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Walking the tightrope

Real estate investors seeking the right balance between caution and necessary risk-taking

- **Acceptance of lower returns currently prevails**
- **Liquidity risk becoming more important in risk assessment**
- **Investment climate in Europe under pressure**

Options for investment in real estate in Europe are shrinking, while the risk of misallocating capital is rising as new money continues to pour in. Investing is thus a balancing act in which the capital side has become a decisive factor. By more actively managing liquidity and constantly balancing lower returns against higher risk, property investors in Europe are attempting to solve the dilemma caused by high levels of available liquidity. Those are the findings of the latest property investment climate study carried out by Union Investment twice a year, which this time involved a representative survey of 161 professional property investors in Germany, France and the UK.

Investments offering lucrative returns remain few and far between in Europe. In fact, 52 per cent of the European real estate investors surveyed do not expect to meet their yield targets in the next three years, as they face continuing high prices and correspondingly low returns. And even taking a five-year view, one in two of those polled are concerned that they will fail to achieve the expected return on investment. “Huge investment pressure in the property markets leads to a higher risk of misallocating capital,” said Olaf Janßen, head of real estate research at Union Investment. “Strategies must strike the right balance between accepting necessary risk in a zero-interest environment and exercising due care given the many threats.”

Cautious risk-taking

The follow-up study by Union Investment shows that Europe’s property investors are currently recalibrating their attitude to risk. “For many groups of investors, the scales are tipping in favour of cautious risk-taking,” said Janßen. Accordingly, in the latest survey 60 per cent of investors cite “returns” as their main motivation, far outstripping “security” (29 per cent) and “liquidity” (9 per cent). This represents a further and significant increase compared to the previous survey in January 2016, when 55 per cent of those surveyed stated that they assessed real estate investments chiefly in terms of potential returns. A year ago, the figure was just 52 per cent. An increasing focus on returns is a consistent feature across all three survey regions, although there are still notable differences. In Germany, returns and security continue to be equally weighted at around 40 per cent each. The focus on returns is most marked in the UK, with 84 per cent of British investors looking primarily at returns when making their investment decisions. In France, 56 per cent of those surveyed consider returns to be the crucial element when weighing up an investment. With a rise of 8 percentage points, the shift towards a focus on returns is particularly pronounced in France.

Only France shows higher tolerance of risk in investment strategies

Despite the increased focus on returns, investment strategies of European property investors remain essentially defensive in the view of the investment decision-makers surveyed. One of the main findings of the Union Investment study was that only around one in three of the companies surveyed (35 per cent) explicitly looks to generate the same returns by taking on a higher level of risk. Only in France is the tolerance of risk in investment strategies comparatively high. Within this group, “same return – higher risk” reflects the strategy of 46 per cent of those surveyed; in the UK and Germany by contrast, only 32 and 28 per cent respectively explicitly state that they intend to take on more risk in order to compensate for factors such as the impact of falling acquisition yields.

The majority of investors surveyed (56 per cent) are not prepared to increase their risk exposure, and accept that they will not meet their self-imposed yield targets or those defined by their clients. An investment strategy based on “same risk – lower return” is being pursued by 56 per cent of investors in Germany, 52 per cent in France and 60 per cent in the UK. “Although there has been a significant rise in the focus on returns, this has not translated into much action yet. There is still no sign of a general shift towards higher-risk investments,” said Olaf Janßen.

Liquidity risk increasing

This latest survey confirms the increased importance of liquidity risk for Europe’s real estate investors today. For one in every four of the companies surveyed, the importance of liquidity risk in risk assessments has significantly increased over the last three years. This result is replicated almost identically across all three survey regions and borne out by the 42 per cent of those surveyed who state that greater emphasis is being placed on liquidity management today than three years ago. This suggests a more sophisticated approach, particularly in France, where more than every second person surveyed confirmed the increased importance of liquidity management over the last 36 months. “Both indicators point to the fact that liquidity management has been incorporated into property investors’ risk management regimes and has become increasingly anchored in their processes,” said Olaf Janßen.

Uncertainty weighing on sentiment

As with the question of how much risk to take on in order to generate appropriate returns, the three largest European economies are also ambivalent about the property investment climate. While the climate index in France appears to be stabilising after a long downturn, in Germany and the UK investor sentiment shows an unexpectedly strong dip, with falls of 2.4 and 4 points respectively. The survey was completed at the end of June, before the UK referendum on whether to remain in the European Union was held. With the index for the UK standing at 64.3 points, the mood among British investors even before the Brexit decision was at its lowest since 2012. For the first time since 2010, the climate index in the UK has fallen below that of Germany (67.5) and France (67.0). “Overall, investors are losing confidence in their respective property markets,” commented Olaf Janßen. “Sentiment is being hit by numerous uncertainties, which are increasingly driven by developments in the capital markets. The next six months will show whether Germany’s climate index will be influenced by special effects and decline further, reaching the low level seen in France and the UK.”

About the Union Investment survey

Union Investment launched its Investment Climate Index of European property investors in 2005, with the survey taking place at six-month intervals since spring 2008. The index is based on four indicators: market structure, the general environment, location factors and expectations, each with a weighting of 25 per cent. For the index, market research institute Ipsos conducted interviews between May and June 2016 with 161 property companies and institutional real estate investors in Germany (n=61), France (n=50) and the UK (n=50).

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