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Savills World Research
European Investment

Spotlight
Alternative Assets

March 2016

An analysis of seven markets

ON THE RISE

Are alternative assets becoming part of the mainstream?

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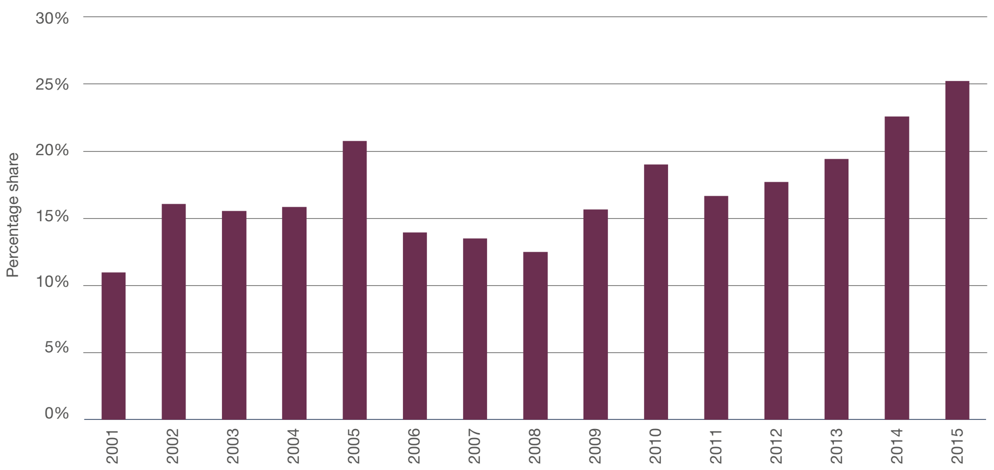
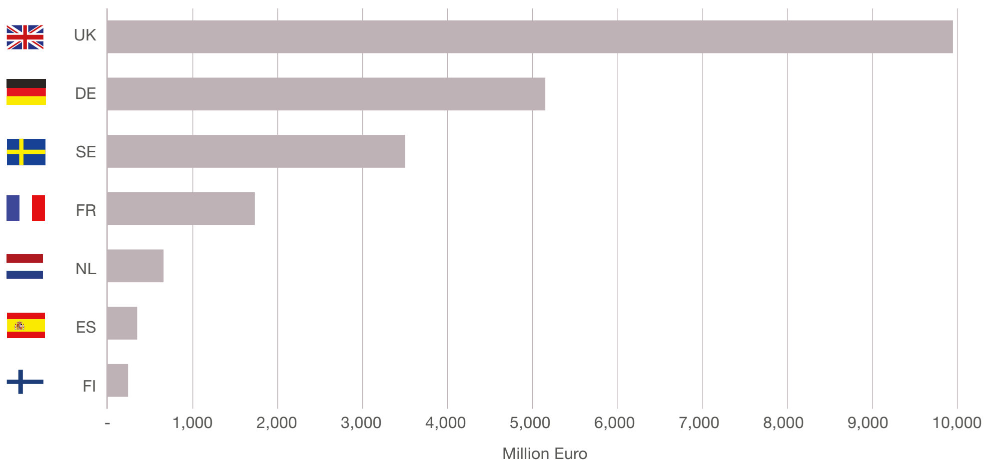
FIGURE 1
Share of 'non-traditional' investments in Europe*



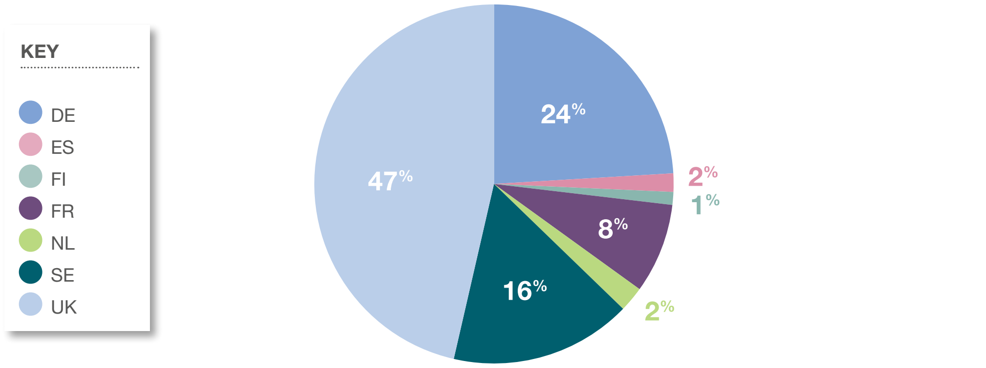
Source: Savills Research *Non office/retail/industrial, excluding multi-family

FIGURE 2
Alternative investments by country 2015*



Source: Savills Research *excluding hotels and multi-family

FIGURE 3
Share of alternatives by country



Source: Savills Research *excluding hotels and multi-family

BEYOND THE 'TRADITIONAL' SECTORS

In our first report of the year 'Themes in European Property in 2016' we highlighted the rising importance of alternative assets for portfolio diversification and enhancement of returns. In our investment transaction analysis we have noticed that over the past 15 years investment allocations outside the traditional commercial sectors (office, retail, industrial) has been increasing by 25% yoy on average. Last year, in the countries we monitor, investments outside the traditional commercial sectors (excluding apartments/multi-family) were about a quarter of the total activity compared to almost 15% in the last market peak in 2007.

Europe has seen a steady growth of real estate trade volumes over the past three years with a significant increase in cross border investment. Last year the share of cross border investment has risen to over 50% reflecting the rising share of portfolio allocations to European real estate by fund managers globally. In this context the greatest challenge for investors has been to find suitable product for their capital.

Despite the fact that prime capital values are above their long-term average, it is not easy to predict when we will have reached the top of the market, especially as long as the low interest rate environment remains. While for some risk averse investors it still makes sense to invest in prime assets, others will need to look beyond the traditional commercial sectors to achieve the desired returns. Some investors are choosing to move on from the search of cyclical capital growth to long-term stable income producing investments.

Rise of the alternatives

Alternative assets is a broad definition of a segment, which broadly includes types of properties characterised by lower transaction volumes, less liquidity, limited market information and therefore less transparency. In some cases they have counter-cyclical characteristics or they are driven by macro trends in the economy and demographics. In our analysis below, we have excluded hotels and multi-family investments from the 'alternatives', focusing on the niche types of the segment, such as student housing, healthcare, mixed use etc. In a separate section of the report, we will comment on the rise of apartments/multifamily investments for institutional investors.

UK most mature market

The UK market, being the most liquid and transparent market in Europe, has led the way with regards to the increase of investments into alternative assets. We have observed that last year the UK accounted for 47% of the transaction volume in the seven countries we analyse at about €10bn. Europe, traditionally lagging behind the UK, has experienced lower transaction volumes. Germany and Sweden follow the UK, and account for 24% and 16% respectively of the total activity.

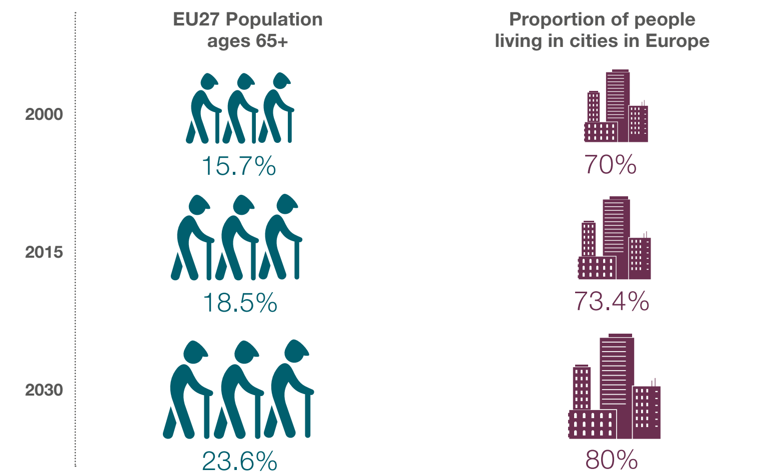
Long-term demographics

Based on the available pricing data last year we observed that mixed use buildings accounted for over a third of the transactions. Mixed use is a broad sector, which may include residential or office buildings with commercial ground floors, commercial parks including workshop and production space and workshop/production assets, which normally host SME owner-occupied companies. Strong shares were captured by student accommodation, which accounted for a quarter of the value and healthcare/senior housing at 15% of the total.

The key factors that pull investors into these sectors are the long-term demographic trends of the ageing population and the growing numbers of international students and tourists in Europe. 4% of the number of deals was attributed to car related uses, such as parking areas, service areas, petrol stations and motor trade. These are also emerging alternative segments, particularly in Germany and the UK.

€10bn
Amount of UK investment in niche alternatives in 2015

FIGURE 4
Long-term trends: ageing and urbanisation



Source: Eurostat, UN

▼ Some investors are looking beyond traditional commercial sectors

Mega deals in student housing

Last year, activity was dominated by the mega deals in the student housing segment that took place in the UK including the portfolios purchased by CPPIB (€1.43 bn) and Greystar Student Living (€780m). Besides, significant activity in student accommodation was also recorded in Germany, Spain and The Netherlands, driven by a variety of investors, ranging from specialist operators/developers to equity funds and institutional investors.

Examples of active players in student housing investment include Deutsche Real Estate Funds in Germany, Knightsbridge Student Housing in Spain, Empiric Student Property, La Salle IM in the UK.

HEALTH CARE AND SENIOR HOUSING

The sector that we expect to see further interest in the coming years is Healthcare/Senior housing, which includes clinics, hospitals, care homes, senior housing and generally facilities that will support the increasing number of elderly people in Europe.

By 2020, the share of elderly people (65+) in Europe is going to increase by 1.9 percentage points and they will account from 18.5% today to 20.4% of the total population. The need for medical support and care will increase and the financial burden on governments will be higher. The private sector is likely to fill in the gaps, either by developing private facilities in regions with affluent population or by investing in public assets where governments need to raise the capital to finance new developments.

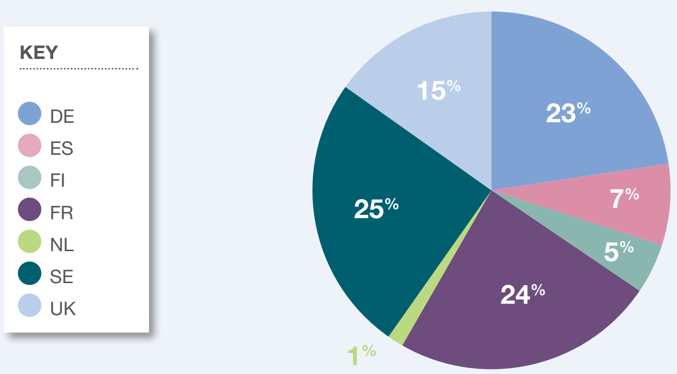
These predictable demographic trends, the low correlation of this segment with economic cycles and the stable income that they can produce are factors that draw investors. The markets that will support private investments from a regulatory and political perspective too will become the most attractive.

Last year more than €2.9bn was invested in the Healthcare/Senior housing sectors in the countries we analyse with Germany, Sweden and France, accounting for over 70% of the transaction volume. One of the largest acquisitions last year was the investment of about €650m in portfolios and clinics across France by property investment company ICADE.

This year there is already another mega deal in the pipeline in France, with fund manager Primonial acting on behalf of institutional investors is acquiring a €1.35bn portfolio off French REIT Gecina. In Spain NMC Abu-Dhabi based healthcare provider acquired 85% of the Barcelona based clinic Eugin for €143m, while in Germany Charleston Holdings and a company that pursues buy-and-build strategy in the German nursing home market invested €112m in the sector last year. At the same time, institutional investors such as La Salle IM, Henderson, AXA REIMand Rockspring were active in the Medical sector in the UK.

FIGURE 5

2015 Healthcare/Senior housing investment by country



Source: Savills Research

FIGURE 6

Alternative investments by type (value)

36% Mixed use

24% Student accommodation

20% Other

15% Health/Senior housing

4% Car use

1% Leisure/sports

Source: Savills Research

APARTMENTS – MULTI-FAMILY SECTOR

Need for homes attracts investment into the multi-family sector

Investment into the residential/multi-family sector is gaining in size and importance as an alternative investment to commercial, supported by the imbalance of demand and supply of homes in the expanding conurbations of Europe and the positive rental growth potential. Particularly after the financial crisis, renting has become the preferred channel for housing tenure also in countries with traditionally high home ownership, due to uncertainty around employment security and lower availability of housing loans and incentives.

Last year over €40.7bn was invested in apartments in the seven countries we analyse; 57% higher than the year before. Germany continues to dominate the international residential investment market in Europe, and last year transaction activity soared by 69% to €22.6bn due to some large acquisitions of listed companies targeting the underlying residential assets. The UK and Sweden follow in terms of market size as they are characterised by high transparency and liquidity.

The rising trend of urbanism, which will concentrate 80% of the population in urban areas by 2050 is already putting pressure on the fastest growing cities. London, Paris, Amsterdam, Madrid, Stockholm and some German cities are all ranking high in the projected population growth of European cities.

The emergence of the residential sector as a destination of institutional capital is also evident. Some political initiatives and regulations are expected to support this trend in some countries, however investors also need to pay attention to the different rental market regulations applied in each country and to incorporate their impact into their management costs.

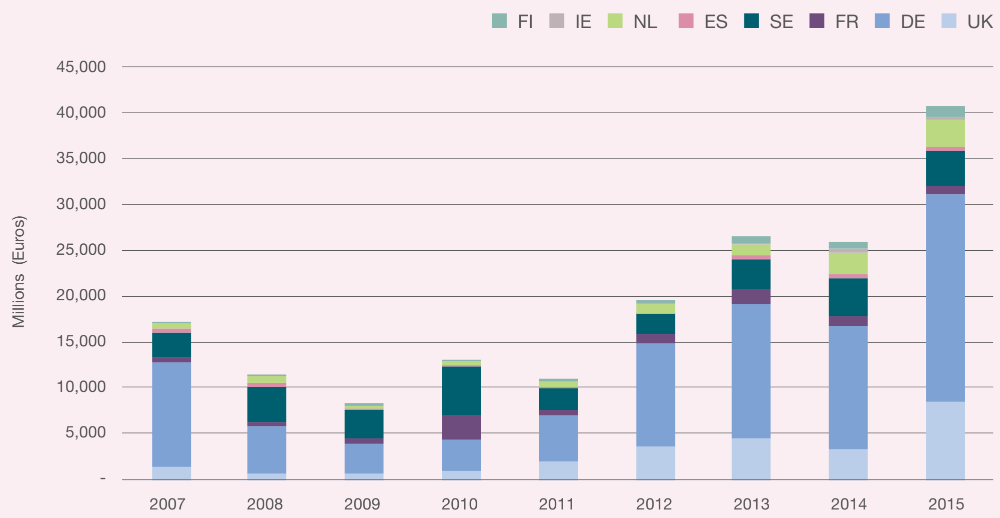
Germany continues to dominate the multi-family sector

€41bn

Amount invested in apartments in 2015 across seven markets

FIGURE 7

European apartment investments (Single and Portfolio)



Source: Savills Research, RCA

The multi-family sector is growing fast

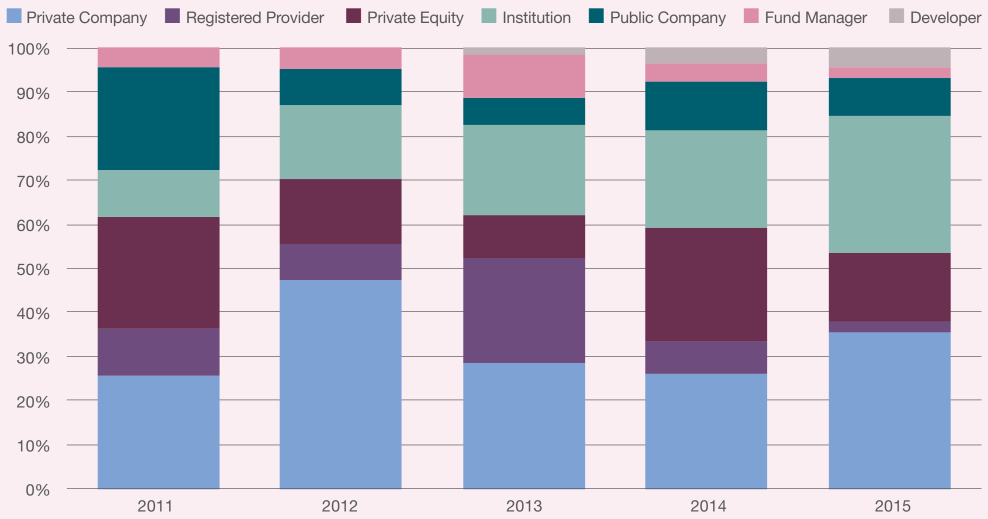
UK

In the UK the mismatch between supply and demand for rental homes is likely to underpin rent rises, particularly in undersupplied markets. It also represents an opportunity for institutional investment at scale which has been growing steadily.

Some big domestic and international players have entered the rental market and the flow of capital is building up. The overall value of deals recorded by Savills own investment database has increased from £2.3bn in 2014 to £2.65bn in 2015. 60% of this is captured by London. The number of deals backed by institutions doubled between 2014 and 2015. (See our report 'Rental Britain, February 2016').

FIGURE 8

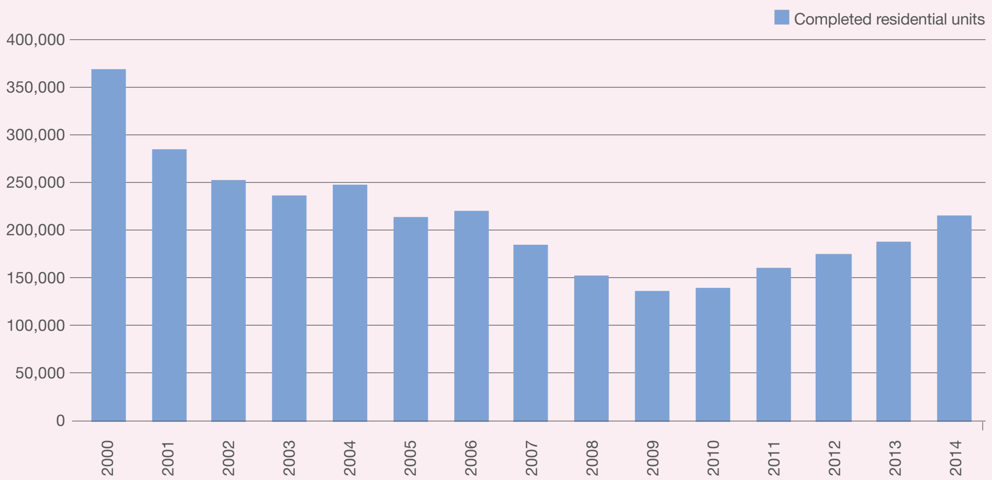
Institutions becoming more active in the UK rental home market



Source: Savills Research

FIGURE 9

German residential completions do not meet demand



Source: Bulwiengesa AG, RIWIS

Germany

Residential property has been high on investors' agenda in Germany for the past five years with transaction volumes steadily increasing. Last year the transaction volume rose by two thirds compared to 2014 to almost €22.5bn. The strongest increase of volume was in the second tier cities (beyond the big seven). Most of the transactions were driven by German investors, who last year accounted for 90% of the transaction volume and in most cases were residential property companies. Favourable market conditions are expected to continue to drive activity (See our report 'Germany Residential Investment Market, February 2016'). Current completion figures are far below the 350,000 to 400,000 units per year, which are regarded as necessary to meet future demand and overall vacancy rate is below 3% and even lower in the largest cities.

Netherlands

In The Netherlands residential investment added €2.85bn (total commercial volume was just over €8bn) on the annual 2015 real estate investment activity. Traditionally the sector has been dominated by private and institutional domestic investors. However, the recent changes in the legislation impacting the social housing market in combination with more favourable financing conditions have fuelled international investor demand for residential portfolios over the last two years.

Although demand and supply of investment product is gradually becoming more balanced, in the mid to long term, the changing demographic trends and the rising number of households in urban areas and particularly in and around Amsterdam could fuel investment in new developments/refurbishments. Currently it is estimated that there is a deficit of 4-5% of the current stock nationwide, which translates to about 300,000 to 400,000 dwellings.

Sweden

In Sweden the residential sector was a strong performer last year. It accounted for almost a quarter of the total investments in real estate in the country driven traditionally by national investors. Swedish institutions and pension funds have been investing heavily into the residential segment after the financial crisis in 2008. The total increase in holdings of residential assets amounts to at least SEK 75bn (€8bn) since 2008.

The market fundamentals here also point to a future that can offer more opportunities to investors as the need for housing is substantial. According to the National Board of Housing, the country will need over 460,000 new homes by 2020 and up to 700,000 in 10 years. A comparison of population growth and new home construction illustrates the market imbalance in terms of demand and supply.

Finland

In Finland the residential sector dominated non-commercial investments with a total of €1.24bn in 2015 representing 23% share of all transactions distribution. After the launch of several residential funds since 2013, investments in residential portfolios have taken more significant exposure. In addition, residential funds are major developers who have boosted development activity, driven by the expansion of the build-to-rent model.

Residential has been the best performing sector for seven consecutive years thanks to high occupancy rates and continuing rent increases. The average total return for residential investments in the recent five-year period is 9.3%, broken down into the income return of 5.5% and the capital growth of 3.6%. Helsinki market value growth outperforms others. (Source: KTI)

Spain

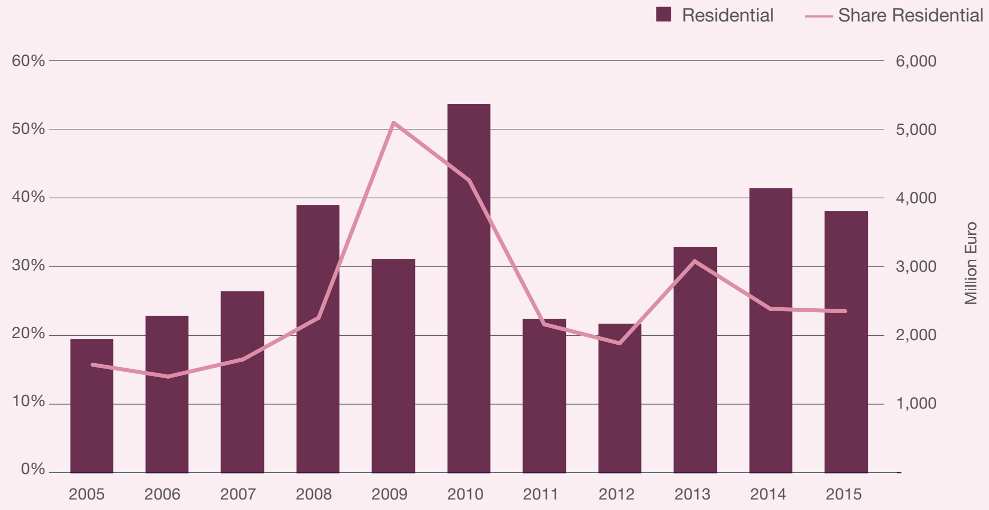
In 2015, the Spanish residential sector has shown signs of solid recovery, after eight years of collapse. Price corrections up to 40% from peak values, coupled with favourable financing conditions are signalling the start of a new cycle.

A total volume of 365,000 residential units was sold. Buyers were mainly domestic, despite the second home acquisitions on the coast, which were once again 56% acquired by foreigners, particularly British, Scandinavians and Belgians. The institutional investment market was dominated by the UK and US funds, focused both on social housing and multi-family assets.

Lonestar led the market recovery early in 2015, when it acquired Neinor Homes and over a hundred plots of land to develop residential property over the next four years. The increasing demand for rental houses has increased their share from 11.5% to 19.2% in the last 10 years and is predicted to continue further. Despite low yields at 3-4%, further capital gains are expected in the mid-term. The market is becoming more institutionalised as investor interest rises.

FIGURE 10

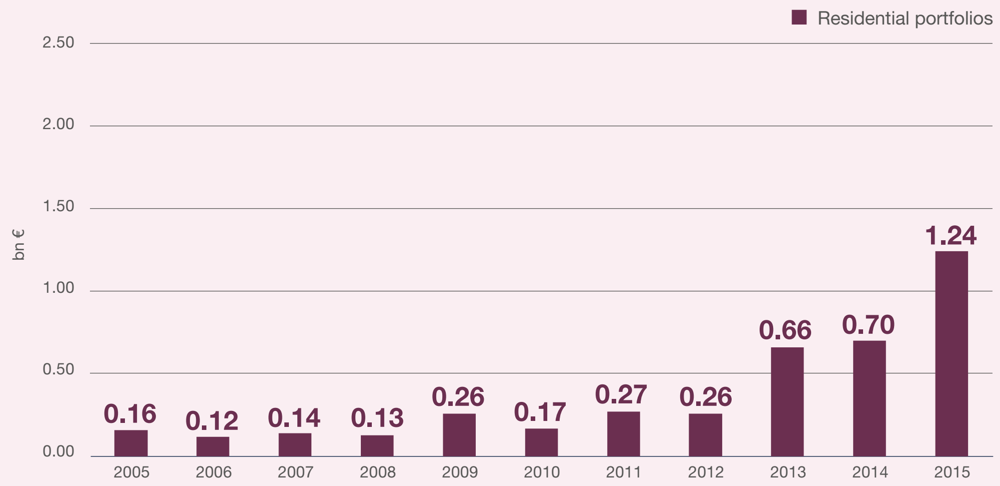
Sweden residential investment accounts for 25% of total activity



Source: Savills Research

FIGURE 11

Finland residential investment accounts for 23% of total activity



Source: KTI

Ireland

Apart from several isolated schemes, multi-family did not exist as a separate asset class in Ireland before 2012. However, following the 2008-2010 economic crisis many unoccupied apartment schemes became available. Early movers spotted the opportunity to buy these blocks at very attractive yields and, from almost nothing, multi-family rose to account for over 12% of total investment in 2012 and 2013.

Over the last four years nearly €1bn has been spent on multi-family assets in Ireland with almost 6,000 units sold. 95% of these have been in Dublin, meaning that 11.5% of all residential units sold in the Irish capital from 2012-2015 were traded in multi-family blocks. Declining affordability has displaced housing demand from owner occupation to the rented tenure in recent years. As such rents are rising and yields now offer a compelling spread over bonds, fuelling the demand for multi-family.

Nonetheless, multi-family investment fell by 41% in 2015, largely because the supply of vacant apartment blocks has been bought up. Therefore, the sector is now transitioning to a design-build-operate model. Within this some developer-investors are likely to move towards specialist niches – for example, student housing, seniors housing, etc.

OUTLOOK

Alternatives sector suitable for long-term strategies

We believe that the alternative sector will further increase its share in the real estate investment universe in 2016. On the one hand the long-term trends in urbanisation, demographics are there to stay and to support the appeal of sectors such as residential, student accommodation, care homes, medical centres and clinics.

These sectors may attract the type of investors with long-term strategies, who can benefit from stable, long-term income. At the same time the demand and supply conditions in some markets and the index-linked income of some of these asset types can prove to deliver positive rental growth prospects in the future.

On the other hand the rising competition in the market for the best assets is outpricing some investors who are interested in higher returns and are also prepared to take higher risk. These investors are looking into niche market segments, are partnering with strong local players and are benefiting from higher returns. The main issue in these market segments is the lack of transparency and lower liquidity as transaction volumes are smaller and the market is not yet institutionalised.

However, if we observe the evolution of the UK market, we could expect Europe to follow with its typical time lag, and demonstrate comparable growth rates in the alternative asset market segments. Already this year we expect investors that have been outpriced from the competitive UK market to turn their attention to Europe. Europe is a less mature market and more diverse in its jurisdictions, something that requires more careful analysis of the local conditions, market fundamentals and regulatory framework that characterises some of the alternative market segments.

In our view, the key sectors that will see strong activity this year are the multi-family, healthcare and student accommodation markets in the UK, Germany, France, The Netherlands, The Nordics and increasingly Spain.

Please contact us for further information

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