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European real estate investors prepare for extended market cycle

- **Growing acceptance of lower real estate returns**
- **Investor sentiment down sharply in UK**
- **Renewed confidence in French real estate market**

Low interest rates, low returns: a clear response is emerging to the question of how long the current market phase is likely to continue as European investors review their real estate strategies. The majority of professional property investors are preparing for the market cycle to last for another one to two years, during which time the same fundamentals will apply. Accordingly, investors are demonstrating a greater willingness to accept lower returns on real estate investments during this phase. In the 2017 investment year, it is more important than ever to avoid additional risk and develop successful property strategies that take into account the expectation of “lower for longer”. 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 175 real estate investors in Germany, France and the UK.

The picture is similar in all three of the regions surveyed. Whether in Berlin, London or Paris, almost half of all the investment professionals questioned believe that the current property market cycle will continue for the next one to two years. Some 27 per cent of those surveyed even expect the current market cycle – which began eight years ago – to last another three years. 38 per cent of the companies taking part in the survey believe that the current property market cycle will continue until at least 2018. In view of increased macroeconomic and geopolitical uncertainty, real estate investors are now more focused on a “lower returns – same risk” investment strategy than they were last year. The proportion of investors who are maintaining their risk structure and are therefore prepared to accept that they will not meet their self-imposed yield targets or those defined by their clients increased to 64 per cent, up from 56 per cent in the last survey carried out in summer 2016. Accordingly, the number of companies prepared to take on more risk in order to compensate for factors such as the impact of falling acquisition yields declined from 35 per cent to just 30 per cent.

Against this backdrop, more than half of the investors surveyed expect that they will not achieve their yield targets in the next three years. “The search for the right balance will continue to be a key driver of investment activity in Europe in 2017. High capital availability requires risk-averse investors to become much more active in their European core markets while also exploiting return potential in opportunity markets. This is likely to result in a significant rise in transaction volumes in CEE markets and also in the peripheral southern European countries in 2017," said Olaf Janßen, head of real estate research at Union Investment Real Estate GmbH, Hamburg. As the Union Investment survey shows, allocating more real estate investment outside Europe is only an option for a very small proportion of investors. Just 6 per cent of the property professionals surveyed intend to scale back investment in Europe in favour of non-European markets.

Differing expectations with regard to impact of Brexit

The fundamentally positive expectations of investors in European commercial property markets are clearly evident in many responses to the survey. Some 35 per cent of those questioned anticipate rising transaction volumes in Europe in the current investment year, while a further 45 per cent expect transaction volumes to remain at the same level as in the previous year. However, the assessment of investment conditions in the three survey regions varied considerably.

French investors regard their domestic market as being in much better shape than in 2016. A good third of investors see an improved or significantly improved investment climate with regard to French office property markets and also for the retail sector in the coming 12 months. One in two believe conditions will remain unchanged. In contrast, British investors take a much more sceptical view of the investment climate in the UK. Half of the British respondents expect the property investment climate in the UK to deteriorate significantly in 2017. Correspondingly, a clear majority of UK investors surveyed (over 75 per cent) are worried that the economic situation in the UK will worsen over the next 12 months. A surprising result is that relatively few UK investors currently believe the British property market has been significantly affected by Brexit. In the survey, 52 per cent of British investors state that Brexit has had a moderate impact on the UK property market, while 38 per cent regard the impact as minor. Outside the UK, the assessment of repercussions for the UK property market is less positive. Some 33 per cent of professional investors in Germany and 21 per cent in France believe Brexit will lead to dramatic changes in the UK property market.

UK index lagging further behind

The EU referendum in the UK has significantly affected the Investment Climate Index. In the run-up to the referendum, sentiment among UK investors reached its lowest level since 2012, as measured by the climate index. After the Brexit vote, the index in the UK fell again by approximately another three points and has now reached a new low of 61.2 points. This means the UK index has fallen further behind the national index in Germany (66.5 points; down 1.0 point since the last survey) and in France (68.6 points; up 1.7 points). Changes in expectations play a major role here. While the "expectation" indicator in France rose in the third survey in a row, it is declining in Germany and down sharply in the UK. "These substantial fluctuations in both directions, downward in the UK and upward in France, illustrate just how strongly investor sentiment is affected by special effects," said Olaf Janßen. "Political decisions are currently having a major impact on the markets."

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 October and December 2016 with 175 property companies and institutional real estate investors in Germany (n=64), France (n=61) and the UK (n=50).

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