Diversification in European Real Estate Portfolios: Is Economic Diversification Superior to Traditional Geographic Diversification?

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Summary

In the past, real estate investment was mainly done following a best deal strategy. In recent years, however, researchers and practitioners alike have made great efforts to improve the risk-return characteristics of real estate portfolios. Empirical research in the U.S. on geographic diversification indicates that economic diversification based on economic variables can lead to risk-return efficient frontiers that are superior to those obtained by traditional geographic diversification based on historically evolved administrative regions. For the first time, this study analyzes whether this is true for the three most important real estate markets in Europe, Germany, France, and the United Kingdom. We find that economic strategies based on industry differentiation fail to deliver superior risk-adjusted returns.