European Commercial - Autumn 2023

SPOTLIGHT
*Savills Research*

# EME Investor Sentiment Survey

savills

● Sectors ● Geographies ● ESG

# UK tops European investor wishlist

Investor sentiment improves for logistics and living sectors.

**Introduction**

Amid falling core inflation and economist consensus that Eurozone interest rates have plateaued at 4%, Europe and Middle Eastern real estate investors are adjusting their investment strategies accordingly. Preliminary MSCI data to end August 2023 indicates European investment transactions fell 58% yoy as higher debt costs continue to restrict deal flow amid a period of price discovery.

To best gauge investor sentiment at this period of uncertainty, Savills has launched its second Europe and Middle East (EME) Investor Sentiment Survey, consisting of pan European investors, representing over €500bn of European real estate assets under management (AUM). The responses were collected between 5th-19th September 2023 with respondents' company HQs located in the UK (35%), Germany (19%), US (15%), France (11%), Canada (8%) and Other European (12%).

**Risk appetite**

Since 2022, investor risk appetite has increased, with the proportion of investors seeking to undertake a more aggressive investment strategy increasing from 14% of respondents to 28% in 2023. Whilst 44% of respondents are now looking to maintain their risk level, likely as a result of higher interest rates and a focus on refinancing their existing portfolio, the majority of investors are actively looking to adjust risk exposure over the next 12 months, suggesting transactional activity will gather pace in 2024.

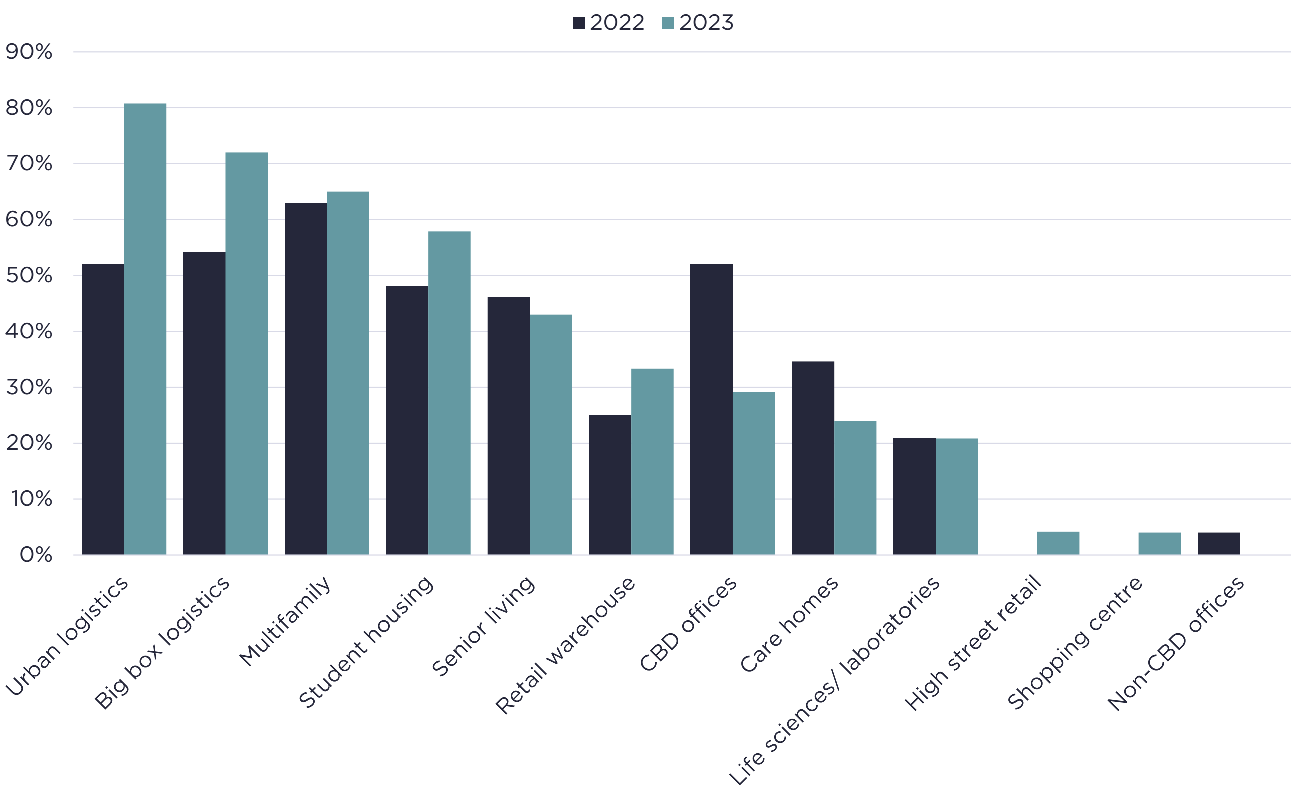
**Sector preference**

Overall, investor willingness to acquire European real estate remains stable year on year. However, demand has intensified for sectors with stronger fundamentals, whilst sectors with slower price discovery and a weaker rental growth backdrop will take longer for investors to return to the market.

2023 has witnessed the return of EME investor confidence to the industrial sector. Urban logistics was the most favoured sector, with 81% of investor looking to invest over the next 12 months, up from 52% last year. It was a similar story for big box logistics, rising from 54% to 72% yoy, supported by the positive tailwinds supporting demand in the sector including rising online retail sales, increased demand for next day delivery, and an increase in companies looking to mitigate supply chain risk through nearshoring.

The proportion of investors willing to invest in multifamily increased from 63% to 65%, supported by population growth, and the ongoing structural shift towards renting. Student housing also marked an increase from 48% to 58% of investors looking to deploy, as the sector matures in mainland Europe and student applications rise, amid waning employer hiring sentiment. Giving ageing European demographics and the increasing maturity of the sector, investors also remain positive on senior

**Chart 1: In which sectors will landlords invest over the next 12 months? (% likely)**




**Source** Savills

housing.

Investor sentiment towards retail warehouses has also improved YoY as recovering consumer confidence and easing inflation have supported the rental growth story, and yields had already moved outwards prior to the interest rate increases. High street retail and shopping centres compared less favourably, although both marked improvements YoY.

CBD offices represent the largest weakening in investor sentiment YoY, with the proportion of investors looking to deploy over the next 12 months falling from 52% to 29% between 2022 and 2023. Clearly there is a difference in attitudes when analysing by origin of investors, with 33% of European investors willing to invest in CBD offices, against only 17% of US/ Canadian investors. This is largely attributable to the higher US vacancy rates and lower office occupancy rates. In Europe, vacancy rates stand at 8%, remaining in landlords' favour, particularly in the core Western European markets. Interestingly, no investors intended to invest in non-CBD offices, given the increasing leasing risk and asset management required for older stock.

This year, more investors are looking to mitigate leasing risk through partnering with a flex office operator, rising marginally from 29% to 31%. The largest driver of the increase was down to landlords looking to implement landlord fitted space.

Life sciences remains in vogue, supported by rising corporate funding into the sector, with 20% of investors seeking to invest over the next 12 months. However, the lack of investible stock will remain a constraint, as landlords will seek to partner with developers.

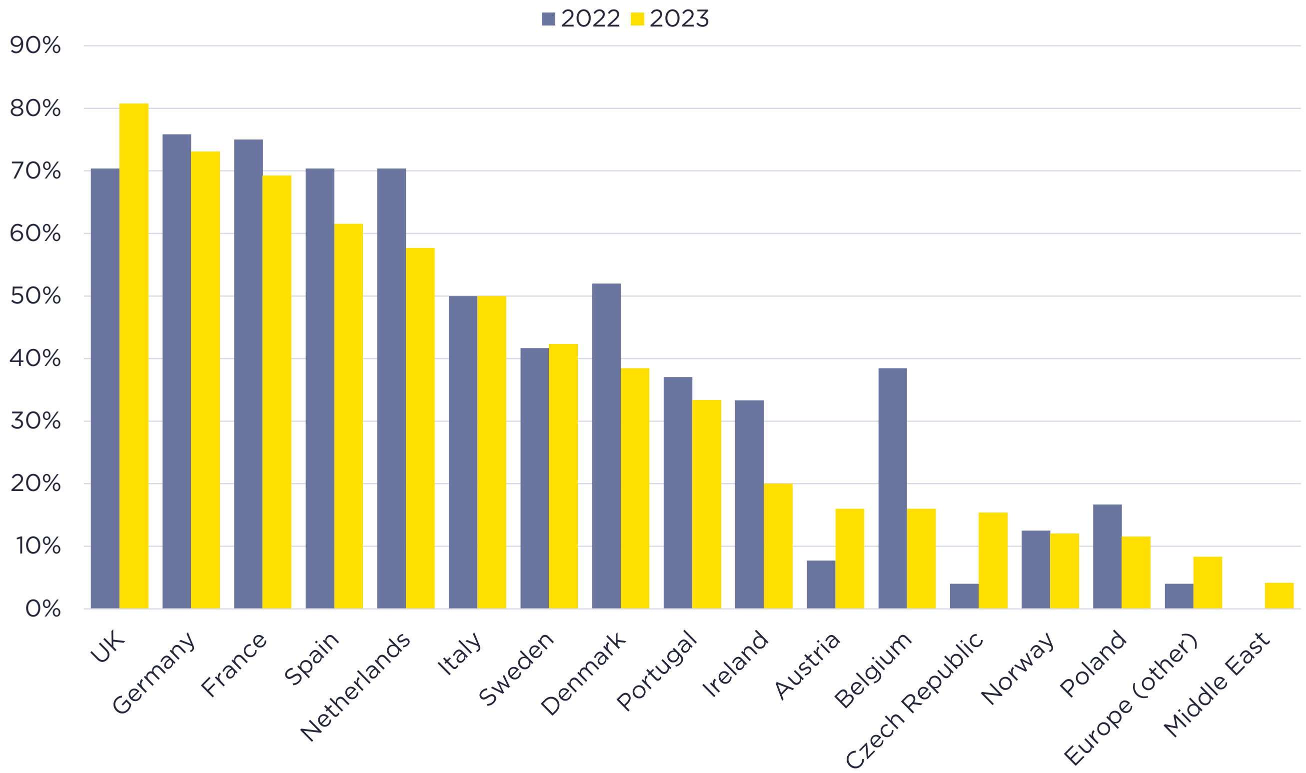
**Geographies**

Investor appetite for core, liquid markets remains high, as non- core markets became less favourable. Investor sentiment has improved markedly for UK real estate over the last year, as the UK became the most desirable investment location, up from 3rd last year. This is likely a result of government bond yields settling following the aftermath of the Truss budget and faster price adjustments in the UK.

France and Germany mark a slight decline following weaker economic growth, although prices have adjusted from a lower base in Germany, whilst French investment transaction volumes have been relatively resilient in H1 2023.

Given stronger economic growth, the Southern European economies of Spain, Italy and Portugal performed well. Recent Eurozone inflation data is also on a downwards trajectory, with economists suggesting the European Central Bank will maintain rates at 4.00%. The volume of short term debt set for expiry and price stickiness

**Chart 2: In which countries will landlords invest over the next 12 months? (% likely)**




**Source** Savills

continue to limit core transactions across the Nordic markets.

**Barriers to investment**

73% of respondents consider higher debt costs to be a major challenge to making new investments across Europe, followed by prices not yet having fully adjusted (62%). Clearly debt has had a significant impact on the ability to transact core assets, and as such, value-add will be the main driver of investment transactions towards end 2023/ early 2024.

Interestingly, only 35% of investors reported dry powder to be a major challenge to making new investments, indicating that there remains capital to be deployed. However, the right product, and at the right price remain central to transacting.

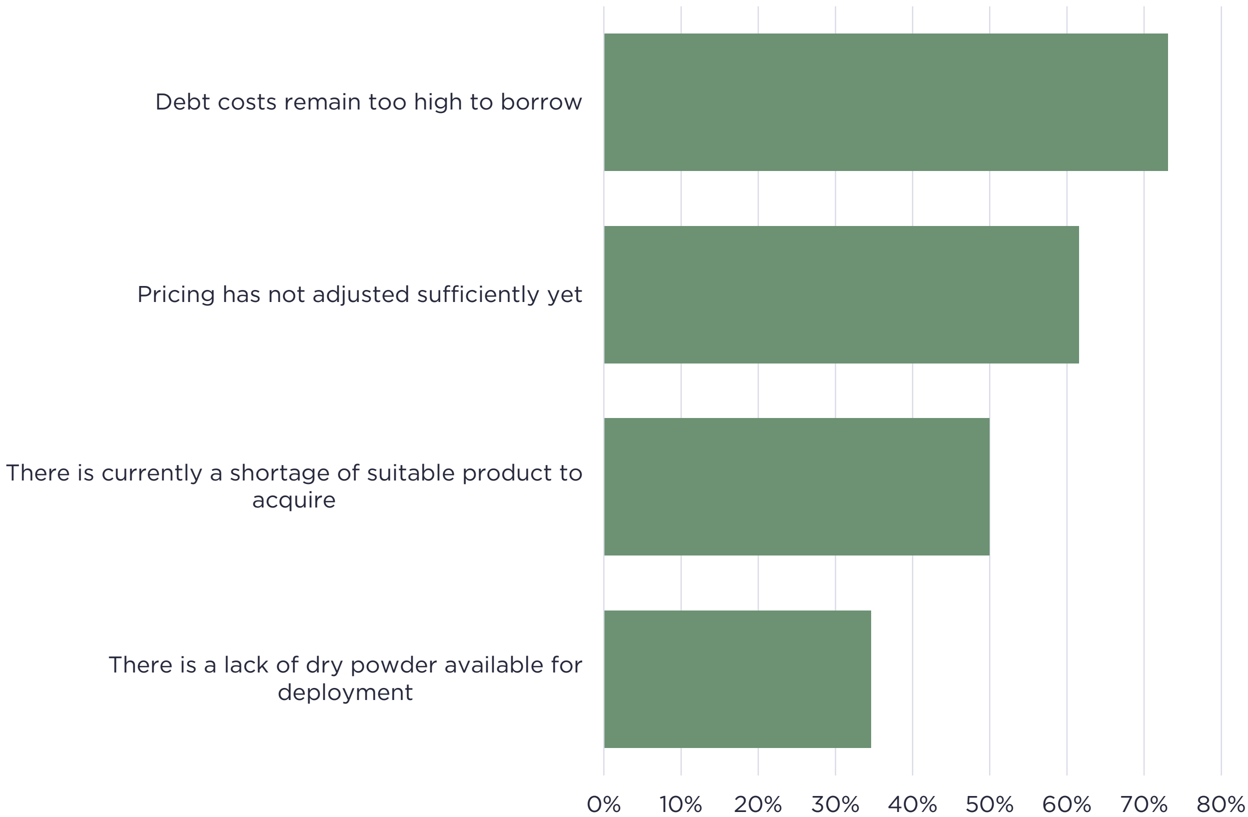
**Lot size**

The €20m-€50m lot size (54% of investors) and €50m-€100m lot size (58% of investors) remain the most favourable size bands for pan European investors. Demand drops off for larger lot sizes over €100m, reflecting the higher cost of debt for core assets, and the thinner pool of buyers who are able to acquire at lower levels of leverage.

**ESG**

In 2023, the proportion of investors willing to undertake a 'manage to ESG' strategy has remained at 72%, whilst the proportion of investors only seeking to acquire ESG compliant assets was 28%. The proportion only willing to invest in ESG compliant assets rose from 24% last year, reflecting the rising impact of environmental regulations on investor strategy. All investors reported that they have a ESG strategy in place.

**Chart 3: Proportion of investors who consider the following factors a "major challenge" to making new investments**




**Source:** Savills

# Outlook

## What do these results tell us?

Clearly, there is still capital that can be deployed, although investors are more selective over the quality of asset they acquire, as pricing has become more sensitive. Until core markets adjust to reflect higher debt costs, value-add stock will remain the main driver of investment transactions.

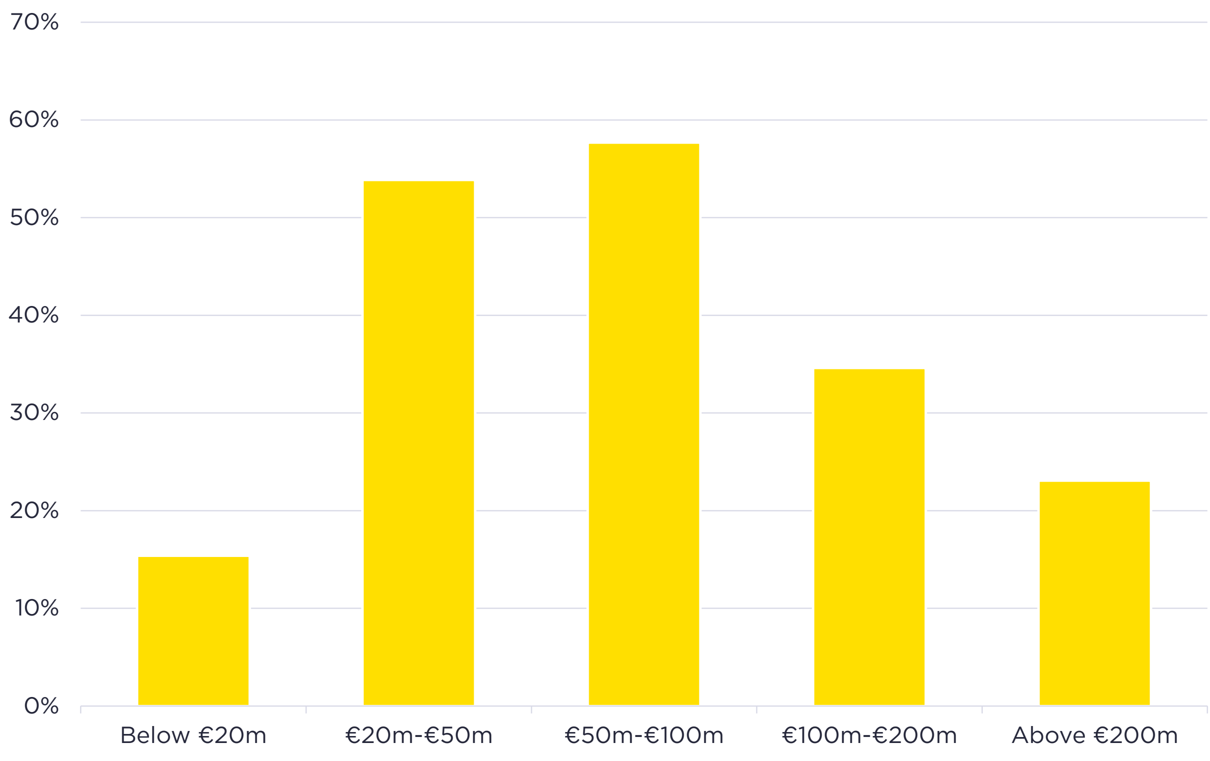
Investors are also still active- the proportion of investors looking to deploy has remained stable on average, but the proportion looking at 'beds and sheds' has intensified, where we expect to see the recovery in investment volumes first. However, those willing to reposition older office assets at a discount in core cities with low vacancy rates are likely to be rewarded with strong rental uplift.

But what will make core pricing adjust? Stress, and in some cases, distress, will come through over the coming months as banks recalibrate their interest rates on maturing debt to reflect a higher cost of financing. Given the higher proportion of long term, fixed rate loans, the correction is taking longer than many landlords had initially expected. Of course, lenders do not want to have to repossess real estate, but cannot keep extending existing debt terms into 2024 and we anticipate some landlords will return to the market in early 2024 to reflect this.

Private equity investors are awaiting for distress to come through, before returning to the market. However, as bidding activity remains at more modest levels, those investors who are willing to undertake a countercyclical approach and acquire prime lots at a discount, are also likely to be rewarded.

ESG regulations present both a challenge and an opportunity for landlords and assets will continue to reprice to reflect this. Astute landlords who are focussed around the changing occupier needs and flight-to-quality will benefit. Those landlords who do not reposition older stock will be left with obsolete assets.

**Chart 4: Which of the following best describes your target acquisition lot size?**




**Source:** Savills

**Savills Commercial Research**

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