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MARKET TRACKER THIRD QUARTER 2019

Strategic Real Estate Asset Allocation 2019

What investors want

In retrospect, the 2019 real estate year will go down in history as the era in which value-add investment strategies replaced conventional core investment styles in structural terms. "In structural terms", because there are no signs whatsoever of any significant change in the interest rate landscape. Changes are also emerging at macroeconomic level: it is becoming increasingly obvious that conventional property selection, when applied to selected markets using a top-down approach, is becoming more and more challenging to implement. Current trade activity on the market clearly shows that the majority of investments are being made primarily on a deal-by-deal basis.

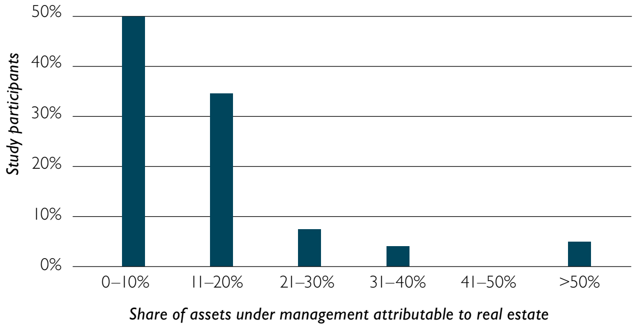
This background situation has promoted a renewed evaluation of investor behaviour at the mid-point of 2019. Our survey relates to a possible turnaround for the real estate asset class as a result of a more prolonged period characterised by a zero interest rate environment. The evaluation allowed for a more in-depth analysis of the current and expected allocation ratios in real estate against the backdrop of the unchanged capital market environment. Or to put it more simply: it documents what investors want and what tactical and strategic action they are taking.

Methodology

The participants in this survey comprise the top 20 players in the various categories of multi-asset investor types in Germany (banks, insurance companies, investment/asset managers, funds, etc.). The population consisted of 240 companies (hereinafter N=240). Of the investors we wrote to, 64 took part in the survey, which equates to a response rate of 26.67%. The encouraging response rate clearly shows that the issues raised are evidently a pressing concern of many of the participants and once again put the question of interest rate policy into the spotlight given the imminent staff changes within the ECB Executive Board in October 2019.

Results of the 2019 survey

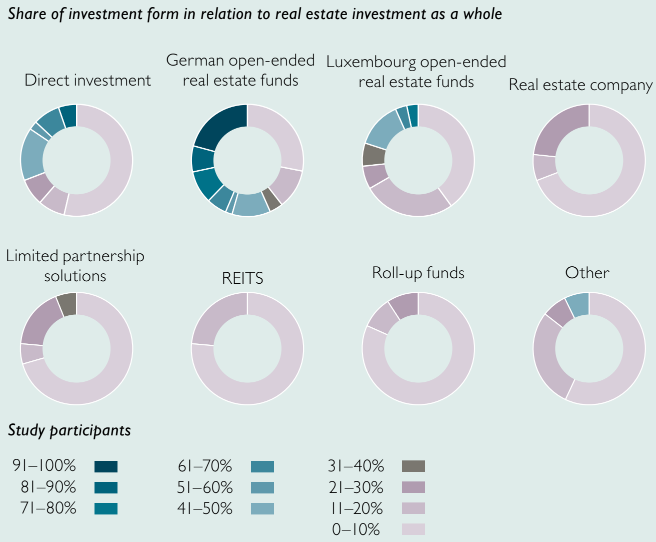
FIG. 1: SHARE OF ASSETS UNDER MANAGEMENT ATTRIBUTABLE TO REAL ESTATE



Source: Catella Research 2019

Exactly half of the participants assign up to 10% of AuM (assets under management) to the real estate category. This result corresponds perfectly to the average real estate ratio of 9.8% in Germany reported by the multi-asset managers surveyed. The survey responses also document a slight upward trend moving towards the target corridor of 11–13% (real estate ratio).

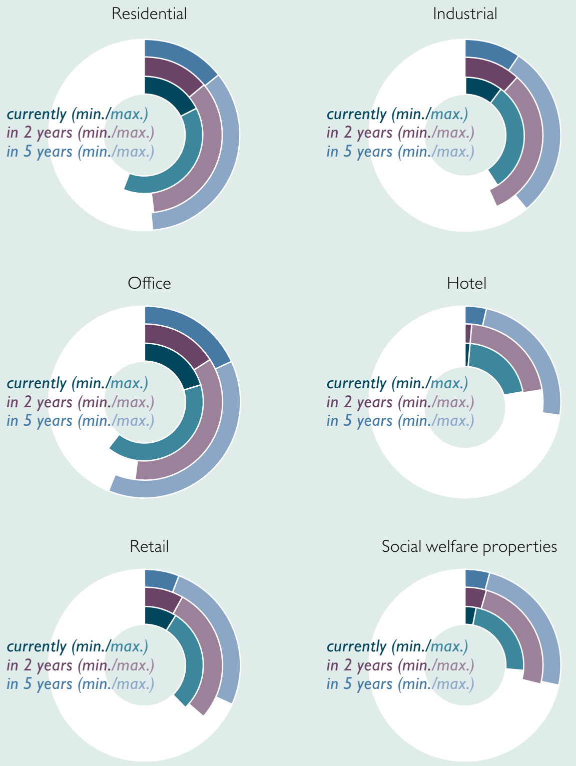
FIG. 2: SHARE OF REAL ESTATE INVESTMENTS ATTRIBUTABLE TO INDIVIDUAL INVESTMENT FORMS



Source: Catella Research 2019

As far as the forms of investment are concerned, it is evident that German open-ended real estate funds account for the largest share. This evaluation reflects the strong investment behaviour among this group of investors over the last 15 months. Some participants have even invested the entire "real estate" portion of their investment in this form of investment. Direct investments come in in second place, closely followed by the Luxembourg open-ended real estate funds. Real estate companies and limited partnership solutions are placed in the middle of the rankings, with REITS and roll-up funds finishing bottom of the table.

FIG. 3: INVESTMENT ACTIVITY IN SELECTED REAL ESTATE SEGMENTS (SHORT, MEDIUM AND LONG TERM)
in %

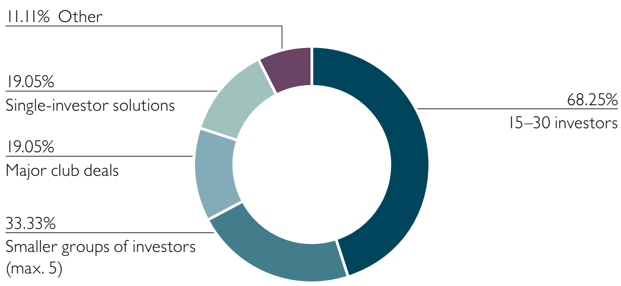


Source: Catella Research 2019

Looking ahead to the next 5 years, it is interesting to see which segments will take priority for the purposes of strategic real estate allocation. The Office asset class remains the most popular although tactical aspects are also at play here: whereas an average of 30% is currently invested in this segment, participants plan to invest around 4% less in office properties in 2 years' time. This share is, however, expected to increase again slightly in the long run.

Residential properties rank second in the popularity stakes, with around 27% currently invested in this asset class. This figure is expected to have dipped slightly, by 2.5%, in 2 to 5 years' time. In the survey we conducted in 2018, the participants at the time took a similar view of the situation regarding these two asset classes. The first signs of this approach actually being implemented on the market are, however, now starting to come to the fore. The Industrial asset class shows a minor fluctuation which is expected to reach its peak 2 years from now. What is also striking is that, according to this evaluation, the Retail segment is expected to show an ongoing decline, falling by approx. 3% in 5 years' time. By contrast, investments in hotel properties are expected to benefit from a boost of 3% in the long term. These results are also consistent with last year's survey. The participants have indicated that social welfare properties could also play more of a role in the future.

FIG. 4: PREFERRED INVESTOR STRUCTURES

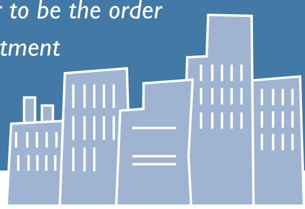


Source: Catella Research 2019

The "15–30 investors" size category dominates with a share of 68.25%, followed by "smaller groups of investors (max. 5)", which account for 33.33%. "Major club deals and single-investor solutions" both make up a share of 19.05% of the preferred structures. The "other" category includes (open-ended) real estate funds, real estate stocks, Swiss investment foundations and REITS.

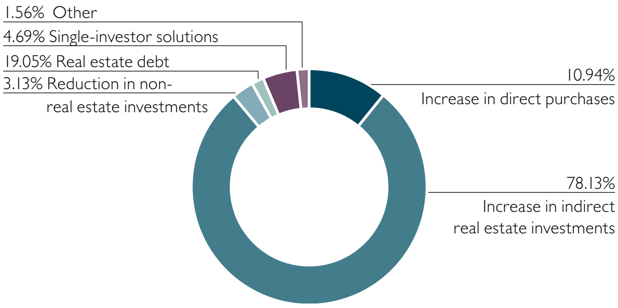
The Office asset class remains the most popular real estate segment. Nevertheless, the asset managers surveyed expect the share attributable to this segment to decline slightly in the near future. Investors are making their intentions in the Retail segment clear: divestment would appear to be the order of the day as far as investment behaviour is concerned.

See Figure 3



Source: Catella Research 2019

FIG. 5: TOOLS TO INCREASE THE PROPORTION OF REAL ESTATE IN ASSET ALLOCATION

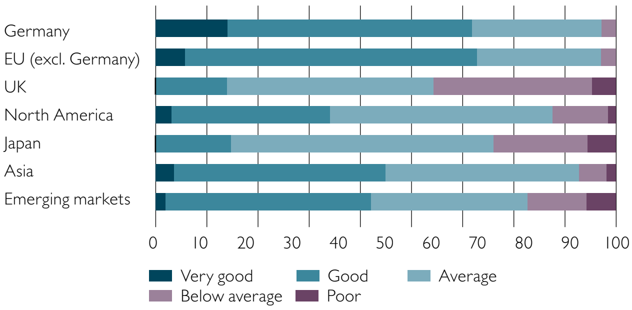


Source: Catella Research 2019

In order to increase the proportion of real estate in asset allocation, more than three-quarters of the participants refer to the strategy of increasing their indirect real estate investments. The group favouring an increase in direct purchases comes in second, albeit with a large gap, at 10.94%. Single-investor solutions, a reduction in non-real estate investments and real estate debt come in at the bottom of the rankings, each accounting for less than 5%. Only 1.56% of the respondents included in the "Other" category said that they were not aiming to increase the proportion of real estate.

FIG. 6: ASSESSMENT OF INVESTMENT OUTLOOK BY REGION IN 2019/2020

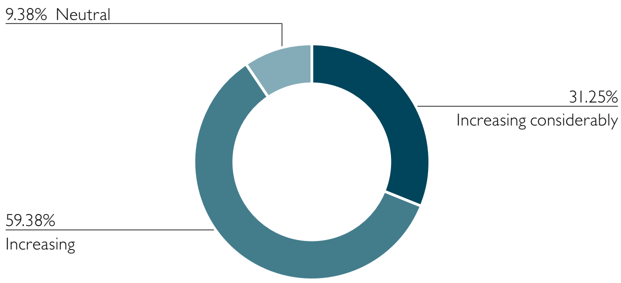
in %



Source: Catella Research 2019

As far as investment outlook for the coming year by region is concerned, Germany is considered the most promising among the selected markets. This market is considered "very good" by 15.63% of the survey participants, "good" by 53.13%, "average" by 28.13% and "below average" by only 3.13%. The values for the EU (excluding Germany) are similar, although only 6.35% of the respondents rate the investment outlook as "very good". North America and Asia also fare relatively well in the responses, with 3.45% and 4% respectively describing the outlook as "very good" and 34.48% and 46% respectively describing it as "good". These figures are also almost identical for the emerging markets, except that 6.38% of respondents rated the investment outlook as "poor". The UK and Japan are considered to have the least positive outlook. No participants describe the situation as "very good", with 34.48% and 20.41% respectively opting for the "below-average" category, while 5.17% and 6.38% respectively describe the outlook as "poor".

FIG. 7: IMPORTANCE OF ESG CRITERIA IN FUTURE REAL ESTATE INVESTMENTS



Source: Catella Research 2019

Finally, given the rising popularity of the topic of sustainability, it is important to analyse how important this aspect will be in strategic real estate investment in the future. Most of the respondents have indicated that the importance of this issue will increase over the next few years (59.38%). 31.25% have even gone as far as to say that they firmly believe that the importance of this issue will increase considerably in the future. 9.38% assessed the importance of sustainability as neutral. The fact that none of the respondents selected the "decreasing" or "decreasing considerably" categories is, however, worthy of mention.

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Summary and recommended action

2019 will pose particular challenges for real estate players – be it single-asset or multi-asset investors. In general, the portfolio allocations/targets are still consistent with the target values traditionally pursued in the market. The firm belief that real estate investments form the backbone of a multi-asset investment approach also remains unshakable. The reasons traditionally associated with this belief continue to apply: relatively stable income flows, low correlations with other asset classes and diversification advantages.

In the section below, we would like to summarise a few other qualitative results of the survey, because the tactical information revealed by the survey also points to aspects reflecting the challenges on the current price front for real estate:

- Investors are becoming increasingly inclined to pursue a more selective investment approach.
- Overall, the coming quarters are expected to bring fewer transactions, but transactions with a higher lot size.
- In the target markets, the majority of the properties available appear to be "too expensive" overall.
- Alternative strategies are directed primarily at the value-add segment, as long as the risks involved are considered to be manageable.
- From a global perspective, the US market is considered to offer the largest performance contribution, followed by Europe and Asia.
- The bottom line is that the investors surveyed are willing to take more of a risk in the hope of achieving higher returns, but that they want to do so using strategies that aim to achieve this using a combination of conservative underwriting, LTVs in line with market conditions and clear transaction security.
- Last but not least: there would appear to have been a move away from traditional investment attitudes. It is becoming increasingly obvious to us that conventional property selection, when applied to selected markets using a top-down approach, is becoming more and more challenging to implement. Investors have started adopting a deal-by-deal process. Bottom-up research, on the other hand, is experiencing a renaissance and is being used extensively in the transaction process.

The results of our survey at the mid-point of 2019 indicate the measures that multi-asset/real estate investors are expected to take in the coming months and quarters. Calling these into question on a regular basis, and adjusting them if necessary, is the responsibility of strategic portfolio management in investment management. Investments on the one hand are countered by portfolio adjustments on the other. This means that in this market phase, it is becoming increasingly difficult to differentiate between operational moves and strategic ones. And that's not all: a whole number of portfolio transactions executed in recent months show a location/property structure that is more diverse.

Taking these results as a basis, the operational recommendations for investors in the coming quarters can be summarised as follows:

- Urbanity is preferable to short-term returns outside of the major metropolitan areas
- Winning regions represent a sustainable increase in performance
- Safety first – stable earnings even in the event of rising interest rates in locations that currently offer good investment potential
- Long-term value preservation and, as a result, future viability thanks to sustainability in investments
- Active real estate management increases the value of existing properties with solid fundamentals

About CATELLA
Catella is a leading specialist in property investments and fund management, with operations in 15 countries. The Group manages assets of approximately EUR 20 billion. Catella is listed on Nasdaq Stockholm in the Mid Cap segment. More at catella.com.

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