The buy signal for Dutch real estate remains strong

savills

Development constraints strengthen Triple-A product

INTRODUCTION

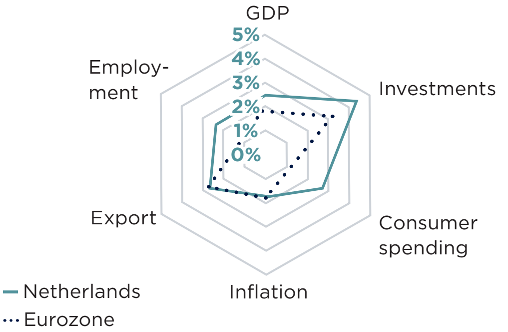
The Dutch economy has now seen growth for 19 consecutive quarters. However, some economic indicators are decreasing slightly YoY. For the first time in four years, consumer confidence is negative (-4) and exports are showing a slight decrease (-1). Both indicators are probably linked to increasing international uncertainty, caused by the Brexit and the US-China trade war. Nevertheless, most indicators remain positive: inflation is expected to remain stable, consumer spending increased by 3.3% and investment is at an all-time high. Moreover, the unemployment rate is at the lowest level of this decade. Overall, the Dutch economy is still outperforming the Eurozone average.

The economic strength of recent years resulted in record-breaking investment volumes in 2017 and 2018. But what will the coming year bring, and how robust is the Dutch real estate market?

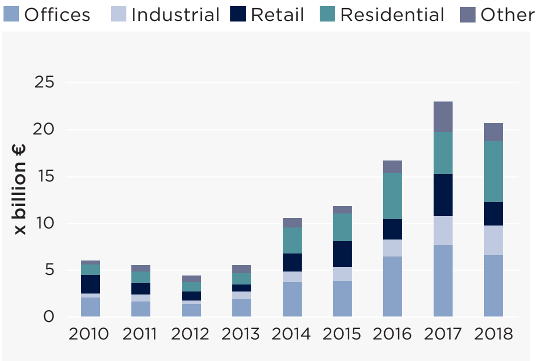
In our opinion, in addition to the current economic situation, commercial real estate values will remain stable in the near to medium term due to:

- increasing occupier demand for prime product
- decreasing number of new developments
- the indispensability of real estate in a mixed portfolio

Performance on key economic indicators
annual YoY %-change.



Graph Dutch investment volumes per sector



BLURRED LINES

Millennials are a key driver of urbanisation, and currently entering the housing and labour market. In 2024, 75% of the active workforce will consist of millennials. This group attaches greater value to living near hotspots and they are more connected, both online and offline. Alongside demographic growth, this is leading to a demand shift in type of product. For residential, this is leading to a rise in single-person households (blurring the student/hotel/conventional market). For offices, flexible concepts are on the rise. Retail is seeing this reflected in the rise of transit-oriented retail and the enormous growth in home delivery (logistics). 'Flexibility', 'serviced' and 'branded' are key terms in this blurring of sectors.

DECREASING NUMBER OF NEW DEVELOPMENTS

The pipeline of new developments for all commercial real estate sectors is shrinking. While some new projects will be delivered in 2019, after that the number of projects is set to drop. A good example of the limited number of issued building permits is the residential sector. Approximately 100,000 homes are needed every year, but only 70,000 permits were issued in the last two years. In preceding years, the numbers were even lower. The main reasons for this are restrictive public zoning policies, a shortage of building plots and rising construction costs.

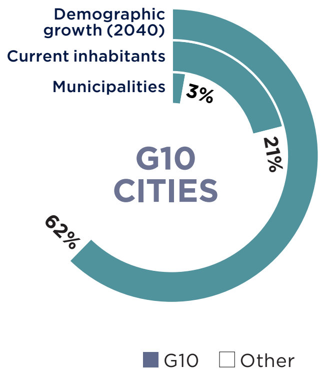
RESTRICTIVE POLICIES

Despite rising demand, municipalities remain quite restrictive when it comes to granting permits for new developments. In addition, they are also setting high demands. The best example is Amsterdam, which has set a social housing quota for new residential developments. Plans are also being prepared to limit the maximum price for new rental housing developments, as well as to prohibit the renting of new assets. For developers, these kinds of restrictions increasingly result in unprofitable projects. In combination with rising land prices, fewer new developments get off the ground.

INCREASING OCCUPIER DEMAND FOR PRIME PRODUCT

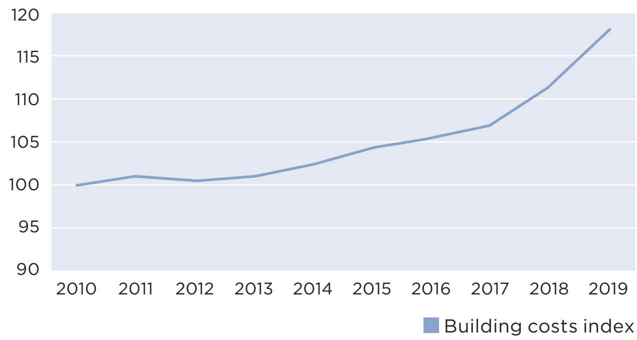
While national population growth of 5.93% is nothing unusual given historical trends, the same cannot be said of the largest Dutch cities. The ten largest municipalities of the Netherlands are expecting growth of 17.60%. Amsterdam stands out: by 2040, Amsterdam will be the first city in the Netherlands to reach one million inhabitants. In addition, decreasing average household size and the limited availability of land are placing additional pressure on cities. Overall, the fact that people want to live and work in cities eventually leads to product scarcity in urban areas and, as a result, stable or rising property values. In addition, the upswing of millennials is leading to a broader shift in product demand. This means that in addition to demand growth, demand is also changing. More serviced, branded and flexible product is gaining ground (flex offices, hotels, co-living), and pressure in prime locations continues to increase. Overall, this means that the ten largest municipalities (3%), which are currently home to 21% of the Dutch population, are expected to account for 62% of total demographic growth in the period until 2040.

Chart Urbanisation is driving concentrated demographic growth in major cities



Source Savills Research

Graph Building costs (index 2010)



SHORTAGE OF BUILDING PLOTS

Another factor that puts a brake on new developments is the shortage of building plots. This applies not only to 'obvious' locations in or close to cities but also to the logistics sector, for which land is becoming scarce. In Venlo for example, developable land for new logistics real estate has already decreased by 236.2 hectares over less than three years (-57%). A sector in which land availability has never been a problem before is now facing rental growth.

RISING CONSTRUCTION COSTS

Rising construction costs are also an important factor in the slow-down in new developments. After a period of moderate growth, costs have been rising sharply since 2015. Accelerating growth since 2017 has undermined the feasibility of many new projects. The expectation is that this trend will continue until at least 2022. This is due to a shortage of manpower and rising material costs.

THE INDISPENSABILITY OF REAL ESTATE IN A MIXED PORTFOLIO

In general, real estate has become an important factor in investor portfolios. Historically, real estate has proved to be a good inflation hedge. Even though all yields are at a (10-year) low, the yield gap persists and is expected to remain. The European Central Bank (ECB), recently announced that it would keep its interest rates at historically low levels, contrary to expectations. The fact that real estate functions as a strong collateral, creates a good alternative to bonds and shares. With a significant yield gap, leverages can be achieved. The current macro-economic and political uncertainties across the world are a risk factor for the real estate market. However, other assets face the same problems by at least the same factor.

Given that real estate is an indispensable factor in a mixed investment portfolio, investors are searching for acceptable risk, and they are continuing to find this in the Netherlands. Currently, only a few countries possess low macro-economic risk. From a global perspective, there are only eleven countries that hold a triple-A status according to Fitch, Moody's and S&P: the Netherlands is one of these. Savills, therefore, expects the share of cross-border investments to continue to grow.

Countries with a triple-A status according to the three largest credit rating agencies

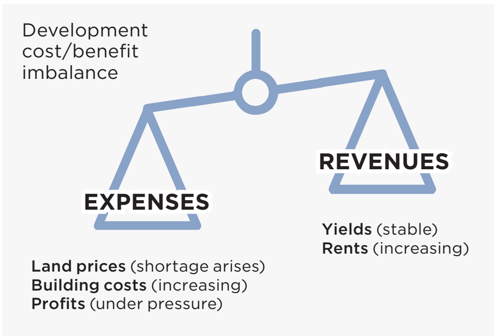
Australia	Luxembourg	Sweden
Canada	**Netherlands**	Switzerland
Denmark	Norway	United States
Germany	Singapore	

Source CBS, Oxford economics, PropertyNL, VGM, Bouwkostenindex, BAK, Savills Research

SAVILLS OUTLOOK

CONSIDERING THE CURRENT SITUATION, THE BUY SIGNAL FOR DUTCH REAL ESTATE REMAINS STRONG.

Rent (3-5% per year) and property value growth can be expected. This is positive for existing owners and is an argument for buying at historically low yields. This argument is strengthened further by the fact that the number of new developments is limited. Normally, an expected lack of supply will fuel new developments. However, due to the current situation, a supply-demand imbalance is there. Restrictive policies, the rising shortage of land, steady growth in land prices and the sharp increase in construction costs are reducing developers' profits. If other factors are not considered to restore the balance, property values and rents will rise.



In the debate on rising rents, affordability for occupiers may become an issue in the future, especially in relation to prime real estate. In recent years, municipalities have done a good job of restoring the balance between stock and demand. However, in hotspots, it is now time to widen the policy focus somewhat. For instance, it may help to freeze land prices in order to restore the balance.

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