Hamburg, 1 February 2018

Investor survey: product shortage as an opportunity for innovation

- **European investors do not expect turning point in cycle before 2020**
- **Subdued investment climate for office and retail space**
- **Logistics expected to see largest increase in value**
- **Climate risks still receive only limited attention**

Necessity is the mother of invention. The squeeze on available real estate products is forcing the sector to change and is boosting its innovation capability. That is the positive view of the transformation process facing many sections of the real estate industry. “The ongoing lack of products will continue to drive the trend within companies that has already been gathering pace due to the megatrends of sustainability, digitisation and urbanisation,” said Olaf Janßen, Head of Research at Union Investment Real Estate GmbH. Over the past nine years, the industry has had to learn that the product scarcity which is pushing up prices is not a temporary phenomenon. In addition, the real estate cycle still appears to be far from a turning point. In the latest investment climate study by Union Investment, two thirds of the 151 property investors surveyed in Germany, France and the UK expected the turning point to be reached in 2020 or later. 36 per cent of the investors surveyed estimate that it will be at least three years before initial returns on real estate in Europe start to rise again. Depending on investors’ expectations with regard to returns, the investment strategy may involve accepting higher risk or lower returns. According to the Union Investment survey, 37 per cent of investors are currently willing to take on more risk for the same returns. However, a clear majority (56 per cent) are not prepared to recalibrate their risk strategy, choosing instead to accept lower returns.

Accordingly, around 50 per cent of the investors taking part in the survey stated that they do not believe they will achieve their own yield targets, either within a timeframe of three years or five. This is supported by the consistently high value placed on security by professional investors, as reflected in the results of the survey. Security remains the most important aspect of investment decisions for 30 per cent of the interviewed investors. For 15 per cent, liquidity is the most important factor, while return on investments heads the list for 54 per cent, as in the previous year’s survey. Only French investors now show a higher tolerance of risk than in the last survey, conducted in spring 2017.

"These findings indicate the most common ways out of the investor's dilemma. A third option between a wait-and-see attitude and excessive risk, although still a much less common choice, involves more innovation with calculable risks," said Olaf Janßen.

UK investors put their faith in logistics

Alternative strategies nonetheless still dominate, which essentially aim to tap into new product sources outside the mainstream market segments. A pointer as to where the supply pipeline will become even tighter in future is provided by investors' assessment of the property types which are expected to perform best over the coming 12 months. The greatest potential is in logistics properties, according to 53 per cent of the real estate professionals participating in the survey, followed by office properties at 26 per cent of the responses. In contrast, investors are more cautious in their expectations for value growth in the hotel and retail segments over the next 12 months. Only 9 and 8 per cent of investors respectively expect significant appreciation in value in these segments in 2018. Faith in the logistics segment is particularly high among UK investors. In an analysis of all major commercial property types, more than three quarters of UK investors expect to see the strongest performance in the logistics segment, including up-and-coming last-mile logistics, over the coming 12 months.

It is notable how widespread the assessment is, across all survey regions, that the climate for retail investments in the respective markets will weaken further in the next 12 months. The general outlook for office investments is rated slightly better. The UK's exit from the EU seems to have dampened sentiment towards the country's office property market far less than expected. Only 16 per cent of local investors expect a deterioration in the climate for office investments in the UK over the next 12 months. As the Investment Climate Index in the UK shows, sentiment among British investors has recovered somewhat, after hitting a low following the EU referendum. Despite the slight upward trend, though, the UK index stands at just 63.6 points and lags the indices in Germany and France, both of which have declined marginally since the last survey. At 69.1 points, for the third survey in a row France boasts the most positive sentiment of the three largest economies in Europe. The Investment Climate Index in Germany levelled off at a modest 67.3 points, reflecting the low expectations of local investors in relation to sourcing opportunities, among other factors.

"Bearing in mind the limited supply of high-quality properties for sale, it will be interesting to see whether investors use this situation to investigate new creative products and solutions or address issues that are more complex and offer greater opportunities," said Olaf Janßen. "There is also still considerable potential in relation to sustainability."

No timetable for "climate neutral" building stock

Companies have undoubtedly recognised that there is no way around sustainability. In many places, however, only slow progress is being made. Targets and sustainability strategies are seldom defined in full. As the Union Investment survey shows, real estate investment continues to adhere strictly to the principle of economic viability, despite sustainability also being taken into consideration. 81% of the interviewed property investors state that they only improve their real estate portfolio in terms of sustainability where it makes financial sense to do so. Climate risks remain largely ignored when investment decisions are made. Just one in three of the property firms participating in the survey has created a fixed timetable for implementing a climate-friendly investment policy.

German real estate professionals appear to be the least prepared in this respect. While the report indicates that in the UK and France 38 per cent and 44 per cent of investors respectively are pursuing a clear strategy to gradually reduce their CO_2 emissions, the figure for Germany of 24 per cent means that only one in four investors has a programme for cutting greenhouse gas emissions, either finalised on paper or at the implementation stage.

"Within the industry, we see worthwhile and innovative approaches to revealing climate risks in the property stock, assessing the risks and actively managing them. The toolkit for risk analysis of the buildings portfolio has grown substantially. The era of climate-neutral building stock is not yet upon us, though," said Jan von Mallinckrodt, Head of Sustainability at Union Investment Real Estate GmbH. Despite ambitious climate protection targets set by the German federal government, sustainability has "no particular importance at present" for one in three German investors, according to their own statements. In contrast, it is noteworthy that in the UK, industry standards and sustainability ratings enjoy considerable importance. Significantly more investors are guided by these factors, or participate in such schemes, than in the two other regions covered by the survey. The differences in relation to ratings are particularly marked. In the UK, 85% of the surveyed investors indicate that they participate in sustainability ratings. In Germany and France, the survey shows that the figures are only 33 and 44 per cent respectively. "International benchmarks and ratings are indispensable for defining targets. This is one of the keys to targeted investment in climate protection," said von Mallinckrodt.

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 November 2017 and January 2018 with 151 property companies and institutional real estate investors in Germany (n=63), France (n=62) and the UK (n=26).

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