Impact of Solvency II Directive on Real Estate Investments

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Solvency II is a fundamental review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards that will replace the current Solvency requirements. It aims to implement solvency requirements that better reflect the risks that companies face and deliver a supervisory system that is consistent across all member states.

During September and October 2010, Preqin surveyed more than 20 Europe-based insurance companies to assess the impact of the Solvency II Directive on the indirect real estate investments of these firms. The results show that the Directive will have a significant impact upon the real estate investment strategy of these institutions, and the size and composition of their real estate portfolios.

Impact of Solvency II on Real Estate Investments

76% of respondents said that the Solvency II legislation would have an impact on their real estate portfolios. Only 19% felt that their real estate investments would be unaffected, while 5% were unsure. The impact which the Directive would have varies depending upon individual institutions. Several insurance companies said that real estate allocations would fall as a result. One Finland-based insurance company, however, anticipated doubling its real estate allocation from 5% to 10%, reducing its equities allocation to accommodate this increase.

Impact of Solvency II on Indirect Real Estate Investments

Insurance companies that invest in private real estate funds were asked how Solvency II would affect these investments. 74% felt that the Solvency II legislation would impact their investments in these funds. Just over a quarter felt their fund commitments would be unaffected by the Directive.

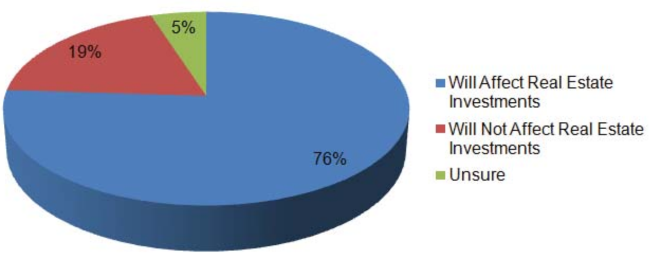
Fig. 3 shows that private real estate fund managers should expect to receive fewer commitments from EU-based insurance companies in years to come. 26% of respondents felt Solvency II would impact their real estate investments as they were expecting to make fewer commitments to private real estate funds as a result of the legislation.

A further 16% said that the Solvency II legislation was a contributing factor in their decision to no longer invest in private real estate funds. One French insurance firm said, “The decision to stop investing in private real estate was partly due to the Solvency II regulations, which place stricter guidelines on the level of risk insurance companies are allowed to take with regards to their investments.”

5% of investors expected to target more core funds, while 5% said that they would need to target opportunistic investments. One German insurance company said that returns from core or value added funds would not be sufficient for them to reach their equity return target. It said, “Only opportunistic investments, mainly in emerging markets would be sufficient.”

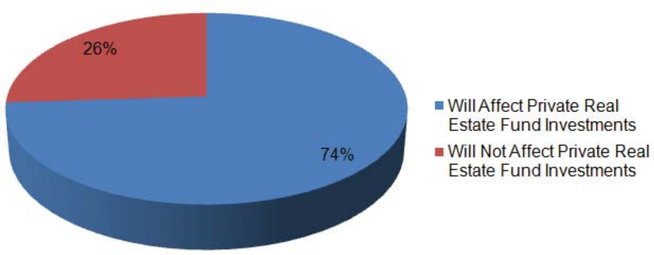
Preqin has identified more than 90 Europe-headquartered insurance companies, managing combined assets in excess of €315 billion, that invest in real estate. These institutions are often significant investors in real estate, as indicated in Fig. 4. 44% of European insurance firms that invest in real estate have €1 billion

Fig. 1: Effect of Solvency II Directive on European Insurance Companies Real Estate Investment



Source: Preqin

Fig. 2: Effect of Solvency II Directive on European Insurance Companies' Private Real Estate Fund Investment



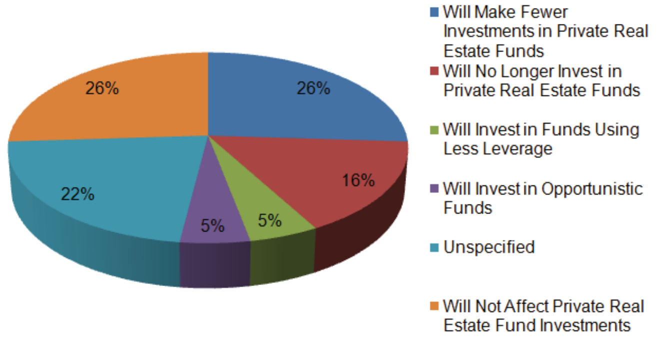
Source: Preqin

or more allocated to the asset class, with 23% allocating €2.5 billion or more.

These results show that the Solvency II legislation will have a dramatic impact on the real estate investments of insurance companies based in Europe. Those raising private real estate funds are likely to receive far fewer commitments from this group of investors. But as a German insurance firm stated, the impact of the legislation could be greater than simply reducing real estate investments. It argued that Solvency II will have "underestimated consequences not only for European insurers but also for the whole real estate industry (developers, banks and funds). Insurers are an important source of capital for real estate, which itself fulfils an important function in the domestic, as well as the global, economy."

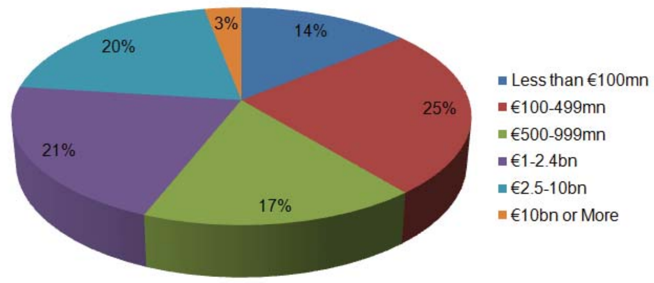
The precise impact the Solvency II Directive will have on the real estate investments of insurance companies is unclear, and institutions are expecting to adopt dramatically different strategies in response to the Directive. The responses to Preqin's survey, however, do indicate that it will significantly alter the investment approach of these institutions and will therefore have a major impact on many other firms within the real estate industry.

Fig. 3: How Solvency II Directive Will Affect European Insurance Companies' Private Real Estate Fund Investment



Source: Preqin

Fig. 4: Breakdown of European Insurance Companies by Real Estate Allocation



Source: Preqin

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