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The European Investment Market: How it Is Affected by the U.S. Subprime Crisis

In recent years, the European investment market has experienced an upturn, which was believed to be the beginning of "golden times" for real estate professionals. Unfortunately, last autumn the European investment market was hit by the international financial crisis, that began as a subprime mortgage crisis in the United States. The entire Euro zone is experiencing an economic slowdown—in some parts even an imminent recession—that is caused mainly by the uncertainty about the U.S. economy, the strong exchange rate for the Euro, and the high cost of resources and energy.

Investment Volume in Europe

In the First Quarter of 2008, the turnover of European real estate investment decreased nearly 50 percent compared to the previous year. The consensus among real estate professionals is that on average, the market value of properties has decreased by 10 to 15 percent since the summer of 2007.

Besides the weakened economic development of the Eurozone, reasons for the weakening of the investment market include the more restrictive credit policy of the banks and the uncertainty and different expectations about the European economy. This also presents an obstacle for investors, especially as the level of private equity has decreased.

In addition, buyers are expecting lower prices because of the slower economies and potential sellers don't feel the need to sell properties while occupancy and rent levels remain good and in some markets are still going up (e. g. in Germany).

Characteristics of the European Investment Market

The European real estate market can be divided into segments; volatile markets, relatively solid but fluctuating markets, and solid investment markets.

Volatile Markets

There are volatile markets in Great Britain and Spain and also in Middle and East European countries such as Bulgaria, Romania, Russia, and the Ukraine. These markets are very sensitive to any kind of political and economic changes—hence they are more risky for investors.

Great Britain, however, is still the biggest European investment location—although the decrease in investment in Great Britain has been especially severe. The investment climate index declined considerably for office spaces—especially in the City of London where the office market decreased by 30 percent in the First Quarter of 2008, while in the West-End it increased, against the odds, by 12 percent.

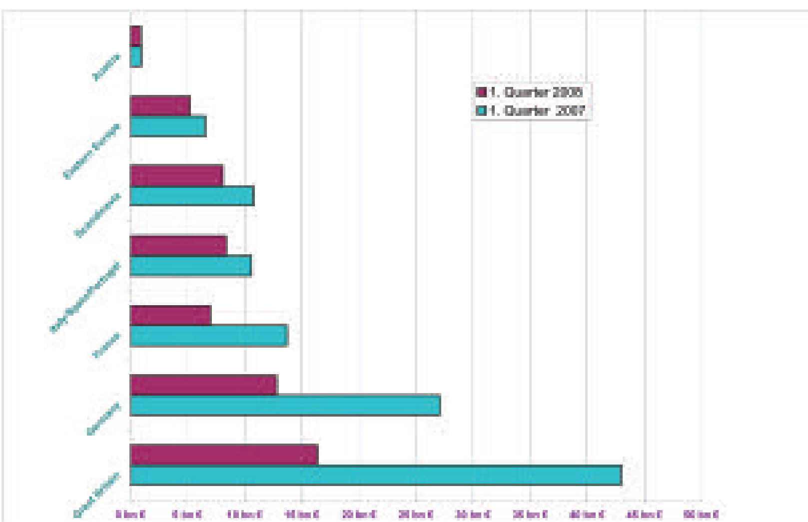
Solid Markets

The markets of France, Italy, and the Netherlands are relatively solid but fluctuating. The most solid investment markets are in Austria, Germany, Scandinavia, and Switzerland.

The German investment market—the second largest market in Europe—was hit hard this time. The total financial value of the transactions in the German commercial property market decreased by more than 50 percent in the first six months of 2008 compared to the same period in 2007.

In addition, yields have decreased slightly: Shopping centers decreased 75 points in average, offices 50 points, and light industrial/logistics property 25 points. This decrease has to be considered more or less a steadying after the investment boom in recent years when everything was for sale.

The higher returns and the existing liquidity in the German market continue to make the country an attractive, solid investment location.



Forecast

The general slow down of the economies in the Eurozone is reflected in the investment market. Some analysts are expecting fire sales in Europe. This could be the case, especially in volatile markets such as Great Britain, Spain, or perhaps even in the relatively solid Italian marketplace. However, the robust office rent situation will reduce the risk of an economic slump in the investment market. For example, in Germany most investments are financed for a period of five to seven years. Therefore, Germany is not expecting any fire sales before 2010 or 2011—if at all.

The European investment markets will become more volatile in the long term. Globalization of the financial and investment markets will affect all local and regional markets and make them more dependent on international changes, either political or economic.

In recent months, banks have become less restrictive, but still have not returned to their 2005 through 2007 patterns in terms of margins and the amount of credit. Up until now there had been sufficient liquidity in the investment market, especially with the classic investors such as pension funds and insurance companies taking advantage of the situation to purchase with good terms.

At the moment, European markets lack foreign investors. But, there may still be investors coming from Arabic or Asian countries. Perhaps this will be the next big thing that will bring back the "golden times" to Europe!

This article was written before the ongoing escalation at Wall Street. Nobody expected such a dramatic situation as it is at the moment. This wave of the financial crisis is spilling over the international financial markets and over Europe. What started as a problem of the U.S. national residential market, has become a global crisis. However, there are always positive aspects in a crisis. When the market returns, investors will be more judicial regarding how they invest and will shy away from high risk investments—perhaps returning to more conservative investments like real estate.