Real Estate Of Mind: 6 Key Outbound Real Estate Investment Insights for GCC Investors

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As Covid-19 restrictions and quarantines lifted around the world in 2022, beginning to draw a line under two years of unpredictability and turbulence, one of the highlights has been the ability to reconnect with clients in-person.

We have travelled across Bahrain, Kuwait, Qatar, the United Arab Emirates and Saudi Arabia these last few months, excited to be back on the road. It has been fascinating to hear the perspectives of our Middle East-based clients. We found a sense of optimism and outward-looking ambition, especially from investors and asset managers alike for real estate deals.

While it is hard to predict exactly what the post-pandemic outbound real estate investment landscape looks like for the GCC investors, from the feedback we have received, appetite remains healthy. Outlined below are six key insights from our contacts. This note focuses specifically on the UK market.

Thanks to our clients and friends for their thoughts and invaluable insights. We would welcome further feedback.

INSIGHT 1: UK REMAINS AN ATTRACTIVE PROPOSITION

Whilst certain asset managers appear reluctant to invest their clients' money into UK real estate (having been put off by factors such as the recent political events in the UK, the continued increase in the property prices, the high interest rates and the lack of availability of stock), others remain bullish and are determined to continue investing in the UK real estate market. The latter view the UK market as a long-term play. They understand that market conditions will always change, and one must find a way to adapt and invest the investors' cash. They believe that investors which currently have dry powder will be in a better position to diversify their investment portfolios by investing outside of the GCC. Such investors do not wish to rely on the local markets and the interest produced by local savings accounts (albeit that the cash returns on such investments may be more than the current UK market yields).

The consensus is that the UK property prices cannot continue to rise at the current levels. There is a belief that inflation, increase in the financing costs and the recession ahead will ultimately bring distressed sellers to the market or that sellers wishing to exit for reasons other than distress will have to agree to sell at lower prices. Therefore, the key is to be ready and to move fast to acquire assets being sold by such sellers - noting that the GCC investors are not necessarily interested in acquiring distressed assets. Instead, they will be looking to purchase high quality assets being sold by distressed sellers.

INSIGHT 2: DIVERSIFYING GEOGRAPHIES

Investors are certainly not putting all their eggs in the UK basket. Clients identified a selection of jurisdictions prime for investment.

The US remains very strong, with investment volumes and investment amounts far exceeding those being witnessed in the UK and Europe. The Netherlands, Germany and Belgium attract some GCC investments. However, the yields in those countries tends to be lower than the yield typically expected by the Middle Eastern investors.

Others are considering Poland, Spain and Finland as potential investment jurisdictions – however, how much money will in fact be invested into those jurisdictions is yet to be seen.

Even so, we can expect investors to target assets in a variety of countries.

INSIGHT 3: IDENTIFYING THE ASSETS

A pattern began to emerge from our clients when discussing the type of real estate assets they are considering for investment. While a selection of potential asset classes were mentioned, three that were noticeable in how frequently cited are:

- Logistics and industrial

These assets continue to be favoured, however, the key issue is the real lack of availability of stock. The current high demand for such asset classes far exceeds the available supply. This in turn reduces the yields produced by those assets.

Some argue that there is a real need to develop logistics. However, two key factors seem to impact the viability of such developments - first being the current shortage of labour in the UK and second being the increase in the cost of construction material (in particular, following the onset of the Russia-Ukraine war). Having said that, developing logistics is an area of focus for some investors who are keen to take advantage of this shortage and are specifically looking for such development opportunities.

- Commercial offices

Whilst some investors are watching the return of the workforce back to offices and questioning whether the pre-pandemic office culture will return, others view offices as a key asset. The well-known “is the office dead” debate.

The proponents of the office investments are more likely to invest in offices in retail parks in secondary cities to ensure obtaining the yields required by the GCC investors. Such investors are alert to the fact that following COP 26 and the recent UK regulatory proposals, offices must meet certain minimum standards for Energy Performance Certificates by 2030 (i.e., only 8 years away). This in turn means that if an office building is purchased capex to "retro-fit" the building must be considered. Such capex may be raised as part of the acquisition financing.

- Student housing

Student housing continues to be of an interest to some. This is particularly so with the increase in the number of mature students (primarily comprising of those who have lost their jobs as a result of the pandemic and are looking to either reskill or to enhance their skills) and need for affordable student accommodation.

INSIGHT 4: WHAT TO DO WITH NON-PERFORMING ASSETS?

What are the options available to those investors who have acquired or are currently holding non-performing real estate assets?

The good news is that over the past year, many disposals have taken place at a sale price higher than that expected by the sellers. This is notwithstanding the fact that due to various factors such as non-performing tenants, or financing covenant breaches, the income generated from such assets has been minimal or non-existent prior to such disposals. Such successful exists create the positive narrative needed for future investments.

Where disposal is not a viable option, investors are putting non-performing assets under the same fund (i.e., allowing for a balance to be created between performing and non-performing assets).

INSIGHT 5: DIVERSIFYING FINANCING MECHANISMS

If the current economic environment in the UK and elsewhere is not likely to produce the yields required by the GCC investors, what are the alternatives?

Certain clients are looking to establish debt funds providing mezzanine debt to the purchasers of real estate. This is likely to be more complex and challenging to implement when the ultimate investors of the debt fund are *Shari'ah* compliant investors, and the asset level loans required by the relevant borrowers are conventional facilities.

We see the debt fund space as a future growth area.

We are also seeing local GCC asset managers setting up asset management arms in the UK or the US (as the case may be) or acquiring existing asset management companies in the UK or the US. The advantage being that they will have local on the ground market knowledge, access to deals on a time sensitive basis and most importantly higher returns for the investors and the GCC based asset managers (as fees will not have to be shared with the UK asset managers).

INSIGHT 6: TAX

Tax remains a key driver in structuring outbound GCC investments. The UK qualifying asset holding company (**QAHC**) tax regime came into force on 1 April 2022. The new regime provides a wide-range of UK tax benefits intending to enable the UK to be more competitive with jurisdictions such as Luxembourg for establishing holdings companies and funds. QAHCs will be of great interest for those investors or fund managers with an existing presence in the UK who are looking to move away from Luxembourg tax structures. Watch the space here!

We would love to hear your thoughts on the topics raised in this short note!

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