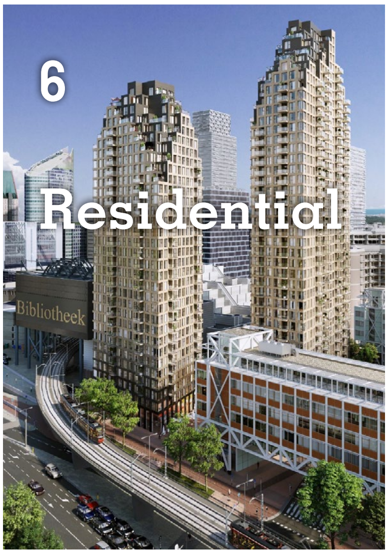
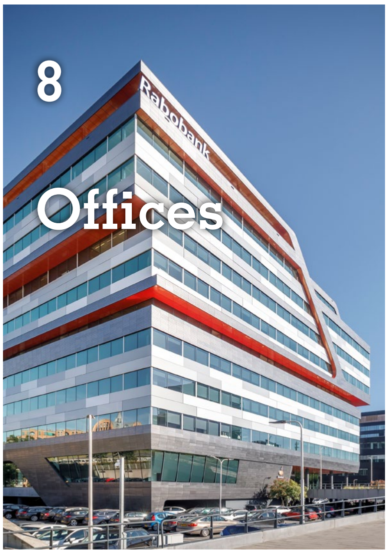
Real estate market update

Third quarter 2022

a.s.r. real estate

Contents





Economy

The Dutch economy continues to shift away from the pandemic impact to elevated prices and interest rates, accelerated by the ongoing war in Ukraine and trade restrictions. Increased consumer prices, largely attributable to energy and food prices, and rising debt costs affect both consumers and businesses, which depresses the economic climate and outlook.

GDP growth	y-o-y real	Q3 2022[1]	**4.5%**	Q2 2022	5.1%	↘
Consumer prices	y-o-y inflation (HICP)	Q3 2022	**14.1%**	Q2 2022	10.4%	↗
Consumer confidence	Average balance	Sept 2022	**-59**	June 2022	-50	↘
Unemployment	ILO unemployment rate	Q3 2022	**3.7%**	Q2 2022	3.3%	↗
Private consumption	y-o-y consumer spending	Q3 2022[1]	**2.0%**	Q2 2022	7.0%	↘
Producer confidence	Average balance	Sept 2022	**2.6**	June 2022	8.1	↘

Source: Statistics Netherlands (CBS), Eurostat, a.s.r. real estate, 2022 | The arrows refer to the experienced change over the comparison period.

Due to a structural increase in money supply since the COVID-19 pandemic consumer prices have significantly increased since the second half of 2021, and **saw the highest year-on-year increase yet again by the end of September 2022 (17.1%),** averaging at 14.1% in the third quarter. The impact of energy prices continues to increase; this represented 61% of total inflation in September, while food prices continued to increase, albeit slightly less fast. As a result, consumer price increases in the Netherlands continue to exceed the eurozone average of 10%.

For the fourth consecutive time this year, consumer confidence reached a record low (-59). In September, consumer confidence dropped both in terms of the economic climate and consumers' own financial situation. As a result of the rising costs of living, consumers were more pessimistic about being able to increase their savings and their ability to make large purchases in the foreseeable future. However, the unemployment rate remained low with 3.6% in the third quarter, which is far lower than the average unemployment rate in the eurozone, which is 6.6%.

Income compensation could improve the economic outlook for consumers, but currently only a few new collective labour agreements include wage raises that are close to the annual expected inflation. It is too soon to expect a large wave of inflation compensation from businesses as they too are affected by the rising prices of resources and energy. Although producer confidence worsened to 2.6 at the end of the quarter as a result of a more negative outlook on their order books, it remained positive and higher than the long-term average.

The ECB increased the key interest by 125 bps in the third quarter to tackle surging inflation in the eurozone. In the same vein as the Fed, the ECB has opted for interest hikes during the summer, arguing that they might implement more increases as prices are expected to remain high in 2023. An additional rate hike of 75 bps by the end of October has already been communicated. As a result, differences in bond rates between economic stronger and weaker countries may continue to increase.

1 Estimation based on year-end forecast

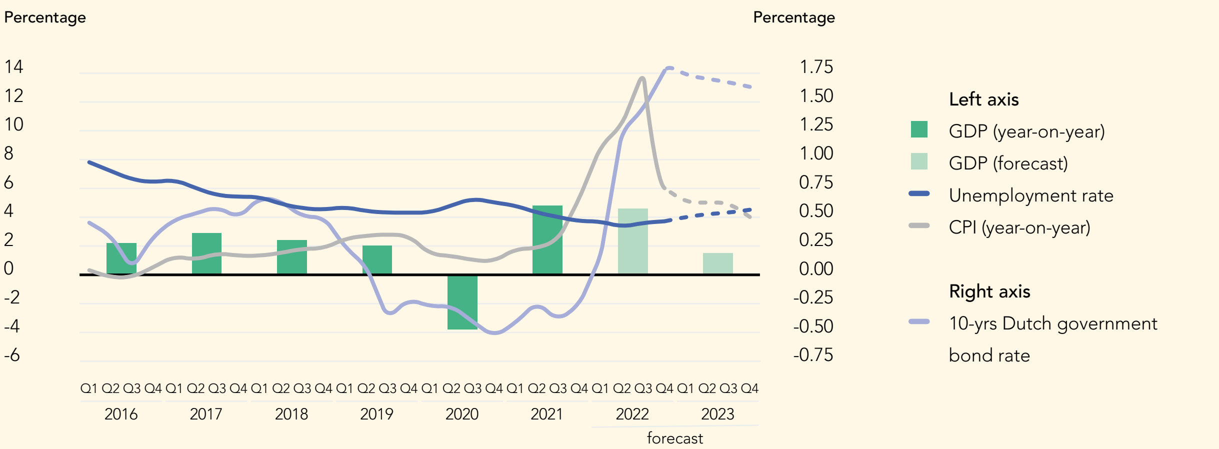
The ECB aims to minimise this gap by reinvesting principal payments from stronger to weaker countries as part of the pandemic emergency purchase programme (PEPP). However, the polarisation within the eurozone is likely to persist further as some Member States are more capable of supporting their local economies than others. Germany, for instance, announced that it would spend up to € 200 billion to support consumers and businesses, while the Netherlands aims to support its economy by spending € 23.5 billion on its enhanced energy policy. These differences are causing concerns about greater fragmentation in the European Union.

The interest rate of Dutch government bonds has continued to increase since the start of the year, ending the third quarter at 2.1%. This increase is in line with the ECB policy. The Dutch bond rate is relatively low compared to the eurozone average of 2.6%.

As usual, the Netherlands Bureau for Economic Policy Analysis (CPB) accompanied the government's new annual policy presented on Budget Day (20 September), with their most recent economic forecast. CPB expects consumers' purchasing power to grow by 3.9% in 2023, mainly because of the large-scale and costly intervention on the energy market. Consequently, **household consumption and GDP-growth are expected to grow slightly in 2023.**

The unemployment rate is forecasted to stay relatively low, whereas long-term interest rates are expected to rise further in 2023. The enhanced energy policy, which was announced in early October, might improve the economic forecast, although there are great uncertainties, both in terms of the war in Ukraine war and the actions of the ECB.

Figure 1 Dutch economic indicators



Source: Statistics Netherlands, Eurostat, CPB, Consensus Forecast, DNB, 2022

Retail

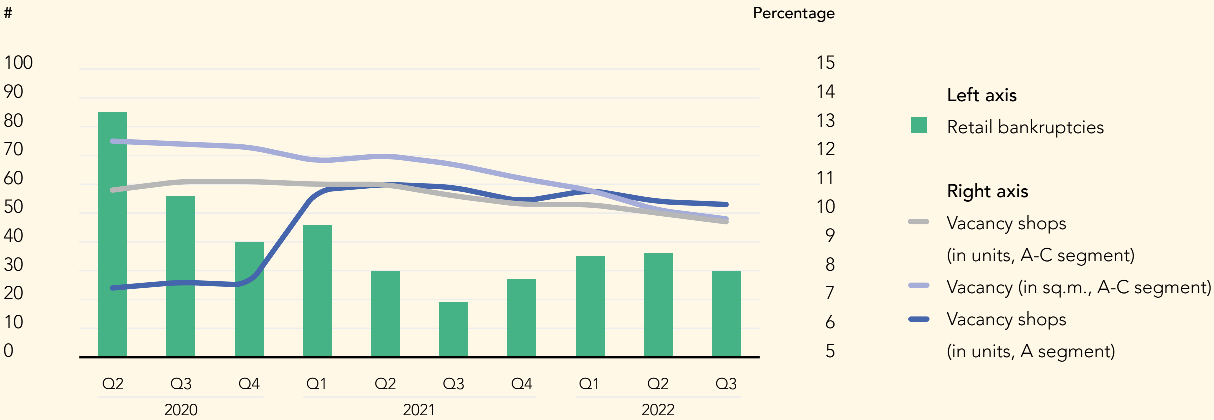
Consumers and retailers tried to cope with high inflation, whilst vacancy continued to decline in Q3. Looking forward, disposable income decline will increase pressure on consumer purchases, whilst retailers face rent payments and high energy costs. On the other hand, relative pricing for investors remains favourable.

Turnover growth continues due to inflation. Both the non-food retail and food retail sectors showed increased y-o-y turnover growth; the growth rate was 5.9% and 2.6% respectively in Q2 2022. However, high inflation has a major impact. The supermarket sales volume decreased by 5.6%, for example, while turnover increased by 2.5%. Consumers are consciously looking for lower-priced products. Supermarket discounters are benefiting and consumers are reconsidering making large purchases such as kitchens on credit. After a record-low y-o-y online shopping turnover decline (-19.7%) in Q1, Q2 also showed a y-o-y decline by 9.9%.

Vacancy decline continues. The continuous economic support packages of the central government are an important driver of vacancy decline. Interestingly, this resulted in a vacancy rate trend reversal during the pandemic. Furthermore, redevelopments helped to temper vacancy rates. As expected, redevelopment into housing proved profitable. Also, the long-time trend of more food and beverage establishments in city centres continued during the pandemic although restrictive measures also heavily affected the hospitality industry.

City centre rental values still under pressure. High street market rental values are still under pressure and retailers face substantial increases in energy costs, whilst support packages are unwinding and payments of deferred taxes and rent are expected. On a more positive note, large retailers and local retailers are opting for the same retail properties in large retail cities, stabilising retail rent levels in this particular segment.

Figure 2 Vacancy rates and bankruptcies



Source: Locatus, Statistics Netherlands, 2022

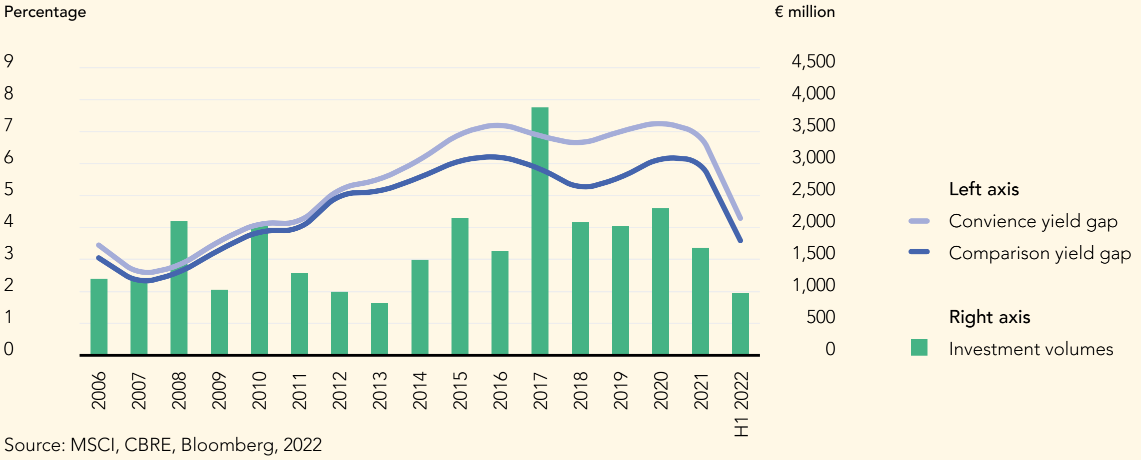
Retail investments showed remarkable growth. Retail investments increased by 54.2% in Q2 compared to Q1 of this year. Interestingly enough, y-on-y retail investments more than doubled in Q2 and H1 investments were roughly 40% higher than the H1 historic average of 2006-2022. Core investors sold non-strategic assets, while value-add and opportunistic investors are buying these assets, thereby adding assets with relatively high yields and growth perspective to their portfolios. Also, an international investment fund purchased city centre assets in Nijmegen and Zwolle. Although yield gaps have declined sharply, relative pricing compared to residential, office and industrial investments is favourable.

Outlook

Occupier recovery under pressure from economic headwinds. With increased energy prices, rents and tax repayments, and staff shortages, retailers are facing serious issues. The extensive central government stimulus package, which supports disposable household income, will bring some much-needed relieve. Held back by historically low confidence levels, consumers will still be selective in their purchases, however. We expect continued market rental value pressure in high streets. Primary streets in large cities will be most resilient as this is where large and financially solid online and brick-and-mortar retailer demand is concentrated.

Relative pricing supports investor demand. Investment dynamics are changing rapidly due to fast-paced economic and monetary developments. We expect investors to remain active as relative pricing remains favourable, although higher transfer tax, increased debt costs and occupier challenges will continue to provide pushback. Valuations of primary high street retail might stabilise, whereas modest increases in dominant convenience retail values are expected. Other retail segments will face continued value pressure.

Figure 3 Retail segment yield gaps[1] and retail investment volumes



Source: MSCI, CBRE, Bloomberg, 2022

1 Yield gap calculated on reversionary yields and 10-yrs Dutch government bond rate, as of Q2 2022

Residential

While the fundamental demand for housing remains high and the addition of newly-built homes has not yet accelerated, rising interest rates are already causing a turnaround in the residential market.

In the owner-occupied market, Dutch q-o-q transaction price growth slowed down to 0.6% in the third quarter. Rapidly rising mortgage interest rates make home buyers more cautious. Moreover, home owners now want to sell their own property first before buying a new one. A recent publication of Q3 figures by NVM seems to confirm the cooling down of the market with a 5.8% q-o-q housing price decline resulting in a y-o-y price growth of just 2.0%. In fact, the y-o-y number of residential properties for sale increased by 80% in Q3.

The number of transactions in the third quarter was approximately 50,500, 6.4% lower than the third quarter of 2021. The q-o-q growth was positive (6.5%), which corresponds with the seasonal pattern.

In the residential investment market valuation reports for the third quarter show a significantly different market sentiment than in the second quarter. Although market rents and y-o-y owner-occupier values continue to increase, yields are experiencing upward pressure from rising interest rates. The interest rates on Dutch 10-year bonds increased to 2.1% in September 2022; these rates were 1.8% at the end of Q2 2022 and as low as 0.3% in the first quarter of 2022.
This increase pressures the yield premium and the appeal of residential investments. Furthermore, rising energy and building costs, especially for unsustainable homes, will limit future cash flows.

That said, the latest available MSCI Quarterly Residential benchmark figures still show strong returns on the residential market. The total return of the Dutch residential property market in the second quarter of 2022 was 19.4% y-o-y. Capital growth accounts for a significant part of this increase, but decreased as well, from 17.5% in the first quarter of 2022 to 16.3% this quarter. This means that the increased pressure on the residential investment market persisted and continues to move in line with the owner-occupied market, but first signs of a market cooldown are showing as well.

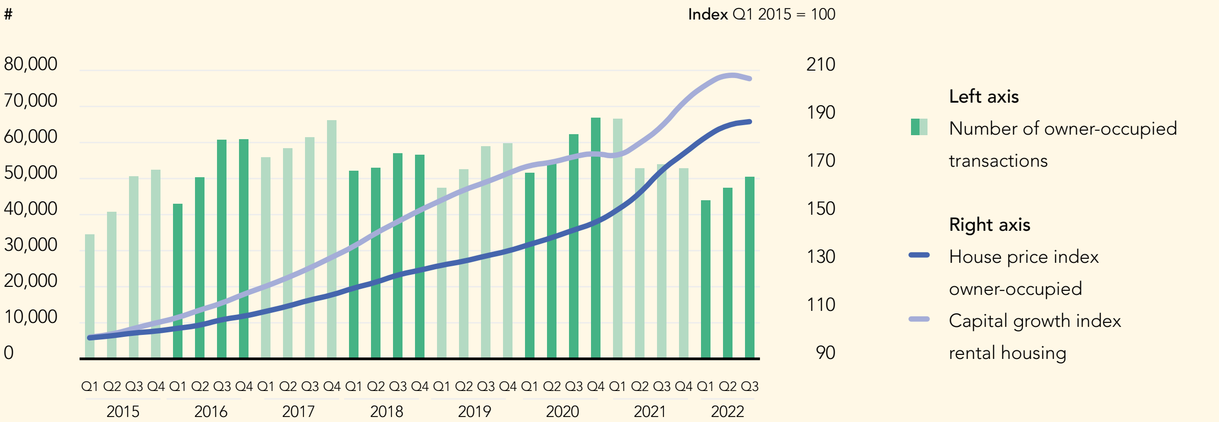
As a result, income return decreased slightly to 2.7% y-o-y, coming from 2.8% in the previous quarter.

In the second quarter of 2022 market rental value growth increased slightly, to 4.5% y-o-y. Now that consumer prices have increased significantly since the fourth quarter of 2021, both market rental value growth and the actual rent passing growth have been unable to outperform CPI for the first time since 2013.

While yields seemed to bottom out in the first year of the pandemic, compression has continued since last year. By the end of the second quarter of 2022 yields stood at 4.0%, a 4 basis-point decrease compared to the previous quarter.

As mentioned before, the Q2 benchmark figures show different market dynamics than we saw in Q3.

Figure 4 Developments in house prices and number of transactions in existing owner-occupied homes



Source: Statistics Netherlands, MSCI, 2022

Outlook

Headwinds are expected to cool down the residential investment market. Rapidly rising mortgage and interest rates, stricter mortgage lending policies, strong consumer price and energy price growth, increased government intervention and low consumer confidence will counterbalance the strong fundamentals on the residential market.

The prospective regulation of the rental sector, especially the extension of the housing valuation system (WWS) to mid-priced rental housing (€ 1,000 p.m.) will have an impact on market rents and, subsequently, valuations.

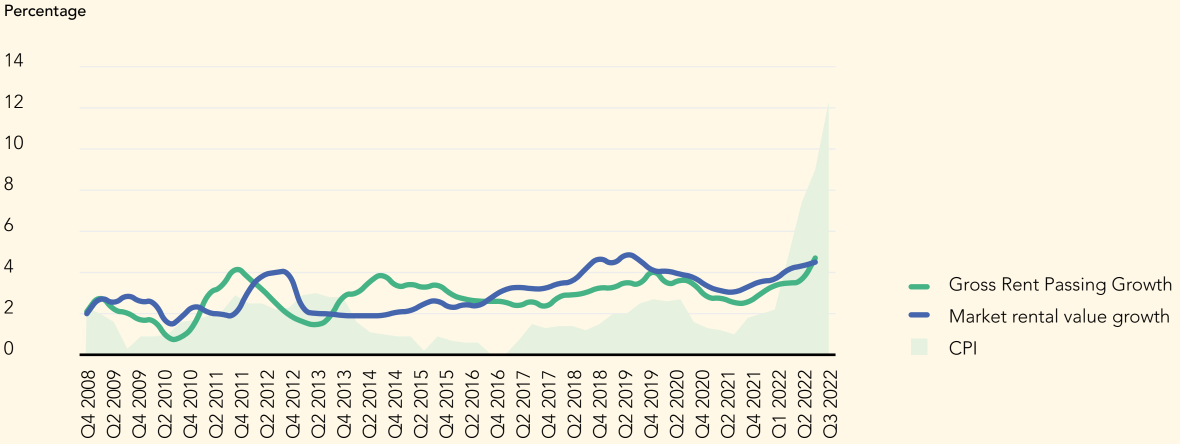
Moreover, with increasing interest rates, it is likely that yields for the residential investment market will increase in the years ahead. However, it is not expected that core investors will sell residential assets on a large scale. Most residential funds have solid commitments and the partial inflation hedge provides the relief that other investments are unable to.

The strong owner-occupier market fundamentals and the (partial) inflation hedge of rental housing might counterweigh the decreasing yield premium and increased government intervention.

The supply of unregulated rental homes is stalling due to rising building costs and increasing government interventions in the market, which will lead to higher rents. Moreover, consumers could prefer renting over having to deal with the increased uncertainties in the owner-occupier market.
The WWS system extension could actually discourage the construction of much-needed mid-priced rental housing. This would further increase the mid-priced rental housing shortage and would push market rental values to higher levels.

With this in mind, residential investment valuations are likely to decrease in 2023. However, the general fundamentals of the rental market remain favourable and will dampen the negative impact of economic headwinds to a certain extent.

Figure 5 Rental growth and Dutch CPI (y-o-y % change)



Source: Statistics Netherlands, MSCI, 2022

Offices

Economic uncertain times adds to the hesitancy among office occupiers and investors. Selectiveness increases and gears towards building characteristics such as sustainability and accessibility. Similar to other real estate sectors, rising interest rates puts office valuations under pressure.

Occupiers of the Dutch office market remain hesitant due to uncertainties. Office take-up in the second quarter of 2022 remained similarly low compared to the previous quarter. At 137,400 sq.m., take-up was 4% lower than Q2 2021. Approximately 63% of national take-up was in the G5 with Amsterdam representing a share of 34% of national take-up, which is on a similar level compared to the previous quarter. The other four cities saw a sharper decline in terms of share of office take-up.

G5 office markets are outperforming the general office market. Compared to the previous quarter, the vacancy rate decreased slightly by 18 bps to 10.8%, and overall office stock continued to decline to just above 46 million sq.m. Companies are still reconsidering their corporate real estate strategy in the wake of increased hybrid working, but most have not yet taken action. This could potentially increase the availability of office space in the medium to long term.

Polarisation continues between the best and the rest of the office market. At 4.9%, the average vacancy rate of offices near intercity railway stations in the G5 declined slightly compared to the previous quarter, while the office stock remained on a similar level. The current vacancy rate near G5 city centre railway stations remains below the natural vacancy rate of a well-functioning office market. This tells us that office space near transport hubs in the larger cities is still sought after.

Average office rents in the G5 cities largely outperformed the Dutch average of € 140 per sq.m. The greatest outperformer was Amsterdam with an average rent of € 265 per sq.m. and a prime rent of € 485 per sq.m. in the Zuidas business district. This prime rent reached an all-time high.

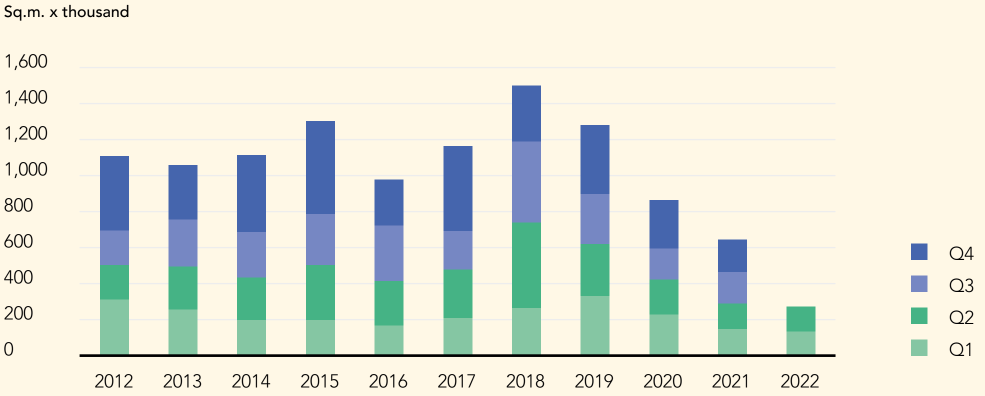
Investor appetite seems to favour better office locations. Prime yields in the top central business districts (i.e. Amsterdam), the secondary CBDs in the G5 (i.e. Rotterdam) and major provincial cities all saw a slight increase in Q2 2022. This yield shift seems to be a reaction to rising interest rates. Climate change, a push towards energy efficiency and potential green premiums are currently driving investor interest towards sustainable and modern offices, which are often located in the major cities. This shift is likely to become more apparent in the rest of the year, favouring prime yields in the prime G5 segments.

Table 1 Market indicators

Market indicator	Q2 2022	q-o-q growth	1-year growth	3-year growth
Average rent / sq.m.	€140	0.0%	0.0%	12.0%
Average G5 IC prime rent / sq.m.	€ 332	2.5%	5.2%	6.4%
Prime rent / sq.m.	€ 485	2.1%	6.6%	10.2%
Stock NL sq.m.	46,250,000	(1.4%)	(3.7%)	(3.7%)
Take-up NL sq.m.	137,400	2.3%	(4.1%)	(52.4%)
Vacancy NL sq.m.	5,013,329	(3.0%)	(8.9%)	(12.6%)
Vacancy rate NL	10.8%	(0.2%)	(0.6%)	(1.1%)
Vacancy rate G5 Intercity	4.9%	(0.5%)	0.1%	0.3%
Prime yield – Prime CBD (Zuidas)	3.1%	0.1%	0.1%	(0.1%)
Prime yield – Secondary CBD G4	4.2%	0.3%	0.2%	(0.1%)
Prime yield – Major provincial cities	5.3%	0.3%	0.1%	0.1%

Source: CBRE, 2022

Figure 6 Take-up of Dutch office space



Source: CBRE, 2022

Outlook

Hybrid working will likely become the norm; corporate real estate strategies in focus. Going forward, office occupiers will likely focus more on the appeal and comfort of the work environment; an attractive office might well become an advantage in the war on talent. New supply of office buildings will be scarce due to rising building costs and challenges surrounding nitrogen emissions.

The Dutch government's sustainability ambitions for offices include for them to achieve energy efficiency label C as a minimum before 2023. Some obsolete office stock, characterised by its advanced age and poor accessibility, will likely be transformed in the future while some stranded assets will be structurally vacant. In contrast, market rental growth is more likely to be achieved in the most sustainable office buildings.

Investors are hesitant to acquire office assets due to rising debt costs and the worsening economic climate. As prices are yet to reflect this sentiment, investors are likely to seek out safer havens in the office market. In the Netherlands, these office locations are often situated in mobility hubs in the G5 cities that match the changing needs of tenants.

Science parks

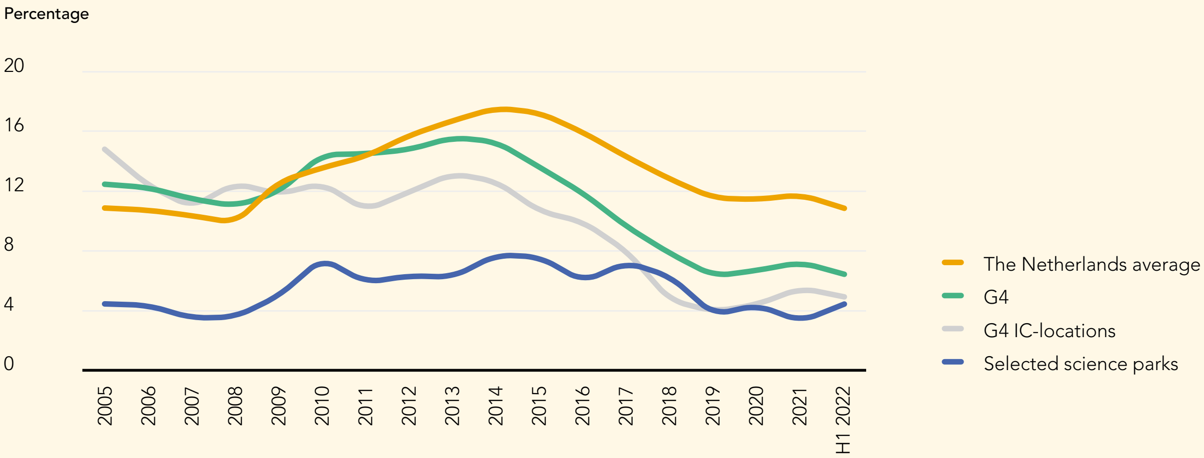
The long-term potential of the fundamentals of the knowledge-based economy has led to increased investment interest in real estate on Dutch science parks. Business cases of new real estate developments and start-ups are under pressure due to rising costs and limited liquidity respectively.

Market evidence is currently lacking for the downturn of the momentum of the science park asset class, as supply is tight and vacancy remains low. Due to the specialist nature of the work people do at science parks, the impact of the pandemic on the vacancy rate was limited. Vacancy rates remained relatively stable at a.s.r. real estate's selected science parks as jobs continued to be created and companies continued to grow. By mid-2022, **the vacancy rate of the selected science parks had increased** slightly compared to the year before, **but it was still lower than the most sought-after office submarkets in the Netherlands**, i.e. G4 locations near intercity (IC) railway stations. In a period of a declining stock on the traditional office market due to transformations, **office stock at science parks grew sharply**. To compare, office stock at G4 IC locations five times outnumbers the stock at the selected science parks.

Although vacancy rates increased slightly but remained relatively low, it can be concluded that stock could not keep up with growing spatial demand, despite a steady supply of additions.

The appeal of the Netherlands for international students has been underscored by the growing influx in recent years. Between 2016 and 2021, the number of international students increased from 41,000 to almost 80,000. The international talent pool further strengthens the competitive advantage of the knowledge-based economy and attractiveness of Dutch science parks. However, some universities and colleges are now warning foreign students that they should hold off on travelling to the Netherlands if they have not managed to find housing before their arrival, the reason being a major shortage of student housing. There are not enough residential units to accommodate both foreign and Dutch students near campuses. Recent figures show that 24% of international students were still in the Netherlands five years after their graduation, which stresses the importance of accommodating international students through housing, guidance and integration.

Figure 7 Office vacancy rates in the Netherlands, G4 and selected science parks[1]



Source: CBRE, JLL, 2022

1 The selected science parks consist of 19 science park locations situated near universities, university medical centers or large corporates.

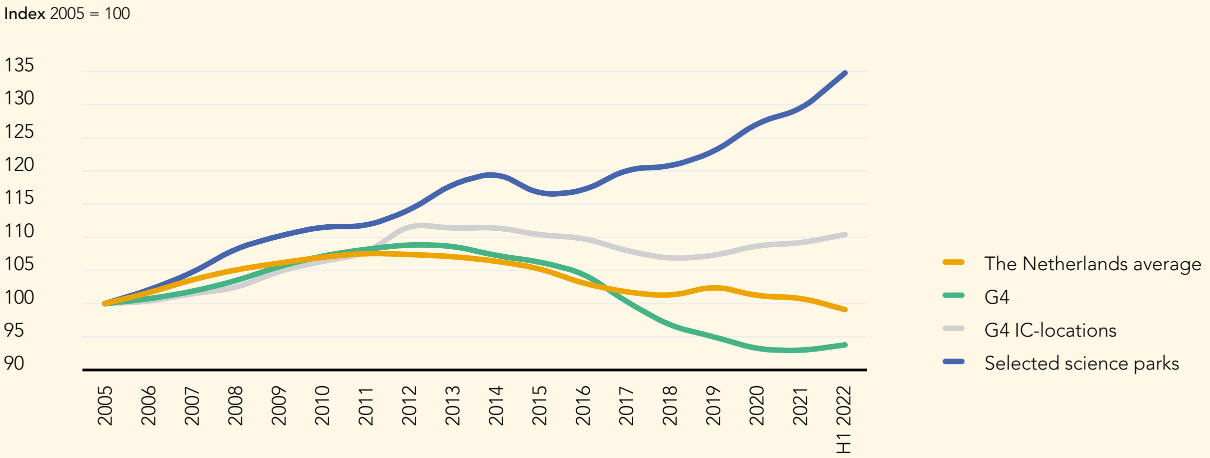
Outlook

The hybrid working trend is having a limited impact on science park real estate. R&D facilities often require on-site presence and jobs they create are of a specific nature. They require an environment that cannot be recreated at home.

In the short-term, rising debt costs are likely to shrink company investments, most importantly in innovation. Additionally, they will impact the financing scope of venture capitalists. For science parks, fewer company investments might lead to the potential failure of start-ups, which will result in fewer jobs, limit spatial demand and an increase in vacancy rate. However, in relative terms, large corporates are still creating most of the jobs at science parks.

Looking forward, because of the specialist environment, science parks are expected to continue to attract technology-based businesses including both university and corporate spin-offs, which means that spatial demand will continue. The long-term potential of the fundamentals of the knowledge-based economy and the spotlight on life sciences in particular tell us that science parks are expected to remain attractive investment opportunities.

Figure 8 Office stock development index in the Netherlands, G4 and selected science parks[1]



Source: CBRE, JLL, a.s.r. real estate, 2022

1 The selected science parks consist of 19 science park locations situated near universities, university medical centers or large corporates.

Farmland

The transition of the Dutch agriculture sector towards a sustainable sector continues. In the meantime, there is still a lot of uncertainty about the nitrogen problem despite Remkes' directional advisory report. In addition, the Europe commission is also adopting a stricter stance regarding the Dutch agricultural policy. All these challenges should lead to a more adaptive agriculture sector with a clear long-term outlook for the sector.

The Netherlands has reached agreement with the European Commission on the National Strategic Plan (NSP). This NSP describes how the Netherlands will implement the new Common Agricultural Policy (CAP) from next year onwards. In the coming years, farmers will receive more targeted support for initiatives that contribute to a future-proof and innovative agriculture that is in harmony with nature, the environment and climate. Between 2023 and 2027, around € 4.7b will be made available to Dutch farmers in this context.

Piet Adema was appointed as the new Minister of Agriculture, Nature Management and Food Quality (Dutch acronym: LNV). He has succeeded Henk Staghouwer, who resigned immediately after the summer recess because, on reflection, he felt that he was 'not the right man for the job. Mr Adema's most important task will be to develop a new perspective for Dutch agriculture as a sector in the face of the nitrogen crisis.

The European Commission has approved the new derogation decision for the Netherlands. This means that, with effect from 2026, Dutch farmers will no longer be permitted to apply more manure than 170 kg per hectare. For dairy farmers, this implies that they have to remove excess manure and buy fertiliser. The Dutch government has reserved an amount of € 130m for financial compensation during the transition period.

Nitrogen mediator Remkes presented an advisory opinion to the Dutch government outlining the way forward in the nitrogen impasse. One of the main recommendations is to tackle businesses that emit the most nitrogen emissions; this means that far-reaching measures will have to be taken for 500 to 600 farms within a year. As a result, intensive livestock businesses in the Gelderse Vallei' and the Peel areas in particular will have to downsize, relocate, discontinue or clean up their operations as a matter of priority. They will qualify for government compensation. The national goal to halve nitrogen emissions by 2030 remains intact, but there are options for local customisation. Mr Remkes recommends introducing two more 'gauge years' before 2030, 2025 and 2028 to monitor the status of the nitrogen targets. In the coming quarters, it will become clear what actions the sector and government will undertake.

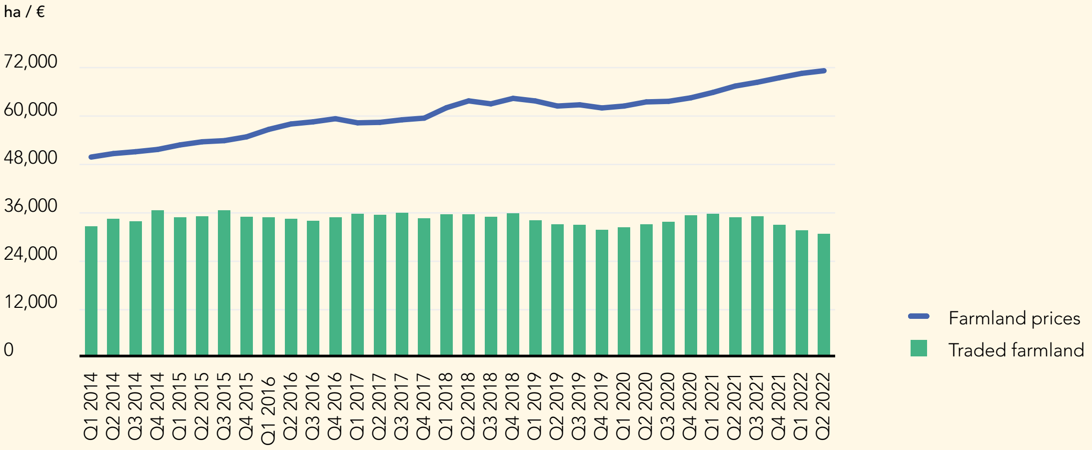
Prices of farmland are still going strong; the number of farmland transactions is declining. At present, the average price of farmland (12-month average) is approximately € 71,100 per hectare, with prices for arable farmland landing at € 78,800 per hectare and grassland at € 63,600 per hectare. Compared to the average price of farmland in the same period a year ago, farmland prices have increased by 5.7%. While prices are increasing, the number of transactions declined by 12% to approximately 30,500 traded hectares on an annual basis. The uncertainty about policies and the economy is causing some restraint in the farmland market.

Table 2 Farmland market indicators

Market indicator	Q2 2022	q-o-q growth	1-year growth	3-year growth
Export of agriculture goods (in millions)	€ 29,226	8.9%	14.0%	26.5%
Farmland (12-month average)	€ 71,123	0.9%	5.7%	14.1%
Traded hectares (12 month)	30,534	(2.7%)	(11.7%)	(7.2%)
Available farmland (in ha)	1,811,910	0.0%	0.0%	(0.2%)
Number of agricultural farms	52,110	0.0%	0.0%	(2.1%)

Source: Kadaster, Wageningen Economic Research (WER), 2022

Figure 9 Farmland prices & traded farmland 2014-2022



Source: Kadaster, Wageningen Economic Research, 2022

Outlook

For the coming quarters, the outlook for the agriculture sector remains positive, but there are some challenges to overcome. There is still considerable uncertainty about how the pandemic, the situation in Ukraine and the economy will develop during 2022 and beyond. Based on the current economic outlook, the pressure on commodities and energy prices is still very high. For the agriculture sector, this means higher output prices for products in combination with increasing shortages of animal feed and fertiliser, which will raise the costs of production.

The nitrogen issue is still causing a lot of controversy in the Dutch agriculture sector. It remains to be seen to what extent Mr Remkes's advice will be implemented. In the coming months, it should become clear in which direction the future of agriculture will develop.

Meanwhile, the transition will continue and it is clear that the farmland market will become more dynamic. The same holds true for the business development of agriculture firms and the demand and need for financing.

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