When real estate investors consider investment strategies and opportunities, which risk drivers do they attach most weight to in their decision-making? And how do they expect banks to weigh these risks? And to what extent do investors’ views actually match bankers’ risk perceptions? The 2014 ING/Nyenrode Survey conducted among international institutional real estate investors and bankers reveals that there are some striking differences.

Nyenrode Business University (the Netherlands) and ING Bank Real Estate Finance (ING REF) recently conducted a survey among 25 European real estate investors (both listed and non-listed) and 27 European real estate bankers to investigate the degree to which investors’ and bankers’ perceptions of relevant risk drivers match or differ, and what this might mean for real estate lending practice. It turns out that while banks allocate significantly more weight to management risk than investors, investors are more concerned about country risk than banks.
Interestingly, investors and banks attach more or less equal importance to property market risk, but investors underestimate the banks’ interest in this risk driver.

Main risk categories
The five main risk categories investigated were (1) country risk (e.g. fundamental, macro-economic, demographic and political aspects), (2) property market risk (e.g. yields, rental development, vacancy risk), (3) financial risk (e.g. interest rate risk and debt availability risk), (4) structure risk (e.g. legal and fiscal aspects) and (5) management risk (e.g. track record of management). Both investors and bankers were asked to weigh each category (total = 100%). In addition, investors were asked how they think that banks weigh these risk factors when reviewing investors’ investment opportunities and strategies. The answers resulted in the following picture:

Figure 1 shows the similarities and differences between how investors argue when it comes to assessing investment opportunities and strategies (orange), how they believe that banks argue (grey), and how banks actually argue (blue). “We see that investors are right in thinking that banks find management risk more important, but that they underestimate the importance banks attach to property management risk,” says Professor Tom Berkhout of Nyenrode Business University. “Perhaps investors see themselves as more expert in real estate than banks. Another interesting difference is in the weight of country risk. Contrary to what investors expect, banks seem to attach much less importance to country risk than investors do themselves.”

Investors and banks clearly share the view that property market risks are of the utmost importance.

Prof. Tom Berkhout
Aspects most frequently taken into account

In a further set of questions, respondents were asked to what extent they take into account specific aspects of the five main risk categories. Within the category of country risk, the most important aspect turned out to be ‘political stability’. However, this aspect is taken into account far more often by investors than by bankers, and investors also overestimate the importance that banks attach to a country’s stability. “In general, it looks as if banks take a more opportunistic approach when it comes to country risk,” says Jan-Evert Post, member of the global management team at ING REF. “They seem to trust the investor’s risk analysis in this respect and attach more value to assessing deal- and property-related risks rather than bigger-picture country risk. As our industry is a local business, and most banks work with teams on the ground, it could be that these teams focus on local opportunities only. That would mean that they are not taking into account why a given country is particularly attractive to investors compared to other countries. And with the dominance of international liquidity flows in our sector these days, I’m wondering whether banks are conscious enough of what drives these flows, and whether they believe that these flows are here to stay.”

“The importance of the yield spread as investment criterion seems to be underestimated by many real estate bankers.”

Jan-Evert Post

In the property market risk category, the most striking difference between investors and banks was observed in the aspect of real estate versus government bond yield spread. “This is quite telling,” says Jan-Evert Post. “Here, too, we see that the ‘bigger-

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Fig. 2 Aspects of country risk

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Fig. 3 Aspects of property market risk

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<td>Pricing - Absolute yields</td>
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<td>Real estate versus government bond yield spread</td>
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picture’ yield spread aspect is far more important to investors than to bankers. The spread reflects the risk/return profile of our industry versus the risk-free return on government bonds. Investors use this yardstick in their country allocation of investments, whereas banks do not. It looks as if banks have little interest in understanding the international macro drivers behind investment flows.”

Management risk
The management risk category also showed some noteworthy results. When assessing investment opportunities or strategies, banks clearly find management risk aspects much more important than investors do. The latter most probably believe that good management on their own part is a given. However, investors still underestimate the importance that banks attach to investors’ management capabilities, particularly track record and morale. “For banks, management risk is particularly important,” says Professor Berkhout. “They not only assess the quality of the underlying assets to a loan, but also the investor’s capabilities in managing those assets. Good management will safeguard the debt servicing capacity in the long run.”

What can we learn from the mismatches?
In essence, the survey results are positive and comforting: investors include most risk drivers when making investment decisions, and banks’ perceptions of these risks are largely in harmony with those. Jan-Evert Post of ING REF sees two main takeaways.

“Other important risk factors are reputation, experience, track record, soft skills and wealth background.”

Banker

“According to economists, real estate is a lagging industry, with real estate investments normally following the economic cycle,” he says. “However, right now, the activity level in our industry seems to suggest that the real estate sector is fronting developments, already factoring in economic growth that has not yet materialised. Part of the current activity level in the real estate sector is driven by a need for rationalisation of distressed property portfolios – typically an exercise that follows the economic cycle. However, another significant part can currently be recorded as buying and selling of property in the ordinary course of business. Banks supporting this basically show loyalty to their clients: they trust that investors are indeed targeting the right opportunities in the right countries. They take the investor’s performance in line with the banks’ view on management risk.”

Fig. 4 Aspects of management risk
In my view, therefore, ‘loyalty’ is the first main takeaway from this survey: banks tend to follow their clients. For the majority of the remaining risk drivers, there is harmony between the investors’ and banks’ approach.

“Of course, the risk factors to be considered (and their weight) may differ depending on the economic cycle. While refinancing risks and country risks were key for both banks and companies after Lehman, currently these risks are considered less important.”

Investor

The second takeaway is slightly more thought-provoking and concerns the banks, says Jan-Evert. “By not assessing country risk and yield spreads when allocating the banks’ capital across countries for real estate loans, the portfolio effect of running a loan book in this asset class can be anything from ‘optimal by accident’ to ‘exactly wrong’. The risk of not focusing on country fundamentals, but merely on the characteristics of the underlying asset and the quality of the management, is that there could be a lack of a long-term view on a specific market, and the way markets interrelate. This might not pose any problems in the short term, but could nonetheless have effects in the long run. And if we add here the fact that banks seem to prefer to make loans in geographies where they have ample liquidity, one could predict a concentration of loans on the banks’ balance sheets in some geographies, based on where they raise their liquidity rather than a balanced view of country fundamentals, timing and correlations. Of course, it is easy for banks to rely on the management views of their clients, but we may wonder whether banks are putting in enough effort to really understand the markets to which they are exposed.”

About the survey
The goal of the explorative research was to identify risk perceptions of European real estate investors and banks through questionnaires completed by selected ING clients and bankers as experts. The respondents included 25 real estate companies and funds (‘investors’) managing assets in, among other countries, Austria, Belgium, Czech Republic, France, Germany, Hungary, Italy, the Netherlands, Poland, Spain and the United Kingdom, as well as 27 real estate experts from real estate banks (‘bankers’) active in Austria, Belgium, France, Germany, Italy, the Netherlands, Poland, Spain and the United Kingdom. The research was carried out under the supervision of Professors Tom Berkhout and Ad Kil from Nyenrode Business University, the Netherlands, in consultation with ING REF, coordinated by Jan-Evert Post, member of the global management team of ING REF. This collaboration falls under the partnership between ING REF and the Nyenrode Center for Real Estate Finance. Set up in 2011, this partnership combines their respective areas of expertise in real estate commercial practice and academic coverage of the sector. The knowledge and expertise thus gathered is shared with ING REF’s clients and made available through publications and meetings, with the aim of making a positive contribution to the general functioning of the real estate market.
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