

# Real Estate Outlook 2023-2025



Pockets of opportunity flash amid darkening economic outlook

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Sluishuis, Amsterdam

# Pockets of opportunity flash amid darkening economic outlook

The macro-economic outlook for the Netherlands has deteriorated significantly since Russia's invasion of Ukraine in February 2022 and the resultant energy crisis has put the country on a track towards a potential recession in 2023. The war follows hard on the heels of the Covid-19 pandemic which has caused structural shifts and disruptions to supply chains worldwide and led to a surge in e-commerce and working from home (WFH). Inflation is soaring on the back of rising gas, fuel, food and construction costs and recent declines in the values of stocks and bonds have triggered the 'denominator effect' of higher relative institutional allocations to real estate.

Despite the worsening economic conditions, there are still several pockets of opportunity in the Dutch real estate market. Strong demographic fundamentals continue to underpin the residential rental sector as supply falls seriously short of demand, particularly in the mid-range affordable rental segment. The same is true of the healthcare real estate market where demand is growing strongly for more modern and 'needs-based' senior living and care complexes due to the country's rapidly ageing population. More alliances between care institutions, investors and other stakeholders including local authorities, developers, housing corporations and insurers, point to the way forward for tackling the huge task of creating sufficient high-quality care accommodation in coming decades.

Overall demand for office space is expected to fall in the Netherlands now that working from home (WFH) has become entrenched, but rents have been rising on the back of record-low vacancies and higher inflation. While initial yields may ease in the period ahead, supply of the most modern and sustainable offices is expected to tighten further due to stricter minimum requirements for energy performance and regulations for new developments.

High street retail was starting to recover from the pandemic, but pressure is building up again and the short-term forecasts are now significantly less positive. Convenience retail is faring better and the performance gap between 'experience' and 'convenience' retail will widen as market conditions sour. Repurposing of obsolete stores is underway, but more transformations in function are needed to keep vacancy levels in check.

The post-pandemic tourism revival has led the recovery in the hotel market, but clouds are building on the horizon as fears of an economic downturn intensify, while the potential emergence of another Covid-19 virus variant remains a threat. As a result, rising prime yields is on the cards in this sector.

Climate mitigation has, until recently, dominated ESG (Environmental, Social, Governance) efforts in the Dutch real estate industry since the Paris Agreement and is now well developed in regulatory frameworks. Other environmental best practices include circularity and climate adaptation amongst others. The focus on the 'S' in ESG is now on the rise as investors are coming under growing pressure to make a contribution to society by helping resolve problems such as the housing shortage for specific target groups, rising poverty due to inflation and energy price hikes, and the shortage of human resources in specific sectors such as healthcare and education.

A gap is already visible between real estate assets with strong 'green' credentials and those where values are weighed down by a 'brown' non-sustainable discount. We believe that divide will widen as discerning investors, spurred by the current energy crisis, increasingly focus on the ESG characteristics of their investments.



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# Macro-economic developments

## Rising inflation pushes the Netherlands to the brink of recession

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### Executive summary:



Inflation soars on the back of rising gas, fuel, food and construction costs.



An economic recession in 2023 seems increasingly likely due to uncertainty about the direction and duration of the Russian-Ukraine war.



Recent declines in the values of stocks and bonds have triggered the 'denominator effect' of higher relative institutional allocations to real estate.



### Political & economic context

## Energy supply disruptions and rising costs depress economic outlook

Russia's invasion of Ukraine in February 2022 has sparked an energy crisis in Europe and put many countries, including the Netherlands, on a track towards a potential recession in 2023. The war follows hard on the heels of the Covid-19 pandemic which has caused structural shifts and disruptions to supply chains worldwide and led to a surge in e-commerce and working from home (WFH). While the pandemic was gradually controlled in the second half of 2021, energy and food prices were already starting to climb and political sanctions and additional supply-demand imbalances since the Russian-Ukraine war have fuelled inflation further to double-digit figures not seen since the 1970s.

## Inflation soars as cost of fuel, food and construction continues to climb

Key indicators for consumer and producer confidence have trended downwards in the Netherlands in recent months, reaching new depths compared to previous crises. The Netherlands saw inflation rise sharply to more than 10% due to higher food and energy prices and building costs. This compares to an annual average increase of 1.9% since 1995. The Dutch government has announced a plan to put a ceiling on the maximum price of gas for private households and small and medium-sized companies in order to reduce inflation and provide financial aid.

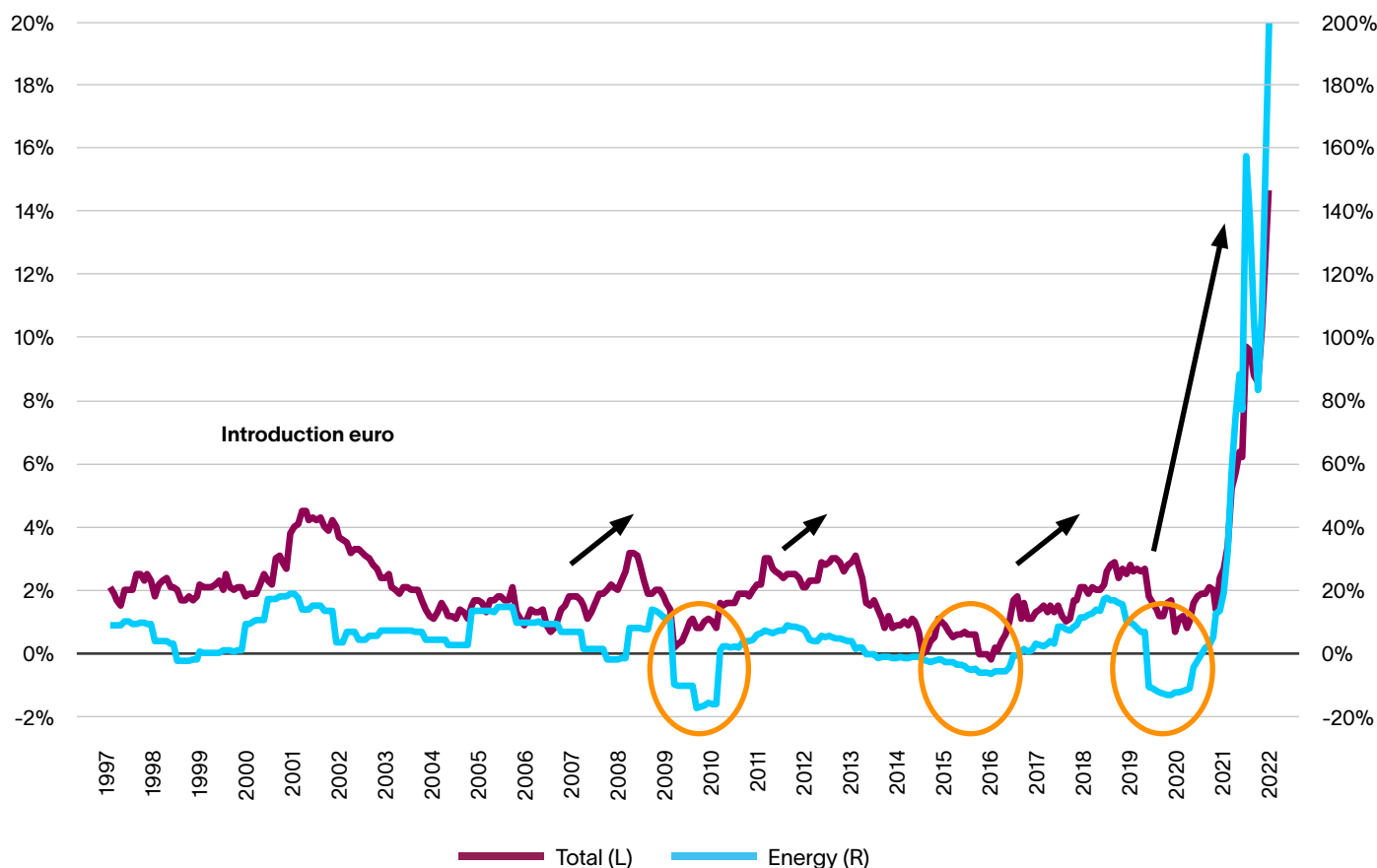
Construction costs - primarily materials and labour - rose by an average 2.3% a year over this period, but almost doubled to more than 4% in 2021. Building materials such as bricks and roof tiles account for the biggest share of construction costs (and have become increasingly scarce as production lines have been halted temporarily due to higher energy prices). The volatility of construction costs largely reflects building material prices, which have been rising sharply.

## Interest rates have kept pace with rapidly rising inflation

The European Central Bank (ECB) has reversed its previous interest rate policy and started raising levels in a bid to keep spiralling inflation under control. After a protracted period of decline during which capital market rates fell to record lows, interest rates have now climbed back to levels approaching those a decade ago. Interest rates in the Netherlands jumped in the first half of 2022 by an average 175 basis points for various durations and yields for 10-year government bonds - a proxy for the risk-free rate - were trending at 2.5% at end-October 2022. Capital market rates have been quite volatile in recent months after the ECB raised rates by 0.50% in July and a further 0.75% in September. Market watchers anticipate further increases to rein in inflation. Central banks elsewhere in the world have also used monetary instruments to tackle inflation.

## Periods of rising inflation are often followed by a recession and decline in energy prices

Source: Statistics Netherlands, adapted by Bouwinvest







### Macro-Economic outlook

## A recession appears to be unavoidable under the baseline scenario

The likelihood of an economic recession in the Netherlands as well as large parts of the rest of the world is increasing as negative news continues to flood in. A short-term solution to the Russian-Ukraine war does not seem very likely and prices of commodities, and gas in particular, will remain elevated. The direct and indirect effects of these high prices are likely to fuel inflation in 2023 as well. On the other hand, supply chain pressures are starting to ease and shipping charges, for example, have dropped significantly. This has a downward effect on inflation but may also be an early indicator of an economic slowdown.

Under the current baseline scenario, we expect a mild technical recession in the Netherlands - or two consecutive quarters of negative GDP growth - followed by a modest recovery. Within Europe, the Netherlands is likely to book above-average economic growth rates and is therefore relatively well positioned. Inflation is forecast to slow down but remain high at an estimated 5% in 2023. Interest rate hikes in the period ahead are expected to constrain inflation but the risk-free rate is not forecast to increase substantially compared to mid-October levels under the baseline assumptions. The situation in the labour market remains tight with a record high number of job vacancies. An expected slight increase in unemployment will bring little or no relief.

### **Upside:** **Rapid decline in inflation rates**

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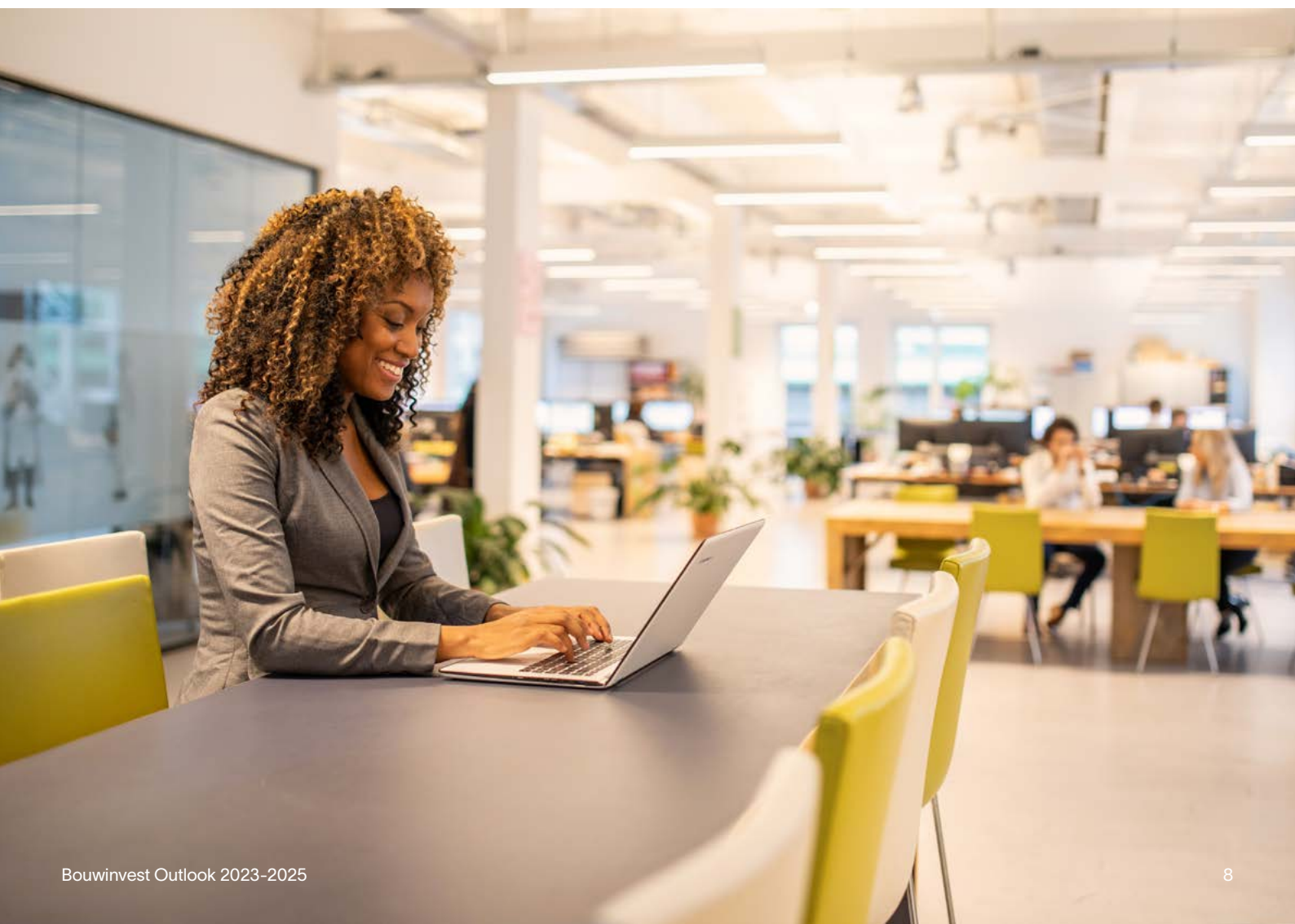
The current economic uncertainties have prompted us to draw up alternative scenarios in addition to our baseline forecast.

Under an upside scenario, we expect downward pressure on energy and raw material costs to help rein in inflation more rapidly than would be the case under our baseline forecast. Interest rates are seen declining as monetary policy eases, with a positive effect on financial markets. This would lift general economic sentiment and consumer and producer confidence and thus generate higher economic growth rates.

### **Downside:** **Higher inflation for a protracted period**

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Under a downside scenario, inflation would remain higher than expected under the baseline forecast for a longer period. The ECB would need to raise policy rates to more than 3% to lower inflation. A substantial fall in real disposable incomes would have an adverse effect on consumer spending and confidence, especially at a time of rising unemployment rates. Economic recovery would remain subdued with high inflation and policy rates for a protracted period.

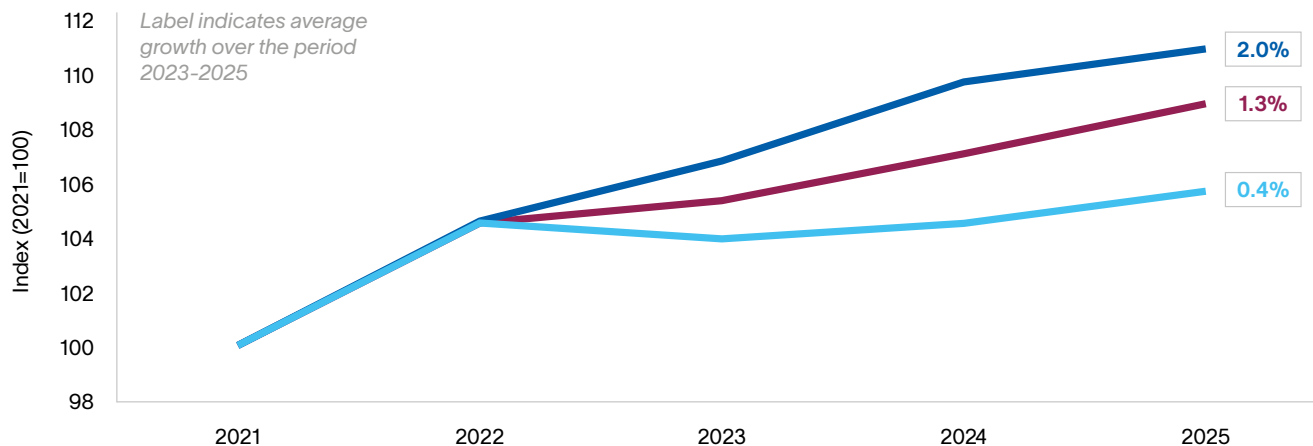




### Three realistic economic scenarios

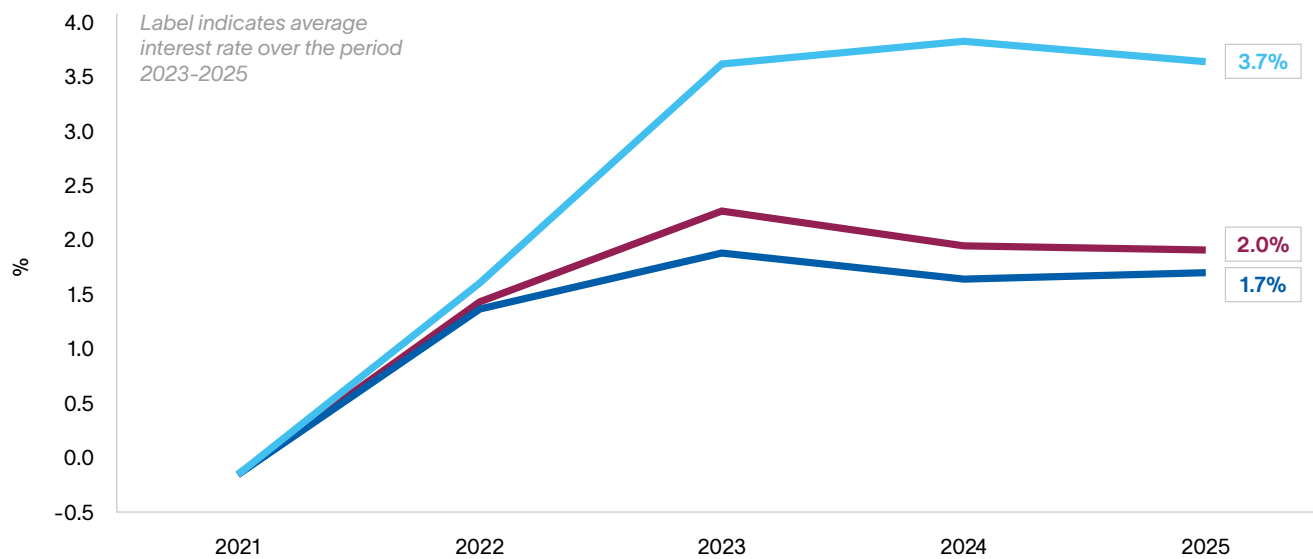
#### GDP

Source: Oxford Economics (13 October 2022), adapted by Bouwinvest



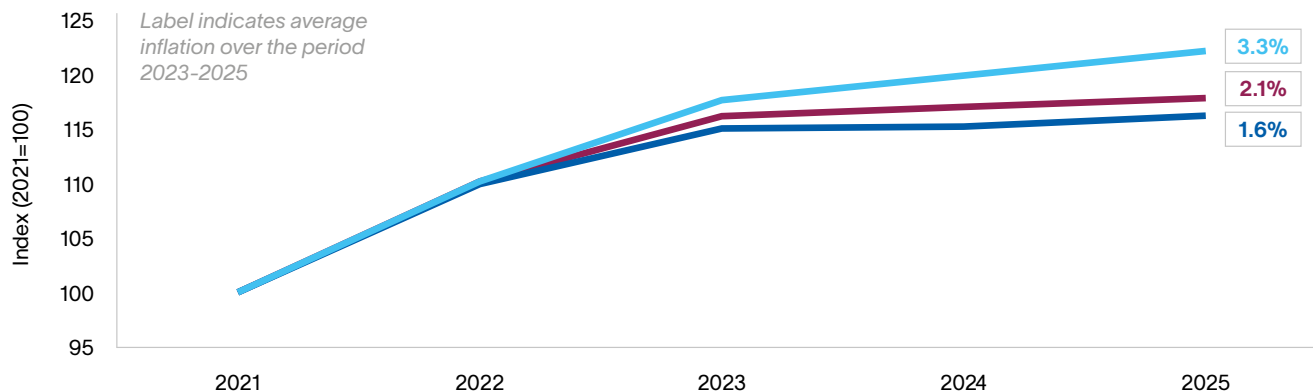
#### Interest Rate (10-year government bond)

Source: Oxford Economics (13 October 2022), adapted by Bouwinvest



#### Inflation

Source: Oxford Economics (13 October 2022), adapted by Bouwinvest



— Baseline — Upside — Downside

### Government policy

The Dutch government plans to raise the transfer tax levied on real estate investments to 10.4%, excluding newly built properties. Investment transactions currently in the pipeline will most likely be moved forward as much as possible and finalised in late 2022, as was the case with previous transfer tax hikes. That could result in a (relative) peak in investment volumes in the final quarter of 2022 and a sharp fall in the first half of 2023, possibly placing values under pressure next year.

### Developers are putting new projects on hold as debate on nitrogen crisis continues

The government's controversial plans for tackling the Netherlands' high nitrogen emissions levels will have major repercussions for the real estate industry. Nitrogen compound nitrous oxide (N<sub>2</sub>O) is a highly potent greenhouse gas (GHG), accounting for 6% of global GHG emissions. A permit is now required for activities in every sector which generates high nitrogen emissions, from farming to building new homes, and many development projects have been put on hold due to uncertainties over their feasibility under more stringent environmental regulations.

### Implications for the real estate market The denominator effect to spark downward shift in real estate allocations

Institutional allocations to real estate are under review following a roughly 20% decline in stock and bond values in the first nine months of 2022. The drop means real estate allocations now represent a larger percentage of the overall pie as indicative values have held up for now. This so-called denominator effect particularly affects portfolios comprising non-listed property where values increased slightly during this period. Repricing in the non-listed real estate sector typically lags movements in the listed property sector where stocks shed an average 20% in the year to end-September. The figures varied widely per geography, however, and Europe performed far worse than APAC, for example.

We expect, nevertheless, that the denominator effect will be offset by the expected double-digit value decline in the non-listed real estate sector in the near future. Should real estate allocations remain relatively high, institutional investors could be forced to sell properties to remain within the desired bandwidths of the overall asset mix. A potential positive outcome is that this could generate opportunities for non-leveraged investors.

### The current property market circumstances put into perspective

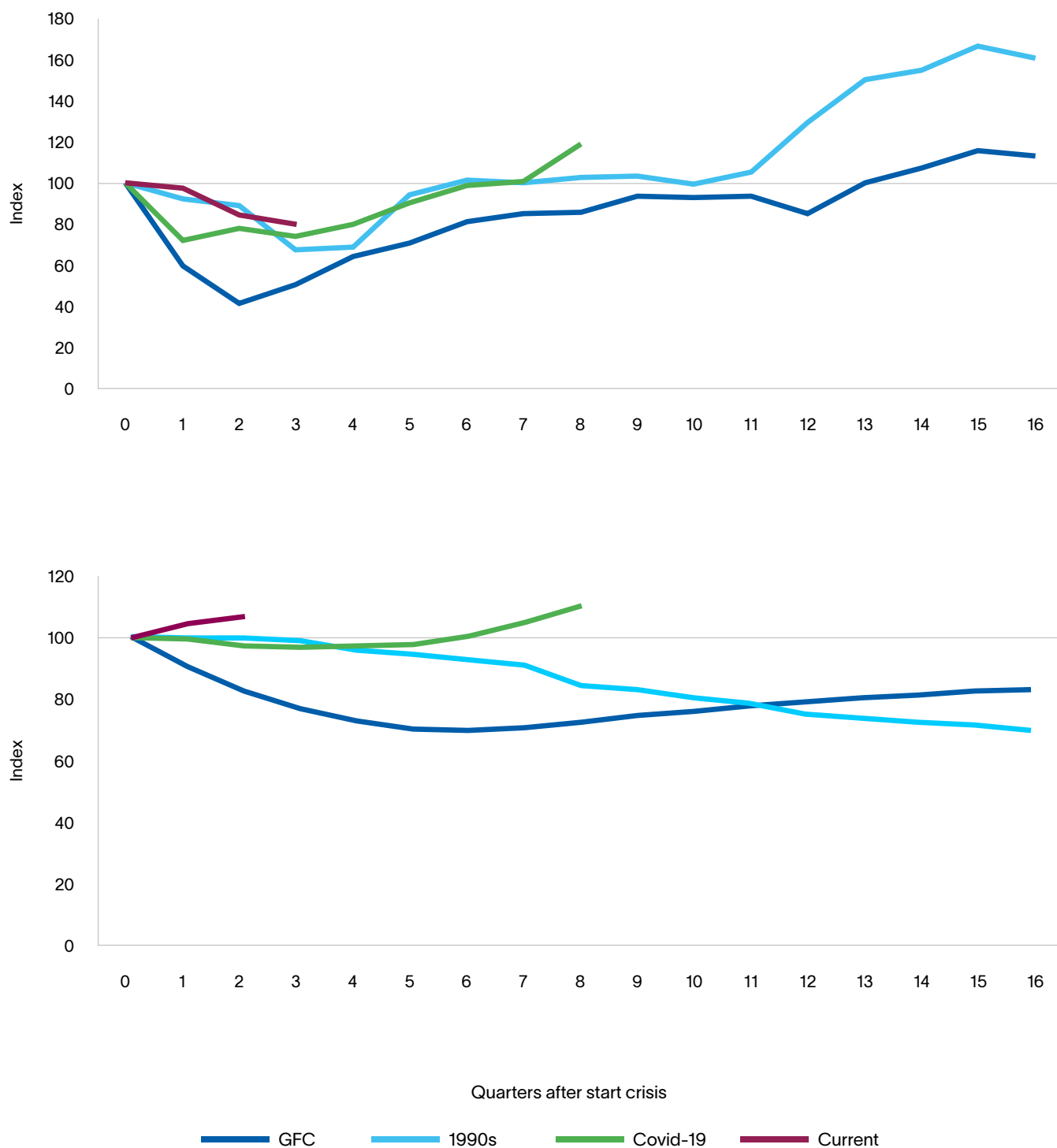
The availability of long data series in the U.S. real estate market (both listed and non-listed), allows for a comparison of real estate performances between the different business cycles over the past decades. During the Global Financial Crisis (GFC) in 2008 and Covid-19 pandemic during 2020/2021, both black swan events, real estate stock prices collapsed before bottoming out after just two quarters. The 1990s recession, however, was absorbed more slowly and it took four quarters before real estate stock prices reached their lowest point. This year's real estate stock market performance resembles that of the 1990s. There are also similarities between the economic conditions of the 1990s and the current situation, such as: high inflation, an energy shock and intervention by central banks. Historic analysis shows that the path to full recovery took significantly more time (about three years) for both the GFC and 1990s recession while the stock markets recovered relatively quickly from the Covid-19 crisis.

In the non-listed market, identical patterns are visible (i.e. a slower reaction in non-listed markets and a hesitant recovery). It took more than four years before non-listed valuations stopped falling during the 1990s crisis (and circa 15 years before full recovery took place). During the GFC, it took around 18 months before valuations bottomed out (and roughly seven years before full recovery took place). The performance of the non-listed sector was not affected all that much by the Covid-19 pandemic. Surprisingly, returns were slightly positive during 2022 until the second quarter.

The expected decline in property values for the period under review will likely be sharp ahead of a long recovery. The non-listed property sector is headed for a price correction, although this might occur faster than during the 1990s, due to the steep increase in risk-free rates. Full recovery is not expected to be reached until after 2025 under the baseline scenario.

### Quarterly real estate price performance compared over various recession periods for the U.S. listed (top) and non-listed (bottom) segments

Source: EPRA, NCREIF, adapted by Bouwinvest





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# ESG

ESG is moving -  
deservedly -  
**more firmly into  
the spotlight**

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## It pays to be green

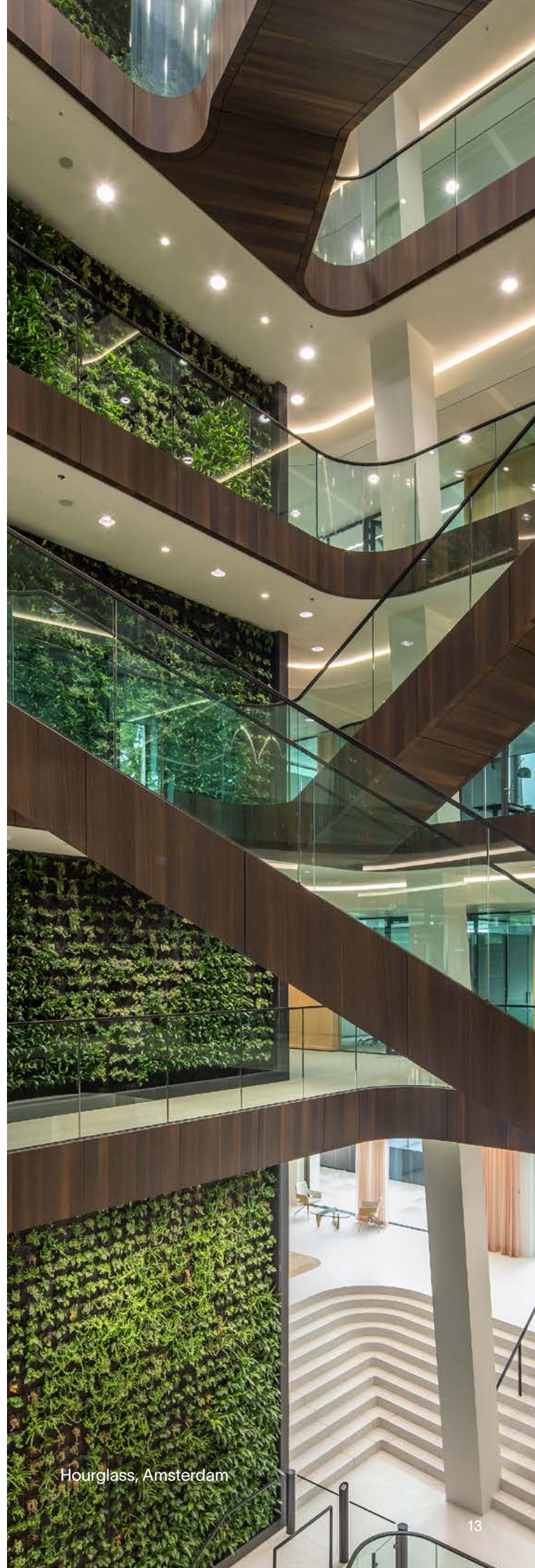
A growing body of evidence shows it pays to be green over the long term, both on the financial front as well as in terms of environmental, social and governance (ESG) returns. A consensus is emerging that sustainable buildings command higher rents and values and more stable financial returns. Impact investing is also gaining ground by prioritising sustainability in both a social and environmental sense, ahead of financial returns.

## Regulation

All regions globally are heading in the same direction: towards more energy-efficient, circular, and sustainable buildings alongside increased reporting and disclosure requirements. 'Green' laws are, moreover, becoming more stringent over time. For example, the EU's SFDR regulation for sustainable investments aims to create a more transparent playing field and to prevent greenwashing. Governments and private-sector companies are also coming under increased pressure from the public and environmental lobby groups to make their operations more sustainable.

## Technology

New technologies aimed at monitoring and implementing ESG continue to evolve, but so far have been primarily focused on the 'E'. There is still a world to be won with improved innovation, especially on the social impact side. Data protection is also a major issue that needs to be addressed.



Hourglass, Amsterdam



## Environmental

# Best practices are broadening and deepening

A major objective of the 'E' in ESG is climate mitigation. This goal is tackled under the Paris Accord of 2015 which commits signatories to significantly reduce harmful greenhouse gas (GHG) emissions in a bid to confine the rise in global warming to no more than 1.5 degrees Celsius by 2050 compared to pre-industrial levels.

## Other examples concerning environmental best practices are:

- circularity as a potential solution to materials shortages. This has become especially acute due to increased awareness of geopolitical dependencies on countries like Russia (a major raw materials producer) and China (a key components manufacturer);
- climate adaptation and possible impact on migration flows;
- biodiversity and the potential impact on the construction sector (e.g. nature-inclusive construction and allocating green space in a single development project).

In the Netherlands, several development projects (mostly those close to so-called Natura 2000 sites) have come to a standstill due to uncertainties over their feasibility under more stringent environmental regulations.







## Social

# Focus on the 'S' in ESG is on the rise but benchmarks still need to evolve

The 'E' in ESG has received a lot of attention in recent years and several environmental benchmarks and tools have been developed to assess ESG integration, environmental performance, and climate risks. It is considerably more difficult, however, to determine how the 'S' in ESG, or the 'social element,' is performing and whether a company or fund strategy has a positive social impact or not. Currently, regulations and guidelines on social investments are limited and the ones that are available give much room to manoeuvre.

By focusing on the 'S' in ESG, property investors aim to find solutions to social problems such as a shortage of affordable housing, a growing gap between rich and poor or loneliness. Social investing can be achieved via different types of real estate including affordable homes and public or community facilities for education, healthcare, infrastructure, and general welfare.

There is a growing interest in impact investments among investors, with a focus both on 'environmental' as well as on 'social'. Many investors have a specific mandate for impact investments and see trade-offs with return and risk. This involves real added value from additionality and intentionality.

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# Residential

## Robust demand underpins market but darkening economic outlook casts a long shadow

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### Executive summary:



Strong demographic fundamentals continue to underpin Dutch residential rental sector as supply falls seriously short of demand.



Capital values and rental levels are, however, under pressure due to a mix of macro-economic factors (e.g. soaring inflation and rising interest rates) and proposed additional government regulation for the free-market rental sector.



The gap between residential assets with strong 'green' credentials and those where values are weighed down by a 'brown' non-sustainable discount will widen as discerning investors increasingly focus on the ESG characteristics of their investments.





Meysters Buiten, Utrecht

### Long-term trends

## Current shortfalls set to persist on the back of growing number of households

Demand continues to outstrip supply in the Dutch residential market and there is little or no relief in sight. New developments are being delayed due to increasing or ongoing uncertainties regarding rising construction costs, new regulations in the free-market rental segment, restrictions arising from government plans to curb nitrogen emissions and the darkening macro-economic outlook. The fundamentals remain favourable, with the number of households set to increase by over 12% by 2040, due mainly to the rising number of single-person households and the ageing of the population. Expats have also returned to Amsterdam and numbers are back at pre-Covid levels. The upshot of these converging trends is that it is becoming increasingly difficult for single professionals and young families, in particular, to own their own home.



The current shortfalls are expected to deepen in the short term, partly because construction has come under further pressure despite a broad consensus on the urgency of the problem. The number of approved building permits for new homes fell further in the first half of 2022. In combination with the growing number of people who are unable to afford their own home or prefer to rent, these developments will result in stable or rising demand for rental homes.

### Government policy

## Investors tread water due to lack of clarity on new market regulation

The Dutch government has adopted several measures to regain control of the residential market and reversed some of the policy decisions taken under previous cabinets since its formation in January 2022. A Minister for Housing and Spatial Planning has been reinstated with the goal to build around 100,000 new residential units annually over the next 10 years, and roughly two-thirds of that number has been designated as affordable to fight the growing shortfall in this segment. The controversial landlord levy ('verhuurderheffing') for social rental housing, which will primarily affect housing corporations, will be abolished.

Additional measures for the housing market were announced in May this year by the Housing Minister, Hugo de Jonge, with a view to keeping rental housing affordable for low- and middle-income households, in particular. The key proposals of his Affordable Living (Betaalbaar Wonen) plan include:

- 1) regulation of part of the free-market rental segment;
- 2) adjustment of annual rental increases for existing contracts;
- 3) overhaul of rental subsidy system;
- 4) allocation of 50% of sales of owner-occupied homes to current residents of a municipality.

“New regulations in the mid-range rental segment could result in less movement in the entire rental segment, leading to a rising number of renters staying in social housing even though their income exceeds the government-imposed threshold.”


These proposed measures have yet to be finalised and it is still unclear whether, when and to what extent they will be implemented. Potentially they could have a significant impact on the residential investment market and restrict investment opportunities for institutional investors.

# 100,000

The Dutch housing ministry aims to build 100,000 new residential units annually in the next decade.







**12%**  
**2040**

The number of Dutch households is set to rise by over 12% by 2040.

Sluishuis, Amsterdam



Little C, Rotterdam

### Occupier market

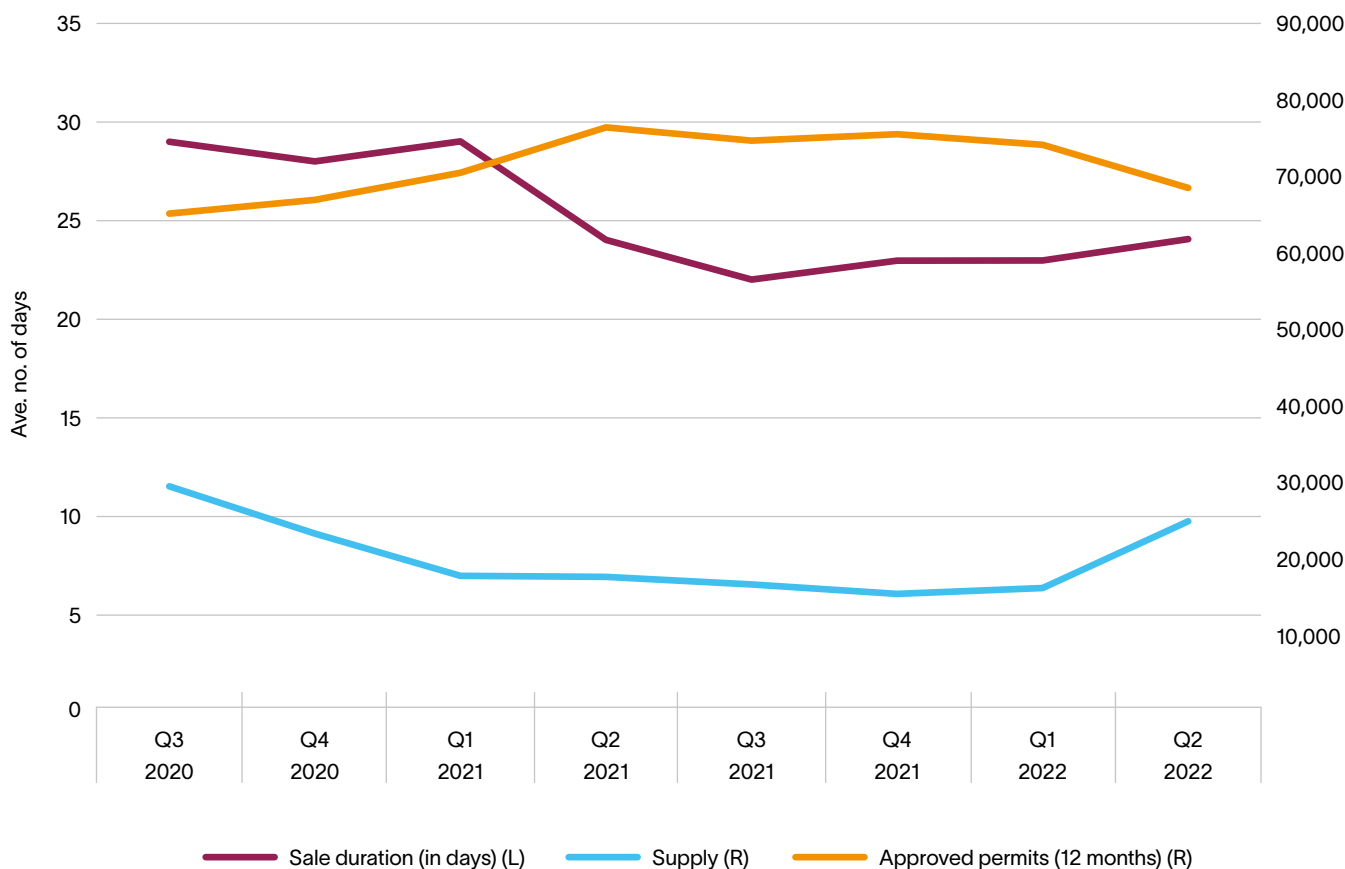
## Owner-occupier market cools on surging interest rates

Price increases in the owner-occupier residential market are slowing on the back of rising interest rates and consequent buyer nervousness over affordability and the future direction of values. Agents were already reporting a drop in requests for viewings, offers and over-bidding in the second quarter of 2022 ahead of a sharp decline of 5.8% in housing prices in the third quarter compared to the previous three-month period. There is a high reverse correlation between the values of owner-occupier homes and interest rate movements, and values are likely to fall further if interest rates continue their upward trajectory. The market is seeing greater bifurcation: location has always been a major driver of values, but asset 'quality-consciousness' is gaining ground and a price gap related to sustainability credentials is now emerging, with a green premium at the upper end of the spectrum and a brown discount at the lower end.



## Development of average sale duration, available supply and approved permits

Source: NVM, Statistics Netherlands, adapted by Bouwinvest



## Rental levels in top segment have rallied

Demand for rental housing in the top segment of the market has recovered after falling away during the Covid pandemic as expats returned home. Market rents continued to increase in the third quarter of 2022, by an average of 6.5% compared to the same year-earlier period. The number of transactions and available properties is declining, however, and supply remains tight, in particular in the urban conglomeration in the western part of the Netherlands where demand is strong. New-build rental units account for a significant portion of rental transactions which means that movement in existing stock is limited.

The difference between rents in primary and secondary locations in municipalities and cities in and around the western Randstad urban conurbation is disappearing, which is leading to a race to the top and is stretching the limits of affordability. Rising energy costs are expected to put tenants under further pressure, particularly if wage increases fail to keep pace with inflation. New regulation in the mid-range rental segment could also result in less movement in the rental segment as a whole leading to a rising number of renters staying in social housing even though their income exceeds the government-imposed threshold.

**11.8%** Market rents continued to increase in the second quarter of 2022, by an average of 11.8% compared to the year-earlier period.

De Monarch, Hoofddorp

“Sustainability credentials are expected to have a bigger impact on the value of residential investments and the gap between properties with a green premium and a brown discount will widen.”



### Investment market

## Interest rate hikes translate into more opportunities for non-leveraged investors

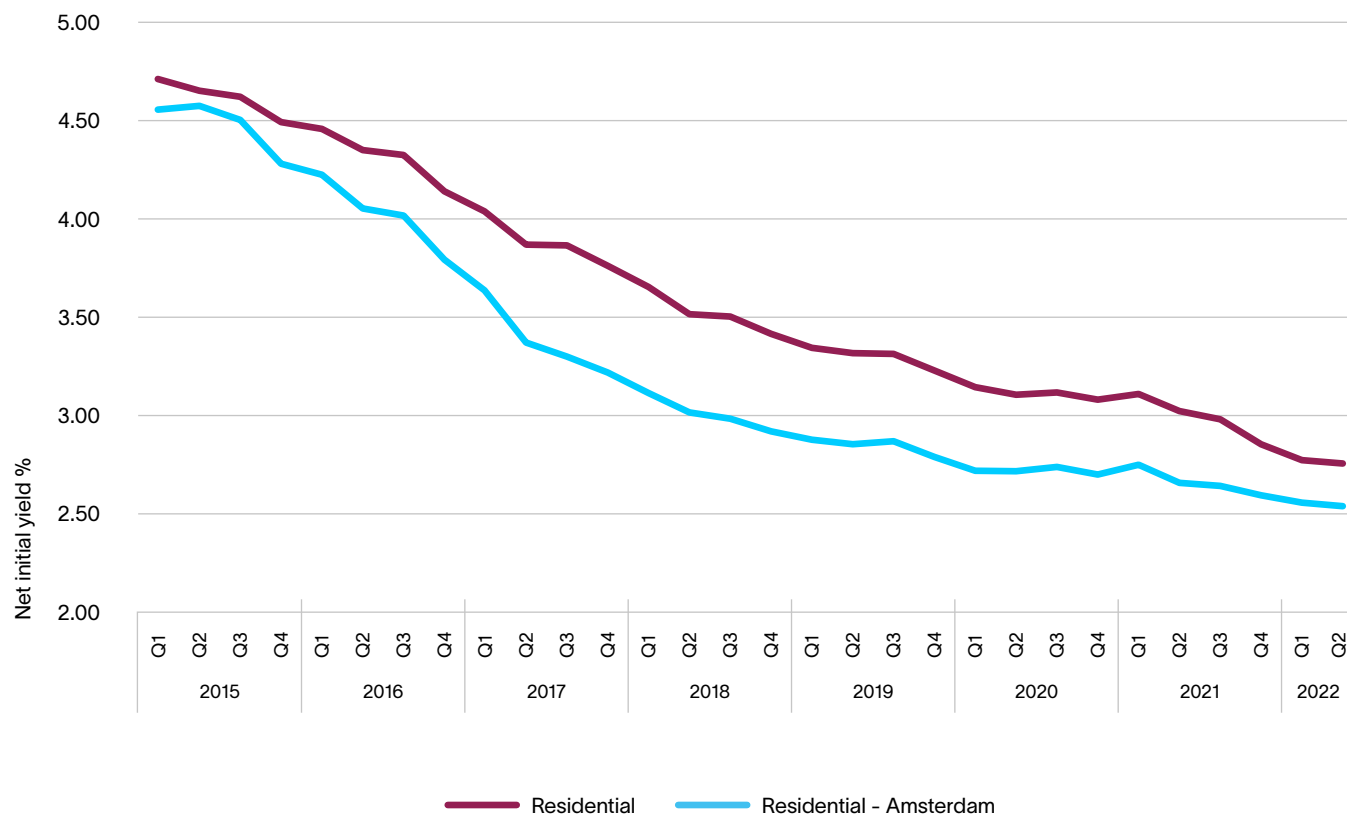
The number of Dutch households is still rising and demand for rental homes is expected to remain stable due to the expanding group of people seeking rental accommodation. This favourable supply-demand dynamic will create opportunities for distinctive projects that score well in terms of sustainability and affordability as well as location. Non-leveraged investors will be in pole position as interest rates rise, squeezing competitors that rely on debt financing.

### Short-term yield correction is on the cards

Interest rate hikes and an increase of supply, due to the 'denominator effect', will lead to an upside yield correction. That dynamic may gather pace if the proposed new regulations for the free-market rental sector are implemented, possibly resulting in falling values for existing portfolios. Investors may have to accept lower initial returns for acquisitions of future new-build projects under that scenario. Sustainability credentials are expected to have a bigger impact on the value of residential investments and the gap between properties with a green premium and a brown discount will widen.

## Net initial yields are trending at record low

Source: MSCI



## A key question is whether rental growth will keep pace with inflation

Rising inflation will lead to an increase in indexed rents in 2023, but it is still unclear by what percentage and most likely that figure will be determined by the government. Nor is there clarity yet on what the impact would be for renters. It remains to be seen whether rental levels will rise at the same pace as costs, especially in the market sector, but also to some extent in the indexed rental segment.

Demand in the lower- and mid-range rental segment is high, and it is expected that it will remain so in the future, with affordability becoming increasingly important. Vacancy rates in these segments are therefore very low, also compared to upper-range rental segments. Affordable market-sector rental apartments generate stable returns thanks to sustained demand and low vacancy rates. This means lower risk and

“Rising inflation will lead to an increase in indexed rents in 2023, but it is still unclear by what percentage and most likely that figure will be determined by the government.”

additional opportunities for investors in projects with a focus on affordable rental segments and a possibility to create impact on communities. The challenge, however, is to create viable business cases for these kinds of projects. All stakeholders (e.g. municipalities, developers, investors) involved should therefore show creativity and flexibility to make this possible.





Little C, Rotterdam

## What does this all mean for residential real estate investments?

### Opportunities

- Huge shortages in the mid-range rental segment are set to persist for the foreseeable future affecting, in particular, single-person households including students and professionals, young families and seniors.
- We do expect more supply of investment-grade portfolios to come to the market in the second half of 2022 and 2023, and that the number of transactions involving existing housing complexes and portfolios will rise as a result.
- Unleveraged investors will have an edge over leveraged players as financing costs rise due to higher interest rates.

### Threats

- An economic downturn is a real possibility with soaring inflation and rising unemployment as potential outcomes. This could lead to higher rent arrears and vacancies in the higher rental segment.
- Rising interest rates are a major threat due to the knock-on effect on initial yields and capital values.
- The government's proposal to regulate part of the free-market rental sector is also a serious threat. Moreover, it is still unclear whether landlords will be allowed to pass on higher costs in index-linked rents in parts of the mid-range rental sector. This regulation could be beneficial for tenants, however, and thus also from a social investment perspective.
- Other government measures including the planned hike in the transfer tax from 1 January 2023 will likely scare off some investors. Alternatively, investors will price this in through lower bid offers.
- New developments and new supply for both the rental and owner-occupier market will remain limited in the near future because of higher interest rates, restrictions stemming from the nitrogen emissions crisis, increase of building costs and proposed new regulation in the mid-range rental segment.



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# Healthcare

## Attractive initial yields and strong fundamentals underpin investment opportunities

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### Executive summary:



The Netherlands faces huge and growing demand for more modern and 'needs-based' senior living and care complexes and supply remains inadequate.



More alliances between care institutions, investors and other stakeholders including local authorities, developers, housing corporations and health insurance companies, point to the way forward for tackling the huge task of creating sufficient high-quality care accommodation in coming decades.



Assisted living and healthcare properties across all segments tick many boxes for institutional investors.



### Long-term trends

## Ageing population spawns demand for assisted living concepts

The 2022 UN World Population Prospects estimates that 16% of the world's population - or 1.6 billion people - will be aged over 65 by 2050 compared to just 10% in 2022, as birth rates decline and life expectancy increases. In the Netherlands, the number of people aged over 65 is expected to rise by over a million by 2050 while the group of seniors in the 75+ age bracket will nearly double by then, according to the 2022 forecast by ABF Primos.



The elderly population is not only expanding significantly in size, the average age of this group is also rising in tandem, and many seniors are managing to maintain a far more active lifestyle than previous generations. A large proportion of people in their seventies, eighties, and even nineties, are now able to live independently in their own home and want to enjoy amenities such as restaurants, sports and cultural facilities close to their place of residence. Many of them have very clear ideas about where and how they wish to spend their final years and have the financial means to do so. As the average age of the elderly population increases, they will face more health challenges and a greater need for care. As their mobility decreases, they are also more likely to experience loneliness, which in turn exacerbates their health challenges. Research shows that preventing loneliness among the elderly is key to reducing their need for care and care facilities. Social care is just as important in that context as healthcare itself.

These demographic and social trends are fuelling demand for new concepts in senior and assisted living and care homes, as well as (specialist) healthcare and medical facilities. The Netherlands - like many other developed nations - faces a huge challenge to provide both the volume and quality of

senior homes and care facilities required in coming decades to address the need for both healthcare and social care, to support independent living and avoid traditional intensive care in dedicated homes.

**“A large proportion of people in their seventies, eighties, and even nineties, are now able to live independently in their own home and want to enjoy amenities such as restaurants, sports and cultural facilities close to their place of residence.”**

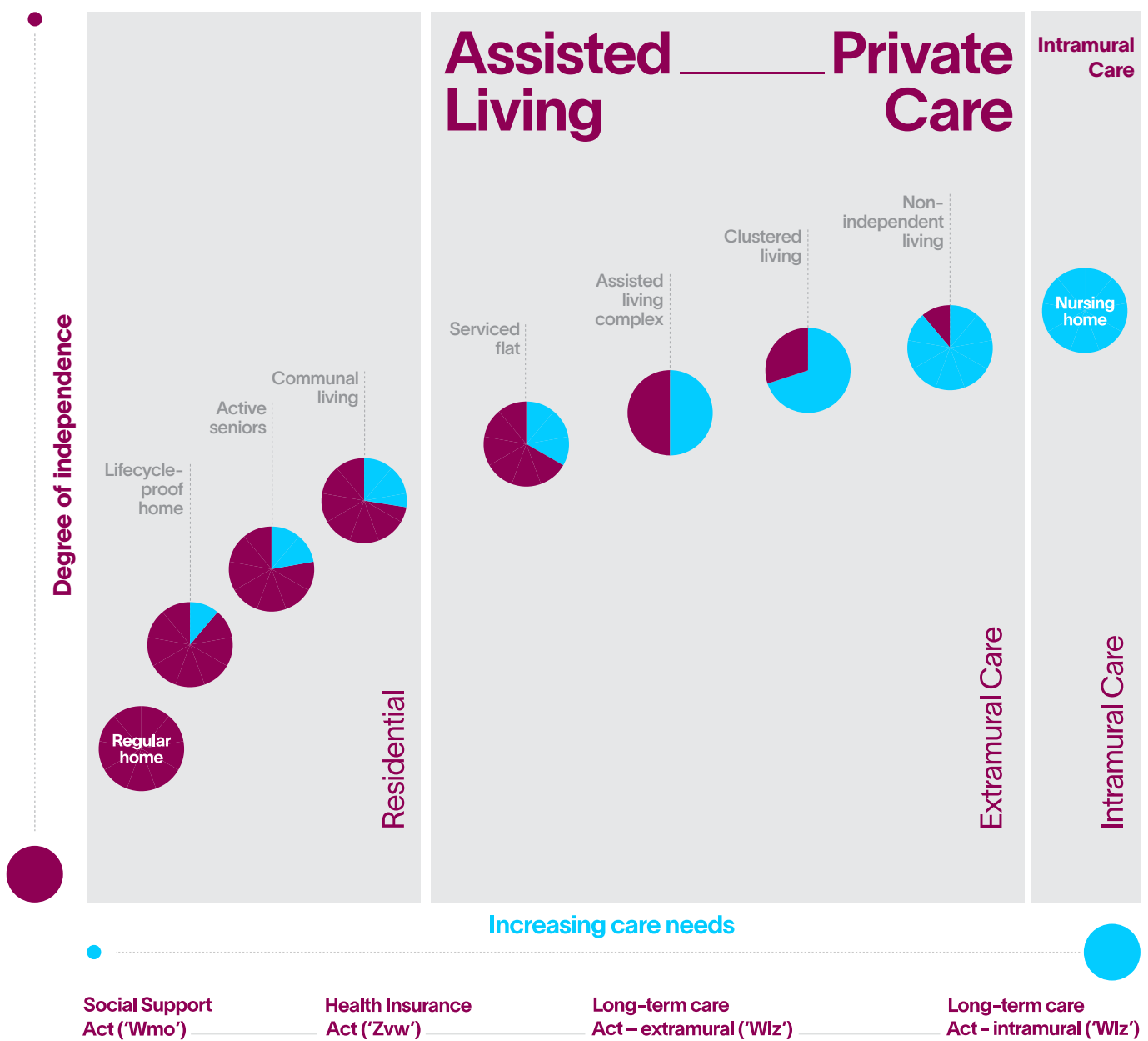
Parledam, Katwijk





Government policy

# Differentiated care facilities in the Dutch healthcare system



### The government is stimulating home aged-care services

The strong growth in demand for assisted living and extramural care facilities is being propelled further by the latest policy plans issued by the Dutch health ministry which are geared, more than ever, to enabling elderly people live independently in their own homes for as long as possible, postponing admission into a nursing home or avoiding it altogether. The government aims to achieve this through dedicated support programmes for the interaction of the elderly with the healthcare system, including more digital tools as well as increased homecare services. The extramural capacity of the system needs to be boosted because there are no current plans to increase significantly the approximately 130,000 nursing home places in the Netherlands. The plans also entail lower government subsidies for accommodation in existing nursing homes from 2024 (through a reduction of the so-called *normatieve huisvestingscomponent* or NHC). While this subsidy cut poses an additional financial challenge to intramural nursing homes, we believe it will also help enforce the shift to extramural elderly care in assisted living and private care homes.

“As nursing home waiting lists and the number of patients requiring care continue to rise, a clear shift is occurring away from institutionalised healthcare to more care services in the home.”

Other new government proposals to regulate rents in the Dutch residential market will also have an impact on the supply side of the healthcare sector. This will push developers and investors towards the assisted living segment where new regulations in the mid-range rental segment are expected to have less of an impact on both rents and investment returns.







### Occupier market

## Seniors' boom is stretching the limits of the healthcare system

The rising pressure on the Dutch healthcare sector from the ageing population is visible in the form of growing waiting lists for elderly care, staff shortages and budgetary shortfalls for implementing digital healthcare applications and sustainability measures. As nursing home waiting lists and the number of patients requiring care continue to rise, a clear shift is occurring away from institutionalised healthcare to more care services in the home. This is especially true of people requiring a relatively low level of care.



A major bottleneck is the shortfall in the existing supply of care facilities. Care providers are under increasing pressure to make greater investments in more modern and 'needs-based' care facilities and assisted living accommodation, as well as sustainability measures to meet the Paris climate accord to achieve a zero net-carbon built environment by 2050. Their profits are already being squeezed by rising inflation from sharp increases in construction and operating costs, including wages, energy and food prices. Rising staff shortages are also preventing the much-needed expansion of extramural elderly care.

If inflation persists, profit margins will decline annually by 0.5% of total turnover, according to estimates by consultancy firm Deloitte, shrinking to 7.9% by 2025. This is well below the optimal level of 10% and would make it very difficult to cover average financing costs of around 8%.

Care operators occupying relatively old and energy-inefficient buildings with high maintenance costs will be particularly hard hit. According to estimates by the Care 2020 sector benchmark, investments totalling as much as €7.9 billion will be needed for long-term care facilities alone to raise their sustainability credentials by 2050. Other necessary investments in digitalization and innovation will also come under threat.

# 16%

16% of the world's population will be aged over 65 by 2050 compared to just 10% in 2022

More alliances between care institutions, investors and other stakeholders point to the way forward for tackling the huge task of creating sufficient high-quality care accommodation in coming decades. In addition, concentrating knowhow and expertise in the field of aged and other long-term care helps to prevent services becoming fragmented and improves their quality. This is already demonstrated by the increased concentrations of medical services, including general practitioners, pharmacies, and other healthcare facilities in physical clusters to achieve greater efficiencies and address structural staffing shortages and rising absenteeism.

Hildebrand, Haarlem



De Kuifmees, Nieuwegein

## Investment market

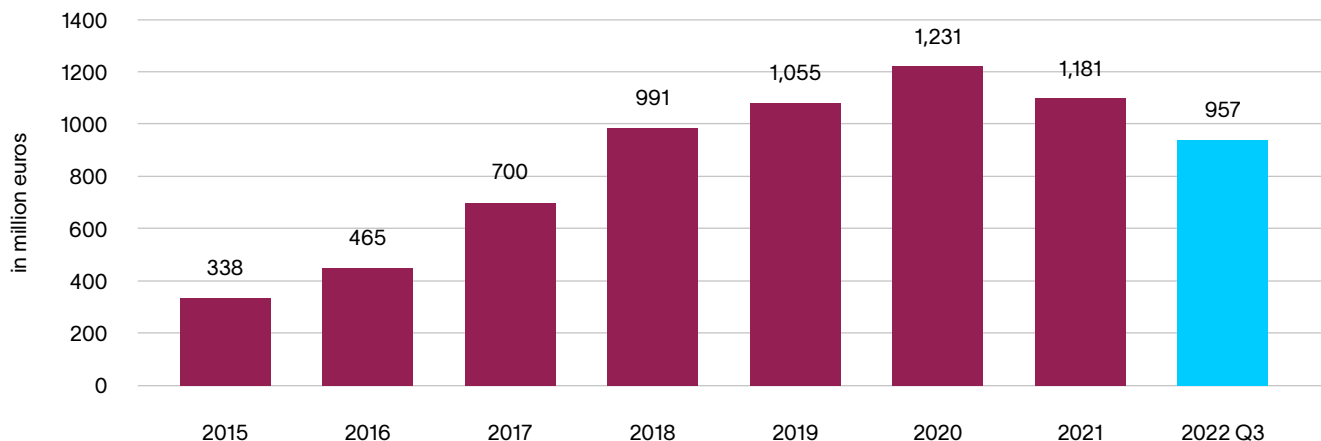
# Investors pile into healthcare properties

The strong fundamentals in the Dutch healthcare market are already attracting a rising number of investors and real estate investment volumes in the healthcare real estate segment are surging as a result. Total transaction volume climbed from €335 million in 2015 to more than €1.2 billion in 2020 before levelling off to just over €1 billion in 2021. A comparable volume is forecast for 2022 following a strong performance in the first nine months of the year.



## Investment volume in healthcare real estate in the Netherlands

Source: Capital Value (2022)



Healthcare real estate has become a fully-fledged investment category in the real estate portfolios of institutional investors. Care and cure properties now account for roughly 6% of total real estate investment volume in the Netherlands compared to about 2% in 2013. Estimates from real estate agent Capital Value point to around €7.5 billion in investment in the Dutch healthcare real estate sector in the next three years. That would mean a doubling in annual investment volume through 2025. We also expect the share of healthcare real estate investments to rise further to over 10% of the total within the next five years.

Healthcare properties share many of the characteristics of residential accommodation, particularly assisted living apartments, as well as commercial real estate. The latter is especially true for private care homes and nursing homes where long-term rental contracts are the norm, often for as long as 15-20 years. These are generally in the form of double-net, or triple-net leases, which means the operator is responsible for part of the maintenance costs.

The rising institutional investment capital flows targeting the Dutch healthcare sector could be given further momentum through the growth of impact investing, where the positive social and environmental returns of investments are ranked alongside the financial returns.

The care real estate sector is especially well-matched to achieving those 'ESG outcomes', providing an opportunity for pension funds to demonstrate their social responsibility and put their capital and expertise to work.

Healthcare properties account for a growing share of total real estate investment volume in the Netherlands.



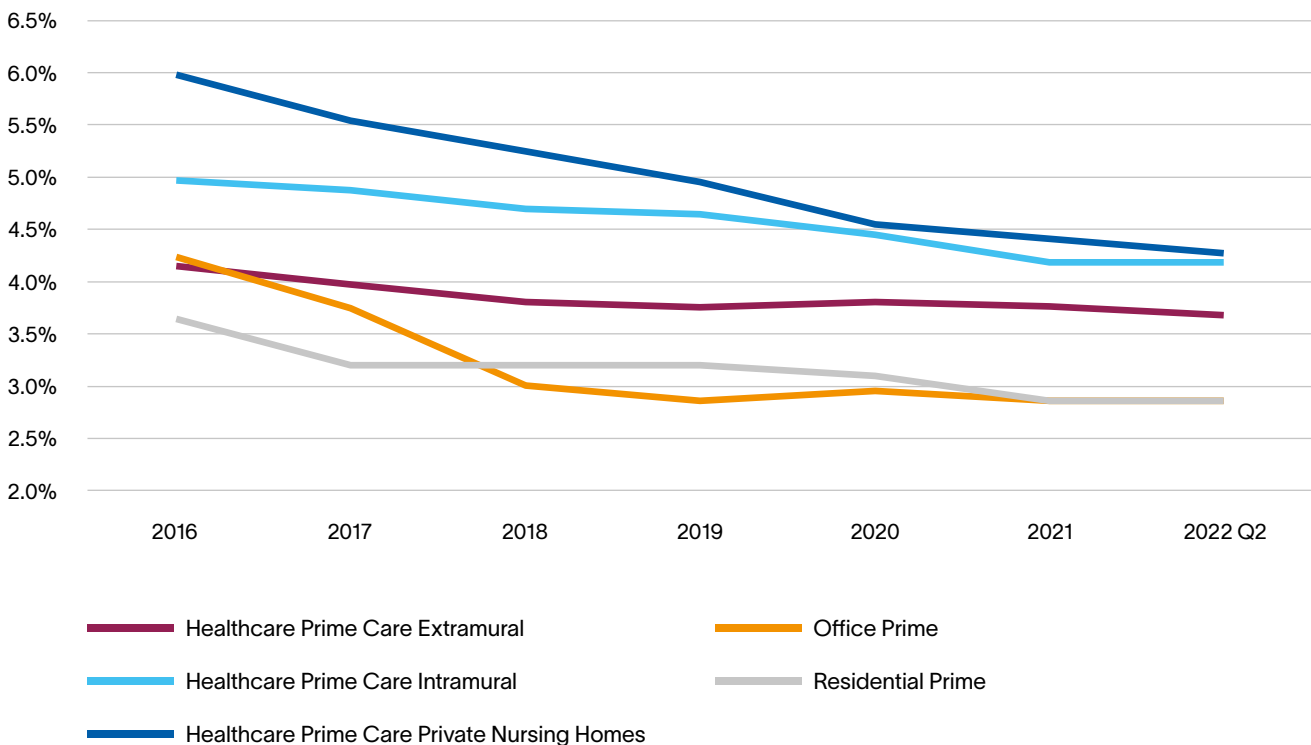
The new-build real estate segment, including extramural private care homes, is expected to see the strongest demand. Opportunities will also emerge for the redevelopment of existing owner-occupied intramural facilities that have become obsolete. Real estate investors, in particular institutional and more long-term investors, are well-placed to partner with care operators to allow them to upgrade their properties while meeting the latest sustainability requirements, for example through sale-and-leaseback transactions. This will enable financially strapped care operators who are now postponing necessary investments in their properties to focus more on their core activities.

However, the darkening economic outlook, with soaring inflation and consequently rising interest rates, has halted yield compression in the Dutch healthcare real estate sector, at least for the time being. Net initial yields in all healthcare segments stabilised in the second quarter of 2022, after tightening each quarter since 2021. New developments will also be delayed or postponed, with a negative effect on healthcare real estate transaction volumes, despite the strong demand.

“The rising institutional investment capital flows targeting the Dutch healthcare sector could be given further momentum through the growth of impact investing, where the positive social and environmental returns of investments are ranked alongside the financial returns.”

### Prime net yields %

Source: JLL, CBRE, Capital Value, Bouwinvest (2022)





## What does this all mean for the healthcare real estate investment market?

### Opportunities

- The market fundamentals for differentiated forms of healthcare properties remain robust and are underpinned by undisputed demographic trends and the current government policy.
- Healthcare real estate also offers risk diversification in an investment portfolio.
- Healthcare properties offer attractive initial yields compared to more established real estate sectors such as offices and residential. This is especially true of the extramural assisted living and private care subsectors due to sustained investor appetite and expected future growth of investor demand in these segments.
- Partnerships between care operators, government institutions, institutional investors and developers offer opportunities to create the type of modern care accommodation needed, also through redevelopment and upgrading of obsolete buildings.

### Threats

- The worsening economic outlook, at least for the short term and possibly also for the medium term, will inevitably affect the healthcare real estate market, both on the occupier and the investment side. However, we expect healthcare real estate will prove to be relatively more resilient during the tougher economic conditions ahead.
- Interest rate hikes are a major threat due to the knock-on effect on initial yields and capital values.
- Rising costs of (temporary) staff, energy costs and (CPI-indexed) rents could squeeze care operators' profit margins.
- Staff shortages could form a bottleneck for the further development of healthcare real estate concepts, for example in the mid-range private care segment.
- Intramural care is dependent on government subsidies and shrinking budgets and uncertainty about new government policy could deter investors. On the other hand, this could also provide an additional impulse to extramural care facilities.

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# Retail

## Resurgent economic headwinds will weed out flailing retailers

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### Executive summary:



High street retail was starting to recover from the pandemic, but pressure is building up again and the short-term forecasts are now significantly less favourable.



Convenience retail is faring better and the performance gap between 'experience' and 'convenience' retail will widen as market conditions sour.



Repurposing of obsolete stores is underway, but more transformations in function are needed to keep vacancy levels in check.





### Long-term trends

## Fickle shoppers put retailers on the back foot

The retail real estate sector was ravaged by the Covid-19 pandemic and is still finding its feet as life returns to normal. Shopping centres and retail destinations have reasserted their magnetic function as people of all ages hit the streets during 2022 and started spending their pent-up savings. Purchasing patterns are becoming more complex, however, with a growing number of consumers allocating an increasing part of their expenditure to leisure and experience, partly at the expense of physical products. Fun shopping is becoming more popular and retailers within shopping centres and at high street locations need to incorporate 'experience' as a concept into their offerings to add value and attract visitors.



Shoppers' desire for experience was visible before Covid, but the pandemic has helped to bring it more firmly to the fore. Online shopping clearly accelerated during the lockdowns and continues to grow albeit at a much slower pace in the more mundane part of shopping – such as convenience purchases. The rise of e-commerce has spawned a new generation of delivery companies, like online supermarket Picnic, which continues to grow steadily, as well as fast-delivery services, although it remains to be seen which ones will survive in the competitive Dutch retail landscape.

### Less retail GLA will be needed in the years ahead

Other long-term developments that are impacting the Dutch retail market include the ageing of the population. That trend is visible across the country but is less pronounced in the biggest cities which benefit from being part of a wider urban agglomeration while their ability to draw in younger generations provides an important dynamic for commercial activity.

Shopping behaviour is also changing as consumers become more environmentally conscious and eager to cut costs in a time of rising inflation. Second-hand clothing sales continue to rise substantially, and even fast-fashion chains are opening-up their stores for second-hand apparel. Online retailers are meanwhile moving towards more environmentally friendly ways of distributing goods, including bicycle delivery. Returning online purchases for free has meanwhile become unsustainable and retailers like H&M are now testing whether they can pass on these costs to consumers.

Consumers' increased focus on experience rather than goods, the ongoing growth of e-commerce and the ageing of the population all point in one direction: less retail GLA will be needed in the years ahead. Exactly how much space will become obsolete remains elusive, however.

“Converging trends mean that shoppers are becoming less predictable than ever, and it is clear that a lower volume of retail GLA will be needed in the years ahead.”







### Government policy

## Municipalities banish dark stores to peripheral sites

Many municipalities around the Netherlands are developing new policies to tackle the 'dark stores' that are springing up in high streets, shopping centres and local neighbourhoods for fast grocery delivery services such as Getir, Gorillas and Flink. Dark stores may be located in a regular store but function as mini warehouses catering to local deliveries, normally within 10 minutes of the consumer. The crackdown stems from a public outcry over the congestion, noise, pollution, and traffic safety problems caused by fast-delivery vehicles – generally motorized scooters or e-cargo bikes. Municipalities are moving to curb the establishment of dark stores in congested downtown areas but are prepared to allow them in more urban periphery industrial sites and business parks.



Jumbo, Zoutelande

### Occupier market

## Retailers are starting to recover but fresh economic challenges loom

Large swathes of the retail real estate sector were battered by the Covid-19 pandemic and the accelerated growth of online purchases. Government support packages helped retailers and food & beverage (F&B) operators to survive during the pandemic and many also received rental reductions or delayed payment schemes. Businesses were thus able to remain operational and the number of bankruptcies was very limited.



Supermarket turnover meanwhile rose sharply during the pandemic, but sales dipped slightly in the first half of 2022 due to resumed competition from inner-city locations as people ventured back into town. Turnover still remains well above pre-Covid levels, however.

Rental levels and capital values plummeted following the lockdowns, even on prime high street locations in the biggest cities. At the same time overall vacancy increased further in the first quarters of the pandemic, but - surprisingly - started to drop significantly from the second half of 2020, primarily due to the transformation of empty stores for other purposes.

The market appeared to have bottomed out at the beginning of 2022, as rents and valuations became fairly stable, but pressure has built up again and the forecasts are now significantly less positive. It should also be noted that high street vacancy levels vary greatly from city to city. Vacancy rates may be minimal on one high street while as much as a quarter of all stores on a nearby shopping street may be unoccupied.

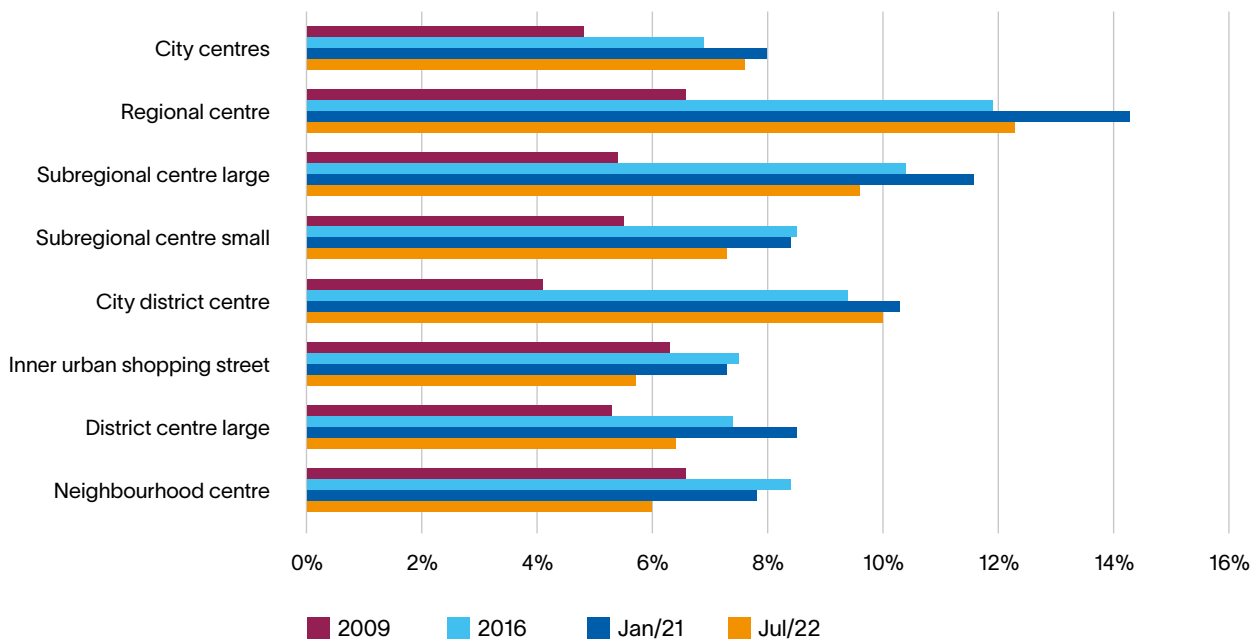
The graph below shows vacancy levels per shopping destination in four periods:

- 2009: lowest vacancy level before Covid-19 effect.
- 2016: highest vacancy level before Covid-19 effect.
- January 2021: highest vacancy level ever due to maximum Covid-19 effect.
- July 2022: vacancy levels start to fall as the market adjusts and stores are repurposed.



### Vacancy rates by shopping destination

Source: Locatus



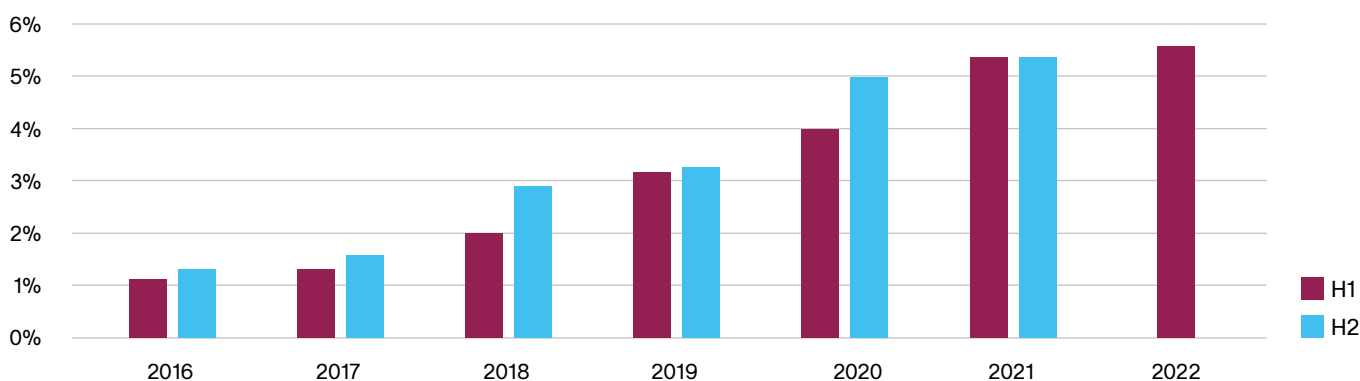
## E-commerce is growing in the grocery sector but at a relatively slow pace

While there were many losers during the pandemic from fashion and shoe stores to F&B chains, there were also winners: supermarkets and grocers. E-commerce is likewise accelerating in this segment, but at a much slower pace and only accounts for around 5.6% of total turnover for supermarkets, according to recent research by Supermarkt&Ruimte/Locatus. Neighbourhood convenience centres in particular benefited from the closure of restaurants and bars, as well as increased working from home (WFH) and more people choosing to shop closer to home during the pandemic.

E-commerce is accelerating in the supermarket segment at a much slower pace than in the broader retail market and only accounts for a small portion of total turnover - just 5.6%

## Share of online supermarket sales

Source: Supermarkt&Ruimte/Locatus



“Online shopping has clearly accelerated during the lockdowns, and it continues to grow as the more mundane part of shopping - such as convenience purchases - is automated further. Like experience shopping, e-commerce is here to stay.”

## The post-Covid recovery may not last long

The pandemic may be ebbing, but both retail tenants and landlords still face multiple challenges due to the current economic uncertainties. A number of major potential risks lie ahead for the Dutch retail sector, including an increasingly negative economic outlook with a likely drop in retail

spending, a shift towards discount retailers and a rise in retail bankruptcies. The sustained growth in online shopping is having a negative impact on in-store sales and retailers are seeing their costs rise rapidly which is denting their profitability. A resurgence of a fresh Covid wave also remains a risk.



### High streets remain pressured

High streets around the country were bustling again during the summer of 2022, allowing many retailers to get back on track after a torrid time during the pandemic. But fresh economic uncertainties are putting new pressure on retailers in the experience sector.

- Vacancy rates are falling but will rise again most likely in coming years as retail chains are pruned or fail altogether in the face of online competition.
- High streets in the biggest cities will ultimately be winners, but they will undergo a transition due to the need for fewer stores and more dynamic retail concepts.
- Market rents remain under pressure for the time being, also at prime locations.
- The difference between contractually agreed rents, which are rising in tandem with consumer price index (CPI) increases, and market rents is widening. Market rental yields will ease as a result.
- Greater economic uncertainties and rising interest rates will also exert upward pressure on initial yields.
- Retailers will increasingly opt for shorter rental contracts with some exceptions.

### Supermarkets are not immune to market threats

Economic uncertainties are also mounting in the convenience sector where staff shortages and rising costs could obstruct further growth. The new tobacco law that will ban supermarkets from selling cigarettes from 2024 will lead to a loss of more than €2 billion in direct sales.

- The convenience sector outperformed during the pandemic but is not immune to economic risks. Many local shopping centres are filling vacant units with service providers to enhance their overall attractiveness.
- District convenience centres with small grocery stores, or none at all will gradually disappear at the expense of dominant centres with one or two fully-fledged supermarkets.
- Market rents will rise, especially in the supermarket sector, which can partly pass on rising costs to customers. For the convenience sector as a whole, however, they will trail the big jumps in contractually agreed rents (through CPI adjustments).



# 2024

The new tobacco law that will ban supermarkets from selling cigarettes from 2024 will have a negative impact on supermarket turnover.

“Shopping behaviour is also changing as consumers - both young and old - become more environmentally conscious and eager to cut costs in a time of rising inflation.”



## Investment market

# Caution still reigns in experience retail; convenience retail loses its lustre

The performance gap between experience and convenience retail is reflected in investor caution for the former and strong enthusiasm for the latter. Prices for supermarket-anchored stores and centres have been rising and yields have tightened in response. The opposite has been true of the experience retail sector and this gap is not expected to close in the short term. The yield gap has tightened significantly due to rising interest rates, putting further pressure on prime yields in both the experience and convenience segments.

## What does all this mean for the retail real estate market?

### Opportunities

- Supermarket-anchored convenience centres will continue to perform well and provide for strong direct returns.
- They will thus remain attractive for non-leveraged investors - both private and institutional - due to the combination of relatively small ticket sizes and moderate risk scenarios.
- Initial yields for convenience retail, a key winner of the pandemic, are forecast to rise only slightly.
- The experience real estate sector will remain under substantial pressure in the short term, but that will generate buying opportunities in the longer term, especially in the largest cities as the market recovers.

### Threats

- An economic downturn or a recession, due primarily to rising interest rates stemming from soaring inflation, is a real possibility and will likely lead to a drop in retail spending and an increase in retail bankruptcies.
- Rising interest rates are a major threat due to the knock-on effect on initial yields and capital values.
- The further growth of e-commerce will pressure weaker retailers, especially those with a sub-standard online offering.
- Staff shortages and rising (minimum) wages could have a negative impact on the profitability of some retail segments, in particular the F&B sector.

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# Offices

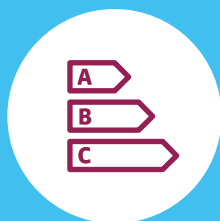
## New energy label requirements could banish outdated stock

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### Executive summary:



Working from home (WFH) has become entrenched, reducing the overall demand for office space.



Supply of the most modern and sustainable offices could tighten further, however, due to stricter minimum requirements for energy performance and regulations for new developments aimed at curbing nitrogen emissions during construction.



Rents were rising on the back of record-low vacancies and higher inflation but rising initial yields is on the cards.





Hourglass, Amsterdam

### Long-term trends

## Office workers and tenants favour flexibility

The good news for office landlords is that the number of workers employed in desk job sectors in the Netherlands continues to grow. The bad news is that the number of people working from home (WFH) is increasing as well. There is, however, a positive side to the WFH phenomenon for investors. Both employers and their staff are becoming increasingly critical about their work environment and that is boosting demand for well-located, smart offices that are easily accessible, offer pleasant and healthy surroundings and a mix of functions such as retail and leisure. Green credentials are also a must and new energy-performance requirements for offices are prompting both investors and users to reject outdated or obsolete buildings that do not make the grade.

## Working from home (WFH) is here to stay

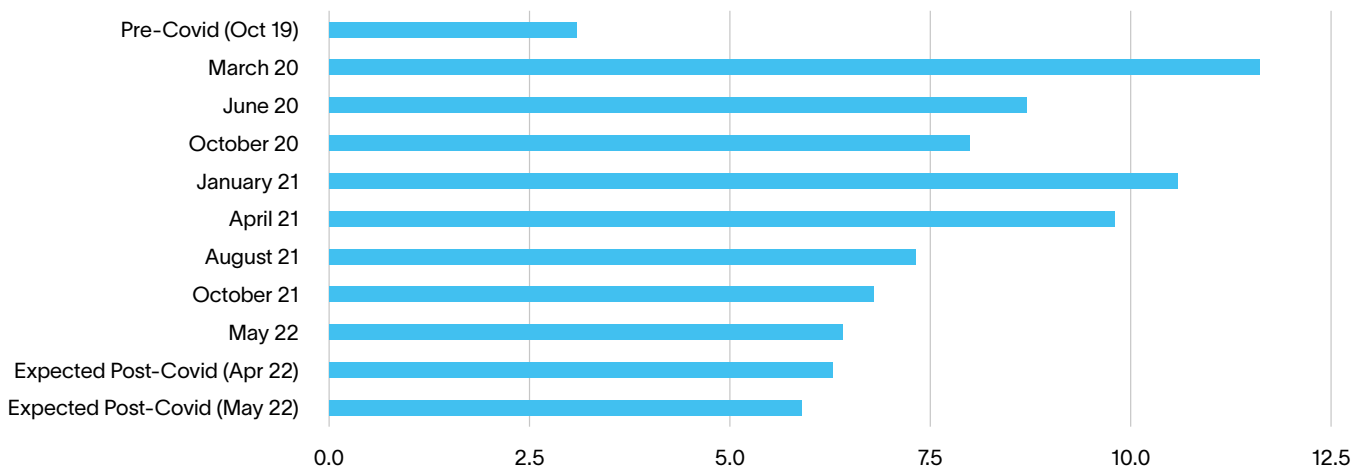
Working from home was already a growing trend before the outbreak of Covid-19 and its share of the total Dutch office market - already relatively high even before the pandemic - has gathered momentum since. Flexible work conditions have become a fixture of the office environment and both younger and older workers are now demanding more leeway on where they spend their time than was usual in the past. While many employers still opt for the traditional five- or 10-year contracts, an increasing share is aiming for more flexible rental contracts and demand for shared office space and flexi-desks is also rising as a result. Additionally, employers' appetite for a healthier and more communal workspace and vibrant mixed-use environments surrounding their office is on the rise as well.

Based on the most recent analyses, in particular from the Kennisinstituut voor de Mobiliteit (Dutch mobility research institute), work hours in the office are forecast to drop by an average 20% compared to pre-pandemic levels. This will translate into a total redundancy rate in office space of no more than 10%, however, according to Bouwinvest calculations. Employers will need to retain space to accommodate all workers on peak days and offer a greater mix of meeting rooms and dedicated desks to facilitate both get-togethers and more concentrated work. Bouwinvest expects any increase in vacancy levels will mainly affect less attractive office locations around the Netherlands. Even so, prime locations might also face rising vacancy rates in the medium term.

“There is a positive side to working from home. Both employers and employees are becoming more aware of their working environment, and this is boosting demand for well-located, smart offices that are easily accessible, offer pleasant and healthy surroundings and a mix of functions such as retail and leisure.”

### Average number of hours WFH (per week)

Source: KiM; adapted by Bouwinvest



10%

No more than 10% of the office market will be impacted by the working from home trend.



“New energy-performance requirements for offices are prompting both investors and occupiers to reject outdated or obsolete buildings that do not make the grade.”

#### Government policy

## Office stock is required to meet a minimum energy-efficiency C-rating from 2023

From 1 January 2023, all offices in the Netherlands - excluding monumental buildings - will be required to have a minimum C-rating for energy efficiency. Owners of offices that do not possess a C certificate or higher (A or B) will not, in principle, be allowed to lease their space from that date. A recent study by CBRE indicated that some 10% of all Dutch office stock had a D-rating or worse, while the energy performance of around 26% of total supply was not even known.

A significant portion of this stock will not meet the minimum requirement of a C-rated energy performance certificate by early 2023 and the construction sector does not have sufficient capacity to upgrade all these buildings on time in any case. The question is, therefore, whether the 1 January 2023 deadline is feasible. Some of the biggest Dutch cities are now offering landlords greater flexibility to tackle the issue at a later stage, but it is already clear that pressure from the government as well as the banking sector will continue to grow in coming months.

### Occupier market

# Rents were rising due to record-low office vacancy rates

Government support measures helped prop up part of the office-based corporate world during the extremely challenging conditions stemming from the Covid-19 pandemic. The number of bankruptcies was limited, and companies continued to retain their staff on the payroll, resulting in the Dutch office market performing very well during this period. Thanks to ongoing transformations of outdated office stock, office vacancy levels fell nationwide to an average of 6.7% in Q2 2022, the lowest level in 25 years, from 10.0% in the first quarter of 2019. Rental levels for both prime and the best secondary office locations rose significantly as a result.

The Dutch office sector is faced with several major potential risks and uncertainties, which make forward planning for investments and developments extremely challenging. These risks include an increasingly negative economic outlook with a likely rise in bankruptcies. Increased working from home is now starting to affect office demand and companies are seeing their costs rise rapidly, resulting in a stronger focus on cost reduction.



WTC, The Hague

# 6.7%

Office vacancy levels fell to an average of 6.7% in Q2 2022 from 10% in Q1 2019, the lowest level in 25 years.

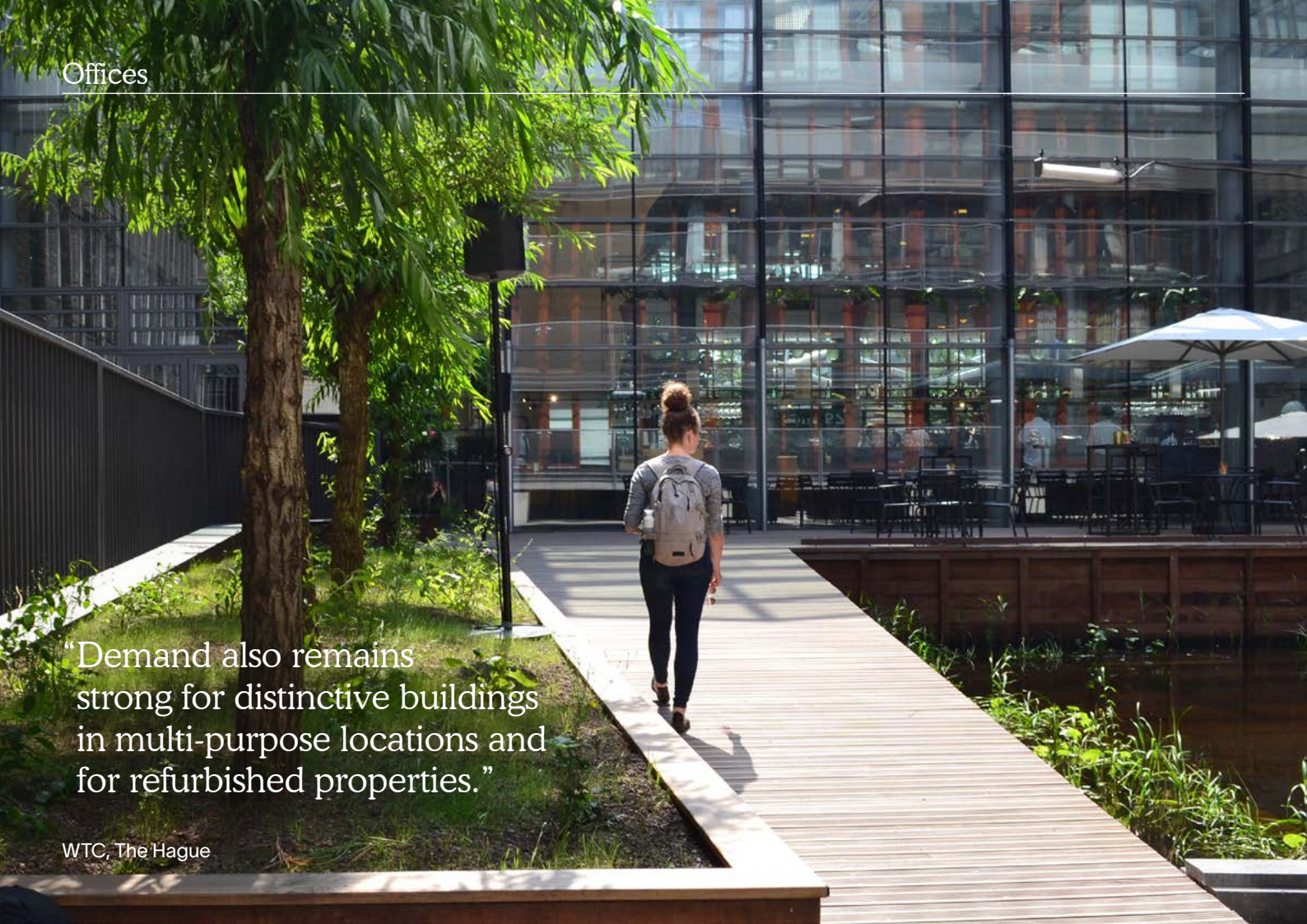
### Delayed new developments will have a positive effect on existing stock values

Rising construction costs (raw materials and wages) as well as government restrictions aimed at curbing nitrogen emissions will lead to a temporary delay in new building starts. Valuations for existing offices could increase as a result and that positive effect could even extend to sufficiently sustainable modern offices on secondary and tertiary locations due to the lack of competition from recently completed supply.

Tenants will continue to focus on sustainable buildings at office locations providing a mix of functions and good public transport connections. These types of properties are therefore likely to be less affected by the structural growth in WFH and new tenants for vacant space will be easier to find.

Secondary locations will see rising vacancy levels, due to working from home effects combined with a less favourable economic outlook, putting downward pressure on rents. The gap in performance between prime and secondary locations will therefore continue to widen. This trend may be offset, however, by the ongoing transformation of office buildings and the potential impact of redundant unsustainable stock being taken off the market.





“Demand also remains strong for distinctive buildings in multi-purpose locations and for refurbished properties.”

WTC, The Hague

#### Investment market

## Initial yields tightened on the back of favourable fundamentals

The favourable fundamentals in the occupier market and the sustained pressure from the weight of capital targeting real estate as an asset class, have led to further compression of initial yields in the past few years. Institutional investors are particularly keen on offices with solid sustainability credentials in well-connected locations or campus-like settings with a mix of established companies and start-ups. Demand also remains strong for distinctive and monumental buildings in multi-purpose locations and refurbished properties.

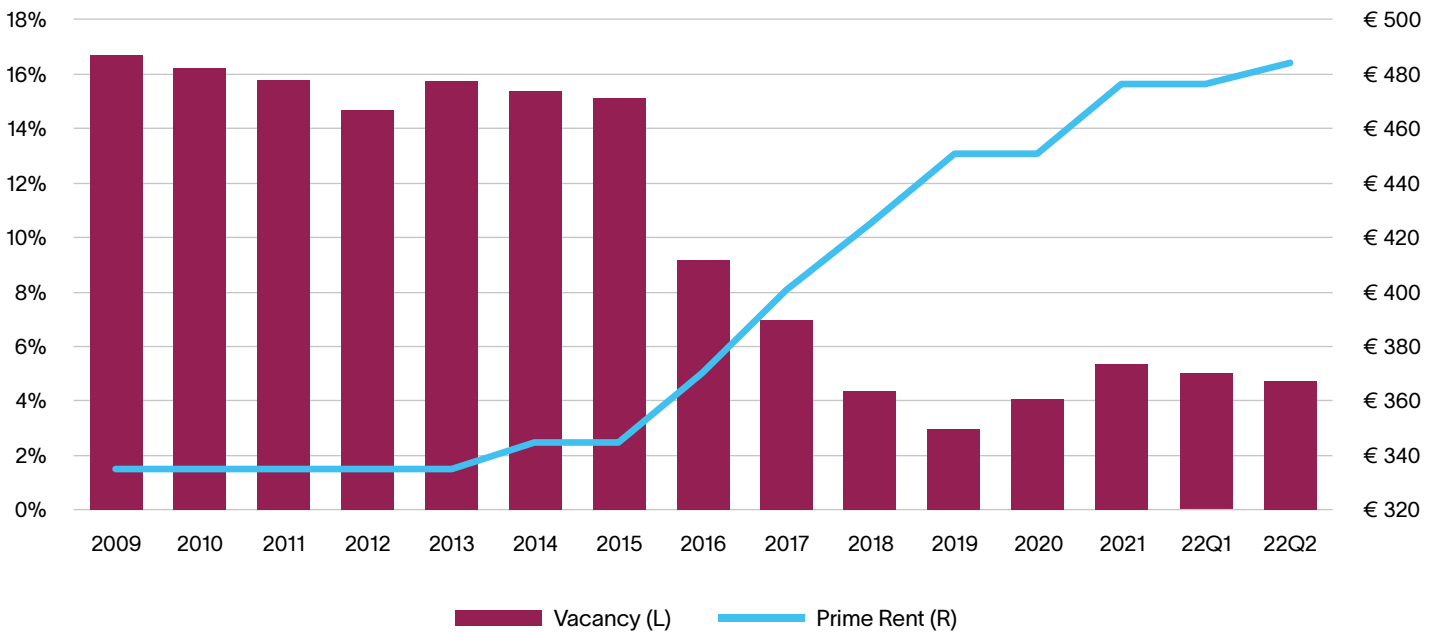
The conversion of vacant and obsolete standalone office buildings continues alongside large-scale redevelopments at locations such as Southeast Amsterdam (Zuidoost). Refurbishments and redevelopments are currently being held back, however, by rising construction costs and restrictions

aimed at curbing nitrogen emissions.

The charts below show how falling office vacancy levels in Amsterdam have coincided with rising rents and tightening yields.

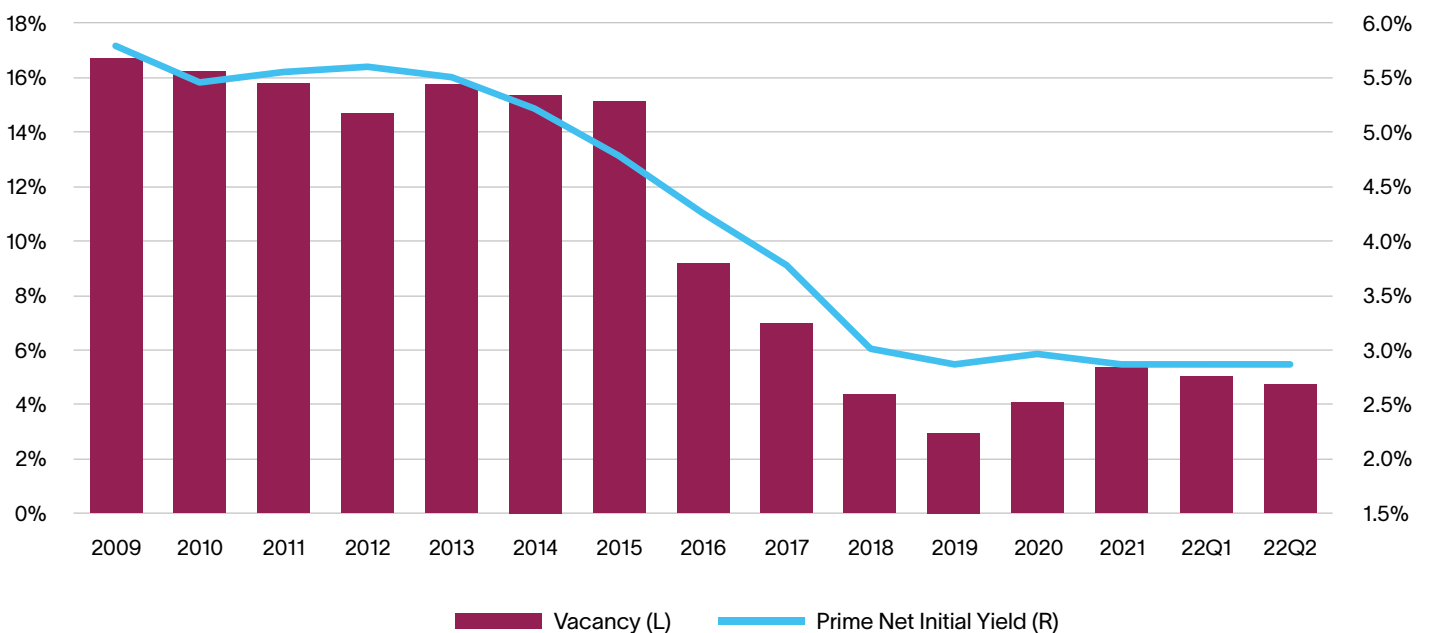
### Vacancy and prime rents Amsterdam offices

Source: JLL



### Vacancy and prime net initial yields Amsterdam offices

Source: JLL







The Garage, Amsterdam

## What does this all mean for the office real estate market?

### Opportunities

- Demand remains strong for modern, energy-efficient offices that are easily accessible, offer pleasant and healthy surroundings and a mix of functions such as retail and leisure.
- Prime supply will likely remain fairly tight due to new minimum energy-efficiency performance requirements, limited new developments stemming from restrictions aimed at curbing nitrogen emissions and ongoing office conversions.
- Unleveraged investors will have an edge over leveraged players as financing costs rise due to higher interest rates.

### Threats

- An economic downturn or even recession is a real possibility due primarily to rising interest rates stemming from soaring inflation triggered by global supply chain shocks and skyrocketing energy prices following Russia's war on Ukraine. That could affect the profitability of some businesses and lead to bankruptcies and higher office vacancy levels.
- Rising interest rates are a major threat due to the knock-on effect on initial yields and capital values.
- The growth of working from home is leading to part of the office stock becoming redundant and greater demand for more flexible rental contracts.
- New development starts are expected to be constrained in the short to medium term due to rising construction costs (raw materials and wages) and restrictions stemming from measures aimed at curbing nitrogen emissions. On the one hand, this limits investment opportunities; on the other, it could have a positive effect on the valuations of existing office properties.

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# Hotels

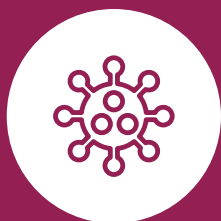
## Tourism revival lifts hospitality sector out of the doldrums

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### Executive summary:



The post-pandemic tourism rally has led the recovery in the hotel market, but business travel is returning more slowly.



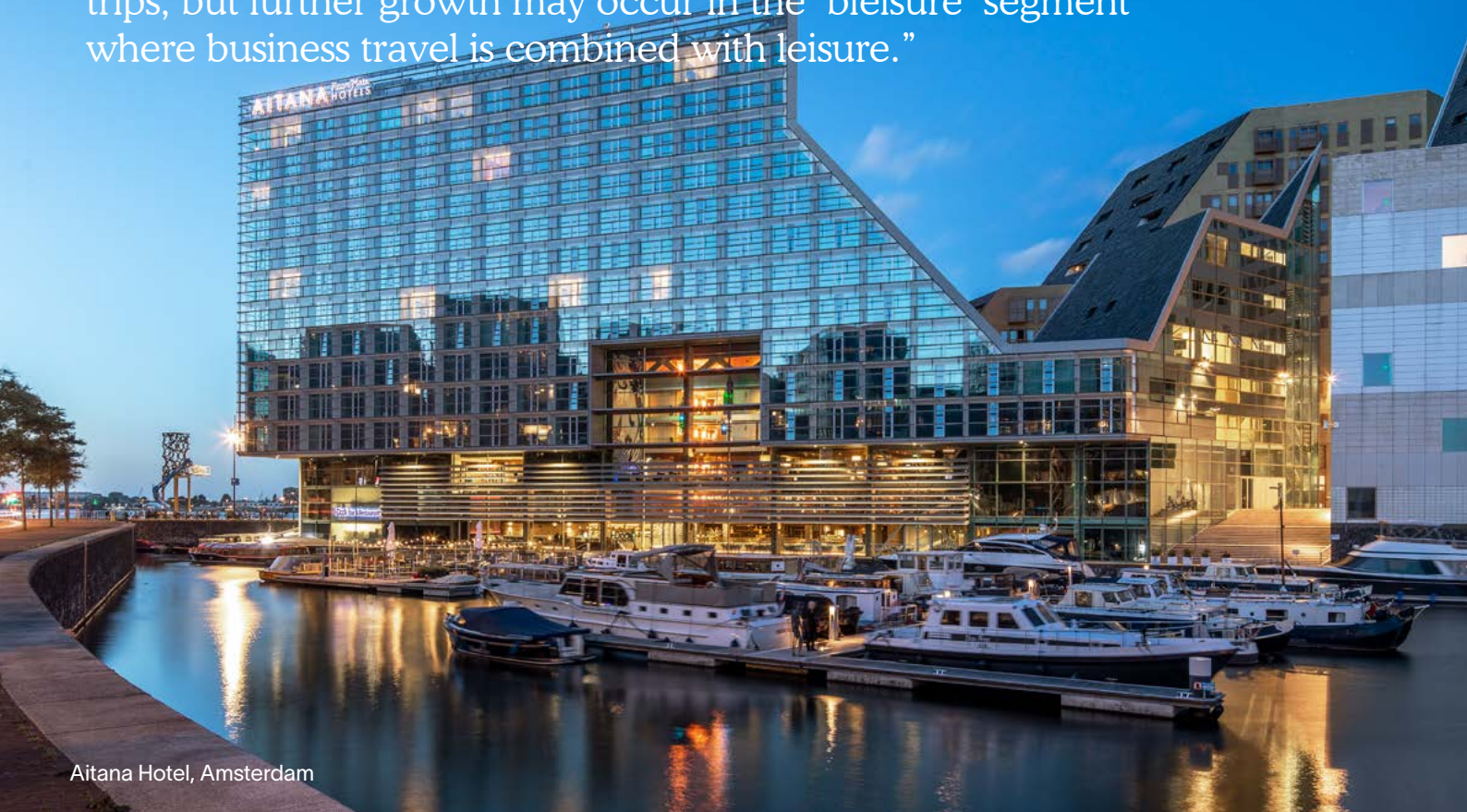
Clouds are building on the horizon as fears of an economic downturn intensify, while the potential emergence of another Covid-19 virus variant remains a threat.



As a result, rising prime yields are on the cards in most markets.



“Business travel has not bounced back as strongly as recreational trips, but further growth may occur in the ‘bleisure’ segment where business travel is combined with leisure.”



Aitana Hotel, Amsterdam

### Long-term trends

## ‘Bleisure’ tourism takes off as zoom bites into ordinary business travel

The hotel sector had an unexpected - and unwelcome - break during the Covid-19 pandemic as business and tourism travel fell off a cliff. Recreational travel has led the recovery thanks to the post-pandemic catchup effect as people want to get back out into the wider world and are willing to spend a greater part of their pent-up savings on leisure and experience travel. Over the longer term, the global tourism market will also resume its strong growth trend, as the expanding middle classes in Asia and other developing markets spend their greater disposal income on the joys of a vacation.



Business travel is also recovering but has not yet returned to pre-Covid levels and the gap may endure due to the convenience of, and wide familiarity with, online meetings which thrived during the pandemic and are now a permanent fixture across all industries, not least because of the big cost and time savings they offer. But the growth in the hybrid 'bleisure' segment where business travel is combined with leisure, may take up some of the slack left by the slashing of corporate travel budgets.

Travellers are becoming increasingly aware of their ecological footprints and there are some signs of a shift towards more environmentally friendly forms of transport, such as trains instead of planes, and short-distance trips. Many people rediscovered the attractions of their home country during the pandemic and staycations have grown in popularity, also in the Netherlands, due to the shorter travel distances and the lack of 'hassle', compared with that increasingly associated with flying in recent times.

**6%** net initial yield as at HY 2022

**“A broader economic crisis would have a negative impact on tourism as consumer spending is hit.”**

Postillion, Rotterdam



## Occupier market

# Domestic tourism has not lost its lustre

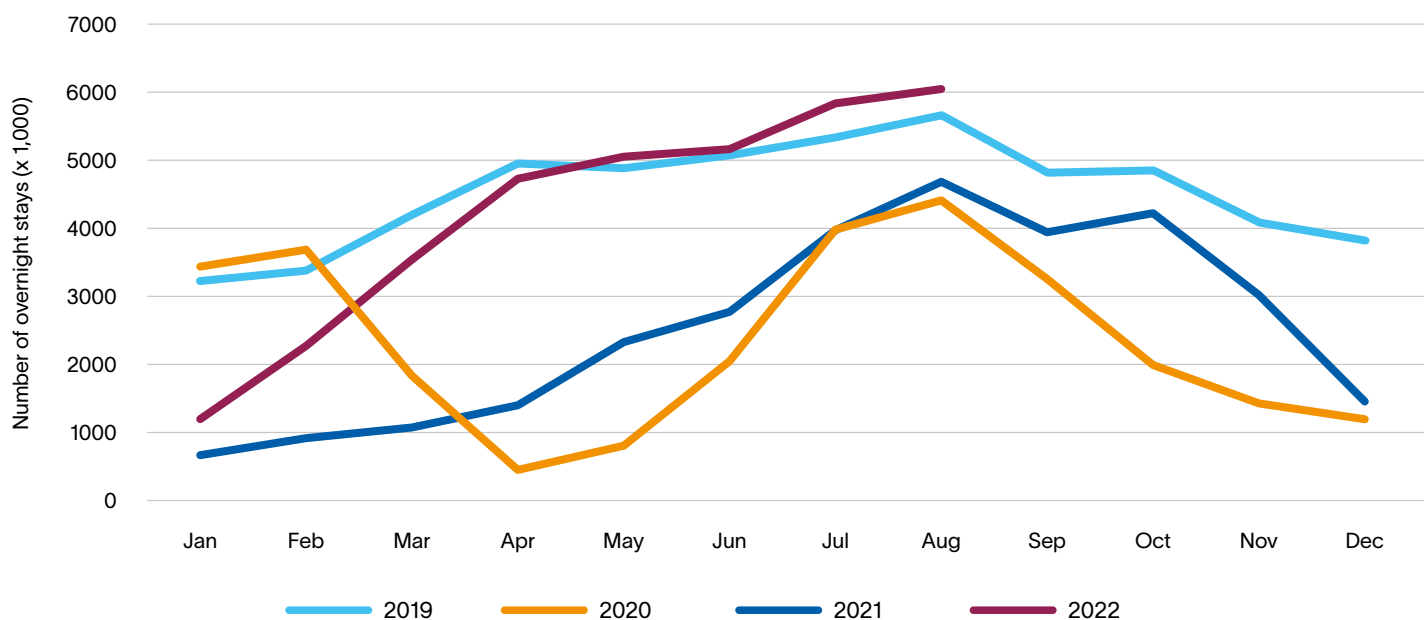
Tourism, both at home and worldwide, collapsed following the Covid-19 outbreak in 2020 as hotels were forced to close their doors and travel restrictions were introduced. Government support packages helped hotel operators and caterers in the food & beverage (F&B) segment to survive during the Covid-19 pandemic and many also received rental reductions or delayed payment schemes. Businesses were thus able to remain operational and the number of bankruptcies was very limited.

Domestic tourism rallied in the summer of 2020 after the first phase of the pandemic and hotels located close to national parks and coastal areas saw a huge uplift in visitor numbers. The surge was so big in some cases that it completely offset the decline in international tourism. Operators in The Hague (on the North Sea coast) and Utrecht (surrounded by forests, lakes and national parks) performed particularly well, while other big cities including Amsterdam and Rotterdam lagged behind. The number of hotel stays plunged again across the board, however, in October 2020 as the Covid-19 virus re-emerged.

The same trend was repeated between May and October 2021 as per the previous year, with an even greater surge in domestic tourism before hotel stays collapsed again in the autumn with a fresh wave of the Covid-19 virus. Tourism remained sluggish in the first two months of 2022 but bounced back across the board from March. In May, the total number of hotel stays in the Netherlands exceeded those pre-pandemic in 2019 for the first time. This was not a blip: data for the three-month period between May through July 2022 show that hotel stays in Dutch hotels were 5% higher than pre-Covid levels.

## Annual hotel overnight stays in the Netherlands

Source: Statistics Netherlands (2022)



“The rebound in hotel occupancy rates in 2022 indicates that the underlying demand continues to rise. The expected economic downturn will brake growth temporarily, however.”

### Catch-up tourism fuels revival, but short-term economic uncertainties persist

The strong recovery in tourism during 2022 reflected the catchup effect after the lockdowns and travel restrictions, but this rise could be expected to subside in the short term as the hotel sector faces a number of potential risks and challenges:

- Fears over the beginning of a potential sharp economic downturn in the final months of 2022 are intensifying due to the European energy crisis and surging inflation, which would hit consumer spending on travel and hotels.
- The economic outlook has deteriorated significantly, and the first effects of rising prices caused by inflation became visible for consumers in Q3 2022. Everyday life has become more expensive from daily groceries to gas and electricity bills.
- Inflation indexation of hotel rents will pressure operators' margins, as will higher wage, energy, and other operating costs.
- Staff shortages could also constrain turnover.
- The possible emergence of another Covid-19 virus variant remains a threat.



# €300M

Investment volume  
for HY 2022

### Investment market

## Long-term investors look beyond the current recovery

Covid-19 had a very direct impact on the hotel investment market. Before the pandemic, hotel investment volumes in the Netherlands stood at between €1-1.5 billion annually, but they subsequently slumped to €200 million in 2020 and €300 million in 2021 (excluding the acquisition of a majority stake in Eden Hotels for €300 million). Valuations were heavily impacted in 2020 but have been climbing steadily since 2021 through the first half of 2022.

### Forecast 2023-2025

By the end of 2021 and early 2022 hotel investors started looking beyond the current period of recovery to the future. The number of transactions started to rise, and pricing has been keen, despite the uncertain economic outlook and operational challenges. This was particularly true of smaller hotels, mainly in Amsterdam, which is where most investors tend to look, even though the Dutch capital was hit hard during the pandemic.

A shift occurred in the course of 2022, however, as some leveraged buyers started falling away due to rising financing costs and demand for prime hotel properties therefore eased somewhat. Although prime initial yields are a bit higher than they were at the beginning of 2022, not all risks have been priced in yet. A further widening in yields is not unlikely in the short term.



Boat & Co, Amsterdam



## What does all this mean for the hotel real estate market?

### Opportunities

- The underlying demand for travel and hotel stays is believed to be strong, as shown in the catch-up response to the Covid-19 restrictions of the past two years.
- If not for the economic downturn now being forecast, hotel occupancy rates across the Netherlands would have likely surpassed pre-pandemic levels in full-year 2023. That would translate directly into higher room rates lifting the industry's main RevPar (revenue per available room) metric.
- Research by hospitality consultant Horwath (June 2022) nevertheless still concludes that hotel operators' average RevPar could reach 2019 levels by 2024.
- Unleveraged investors will have an edge over leveraged players as financing costs rise due to higher interest rates.

### Threats

- An economic downturn is now a very real possibility. Occupancy levels and room prices will likely recover less quickly than previously expected and it could take an additional one to two years before they are back to pre-Covid levels.
- Rising interest rates are a major threat due to the knock-on effect on initial yields and capital values.
- Additionally, hotel operators face substantially higher costs due to the energy crisis and overall inflation.
- Staff shortages could also prevent operators from achieving full capacity, compounding the squeeze on margins from higher operating costs overall and pushing them to seek rental discounts from landlords.
- New development starts are expected to be constrained in the short to medium term due to rising construction costs (raw materials and wages) and restrictions stemming from measures aimed at curbing nitrogen emissions. On the one hand, this limits investment opportunities; on the other this could have a positive effect on the valuations of existing hotels.

# Want to find out more about investing with Bouwinvest?

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