For many investors, now seems to be the time to take profit and exit the European real estate markets. It seems an obvious strategy when valuations are near an historic high, economic growth remains subdued, the likelihood of higher long-dated government bond yields is increased and geopolitical risk mounts with uncertain elections ahead. But while there are risks which need to be addressed, Amundi believes European markets still offer attractive investment opportunities and investor demand will continue to be strong in 2017. While bond yields are expected to rise, increases should remain slow and under control this year. In this low-yield environment, real estate assets will continue to offer attractive risk premiums. At the same time, relaxation in some international regulations and reallocation of investment strategies from large investors towards real assets will increase international investor demand for European real estate further.

**What is your outlook for 2017?**
We expect most of the trends which shaped 2016 to continue into 2017. The European leasing market performed well last year with commercial vacancy rates falling as a result of sustained activity in major cities. Investment demand for assets has remained high as competition increased, particularly for secured high-quality buildings. The exception to this trend was the UK where investment in the commercial property market slowed down significantly after the European referendum, especially for offices. We expect limited yield compression in 2017 benefitting only the best assets located in the deepest markets. Prime rent increases are forecast to continue in those cities that are attractive to corporates and where individuals like living. Investor demand for higher-yielding assets will continue to be strong.

**Which real estate assets will be popular among investors this year?**
As prime yields will remain low, especially for office and retail assets, investors will continue to be interested in alternative asset classes such as hotel buildings, light industrial and e-commerce-related logistics and serviced residences. However, the combination of low supply and high investor demand could push prices for these specific assets higher than fair value. Investors should remember that these alternative assets must offer attractive yield premiums remunerating their respective risks.

**How does the macroeconomic outlook affect your investment strategy?**
We will be paying very close attention to bond yields as these affect the relative attractiveness of the real estate sector. After a period of historically low long-dated government bond yields, the consensus is that they will increase. The speed of this increase is the key factor to watch and will shape our strategy. Our central economic forecast is for short- and medium-term bond yields to rise slightly in 2017. At the moment, the spread between prime office yields and long-term interest rates is still wide compared with the historical average. If bond yields rise gently, as forecast, this spread is likely to compress, but remain attractive, as it did in France or Germany in Q4 2016. In this scenario, we continue to favour core-plus assets. A less likely scenario is a rapid increase in bond yields across Europe in 2017. This would have a negative impact on all real estate asset values, particularly for the highest quality assets acquired at low yields and financed using high levels of leverage – even though an expected future increase in prime market rents could partially offset the decline in capital value of the assets in this environment of increasing interest rates. Prime offices with 20-year leases would become relatively unattractive assets in this environment as the value of such assets would decrease due to increasing cap rates and lack of increase in rents, locked over longer terms. The more debt the investor has used to purchase such an asset, the higher the negative financial gearing. In an environment of higher interest rates and inflation, adding value to existing assets is a good strategy. Restructuring assets gives the investor the opportunity to upgrade its building and capture future rent increases which would compensate for the higher cap rate. While we remain confident in our central scenario of slow rate increase, we will increase the proportion of our portfolios invested in value-added assets but still located in attractive areas, to hedge against the risk of a more rapid increase in interest rates than we currently anticipate.

**How do you factor geopolitical risk into your investment process?**
Political uncertainty will continue to loom large over all asset classes. This is an important factor for European real estate markets in 2017 with a swathe of elections around the continent as well as continued uncertainty, at the time of the interview, as to how the UK will implement its withdrawal from the EU. The London real estate market will not be completely off the radar of investors – the UK is still the fifth largest economy – but investors might delay their investment until they have received more clarity. London continues to remain attractive to some Middle Eastern and Asian investors, because of the sharp depreciation of sterling against local currencies. A UK property with an existing secure long-term lease could be a good investment decision as most investors can reasonably expect that political uncertainties in the UK should be resolved by the time the lease contract needs to be renewed. As an asset manager and investor, the best way to deal with geopolitical uncertainties is scenario planning and to include sensitivity analysis to ensure our assumptions are fully transparent. In all our financial models, for asset acquisitions or in asset management strategy planning, it is wise not to be over confident of the central case assumptions made in the sensitivity assumptions. It is also important for us to manage our own behavioural biases, especially after the unexpected election of Trump and Brexit. It is vital to remain rational about each political event and be neither too optimistic nor too pessimistic.
How do you create value in the current market conditions?
It is vital to manage your real estate assets actively when you are investing in a highly valued market – neither passive investments nor ‘buy, finance and hold’ strategies will produce adequate returns. We focus on the technical improvements of our buildings as well as securing better occupants or filling vacant space. Investment selection has never been more crucial, so we ensure we buy well-located attractive assets, but it is also important to select buildings that are well positioned in their respective local markets. For example, there is no point investing in a very high-end building in second-rate locations, or developing office buildings that are not adapted to the services and industries present in that zone. A growing number of occupants want more flexible office spaces as well as more services located in the building. More companies are interested in a building with a creative working environment. Offices increasingly need to allow occupants to implement a ‘hot desking’ policy – where employees sit at different work stations to encourage each employee to build broader connections within the company. Today’s offices need to make efficient use of space to enable them to be adapted to these different demands. These changing working environments offer exciting opportunities for refurbishing existing buildings and making them more attractive to tenants. Both investors and occupant increasingly demand buildings offering high standards of environmental performance. Investors like environmentally efficient buildings because these assets maintain their value better and remain more liquid over the long term. Tenants like these buildings because their utility costs are lower and they project a better image for them.

What appetite will institutional investors have for European real estate assets in 2017?
We expect demand from local and international institutional investors to remain strong this year. This appetite will be driven by these investors continuing to look for sources of higher yield in a low interest rate environment. Regulation is also helping to drive demand as a growing number of jurisdictions allow institutions to increase their allocation to real estate assets and permit them to make more international investments. These evolutions are now particularly changing the behaviour of large institutions and sovereign wealth funds, but smaller investors are also starting to follow this trend. This will create greater demand for European real estate, which will underpin the value of the European real estate market. There has already been increased interest among French pension funds and insurers and Asian organizations (from Korea, China and, increasingly, Japan) for European real estate. We have seen institutional investors increase their allocations to real estate from an historical 2-4% to 6% or even 8%. For most of these institutions, real assets, including real estate, now play an important role in their asset-liability matching strategy as well as their asset allocation optimization strategies, and this will remain a long-term trend.

AMUNDI REAL ESTATE
Amundi Real Estate is a company specialised in developing, structuring and managing European focus property funds for private investors, private banks and their distributors, institutional investors, large companies and real estate professionals. With above €20bn of assets under management as of 31 December 2016, the firm is No 1 in France in terms of fundraising and assets under management for SCPI and retail OPCI (IEF – March 2016), and is part of the Top 10 Asset Managers for offices in Europe (IPE – December 2016). Amundi Real Estate is an authorized management company active in France, Germany, Italy, UK, Benelux, Czech Republic and Austria, and is fully-owned by Amundi. Publicly traded since November 2015, Amundi is the largest European Asset Manager in terms of AUM(*), with over €1,000bn worldwide and more than 4,000 employees. Headquartered in Paris, France. Amundi is the trusted partner of 100 million retail clients, 1,000 institutional clients and 1,000 distributors in more than 30 countries, and designs innovative, high-performing products and services for these types of clients tailored specifically to their needs and risk profile

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*Data at 30 September 2016. No. 1 in total assets under management of management companies with their main headquarters in Europe. Source: IPE “Top 400 asset managers” published in June 2016, based on assets under management at 31 December 2015.

RECENT INVESTMENT EXAMPLES:
Parisian Office Portfolio:
Acquisition in 2016 of a large pan-European office portfolio, including three assets located in Paris representing €750mn, which has been structured as a club deal, in which institutional investors have been invited to co-invest along discretionary funds managed by Amundi.

De Rotterdam Office and Hotel Towers in Rotterdam:
Acquisition in Q2 2016 of a large asset in Rotterdam, including offices, a hotel, retail space and parking for close to €350mn by a club of investors managed by Amundi, including a group of Korean investors and an existing Amundi Fund.