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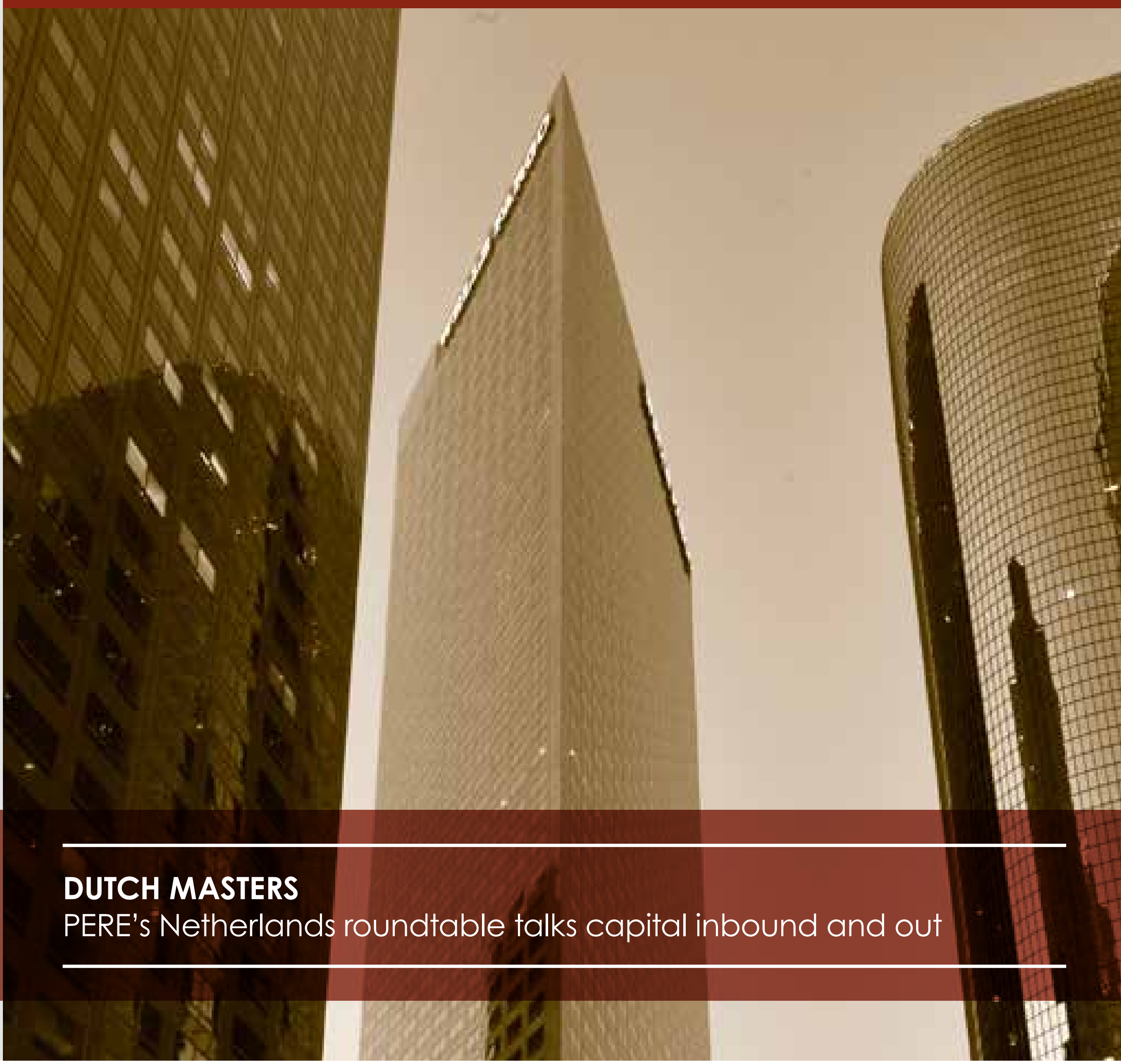
FOR THE WORLD'S PRIVATE REAL ESTATE MARKETS



DUTCH MASTERS

PERE's Netherlands roundtable talks capital inbound and out

Europe's late recovery story

The Dutch economy has outperformed many of its European neighbors over the past year, leading many institutions to return to its property market. By Stuart Watson

Photography by Bas Westerbeek

(L to R) Peter Helfrich, Marleen Bosma-Verhaegh, Tinka Kleineand Arie Hubers

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These are unsettled times in European politics. A weak recovery and the influx of refugees has led many people to call into question the validity of the European project of "ever closer union". The potential for a British withdrawal from the European Union, or "Brexit", if Eurosceptics prevail in a referendum slated for June 23 currently casts a particularly long shadow.

As the participants met on April 5 for *PERE*'s Netherlands roundtable the Dutch were preparing to vote in a plebiscite of their own, having been invited by their government to give their opinion on an EU-Ukraine treaty on closer political and economic ties. When the result was published two days later it illustrated that anti-EU sentiment is not restricted to the UK alone. Only 32 percent of the electorate turned out, but, of those who did, 64 percent voted against the treaty.

PERE gathered four leading Dutch property professionals to consider both how the big European political picture will impact real estate markets and which strategies will best serve foreign and domestic investors in the country.

Peter Helfrich, head of German fund manager Patrizia's Netherlands operation, spoke on behalf of foreign capital. He was joined by representatives of two Dutch pension fund managers: Tinka Kleine, a director in the private real estate investment team at PGGM, and Marleen Bosma-Verhaegh, head of research at Bouwinvest. Arie Hubers leader of the real estate finance team serving corporate clients at Dutch bank ING, completed the quartet.

UK opinion polls suggest that opinion is currently evenly divided between the leave and remain camps with Brexit very much a possibility. Against that backdrop the impending referendums in Holland and the UK drew some interesting comment from the roundtable participants on the future of the EU.

The European question

Anti-EU sentiment has been gaining ground in the Netherlands as well as in Britain, suggests Helfrich: "Our own vote is less about Ukraine than whether we want to be part of the European idea, or to assert our national identity and be on our own. If you were to have a referendum on EU membership in the Netherlands now I would be surprised if it also wasn't split 50-50," he says.

However, he adds that the desire to defend national sovereignty is balanced by uncertainty over the consequences of leaving the European fold. "That is probably going to drive the vote at the end of the day. The fact that you know what you have, but you don't know what you're going to get."

PGGM's Kleine believes the UK is likely to vote to remain: "From this side of the North Sea, it is hard to believe there will be a vote for Brexit because at the moment they have the best

Hubers: Brexit possibility causing a pause in investment

of both sides with their own currency and monetary policy," she says.

Hubers says that ING's local team in the UK reports a market at a standstill: "People are just waiting. Nobody knows exactly what a British exit would imply, so they are waiting to see and making up their minds after 23 June," he says.

The prospect of an EU without one of its biggest members is, perhaps surprisingly, not a matter for great consternation among the participants, however: "We are more curious than worried," says Bosma-Verhaegh.

Kleine suggests that while the UK may suffer as a result of Brexit, the business and investment appeal of other countries could benefit. "Overall it doesn't have to be negative if the EU is forced to redefine itself," she says.

If the UK leaves, other countries will examine its fate to gauge if a similar move will ultimately prove to be in their own interest, offers Helfrich: "Everybody will wait and see what happens to the UK because everybody believes that in the short term it will have negative effects, but it could be good in the longer term. We have the example of Sweden and Denmark which didn't join and have been doing very well."

Brexit is not even the most serious threat to the EU's stability, argues Hubers: "Our national bank president has opposed the recent interest rate reduction by the European Central Bank. To me that is a more strategic threat to the EU in the long term than whether the UK stays in. The UK was always in a bit of a solitary position anyway in that it didn't have the euro and I think that in or out we will make it work to some extent. But if the solidarity between the north-western countries supporting southern Europe becomes an issue then the EU could collapse."

A late but steep recovery

The Dutch economy has outperformed many of its European neighbors over the past year: "GDP growth in 2015 was about 2 percent in the Netherlands with a stable and improving forecast. Consumer spending and confidence have improved. Unemployment is stable at around 7 percent. The economy is going OK, especially given where we came from after the crisis," says Bosma-Verhaegh.

"House prices fell 20 percent on average and the Netherlands lagged behind other countries in the recovery of confidence. Our €3.2 billion Dutch residential fund, which is the largest investor in new housing developments in the most dynamic market of Amsterdam, as well as investing in other core cities, achieved capital growth of 8.6 percent last year. That demonstrates how strong the recovery has been."

Hubers explains why the Netherlands was particularly hard-hit by the global financial crash: “We have a very large concentrated financial sector which got hit pretty badly and which has an effect not only on real estate lending but also lending in general. We had a housing market that was very reliant on high mortgages, which reinforced the distress. House prices fell even quicker in the Netherlands than elsewhere. However, we now see that the recovery is also steeper and more robust than it is in the surrounding countries.”

Helfrich adds: “And on top of that we are very much a service-orientated and export driven society as well. We are a late-cyclical country. We went from very much the non-favorite for international investors to very much the hot favorite.”

The Netherlands’ delayed recovery has caused real estate there to appear comparatively cheap in the eyes of international investors when set against sky-high prices in London, Paris and the big German cities.

“There is still relative value,” argues Helfrich. “There is still a lot of international appetite to enter into the Netherlands. In every research report you still read about the wall of capital coming into the Netherlands, especially for the residential market. International capital is coming from everywhere at the moment. There is really global interest in the Netherlands. Asian investors are accustomed to even much lower yields so in their view it looks cheap.”

Domestic fund managers are refreshing their portfolios and selling off assets. “It is a good time to sell the assets that you don’t believe in,” says Kleine. “Fund managers that raise Europe-focused funds have to fill their programs and they get a little bit more yield in the Netherlands for the same risk.”

One factor which deters international investors from buying real estate in the Netherlands is the limited size of the market. The country has a population of fewer than 17

Helfrich: Netherlands a hot favorite with international investors

Arie Hubers

Managing director
ING Real Estate Finance, corporate clients

Hubers has led the ING Real Estate finance team serving listed and institutional clients in the Netherlands since 2011. His 20-strong department is responsible for a €3 billion loan portfolio across the retail, residential, logistics and office sectors. He joined NMB Bank, one of ING’s predecessors in 1989, holding various positions in wholesale banking before becoming involved with real estate finance 18 years ago.

Marleen Bosma-Verhaegh

Head of research
Bouwinvest

Bosma-Verhaegh joined Bouwinvest, a Dutch institutional real estate investment management business with €7.5 billion assets under management, in March this year as head of research. Before joining Bouwinvest she was responsible for international property investments and strategic client advisory at pension and investment manager Blue Sky Group in the Netherlands.

Tinka Kleine

Director, private real estate
PGGM

Kleine is a director in the private real estate investment team at PGGM. She joined the Dutch pension fund, which manages pension assets worth €183 billion, in 2006. She has previously worked as asset manager at a Dutch residential company and as real estate securities analyst at SNS Securities.

Peter Helfrich

Managing director
Patrizia Netherlands

Helfrich took charge of Patrizia’s Dutch business when it was founded two years ago. Since then the listed German real estate manager has built up a portfolio of assets in the Netherlands valued at €1.1 billion. He has 20 years’ experience in the European real estate market and has previously held positions at CBRE Global Investors, ING Real Estate Investment Management and Jones Lang LaSalle.

Kleine: Circumspection among Dutch pension funds is leading to more domestic investing

million people and there are not many assets available which meet big funds' requirements in terms of lot size. Many of the deals done by foreign investors have been for portfolios rather than individual properties.

Has the market already peaked? Helfrich responds: "Sentiment is a little bit lower than it was half a year ago. Both investor and consumer sentiment have plateaued already. From a risk perspective that is a good thing. Everybody is a bit wary so they are cautious where they invest."

The explanation for the slight diminution of confidence lies in international trends, suggests Hubers: "Optimism is fading a bit. Interest rates are artificially low and it looks like they will be for some time, but what happens if they have to rise? That is a factor people are getting more nervous about. There is also the geopolitical turmoil at the borders of Europe making people a bit nervous, combined with potential Brexit. The cocktail of all these factors makes me more cautious than a year ago," he says.

Limiting the downside

Despite the strength of the recovery the downturn remains fresh in the memory of many real estate professionals in the Netherlands. Institutional investors are still adopting a cautious approach, says Bosma-Verhaegh: "Before the crisis, returns soared and you had to meet total return targets to keep up with your peers. With the current extremely low interest rate levels and monetary stimulus, there is much more attention being paid to risk and the potential downside – do not leverage too much and focus on quality. Keep an eye out that your portfolio is sufficiently diversified and stay with core assets to limit the potential downside in the future. These are the focal points of our strategy."

Dutch pension funds have historically been happy to buy outside their small home market, but the atmosphere of circumspection is prompting then to look closer to home, says Kleine. "We are multi-client and we are discussing with a few new clients how to integrate their portfolio in our global portfolio. It is scary for them even though the return from our global portfolio has been great – better than the Dutch one. They are considering doing it, but there is also a hesitation to let go."

Hubers says that lenders are not getting carried away either: "Banks are offered a lot of liquidity by the ECB and you have to do something with it. On the other hand, lessons have been learned from the crisis. Banks are not that aggressive in going up the risk curve in their real estate lending. Loan to value ratios are not increasing. The competition is more on margin, but we are nearing the bottom of that to a certain extent. The all-in cost of debt is at a historic low in the Netherlands although it is still a tad higher than in France, Germany and

Bosma-Verhaegh: mixed moods in the Dutch retail market

the UK because it is a smaller market with less competition."

Residential takes center stage

For the past two years, the residential sector has been the poster child for the Dutch property investment market with a string of big portfolios sold to foreign investors (see box out). Patrizia has been one of the biggest purchasers as it seeks to build up scale quickly.

Helfrich says "We have been buying existing, but we are very interested in buying newly-built as well. We have an appetite for housing now and also an appetite for housing in the next ten years, especially for major separate accounts who like to add something to their portfolio every year."

Foreign buyers entering the development market will compete with domestic fund managers like Bouwinvest, which have hitherto concentrated on forward-funding the construction of new rented housing.

"During the downturn we maintained relationships with developers and signed deals that are now paying off. We acquired newly built residential real estate with a total value of €470 million in 2015," says Bosma-Verhaegh. "We see great demand in the private rental sector and supply is lagging that market appetite.

"We have invested in new areas of Amsterdam and elsewhere and we are thinking about new concepts to meet the demand from the increasing number of smaller households. For example, Bouwinvest is thinking about a 'Friends' concept, like the US TV series, with single people sharing housing in Amsterdam. But different new formats for elderly people are also a focus point, driven by the Netherlands' ageing population."

PGGM is seeking to bring its experience of the residential sector to bear in another fast-developing market, the UK. In January, it joined British pension fund manager Legal & General in a £600 million (€755 million; $854 million) joint venture to develop private rented housing in the UK: "The mid-price sector that we know very well is very undeveloped in the UK and we can copy what we have done in the Netherlands and the US, producing the residential product that we like and keeping it for a long period of time," says Kleine.

Tipping point

"Residential has been a big focus of activity in the Dutch market over the last few years. Now it's the turn of retail and offices, which are also producing solid returns," says Bosma-Verhaegh. "In both sectors it is essential to have deep local knowledge as these markets are characterized by strong polarization in the quality of assets. The spread between the future potential of good and bad assets has rarely been higher."

Much of Amsterdam's new office space is located in the

Social life

Dutch social housing reform creates opportunity for investors

Until 2014, Dutch residential real estate was a comparatively sleepy sector. The country's large housing associations dominated the rented sector, controlling three quarters of the total stock. Meanwhile, investment activity in the private rented sector was mostly limited to domestic funds and local private investors.

That began to change when the Netherlands' largest social landlord Vestia, which owned 90,000 homes, ran into financial difficulties in 2012 threatening the whole social housing sector with collapse. Soon the Dutch government was taking steps to rein in housing associations which were believed to have over-reached themselves.

Legislation was introduced to open up the market to the private sector by restricting housing associations to providing low-cost homes only. Meanwhile, rent controls have been relaxed so that well-off tenants will be expected to pay more.

Patrizia's Helfrich says: "We were looking for a substantial portfolio when this whole liberalization of the market started two and a half years ago. Vestia was in financial trouble so they had to sell a major part of the portfolio and that is where we went in." In July 2014, Patrizia acquired 5,300 homes from Vestia at a price for €550 million.

Four months later, US investment manager Round Hill Capital purchased €365 million of property from social landlord WIF and further portfolio sales have followed as international investors wake up to the opportunity that the rapid expansion of the Dutch private rented residential market represents.

Not all of the sellers have been housing associations.

Vestia: its financial strife lead to private investment opportunities for others

Domestic funds have also looked to cash in on the sector's increased popularity. In 2014, Bouwinvest disposed of €100 million of residential property to Aventicum Capital, a joint venture between Qatar Holding and Credit Suisse.

The latest big transaction was concluded in March as Patrizia bought a portfolio of 1,275 residential units mainly located in the Randstad from fund manager Holland Immo Group for €152.5 million. Patrizia still has an appetite for more: "The problem is about where you find it and for the right price and that is something that keeps us busy all day," says Helfrich.

PGGM's Kleine concludes: "If you want to invest at scale in residential in Europe there is Germany and the Netherlands and that's about it. Traditionally the Dutch residential market has been a very good place to invest. Foreign investors have now discovered that as well."

South Axis, a district of high-rise glass towers outside the city's historic center. German funds have dominated the investment market there in recent years. The most recent big deal, saw The Edge, billed as the world's most sustainable office building, bought by another German investment manager, Deka.

Kleine explains why PGGM chose not to bid for the asset despite having expressed a strong preference for sustainable buildings: "We prefer to invest in an asset like the World Trade Centre in the South Axis because it is better located in the transportation system and it is a flexible multi-tenant building suitable for different types of tenants. The Edge is not in the best location if you want to be on the South Axis and it is a single tenant so there is a greater risk."

Having a single tenanted building might be seen as an advantage for a foreign investor because it requires less operational management, counters Helfrich. "And don't underestimate the volume part. You get foreign investors who want to buy a building of at least €150 million. How many buildings do you get like that in the Netherlands?"

Dutch funds preference for spreading the risk among multiple tenants may be partly explained by the fact that the country's office market has been plagued by high vacancy. That is still the case, but the attendees argue that much of the space remaining on the market in out of town business park locations for which there is no occupier demand is now effectively obsolete.

Positive sentiment: the future looks bright for Dutch real estate

There is a consensus that a tipping point has been reached where the value of the offices on some sites has declined so far while residential values have risen so high that redevelopment of some sites for housing may soon become possible. Helfrich says: "If you compare the office stock with the current demand from occupiers you see that there is a clear mismatch. It took a long time for investors to realize that this was driven by structural change and much less by business sentiment. That is where the transformation starts, led by investors who believe that there is no value in waiting for an occupier to come there after seven or eight years. When values get at or below replacement values then things get interesting."

Redevelopment and change of use are important strategies for the two Dutch funds present at the roundtable: "We see a lot of potential in the redevelopment of existing buildings to change their function and convert them into residential and mixed-use concepts," says Kleine. "The Netherlands has a reputation for having one of the highest office vacancy rates in Europe, but the rate of conversion of old offices into residential and hotels is very impressive."

Meanwhile, Bouwinvest is converting the two historic Citroen showroom and garage buildings which lie next to Amsterdam's Olympic stadium into a 269,000 square feet mixed-use scheme including offices, retail and hospitality space.

Retail hard to read

The retail market in the Netherlands is also undergoing structural change. "It is a hard market to read. We have seen a lot of bankruptcies in the retail chains especially in the last quarter. I think to a certain extent that has surprised the market," says Hubers. The country's largest department store chain, Vroom & Dreesman announced its bankruptcy at the end of 2015.

One of the most notable events of the year so far in the retail market was the cancellation of a deal under which Amsterdam-based asset manager Syntrus Achmea would have purchased €1.2 billion of high street shops from Dutch retail magnate Ronny Rosenbaum. Nonetheless the fund managers around the table are all positive about making acquisitions.

"That was a good indication of the mixed moods in the current market," argues Bosma-Verhaegh. "Some parties want to sell because they are very bearish about their high street retail portfolio and then suddenly six months or a year later they want to keep it because the sentiment has changed so much. You now see a lot of takeovers of the chain stores that have gone bankrupt and then are revitalized by the new owners or brands. We also see a move away from falling rents and short-term contracts. Last year was positive. But there is a strong polarization in the market, so only retail locations that benefit from the "convenience" and "experience" shopping factors will be the winners in the future."

In October, Patrizia acquired a €340 million portfolio of mainly prime high street retail properties. "There are maybe three or four substantial prime high street retail portfolios in the hands of high net worth individuals in Holland," says Helfrich.

Because the nature of demand in the market is changing so fast Kleine calls this "an extremely interesting time for the retail sector". She adds: "Being at the right location and being able to invest in your assets is more important than ever."

Retail is currently the largest asset class within ING's real estate loan book in the Netherlands, but Hubers says that in the year ahead the bank would like to increase the proportion of residential and logistics property in its portfolio.

Logistics is also a favorite sector for PGGM, says Kleine. Optimizing the Dutch portfolio and backing urban redevelopment projects are also on the agenda for 2016-17. Meanwhile Bouwinvest will also focus on acquiring newly built real estate and redevelopment, particularly in areas of Amsterdam and other Dutch cities that are in line for urban renewal. Helfrich says Patrizia will be "very much still on the buying side" for offices, retail and residential property.

The immediate future looks bright even though the Netherlands is no more immune than any other European market to the sense of unease that pervades the continent. Real estate investors will continue to be attracted to a country offering decent economic performance together with a bit more yield than Europe's bigger property markets. □