Netherlands Real Estate Strategic Outlook

February 2016

We have not been strong advocates of the Dutch Real Estate market in recent years given the stubbornly weak economy and an office market plagued by oversupply. But we also have been surprised by the positive momentum in the Dutch economy over the past year. This has led to a much friendlier outlook on the real estate markets. A rising number of investors are back and are bidding aggressively. We have also upgraded the Netherlands from “Neutral” to “Overweight”, however, we remain cautious about a number of hidden traps outside the prime segment and would focus on Amsterdam for the time being.

Dutch GDP growth forecast has been upgraded

In 2015 The Dutch economy has surprised to the upside. As a result, the forecast for 2016-2018 have been upgraded significantly. The Netherlands is now expected to be among the strongest growers in Core Europe over the next five years. Rising world trade and exports, fading households deleveraging and improving investment prospects should pose some upside over the next couple of years, However, it is worth noting the Dutch economy remains exposed to external shocks, as financial markets remain nervous about China, oil price and geopolitics.

Foreign investors have different objectives

Cross border inflows made up 79% of total activity in 2015[1]. U.S. investors are seeking to exploit value add and opportunistic themes, while German investors do consider the Netherlands as a late recovery market, which offers more attractive prime entry yields compared to their home market. However, as yields have moved in sharply over the past six month, Dutch prime real estate has already seen considerable price growth. Relative pricing still offers value, however, core investors should avoid applying the definition of prime more generously as occupier markets have yet to gain momentum and spread into decentral location.

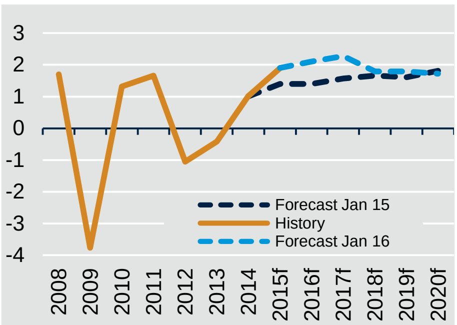
Conversions help reducing obsolete stock

Some notable progress has been made over the past 12 month, when looking at the trend in vacancy rates. Take up initially picked up only gradually over the past 12 months but an extraordinary final quarter in 2015 helped to push annual activity above the long term average. Supply has been declining, supported by low construction volumes and numerous conversions into hotel and residential properties. As a result, total office stock in Amsterdam is now lower than before the financial crisis.

Economy: Less slack

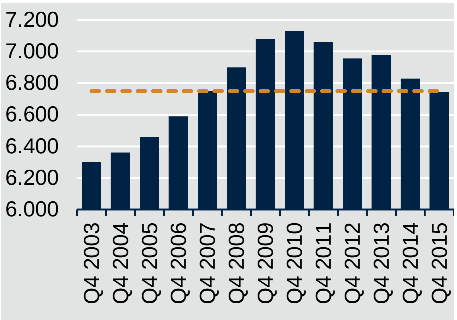
GDP growth turned positive in 2014 at 1.0% and reached 1.9% in 2015. Forecast for 2016 and 2017 hints at even stronger growth above 2%, before stabilising at around 1.8% per annum. This is well above the previous forecast from 12 months ago.

GDP: Forecast vs. 12 month ago (%)



Source: Oxford Economics, Jan 2015/Jan 2016

Amsterdam Office Stock ('000 sqm)



Source: CBRE, Jan 2016

[1] Real Capital Analytics, Q4 2015

Owners should benefit from NOI growth

There is still a great amount of polarisation in the market. Fundamentals have improved in well connected and central submarkets like Zuidas, IJ Overs, Amstel Train Station and in the northern parts of South East which had a positive impact on rising effective rents as incentives declined. However, peripheral submarkets and pure play office parks without access to local amenities still struggle and some will need to cope with obsolescence for further years to come.

Peripheral office locations not competitive

We expect that peripheral locations will suffer from oversupply in the long term as the level of obsolescence of office space is probably higher in the Netherlands than anywhere else in Europe. Easily accessible submarkets like Sloterdijk or suburban locations like Diemen have seen a welcomed transformation of office space into hotels and student housing. But this doesn't work in corridor locations like Amstelveen or in satellites like Hoofdorp, which have a lack any access to public transport and don't offer a minimum level of other amenities.

Owners should try to dispose non-core assets

Given that investment sentiment has improved significantly and markets become more liquid, owners of properties in decentral locations may find a very rare time window to dispose of these assets. While capital value may remain well off their peak, this seller should caution against taking these assets into the next cycle, when buildings have grow even older and may have become virtually impossible to lease out without major capital expenditure.

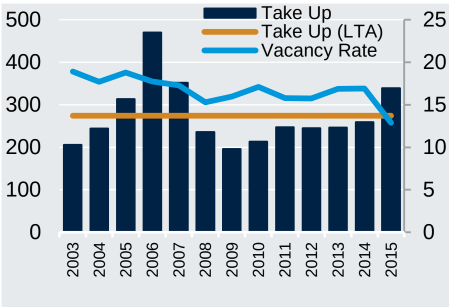
Summary: Amsterdam Office market on the right track

The Dutch economy has surprised to the upside. But external headwinds are still strong for this open economy, as financial markets remain very nervous and global export markets are weak. Things looking up for households and fundamentals in some submarkets have improved notably. While consolidation in the much fragmented office market continues to take place, opportunities for investors should arise on a case by case basis. We continue to see opportunities in selective logistics locations, despite pricing now being higher than pre-crisis. The retail segment is starting to look attractive again. However, attractive stock is difficult to access by cross border investors. Also asset holders should try to use this favorable investment sentiment for portfolio optimisation and strategic asset sales.

2015 ends on a high

Over 170,000 sqm of office space was leased in Q4 2015, resulting in the strongest year of activity since 2007. Vacancy rates have fallen significantly, supported by negative net additions, but the divergence between micro locations remains strong.

Amsterdam Prime Office Indicators (%)

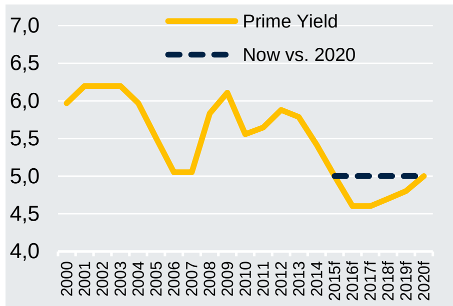


Source: CBRE, Jan 2016

Prime yields to compress further

While prime office yields in Amsterdam will also face the challenge of rising interest rates at one point, current yield levels at 5% should still leave some cushion for those investors looking to enter the market in the next 6 month.

Amsterdam Office Yield (2015-20f, %)



Source: Deutsche Asset Management, Feb 2016
Note: f = forecast

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