Catella Market View 2021 – bumpy road ahead

CATELLA

In 2021, the economy will bounce back as the further spread of the virus gets contained. Catella Research furthermore sees moderation of political risk as the global economy steadily recovers. The early phase of recovery will be characterised by continuation of accommodative monetary policy, abundance of liquidity and more expansionary fiscal measures. Commercial real estate will continue to benefit, in particularly assets in the dominant markets for investors, although the current year will be characterised by a slowdown in momentum on the rental markets as a whole. The individual asset classes are showing very different recovery dynamics.

Economic Outlook

The expected return of the USA to a calmer foreign and trade policy under President Biden, and an emerging abatement of the Corona pandemic in the coming spring, should ensure the global economy pick up in the course of 2021. The year of Covid-19 restrictions should be followed by a year of vaccinations, re-opening and economic recovery. Capital and CRE markets will be supported by continuation of a lax monetary policy combined with the expansionary fiscal policy at negative real yields. Nevertheless, a degree of uncertainty surrounding the economic outlook remains outstanding.

The situation with Covid-19 should noticeably ease towards the mid-year due to warmer weather and medical advances. In Q3, between two lockdowns, Eurozone managed to make most of lost ground from the second quarter of 2020. The next stage of the recovery is expected to be characterised by a rapid acceleration of GDP growth further supported by low inflation.

OPPORTUNITIES:

- Governments and central banks remain dovish and continue to support the recovery with all available tools at their disposal.
- Inflation is not expected to rise in the short term.
- Monetary and fiscal policy support, a greater availability of vaccines and medical news are supportive to rapid recovery from 2021 onwards.
- Earnings are expected to recover from their low point caused by a fall of corporate profitability in 2020, especially in sectors hit hard by Covid-19 such as energy, finance and leisure.
- Bond yields are set to remain low with a significant number in negative territory (currently more than €8 trillion bonds issued in the eurozone have a negative yield, of which €7 trillion are government issues and €1 trillion are corporate debt)
- From a multi-asset manager's perspective, equity and real estate investments remain preferred asset categories in view of capital pressures and low interest rates. We also expect a strong M&A activity which will be further fuelled by IPO's.

RISKS:

- Mutation risk: possibility of a more infectious, vaccine-resistant strain of virus.
- Tapering monetary and fiscal stimulus measures too soon.
- Inflation acceleration: While the consensus view allocates only a minor probability on inflation acceleration, a stronger than expected global recovery might create upwards inflationary pressures.
- Rising insolvencies and default rates increase risks for the CRE markets.
- The fundamental negation of ESG requirements on the part of the capital markets will have negative consequences for individual market participants in the medium term.
- Risks of a double-dip recession due to extended lockdowns increase. Forecasts for the first quarter of 2021 have already deteriorated.

REAL ESTATE:
Investors are still sitting on a high amount of liquidity at negative real interest rates

2021 will be a challenging year for CRE, particularly since effects of Covid-19 are going to be increasingly felt as the government stimulus begins to taper off. Although a lax monetary policy and government stimulus are supportive, many landlords will face challenges as relative to the economic cycle, tenant demand is a lagging indicator. Therefore, tenants' capacity to expand business activity and to take up new space is very limited, while at the same time the risk of rent paying delinquencies increases. Nevertheless, economic recovery will be gaining momentum and those bottlenecks are expected to be only of temporary nature.
We expect that investment portfolio demand for CRE assets will remain strong which in turn will continue to support pricing of CRE assets.

- The 2020 European CRE Investment volumes are expected to be 20-30% down.
- The decline in investment was not driven as much by decline of investors' interest as it was by constrained supply.
- The uncertainty triggered by Covid-19 resulted in a change in investor preferences.
- The outbreak of Covid-19 has elevated investors risk aversion which shifted investors' attention further toward core CRE assets and public properties. We expect supply in these areas to remain constrained.
- In short run, investment flows into CRE will remain under pressure due to supply constraints which weaken market activity.
- Real estate debt market also becoming more attractive to investors.
- Sector and geographic divergence remain wide:
  We expect that by the end of 2022, investor demand will normalize, but also that for time being core assets will remain to be preferred. For investors able to tolerate risk value add, retail and hospitality sectors will offer some great discounts.
- The rental markets of the various asset classes largely oscillate between stagnation and decline - with the exception of logistics & residential.

CATELLA

MARKETS

Office:
Still the largest asset class in Europe among investors. The reintroduction of the lockdown has impacted leasing activity, which is now expected to partially recover in H2 2021. Vacancies are expected to increase moderately but the increase of vacancies is greatly contained as supply of new space in majority of key market is miniscule. Landlords are likely to increase their perks to tenants via offering various modes of refurbishment combined with some added rent-free periods, thus no strong relocation behaviour expected. Coworking strategies of corporates will weigh on overall rental growth prospects.

Retail:
Major market adjustments are expected, both structurally and from current valuation levels perspective. In H2 certain segments of retail market could partially benefit from the pent-up demand but which still need to come a long way in terms of repricing and eradicating excess supply. Nevertheless, the food retail segment is proving to be largely resistant to the crisis, (early) refurbishment activities in the shopping centre segment can basically provide momentum, although valuation levels are coming under pressure.

Logistics:
Strong investor demand should continue with unbroken market dynamics and the expectation of further price increases. A strong occupier demand is also expected to continue as the sector benefits from increasing online sales, despite uncertainty in production and the automotive segment. Especially last mile logistic in demand, whereas only a limited number of properties are available.

Hotel:
European hotel market - this affects all segments - is hit hard by the pandemic and remains under pressure. The recovery will vary on vaccine progress while the high vacancy rates are putting pressure on the cash flow of many operators and owners.

Alternative properties:
The overall high allocation to real estate will continue to drive demand for specialist properties in 2021. We observe increasing demand for data centres, benefitting from the widespread switch to digital. Possible value declines in the leisure and entertainment sector offer investment opportunities, while we see high demand with low supply in parking garages.

Residential (overall):
"Rise of resi" will continue to progress, although available objects are increasingly limited. Overall, an investment market for long-term investors with a clear focus on conurbations. Relative dynamism can be observed on the suburban fringes of the cities. Further yield compression and high demand for core assets expected. New players are entering the market, focusing on more defensive risk averse strategies due to high uncertainty, but there is a trend of investors to buy with less securities/guarantees, too.

Student Housing:
Might pick up in transactions a bit this year since performance was quite good in 2020 in most of the European countries (except the UK, lots of market participants are in troubled waters), but still an asset class that is partially dependent on mobility (int. students).

Serviced Apartments:
Overall challenging situation due to current restrictions, business travel may not bounce back to 2019 levels in the upcoming years. Classifying as Opportunity market.

Senior Living/Health Care:
A still very fragmented and segmented market, although overall growth prospects are excellent. Positive growth outlook for that niche in transaction volume in Europe, yield compression/high demand for core assets/new players entering the market.

Developer (overall):
Overall positive situation, construction industry remains very resilient to the crisis. But the tension between high land prices, increasing regulations (rent caps, densification) and connections to mobility infrastructure is rising. Neighbourhood developments with a stronger mix of use to be expected. New construction sites are still rare, especially in the vicinity of metropolitan areas. We continue to see the greatest demand for logistics and residential space.

About Catella
Catella is a leading specialist in property investments and fund management, with operations in 14 countries. The group has assets under management of approximately EUR 14 billion. Catella is listed on Nasdaq Stockholm in the Mid Cap segment.

Read more online at catella.com

Contact:

Prof. Dr. Thomas Beyerle
thomas.beyerle@catella.de
+49 30 310 193-220

Alex Milojevic
alex.milojevic@catella-investment.com
+49 89 189 16 65-251

Carsten Lieser
carsten.lieser@catella.de
+49 30 310193-242

Ulrike Hagendorf
ulrike.hagendorf@catella-residential.com
+49 30 887 285 29-27