OAK INVESTMENT MANAGEMENT GROUP

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# The price of Oil and European Real Estate

*The price of oil has many variant inputs it also has huge consequences on the economies of the European continent. This in turn has big consequences on the real estate market of Europe. However so fundamental is the price of oil to the economies of Europe it is hard to distinguish cause and consequence.*

*Super facie* cheap oil is good for economies of Europe, but momentum also matters (where the price has been), expectations matter (where the price is expected to be) – insofar as this feeds through to investment or consumption decisions by individuals and firms. If oil is cheap it can either act as a stimulus to more consumption or it can mean that future consumption is unlikely to materialise. Both scenarios are perfectly logical readings of the same fact with completely different outcomes.

There is also an asymmetry in the behaviour of oil on the general market in that the price going down has less effect than the price going up. Oil's price rise encouraged efficiencies on the way up but this does not mean that more oil is necessarily consumed on the way down. Oil is an active ingredient for producing goods as well as an active ingredient to consumption itself. In the former case, this will result in higher margins on average for European companies. In the latter case this will mean more 'cash' in the pocket of the European consumer. Both do not necessarily feed through to economic growth. European companies (like banks of late) might choose to firm up their balance sheets and consumers might actually choose to bank their savings on for example the price of fuel into paying down debt.

In terms of real estate – this means that most occupier companies are likely to have a windfall (or more leeway) on their margins. This means that a landlord with pricing power can apply pressure now to rent levels and succeed. This is likely to have an impact of the 'fundamentals' of property return i.e. the observed and potential yield from an asset.

From an investment point of view one would assume more liquidity as a result of cheaper oil. But this has not happened empirically. Currently, it seems that with investment there are much many more factors at play pulling back market e.g. the lack of a functioning commercial real estate lending market.

Even though this flies in the face of long term economic logic, therefore, commercial real estate is likely to see higher rents but lower capital values. This should make the sector attractive for entry by new participants. This is very much likely to support the fundamentals of the commercial real estate sector in the near term. The only major issue now is of course that at some point in the future one can hypothesise about an economic scenario where both the price of oil and the price of money go up at the same time choking economic activity. Hopefully, this is a challenge for another era.

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