocation within the Dutch real estate investment market is to be expected in these uncertain times, but also a further allocation to real estate.

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