# Research Blast

European Real Estate Market, January 2016 Update

## How low oil price may impact Middle East investments into commercial European real estate

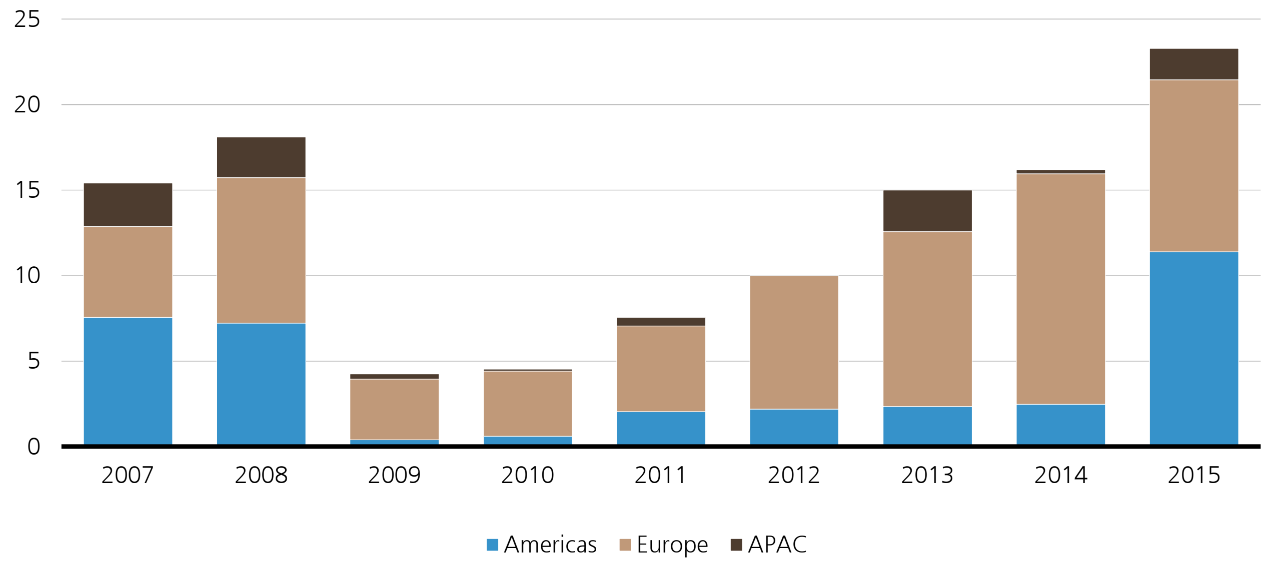
The weak oil price has pushed Middle East government budgets into significant deficits, with some starting to sell off assets in order to balance their finances. Middle Eastern investors have also been quite active in European real estate in recent years, and the question is would they also start selling real estate assets as they have been doing with their more liquid assets (equities and money market funds) in 2015.

Until 2014, Europe was the main destination of Middle Eastern capital; however, several very large deals in Manhattan and involving a US industrial portfolio, both in 2015, have pushed the Americas ahead of Europe. While Middle Eastern investors have increased their investment activity in some continental European markets, investment volumes in their most favored investment destination, London, were more muted. Close to 50% of Middle Eastern activity is still focused on London. Preliminary statistics suggest that the slowdown in investment activity in London led to decline of circa 20% of Middle Eastern investment activity in European commercial real estate. Even though this decline is significant, we do not expect a major impact on the overall European real estate market, although some sub-segments may be affected.

Source: RCA, January 2016

Middle East investors may shift more from direct to indirect real estate investments

**Middle East: global investment volumes** (USD billion)

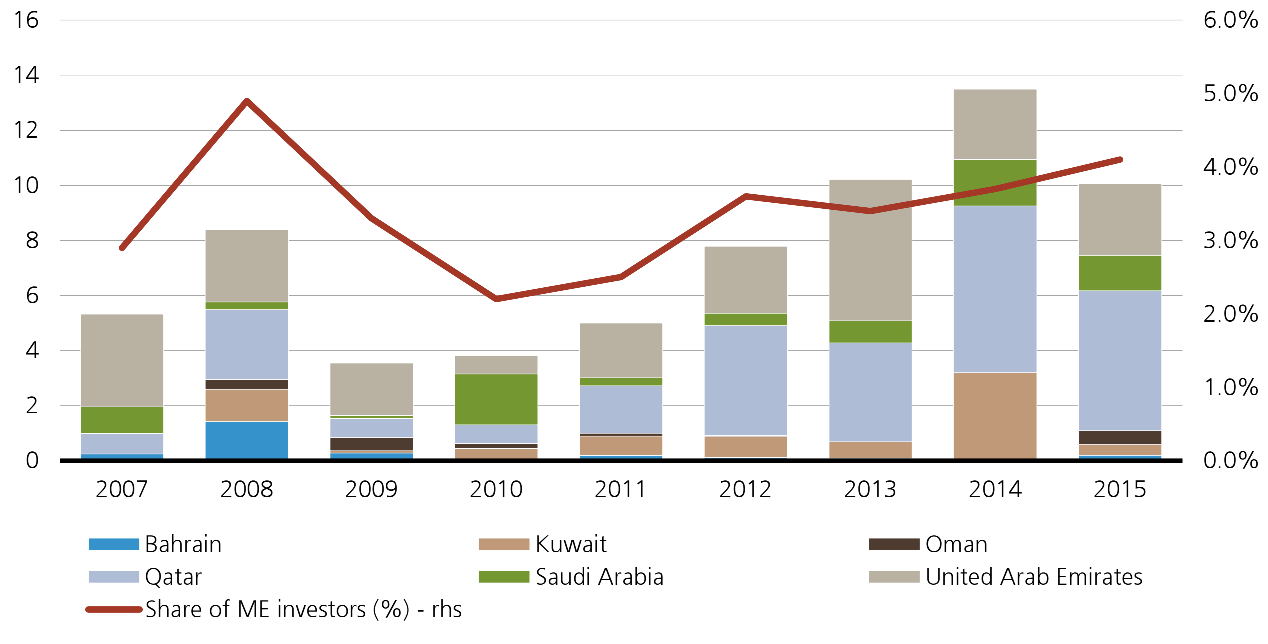



Source: RCA, January 2016
Note: 2015 numbers are preliminary

UBS

Over the last few years, Middle Eastern capital contributed between 3-4% to total European commercial real estate investment volumes. However, sovereign wealth funds have been focusing on larger lot sizes (above EUR 150 million) in the office sector – most notably in London and Paris but also in major German cities – as well as the hotel sector. Despite many real estate professionals' perception, data does not prove that Middle Eastern investors have pushed prime office yields down. However, in London transactional yield evidence does suggest some decline over the last few years, but this is more or less in line with the overall falling gilt rate environment. Recently, there is some (anecdotal) evidence that several deals in London were cancelled as investors were not prepared to pay the asking price. It cannot be definitely confirmed if the falling oil price and a change in investor strategy were the reason behind the failure of the deals as investment activity in the rest of Europe continued. USD-denominated investments in the eurozone have become slightly more affordable following the devaluation of the euro, which was stronger than for the British pound. Furthermore the recovery of the eurozone commercial real estate market, in particular the occupier and rental cycle, is only at its early stages while the UK and, in particular, the London office market is at a more advanced stage. Therefore it makes sense for Middle Eastern investors to diversify their European investments outside the UK. Investing in US commercial real estate also makes sense from a currency perspective. Another hypothesis behind investor caution on London is the political discussion on the UK's EU membership, which may influence future decisions.

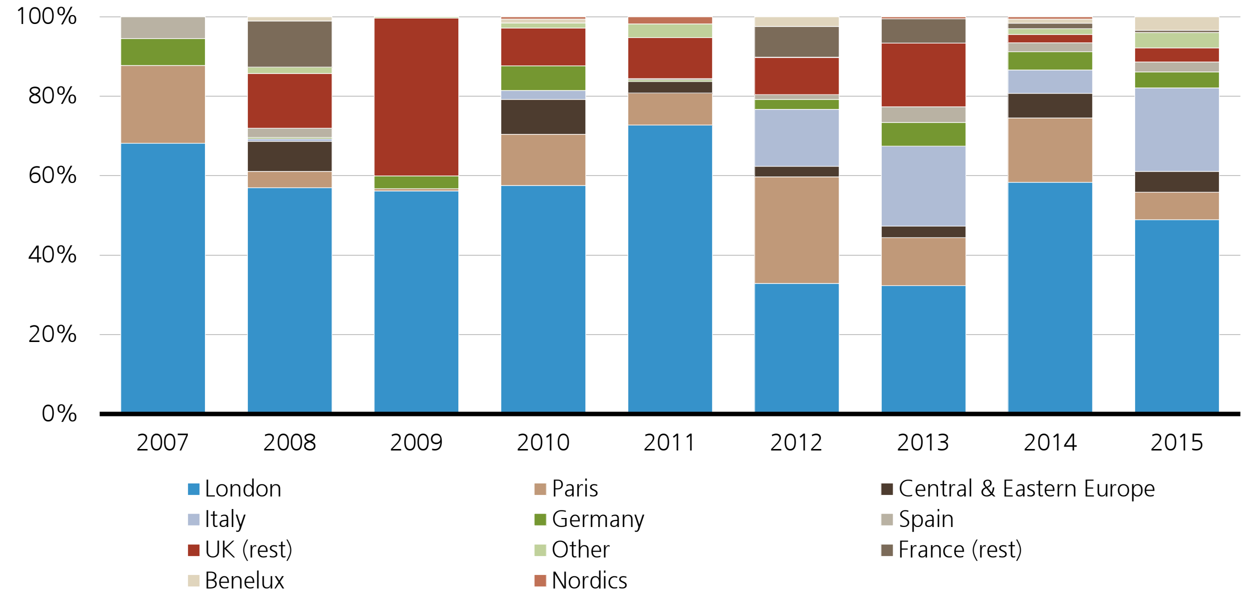
**Middle East: European investment volumes** (USD billion) **and share on total investment volumes** (%)




Source: RCA, January 2016; UBS Asset Management, Global Real Estate calculation, January 2016
Note: 2015 numbers are preliminary

With the oil price unlikely to return to 2013 levels anytime soon, could the market expect a retreat of Middle Eastern capital from global real estate, in particular from Europe? First of all, commercial real estate investment volume statistics show only part of the market, namely the direct commercial real estate investment market. The direct commercial real investment market data is somewhat biased toward sovereign wealth funds, and lower inflows from oil revenues could well influence their investment strategies. Middle Eastern investors, however, in particular HNWI (high net worth individuals) and smaller institutional investors have also been investing indirectly into commercial real estate, which is more difficult to follow. The Middle Eastern commercial real estate domestic markets offer only limited income-producing product. The search for yield from institutional and HNWI investors alike favors investing in commercial real estate, meaning increased demand for income producing assets in global markets. The current geopolitical environment in the Middle East is translating into an increased demand for global commercial real estate to meet investor needs for regional diversification

**Geographical distribution of Middle East investments** (%)

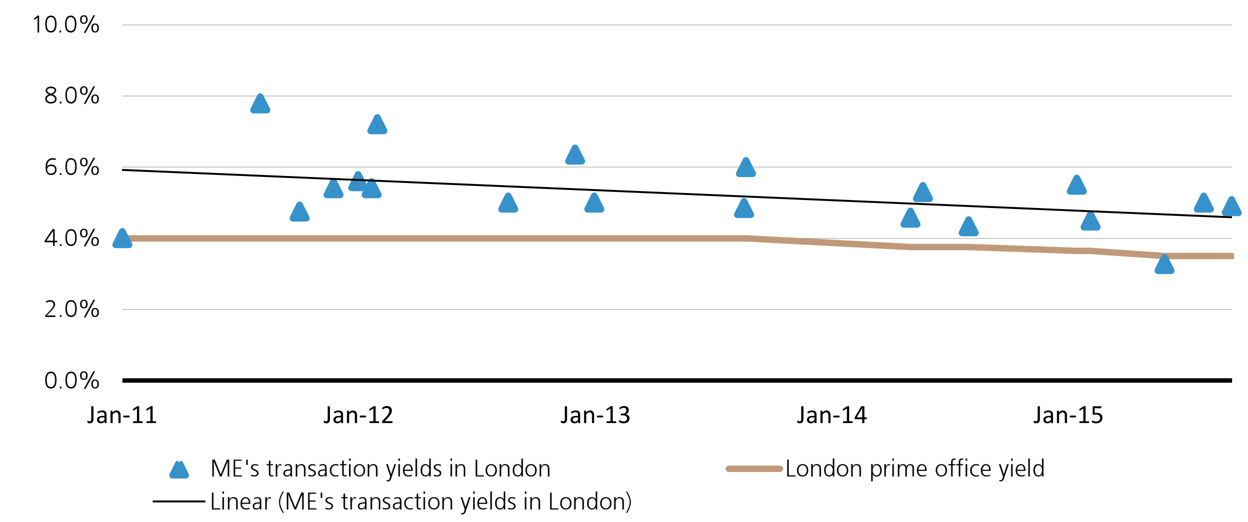



Source: RCA, January 2016; UBS Asset Management, Global Real Estate calculation, January 2016
Note: 2015 numbers are preliminary

but also increasing need for income return and wealth preservation. Lower oil revenues may also result investing in lower lot sized real estate assets. This could broaden the investment scope of Middle Eastern investors, in particular in Europe where lot sizes in the office and retail sector are mainly below EUR 100 million. However, a more geographical diverse and lower lot sized portfolio may challenge/stretch the current business set-up of some institutional investors in the region as a more granular portfolio is more management intensive than a handful of big assets in a limited number of locations. A consequence could see Middle Eastern investors move more towards more indirect investments or partnerships with regional/local managers or explore fund of funds strategies. As such public data for direct commercial real estate investment volumes may show a decline of Middle Eastern investor real estate investment activity in the future but might get shifted to the indirect market which gets often quoted as "global" capital.

Source: RCA, January 2016

**European Investment Volumes** (EUR billion)




Source: RCA, January 2016; CBRE 4Q15
Note: 2015 numbers are preliminary

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