European Commercial - October 2022

SPOTLIGHT
Savills Research

EME Investor Sentiment Survey

savills

Dry Powder | Debt Costs | ESG

Introduction

Savills EME Investor Sentiment Survey collected responses from 5 - 26 September 2022. Replies came from investors targeting real estate in Europe and the Middle East (EME), representing total EME assets under management (AUM) exceeding €500bn.

Key Points

76% of investors expect higher refinancing rates to significantly impact their total returns over the next two years

55% of investors are adopting a more defensive strategy over the next 12 months

76% of investors said they were targeting investments in Germany and/or France in the next 12 months

MORE THAN HALF of investors reported dry powder inflows as remaining stable over the last 12 months

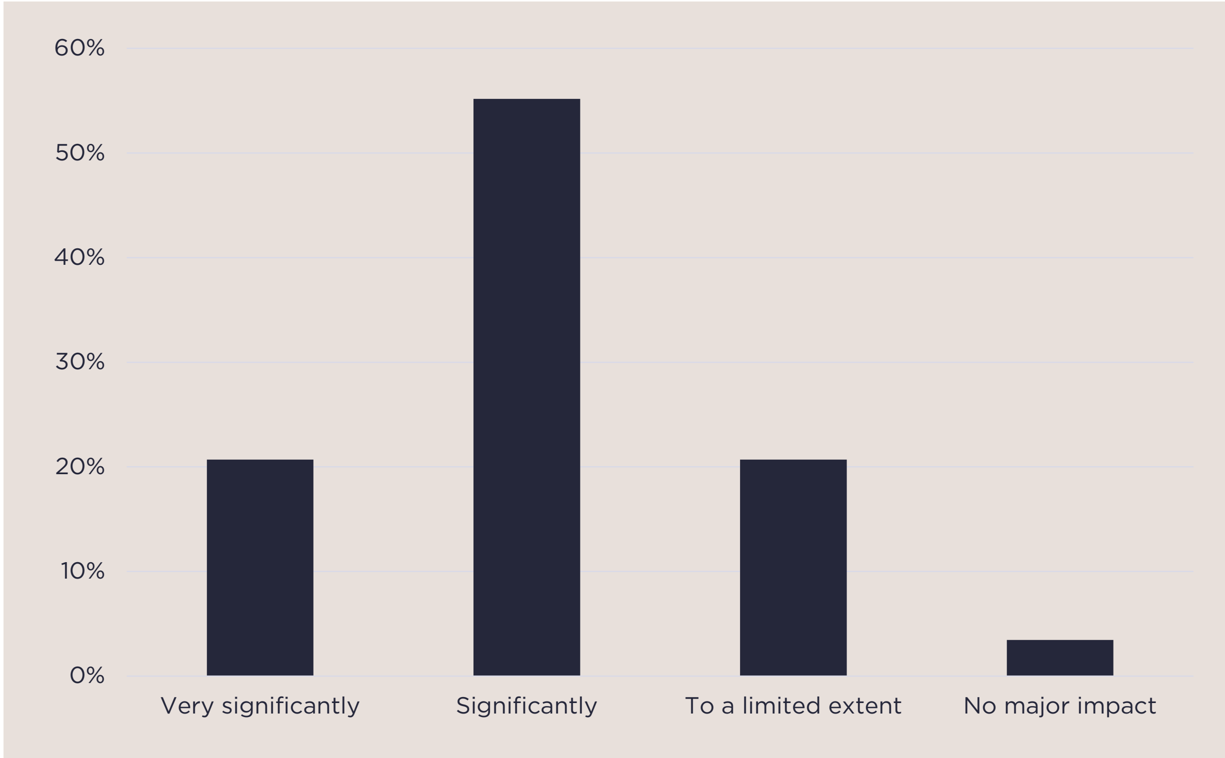
THREE QUARTERS of investors would be willing to undertake a "manage to ESG" strategy, while around a quarter would only acquire "ESG ready" assets

Multifamily and PBSA are the sectors where investors say they are still most willing to take some development risk

Investor intentions

Record inflation and interest rate increases have continued to disrupt investor sentiment during 2022. Following base interest rates in the Eurozone rising to 1.25%, with expectations for a further 75-100 bps increase during October 2022, 76% of investors expect that higher refinancing rates will significantly impact their total returns over the next two years. The majority (55%) of investors are now adopting a more defensive investment strategy over the next 12 months.

Figure 1: To what extent do you expect rising refinancing terms to affect your total returns over the next two years?



Source Savills Research

Despite a change in macroeconomic conditions, investor focus remains resilient for the sectors that enjoy the same structural tailwinds as prior to the Russia/ Ukraine conflict - in particular multifamily, followed by big box logistics, urban logistics, student housing and CBD offices.

For the residential sectors, factors like population growth, ageing populations and a shift from home ownership to renting continue to support investor demand for multifamily, senior living and care homes.

Investor demand for purpose-built student accommodation (PBSA) has also remained strong, as PBSA has continued to show it is countercyclical, with Savills previous research highlighting growth in student numbers during times of economic uncertainty.

Likewise, in both the big box and urban logistics sectors, e-commerce growth, nearshoring, and supply chains shifting from just-in-time to just-in-case strategies continue to support investor demand. Vacancy rates remain low, particularly for higher quality space, with no clear signs of a slowdown in tenant demand, supporting rental growth.

Investor sentiment

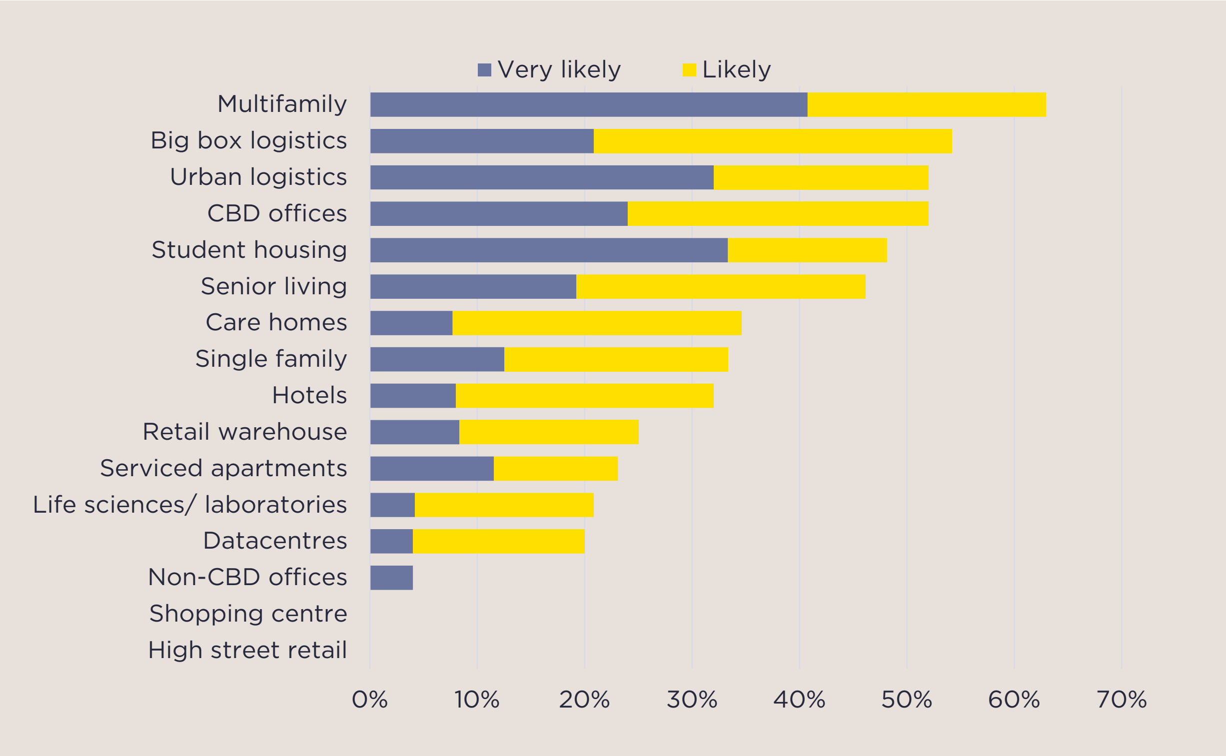
Investor sentiment towards CBD offices remains positive, with 52% of respondents likely to invest over the next 12 months. However, less than 5% of investors would choose to acquire non-CBD buildings over the next 12 months, reflecting a shift to prime locations. Investors continue to seek long, secure income, and are less willing to take leasing risk in secondary locations.

20% of investors would invest in the life science and datacentre sectors, although many institutional investors are not yet comfortable with investing due to a shortage of price evidence and lack of transparency.

Retail warehouses remain the most positive retail subsector in the survey, although a weaker consumer outlook will challenge pricing within the sector. Even prior to rising debt costs, some retail subsectors including shopping centres would not have received financing, so yields would be less susceptible to rising interest rates.

Development sentiment, however, remains positive, with investors most willing to develop speculatively in the multifamily and student housing sectors. Interestingly, development sentiment is more positive around CBD offices than both big box logistics and urban logistics, possibly due to the undersupply of energy-compliant office space. We expect to see more positive sentiment for logistics development once vendors' land price expectations adjust.

Figure 2: How likely are you to invest in the following sectors over the next 12 months?



Source Savills Research

❝ Multifamily, Logistics and CBD Offices topped the list of sectors in our survey ❞

Country analysis

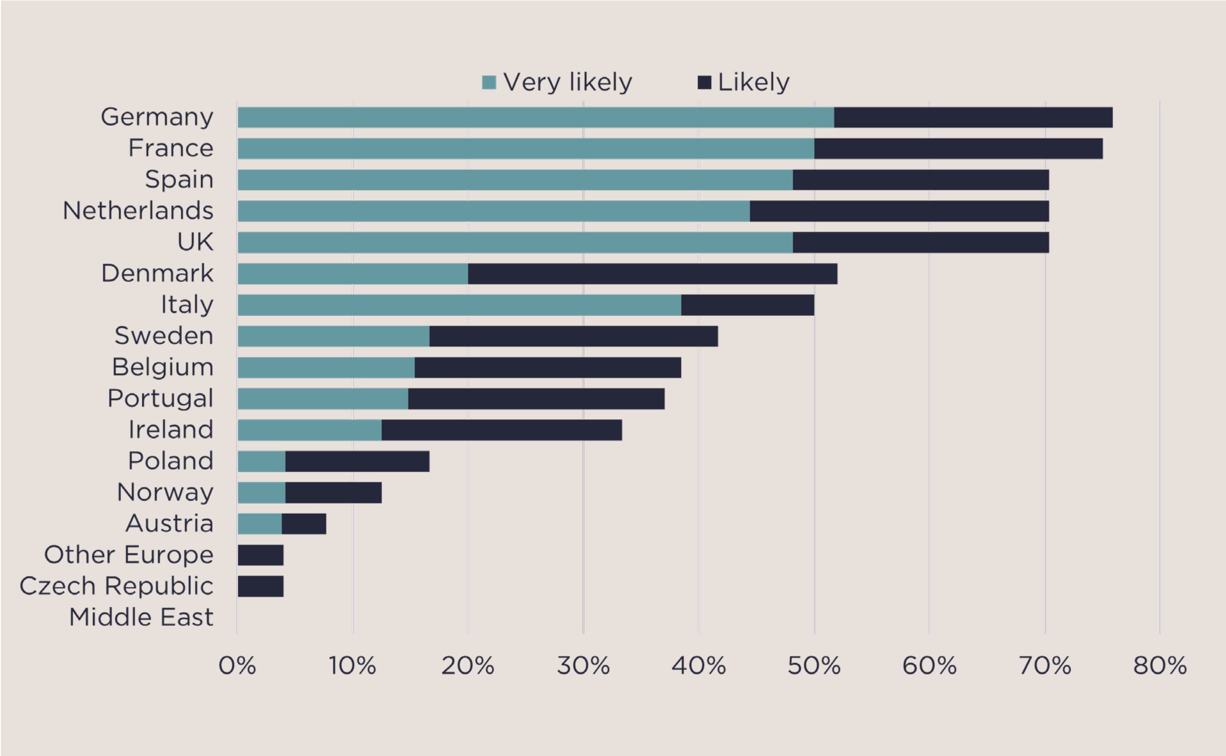
Germany and France are the top investment locations for investors, with 76% of investors looking to invest over the next 12 months, due to their relative liquidity and lower yields. Netherlands, Spain and the UK completed the rest of the top five investor locations.

The Netherlands' transfer tax increase to 10.4% in January 2023 will however add to differences in buyer/vendor expectations. Investors will continue their flight to more liquid markets, including London, Paris, Frankfurt, Madrid, Amsterdam and Berlin.

Investors remain more cautious in CEE markets, with Poland, Austria and Czech Republic given higher inflation driven by increasing energy prices due to the Russia/ Ukraine conflict. Denmark, Italy, Sweden, Belgium and Portugal completed the top 10 markets on investors' wishlists, offering more attractive yield profiles than the core markets.

Despite a rising interest rate environment, over half of respondents reported that dry powder inflows remained stable over the last 12 months, with a quarter of respondents reporting dry powder increases of over +10% against the previous year. There remain discounts on offer for cash-rich buyers, and we may begin to see more all-cash acquisitions for circa €50m lot sizes.

Figure 3: How likely are you to invest in the following countries over the next 12 months?



Source Savills Research

❝ A quarter of respondents reported dry powder increases of over 10% in 2022 compared with the previous year ❞

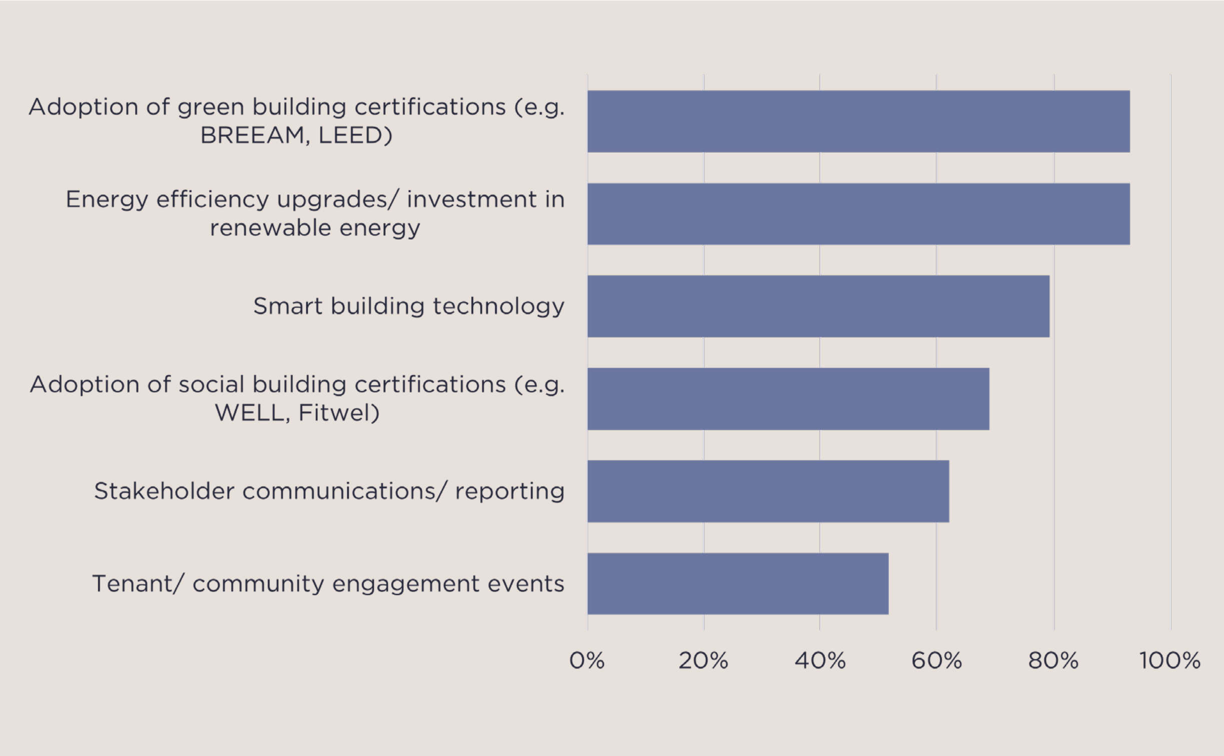
ESG requirements

97% of investors have an ESG strategy in place- around three-quarters of these would be willing to undertake a "manage to ESG" strategy, whilst a quarter would only acquire "ESG-ready" assets.

Over 90% of respondents reported that adopting green building certifications such as LEED and BREEAM, along with energy efficiency upgrades and renewable energy investment form part of their investment strategy.

We have also witnessed the rise of smart building technology (79%), adoption of social building certifications (69%) and tenant community engagement events (52%) forming part of investors' ESG strategies.

Figure 4: Which of the following ESG initiatives form part of your real estate investment strategies?



Source: Savills Research

❝ More than 90% of investors surveyed are conscious of the need to invest in energy-efficient assets ❞

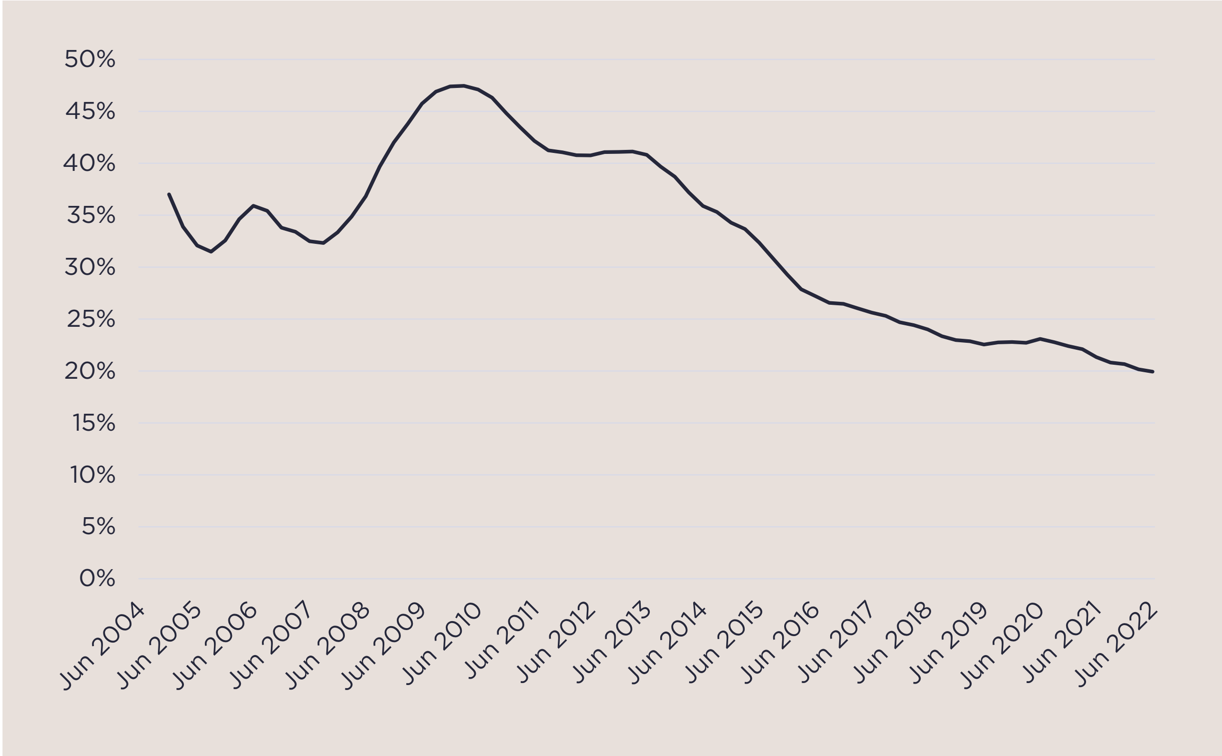
Outlook

Investors remain in the hunt for beds, sheds and CBD offices, although rising debt costs may impact the timing of acquisitions.

Following the fall in government bond prices in recent months, many multi asset investors are now overweight to real estate. Some of the UK property funds have imposed restrictions and limited withdrawals from institutional accounts, shifting from daily to monthly redemptions to improve liquidity. Vendors are generally unwilling to take discounts of more than circa 5%, whilst buyers are seeking discounts of 15%+.

We are now observing increased lender caution, with all in debt costs for mainland Europe's CBD offices now ranging between 4% to 5% at the end of Q3 2022 and above 6% in the UK. What should be considered, is that LTVs are significantly lower than pre-GFC. MSCI data indicates that debt as a % of gross asset value (GAV) was 32% in 2007, falling to 20% in 2022, suggesting the rise in debt costs will have a more limited impact than previously.

Figure 5: Debt as a % of gross asset value (GAV), Europe



Source: MSCI

Looking forward, Europe will remain attractive to US investors given the strength of the US dollar. US investors have become the most active cross-border investor type, with €33.5bn of European capital transacted as at the end of Q3 2022, only 3% behind this stage in 2021. A similar story has been observed from Singaporean investors, who have overtaken German investors to become the second most active cross-border investor type in Europe during 2022, reaching a total of €10.7bn by the end of Q3 2022. The German banks are well financed and previously signed debt terms for circa 10 years post-Eurozone crisis, with refinancing rates on loans more similar to those of today, although we may begin to see more German investors looking cross-border .

Vendors will be more visible once more landlords are forced to refinance at higher rates. Some landlords will seek to refinance on shorter terms in the hope that rates fall. Closed-ended funds will be one of the major sellers, with over €10bn of European closed ended funds terminating by the end of 2024, according to INREV. Likewise, we tend to observe an increase in sale and leaseback transactions as companies seek to liquidate their assets to improve their balance sheets.

Given the rising debt costs, we expect a further pricing correction to evolve in the coming quarters as new debt terms filter through into yields. Deal flow is likely to remain well below average levels during the final quarter and we expect assets with an element of rental indexation in core locations to remain on investors' wishlists.

Savills Commercial Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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