PRESS RELEASE

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Catella forecasts rising purchase prices despite rebound in interest rates

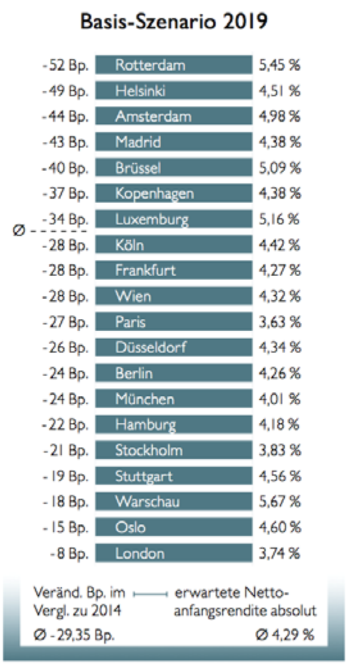
Catella Research anticipates a continuing increase in purchase prices paid by institutional investors for first-class, large-volume real estate in good positions and with solid occupancy rates. Investors are currently focusing to an increasing extent on the issue of interest rate developments as a lead indicator for initial yields on office property. This is because according to conventional principle, they should lead to falling prices and valuations. This gives special significance to interest rate analysis.

In the first half of 2015, most central banks continued their expansionary monetary policy. "We expect that this monetary stimulus will translate into a gradual improvement in Europe's economic growth rate towards the end of the year", says Dr Thomas Beyerle, Chief Analyst at Catella. The yield on 10-year German government bonds has risen from a record low of 0.05 per cent to 1 per cent. Catella believes that this effect is attributable to excessively low interest rate policies and slowly rising inflation, combined with growth expectations. "This is why, when we look back at developments in Q2 2015, we see a rebound in interest rates beginning to gain traction", continues Beyerle. By the turn of 2015/2016 at the latest, when the European economy has broadly stabilised, there will be a turn away from the policy of providing cheap money and interest rates are expected to rise generally.

As a result of this change in the interest rate landscape, the available debt capital will become scarcer. Property prices should therefore decline. Conversely, initial yields, as they are called in real estate speak, i.e. the return investors expect for their investment and the risk they have taken, will rise. That, at least, is the conventional textbook wisdom.

But according to Catella, this development will not start immediately. Factors to be taken into account are the time aspects of the delayed response in the real estate industry and possible lasting changes in the overall environment. For example, political and monetary uncertainty could increase investors' willingness to pay higher prices for investments in secure assets that offer stable value.

In the latest Catella Market Tracker (July 2015 issue), Catella ventures a yield forecast for 20 European investment locations until 2019 and arrives at a result that defeats conventional textbook logic: The initial yields will continue to decline – despite a change in interest rate policy.



Analysts offer two arguments to explain this:

- The "liquidity mountain" is only slowly getting smaller.
- This "recovery" continues to be determined by a clear "no-risk

The base scenario for 2019 shown here maps expected price changes over the next 5 years. The indicated yield is the yield expected by investors for first-class office properties with good occupancy in prime locations, known as core properties. An expected yield of 5% reflects the investor's willingness to pay 20 times the annual rent to acquire the property. A reduction in this yield by 50 basis points (bp), for example, corresponds to a price increase of 10%, and vice versa.

In Catella's research, the Nordic real estate markets represent a two-class society: While Helsinki at -49 bp and Copenhagen at -37 bp are above the 30 bp threshold, thus signalling the expectation of significant price increases, the measurable impact on Stockholm (-21 bp) and Oslo (-15 bp) is relatively minor. London, at -8 bp, which indicates almost stable prices, is the only city behind Oslo and thus last in the ranking of expected price rises.

For Southern Europe, with Madrid at -43 bp in this list, Catella forecasts a considerable decline in initial yields in all scenarios. This is primarily due to the expected recovery in the leasing markets and the resulting fall in risk levels. The impact of interest rates is relatively small in these markets.

For the German markets, changes in interest rates will initially only have a negligible effect. With the exception of Stuttgart (-19 bp), all cities range in a corridor of between -22 bp (Hamburg) and -28 bp (Cologne). Catella continues to expect rising price levels here, even though a high level has already been reached.

"In our assessment, the textbook style development in interest rates referred to earlier will not necessarily lead to an increase in initial yields on the European office property markets", says Beyerle confidently. On the contrary: in this phase, an investor will consciously accept "relative" losses in yield caused by higher interest expenses and lower initial returns. According to the analysts at Catella, the ride on the risk-yield curve will not be as pronounced as at the previous height of the market.

For more information, please contact:
Dr. Thomas Beyerle
Head of Group Research
+49 69 310 19 30 220
thomas.beyerle@catella.de

Press contact:
Ann Charlotte Svensson
Head of Group Communications
+46 8 463 32 55, +46 72 510 11 61
anncharlotte.svensson@catella.se