# YIELD TARGETS REASSESSED:

## EUROPEAN REAL ESTATE INVESTORS FOCUS ON RISK AVOIDANCE IN LATE STAGE OF MARKET CYCLE

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**Property investors** believe the cyclical turning point will soon be reached in European real estate markets. Accordingly, professional investors are increasingly worried about misallocating capital. Yield targets are being reassessed.

The latest investment climate study carried out by Union Investment shows that the majority of real estate investors in Germany, France and the UK expect the initial rate of return on real estate to start rising again in 2019 or 2020. Only a quarter of investment decision-makers believe the real estate market cycle will continue beyond 2021. Of the 163 European property companies polled in the latest Union Investment survey, only 28% said they were prepared to take on more risk in order to achieve the same return. This figure is down a further 9 percentage points compared to the previous survey carried out six months ago. By far the largest proportion of investors, some 64% (winter 2017/18: 56%), plan to stick to their risk strategy and are therefore prepared to accept lower returns.

Mirroring this declining appetite for risk, European property investors are being very restrained in their yield expectations, at least over the short to medium term. Less than half of the property companies surveyed believe they will achieve their self-imposed yield targets in a timeframe of three or five years. Yield forecasts by German investors are particularly pessimistic: 55% of the property professionals surveyed anticipate reduced real estate returns until at least 2023.

Tenant creditworthiness and the construction quality of properties continue to have the biggest impact on investment decisions. We can conclude that the style drift among European investors which was widely predicted to occur during this unusually long market cycle has not materialised, and we will not see it now in this cycle.

This is backed up by the study's finding that investment professionals are continuing to focus heavily on security. Nearly 30% of the investors surveyed consider security to be the most important aspect when making investment decisions. Liquidity is the top priority for 9%, while 58% say returns are the crucial factor. Only in France was risk tolerance higher compared to the previous survey in winter 2017/18. The strong focus on security is limiting investors' options. It is particularly striking that investment in entire market segments is being ruled out over the coming months.

For real estate investors, retail properties are currently top of the list of investments to avoid. Some 63% of the investors polled intend to steer well clear of retail investments over the next 12 months. A major factor here is the strong reluctance of British investors to consider retail properties at present: 82% are aiming to avoid investing in this segment in the short term. The figure is also high in France, at 70%. By contrast, in Germany there is still a relatively high level of confidence in the domestic retail market, with only 40% of investors avoiding this segment.

### Cautious approach to hotel investments

The study shows that investors also intend to tread carefully when weighing up hotel investments over the next 12 months. Some 33% of all the companies surveyed aim to avoid hotel investments altogether, while 29% of respondents see a need to avoid logistics properties. The residential and office segments, by contrast, have been temporarily ruled out by only 20% of investors. However, all segments need to be considered on a country-specific basis. In Germany and France, scepticism regarding the long-term value of investments is apparent across the board in all the property segments covered by the survey. Here, avoiding risk in a very late stage of the market cycle is the prime concern. By contrast, UK investors are focusing their risk-avoidance strategies solely on the retail segment.

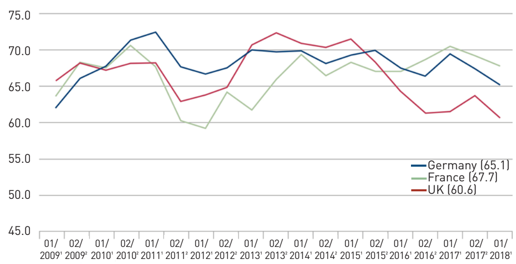
### Opportunities in the co-working segment

The study also examines whether the trend towards co-working provides viable opportunities for investment. This segment is considered to offer very different levels of potential returns depending on the region surveyed. When asked whether they would invest in single-tenant properties let to a co-working provider, around 60% of the survey participants said yes. Investors in France are most open to investment of this type (73%), followed by the UK (58%). In Germany, however, opportunities for returns in the co-working segment are still viewed with a degree of caution: currently, only 46% would invest in properties with a single tenant such as WeWork or Mindspace.

### Declining investment interest in the UK

The yield expectations for property investment in the United Kingdom are even lower at present. Three quarters of investors based in Germany are not currently planning to invest in the UK property market. French investors have slightly more confidence in the British property market: here, 55% have put investment in the UK on hold for the next 12 months. Meanwhile, the view from within the UK itself is not particularly favourable with regard to the current state of the country. Some 32% of British investors expect conditions to deteriorate over the next 12 months, while a further 56% do not expect the investment climate to improve until at least summer 2019. All the regions surveyed had markedly negative expectations with regard to investment in retail, but these are at an all-time low in the UK, with 56% of British investors expecting conditions for retail investments to worsen significantly over the next 12 months. The equivalent figure for office investments is only 14%. Overall, sentiment also remains subdued in the European office investment markets. Only a quarter of investors see signs that the market will pick up in the near future. In the UK, a mere 2% believe the outlook is improving in their home market.

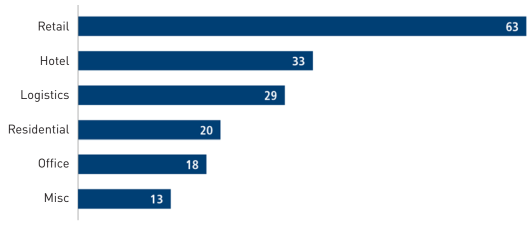
#### Investment climate index for property investors




*Source: Union Investment, property investment climate study I/2018 (survey of 163 property investors in Germany, France and the UK)*
*[1]Survey period: summer [2]Survey period: winter*

#### Growing caution with regard to retail and hotel investments

European investors intend to avoid the following types of use over the next twelve months...




*Source: Union Investment, property investment climate study I/2018 (survey of 163 property investors in Germany, France and the UK). Figures in percent, multiple responses allowed. As of August 2018.*

### Index falling in all markets

As the Investment Climate Index results for the UK show, sentiment among British investors has deteriorated further against the backdrop of Brexit. Now standing at just 60.6 points (previous survey: 63.6 points), it is continuing to lose ground against the similarly weak indexes in Germany and France. At 67.7 points, sentiment in France is the highest out of the three largest European economies, despite a slight decline for the fourth time in a row. The Investment Climate Index for Germany has also fallen slightly and settled at a low level of 65.1 points, reflecting modest expectations with regard to sourcing opportunities, among other factors. If sentiment does not improve soon, it will start to translate into falling transaction volumes.

Union Investment