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Netherlands Real Estate Strategic Outlook

February 2017

We hold an overweight position on the Netherlands. Not only do we see continued momentum over the coming year, we expect the market to be one of the strongest performing throughout the rest of the decade. This outlook is being driven by a robust economic recovery and yields that remain attractive relative to other core European markets. On the back of an overall improvement in real estate market conditions, investors are increasingly tempted to look for opportunities outside the prime segment when searching for higher returns. However we would recommend not moving up the risk curve too much, keeping in mind that vacancy often remains high in secondary locations.

Strengthened economy amid political uncertainties

The Dutch economy continues to experience GDP growth above the European average, with an estimated 2.1% increase in 2016, on the back of rising consumption and robust export growth.[1] Against this positive background, the labour market has continued to improve. Jobs growth averaged 2% in 2016, and is expected to remain above the Eurozone average over the next five years.[2]

In the immediate term we see political risk in the run up to the March general election. This should not be taken lightly, but in the absence of a shock outcome, falling unemployment and sustained domestic consumption are expected to support solid GDP growth through to the end of the decade, averaging at around 1.6% per year.[3]

Improved office market conditions offer opportunities

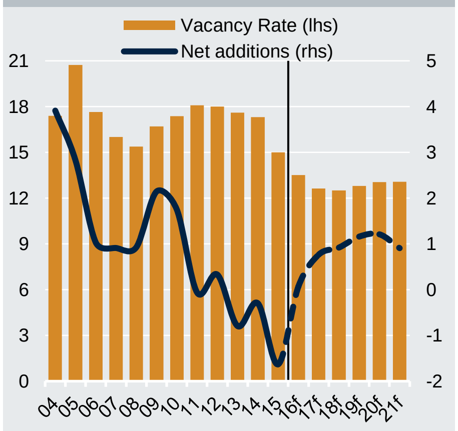
Dutch employment growth has translated into rising office take-up. Take-up in Amsterdam posted strong performance in 2016, up by more than 40% on the previous year.[4] Office vacancy in Amsterdam is still trending down, given both the modest office construction activity and the steady pace of office conversions into other purposes. Against this backdrop, we anticipate rental growth will average around 1.8% over the next five years.[5]

Well-established 'prime' office districts in the likes of Amsterdam city centre and Zuidas are expected to register strong performance. Emerging submarkets close to the CBD should also perform well in the long term, given relative short supply and potential for demand from the likes of the tech sector. However, due to persistent high structural vacancy, we see a risk that other peripheral submarkets such as Sloterdijk and office parks will likely underperform, and therefore recommend caution when considering investments in these locations.

Office market rebalacing

Amsterdam has seen a sharp fall in office vacancy rates in recent years. Supported by stronger take-up, this downward trend was also due to a combination of low new completions and many office space conversions into hotel and residential purposes. The pace at which reconversions would remove obsolete properties from the market will heavily depend on the capacity of both hotel and residential demand to continue to absorb this new supply. In any case, vacancy rates are expected to remain quite stable in the coming years, given limited pipeline activity and improvement in occupier demand.

Office Vacancy (%) and Net Additions (%)



Source: PMA, Deutsche Asset Management, January 2017.
Note: Vacancy rate and Net additions as % of stock.
Past performance is not indicative of future results.

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[1] Oxford Economics, January 2017
[2] Oxford Economics, January 2017
[3] Oxford Economics, January 2017
[4] JLL, February 2017
[5] Deutsche Asset Management, December 2016

Investor interest supported by attractive pricing

Investors increased their exposure to the Dutch market in 2016.[6] With volumes up 14%, the Netherlands remained a popular destination for foreign investors looking for markets with both strong fundamentals and yields higher than other Core European markets.

Yields continued to compress in 2016, and while we still see room for further prime yield compression, especially for office and logistics, we also expect yields to begin to move out gradually towards the back end of the decade.

The shortage of prime assets for sale has driven some investors to move further up the risk curve.[7] Although market fundamentals are improving, we recommend caution in secondary locations where structural vacancy remains high.

Higher consumer spending to boost the retail market

The retail market continues to improve. Despite high profile business failures such as V&D, in general rising retail sales are laying the ground work for future rental growth – particularly along the most popular high streets and in dominant shopping centres.

Strong competition amongst investors is keeping pressure on prime high street yields to an historical low at 3.3%, while the spread with secondary locations is increasing at 520 basis points.[8]

Focus on prime logistics assets

The logistics market is still gaining ground, as buoyant demand for distribution centres continues to sustain further falls in vacancy, and positive rental growth.

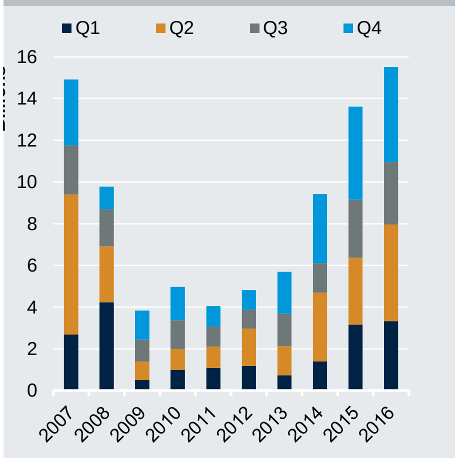
Overall we have slightly reduced our outlook for rental growth, mainly due to rising levels of speculative developments. Overall we expect returns to stand just below the European average over the next five years.

Nonetheless in those locations where space cannot be easily replicated we see a high probability of outperformance. For example, with the consumer spending more and online sales growing quickly, urban logistics in cities such as Amsterdam should do well. Given the importance of location for this type of logistics, and with high competition for land in these densely populated areas, we see a continued rise in the rental premium for this space.

Record investment volumes

Investment activity in the Netherlands Increased by 14% in 2016, posting new historical highs. At €15 billion, this performance has been partly driven by strong investor interest for Dutch offices, especially from foreign players. Amsterdam proved particularly attractive last year, being the seventh most traded city across Europe.

Transaction Volumes (€ billion)



Source: RCA, January 2017.
Note: All Property Types volume in the Netherlands, consisting of Office, Industrial, Retail, Apartment, Hotel and Land sales.
Past performance is not indicative of future results.

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6 Real Capital Analytics, January 2017
7 Real Capital Analytics, January 2017
8 CBRE, December 2016

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Adverse changes in economic conditions including changes in the financial conditions of tenants, buyer and sellers, changes in the availability of debt financing, changes in interest rates, real estate tax rates and other operating expenses;

Adverse changes in law and regulation including environmental laws and regulations, zoning laws and other governmental rules and fiscal policies;

Environmental claims arising in respect of real estate acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established;

Changes in the relative popularity of property types and locations;

Risks and operating problems arising out of the presence of certain construction materials; and

Currency / exchange rate risks where the investments are denominated in a currency other than the investor's home currency

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