CONTINENTAL

The continuing evolution of the European investment market

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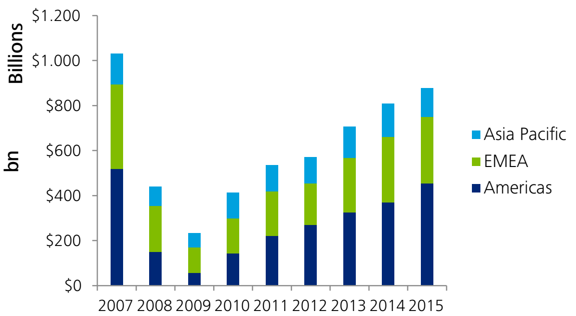
With the dust having settled on 2015, we can now look back on the investment trends that defined the year and ask what 2016 might have in store.

There is certainly a lot to talk about: 2015 saw global real estate investment reach US$877 billion, the highest since 2007, driven by rising activity in both the Americas and EMEA. Yet beyond the headlines, the data point to a market that is evolving in terms of the sources of capital, the type of vehicles most active, and the type and location of properties being targeted.

Figure 1: Global investment volumes



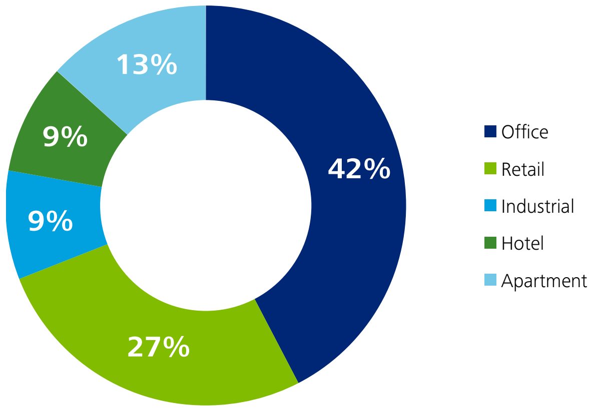
Source: RCA/Deloitte

In the EMEA region, although overall activity in 2015 was weaker than in 2007, Ireland, Italy, Norway, and Switzerland all saw investment exceed this previous peak. While parts of the region are yet to see activity recover to 2007 levels, a number of the larger markets including Germany, the Netherlands, and Belgium are seeing double-digit growth.

The office sector has long been a favorite for international investors, and still accounts for well over one third of investment globally. Within the EMEA region, 12 of the top 20 locations by investment volume were office markets. Predictably, London, Paris, and Frankfurt recorded the highest volume of office investment in 2015 within the EMEA region, but investors showed a clear renewed interest in other EMEA office markets.

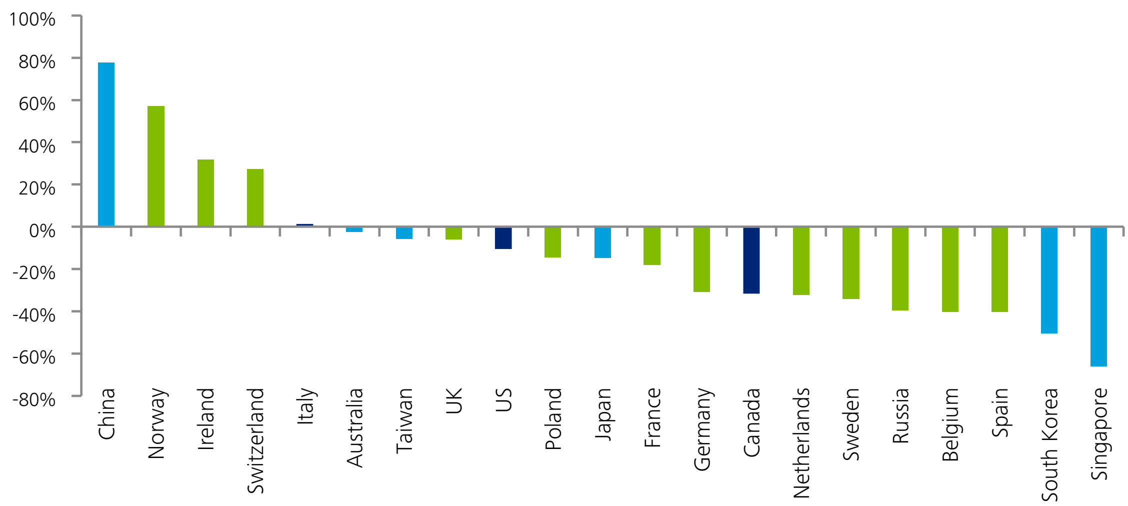
A clear characteristic of investment post-recession, and especially in 2015, is that purchasers have shown a growing preference for alternative types of property, such as retail, hotels, student housing, and apartments. The strong growth in many of Europe's retail property markets is partly cyclical, reflecting the gradual economic recovery taking hold and improving consumer sector confidence, as well as the increasing willingness for investors to look beyond traditional "core" cities. Yet the rising interest in other types of property is arguably of greater interest, as it provides proof that investors are willing to consider an altogether broader range of investment types in their hunt for yield.

Figure 3: Investment volume growth 2015 vs. 2007



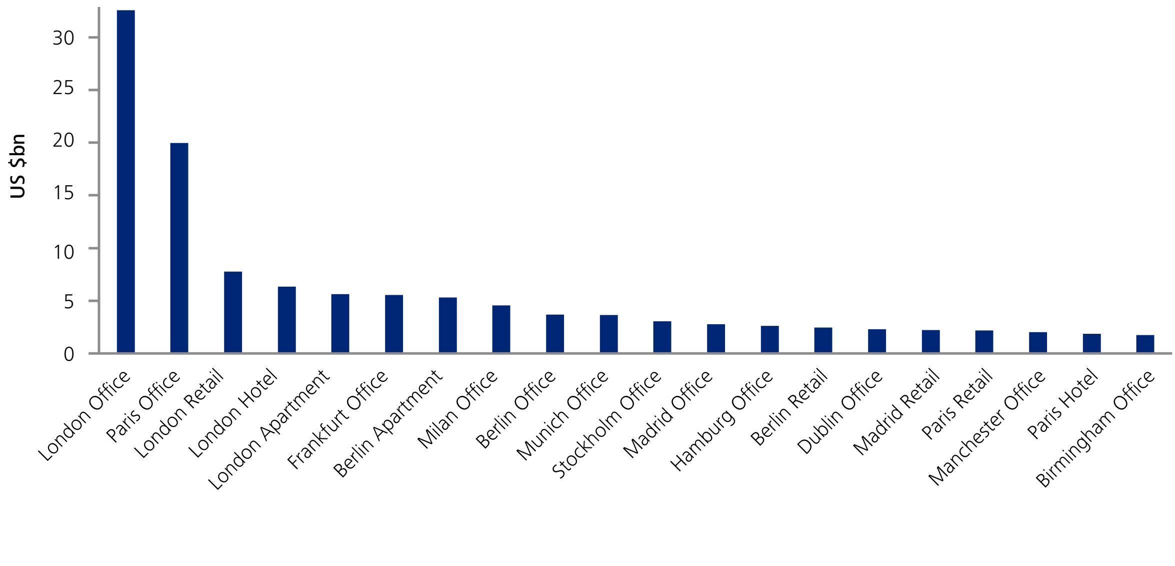
Source: RCA/Deloitte

Figure 2: Investment volume growth 2015 vs. 2007



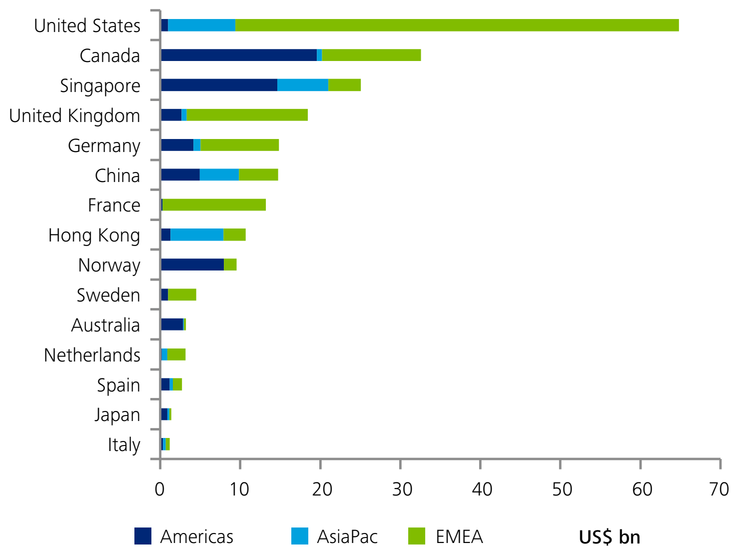
Source: RCA/Deloitte

Figure 4: Top 20 EMEA markets by volume 2015



Source: RCA/Deloitte

Figure 5: 2015 outbound capital flows

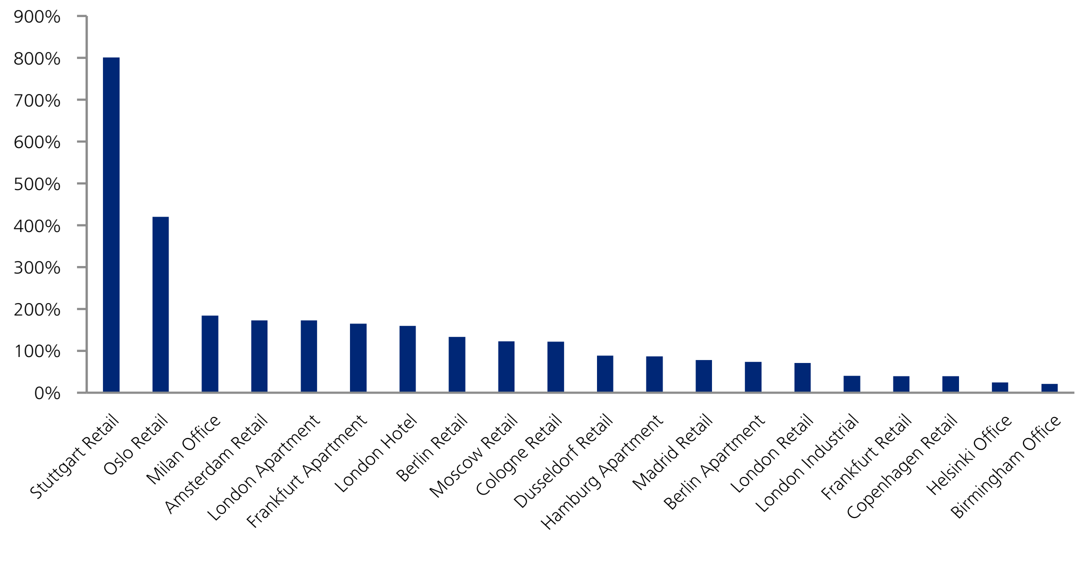


Source: RCA/Deloitte

Another clear trend during the recovery cycle has been the internationalization of real estate investment in the EMEA countries. The year 2015 saw a further significant increase in the share of cross-border transactions, especially within the main European destinations, with overall cross-border purchases of European real estate up by almost 20 percent compared with 2014. This has come in part from cross-border trading within Europe, but has also been heavily supported by a rise in demand from North American and Asian investors.

Focusing on the source of global capital into real estate shows a number of different trends. For example, while US players invested heavily across EMEA real estate in 2015, the foreign real estate that Singaporean investors bought was mainly in the Americas and the UK; whereas Chinese foreign investment was expanded in 2015 across all major regions. Similarly, while French investment abroad has been almost entirely in Europe, around one third of German foreign investment went to the Americas or Asia.

Figure 6: Top 20 EMEA markets by growth in volume*



Source: RCA/Deloitte

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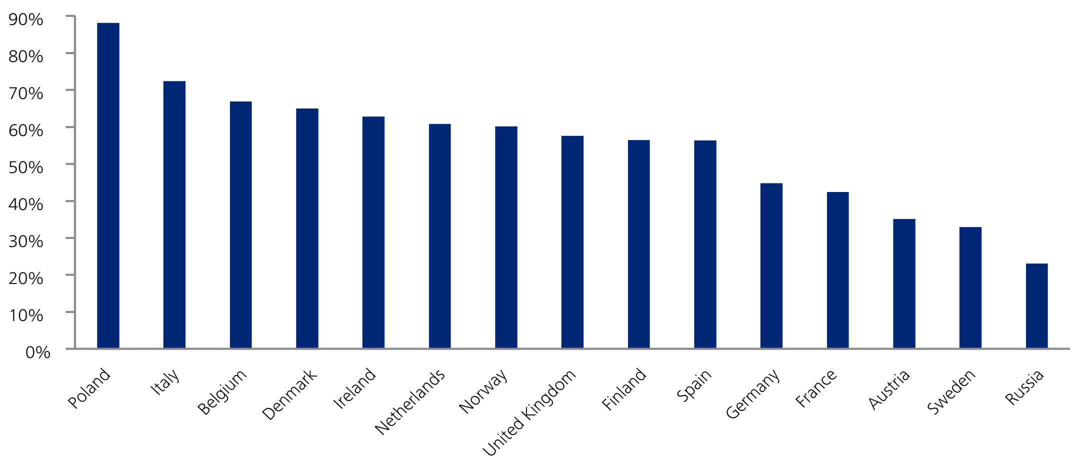
In Europe, some markets recorded extremely high levels of foreign investment activity in 2015. Nearly 100 percent of all investment in Polish real estate was from foreign sources. Investment from foreign sources was also high in Italy, Belgium, and Denmark, reflecting improving expectations for returns in these markets.

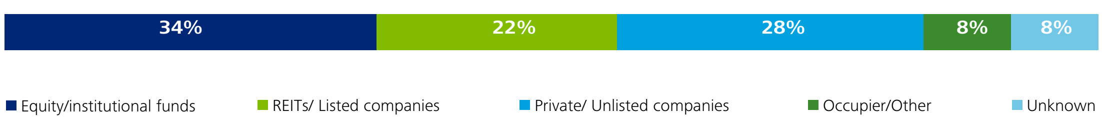
Equity funds, institutional funds, and private and unlisted companies were the most active purchasers in 2015, accounting for 62 percent of all purchases made globally. However in net terms, REITs and listed companies were the most active acquirers of real estate. Meanwhile, private and unlisted companies accounted for a much smaller share of total net investment, selling over US$320 billion of real estate globally, which was nearly as much as they purchased—therefore neither increasing nor decreasing their exposure to global real estate.

Figure 7: 2015 investment from foreign sources



Source: RCA/Deloitte

Figure 8: Investment by investor type 2015

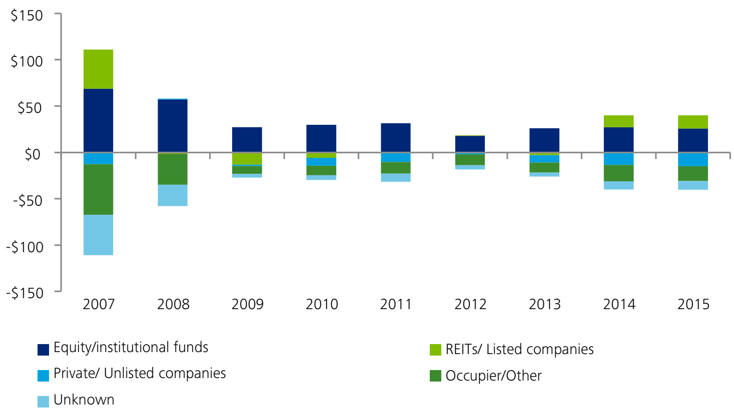


Source: RCA/Deloitte

While US equity funds and institutional funds were the biggest buyers of real estate in 2015, REITs and listed companies in Asia Pacific, specifically J-REITS, were the most active investors. They spent over US$126 billion whilst only selling US$53.5billion, and therefore significantly increasing their global real estate allocation.

There is also some evidence that the weight of capital targeting real estate is causing some investors to pursue portfolio deals and club deals as a means of deploying funds more quickly—a trend clearly visible in the US, UK, and other parts of Europe.

Figure 9: EMEA net investment by investor type



Source: RCA/Deloitte

EMEA investment was boosted in 2015 by recovering prospects for real estate returns, growing diversity in the type and location of real estate that investors are willing to consider, and further net increase in acquisitions by listed investors. Looking ahead, we expect these drivers to remain largely intact during 2016, but highlight some factors that we believe will exert additional influence on the EMEA market during 2016:

1. ***Improving fundamentals for core European property***
   The outlook for rental growth is relatively positive, in particular in the Eurozone, and is underpinned by comparatively buoyant economic prospects (see figure 10) and rising consumer sentiment. Furthermore, there are many locations in which further yield compression could be seen as investors compete for the best assets. This combination of rental growth and yield compression could be enough to elevate total returns to levels not seen for some years, attracting further interest from investors

2. ***Financial and political instability will continue to impact global demand for real estate***
   Falling oil prices and political instability have hit investment levels in global real estate. Demand from Middle Eastern Sovereign Wealth Funds (SWFs) slowed at the end of 2015, and there is an ongoing risk that some may need to repatriate foreign capital (such as that invested in real estate) to meet domestic budget obligations.

   Nevertheless, in other emerging markets, economic instability is driving some investors to look abroad for investment opportunities. For investors who may be seeking diversification—or may simply be looking for lower risk assets—real estate in core European and North American cities is likely to remain very attractive.

3. ***The relative weakness of the Euro could support investment***
   Although currency is rarely a primary driver of investment activity, it is difficult to ignore the fact that the strength of the US Dollar has made Euro (and Sterling) denominated investments look increasingly attractive to Dollar-based investors. If anything, the Euro weakness could be exacerbated, as US and Eurozone monetary policies diverge over the coming year.

4. ***Attractive yield premium of property over government bonds will persist***
With little prospect of significant interest rate rises across Europe in the medium term, government bond yields will remain close to historic lows in many counties, meaning that real estate yields will stay comparatively attractive for investors seeking income. In particular, we expect this differential to remain a driver for global investment funds—many of which remain entirely focused on bonds and equities—to consider increasing capital allocations to real estate.

5. ***Competition for core assets will cause some investors to broaden their search***
London remains an extremely attractive location for overseas investors but the sheer weight of money has put strong pressure on pricing. For some investors, London and other core European cities may have become overpriced, and so a trend has emerged to increase investment into other core European markets. Additionally, the weight of capital chasing core investments may drive cash-rich investors to development opportunities in order to deliver the required returns. However, lenders are still cautious about lending on speculative development.

6. ***Evolving regulations could help Asian institutions increase real estate allocations***
Recent changes in Chinese regulation have permitted institutional funds to invest a higher allocation to real estate within their portfolios, and to invest in overseas real estate. Lately, Taiwan and Malaysia have also seen a liberalization of regulation surrounding investment in real estate. As a consequence of ongoing liberalization, it is expected that funds in Asia will continue to climb the rankings as significant players in global real estate investment in the future.

Figure 10: Economic overview

Country/ Region	Overview	Real GDP growth 2016	Inflation 2016
United States	Despite global economic and financial market volatility, short-run indicators suggest a reasonably positive outlook for the US. Growing business investment is expected to cement the recovery and, as hiring picks up, the labor force participation rate of younger cohorts will begin to rise. The large amount of slack will prevent rising demand from translating into inflation, despite relatively accommodative Fed policy.	2.40%	1.49%
Eurozone	The Eurozone is in recovery, but the variance in growth rates between counties is widening. Ireland and Spain have bounced back in a spectacular fashion, while Germany grew very slightly above the Eurozone average in 2015; Italy and France failed to reach the Eurozone average by a substantial margin. A key question for 2016 will be the extent to which corporate investment activity will recover.	1.95%	1.02%
UK	Despite uncertainty, momentum in the UK domestic economy remains resilient. Yet while the consumer sector has picked up, the outlook in the corporate sector is more mixed; against a backdrop of the Sterling's rise in the last two years, moderating global growth does not bode well for UK export demand. In addition, the United Kingdom may hold a referendum on EU membership in 2016.	1.70%	1.50%
Japan	The economy narrowly avoided recession in 2015, with sluggish growth in domestic consumption and external demand weighed down by slowing growth in China. Despite healthy profits, Japanese corporations have been loath to increase capital expenditure—possibly due to factors such as uncertainty in the global economy and subdued domestic demand.	1.10%	0.44%
China	China's economy has continued to disappoint those observers who had expected that the slowdown would abate and possibly reverse. Growth in domestic and foreign investment into China is still falling, although domestic consumption remains relatively robust, driven partly by rising wages.	6.50%	1.50%

Source: Deloitte/EIU/Statista