Press Release

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Catella: Real Estate Investments in Europe 2019 – Monetary Turnaround on the Move?

- Catella Research investigates the interaction between capital and real estate markets
- Concentration on attractive rental growth potentials falls short
- Higher rents can offset losses in value, but the challenge is greater in metropolises than in medium-sized cities

Frankfurt, 7.1.2019 – If interest rates are expected to rise in the euro zone, commercial real estate investments in medium-sized cities will be more robust against losses in value than corresponding investments in the major cities - and this despite the still existing growth potential in rents in the major cities. This is the conclusion reached by Catella Research in an analysis of the interaction between the capital market and the real estate market that sheds light on the effects on market values and compensation options via rents for 2019.

According to Catella Research, the major metropolises still show the greatest potential for rent increases until 2022. In a European comparison, Berlin leads the rental growth list for real estate investments in the office sector with a possible plus of around 20 percent compared to the current level. The analysts also see considerable upward scope for Paris La Défense (+15.5%), Munich (+15.3%), Stockholm (14.5%) and Frankfurt (13.5%). London is a special case. Here [in the context of the brexit] a negative growth of up to 3.2 percent is even possible in various sub-markets. In contrast, Catella expects rents in smaller and medium-sized cities to grow by less than ten percent.
"The higher expected rental dynamics in the larger metropolises - in addition to increased liquidity - usually lead to numerous fund concepts concentrating solely on the large cities," explains Maximilian Radert, responsible for product development and conception at Catella Real Estate AG. "However, this does not go far enough because it almost exclusively takes into account the conditions on the real estate market. The possible change in the interest rate level and thus the parameters of the capital market are largely ignored".

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The current historically low interest rates have led to a considerable inflow of funds into the real estate market and have driven prices to record levels, especially in large cities. As a result, net initial yields in German cities such as Berlin, Munich, Frankfurt and Hamburg are currently around three percent. On the other hand, the comparatively moderate price level in medium-sized cities to date has led to considerable mark-ups. Around four and a half percent, for example in Münster, Leipzig or Hanover, are no exception. In other European countries, too, significantly higher initial yields can be achieved in cities such as Aarhus (4.5%), Lille (4.75%), Rotterdam (5.05%) or Utrecht (5.75%).

Assuming an interest rate hike, Catella Research expects the capital to be reallocated in favour of fixed-interest investments, which can subsequently lead to an erosion of the market values of commercial real estate. In their study, the analysts assumed that government bond yields would rise by an average of 140 basis points by 2022. In this scenario, the experts expect that in many large cities losses in market value of more than 15 percent will have to be accepted. In order to compensate for such a slump through rent, however, a rent increase of up to 33 percent would have to be realized for a real estate investment in Berlin or Dublin, for example, which is to be seen as a challenge. On the other hand, for numerous medium-sized cities in the same scenario, there is compensation for the expected losses in market value even with an effective rent increase of slightly more than eight percent.
Dr. Thomas Beyerle. Head of Group Research at Catella on this effect: "The implementation of a real estate strategy geared to rent increases in the metropolises can only be implemented within the framework of an increased risk category of the fund strategy. In the case of real estate investments in medium-sized cities, real estate managers can already compensate for the price effect by achieving low rental growth rates."

As a result, the analysts at Catella Research come to the conclusion in their model calculation that losses in market value for properties with a net initial yield of 4.5 percent or more will be significantly less pronounced. This should make it much easier to compensate for these losses by increasing rents. Commercial real estate investments in medium-sized cities offer better protection against possible losses in value due to a turnaround in interest rates than in large cities - despite the rental dynamics still expected there.

The full analysis can be found at catella.com/research.

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