Mid Year Real Estate Market Outlook Report

Report — Research CBRE

Content

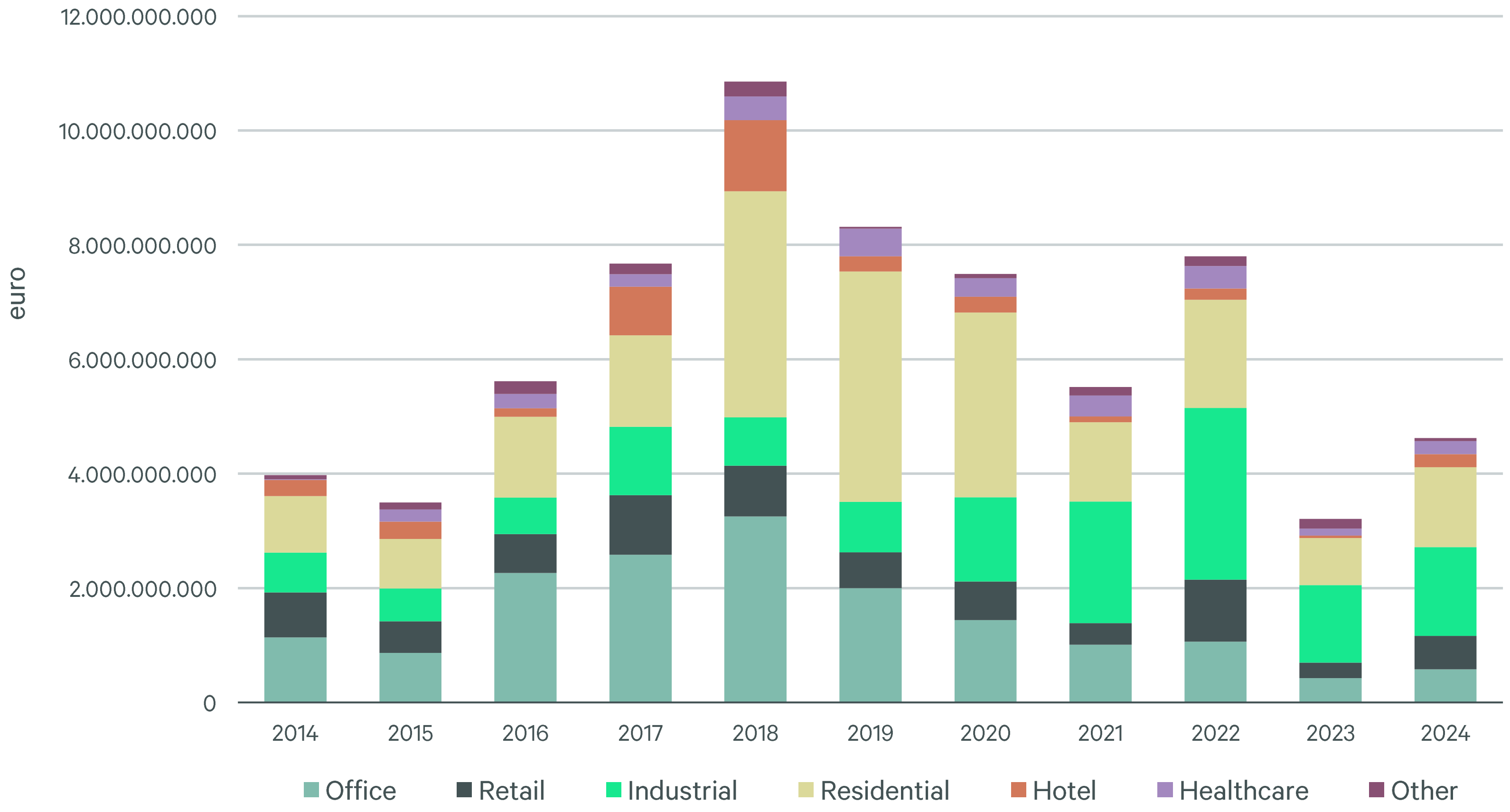
Recovery of the real estate investment market has begun

The first half of 2024 clearly showed an upturn in investment activity among real estate investors in the Netherlands. Real estate values have taken a fall in the last two years, and there now appears to be a broad consensus on pricing among buyers and sellers of real estate. Against this backdrop, purchasing real estate became a lot more attractive, which has given an impulse to investment activity in recent months. Compared to the historic low of H1 2023 - where only €3.2 billion was invested - the first half of 2024 showed serious growth of 44% with a volume of €4.6 billion.

Industrial remains the largest sector with an investment volume of more than €1.6 billion, an increase of 15% compared to H1 2023. Investments in residential and retail properties in particular increased compared to H1 2023, by 71% and 103% respectively. The hotel sector also saw significantly more investment; Only €42 million was invested in H1 2023, but in the past six months this investment volume increased to no less than €250 million. Offices in particular are lagging behind in volume compared to previous years. Although the sector showed growth (37%) compared to H1 2023 – like other sectors - the H1 2024 volume lags significantly behind long-term averages.

FIGURE 1

Investment volume H1 (2015-2024)



Source: CBRE Research

ECB in a balancing act with respect to the further lowering of interest rates

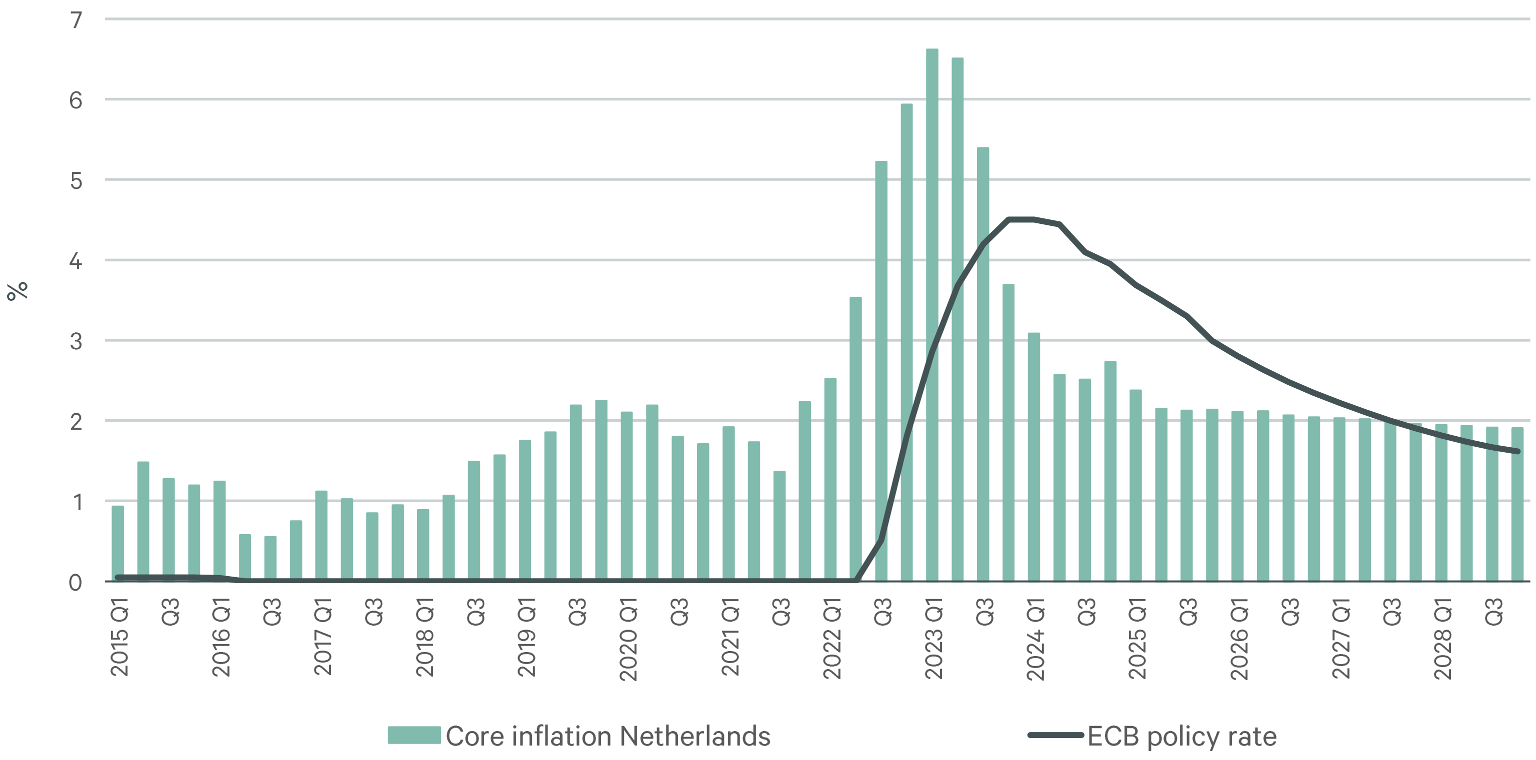
The extent to which the positive trend continues depends to a certain extent on the development of capital market interest rates and, by extension, the interest rate policy. Last June was therefore an important moment at which the ECB changed its policy. A decline in the policy interest rate that had been expected - and priced in - by the market for some time, while given the circumstances this may have been a little too early given the core inflation level in combination with the still high wage increases in Europe. Despite the downward trend, wage increases in the Netherlands are still approximately 4.5%. These structural wage increases ensure that a wage price spiral has still not been completely averted and that price increases are therefore still visible in the consumer goods and services sectors.

If we look to the near future, the ECB will continue to seek the right balance between fighting inflation on the one hand and stimulating the economy on the other. Not only inflation, economic development and wage increases must be taken into account, but the international competitive position and thus currency exchange rates also play a role, as does the still ongoing ' quantitative easing'.

All in all, CBRE expects a 25 to 50 basis points decline in the policy rate at most until the end of the year. However, this expected decline has already been priced into the current capital market interest rate, which means that interest rate developments are expected to show little volatility.

FIGURE 2

ECB policy rate and core inflation expectations (2015-2028)



Source: CBRE Research

Investment activity is slowly picking up steam

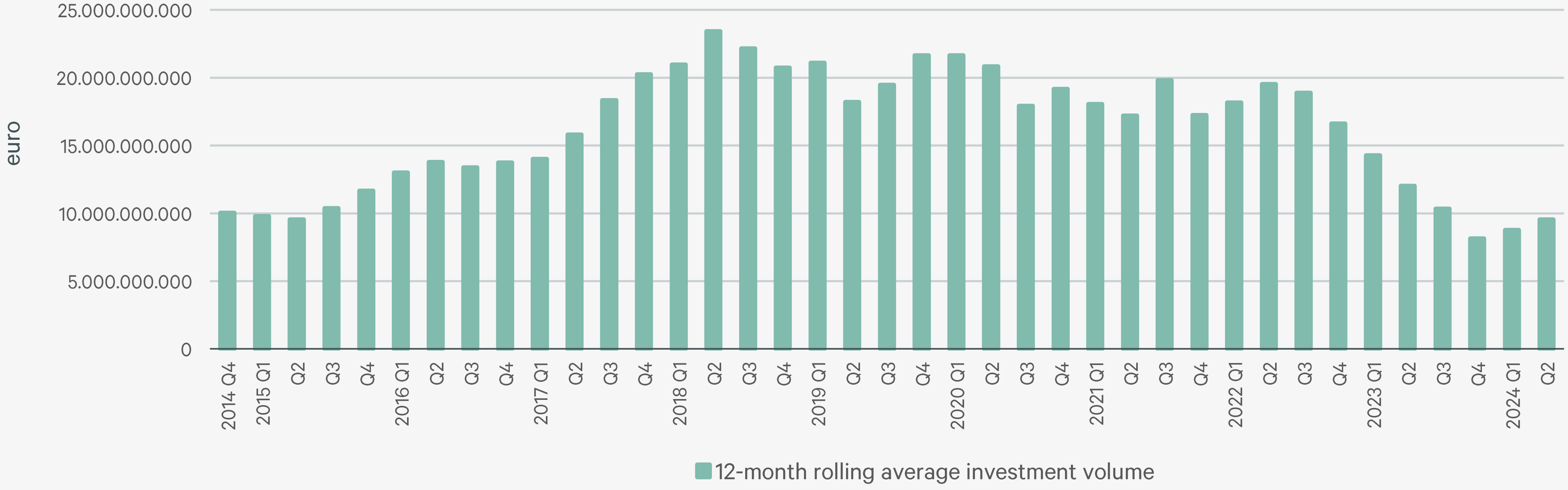
The development of the 12-month rolling investment volume clearly shows that in 2023 the investment volume decreased rapidly and reached its lowest point in the last quarter of 2023. In particular, the declining capital values and volatility of financing rates caused reluctance with investors. It is now apparent that the market has passed the low point, now that important conditions for the return of capital, such as stable financing rates and capital values, appear to have been consolidated.

The first two quarters of 2024 already show progressive growth in the rolling investment volume. In addition, the very recent interest rate cut is expected to give a further boost to investment volume in the second half of 2024. This also means that the “window of opportunity” for opportunistic or value-add investments is slowly shrinking, especially because the number of players on the market will continue to increase.

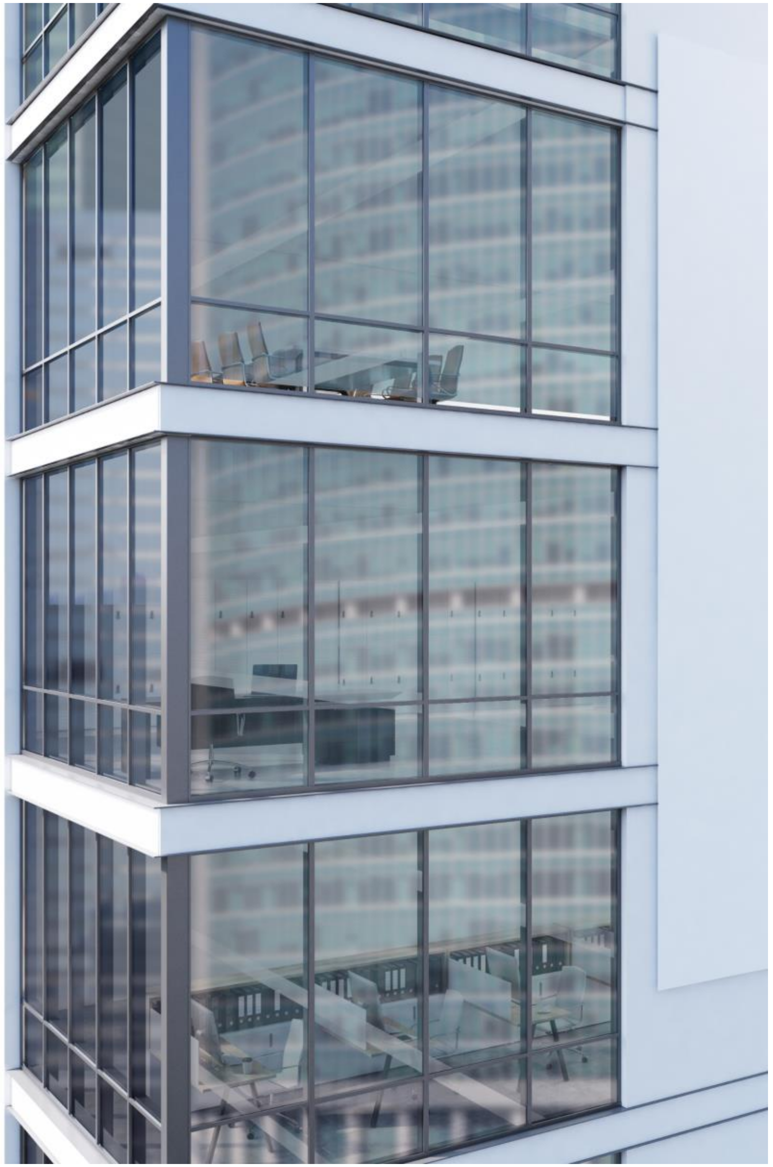
One of the most important reasons for investors to become more active in the investment market again is the stabilization of price setting. From mid-2022, CBRE saw a sharp increase in net initial yield. The acceleration in the increase in net initial yield leveled off somewhat at the beginning of 2023, but throughout Europe the different markets continued to search for the right pricing for a year. However, a different picture has emerged since the beginning of this year, and net initial yields appear to have completely stabilized. Taking into account a delay effect in the appraisals, this means that book values will be fully in line with market prices during the course of the year, which greatly improves the dynamics in the market.

FIGURE 3

12-month rolling investment volume (2014Q4 - 2024Q2)



Source: CBRE Research

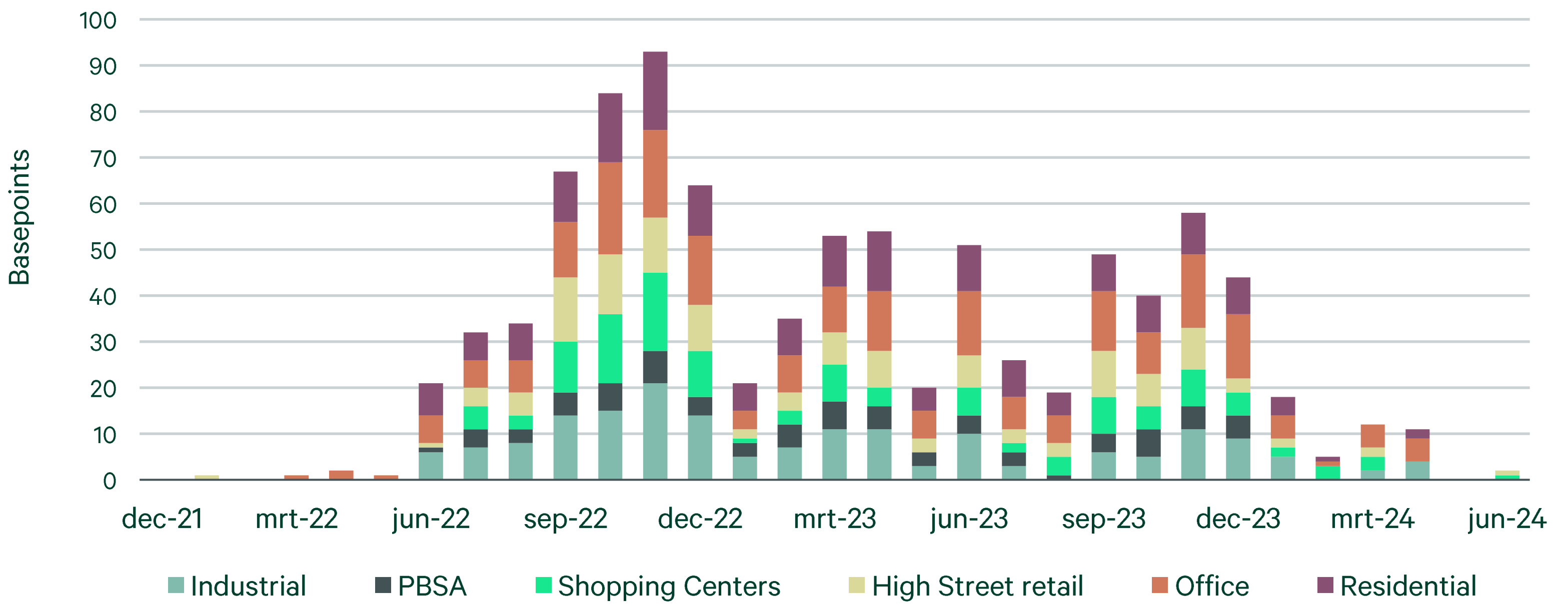


At the same time, the question may arise to what extent the falling policy interest rate and thus the capital interest rate again allows room for a decline in initial yields. However, this is still too early for the prime product. If we look at current risk premiums, they are still historically low. Even if government bond yields fall during the rest of the year, it is not expected that this will immediately lead to a downward movement in initial yields.

This may be different for core+ or value add products. Demand for these types of investment products is now increasing to such an extent that this can also lead to upward price pressure and thus reduce the initial yield.

FIGURE 4

Average net initial yield adjustment in Europe (2022-2024 H1)



Source: CBRE Research

International comparison: The Netherlands at the forefront of the recovery

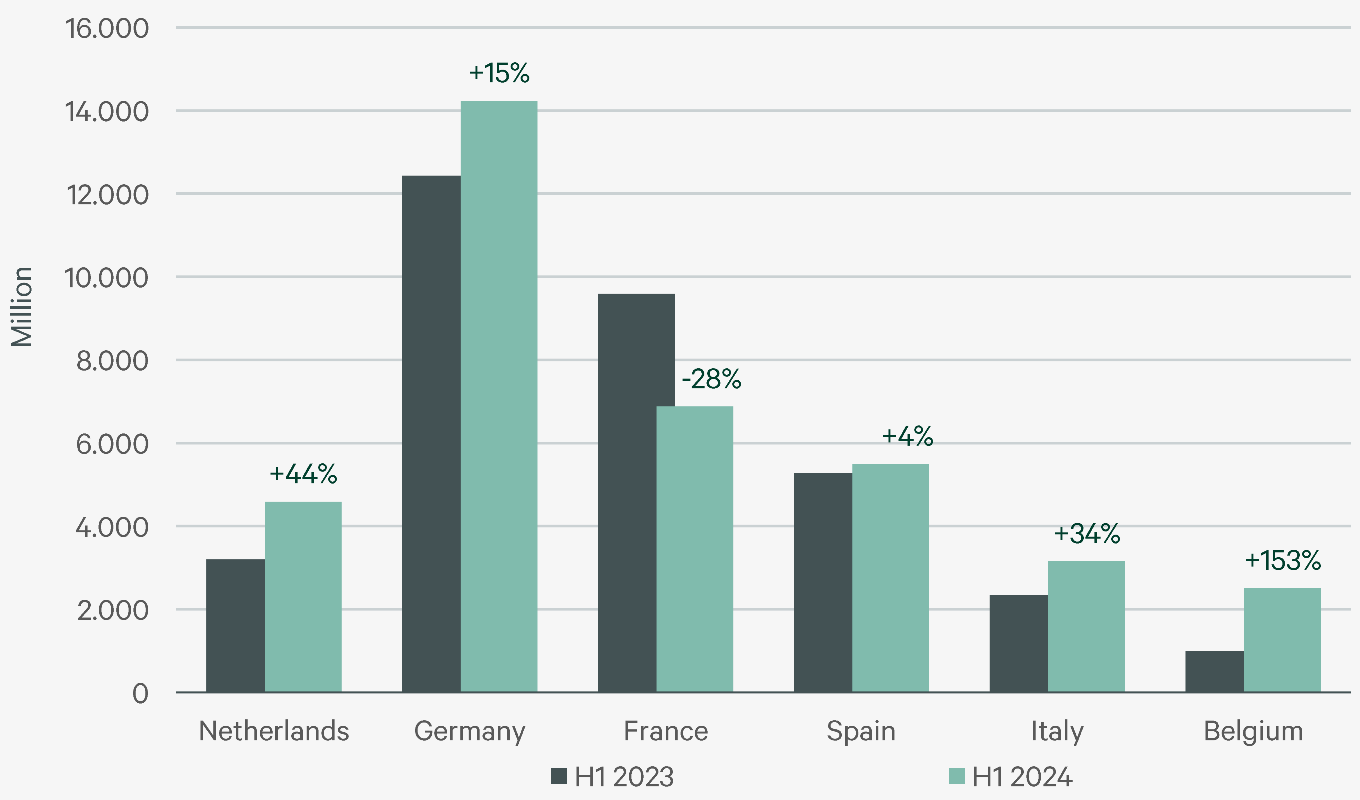
If we place the situation of the Netherlands in perspective of Europe, there appears to be an improved sentiment throughout Europe. With an increase in investment volume of 10% across Europe, there appears to be some market-wide recovery. However, if we look at the larger and surrounding countries, there is indeed a difference in recovery speed.

In part, this has to do with the speed at which different countries are devaluing real estate. The faster the write-down within valuations, the sooner liquidity appears to return to the market. In addition, it obviously also has to do with the historical composition of investment volumes in different countries. For example, the share of office investments has historically always been relatively large in Germany and France. This is one of the reasons why investment dynamics in France in particular still lag behind other European countries.

The Netherlands not only benefits from the relatively rapid depreciation in the market compared to other European countries, but also because the vast majority of the investment volume is made up of the industrial sector. A sector that - due to the strong rental growth - has recorded a less significant depreciation and also saw a significant increase in investor interest in investing.

FIGURE 5

International comparison of investment volume H1 2024 versus H1 2023



Source: CBRE Research

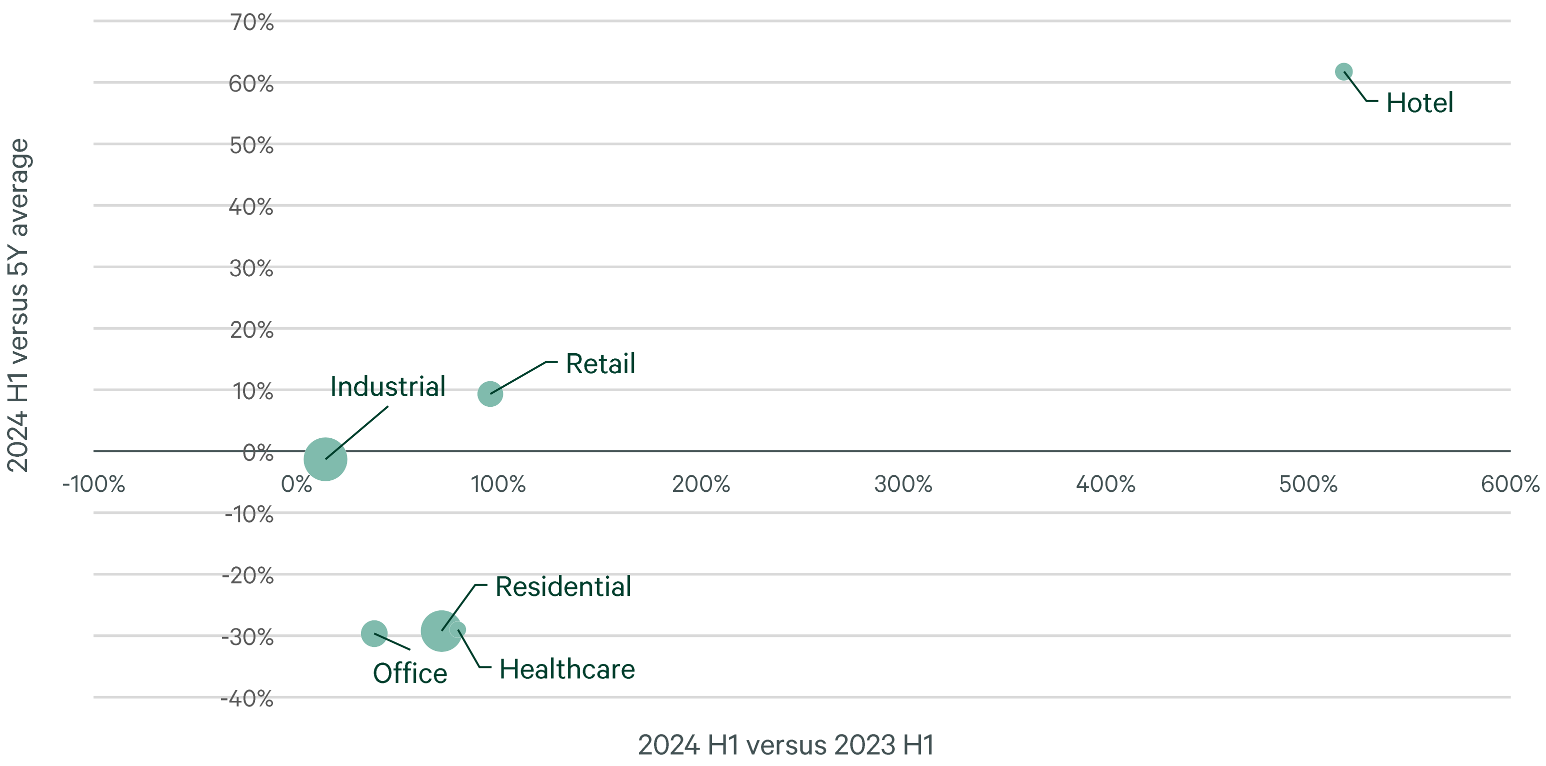
There are still major differences in the recovery sector-wise, with the hotel investment market leading the way

There are therefore major differences visible in the market recovery across sectors. It is visible that all sectors show a strong improvement compared to the first half of 2023. However, when comparing H1 2024 with the five-year average, the volume in the past half year was still considerably lower. If the decline in value is included, it is striking that only in the hotel market, retail market and to a lesser extent the industrial market are back at a comparable level than in the past five years.

In the aftermath of the corona years, the hotel investment market is in the process of a rapid recovery compared to other sectors. The operating results are stronger than ever before. Compared to last year, however, it is clear that purchasing parties are once again convinced of the hotel product and are therefore willing to pay the price that selling parties have been charging for their hotel investments for some time. In fact, we now see - with a strong concentration in Rotterdam - that redevelopments of office space are also being initiated to meet the growing demand for hotel rooms.

FIGURE 6

Sectoral investment volume versus 2023 and 5-year average corrected for price decline



Source: CBRE Research

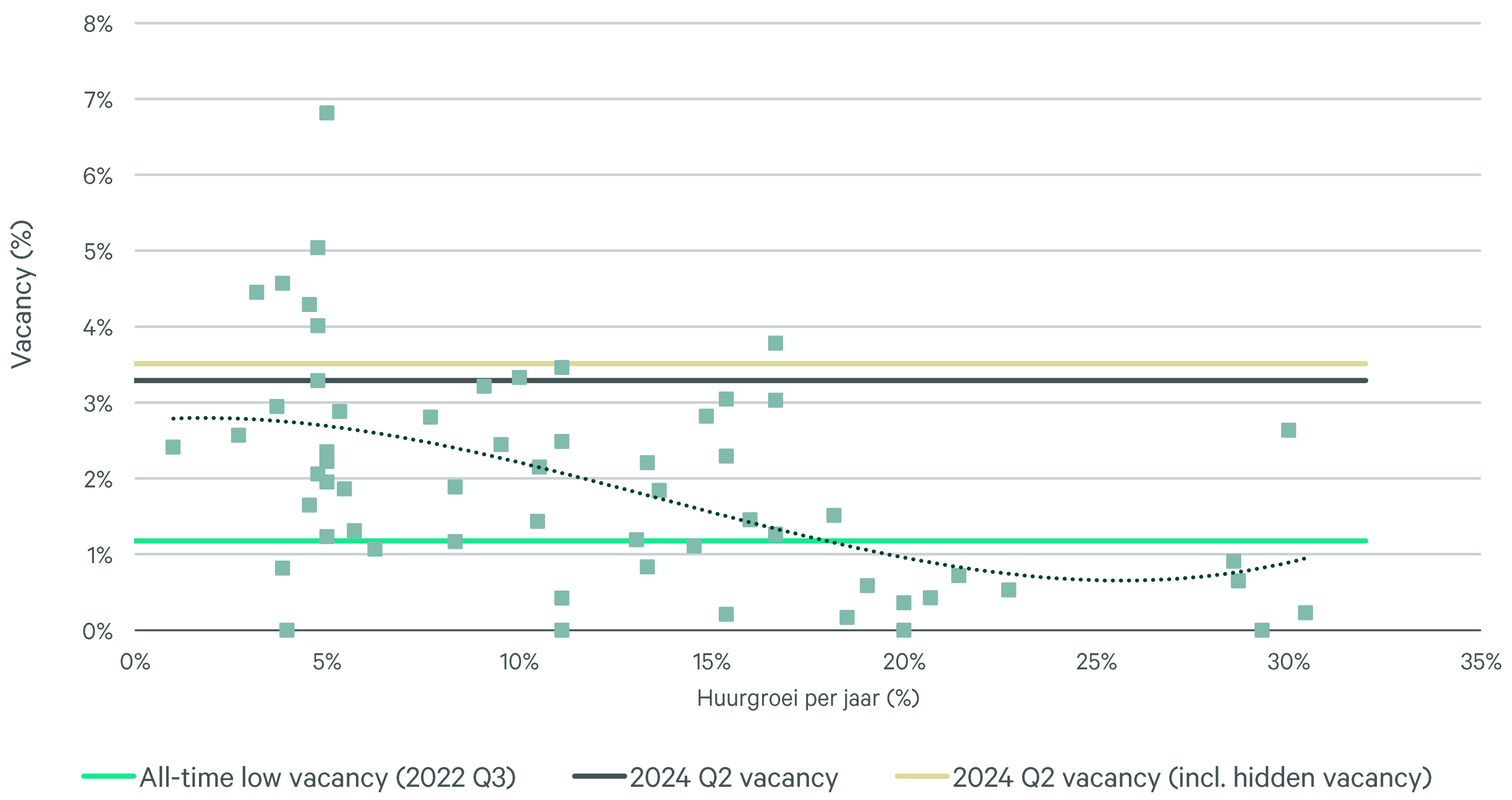
Industrial: expected rental growth is falling due to rising vacancy rates

In the first half of 2024, the investment volume reached €1.6 billion, making the industrial sector the largest asset class for investments by far. About 34% of the investment volume in the first half of the year came from industrial and logistics real estate. The investment volume for industrial already represents 67% of the total volume of 2023, indicating a significant recovery of the industrial sector.

However, some caution also seems appropriate. The occupier market is showing clear signs of stagnating growth for the first time. After years of growth in stock and shrinking vacancy rates, resulting in continued rising rent levels, this market situation appears to be turning around. The economic vacancy rate has increased in a relatively short time from 1.2% (Q3 2022) to 3.3%. Taking into account supply from subletting this number climbs to 3.5%. Still a relatively low vacancy rate, but it does have significant implications for market rental growth in the short term. The strong relationship between vacancy levels and rental growth implies that rental growth in most industrial regions is reduced to a bandwidth of 0 to 5% per year. This step back in market rental growth expectations may ultimately also have some implications for the expected net initial yield visible in the market. Yields may therefore move slightly upwards in some regions in the next six months.

FIGURE 7

Correlation between vacancy level and rental growth per regional industrial market



Source: CBRE Research

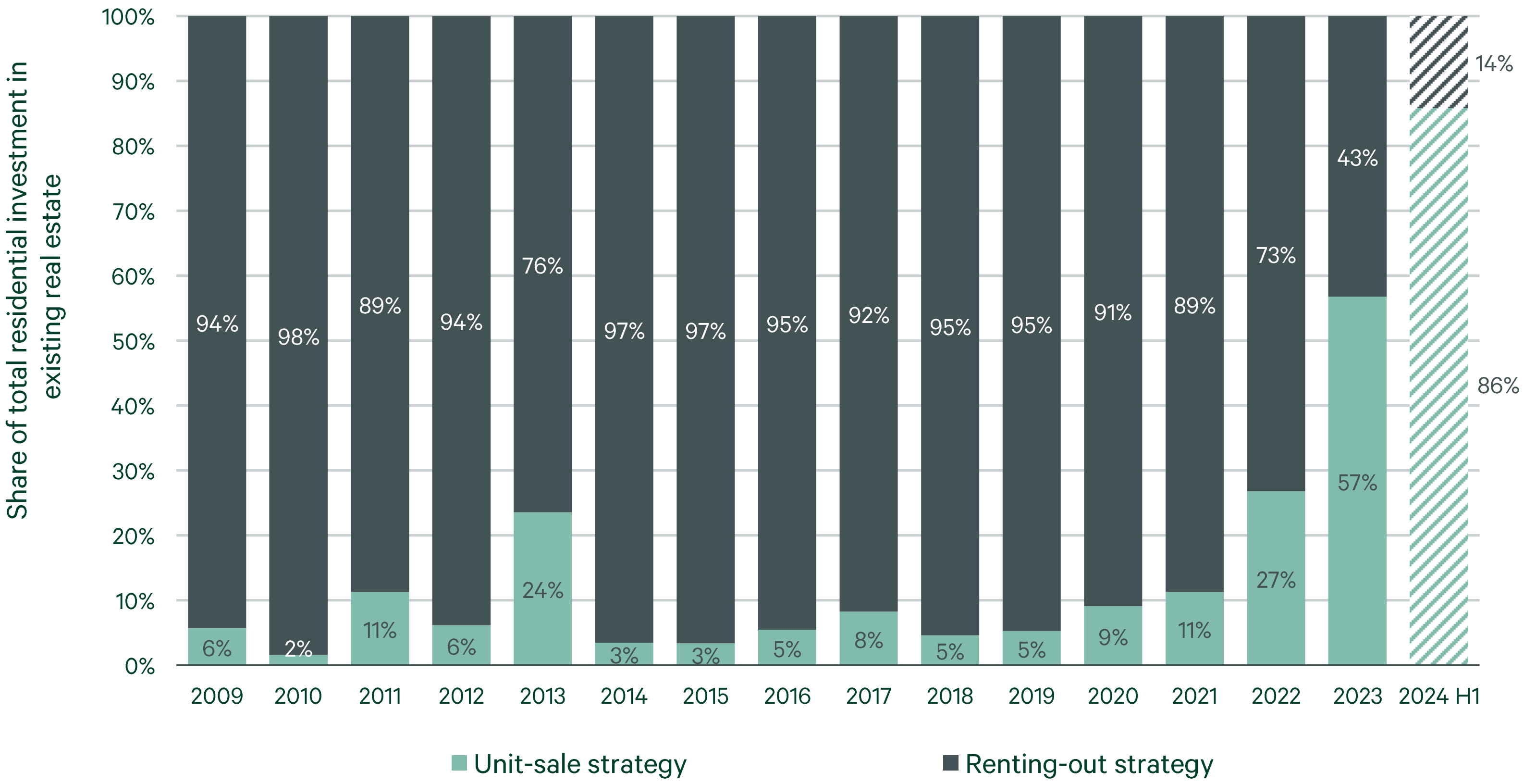
Residential: despite recovery of investments in new-build, size of the rental sector is under pressure

The residential investment market has slowly started to recover in 2024 compared to the very moderate investment volume in 2023. With a volume of € 1.4 billion, the first half year showed a growth of 70.3% compared to H1 2023, when only € 822 million was invested in housing. The growth compared to H1 of last year was mainly caused by a strong increase in investments in existing complexes, which amounted to a total of € 646 million. That is a volume growth of 177% compared to H1 2023. The new construction investment volume also increased compared to H1 2023 (28%), and amounted to € 754 million.

The increase in investment volume in new-build homes is positive given the tight private rental sector. However, at the same time, CBRE sees that the sales strategy remains largely dominant when investing in existing homes. The percentage of rental properties purchased on the basis of a sales strategy is now no less than 86%. Because these homes will eventually disappear from the rental market – in addition to a significant wave of sales in the private investor market - the rental housing stock will become smaller in the coming years despite the new construction. Resulting in stronger rental growth in the unregulated segment.

FIGURE 8

Investments in existing houses, broken down by investment strategy (2009-2024 H1)



Source: CBRE Research

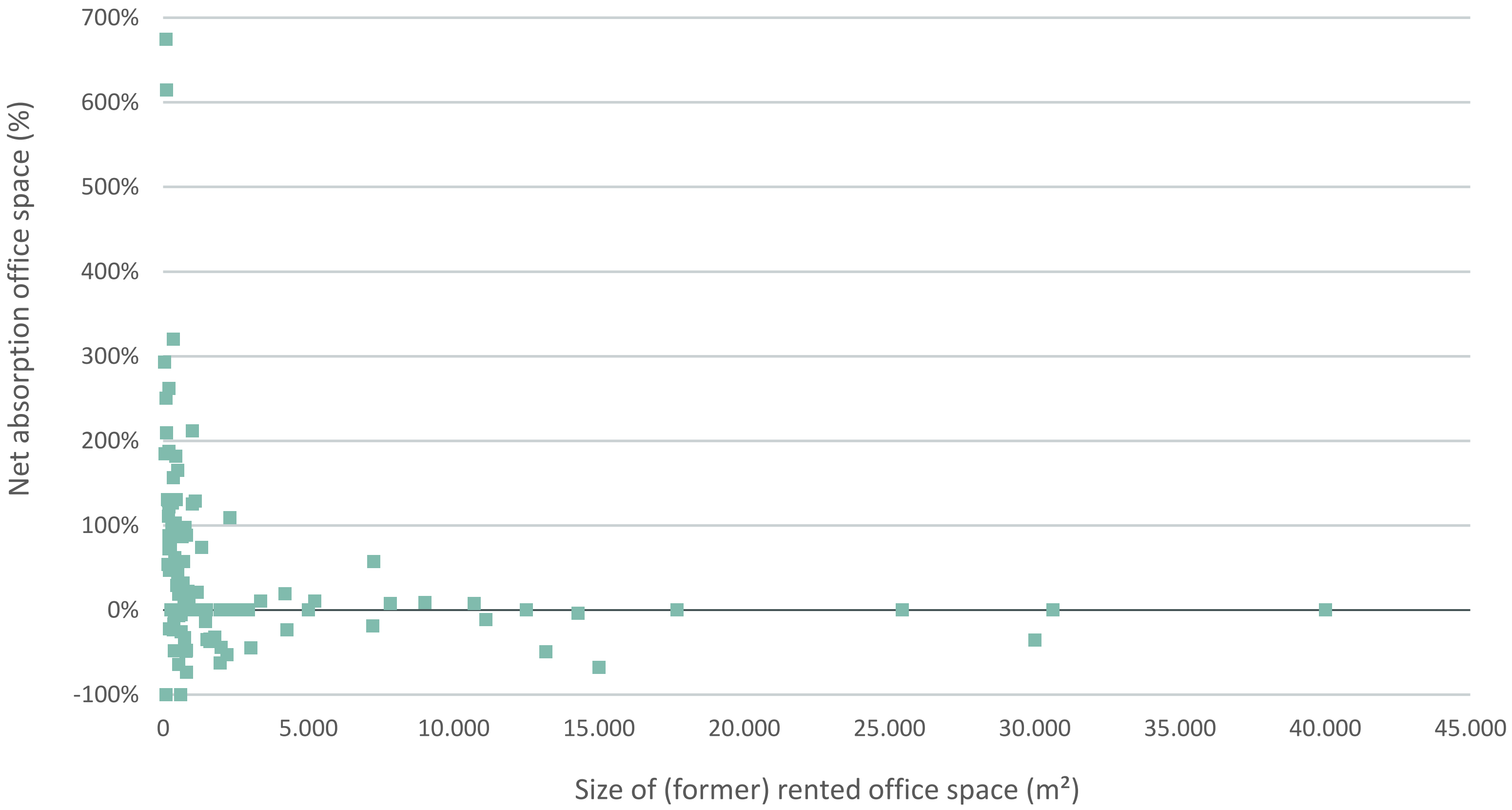
Offices: growing companies are still compensating for hybrid working impacts

With an investment volume of €600 million in office real estate after the first half of 2024, the investment market appears to be slowly recovering from the low point of €420 million in H1 2023. However, activity still lags behind the five-year average volume for the first half of the year, which amounts to almost €1.2 billion.

This reluctance has everything to do with the risk perception surrounding office real estate. The uncertainty about the impact of hybrid working on the operation of office buildings remains. However, on the user market signs are not so negative at all. The demand for office space is increasing, with the take-up volume in H1 2024 being the highest since H1 2020, while vacancy also remains limited. Of the larger office cities, only Amsterdam (8.6%) and Haarlemmermeer (11.9%) have clearly higher vacancies than the friction level. This has everything to do with the mixed picture we see in transactions: some large companies can manage with fewer office meters through hybrid working, while many smaller and medium-sized companies continue to grow. On balance, this still results in net absorption on the total office market.

FIGURE 9

Net absorption of new contracts among office users in 2024



Source: CBRE Research

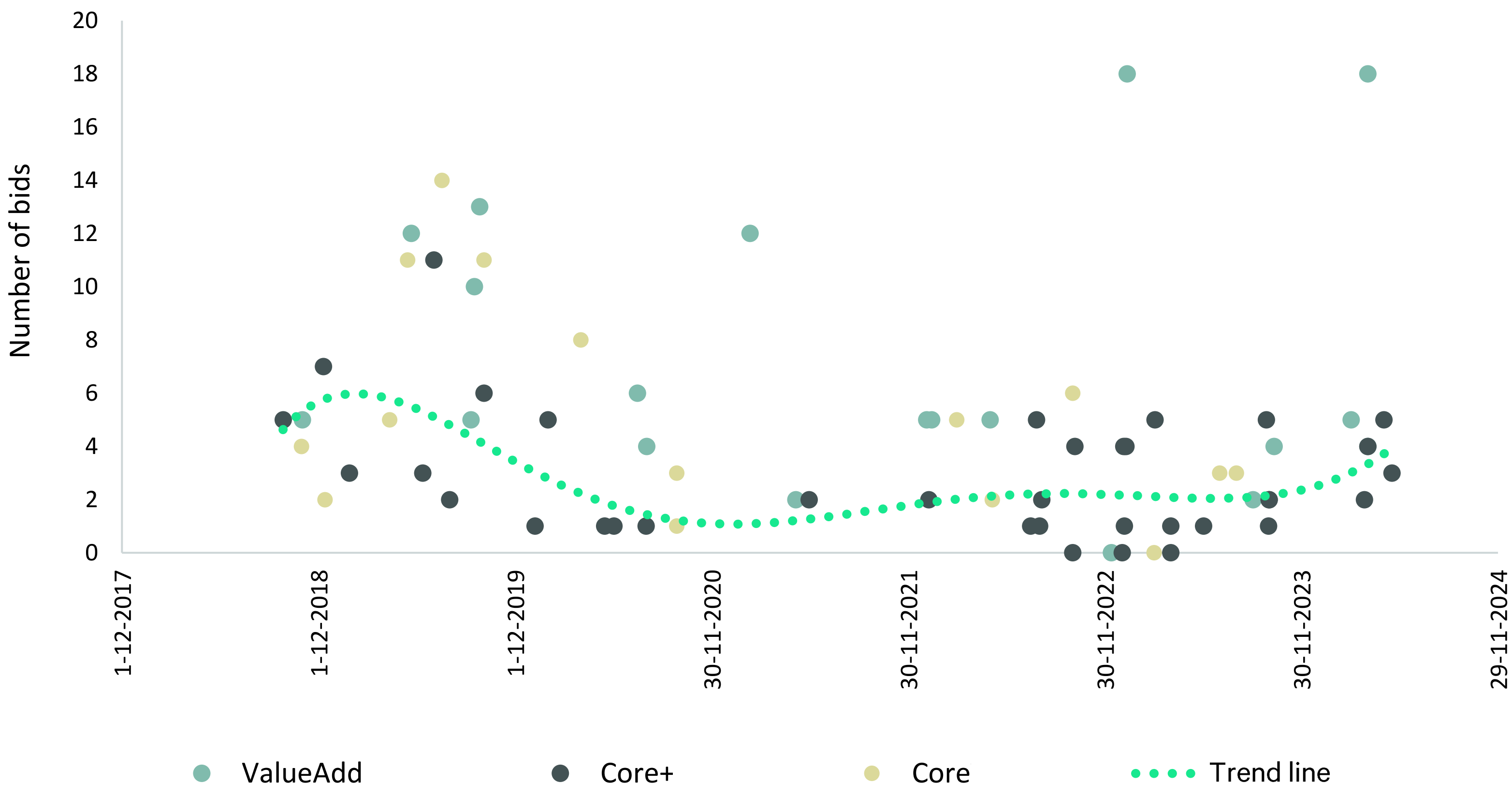
Market depth is also increasing in the office market

The increased interest rates and the uncertainty surrounding the impact of hybrid working have now largely reflected in price setting on the office market. Partly due to this significant correction in values, it is visible that the depth in the market is increasing again. More and more investors are again seeing opportunities in office investments and for now mainly in office investments that can be classified as a core+ or value add investment product. Activity within the core investment market still remains very limited.

Based on the number of bids during sales processes, it appears that more parties are willing to bid on office real estate. Since 2020, a clear deterioration has been visible and the number of bids regularly fell to 0 bids in a sales process, especially for core investments. Based on the most recent sales processes, it is now clear that more investors are becoming more active in the market. The net initial yield appears to have increased to such an extent that investors realize that this is the time to get back into office investments.

FIGURE 10

Number of bids per sales process on the office market, by risk profile (2018-2024)

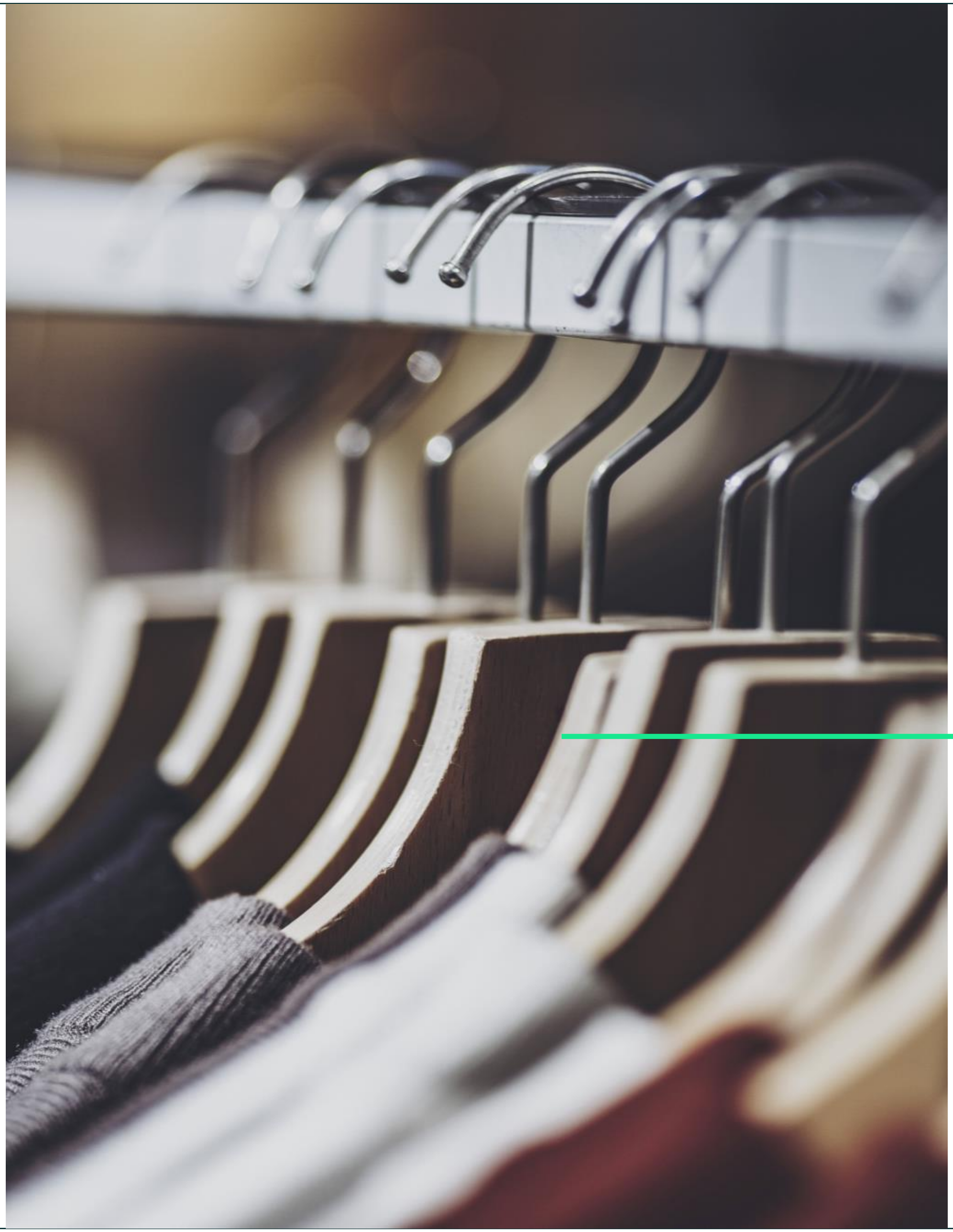


Source: CBRE Research

Interest in retail investments broadened

In the first half of 2024, €558 million was invested in retail. This is an increase compared to last year, but still more than 8% below the 5-year average. This is largely because there is little available product on the market and buyers and sellers still do not fully agree on price. The larger transactions that did go ahead often involved more special buildings or were attractive for the seller in terms of returns. In addition to these large transactions, there were relatively many smaller transactions in the market compared to previous years.

An important fact in the retail market is that after years of rental price declines and a recent correction to the initial yield, price setting is bottoming out at an attractive yield level. This is now tempting more and more parties to increasingly consider retail real estate. In addition, at the most important high street retail locations, occupiers purchase the best locations themselves. This increases competition in the market.



Despite a small increase in overall vacancy, the most sought-after high street retail locations are now showing some rent growth. A situation that has not been visible in the retail market for a long time. This is partly due to the fact that several (international) retail chains are still expanding in the Dutch market. However, in light of this increase in vacancy rates, polarization is still increasing and the spread between the A1 retail locations in the best shopping areas in the Netherlands and secondary main shopping areas is therefore increasing. A segment in which private investors are most active, mainly due to the very attractive initial returns.

Confidence in the future

All in all, the first half of 2024 strengthens confidence in a strong second half of the year, with the expected further reduction in policy rates helping to upkeep investment activity. A potential favorable policy decision regarding a reduction in the transfer tax - which so far only seems to be under discussion for the residential investment market - could worsen the dynamics in the short term. The stabilization of real estate values ensures that more and more investors see the opportunity to become more active in the market again.

If we look at the medium term, there is even a chance that there will be a reverse denominator effect. The significant increase in value of shares in particular and to a lesser extent the bond market, means that real estate is now under-allocated by most pension funds and insurers. In the long term, this may lead - provided the risk-return ratios improve - to more money being allocated to the real estate market. This can ultimately improve the dynamics and price formation in the real estate market towards 2025-2026.

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