

# Changing Tides: How the Iran war is Affecting Middle Eastern Capital Flows

**Sovereign wealth funds, private capital and local developers are responding in different ways**

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Two contradictory narratives surround the impact of the Iran war on capital flows from the Middle East. One is that it will force Middle Eastern investors to pull back as they seek to raise cash and support domestic investments. The other is that they will increase overseas investment, with the war having underlined the value of international diversification.

Which version is correct matters, because of the scale of Middle Eastern investment.

Over the past decade or so, Middle Eastern buyers have accounted for anywhere between 2% and around 10% of total European investment volumes, depending on the year, according to data from MSCI.

However, this underplays the true significance of Middle Eastern investment, as investors in the region also invest through funds and deals fronted by local managers. Some high-profile examples of fund investments in recent years include Arrow Global Group Capital Management securing \$400m from Abu Dhabi Investment Authority (Adia); Mubadala, Royal Group and a clutch of other Middle Eastern investors backing One Investment Management's debut \$7bn fund; and Greykite securing Wafra's Capital Constellation as a cornerstone investor in its first fund.

Middle Eastern investors range from giant sovereign wealth funds such as Adia and Mubadala, through to local investment firms, family offices and developers. There are significant differences in how these different groups are responding to the war – and how they might act in future

For now, when trying to interest a buyer in a Bayswater home, Lewis said, his team doesn't lead with its location. "We pitch it as just north of the park, convenient, and in an area where a lot of regeneration is going on," he said. "I doubt we would go straight in with: 'Bayswater.' If we did, I think they might take some convincing."

For the sovereign funds, the mantra coming out of the Middle East is that it is business as usual. They continue to compete for deals. Adia, for example, was in the mix for Vastint's £420m Project Bird hotel portfolio.

Ed Price, director, global and Middle East capital markets at Savills, says: "We haven't witnessed any material changes to real estate allocations or strategies. These are long-term investors and we don't anticipate recent events prompting any deviation from their overall strategic approach."

However, the longer the conflict drags on, the greater the economic damage in the region will be. That could force change on the sovereign funds. In previous crises, they have raided funds – for example, during the Covid-19 pandemic, Adia and Kuwait Investment Authority reportedly drew down \$24bn and \$25bn respectively to meet pandemic-related expenditure needs.

Top Middle Eastern investments in Europe:

- The Shard, London – 95% owned by Qatar Diar
- Canary Wharf Group, London – 50% owned by QIA
- 8 Canada Square, London – owned by QIA
- More London – owned by KIA/St Martins Property Group
- Porta Nuova, Milan – owned by QIA
- Sturegallerian AB, Stockholm – owned by Adia
- Le Royal Monceau – Raffles Paris – owned by Katara Hospitality
- Inmobiliaria Colonial, Spain – 20% owned by QIA
- Grosvenor House, London – owned by Katara Hospitality
- Istanbul Cevahir, Turkey – owned by KIA / St Martins Property Group

The United Arab Emirates' move to secure emergency dollar liquidity from the US shows how governments in the region may be able to avoid having to sell illiquid assets, including overseas real estate holdings, in order to meet spending needs. However, at the very least, there could be a reduction in the sums available for overseas investment. The need to support domestic economies, boost defence spending and fund infrastructure rebuilding projects may well take precedence.

Saudi PIF's decision to withdraw funding for LIV Golf and pull out of a \$200m deal with New York's Metropolitan Opera House already speaks to its changing priorities and reduced willingness to finance soft power projects with no financial return.

It is a different story for private money, which has traditionally been drawn to higher-yielding, well-let UK and European property. In the wake of previous crises in the Middle East, there has been significant capital outflows into overseas property.

Investment managers that fundraise mainly from family offices and high-net worth individuals in the Middle East say this has not happened yet – although they do expect capital flows to increase.

Paul Simmons, partner and co-founder at Greenridge, says: "There was some speculation that there would be an avalanche of capital. That hasn't happened but sophisticated investors remain active. They can see that there are attractive opportunities."

Many took a wait-and-see approach initially, but that is now changing. A key driver is the need to diversify internationally and protect wealth.

“Initially it felt like the start of Covid – people were focused on getting their affairs in order locally, and there was no immediate rush to move capital out of the region into real estate, although the private banks in Geneva were reportedly seeing inflows during that early period,” says Michael Ferris, head of investment at JR Capital.

“That now seems to be changing. There is a growing willingness to deploy capital overseas, and the UK – particularly UK commercial real estate – sits at the top of the list for overseas allocation among Gulf Cooperation Council based investors.”

The expectation of increased investor demand is also prompting banks, syndicators and other investment groups in the Middle East to start looking more closely at opportunities abroad.

“We have seen a moderate uptick in those groups looking at global markets in anticipation of increased demand from their underlying investor base,” says Price.

The caveat here is that the ability of private money in the region to invest more in UK and European real estate could be curtailed by the economic fallout from the conflict. Some investors may have other calls on their capital and have to divert money to prop up domestic investments or businesses. Even if that is not the case, they may prefer not to tie up too much capital in illiquid investments.

Ultimately, the picture may vary significantly from country to country. Some economies look to be particularly exposed – the Bahrain economy looks vulnerable, with Moody’s having downgraded its outlook to “negative” last month, and the collapse in tourist numbers will hit the UAE especially hard.

The UAE had been enjoying a housing boom in the run-up to the war. Flush with cash, local developers had been diversifying into foreign markets. Arada’s acquisition of Regal London last autumn was one of the latest examples.

The rationale for international diversification remains, but the Iran war will curtail the ability of developers to pursue it. Early in the conflict, credit agency Fitch warned: “If cash needs to be conserved, overseas forays, often funded on a non-recourse basis, are likely

to be scaled back.” Since then, the first evidence has started to emerge of the war’s impact on the residential market. Data from ValuStrat points to a 5.1% month-on-month drop in prime residential values in March.

There are fears of a material correction that could hit developers hard, particularly given how the market has become increasingly reliant on foreign buyers. Around 60% of purchasers have been non-domestic, according to Fitch.

Inevitably, some developers will be hit harder than others, with the financial strength of some supported by deep-pocketed backers, including investment groups linked to the government or its rulers. This week, Dubai Holdings – the investment company of Dubai ruler Sheikh Mohammed bin Rashid al-Maktoum– bought a \$6.5bn stake in Emaar Properties from Investment Corporation of Dubai, a sovereign fund.

Pointing to movements in the UAE’s Shariah-compliant bond market, Faisal Durrani, partner and head of research MENA at Knight Frank, says: “Investors are no longer treating all developers the same. Instead, they are focusing on financial strength and the gap between stronger and weaker developers is widening.

“This is not just about geopolitical tensions, but a reflection of late-cycle concerns, including an exacerbation of downside risks linked to slowing demand, possible oversupply, and tighter access to financing.”

Well-financed developers already established in the UK and Europe may well be able to push on with their growth plans. But that won’t be the case for all and those that had been weighing up expanding into new markets will no doubt press pause.

All in all, it remains a decidedly mixed picture for capital flows from the Middle East, even if there may well be an uptick in investment from private capital in the region.