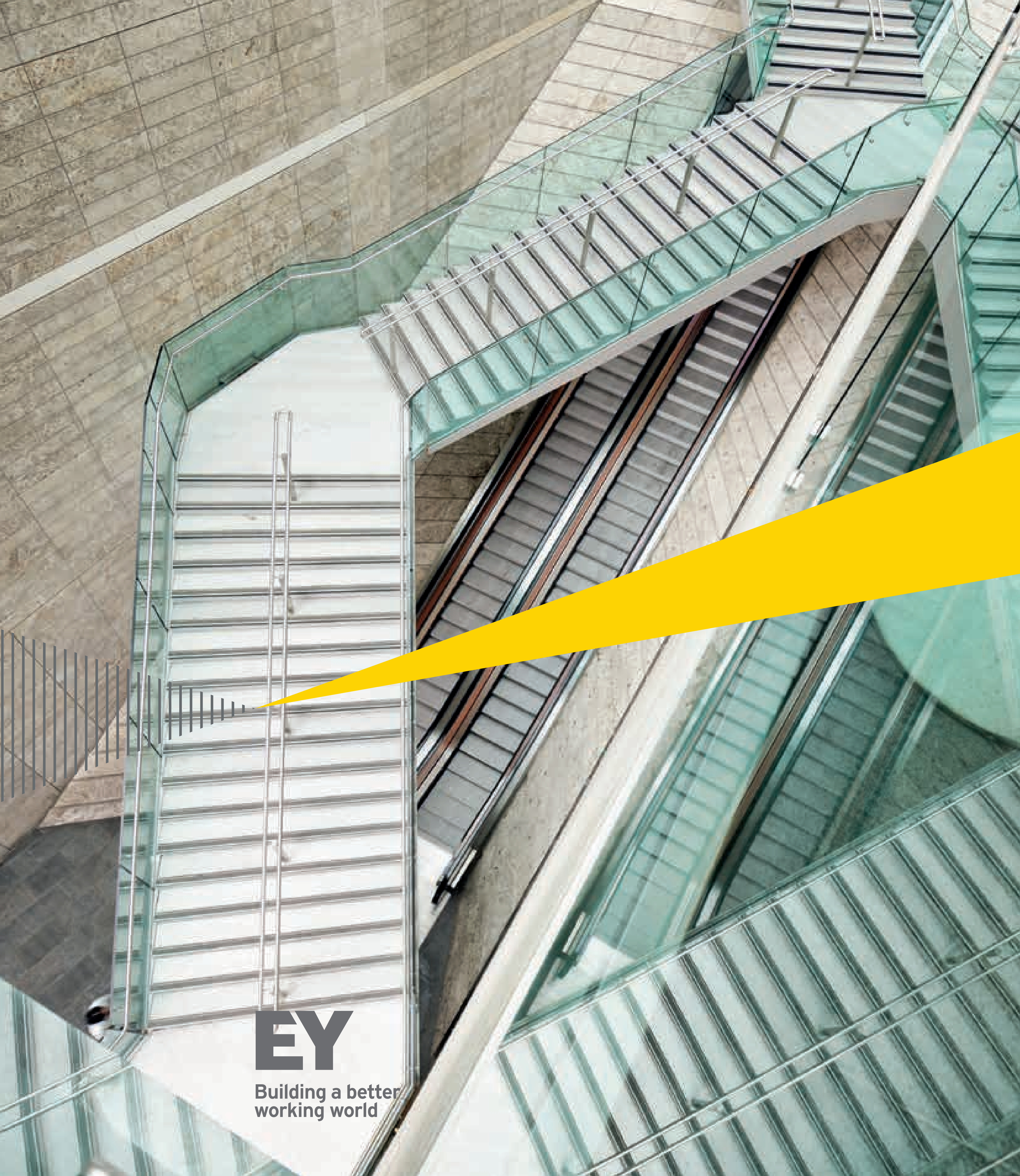
European real estate assets investment trend indicator 2014

Building confidence

Investor sentiment rises as the real estate market starts to recover from the Eurozone debt crisis



EY

Building a better working world

About this report

Welcome to the third annual *EY's European real estate assets investment trend indicator*. This report is based on a forward-looking survey of executives from across Europe, from organizations that invest capital in real estate assets.

In this report, we examine investors' opinions on the likely state of Europe's real estate markets in 2014.

Our findings are based on a survey of more than 500 real estate investors, including selected EY clients. Opinions were canvassed in October 2013 by EY and Valid Research GmbH.

The participants are based in 15 countries: Austria, Belgium, France, Germany, Italy, Luxembourg, Netherlands, Poland, Russia, Spain, Sweden, Switzerland, Turkey, Ukraine and the UK.

In this report

Building confidence

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As the Eurozone economy starts to recover, real estate investments are looking increasingly attractive across Europe. Transaction volumes are set to increase for the second consecutive year, driven largely by cross-border investments.

In 2014, with banks under growing pressure to contain lending, and with deleveraging continuing in both the private and public sectors,[1] demand is likely to rise for mezzanine financing and other alternative sources of capital.

Real estate investors have differing attitudes toward capital growth versus income, and to asset class and quality. But there does appear to be a consensus on the expected macroeconomic developments. Most respondents expect inflation fears to continue to bolster the real estate markets. But a majority of respondents also expect that the Eurozone crisis will no longer be the main driver for investment. Meanwhile, the maturing of billions of dollars' worth of commercial mortgage-backed securities and structured debt, and the liquidation of poorly performing loans, will help to fuel a healthy supply of properties available for transactions.

Respondents overwhelmingly agree on the broader issues such as market attractiveness, transaction volumes and cross-border activity. But there is little discernible pattern across Europe in their answers to questions about investment attitudes, objectives and priorities.

The traditional distinction between mature and emerging markets has been replaced by less clear-cut categories. On some issues, there are differences between countries located in Europe's core countries and those on the periphery. But on other issues, the division is between investors in property markets that have already seen an increase in real estate prices, such as the UK and Germany, and those in markets where prices appear to have bottomed out, such as Spain and the Netherlands.

The absence of clear geographical trends is particularly evident when looking at purchase price expectations. For example, investors in countries as Italy, Turkey, Sweden and the UK expect the prices of prime office property to fall from previous levels. This is in sharp contrast with most of their European neighbors. Similarly, when asked about emerging trends, such as the future of home offices, Austria had more in common with Spain and the BeNeLux (Belgium, Netherlands and Luxembourg) countries than with neighboring Germany and Switzerland.

1. *EY Eurozone Forecast*, September 2013.

Key findings

Expectations for 2014

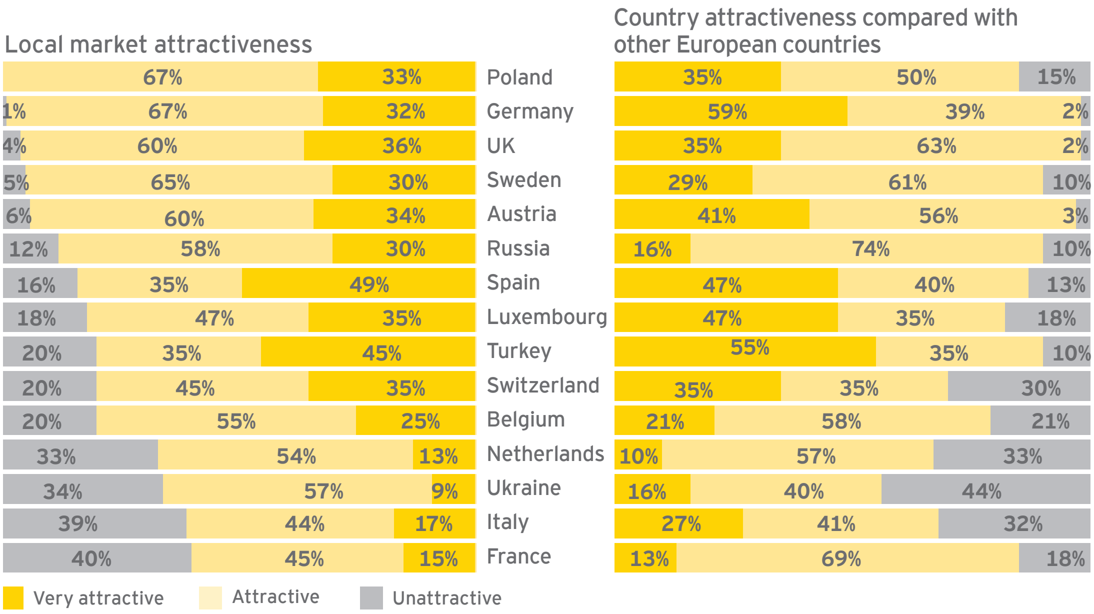
- Transaction volumes are set to increase in 2014.
- The Eurozone debt crisis is no longer seen as the main driver for real estate investment.
- Respondents expect the real estate markets of all European countries to be attractive in 2014.
- Most European countries expect the supply of real estate assets to increase in 2014.
- Demand for mezzanine financing and alternative lending is set to rise.
- Commercial mortgage-backed securities markets are expected to revive in 2014, especially in the more mature markets.
- Investors' risk appetite is increasing, and speculative developments are set to improve slowly in some markets.
- Investors see a mixed outlook for prices in prime locations. Price levels in the hardest-hit Eurozone markets are expected to bounce back. But in markets that recovered earlier, prices are expected to top out or decrease.

Market outlook

Our survey of European investors allows us to make some clear observations about the likely state of the real estate transactions market in 2014 and beyond.

As the Eurozone rebounds from the longest recession since its inception, investors are increasingly confident about European real estate markets. They predict that transaction volumes in this sector will increase over the next year.

Market outlook



Question: How do you rate the country's overall attractiveness as a location for real estate investment in 2014?
Source: Valid Research and EY.

84%

of respondents in Spain view their country as an attractive investment destination. This is a significant increase compared to only 37% in 2013.

Market attractiveness continues to improve across Europe

For the first time in two years, the majority of respondents in all European countries believe that their real estate market is an attractive investment destination. The change in sentiment is particularly striking in Spain and Italy – two of the countries hardest hit by the Eurozone debt crisis – where, in late 2012, a minority of respondents viewed their countries as attractive. But now, 84% of respondents in Spain and 61% of respondents in Italy view their country as an attractive investment destination.

When respondents were asked to rate the comparative attractiveness of their local real estate market compared with other European real estate markets, Germany and the UK came out on top. But 14 of the 15 countries in our survey pool were rated as attractive or very attractive by more than two-thirds of their respondents. Only in Ukraine did 44% of respondents rate their country as a less attractive investment location compared with other European markets.

Real estate transaction market

Transaction volumes are expected to exceed 2013 levels

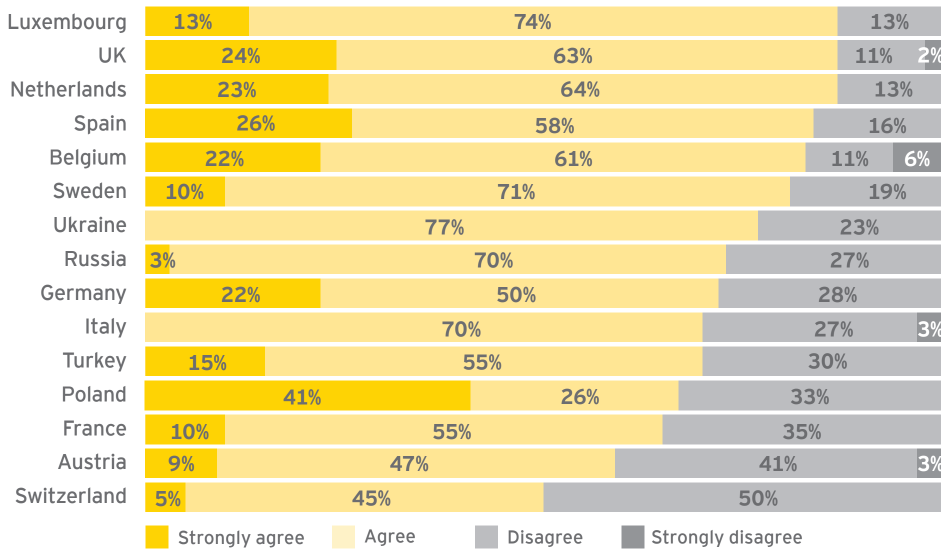
Respondents across Europe expect transaction volumes in their local market to rise.

Again, the change in optimism is most striking in Spain and Italy: 84% of respondents in Spain and 70% of respondents in Italy say that they expect volumes to improve. These figures are up from 17% and 20% a year ago.

In contrast, little more than half the respondents in Austria and Switzerland expect transactions in their countries to exceed last year's levels. This is because cross-border investors will want higher returns on investment than these markets can give.

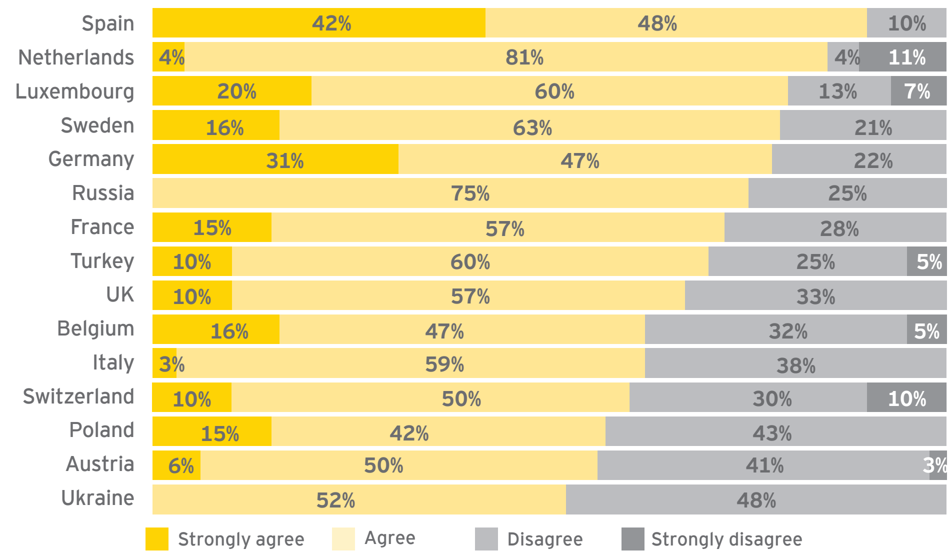
Expectations of cross-border activity have also improved markedly across the board. A majority of respondents in all countries expect that, in 2014, foreign real estate investors will become more active in their countries. In 2013, the majority of respondents in Italy, Spain and Poland did not expect foreign real estate investors to be more active in their countries.

Will transaction volume rise in 2014?



Do you agree to the following statement: Overall, transaction volume in 2014 will exceed the level seen in 2013.
Source: Valid Research and EY.

Will foreign real estate investment activity increase in 2014?



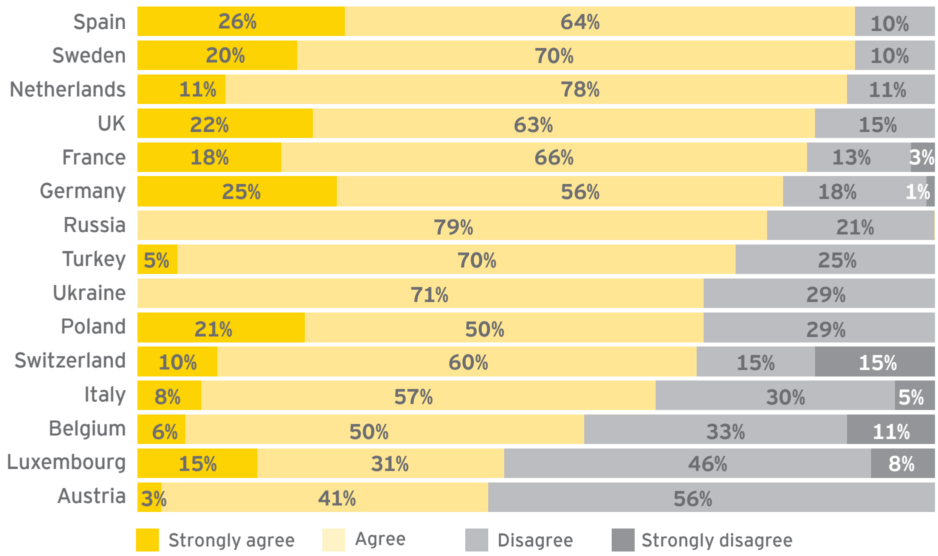
Do you agree to the following statement: The investment activity by foreign real estate investors will increase compared with 2013.
Source: Valid Research and EY.

Riskier investment targets on the rise

The broad majority of investors expect the share of more risky investments – including value-added and opportunistic targets – to increase. This is because yields on core investments are continuing to fall in many markets. With the exception of Luxembourg and Austria, the majority of respondents in every country agree that the share of riskier investments will increase in 2014.

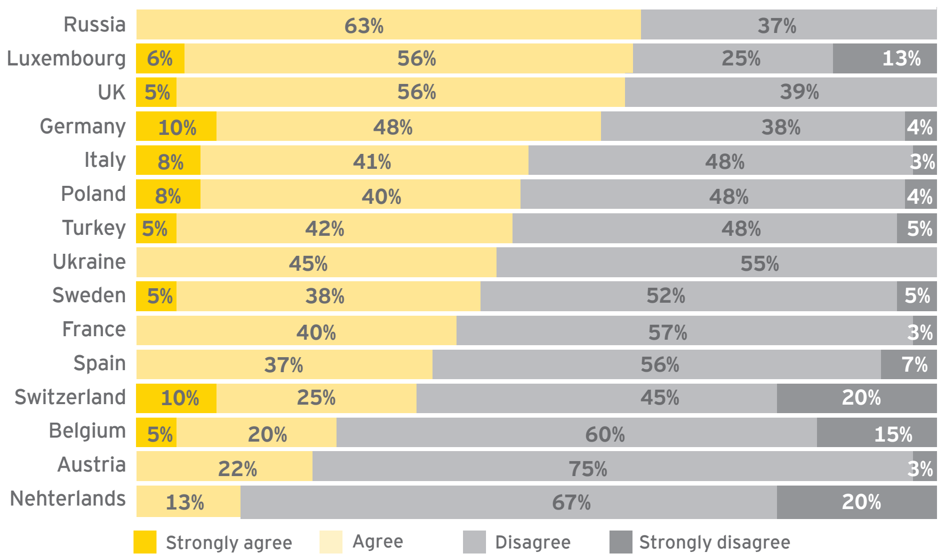
Some respondents also expect a slow increase in investment in speculative project developments. This is particularly true in markets such as Russia, Luxembourg, the UK and Germany, where the supply of core products that are able to deliver sufficient returns is limited. However, few participants expect a significant trend to emerge toward speculative project developments.

Will the share of riskier investments increase in 2014?



Do you agree with the following statement: The share of value-add and opportunistic investments will increase in 2014.
Source: Valid Research and EY.

Will speculative project developments return in 2014?



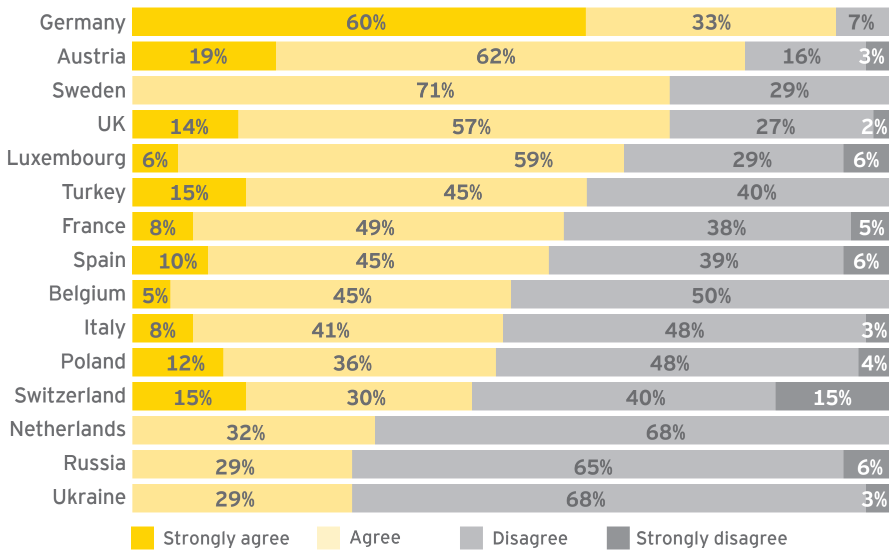
Do you agree with the following statement: Speculative project developments will return in 2014.
Source: Valid Research and EY.

Real estate market drivers

The Eurozone debt crisis is no longer the main investment driver

Few European countries still view the Eurozone debt crisis as the main driver for real estate investments. In only four countries — Germany, Austria, Sweden and the UK — did more than two-thirds of investors think the debt crisis would push investors toward real estate. And in the Netherlands, Russia and Ukraine, more than 60% of respondents believe that the debt crisis will not increase investment.

Will the Eurozone debt crisis increase real estate investment in 2014?



Do you agree with the following statement: The Eurozone debt crisis will increase investments by European investors in the real estate markets.
Source: Valid Research and EY.

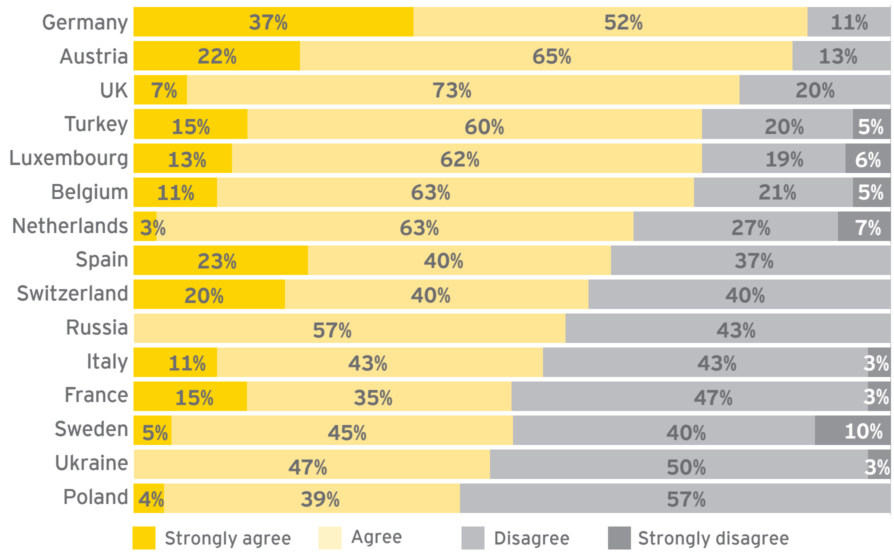
Fear of high inflation still viewed as an investment driver

Inflation in the Eurozone is stabilizing. Forecasts expect it to have fallen by nearly one percentage point in 2013.[2] Nevertheless, the majority of respondents in most European countries expect high inflation in the medium-term to drive investors toward the continent's real estate markets. In Germany and Austria, close to 90% predict that fear of inflation will be a driver of investment in real estate. Only in Sweden, Ukraine and Poland do 50% or less see fear of high inflation as a factor driving investment in real estate.

The overall percentage of respondents who expect inflation to be a driver of real estate investment has decreased since last year. In 2012, majorities in all countries, apart from Spain and Italy, expected fear of high inflation to be an investment driver.

2. *EY Eurozone Forecast*, September 2013, p.5.

Will fear of high inflation drive real estate investment in 2014?



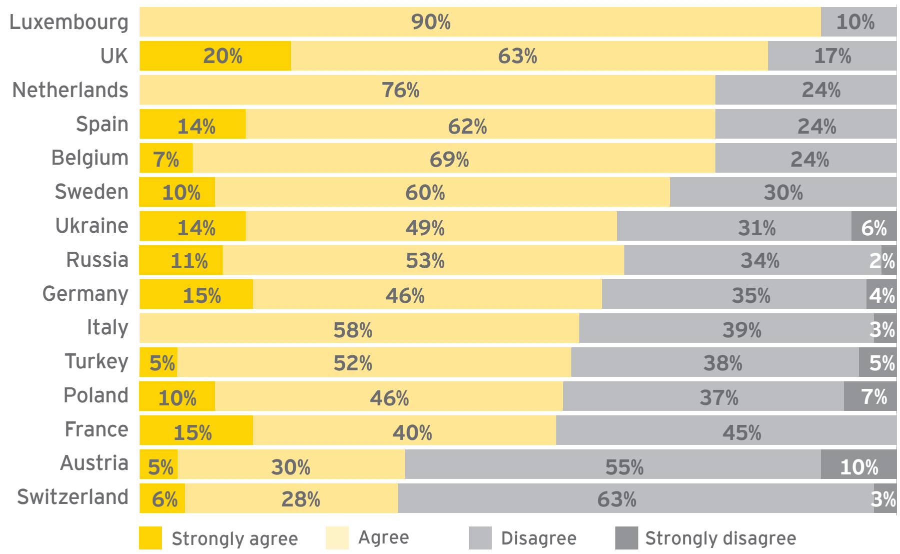
Do you agree with the following statement: Fear of high inflation in the medium term will drive investors toward the real estate market.
Source: Valid Research and EY.

Debt maturity, NPL disposal and fund liquidation set to drive real estate supply

The maturity of structured debt, the disposal of non-performing loans (NPLs) and the liquidation of open-ended funds is set to boost the supply of assets for sale in Europe's real estate markets. Tens of billions of commercial mortgage-backed securities (CMBS) are due to mature in 2014. The majority of respondents in most European countries expect the maturing of CMBS, along with the continuing liquidation of large pan-European open-ended funds and the greater willingness of banks to unload NPLs will help fuel an increase in supply.

Switzerland and Austria were the only countries in which less than half of respondents expect the supply of real estate assets to increase.

Will real estate supply increase in 2014?

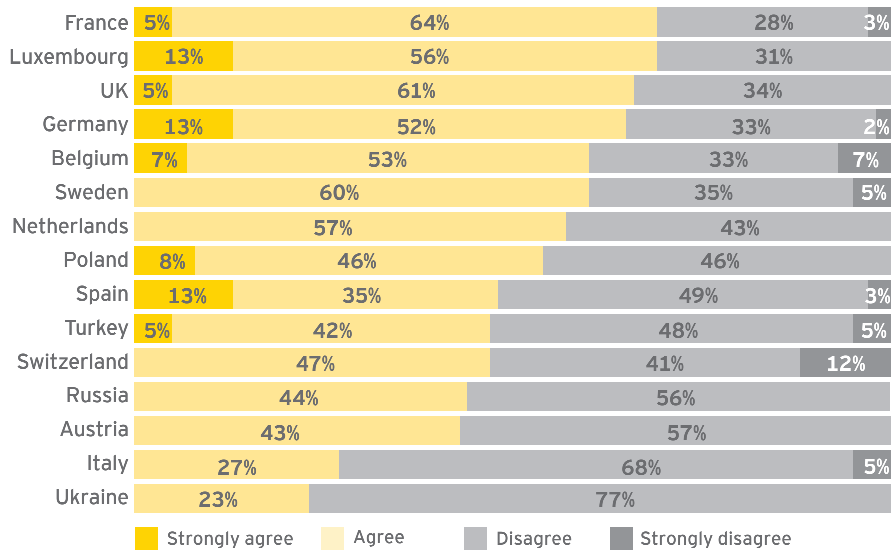


Do you agree with the following statement: Supply in the real estate market will increase in 2014 (maturity of structured debt, disposal of non-performing loans, liquidation of open-ended funds).
Source: Valid Research and EY.

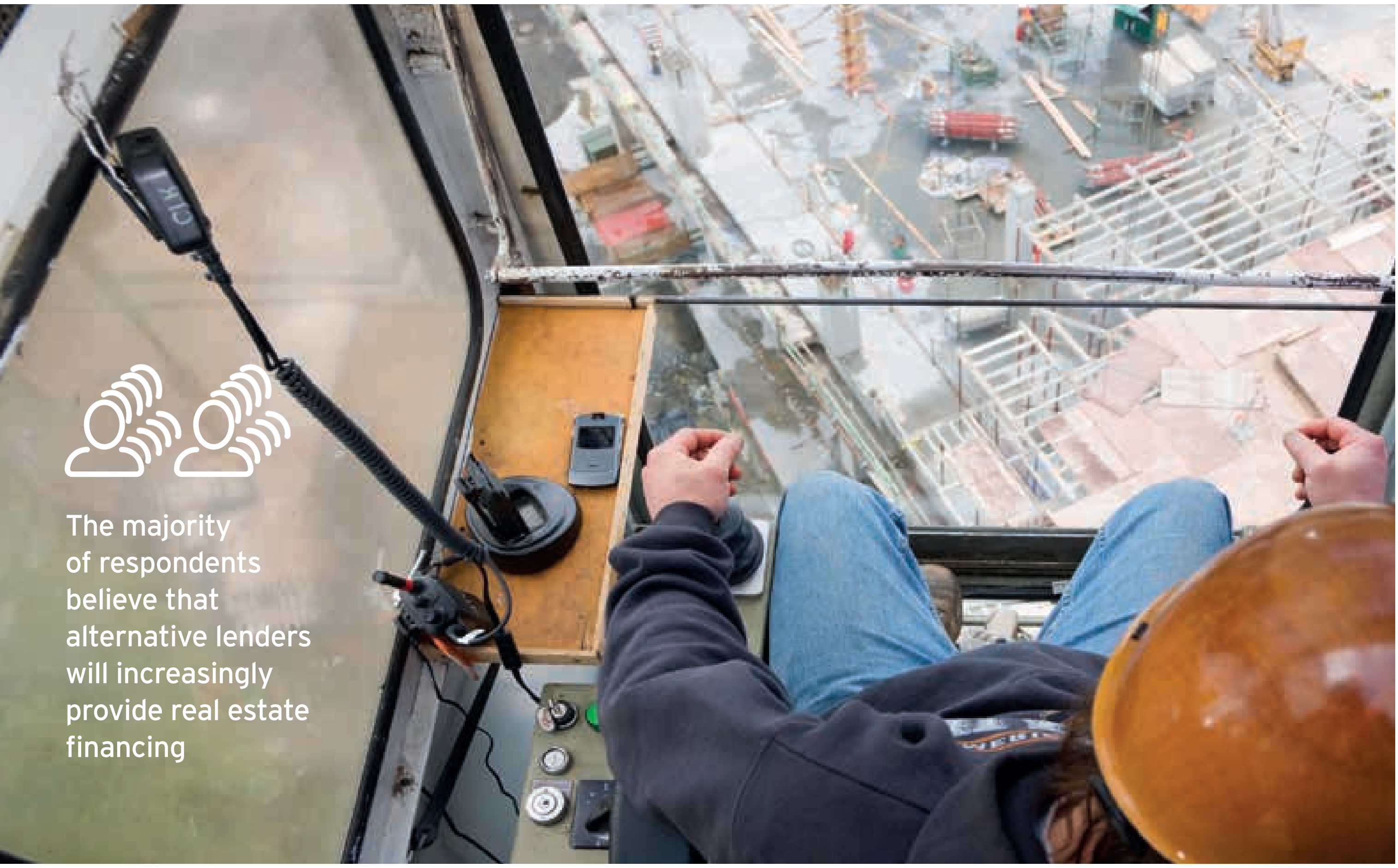
CMBS market well positioned for revival

The CMBS market is expected to rebound in 2014. This improvement is set to be particularly strong in the most liquid property markets of the core Eurozone, following the successful issuance of a number of CMBSs led by the German multifamily housing market. A majority of respondents in over half of the countries expect a revival in CMBS issuance. Those who disagree are principally concentrated in eastern and southern European countries, including Ukraine, Russia, Italy and Turkey.

Will the CMBS market revive in 2014?



Do you agree with the following statement: The commercial mortgage-backed securities market will revive in 2014.
Source: Valid Research and EY.



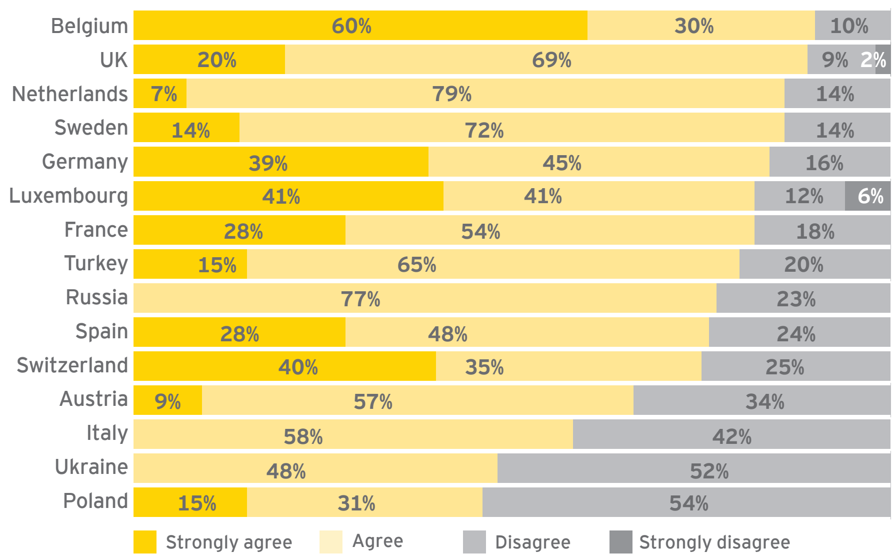
The majority of respondents believe that alternative lenders will increasingly provide real estate financing

Rising demand for alternative lenders

Credit terms for prime investments have eased in most markets. However, as many banks reduce their exposure to real estate, respondents predict a rising demand for mezzanine financing and other alternative sources of finance.

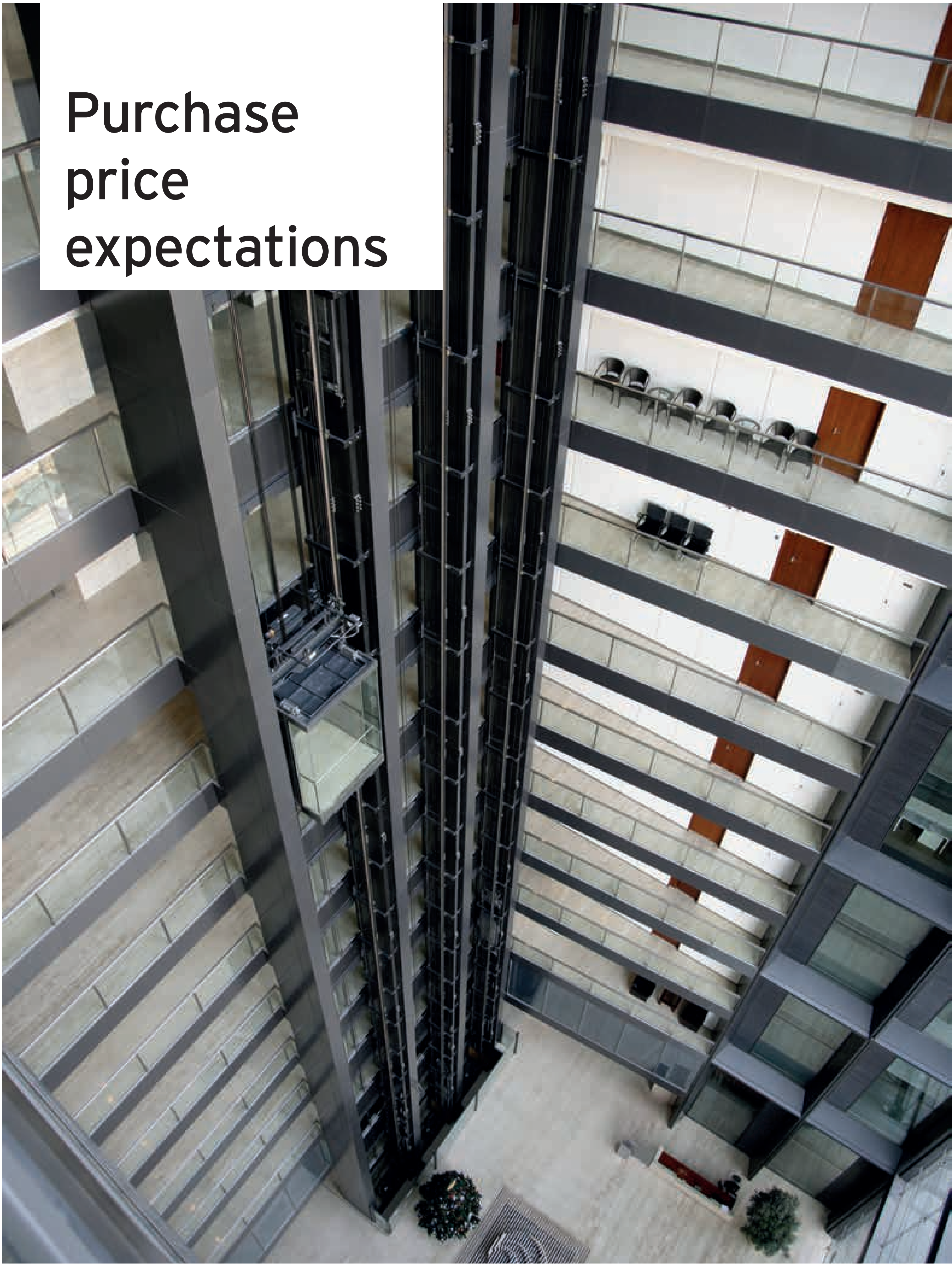
Clear majorities of respondents in all the countries, apart from Ukraine and Poland, expect alternative debt sources to make up an increasingly large share of the finance for real estate transactions. These new debt sources will also help reduce the funding gap in the most liquid European markets.

Will alternative debt financing increase in 2014?

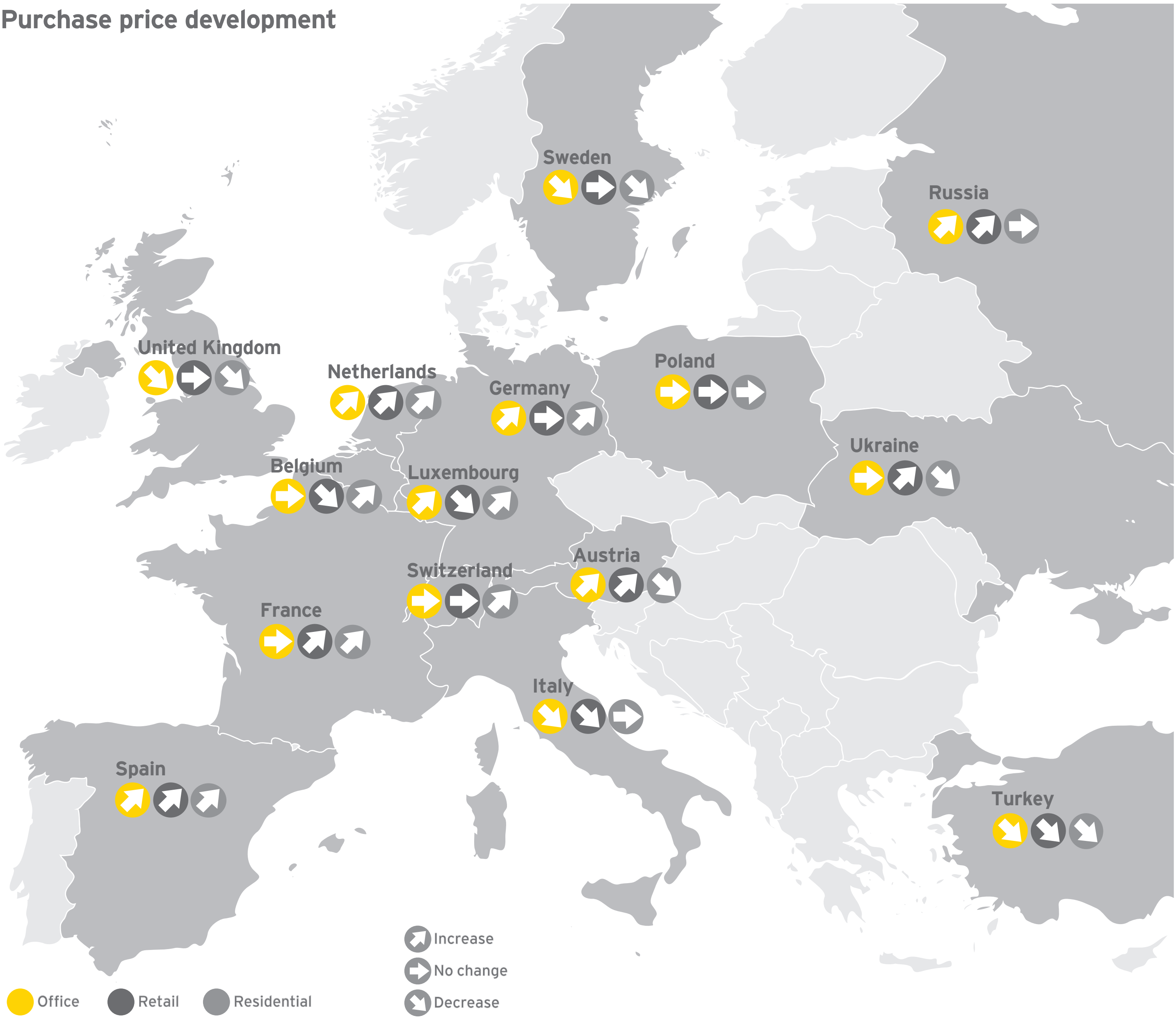


Do you agree with the following statement: Alternative debt providers (insurance companies, pension and debt funds, mezzanine providers) will increasingly provide financing for real estate investments.
Source: Valid Research and EY.

Purchase price expectations



Purchase price development



Question: How do you expect purchase prices in prime locations to develop in 2014, based on the type of use and locations?
Source: Valid Research and EY.

Office prices in prime locations remain healthy

In most of the countries surveyed, the majority of respondents expect prices for office space in prime locations to remain stable or increase. But several countries, including Italy, Turkey, Sweden and the UK, expect prices to fall from previous levels. In countries such as the Netherlands and Spain, which have been hit particularly hard by the market downturn, prices are expected to strengthen over the next year.

Retail prices stable or rising

Among the respondents from across Europe, only those in Belgium, Luxembourg, Italy and Turkey expect retail property prices to decline over the next year. In countries where prime retail prices have already reached a peak, such as the UK, Germany and Sweden, investors predict that retail prices will remain steady.

Residential property leveling off

Sentiment about residential prices for the year ahead is weaker, with the majority in nearly half the countries surveyed predicting that prices in prime locations will fall. Optimism about residential prices is confined to two groups of countries. The first comprises Germany, France and Switzerland. Investors see them as stable markets. The second group is made up of Spain and the Netherlands. Investors think these markets have already bottomed out and anticipate price rises.

Sellers and buyers groups

80%

of respondents expect REOCs/ REITs to be active sellers in 2014.

81%

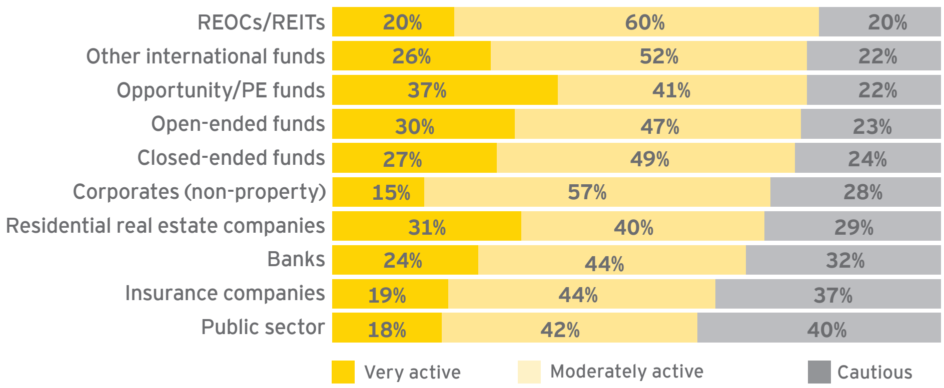
of respondents view opportunity/ PE funds to be very active buyers in 2014.

REITS, international funds and PE become more active

Real estate operating companies (REOCs), real estate investment trusts (REITs), international funds and private equity (PE) funds are expected to be among the most active investors in real estate throughout Europe in 2014, on both the buy and sell sides. In contrast, just over two-thirds of respondents saw banks as likely sellers, and 39% saw them as likely buyers.

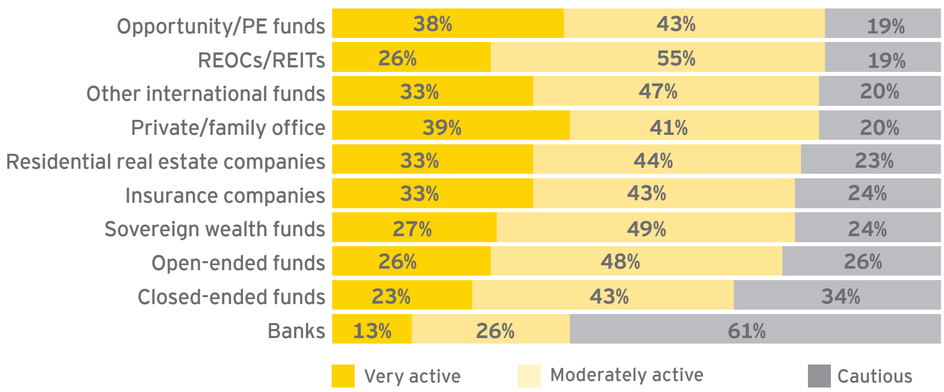
In addition to the top three sellers groups, private and family office and sovereign wealth funds are also seen as likely buyers of property in 2014.

How active will sellers groups be in 2014?



Question: How active do you think the following sellers groups will be in 2014?
Source: Valid Research and EY.

How active will buyers groups be in 2014?



Question: How active do you think the following buyers groups will be in 2014?
Source: Valid Research and EY.

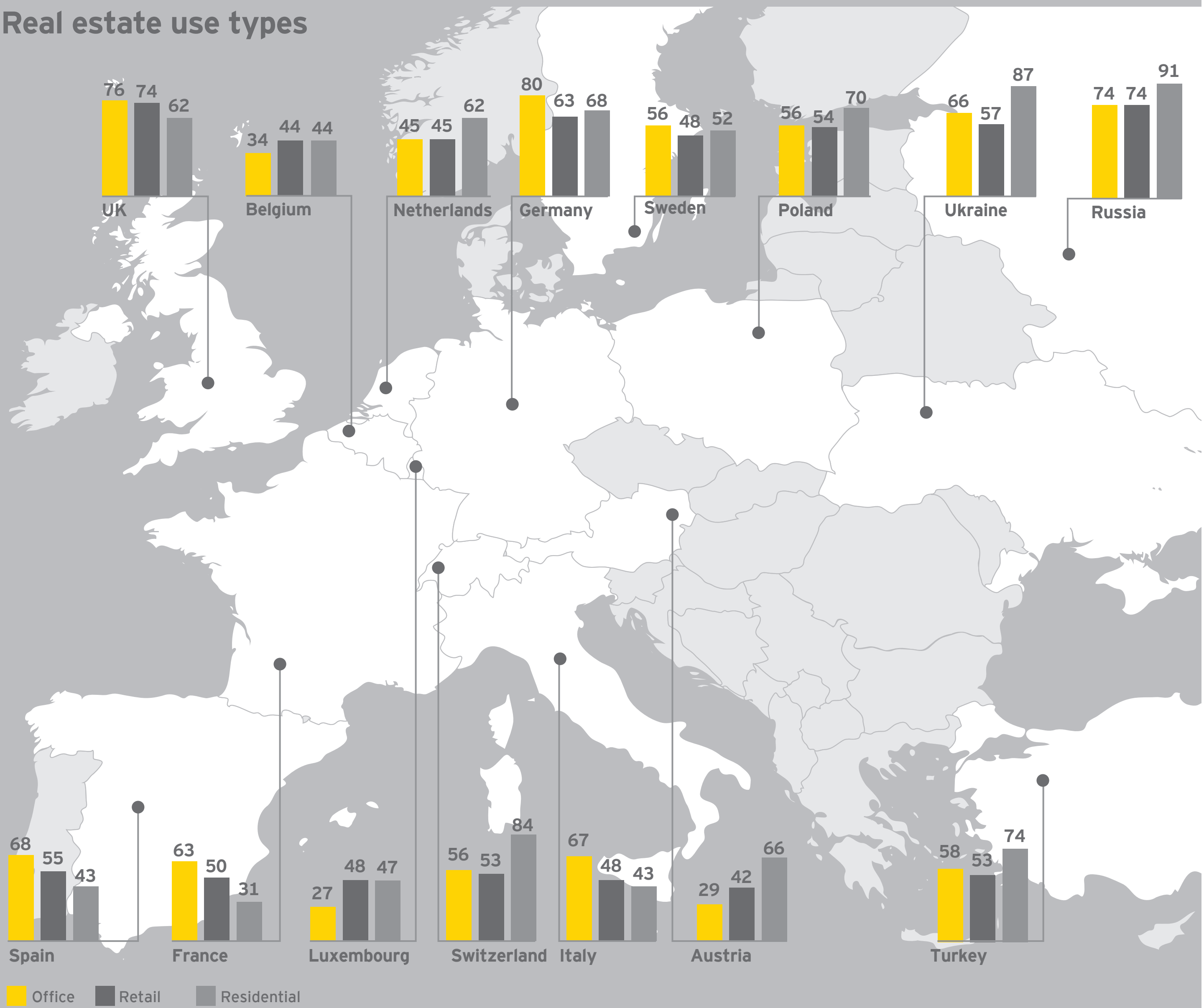
Real estate use types

Main investment focus is on residential property

In more than half the countries surveyed, the majority of respondents expect residential real estate to be their primary investment focus. Such majorities were largest in central and eastern Europe.

But respondents in the UK, Spain, France and Italy all show the strongest interest in office properties, with investors in all four countries making this property class the center of their investment strategies.

Real estate use types



Question: Compared with 2013, what kind of focus do you intend to give to the following real estate use types in your investment strategy for 2014?
Source: Valid Research and EY.

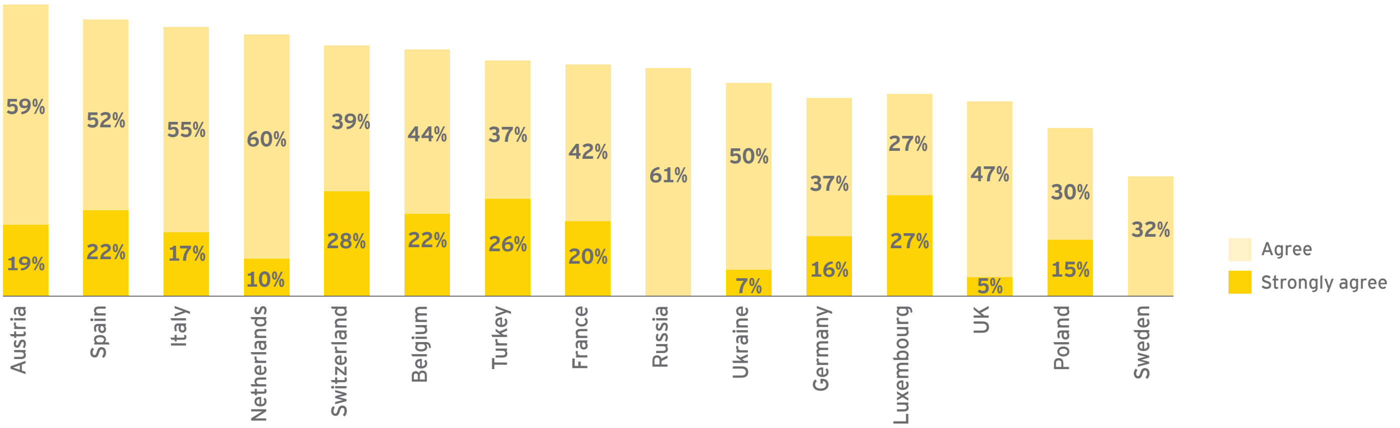
New trends

Brokers to lose out to internet listing services

The majority of respondents in most countries believe that residential real estate brokers will continue to lose market share – both in rentals and sales – to internet listing services. Brokers in Austria, Spain and Italy expect to be affected the most.

In contrast, less than half the respondents in Poland and Sweden expect online-based brokerage platforms to take significant market share from traditional brokers.

Will brokers lose market share to internet listing services?

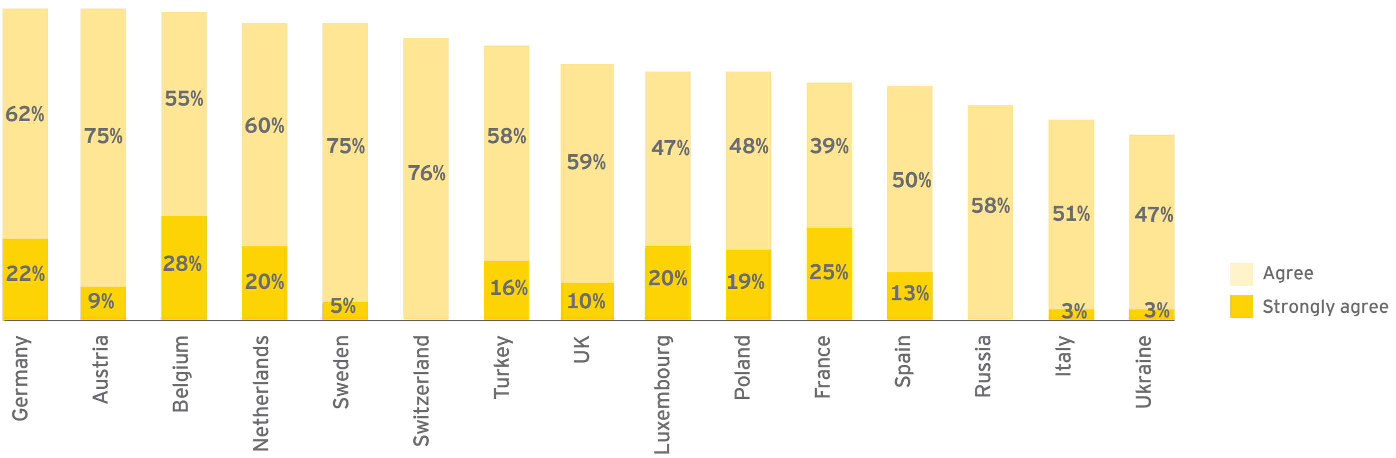


Do you agree to the following statement: Brokers will lose market share for renting and selling residential real estate to Internet listing services.
Source: Valid Research and EY.

E-commerce a major threat to retail outlets in non-prime areas

A majority of respondents in all of the countries surveyed see online shopping as a key danger to retail stores in non-prime locations. This is a particularly common perception in many central European countries, such as Germany, Austria and Belgium, where more than 80% of respondents view online shopping as a threat.

E-commerce is a potential threat to over-the-counter retail stores



Do you agree to the following statement: Online suppliers will replace over-the-counter retail stores in weak locations.
Source: Valid Research and EY.

Opinion divided on the role of home offices

European countries hold a wide range of views on the future of the home office. When respondents were asked if home offices will be outdated in countries like the BeNeLux (18%, 30%, 28%) Spain (27%) and Austria (25%), only minorities agreed to this. Considering these responses it is most likely home offices will continue to play an important role in the future in these countries. In contrast, respondents in Switzerland (94%) and Germany (85%) – where employees are mostly working in the office – are very likely to say that home office working is outdated.

Summary

Europe's real estate market is showing increasing signs of recovery. As Europe's economy stabilizes, improved sentiment is evident among investors from all parts of the continent. Indeed, countries that had been among the hardest hit by the financial crisis, including Spain and the Netherlands, are now among the most optimistic about their real estate market. This renewed confidence is set to attract international investors and boost transaction volumes.

Investors are becoming more aware of new developments in the sector. These include the ongoing loss of traditional brokers' market share to online listing services, the evolution of home offices and the impact of e-commerce on commercial property.

Broader changes in Europe's property sector are also becoming more pronounced. Previous divisions between mature and emerging markets, and between Europe's periphery and its core, have given way to a more complicated picture of the region's real estate markets.

Efforts to restructure the region's banks and to prop up weaker economies are likely to have a significant effect on European property markets. These efforts will encourage investors to rely more on alternative debt sources to finance real estate transactions. And they will help to increase the supply of assets, through the disposal of non-performing loans and the maturity of mortgage-linked securities.

Navigating these trends will keep investors busy well into 2015.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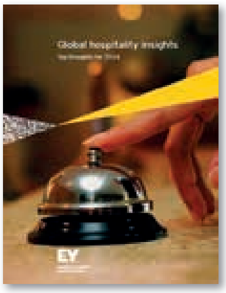

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