



foreign capital and **Dutch real estate**

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Summary

2014 was an exceptional year for investments in Dutch commercial real estate. More than 9 billion Euros was invested, compared with 5 billion in 2013 and 4 billion in 2012. Noteworthy were the transactions by, amongst others, PATRIZIA, Lone Star and Round Hill Capital, that together accounted for 1.7 billion Euros. Though foreign investors in the Dutch market are not a new phenomenon, there are clear changes afoot.

Our analysis shows that compared to other countries the Netherlands is currently attracting a lot of interest from foreign investors. This is mainly due to the attractive property valuations and the risk premium (the difference between the initial yield and the interest rate on 10-year government bonds) of 5.7%. Investors also benefit from the lending that began to pick up last year.

Over the past two years, foreign investors have mainly invested in opportunistic investments such as non-prime office portfolios and residential portfolios. ABN AMRO expects foreign parties to remain prominent players on the Dutch market in the coming years. Dutch real estate provides an attractive yield and the prospects for the credit market are positive. In addition, several players have indicated that they want to build up a large Dutch property portfolio.

Foreign investors offer opportunities for Dutch parties. They create additional liquidity, in particular in the market for non-prime office properties. And add value to current stock by addressing vacancy rates and investing in properties so that they are once again modernised. Finally, they are essential for the transformation of the housing market into one where housing associations are less dominant and there are more opportunities for commercial landlords. The moment housing associations begin to sell property on a structural basis, they will have a crucial role to play.

The dialogue with foreign investors offers opportunities for Dutch parties to come to transactions and enter into partnerships. Dutch parties have invaluable knowledge to offer that is essential for operating successfully in the Dutch market. Both in the area of transactions and of managing the portfolio.





1. A changing market dynamic: predominantly Anglo-Saxon interest

In the period 2004 - 2012, the Dutch commercial property market was dominated by Dutch investors. They were responsible for 70% of acquisitions. German investors made 14% of acquisitions, investing predominantly through open and closed funds in the office market. But investor demand over the last two years has shifted from domestic to foreign parties, and in 2013 and 2014 foreign investors were responsible for 66% of the total investment volume.



Figure 1: Share of domestic and foreign investors in total investment volume in The Netherlands (source: JLL)

Figure 2 shows how the composition of this group has become more diverse. The growing proportion of Anglo-Saxon investors is striking. They were responsible for no less than 30% of the total investment volume during this period. US investors, such as Blackstone, have discovered the Dutch market, making up 23% of the investment volume over the past two years. Investors from the UK, too, such as Round Hill Capital, play an increasingly important role.

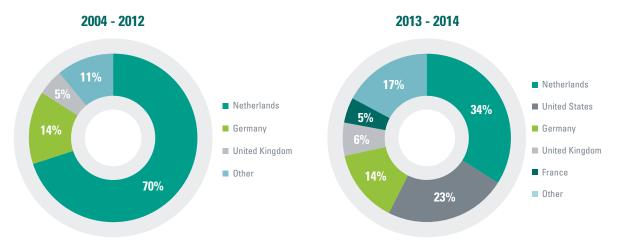


Figure 2: Origin foreign investors, period 2004 - 2012 en 2013 - 2014 (source: JLL, ABN AMRO)

The Anglo-Saxon investors are active across the entire commercial real estate market. What sets them apart is that they have a clear exit strategy, for example an IPO. Blackstone, for example, floated several foreign portfolios last year.



2. The Netherlands compared with other European countries

In the past two years, foreign investors have accounted for some 66% of the total transaction volume in the Netherlands. Figure 3 shows that this percentage is the highest in Europe over this period.

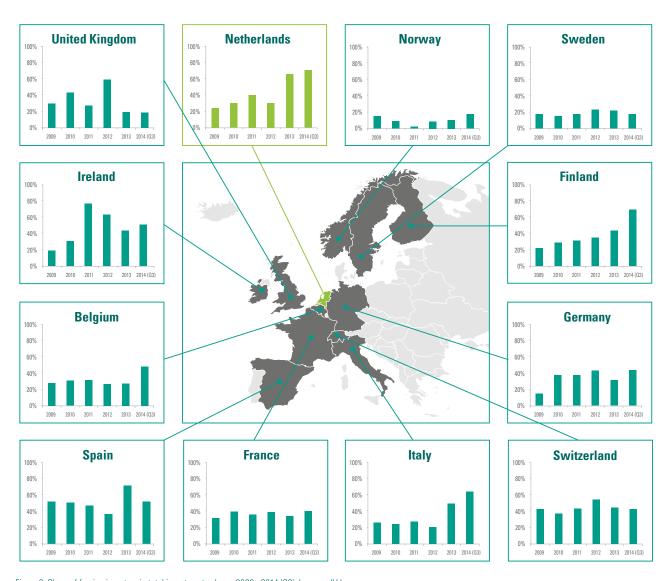


Figure 3: Share of foreign investors in total investment volume, 2009 - 2014 (Q3) (source: JLL)

We can divide these countries into three groups. Countries in which the share of foreign investors in the total transaction volume 1) grew 2) remained the same, or 3) decreased. Finland, Italy and Spain belong to the first group. Foreign investors dominate the market here. In France, Germany and Switzerland, the share of foreign parties remained about the same. Their share continues to fluctuate around 40%. The UK and Sweden belong to the group where the share declined in recent years.



If we look at the three most important countries in Europe for real estate investments in terms of volume, we see that the UK is the largest market for foreign investors. Of the 125 billion Euros invested, some 24 billion was by foreign parties. The German market is around 56 billion and the French 29 billion Euros, with the share of foreign investors at 21 and 11 billion Euros respectively. As we see in Figure 4, in all three countries domestic investors are responsible for most of the transactions volume.

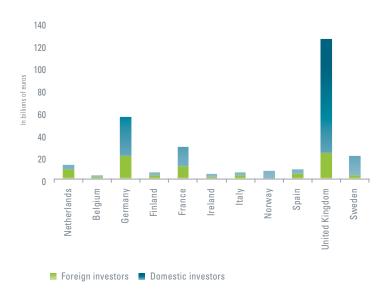


Figure 4: Investment volume, 2013 - 2014 (Q3) source: JLL, DTZ and CBRE)

ABN AMRO expects foreign investors to remain prominent on the Dutch market. Several players have said they want to build up a large Dutch residential property portfolio. And the projected structural sales of housing corporation stock will give them opportunities to do so. In addition, due to the attractive yield, they will continue to look for opportunities in non-prime real estate. Opportunistic parties who in recent years have invested heavily in greatly devalued real estate will tend to look to other markets once the price of Dutch real estate starts to recover.



3. A comparison of countries with devalued real estate: the Netherlands extremely attractive

There are several factors that influence the interests of investors in commercial real estate in a given country. In particular the risk premium, the difference between the initial yield and the interest rate on 10-year government bonds, is an important factor. In a climate of low interest rates, hardly anything is earned on bonds. So in their quest for yield, investors will turn to real estate. Another important factor is the ability to finance real estate with debt. A well-functioning credit market is essential.

Since the financial crisis, the European commercial real estate market has been under considerable pressure. Disappointing economic growth and limited access to credit caused a decline in demand from both users and investors. During this period the real estate markets in Ireland, Italy, Spain, the United Kingdom and the Netherlands have been severely affected. Although each market has its own particular dynamics, it is interesting to compare how the valuation of real estate in these countries developed.

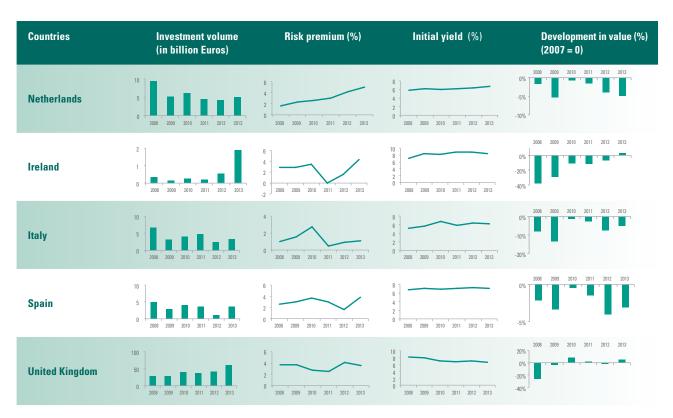


Figure 5: Comparison real estate markets Netherlands, Ireland, Italy, Spain, United Kingdom (source: IPD, JLL, DTZ)

Ireland

Irish real estate has seen the greatest devaluation. On average, the value has decreased 16% per year over the period 2008 to 2013. In the past two years, the interest of foreign investors has increased significantly, though the annual investment volume is still the lowest of the countries analyzed. Ireland offers the highest yield in Western and Southern Europe of 8.4% (2013)*. Since 2011, the risk premium has risen sharply in the market from 0%** to 4.2% in 2013.

^{*} This is the reported initial yield according to the benchmark (IPD). This is the average across all asset classes of institutional portfolios.

^{**} The yield on 10-year government bonds was 8.8% in 2011, equal to the initial yield.

Italy

In the same period, the Italian market has seen an average devaluation of about 2% per year. At 7.1% (2013), the initial yield is very attractive. The risk premium has risen sharply from 1.6% in 2012 to 3.8% in 2013. The annual investment volume is most closely comparable to the Spanish real estate market. Following a low in Italy of 1.1 billion Euros in 2012, this rose to 3.6 billion Euros in 2013.

Spain

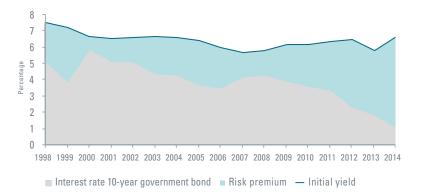
In Spain, the depreciation of real estate between 2008 and 2013 averaged almost 7% per year. The initial yield was 6.1% in 2013, the lowest of the five countries. Since the risk premium was 1%, the return on investment in real estate was virtually the same as from investing in bonds.

United Kingdom

In the UK, we can see that a rapid correction took place. In 2008 and 2009 there was a devaluation of 26% and 4% respectively. In 2010, the market picked up again, with the value of real estate rising by over 8%. In that same year, the investment volume picked up again, rising almost 50%. The speed with which the devalued property and investment volume recovered was unique within Europe. The initial yield was 6.7% in 2013.

The Netherlands

The Dutch market has seen a considerable devaluation. Between 2008 and 2013, the value fell on average by 3% per year. In 2013 and 2014 the demand from investors rose sharply. Of the countries analyzed, the Netherlands has the highest risk premium at 5% in 2013. Even rising to 5.7% in 2014. Combined with a high initial yield of 6.6% in 2014, this has created an extremely attractive investment market.



The level of the risk premium on real estate in the Netherlands sets it apart. Investing in commercial property has never before been so attractive relative to government bonds. Now that the bulk of the devaluation in the market seems to be behind us, the Netherlands will enjoy the full attention of foreign parties.

Figure 6: Development of risk premium, 1998 - 2014 (source: IPD and Reuters)





Lending in the Netherlands

Dutch banks are again more actively offering loans. In 2013 the total volume was 3.4 billion Euros, similar to 2012. Given that the number of transactions in the market is increasing, ABN AMRO expects this amount to grow over the coming years.

Foreign financiers also have a dominant presence in major deals. In particular German banks, such as Deutsche Hypo who was involved in the acquisition of the Vestia portfolio. Another important player is the Royal Bank of Canada, which finances Blackstone's deals in the Netherlands (PropertyNL, 2014).

The CMBS is making a return to European and Dutch markets. The Deco Tulip CMBS was recently put on the market for 250 million Euros. This was a combination of a 125 million Euro loan for Dutch real estate of PPF Real Estate (9 offices and retail properties) and a 125 million Euro loan for the acquisition by Mount Kellett and Sectie 5 Investments of the Corio portfolio (11 Dutch retail outlets).

Finally, there are the "non-banks". These are investors who, via a fund or one-on-one via a private placement, provide loans to real estate investors such as AXA and M&G Investments. INREV reported that in 2013 7.5 billion Euros was invested in European real estate funds that invest in loans.



4. Strategies of foreign investors

Foreign investors have their own strategy that determines their acquisition decisions. For more insight into these various investment strategies, we have analyzed the largest real estate acquisitions over a period of two years. Based on the risk profiles of the real estate, the amount of leverage, and the attitude of the investors themselves, we have identified three broad strategies:

- ≫ Core strategy
- >> Value-add strategy
- >> Opportunistic strategy

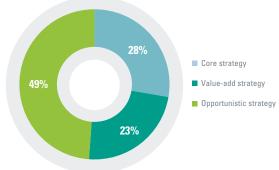


Figure 7: Share of each investment strategy in total investment volume (source: ABN AMRO)

The return on equity is largely determined by four factors. The importance of these factors varies per investment strategy. Which means that not every strategy makes equal use of financial leverage, and that each has its own approach to rent increases.



Core strategy

This strategy is the least risky in nature, and mainly based on the quality and predictability of rental income. The use of debt to finance real estate is often limited, and not more than 40% of the value of the portfolio. These investors are looking for an internal rate of return of between 5% and 7%. This strategy characteristically has a long investment horizon. Generally there is less focus on increasing cashflow, investors being content with indexation. When investing in offices, investors are particularly keen on the Netherlands due to an attractive risk/return ratio compared with other international top locations.

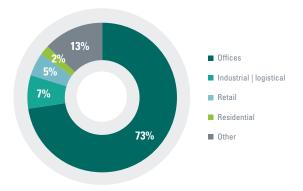


Figure 9: Breakdown investments per asset class, Core strategy

As far as individual parties are concerned, these are predominantly German investors, such as Union and Deka, who mainly invest in offices in prime locations such as the Zuidas and Amsterdam center. The fact that Core investors invest primarily in offices can be explained by the fact that Dutch retail has few prime shopping centres. There is also less legislation in this segment than in residential property. On the selling side, we often come across Dutch developers such as OVG Real Estate (The Edge, Amsterdam) and Van Deursen (The Marquis, The Hague).

Value-add strategy

The Value-add strategy has a higher risk than the Core strategy. There is a clear focus on value growth based on an increase in occupancy rates. Investors make greater use of debt, which is about 60% of the value of the real estate. This strategy should provide an internal rate of return of about 10%. This strategy is suitable for all the various asset classes. The investment horizon varies, but on average investors want to retain an object in their portfolio for at least five years.



Figure 10: Breakdown investments per asset class, Value-add strategy

These are largely listed real estate investors, such as WDP or Unibail-Rodamco, but also includes parties active in the opportunistic area of the market. This is because many of these parties build up a balanced portfolio, to which less risky investments are added. Such a portfolio can be beneficial for a potential sale. Transactions that fall into this category might include the acquisition of a neighbourhood shopping mall or run-of-the-mill office building. Examples include the acquisitions by Unibail-Rodamco in Leidsenhage shopping mall and the acquisition of two offices in Leusden by Moorpark Capital.

Opportunistic strategy

This is a strategy with a significantly riskier character. The emphasis is on achieving indirect yield by improving cashflow, and the acquisition and sale of assets at the right time within the real estate cycle. The aim is to realize an internal rate of return of over 10%, for which investors use a financial leverage. The amount of debt can rise to 70% of the value of the real estate, whereby parts may be provided as mezzanine. The investment period depends on the recovery of the market; or the speed with which value can be added to the building, for example by addressing occupancy rates. Generally, the term is no longer than five years, half the length of an average economic cycle.



In general, this strategy is adopted by investors who do not shun risk and dare to take on problem buildings or real estate with significant vacancy rates. So we see mostly investments in offices, retail and industrial property. However, now that foreign parties using considerable financial leverage are buying up property portfolios, we can see this group as a specific sub-category within this strategy.

Figure 11: Breakdown investments per asset class, Opportunistic strategy

Investors in residential property

These are established international property investors such as PATRIZIA, Round Hill Capital and Heitman. They are looking for large property portfolios, having made this their specialty and studied the complex regulations. PATRIZIA has indicated it wants to build a Dutch portfolio of 1 to 2 billion Euros. Round Hill Capital is also building a substantial Dutch portfolio. These investors offer Dutch parties interesting sales opportunities.

Investors in other real estate

These are mainly Anglo-Saxon parties who are attracted by the high returns due to substantial devaluations. Blackstone is one of the most active foreign players on the Dutch market. They have carried out five transactions in retail, office and logistics properties with a total value of over 600 million Euros. Blackstone is known to have a clear

exit strategy in the form of an IPO. The question remains how the Dutch assets will be sold, as they often are part of a European portfolio. The strategy of Lone Star is similar to that of Blackstone. This American fund manager has an active fund of 7 billion USD and operates mainly in the Opportunistic segment. In the Netherlands, Lone Star has bought up over 340 million Euro in offices, most of which non-prime.



Interview with Round Hill Capital, Tom Hillegers "Profiting from first-mover advantage on the Dutch housing market."

What is the main attraction of the Dutch Residential market for Round Hill and how do you compare the Netherlands to other countries? Round Hill Capital is a strategic investor in European residential property. We initially identified a number of factors (demographic, economic and real estate fundamental) that led us to establish our Dutch residential business. The positive underlying fundamentals in the Dutch residential market, where demand growth is outpacing supply are an important consideration. While this has existed for some time, there has been limited liquidity in the market, which meant until recently we could not create a large enough portfolio to justify the expense of setting up our local business. With the opportunity to be a first-mover as an international investor we believe that we have been able to take advantage of a market opportunity that may already be harder for new entrants to address.

What is your view on the structure of the Dutch housing market? Do you expect the unregulated rental segment to grow, and is this critical for your success?

We understand that one of the key policy goals of the current government is to grow the size of the unregulated rental segment, and this is the reason behind several of the changes in the regulatory environment. On this basis we expect the overall rental housing market to grow, including both the regulated and unregulated segments. We currently manage both regulated and unregulated rental housing. Whether housing is regulated or not, is not the most important investment criteria for us; far more important are traditional real estate factors such as location, state of repair, quality of housing, etc. We consider the growth in the unregulated rental segment not critical to the success of our investments.

How does Round Hill Capital want to add value to the portfolio?

Our primary focus is on the tenants of our properties, who are fundamentally our customers. By operating with a professional management approach we believe that value will be added to our portfolio as a consequence. We believe that we can be most cost effective by establishing our own local business and making sure we can provide services as efficiently as possible. In addition we can make sure that every euro that we spend on improvements or costs provides the maximum benefit for our tenants, and by extension, the value of the portfolio.

How long is your investment horizon and do you have a desired size (number of units or invested capital) of the portfolio? Our fund does not have an explicit end date. We view residential real estate as well suited to a long-term investment horizon. Likewise there is no specific target size for the business. We have the ability to grow so long as we can identify opportunities.

How important is it for Round Hill Capital to work with a Dutch partner?

It has been fundamental to our business case to establish our local business in the Netherlands. We have consistently built local businesses across our investment platforms in other European markets and have determined that this provides a competitive advantage and enables us to correctly judge market dynamics and potential opportunities.



Interview with Lone Star, Jordi Goetstouwers "We aren't strategists, we're tacticians."

With the purchase from CBRE Global Investors of an office portfolio of 32 properties totaling some 300,000 m², the US private equity house Lone Star was last year once again active on the Dutch market. And there have recently been further acquisitions. Jordi Goetstouwers, responsible for Lone Star's real estate investments in the Benelux, offers an insight into the reasons and strategy behind all this activity.

How do you choose between the Netherlands and other European countries?

We have no clear preference for the Netherlands over other European countries. About 5% of our fund of 7.25 billion USD has been allocated to the Netherlands to date. The fund is also active in other countries. We've made major purchases in Paris, for example, where we bought the Cœur Défense, a 170,000 m² building, for about 1.3 billion Euros. In the UK and Ireland we've purchased a number of mixed portfolios for several billion pounds. We continue to seek investment opportunities in the Netherlands, not just large portfolios but individual buildings too, as demonstrated by our recent acquisition of an office building in Amsterdam Sloterdijk hired by GVB (Amsterdam's public transport company).

What's the strategy with the two current portfolios?

When buying, we don't so much look at whether it's prime or non-prime real estate, but at adding value. The focus is on resolving the vacancy issue by improving buildings and offering attractive rents. We're not hampered here by a legacy portfolio containing properties that only have value if they're given a new function. The Lone Star portfolio is first and foremost about investing in user-friendliness and offering an attractive rent.

Are there other comparable players in the market?

Yes, parties like Blackstone, Kildare and PPF Real Estate. The latter two are smaller, but all three adopt a similar strategy. That different parties do employ a similar strategy illustrates the attractiveness of the Dutch market and indicates that there are good opportunities in the Dutch office market. Vendors of buildings also benefit from a bit of competition.

What's your vision for the Dutch market?

Our strategy focuses on adding value to the portfolio and not so much on predicting yields. We realize that the user's market is climbing out of a deep slump, but we believe that it will recover. We're less concerned about the current vacancy rate regarding our own portfolio. It's not the case that every building in the Netherlands is 15% empty. The vacancy rate is largely concentrated in unsuitable buildings/locations. A major part of the occupancy rate can be resolved through redevelopment or reuse.

"Essentially, the difference often lies not so much in the building or location. In many cases, it's about the convenience and costs of the accommodation."





5. The impact of foreign investors: plenty of opportunities for Dutch market parties

Foreign investors are thus highly active in the Dutch market. And given the relatively good economic prospects and attractive commercial real estate market, we expect that they will continue to remain extremely active for the time being. Their presence offers many opportunities for Dutch players. They are vital to the prime segment of the offices market and also buyers of non-prime assets, for which there is relatively little Dutch interest. They add value to the existing stock of commercial real estate, and finally, they play a major role in the development of the residential rental market.

Buyers of prime offices

There are relatively few Dutch investors in top locations such as the Zuidas in Amsterdam, the Beatrixkwartier (Beatrix Quarter) in The Hague or Rotterdam center. Initial yields of up to 6% are often seen as too low by domestic parties. Foreign investors predominate here. These locations benefit from a low vacancy risk and reliable rental, and therefore stable cash flows. Making real estate an attractive substitute for government bonds. This is very interesting for Dutch developers and, going against the general trend, in prime locations new office spaces continue to be developed. For example, over the coming two years more than 70,000 m² will be developed on the Zuidas. Much of this space has already been leased and sold on by developers. What's more, these locations offer plenty of space for redevelopment.



Additional liquidity non-prime portfolios

Foreign investors are increasingly active in non-prime real estate, especially in the office market. This market was still for a long time, but this interest has brought more liquidity with it. This has benefits for existing investors, who can thus free up their capital to invest elsewhere. A good example is the sale of 10 shopping centers by Corio at a discount of 27%. Another transaction being the sale of 32 branches of CBRE GI Dutch Office Fund to Lone Star.

Adding value to existing commercial property stock

Foreign investors add value to existing stock by mobilizing resources or expertise to address occupancy rates, or make a property marketable again. This applies mainly to non-prime real estate. The financial position of the new foreign investor is often stronger. They can also be more flexible about rent to attract new tenants. A lower rent is positive for the owner as it leads to lower vacancy rates. But in the short-term it can be seen as a threat by the owners of neighbouring properties, who are then faced with lower market rents and increased competition. The acquisition of Uni-Invest (now Merin) by TPG Capital and Patron Capital fits into this category, and is an example of an opportunistic investor adding value to the Dutch stock. Following the acquisition Merin had sufficient financial strength to successfully begin recruiting new tenants through lower rents and improved properties.

Pioneering role in the transformation of the housing market

The housing market is on the move. Foreign parties like PATRIZIA and Round Hill Capital offer both Dutch institutional investors and housing associations the opportunity to sell their existing portfolios at favorable prices. There is also the possibility to set up joint ventures. The existing portfolio and management form the basis for further growth, to which foreign investors can contribute capital. So that Dutch parties can benefit optimally from rising prices, while foreign parties can pursue their growth ambitions.



In our opinion, Dutch investors need to start talking to foreign parties in order to arrive at transactions. Or even enter into partnerships, to which the Dutch party will bring their extensive knowledge of the market and the foreign party their financial strength and entrepreneurial drive.



When sales by housing associations get going, foreign investors will be needed.

The Netherlands has 7.3 million residential properties. Housing associations manage 2.3 million of these. 6% of which are private housing properties. Institutional investors manage 140,000 properties and private investors 760,000.

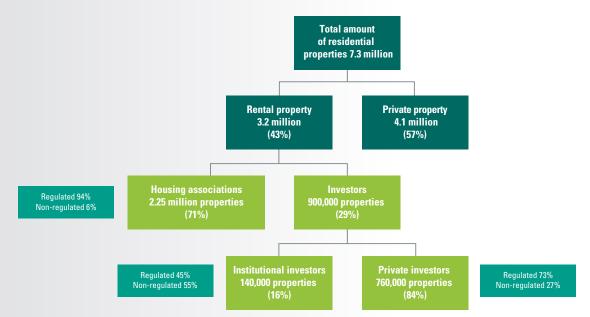


Figure 12: Breakdown Dutch residential property market (source: CBS, IPD)

When housing corporations come under pressure from the new Housing Act and the landlord property charge, and start to sell, there will also be a need for foreign investors. Existing institutional parties won't be able to absorb it all. Moreover, corporations prefer not to accept offers for parts of their portfolio, making it difficult for private parties to absorb these portfolios.

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Sources

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- ▶ IPD
- ▶ JLL
- Reuters

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