European Commercial - February 2021

SPOTLIGHT
Savills Research

European Cross Border Investment

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● Investment Activity ● Investor Intentions ● 2021 Outlook

Intra-EMEA investors dominant

Travel bans hamper cross border transactions in 2020.

Economic Overview

As vaccine rollouts are in full flow across European markets, green shoots will begin to emerge for Europe's economies as we head through the year. Nevertheless, further lockdowns imposed during the first quarter of 2021 as a result of new variants within the virus will continue to hamper the recovery, with the Eurozone economy expected to contract by 2.5% yoy in Q1 2021. Overall, the economy is expected to grow +4.6% in real terms in 2021 and is expected to be back to the pre Covid levels by the end of 2022.

2021 will present more evidence of the impact on Eurozone unemployment rates, although this is only expected to peak at 9.3% during Q2 2021, suggesting the furlough packages are generally delivering the desired results.

Despite the ebb and flow of transit mobility levels, business confidence continues its upwards trajectory as companies are able to adapt to new lockdowns more efficiently and will have increasing clarity in planning for longer term.

Interest rates will remain low and in some cases negative, with an expansionary monetary policy adopted by the European Central Bank (ECB). Eurozone inflation still hovers around the zero mark (dragged down partly by falling oil prices) and well below the historic target rate of 2%.

The strength of the euro will remain a concern for cross border investors in 2021, currently around the highest level for three years. Given that the ECB's Pandemic Emergency Purchase Programme (PEPP) rose to €1.85tr at the end of 2020, this may stabilise the euro later in the year.

Cross Border Investment 2020

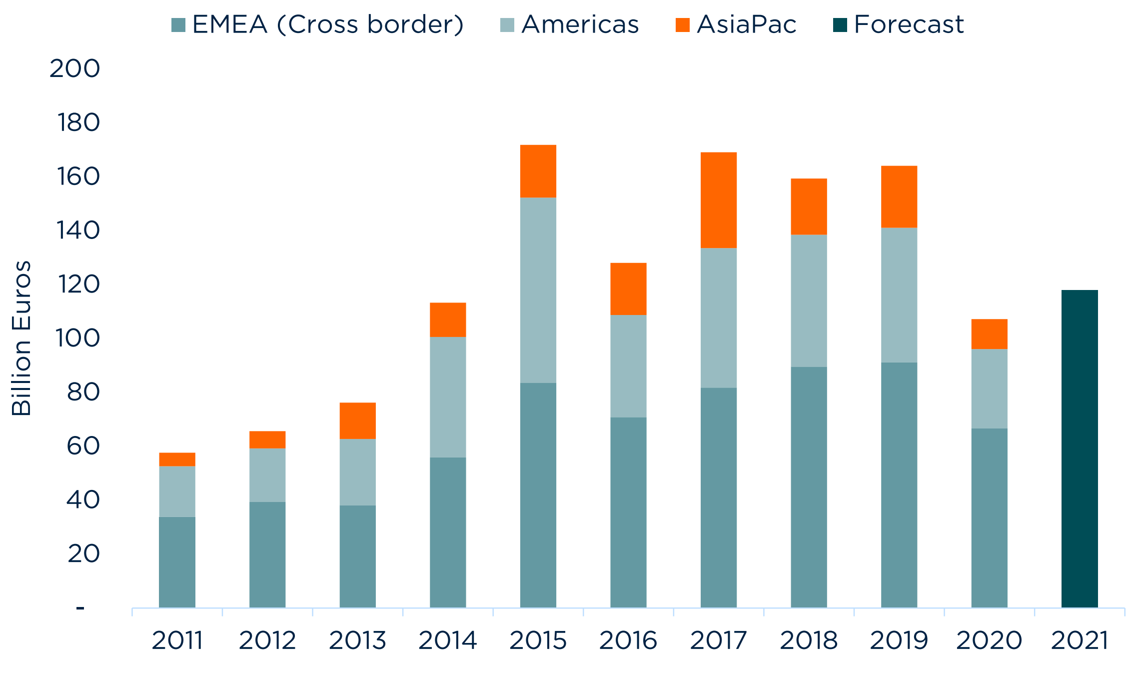
European cross border investment reached €107bn in 2020, down 32% against the five year average according to data from RCA. Total European investment reached €245bn over the same time period, down 24% on the five year average.

Travel bans as a result of coronavirus prevented the levels of extra-European capital we have observed in more recent years, with inward investment from Asia Pac (-53%) and Americas (-43%) significantly down against respective five year averages. Cross border capital from EMEA marked a 20% reduction over the same period.

Whereas 49% of total investment in Europe originated from cross border sources during 2019, this slipped to 45% of transactions in 2020. Intra-EMEA cross border investment rose from 27% to 28% of total activity, although it was the European domestics who benefitted from a less competitive bidding environment.

Cross border investors favoured core countries as safe havens for their capital in 2020. By country, the UK attracted the most cross border capital in 2020, reaching €24.9bn (-10% yoy) and replaced Germany at the top. Germany attracted €19.9bn (-40% yoy) of capital, whilst France recorded a 46% fall yoy to €11.3bn. It's worth noting however, that several of the largest pan European real estate funds are already located in UK, Germany and France, which would be considered domestic investment.

Chart 1: European cross border investment by region (€bn)



Source: RCA, Savills Research

2020 strong for beds and sheds

Industrial rises from 13% to 20% of investment activity.

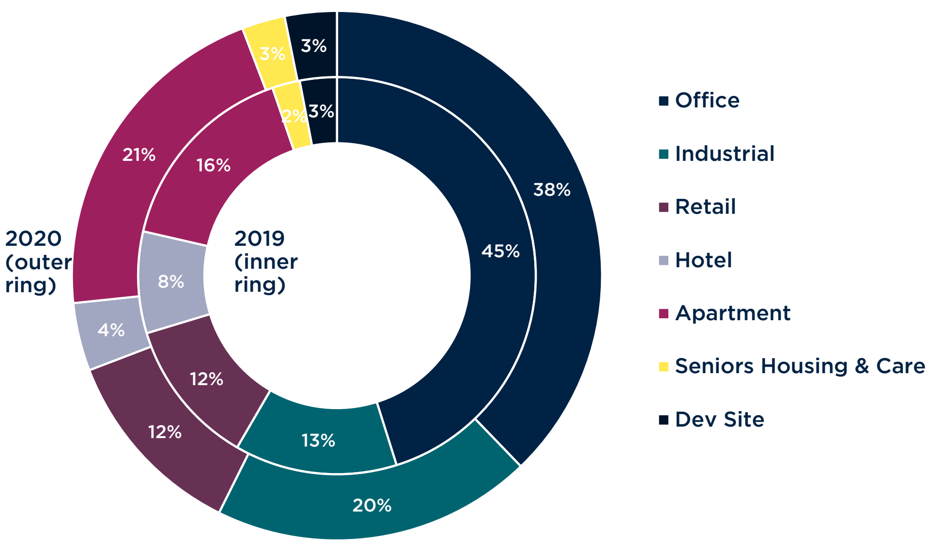
Investment by sector

Between 2019 and 2020, "beds and sheds" continued to drive European cross border investor interest. Industrial investment rose from 13% to 20% of total investment volumes, and remained stable at €21bn, driven by a number of portfolio deals in the final quarter of the year such as JP Morgan Asset Management's €550m acquisition of 11 assets across France, Ireland and the UK. Multifamily investment rose from 16% to 21% of total activity, although the absolute volume fell by 15% yoy to €22bn. Long-dated income streams with rental growth prospects continue to pique investor interest in order to meet pension fund liabilities, however the availability of 10+ years income remains scarce.

Offices remained the largest investment sector for cross border capital and accounted for €40bn of transactions, although the proportion fell from 45% to 38% and this marked an absolute fall of 45% yoy. Investors are paying closer attention to corporate signals regarding the return to the workplace and sentiment continues to split the bulls from the bears.

The retail sector maintained its 12% share of the cross border investor market between 2019 and 2020, suggesting 2021 could be the year where investors seeking higher yields will return back to the market for repurposing opportunities. Investor demand for core assets remains resilient, particularly food based retail, although price points are still being discovered for non-core retail product.

Chart 2: European cross border investment by sector (%) 2019, 2020



Source: RCA, Savills Research

2021 outlook

Europeans will continue to seek core opportunities close to home.

In 2021, we anticipate European cross border investment to increase between 10-15% yoy to circa €120bn, due to the ever-growing appetite for European real estate.

We anticipate non-European investors will continue to seek to diversify their portfolios with European acquisitions. This is of particular appeal at the moment since sovereign bonds offer near zero returns, ensuring an enticing yield spread for real estate. The attraction of European markets is further underpinned by its relative macro stability with political tension, oil price volatility and a desire for geographical diversification all bolstering outflows towards Europe. Non-European funds will seek to further de-risk their investments in Europe by adopting JV structures with local managers. The shape and form of these partnerships will vary on the basis of individual investor requirements but the commitment of equity from the European manager will likely become more important in 2021.

Debt rates on core product have partially recovered to pre-pandemic levels. Across most commercial sectors, loan to value ratios are circa 5bps below the pre-pandemic levels.

Travel restrictions will likely prolong the completion of transactions in the first half of the year, though a proliferation of partnerships between non-European capital and European based investment managers may result in greater market momentum, in the absence of the ability to freely travel. Consequently, European funds will have a comparative advantage when acquiring "close to home", as evidenced by French SCPIs and German funds investing in Benelux and CEE markets respectively in 2020. Many vendors will treat 2021 as a year to take stock, as the opportunities to redeploy capital are limited and net inflows remain positive.

Chart 1: Cross border investor intentions 2021

Investor Origin	2021 Investment Targets
South Korea	Korean sovereign funds are less likely to be impeded by the inability to travel than securities companies and AMCs on account of their operational presence in Europe and established partnerships with local asset managers. Despite such hurdles, we envisage a continued interest in core European product, although we do not anticipate a return to 2019 transaction volumes. Logistics real estate with robust tenant covenants will remain popular in spite of compressing yield levels.
Singapore	2020 saw Singaporeans undertake a number of headline transactions in the core central London office space. This complements a continued interest in suburban business park offices where higher yielding opportunities in both the UK and continental European markets can be found. 2021 will see Singaporean investors further reinforce their established presence in thematic strategies across Beds, Sheds and Meds, with data centres and life science orientated real estate highly sought-after in spite of limited supply.
China	Government capital controls remain in place for Chinese buyers, although opportunities will arise for One Belt One Road (OBOR) led infrastructure schemes in Central Eastern Europe, with logistics a notable inclusion in this broad definition. Recent transactions by Chinese capital have seen substantial investments into Pan-European logistics platforms in 2020, bolstering exposure to a number of European markets. Nascent interest for life sciences orientated property is testament to the ambitions of private Chinese investors in Europe.
North America	Recent robust activity from North American capital in Europe will persist into 2021 with focus anticipated to fall on large platform plays, in particular across residential and logistics sectors. However, we also expect US and Canadian investors to be omnipresent across more traditional sectors, with opportunistic acquisitions in offices, retail and hospitality likely as well-capitalised funds look to exploit narrow windows of opportunity. Their ability to compete in core processes should also not be dismissed.
Malaysia	2020 saw Malaysian investors increase their capital allocation to outbound investment and we expect this trend to continue in 2021. Malaysian investors will remain focused on best in class assets, working with local asset managers to deploy their capital. Their current focus is in the logistics and living sectors, however we expect core offices will return to favour in 2021, with evidence of this already emerging in key European capitals in late 2020.
Middle East	Investors will continue to seek attractive cash on cash returns and, whilst yields for stable, core assets appear sharp, Middle Eastern buyers will remain active in the regional cities of core European markets like Germany, Netherlands and the UK where return hurdles can be more easily fulfilled than in competitive gateway cities. Whilst this capital has traditionally favoured offices and logistics, we are seeing growing interest in some sectors of retail, in particular food, as well as student accommodation and life sciences.
Europe	Investors reasserted their competitiveness in core product in 2020 and we anticipate a similar dominance in 2021 in Europe. INREV's Investment Intentions Survey for 2021 indicates a rising target allocation to real estate from 9.0% to 9.3% within Europe this year, as European investors with strong net inflows into their funds look to deploy capital across various asset classes. Travel restrictions on intercontinental travel will further amplify European investment in neighbouring jurisdictions where travel will encounter fewer difficulties.

Savills Commercial Research
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