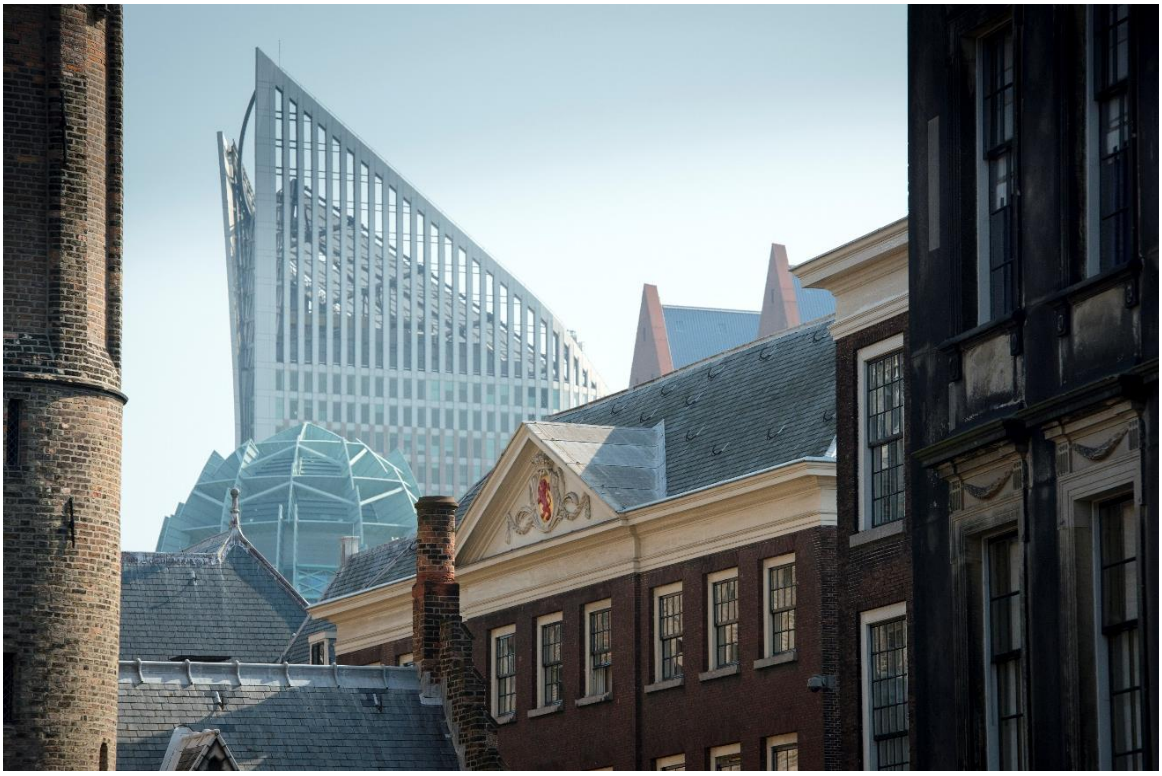
The Hague office market

Green shoots appearing



After a period of low activity in the office market of The Hague, the turnaround seems eminent. Interpreting the early signs of the local market cycle, CBRE sees investors anticipating on the recovery in the occupier market.

The occupier market, which is dominated by large corporations and public organisations, went through a period of consolidation and appears now to be set for growth again. The Q1-Q3 2017 take up volume suggests that the letting market has bottomed out. This turn-around is supported by the economic forecasts of growing office based employment in the region. As drivers of occupier demand, the governmental, financial and oil and gas clusters already prove their strength in attracting and retaining office occupiers to The Hague.

Meanwhile, the central government real estate agency concluded its office portfolio optimisation strategy. The programme led to a modern office stock, an occupier concentration in CBD and an overall lower vacancy rate.

MODERN OFFICE STOCK

Low building age

The office stock of The Hague generally consists of modern buildings. Measured by weighted average age of the buildings of the CBD, The Hague has the second youngest CBD of the four largest cities in the Randstad conurbation, just after Amsterdam CBD. This relative young age can be explained by the reasonable recent completion of a few large buildings such as the Jubitowers and Monarch II.

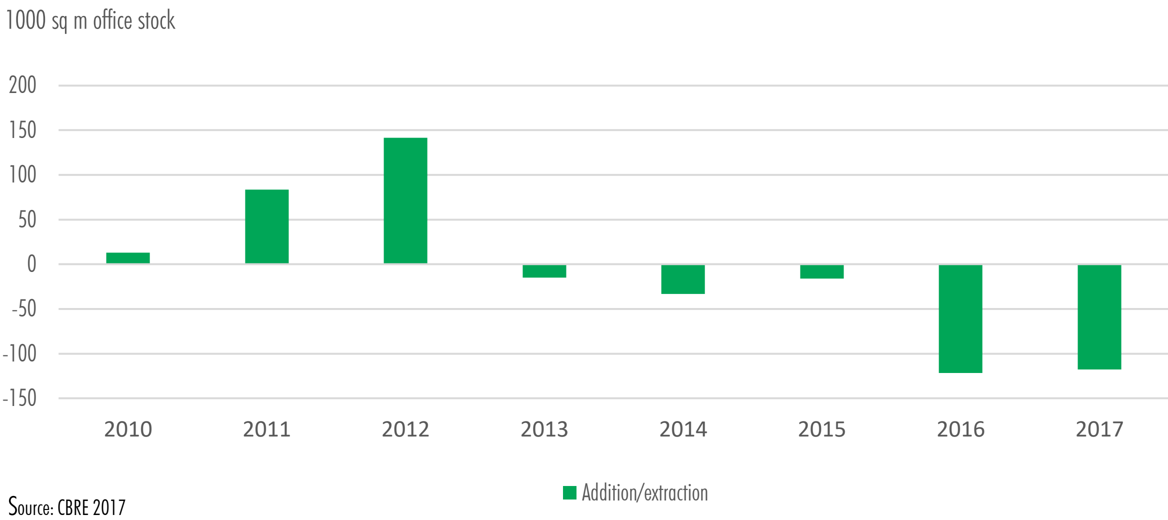
The modern office stock in the CBD is the result of combined efforts of the public central government real estate agency, commercial property developers and investors. Together they developed a modern CBD with a high density of office workers, residents and hotel guest. This combined use of space creates an increasingly vibrant place and a growing market for shops, restaurants, lunch rooms and sport and wellness facilities that make the place even more attractive.

Conversion of outdated and vacant offices

The relatively young age of the office stock is not only due to newly constructed buildings, but is also attributable to the conversion of outdated offices to residential and other uses. In the period 2012 – 2017 Q3, a total of 703,000 sq m outdated offices has been extracted throughout the city, equal to 13% of total stock as per 2017. This is the highest percentage of extractions of the four large cities in the Randstad conurbation.

As a result of these extractions, the office stock of The Hague shrank from its peak volume in 2012 of 4.1 million sq m to 3.8 million sq m in Q3 2017 which is a decrease of 7.6%. Most of the office buildings that were converted were located in secondary locations. Binckhorst, Laakhaven and Bezuidenhout were the submarkets where reductions in stock were strongest[1]. Many office workers located in these properties have been relocated into the CBD.

Chart 1: Net growth and decline of the office stock of The Hague



Source: CBRE 2017

[1] Measured as percentage change since its maximum number of sq m office space.

Central government real estate agency

In 2011 the central government and the municipality of The Hague agreed on the masterplan for the optimisation of the office use of all government services. In the plan, the central government real estate agency estimated that by 2020 the office use would be decreased by 400,000 sq m. The estimate was based on more efficient use of office space and a decreasing headcount. In the execution of the master plan, many outdated office buildings owned by the government were vacated and converted into other use. In addition, lease contracts for office space owned by other landlords were terminated.

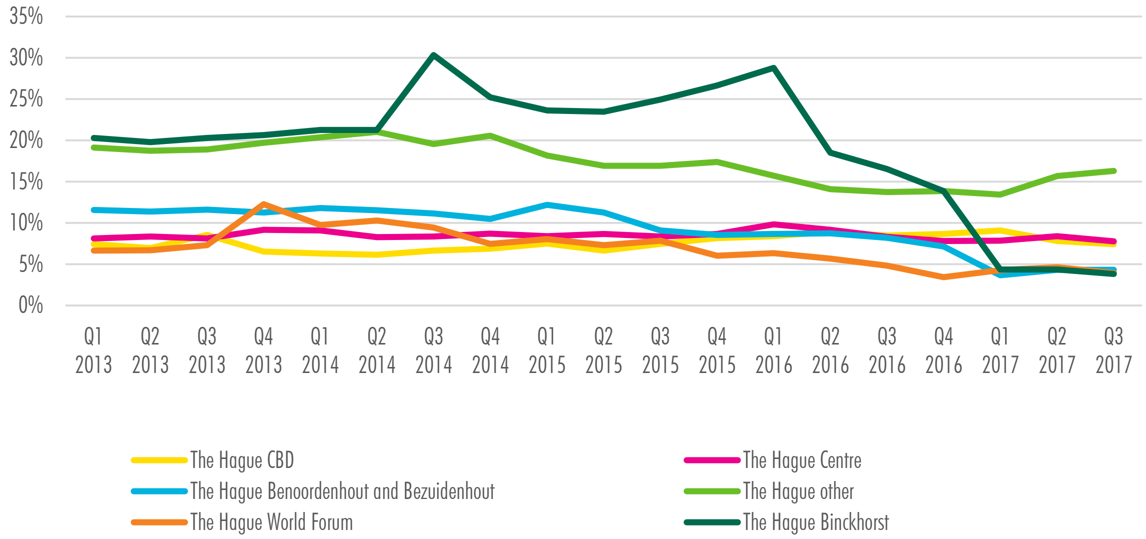
Currently the central government real estate agency office optimisation strategy is at its end and no further dispositions or relocations are expected. To the contrary, the public sector take-up has been growing in the first three quarters of 2017 and may expand further if initial informal announcements by the government will come to fruition.

CONVERSIONS DRIVE VACANCY RATE DOWN

As a result of the high conversion volume of vacant offices, the office vacancy rate in The Hague has been decreasing for a number of years in a row. Especially in Binckhorst, World Forum and City centre the vacancy rate declined as a result of this trend. Moreover, based on continuing alternative demand, mostly from the residential sector, conversions are likely to continue.

As a consequence of this, the remaining office areas in the City centre, CBD and World Forum better suit the volume and quality of the current occupier demand. Therefore, it is likely that these areas can count on increasing office occupier interest.

Chart 2: Vacancy percentage by submarket



Source: CBRE 2017

EMERGING TAKE-UP GROWTH

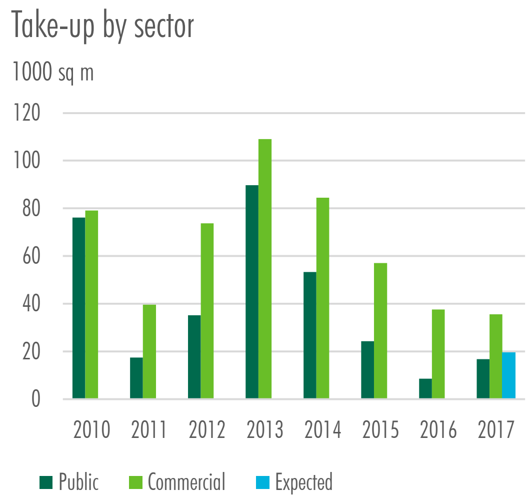
The declining annual take-up levels in recent history concerned many investors in the office market of The Hague. But, looking at the take-up of 2017, first signs of increasing take-up are visible.

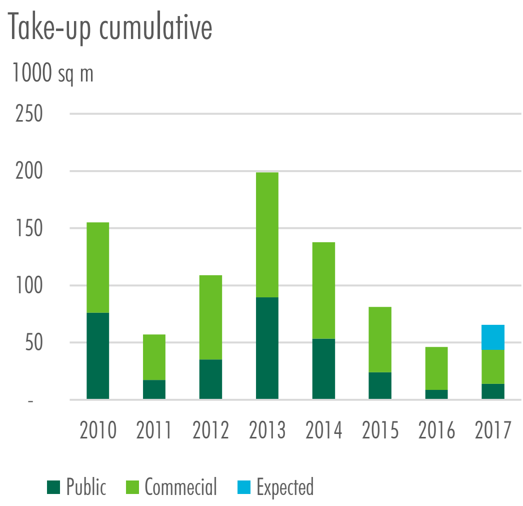
Although the common perception is that the public sector dominates the letting market, it is actually the commercial sector that has had a consistent higher annual take-up volumes in the period 2010-2016 of on average 67,000 sq m per annum against 43,500 sq m per annum in the public sector. Within the commercial sector, business services dominate the occupier market. The business services companies that have been active on the letting market, have a strong relation to the (international) government, financial services or oil and gas cluster. Their letting activity confirms the strength of these clusters and significance for the office market.

Obviously, the public sector take-up volume has been restrained due to the consolidation strategy of the central government real estate agency. As the optimisation programme of the central government real estate agency has been concluded, the activity in the occupier market of public services has gradually declined over the last years. The take-up volumes as presented in graphs 3 and 4 consist of all public occupier movements in the market, including the relocations of public services to or away from buildings owned by the central government real estate agency.

Nonetheless, a deeper look into the public sector, points towards the recovery of this sector's letting activity. In 2017 the city of The Hague has been concentrating its office workers in and around the town hall, located in the CBD. The municipality acquired Forum building (9,400 sq m) for its own use and leased another 2,000 sq m at Fluwelen Burgwal. The current signs in the market suggest a careful continuation of the activity of the public sector.

Chart 3 and 4: Take up by public and market office occupiers





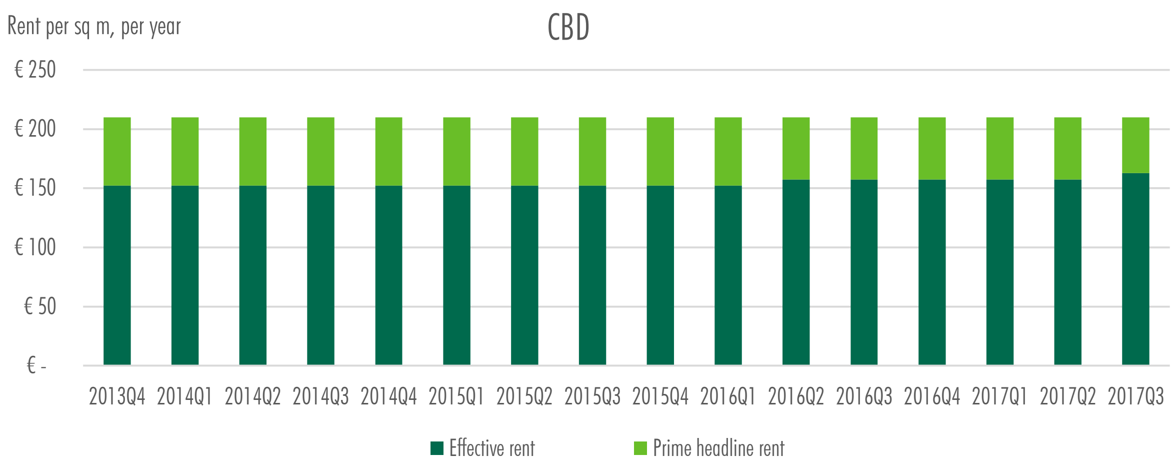
Source: CBRE 2017

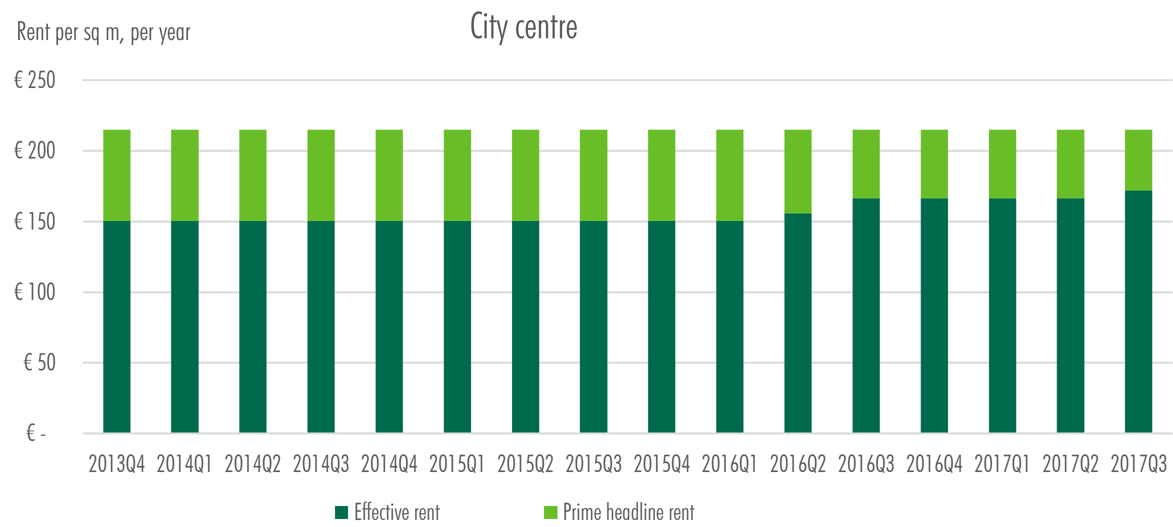
FLAT HEAD LINE RENTS, DECREASING INCENTIVES

The declining vacancy and the first careful recovery of activity in the letting market did not yet result in growing headline rents in prime buildings of the CBD. The effective rent however, did rise marginally as the still substantial incentive packages have been reduced in recent quarters. In the CBD, current incentives on a standard five year's contract are on average 22.5% of the headline rent of € 210 per sq m, per year.

The incentives will have to be reduced further, before rental growth will surface. This means that in the near future rental growth is likely to come from improving effective rents, and less likely from headline rental growth in the short- to mid-term.

Chart 5 and 6: Take up by public and market office occupiers





Source: CBRE 2017

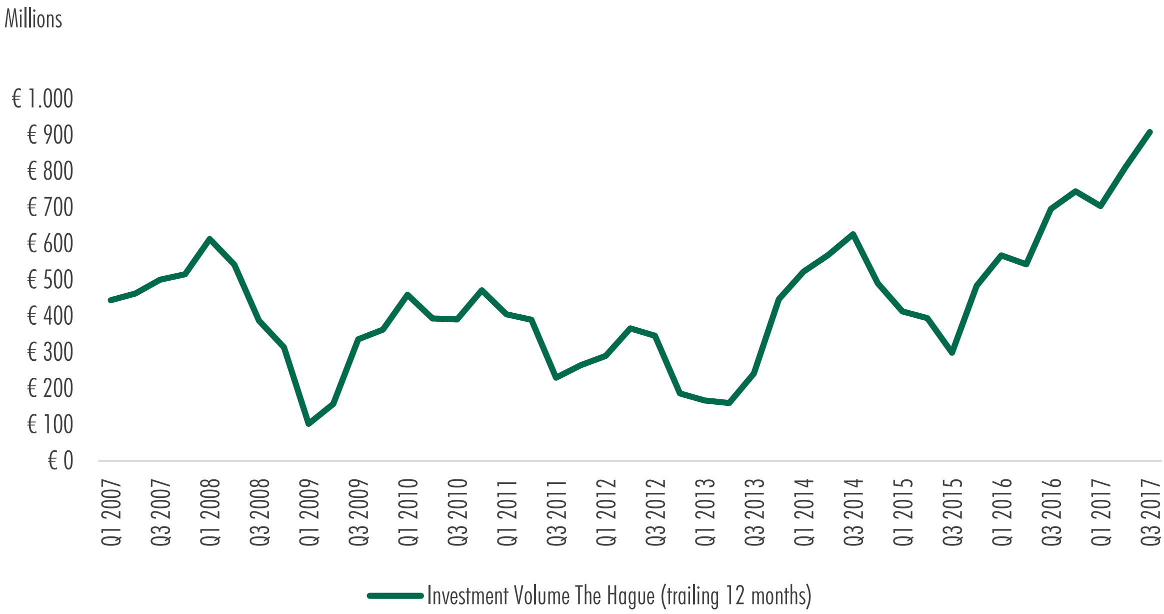
INCREASED LIQUIDITY IN THE INVESTMENT MARKET

Record high investment volume

Since the first half of 2016, investor interest in The Hague increased considerably, which resulted in a rapidly rising investment volume. Over the twelve months to Q3 2017, almost € 910 million was traded in The Hague – a record volume by historical standards and 51% above the pre-crisis high of € 601 million in 2006.

Trading activity over the last twelve months was dominated by investments in office properties, representing 53% of the total volume, followed by residential (39%) and retail (6%).

Chart 7: Real estate investment volume in The Hague

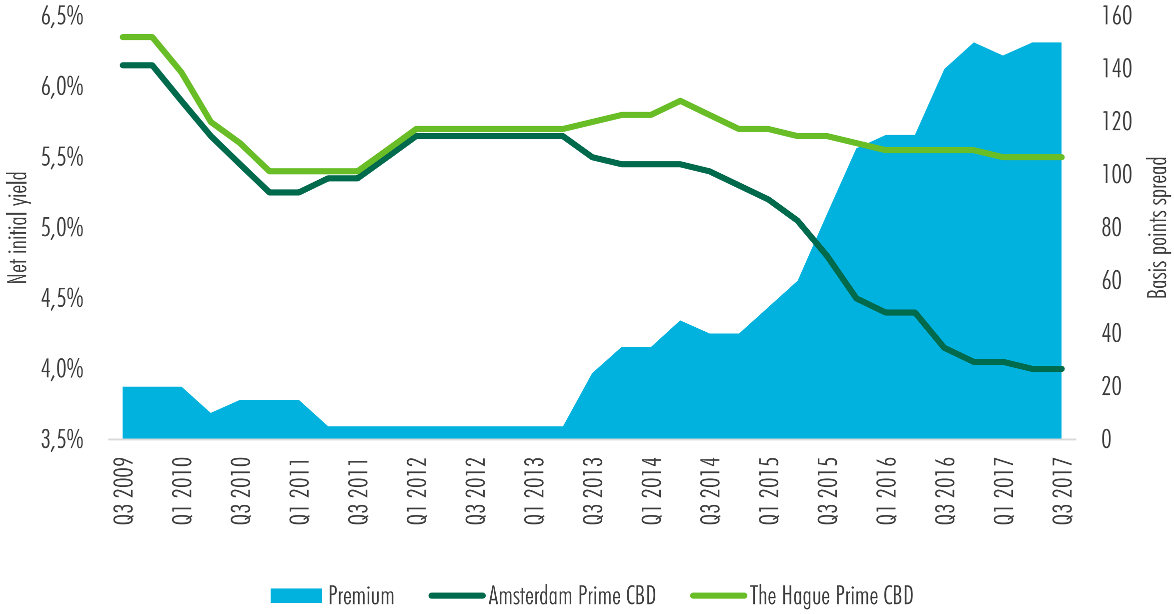


Source: CBRE 2017

Yield gap at historic levels

The strong investor demand is largely driven by favourable pricing compared to other cities in the Randstad conurbation. While investment activity is picking up rapidly, the yield gap between The Hague and Amsterdam remains extremely wide by historical standards. The yield gap currently stands at 150 basis points (bps), which is well above the 10-year average of circa 35 bps. With growing investor demand for office properties in strategic locations, this gap is expected to tighten. The compression of the prime yields in The Hague is expected to be supported by the improving occupier fundamentals and declining vacancy rates.

Chart 8: Yield gap between The Hague and Amsterdam



Source: CBRE 2017

Over the last 18 months, acquisitions have mostly concerned assets with leases over 5 years. More recently, investors have started looking into assets with shorter leases as they are increasingly confident that occupier fundamentals will improve and will be able to re-gear leases against better conditions in the future.

CONCLUSION AND OUTLOOK

The The Hague office market has been lagging behind compared to other main markets in the Netherlands, which has resulted in a historically wide yield gap combined with an improving occupier market. However, based on the market data and the feedback from local occupiers, we expect the take-up level from both the government and commercial sector to increase further. Meanwhile, on-going conversions will continue to reduce the available space. For these reasons, investment volumes have clearly picked-up and we expect more investors to see the opportunity that the The Hague market presents.

CONTACTS

This report was prepared by CBRE's the Netherlands Research Team, which forms part of CBRE Global Research – a network of preeminent researchers and consultants who collaborate to provide real estate market research, econometric forecasting and consulting solutions to real estate investors and occupiers

For more information about our office services please contact us using the details below.

Joep van Vliet
Associate Director
Netherlands Research
+31 20 626 2691
joep.vanvliet@cbre.com

Bart Verhelst
Executive Director
Capital Markets
+31 20 626 26 91
bart.verhelst@cbre.com

Raphael Rietema
Associate Director
EMEA Research
+31 20 626 2691
raphael.rietema@cbre.com

Roel Lamb
Director
Advisory & Transaction Services
+31 70 750 89 00
roel.lamb@cbre.com