Capital flows from Asia into European real estate

By the end of 2015 we expect investors from Asia to have invested around €90 billion into global real estate with increasing capital flows into Europe.
Since 2010, we have witnessed a growth of capital from Asia into European real estate. A total of €50 billion has been invested over the last five years, and this stream of investment is set to continue. Asian investment in Europe, which typically has come from Singapore, China, Hong Kong, Malaysia and South Korea, currently accounts for around 5 percent of total European investment with a far larger concentration in London as a percentage. However, we expect the flow to increase, driven by a number of factors that continue to boost Asian investors’ appetite for European real estate.

At present, London is the main market within Europe in which Asian investors have made significant moves: over the last five years, 62 percent of all capital flows from Asia into Europe have been invested in London. Asian investors, in particular Asian institutions, have joined a raft of other international and local purchasers in buying up London property. They have favored direct investment and the London office sector in particular. So far, a relatively small proportion of Asian capital has been invested in other European cities including offices in Paris and Frankfurt.

Asian equity funds and institutions have been the major players to date, consistently accounting for more than half of all Asian investment in Europe since 2007. Institutions are likely to remain the dominant investor type in the medium term, however, we predict a rise in private, unlisted, and listed investors as they become more comfortable with investing in other European markets.

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Top 10 Asian investment destinations in Europe (last 5 years)

- London office
- Paris office
- Frankfurt office
- London retail
- Paris other
- Brussels office
- Milan office
- Moscow office
- Milan other

Source: Real Capital Analytics
Top 10 Asian sources of Asian investment in Europe (last 5 years)

Source: Real Capital Analytics

Asian investment in Europe by buyer type

Source: Real Capital Analytics

Asian investment in London by sector (£bn)

Source: Real Capital Analytics
So what is driving these flows from Asia into European property markets? There are a number of factors.

A long-term demographic shift is driving growth in savings and pension institutions within Asia, with growing inflows but limited opportunities to invest domestically. Meanwhile, growth in high and ultrahigh net wealth in Asia is leading to a rise of family offices.

The domestic Asian investment environment has provided a backdrop for the fundamental drivers of cross-border flows into Europe. Asia accounts for over 50 percent of the world’s population. Recent years have seen increased flows into pension and savings funds, especially in Malaysia and South Korea, and this growth is set to continue as the population ages. High net wealth individuals’ investments in foreign real estate have been driven by various factors including portfolio diversification, risk spreading, capital preservation, their children’s education in world-renowned European universities, immigration drivers facilitated in Europe by the Schengen visa program and the desire to have capital outside their home jurisdiction due to economic, political, or business risks. This is in addition to the fact that we have witnessed major growth in high net wealth individuals and family offices across the major Asian economies. The Forbes 2015 billionaires list shows that after the United States, China and Hong Kong have the highest number of billionaires—30 and 24 respectively—and that Asia-Pacific leads the world in terms of real estate wealth by being home to 96 of the 157 global real estate billionaires. Wealth-X and UBS estimate that by 2024 Asia ultra-high net wealth individuals will overtake Europe in terms of wealth, and by 2027 in terms of population. The increase in wealth across Asia has led to growth in family offices looking to invest capital.

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Sovereign wealth funds’ appetite for real estate is on the rise

The volume of Sovereign Wealth Funds (SWFs) has reached a record high of US$6,977 trillion (SWFI November 2014), with more than 50 percent invested in real estate. According to the Preqin Sovereign Wealth Fund Review 2014, SWFs allocate at least 5 percent to real estate. On this assumption, we can estimate that there is currently US$348 billion to be invested in this asset class. It therefore comes as no surprise that Asian SWFs (including Chinese SWFs that represent approximately 30 percent of the total value of global SWFs) have become increasingly active in Europe. In recent months, they have been involved in some very large transactions, including recent acquisitions of more than US$1 billion in commercial real estate.

An overhaul of institutional regulations across Asia over the last three years is facilitating greater overseas investment in real estate

Since 2012, changes in Chinese regulation have allowed institutional funds to allocate more assets to real estate within their portfolios, and permitted funds to invest in overseas real estate. Lately, Taiwan and Malaysia have also seen a liberalization of regulations on investment in real estate for institutional and regulated investors such as insurance funds and companies. Despite these moves, many Asian institutions remain underallocated to real estate. However, as a consequence of the liberalization, it is expected that insurance funds in Asia will become increasingly focused on real estate investments and climb the rankings as significant players in global real estate investment in the future.

The weakness of the euro (and past weaknesses of the pound) has increased the attractiveness of European real estate to overseas investors

The improving economic landscape in many parts of Europe has made the continent increasingly attractive to foreign investors. The weakness of the euro is rarely cited as a primary reason for investing in the eurozone, but it is one of many factors that have increased the popularity of European real estate to cross-border investors.

The attractive risk/return profiles on certain European markets are not always easily obtainable in domestic Asian markets

For some types of investors, sourcing the right product within Asia can be difficult. In particular, this can be a hurdle for institutional investors that demand stable income streams at levels that are not always easily achievable in their own markets. In the core Asian markets of China and Taiwan, exceptionally low yields are often quoted on prime investments. In addition, the tradition of “building to hold” by Asian construction companies has made Asian markets comparatively illiquid. A high level of owner-occupation by conglomerates is a particular feature in South Korea. Compare this to Europe, where there are opportunities to invest in relatively transparent, highly liquid markets with strong growth potential and diversification benefits. Liquidity is an especially important factor, with the ability to disinvest as well as invest seen as an attractive feature of real estate markets in Europe.

Financial and political instability driving investors towards perceived safe havens and in search of diversification opportunities

The recent volatility of the Chinese stock market might serve to boost capital flows into overseas real estate further as Asian investors seek to invest in perceived safe havens. These are likely to be trophy assets in core global cities, such as London, New York and Paris. There is precedent for this: during the recent global financial crisis, huge amounts of overseas capital were ploughed into prime London residential property, whilst political instability in the Middle East has also resulted in vast quantities of sovereign wealth flowing into core European real estate markets, including London.

An explosion in the number of Asian (particularly Chinese) tourists visiting continental Europe

Over the past few years, the rise of the middle class in China, the fall in the cost of air travel, and the growing interest in European luxury items have generated waves of new Asian tourists in Europe. Major players in the Asian tourism sector have understood the economic stakes of this new trend and have started to invest heavily in the sector, including in European hotels, resorts and apartments. Developing an approach fully focused on Chinese tourism has led large Chinese private equity and hotel groups to purchase real estate in popular tourist locations such as Paris, Rome, and Stockholm.
It is worth considering whether there is anything that might stem the flow of capital from Asia into Europe. It is unlikely that the volume of money moving from Asia into Europe will decline in the short to medium term. From a performance perspective, we can question whether Asian investors will continue to allocate funds to real estate over bonds and equities, increasing their weighting of this asset class, especially when interest rates start to rise. Given the fact that Asian institutions are, at present, underallocated to real estate, that Asian equity markets are looking increasingly volatile, and that there are uncertainties surrounding Chinese economic growth, we see no current reason why Asian institutions will not continue to invest in overseas real estate.

In addition—and as alluded to earlier—at times of political or financial instability in a region, we have witnessed money flow from the troubled region into markets such as London and other perceived safe havens. However, there are several factors that could suppress cross-border flows into core European markets. Firstly, if there were an adverse change in business taxation or if, for example, London were to lose its ranking as one of the most important financial centers in the world, the attraction could fade.

Additionally, if Europe could no longer deliver attractive returns to Asian investors, then this would have an impact on cross-border flows. We should not underestimate the risk of the current weight of capital leading to an overheated market. In London, investment from Asia and the Middle East has contributed to huge downward pressure on yields and has priced some UK-based investors out of the market. Given the low yields in London, and the expectation of interest rate rises in early 2016, we question how much yield-driven growth is left and whether the attractive yield-to-risk opportunities for Asian investors in London may diminish.

Even so, there are good reasons to suggest that capital flows from Asia will continue to gather pace. The strategy of Asian investors is quite diverse and depends on the investor profile, however we anticipate as Asian investors become increasingly comfortable with European markets, they will move away from the core cities and search for higher growth opportunities.

This is already apparent in the UK where we have seen Asian investors venture out of London and invest in other cities, including Manchester, Leeds and Liverpool. The UK should continue to receive a large share of capital from Asia in Europe, however Asian investors are showing interest in other jurisdictions such as Germany, France and Northern Europe, attracted by the lower risk opportunities, or in Spain, Italy and Eastern Europe, where potentially higher returns can be found. The current weakness of the Euro should support the shift towards these other European countries.

So how much capital do we estimate is still expected to come out of Asia into European real estate over the next five years? According to Real Capital Analytics, in January 2015 to July 2015, Asian investors had already invested €50 billion in global real estate. At this rate, we can expect around €90 billion in total to be invested globally in 2015 alone, and of this around one quarter to one third is likely to be invested in European real estate this year. Although this is a small proportion of total Asian investment in global real estate, we believe all indicators suggest this figure will increase in 2016, and we expect these to remain in place in the medium term, bringing an increased movement of capital from Asia into European real estate.

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