AM

NL real estate | Knight Frank

NETHERLANDS PRS REPORT

SUMMER **2018**

THE NETHERLANDS HOUSING GAP IN A EUROPEAN PERSPECTIVE

KEY POINTS

Over the next ten years, the Randstad region is expected to have the highest ratio of new professional jobs to new households amongst key comparable metropolitan areas in Europe.

According to data from MSCI, the income return of institutional investments into the residential sector in the Netherlands experienced growth of 7% over the last four quarters as a result of increasing demand for privately rented properties.

The average household income of those aged 25-29 years old is too high to qualify for social housing, but too low to afford to buy. The maximum loan available to this age group would only cover 60% of the value of an average property in Amsterdam.

Despite the long-term delivery of new dwellings closely mirroring increases in the number of households, analysis shows that there is less than 1 dwelling per household in the Netherlands.

The focus for the delivery of new homes has typically been owner-occupied or social rented stock. This has created an undersupply of stock in the mid-market – which includes the delivery of private rented accommodation.

THE RANDSTAD – HOUSING THE EXPANDING WORKFORCE

Increasing demand for residential rental accommodation in the Netherlands is making this market an attractive destination for investors.

Affordability

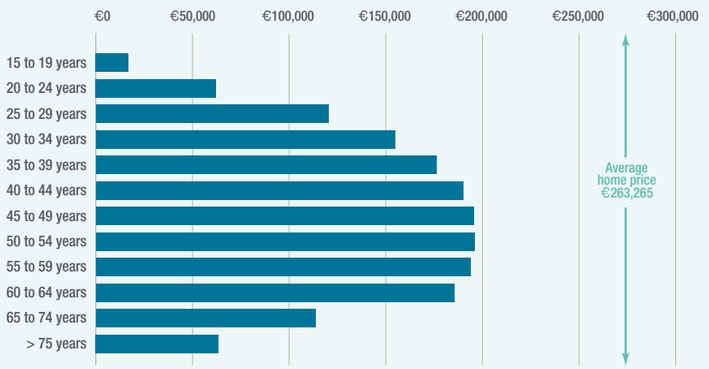
Since 2000, residential property prices in the Netherlands have increased by an average of 53% and now stand at EUR 263,265. Amsterdam has been a focal point of much of this growth, with prices almost doubling over the period. However, over the same time, increases to disposable household income haven't kept pace, rising 37% in the Netherlands as a whole and 46% in Amsterdam. As a result, housing affordability has become stretched for some buyers.

A closer look at the data presents a more nuanced picture. Personal annual income in the Netherlands varies significantly by age group. Those aged between 50 and 54, for example, have the highest average personal annual income at EUR 43,510. According to our calculations, these individuals can borrow a maximum of EUR 195,795 to put towards the purchase of a property. This amounts to approximately 74% of an average priced home, meaning that there is a 26% shortfall in capital required to afford home ownership.

Homeownership does, however, become more affordable for those applying for a mortgage as a couple. This is especially the case for older generations (most notably couples in the 45 to 59 age bracket), where typically average earnings are higher. These age cohorts could potentially afford to purchase a property valued at EUR 390,100 if they were applying jointly for a mortgage. This is 48% higher than the price of an average home in the Netherlands.

Affordability is, however, a real issue for younger generations. The current average household income per annum for a couple aged 25 to 29 in the Netherlands is estimated at EUR 53,500. Latest statistics suggest that the maximum loan amount available to them is approximately EUR 240,750, 91% of the value of an average priced property.

FIGURE 1
Current maximum loan (mortgage) amount in the Netherlands
Based on average personal annual income



Source: CBS

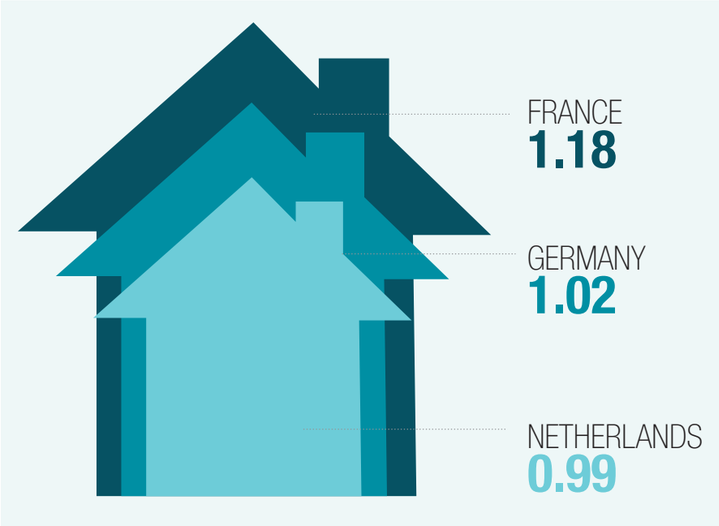
TABLE 1
Affordability analysis

REQUIRED INCOME FOR HOME OWNERSHIP OF AVERAGE PRICED HOME IN AMSTERDAM*	€90,593
MAXIMUM HOUSEHOLD INCOME TO QUALIFY FOR SOCIAL RENTED ACCOMMODATION	€35,739
AVERAGE HOUSEHOLD INCOME FOR 25 TO 29 YEAR OLDS**	€53,500

*Based on the assumption that maximum mortgage is 4.5 household income.
**Based on assumption that the household is comprised of two persons on annual average salary of this particular age group (25 to 29).

Source: Knight Frank, CBS, AM

FIGURE 2
Dwellings per household European comparison,
2011-2016



Source: Hypostat 2017, Oxford Economics

This lack of affordability for younger generations becomes even more apparent in Amsterdam, where the average house price is currently EUR 407,670. According to our calculations, the maximum loan value available for a couple aged 25-29 would only cover 60% of the value of an Amsterdam property.

Despite this perceived lack of affordability in terms of home ownership for the younger generations, many within this age cohort earn too much to qualify for social housing. Their earnings also put them above the threshold to be able to qualify for rented accommodation under regulated rents (a type of social housing). The average household income for a couple is 50% higher than the maximum income accepted to qualify for a regulated rental property – which currently stands at EUR 35,739.

This has left a gap in the mid-market. With mortgage regulations tightening and property prices continuing to rise, households are unlikely to be able to afford to own as previous generations could.

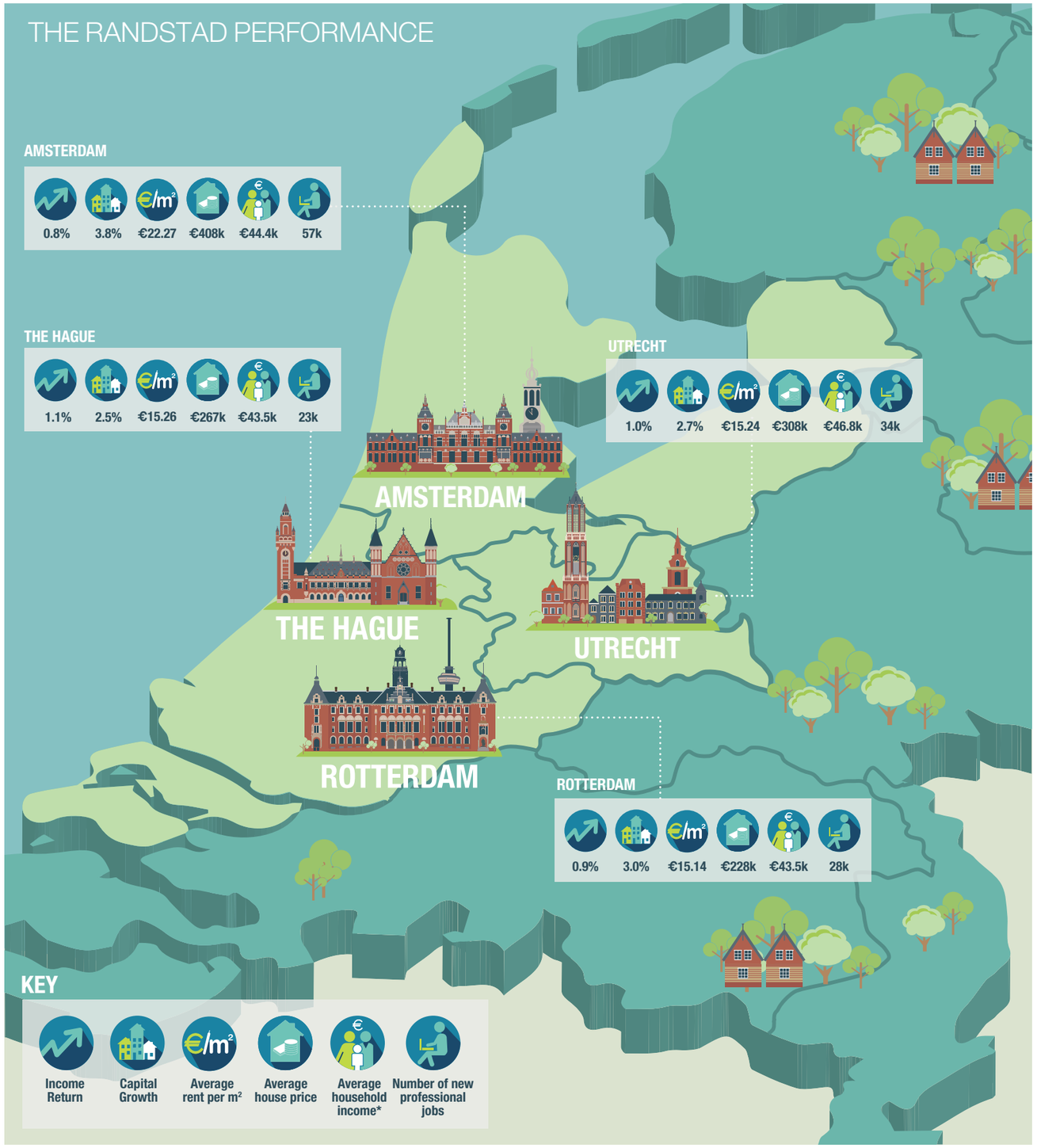
FIGURE 3
Annual additional households vs. dwellings in the Netherlands 1999-2017

Source: ABF Research – Socrates 2017

Supply

Perhaps the most significant factor underpinning house price growth in the Netherlands has been the historic lack of supply relative to demand.

Data from ABF Research suggests that the total number of dwellings has lagged behind the total number of households since at least 2001. When this gap was at its peak in 2012, it was estimated that there was a potential shortage of 246,608 dwellings. Since 2012, this perceived shortage has declined, with the latest statistics suggesting the shortage has fell to 120,000 dwellings in 2017. There is still however a clear imbalance between the rates of household growth and new dwelling growth.



Source: IPD/MSCI, Pararius, CBS, Oxford Economics. Please note, Income Return as of Q2 2017, Capital Growth as of Q2 2017, average rent per m2 as of Q4 2017, average house price as of 2017, average household income as of 2017*, number of new professional jobs 2017-2018. * Estimates by Oxford Economics.

THE RANDSTAD MARKET PERFORMANCE

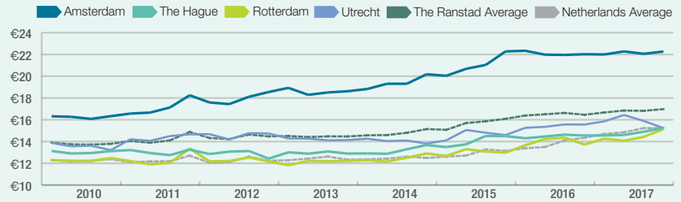
Average rental price

Since 2010, average rental values in the Randstad have been consistently higher than the Netherlands average. As of 2017, average rents in the Netherlands stood at EUR 15.01 per m2, compared to the Randstad average of EUR 16.83 per m2. This has been driven by stronger performance within the Amsterdam market. Since 2014, values in Amsterdam have increased by 14.1%, with a lot of this growth concentrated on the period between 2014 and 2016.

Since then, rental prices have been relatively unchanged. This, coupled with the continuous growth in income return, could indicate a decrease in capital costs, as we define income return is a measure of income net of all irrecoverable costs (source MSCI).

FIGURE 4

Average rental price per m² per month



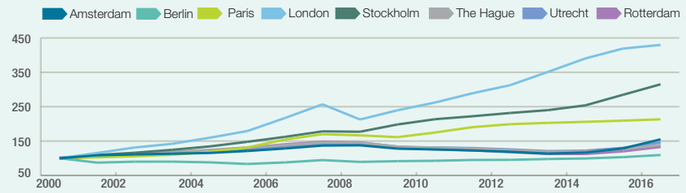
Source: Pararius

Capital growth

When comparing the Randstad in terms of capital growth of multifamily investment assets to peer cities in Europe, it is evident that the Randstad is lagging. In London for example, capital growth in the 2000 to 2016 period saw an increase of 4.3 times – compared to a figure of just 0.5 times for the Netherlands (similar to levels experienced in the post-2008 period).

FIGURE 5

Residential investment market Capital growth index



Source: IPD/MSCI

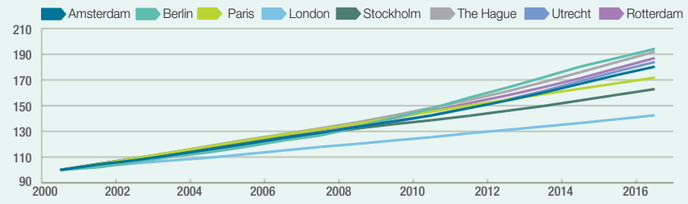
Income return

Despite this, income performance of multifamily assets has generally performed better than other European cities. Whilst income returns in some European cities were affected by the financial crisis of 2008/9, all cities within the Randstad region have experienced healthy levels of growth, with levels consistently higher than London, Stockholm and Paris.

Across the Netherlands, the income return index of institutional investments into the residential sector shows growth of 7% over the last four quarters (data up to Q3 2017). This is the result of rental growth driven by the increasing demand for privately rented properties. In summary, while the annual average growth of income return was 4% since the crisis, the average annual capital value growth was only 0.4%.

FIGURE 6

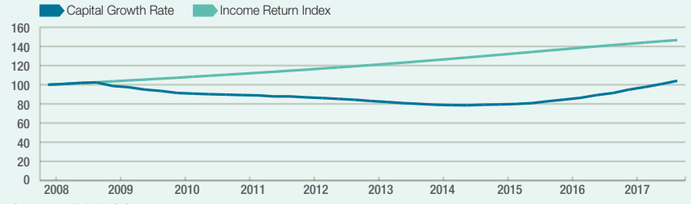
Residential investment market Income return index



Source: IPD/MSCI

FIGURE 7

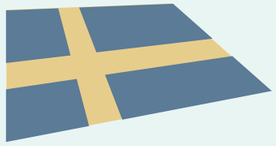
Quarterly capital growth and income return since 2007



Source: IPD/MSCI

Below are definitions of the above measures from the source:
(*) Capital Growth Index – represents the capital growth or appreciation of the value of an asset over a period of time, relative to the capital employed. This measure of the 'growth' component of performance is based on the change in the value of properties held at the start and end of an analysis period.
(**) Income Return Index – represents the income return growth or income receivable in relation to the capital employed over a period, net of all irrecoverable cost (capital expenditure including purchases & developments).

MARKET COMPARISONS

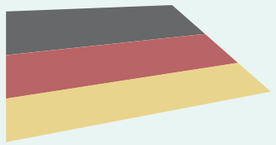


SWEDEN

Residential mortgage lending has been on the rise in Sweden, although the pace of growth has slowed slightly since 2015. The shortage of housing and the tightly controlled rental market, combined with favourable borrowing rates and increasing household income levels is driving demand among homebuyers. In Stockholm these factors are also underpinning house price growth. Infrastructure improvements (particularly the construction of the new ring road) alongside the expectation that the government will focus tax reforms on the real estate market for investors next year are likely to attract and increase investment into the country.

FRANCE

The housing market has been in a strong position of recovery over the last few years, following a lull in the aftermath of the financial crisis. Falling interest rates and incentives for buyers have contributed to an increase in demand for housing. Annual house price growth is still lower than that of Sweden and the UK, making affordability of owning a home in France less of an issue. Paris in particular is undergoing significant infrastructural expansions ahead of the 2024 Olympics, and we anticipate this will make the city even more attractive for investors.



GERMANY

In Germany, population growth has been driving increased demand for residential accommodation. As a result, both property prices and rental values have risen significantly since the financial crisis. This has not gone unnoticed by investors. However, the scarcity of available stock due to a long term undersupply is a real issue in the market.

During 2015, the new opt-in rent regulation rules were introduced. Each region can choose individually whether to implement these 'rent breaks'. So far these have been implemented in Berlin, Hamburg and cities in Bavaria. The rent breaks serve to stop new tenancies starting on more than 10% of the reference rent; this being the local rental benchmark for the area. New build dwellings however, are exempt from this rule.

UK

In the UK, the majority of PRS stock is owned by individual investors, of which a large proportion are owned under a 'buy-to-let' mortgage arrangement. There is an expectation that this share may start to adjust due to the changes in the tax reliefs for these landlords. Since April 2017 there has been a phased reduction in tax relief for buy-to-let landlords. By April 2020, there will be a standardised flat rate of tax relief at 20%. Whilst this should not have a major impact for some landlords, namely those who are basic rate taxpayer's already receiving 20% tax relief, this reform will have a significant effect on returns for landlords currently on higher rates of tax who currently receive 40-45% tax relief, which may lead them to review their portfolios.

IN THE NETHERLANDS, HOME OWNERSHIP AND SOCIAL RENTING ARE MORE POPULAR THAN PRIVATE RENTING.

However, due to rising demand and prices, a significant portion of the population is being priced out of home ownership. The private rented sector could be the solution for both individuals and housing authorities. As demand increases and supply lags behind, there is a real opportunity in the Randstad region for investors.

Despite the large gap in supply, there has been a period of turbulence over the past five years. Historically, the annual number of new dwellings being delivered has been parallel to the influx of additional households. In 2013, the number of new dwellings delivered increased significantly, and outstripped the annual increase of households for the first time since 2008 by 52%.

However, by 2015 this trend had reversed as the number of new households bounced back and overtook the annual number of new dwellings. Over the past three years, the number of new households created was on average 43% higher per year than the rate of new dwellings completed, widening the gap even further. The Netherlands has historically had a lower ratio of dwellings per household, a good measure of a potential lack of supply, compared to other European countries. In 2016, the latest available data, the Netherlands had a ratio of 0.99 dwellings per household, compared to 1.02 in Germany and 1.18 in France.

There is clear evidence of a lack of dwellings to meet the demand of a growing population, but what has become problematic for the mid-market in particular is a lack of suitable housing that is aligned with their affordability. This can be attributed to a lack of regulation by the Dutch government to enforce housing provision targets. At present, municipalities are not required to assign specific targets for delivering rental housing for the mid-market.

Although there is not necessarily widespread adoption of this across Europe, in the Netherlands this has meant that as municipalities are not required to deliver a minimum level of mid-market rental housing, this segment of the market has become neglected in terms of housing policy, further widening the gap with demand.

Demand

Household growth

Current forecasts show that there will be an additional 326,651 households created in the Netherlands over the next five years. Oxford Economics suggests that the number of households in the Randstad region will increase by 3% over the next five years and by 6% over the next ten years.

Growth in high earning professional jobs

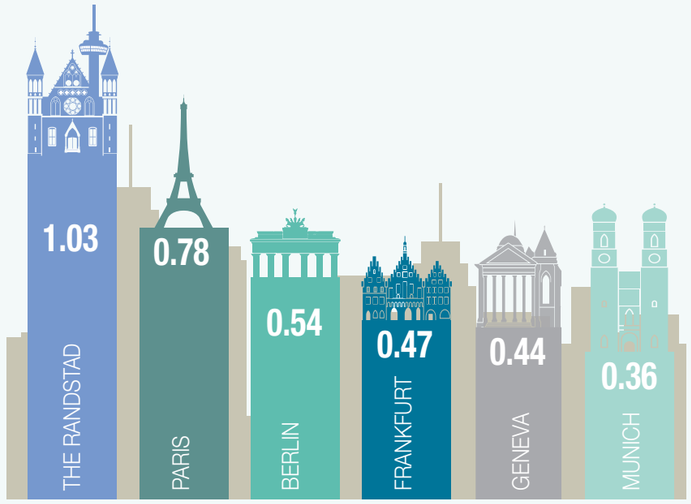
The number of individuals working in the Randstad is forecast to rise by 280,000 over the next decade. Half of these new jobs will be in the finance and business services sector. According to Oxford Economics, the density of these jobs in the Randstad are expected to be higher than in any other major metropolitan region in Europe.

This acceleration in high earning jobs will not only increase the demand for privately rented housing, but also specifically for high quality privately rented housing.

TABLE 2

Density of finance and business services sector jobs in large metropolitan regions across Europe, 2017-2027

Ratio of new jobs to new households over the next 10 years



Source: Oxford Economics

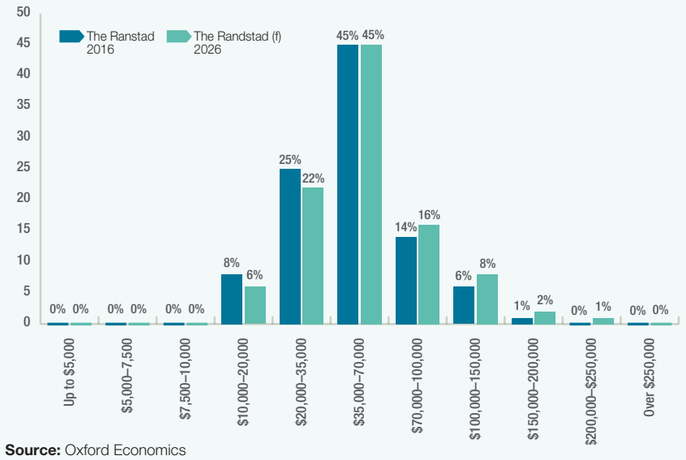
GROWTH IN HIGH EARNING HOUSEHOLDS

Income distribution amongst households in the Randstad region is expected to shift slightly. Over the next ten years we expect to see more households in higher earning groups, while the number of households in very low income groups is expected to decline (income bands of EUR 10,000 to 20,000 and between EUR 20,000 and 35,000).

FIGURE 8

Households by income band in the Netherlands, 2016-2026

(resident based, PPP constant 2015 prices)



Source: Oxford Economics

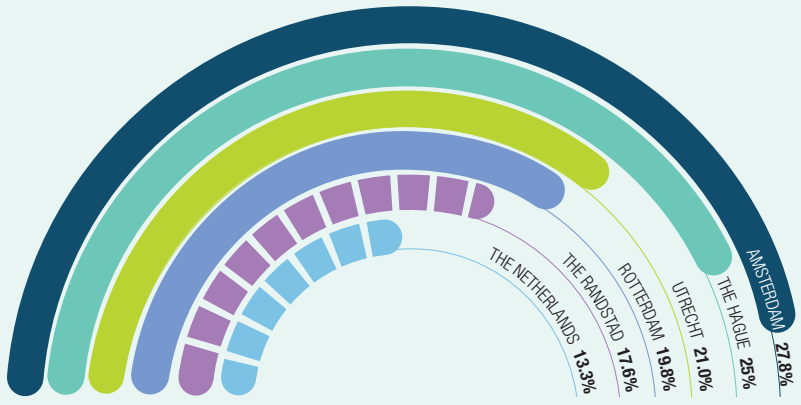
GROWTH IN PRIVATELY RENTED ACCOMMODATION

Demand for privately rented accommodation is expected to grow in the future.

The share of privately rented properties in the Netherlands has steadily increased over the last five years and this trend has been replicated in the Randstad. In 2012, 15.5% of properties in the Randstad were privately rented. Today this share has risen to 17.6%. Within the Amsterdam metropolitan area, 23% of all residential properties are privately rented, while in the Amsterdam this share is even higher at 28%.

FIGURE 9

Privately rented accommodation as a proportion of all housing stock, 2017



Source: CBS

OUTLOOK FOR THE RANDSTAD HOUSING MARKET:

- The Randstad has the highest growth of high earning jobs among peer European cities, underpinning the huge potential of this area
- This concentration of economic development and job growth suggests housing demand will remain high in the Randstad area
- Both existing stock and the supply pipeline lag behind this growing demand, creating the need to accelerate housing production going forward
- In the period up to 2030, an additional one million dwellings are needed to accommodate the growth in households. This will add even more pressure on an already tightening housing market
- Housing costs are likely to therefore continue to increase, both in the owner occupied and rental sectors, and in the suburbs and the peripheries alongside the growth expected in the major cities
- This will reinforce the affordability issue, especially among young people who will face difficulties in obtaining an owner occupied dwelling. Many will turn to rental options, which will increase the demand for PRS
- This trend will create new opportunities for developers and investors: demand is high and will remain high, so more focus on the amenities in and around PRS schemes will be key to assure the future value of new assets within these newly built environments
- The redevelopment of former office buildings to residential is expected to decline in the coming years, so it is therefore anticipated that the redevelopment of brownfield sites will accelerate in the near future, with developers increasingly looking at greenfield sites as potential opportunities.

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