

Market in Minutes

Asian investors' buying spree in Europe

October 2017

Asian capital flow into Europe soaring by 57%

According to our first estimations, Asian investment in Europe since the beginning of the year reached €23.2bn in Q3. This is a 57% increase compared to the same period last year. And the trend is set to further accelerate. Indeed, we anticipate the Asian investment volume in Q4 will be well above the volume accumulated during the first three-quarters of the year, approximately €18bn. This will bring the annual Asian outbound investment volume in Europe to €41.2bn, which is 2.5 times higher than the volume recorded in 2016.

Such an apex is notably due to the large pan-European Logisor logistics portfolio sold by Blackstone to China Investment Corp (CIC) for €12.12bn, which will mark the largest investment transaction in European real estate history. A portfolio of 630 distribution centres across 17 European countries totalling 13.6 m sq m. Over 70% is concentrated in the UK, Germany, France and Southern Europe.

The UK and Germany absorbing 65% of all Asian investment

Most Asian investors focus on the UK and in Germany, which accounted for 53% and 12% respectively of the total Asian money recorded in Europe over the past 12 months. Although it appears to be highly concentrated, Asian investment is far more evenly spread across European countries than it was during the last peak. Back in 2007, the UK accounted for 87% of all Asian investment in Europe, few other investments were recorded in Germany, Sweden, France and Belgium.

Since 2016, the breakdown picture is more diverse with notably growing activity in the Netherlands recorded since 2015 mainly thanks to large Chinese and Korean investment but also to Singapore and Malaysian investment.

Asian investors' target is also slowly moving toward Eastern Europe. CEE countries totalled 11% of the whole Asian investments in Europe recorded between Q2 16 and Q2 17. The volume is particularly high in the Czech Republic, thanks to two large deals signed at the end of last year; the acquisition by Singapore's sovereign wealth fund GIC of P3 Logistic Parks for €375m and the acquisition by CEFC China Energy co of the Florentinium office building in Prague for €281m. Growing interest was also recorded in Poland, Romania and Slovakia.

Trophy assets targeted

Asset types targeted by Asian

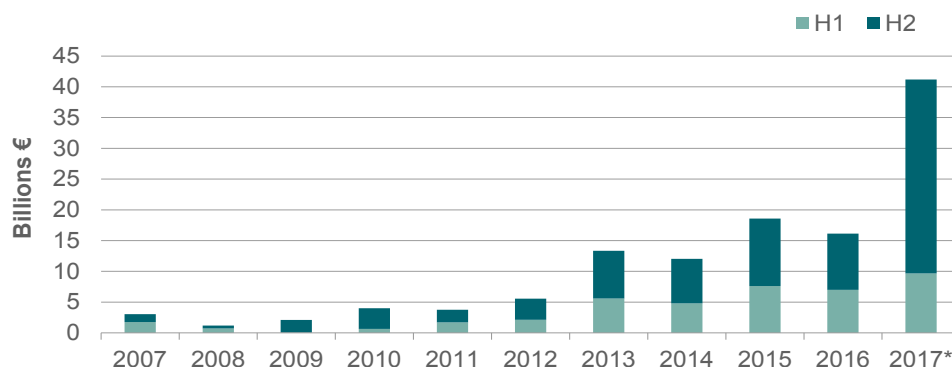
OUTLOOK

Bright blue sky ahead

- We expect Asian outbound investment volume in Europe to €41.2bn, which is 2.5 times higher than the volume recorded in 2016. This is notably due to the large Logisor logistics portfolio transaction due to be signed in the fourth quarter of the year.
- Strong property fundamentals will continue to attract Asian money in 2018.
- In spite of the new tight financial regulation, Chinese investment activity in Europe will not lose its momentum. It will become however more strategic and in line with the government's key policy initiatives such as the One Belt One Road
- Other large M&A are not unlikely in 2018, notably in niche sectors such as healthcare, student housing, infrastructure of logistics.
- As Hong Kong maintains strict judicial independence from the mainland, it will increasingly play a role as China's global financial intermediary.
- We expect Asian money will continue to spread across Europe, notably to seek higher yields. In that respect Spain and Italy will be ideal destinations.

GRAPH 1

Chinese investment in Europe The end-year volume is expected to be 2.5 time higher than last year



Source: Savills* forecast/ RCA

investors have also changed over the past 10 years, pretty much in line with the breakdown allocated by European investors. While the strong appetite for offices remained relatively unchanged – accounting for 52% of all Asian investment in Europe over the past 12 months, compared to 58% during 2007 – interest for retail assets nearly vanished (2% over the past 12 months against 41% in 2007). At the same time, their logistics investment in Europe increase substantially and accounted for 18% over the past 12 months, compared to 3% in 2007. This new allocation from retail to logistics is reflecting the growth of e-commerce and the consequent need for distribution centres.

Asian investors are no exception to the global trend. The hunt for high yields is leading to diversification notably toward income-stream asset type in niche markets fuelled by demographic global trends. They invest increasingly in the multifamily segment and senior housing, mainly in the UK.

The deal size has also significantly increased as Asian investors are increasingly seeking trophy assets, such as prime office buildings in central locations of European capital or key cities or large logistics portfolios. LKK Health Products Group acquires the “Walkie Talkie”, a landmark office building at 20 Fenchurch street in London for €1.45bn (£1.28bn).

Their strong appetite for large and best in class properties is having a hardening impact on prime yields.

According to RCA, since 2013 their yield range is on average 100bps below that of European cross-border investors and 150bps below US investors.

Most active investors

Ten years ago, most of the Asian capital flow coming onto the European property market was from Singapore. According to RCA, it accounted for more than 70% of all Asian money invested in Europe in 2007. Additionally, Sovereign Wealth Fund (SWF) were the most active investors.

Today, capital is still coming from SWF but increasingly from property companies and also from private investors notably in China. Asian money is now more evenly broken down between Singapore, Hong Kong, Korea and China.

Hong Kong investors are mainly targeting its previous sovereign country, the UK, while Korean and Singapore investors are mainly concentrating on mainland Europe. Chinese investment in Europe is increasingly spread over the whole region.

So far there is no evidence of activity slowing down from Chinese investors following the tightening rules on their cross-border investment. On the contrary, the Logisor investment deal is the first sign of a shift in strategy toward long-term corporate investments.

As Hong Kong maintains strict judicial independence from the mainland, it will increasingly play a role as China's

global financial intermediary.

Why is the European property market becoming a magnet for Asian investors?

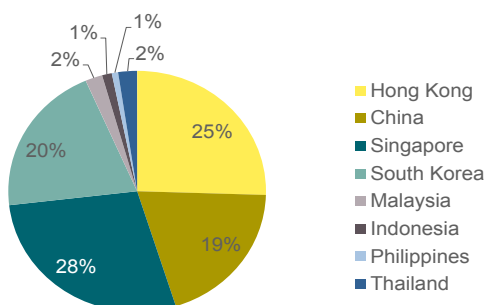
First and the main reason is to catch the property cycle. Business sentiment is rising and unemployment is falling across Europe. Business expansion continues to drive office demand while office vacancies are falling in all European capital city markets. Although development activity is slowly picking up, it remains insufficient to face the growing demand. We expect this under-supply situation will not decompress until 2018-2019 as it generates strong rental growth. In Q2 2017, prime CBD rents increased by 5.2% yoy on average, we expect it will reach 7.1% by the end of the year.

Whilst offering strong property fundamentals, yields in Europe is also comparatively attractive for Asian investors.

In general terms, the growing amount of capital allocated to real estate in the face of rarefying prime assets is pushing investors from all the world to look beyond their borders. Additionally, portfolio diversification is a strategy to balance risk and optimise return.

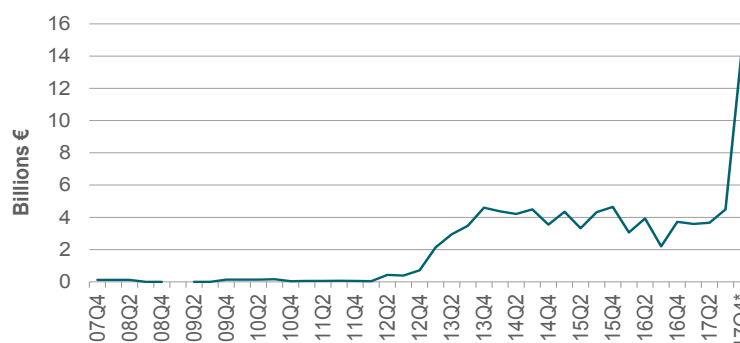
Finally, Trump's election to the US presidency also played a positive role in making Europe a preferred arena for Asian's outbound investment.

GRAPH 2
Breakdown by country of origin in H1 2017



Source: RCA

GRAPH 3
Chinese investment activity over the past 12 rolling months



Source: Savills * / RCA

Our local expert insight

China

Mainland Chinese money has been seeking opportunities in overseas markets in increasing numbers now for over five years. Initially, Chinese money was chasing residential development opportunities, end-use office purchases and core assets in key gateway cities in familiar markets such as Hong Kong and Singapore as well as anglophile markets with significant Chinese diaspora such as the UK, Australia, Canada, and to a lesser extent the US. As many of these markets have seen restrictions imposed on foreign buyers and values rise to all-time highs, yields to near all-time lows, Chinese buyers who were at the vanguard of the outbound investment wave and now have more confidence in investing in overseas markets, are starting to look further afield. Chinese investment has seen some increase in the US, Europe and emerging South-East Asia.

The government concerned about the aggressive nature of outbound investment to date has started to review investment stratagems for the most aggressive investors and imposed controls on others. While outbound investment will continue, the nature of investment, the volumes and targets are likely to shift, away from trophy assets and towards long-term corporate strategic investments such as logistics, student housing, and healthcare facilities and platforms, especially those aligned with the government's key policy initiatives such as the One Belt One Road.

Korea

Korea is seeing an increasing amount of capital being allocated as discretionary capital or 'blind funds' for overseas investment. On the supply side, domestically the investable real estate universe is simply small. The market only opened up to investment in 1999 after the Asian financial crisis, even after this favourable tax efficient structures took a few years to appear, therefore a huge percentage of real estate is still owner-occupied. Similarly, in terms of demand, real estate is still a new asset class (in relative terms) to many Korean investors who require exposure as part of a diversified portfolio. Korean is the world's 12th largest economy and has accumulated almost unprecedented wealth in less than two generations and that money needs somewhere to go to match liabilities and real estate still offers some of the best risk-adjusted returns. Domestically these deals still tend to be focused on core and core plus, whereas when going overseas this is where you see some of the more established players moving up the risk spectrum into value-add or even opportunistic territory.

Hong Kong

Hong Kong investors are faced with some of the highest valuations globally while the potential for further rental growth is limited. Europe's well-developed, high liquidity and transparent markets, along with cheap currencies has led many to identify long-term value in the continent, even when faced with relatively low yield returns.

According to Real Capital Analytics, Hong Kong invested €3bn (US\$3.53bn) in European commercial real estate in 1H 2017, accounting for 48% of the total outbound investment. A high proportion of these funds will probably have originated in mainland China. Outbound investment rose by a robust 103% yoy in 1H 2017 while investment into the EU grew by 177%. The UK alone accounted for 90% of Hong Kong's real estate investment in Europe.

In China, capital outflows have gathered pace since 2014, escaping a slowing economy and a weakening Renminbi. This year the government has moved to stem these outflows and at the same time encourage more 'rational' investment by placing overseas investments into three broad categories: banned; restricted; and encouraged. Real estate falls under 'restricted' and many firms are currently digesting the new regulations and re-calibrating investment strategies accordingly. Despite some short-term cooling, we remain broadly bullish on China outbound and Hong Kong's role as China's global financial intermediary.

Singapore

Since 2009, in an attempt to bring rampant asset price appreciation to a halt, the authorities in Singapore threw a slew of cooling measures on the residential market. As most developers here derive a significant portion of their income from developing residential properties for sale, these measures increased the risk of doing business in the sector. For investors, looking at buying office and retail assets, yields had been compressing over the years. At the start of 2011, the yield for CBD Grade-A office space here was 4.5% which compressed to 3.3% in Q2 2017. Therefore, the confluence of policy measures and rapidly declining yields forced Singapore developers and investors overseas to look for greener pastures. Also, for large investors such as REITs looking to grow their portfolio, the lack of investment grade assets on the market on offer here pushed them to look for growth offshore where yields are much higher than in Singapore. In the next six months, we are likely to see a continuation of Singapore based companies looking to Europe and elsewhere for investible grade assets such as offices, shops, retirement homes and in particular data centres.

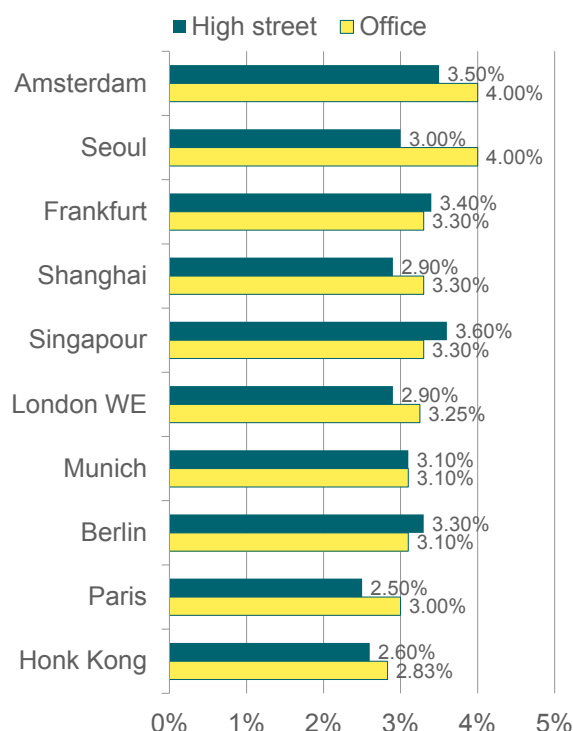
“We expect Asian investors' appetite for European property market to continue growing in 2018, driven by strong property fundamentals, the hunt for higher yields and the need for diversification.” Lydia Brissy, Savills European Research

TABLE 1
Major office investment deals

Name / location	Buyer	Origin	Price in m€
Walkie Talkie/ London	LKK Health Products Group	Hong Kong	1,447
Leadenhall Street, 122 / London	C C Land	Hong Kong	1,020
So Ouest Plaza / Paris	Vestas Investment	Korean	474
T8 / Frankfurt	Mirae Asset Global Investments	Korean	300
Atrium / Amsterdam	Amundi Real Estate	Korean	519
nationwide	Anbang / Vivat	China	500

Source: Savills

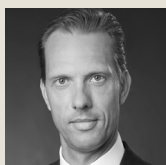
GRAPH 4
Prime net yields



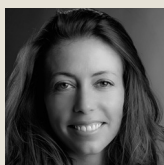
Source: Savills

Savills

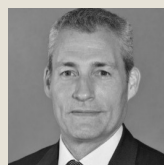
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