OUTLOOK

OFFICES
2023 MID-YEAR UPDATE

CUSHMAN & WAKEFIELD

OUTLOOK

TO BALANCE BETWEEN FOUNDATION AND LIQUIDITY

CUSHMAN & WAKEFIELD

INVESTMENT MARKET

There has been a visible decline in investment activity in the office market since the second half of 2022, prompted by increased uncertainty and significantly higher interest rates. In the first half of 2023, this has manifested in a lagging investment dynamic of around EUR 300 million, about a quarter of total investment volume.

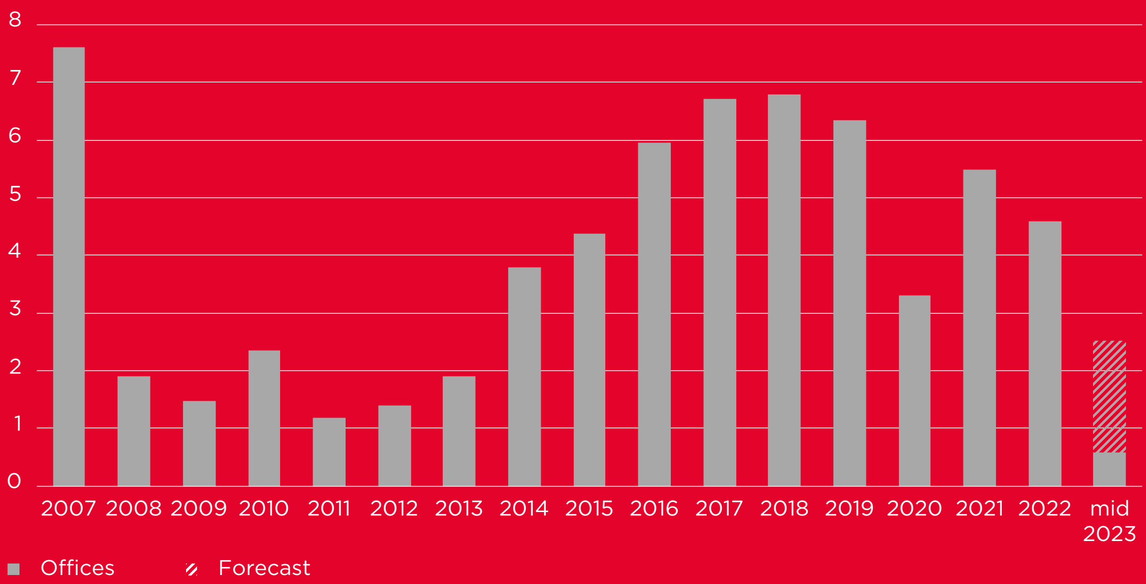
This represents a decline of 70% compared to the same period in 2022, when office investment volume amounted to approximately EUR 1 billion. Investment volume in 2022 was boosted by the sale of the Booking.com offices in Amsterdam for EUR 566 million euro, the World Port Center in Rotterdam for EUR 193 million and the Strawinskyhuis in Amsterdam for EUR 133 million. Over 60% of the investment volume in offices in 2022 was invested in the five largest cities (G5).

The cautious attitude taken by real estate investors in the office market has eased slightly compared to the first quarter, but is still affected by the uncertain outlook. The costs of funding indeed are currently higher than the initial yields for the most risk-averse (core) office investments. Significantly higher interest rates are leading real estate investors to demand higher returns, due to the increase in risk and volatility. The bid-ask spread has thus become too big for transactions to be effected. More reference transactions and clarity regarding the stabilization of interest rate levels will have an important role and will have a direct effect on the investment dynamic for the rest of this year. Investors are also looking at the length of leases, the solvency of the tenants and the location and quality of the office in question. There is as yet no sign of forced sales as a result of refinancing, due to the strong fundamentals in the office market.

Gross initial yields have risen further across the board during the first half of 2023 on the back of the increased uncertainty and higher funding costs. In the centre and at the Zuidas in Amsterdam, the correction amounted to 60 basis points to a top gross initial yield of 4.60% (with costs payable by the purchaser). Investors are risk averse and are focusing mainly on the core segment, which is also the focus of the office users. These prime locations have the lowest vacancy figures and also the largest rental value growth, also due to the availability of high-quality and sustainable office buildings. In addition, specific locations, bio/life science parks such as the Leiden Bio Science Park, are in demand as further rental growth is expected here and these premises feature less cyclical business activity. Investors are showing limited interest in assets that are higher on the risk curve: there are virtually no transactions occurring in the value-add segment, due to limited availability of funding and the uncertain economic prospects.

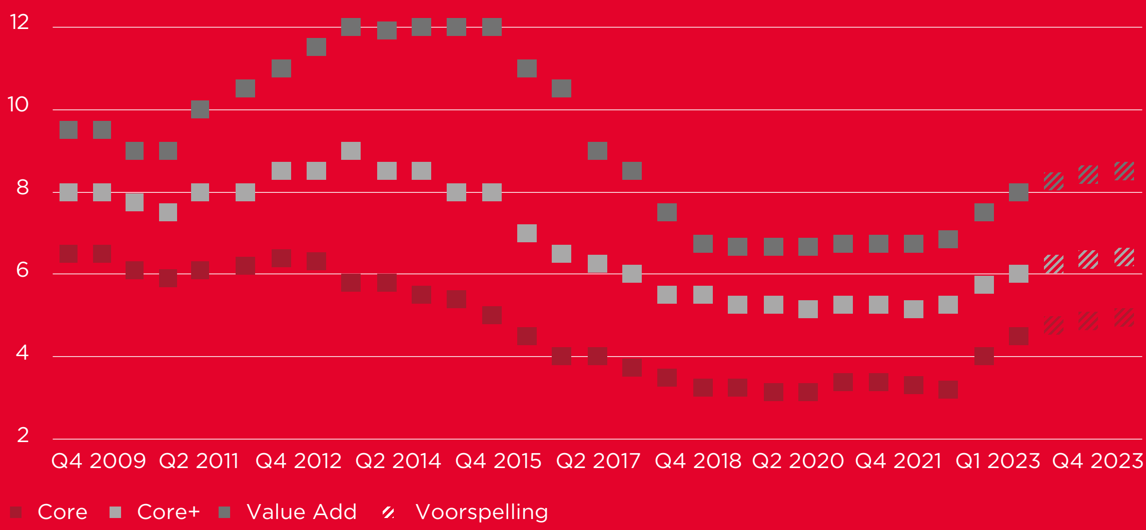
As a result of the higher costs of finance, investors with their own resources and a longer horizon, such as institutional players and family offices, are becoming the main buyers. Institutional parties have capital available to have the various funds comply with ESG (Environment, Social and Governance) requirements.

The Dutch real estate investment market
Investment volume in offices (in EUR x bln)



Source: Cushman & Wakefield

Development of gross initial yields - Offices
GIY with costs for buyer (%) Core, Core+, and Value add



Source: Cushman & Wakefield, 2023

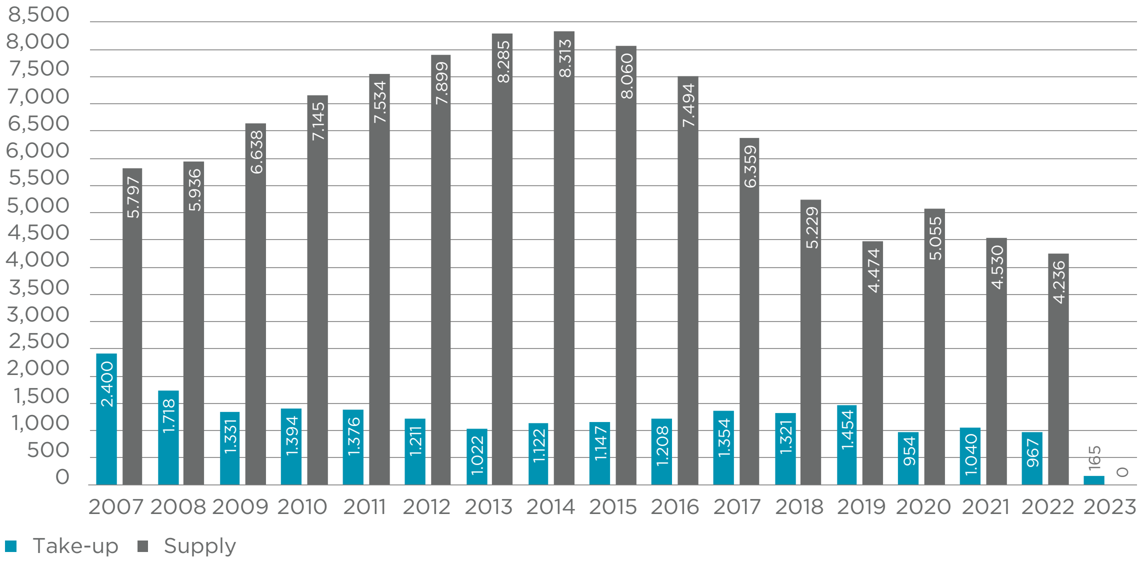
USERS' MARKET

In the first half of 2023, 302.000 square metres of office space was taken into use. This represents a decline of 11% compared to the same period in 2022 (185,000 m²). The office market thus made a cautious, but solid start to 2023, that is surrounded with structural and economic uncertainties. We expect these uncertainties to weigh even more heavily during the second quarter.

Inflation, interest rate increases and higher costs are contributing to uncertainty among office users, as is policy with respect to the balance between working from home and working at the office. Most existing leases are being extended. Commercial organizations, such as business services providers and/or creative businesses are still working on reconciling the costs of business premises with the need to attract talent. There is more dynamism in the public sector, as premises strategies are being reformulated and there is less dependence on cyclical developments. Businesses with high levels of external debt, such as the tech sector, are more at risk as a result of the rise in interest rates. We expect take-up to moderate in 2023, while the supply side remains stable. Supply of available office space in the market will be limited, as existing leases will mostly be extended.

As of mid-2023, supply increased slightly by about 2.6%, but had no impact on the vacancy rate, which actually decreased slightly by 8.1%. 3.9 million square metres of this space was physically vacant, giving a vacancy rate of 8.2%. This stable level of vacancy with a decline in supply is due to the unwillingness of existing tenants to relinquish too much office space, as their staff are increasingly returning to the office and the high-quality office space at prime locations they would like to acquire is not available. Another reason for the decline lies in the pressure for change of use to other purposes, such as residential, meaning that an increasing amount of office space is disappearing from the market. Moreover, several office buildings have been withdrawn from the market for use as (temporary) housing for refugees.

Users' market for offices in the Netherlands
Take-up and supply of office space (x 1,000 m² LFA)



Source: Cushman & Wakefield, 2023

All the large cities are reporting lower vacancy figures than the national average. The tightest office markets this year are once again to be found in The Hague and Utrecht, with vacancy rates of 4.4% and 4.6% respectively, while there is more office space available in Amsterdam (7.1%), Rotterdam (6.9%) and Eindhoven (6.8%). New-build projects have been postponed or abandoned due to the increase in the costs of construction. This places further pressure on the office market, and in some areas the potential demand cannot be met. In core districts of the G5 cities, vacancy rates are mostly below the friction level at between 2% to 5%. This explains the continuing popularity of multi-modal hubs at locations with high-quality facilities among office users.

Rents rose in the first half of 2023, due to the tight market situation at the prime office locations, the addition of various high-quality new-build developments and indexation in line with the CPI. The top rent in Amsterdam is EUR 565 per square metre per year, followed by Utrecht (EUR 300), Rotterdam (EUR 300), The Hague (EUR 240) and Eindhoven (EUR 240). These top rents are mostly achieved in high-quality (new-build) office buildings at multi-modal locations with high-quality facilities. These top rents are expected to increase further due to the continuing lack of availability.

The ‘war for talent’ among organizations due to the low level of unemployment is as intense as ever, and organizations have to present themselves as attractive employers in order to succeed. On the one hand, cost control at employers is becoming a higher priority, on the other, scarce employees need to be tempted by an attractive workplace at a central, easily accessible and vibrant location. The result is a search for a high-quality office, usually located at a public transport hub with a variety of facilities in the immediate vicinity. This search for quality frequently involves higher premises costs, and thus optimized use of the available square metres. A good and customized workplace strategy is becoming increasingly important, with less focus on traditional workplaces and greater attention to informal working spaces, focus spaces and communication rooms.

Good quality offices at slightly less desirable city locations are now gaining in popularity due to the tightness in the market. The owners of these offices appear to be more prepared to offer the flexibility that tenants are increasingly demanding: short leases, break options and return clauses in the lease contracts. A temporary workforce in combination with a co-working party usually leads to a solution. Sustainability is also becoming a very important issue for users that need to meet their ESG targets.

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