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The property market stands at a crossroad where the trajectory of long-term real interest rates is the decisive factor

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Transactions amounting to SEK 11.3 billion took place in March, compared to SEK 11.8 billion and SEK 15.0 billion during the same months in 2019 and 2020. The rolling 12-month transaction volume ended up at SEK 160.0 billion, slightly down from SEK 163.8 billion in February.

The number of deals exceeding SEK 80 million ended up at 28 deals in March, above the 12 and 23 deals that took place in January and February respectively. The rolling 12-month number of transactions remains stable at 369 deals, which is well in line with the long-term average. The single largest deal in March was Skanska and Fabege's joint acquisition of 150,000 sq. m. land in Solna for SEK 2 billion from the municipality of Solna, where they will develop residential buildings and offices. The second largest deal was Skanska's SEK 1.5 billion acquisition of 41,000 sq. m. building rights regarding residential, school, office and retail/service premises on Kungsholmen in central Stockholm from Region Stockholm (the S:t Erik hospital). There was a number of large public property deals too during March. Genova acquired four public properties located in the Stockholm region from Profi for SEK 970 billion. In addition, SBB acquired a centrally located public property in Uppsala from SPP (with criminal justice system tenants).

The investor demand on the property transaction market remains strong. Especially institutions and funds/asset managers (loaded with international institutional capital) are strong buyers. The institutional investors have been net-acquiring SEK 22 billion on the Swedish property market over the last 12 months, while funds have net-acquired SEK 19 billion. The listed property companies are not net-buyers as a group. In fact, they have hovered around the zero mark during the last 12 months. Although the listed companies focusing on residential and public properties remain strong net-buyers, the net-acquisitions by these companies are being cancelled-out by net-selling by companies focusing on the office and retail segments. The transaction market activity is overall very focused on the residential, logistics/industrial and public property segments. Transaction volumes have been especially strong within the residential and logistics/industrial segments over the last 12 months.

The rolling 12-month transaction volume of residential rental properties was rather stable and fluctuated within the interval SEK 32–44 billion from 2014 until early-2020. From mid-2020, however, the volume broke upwards and reached an all-time high of SEK 57.5 billion in January 2021 (it fell back slightly to SEK 55.5 billion in March). The number of residential deals has remained rather stable since 2014 (the rolling 12-month number of deals has fluctuated between 90–125 deals and currently stands at the high end of the interval). The increasing transaction volume is due to larger average deal sizes. The average deal size has increased to an all-time high of SEK 454 million for the preceding 12 months to February 2021 (it fell back somewhat in March). This can be compared to the average deal size during 2012–2019 of SEK 314 million. There has been a clear focus among investors to build volume, and large deals have generally been prioritized. Residential property prices have also increased significantly as a result. Property yields have plunged all over the market both for old and new stock. A trend that has been stronger the further out on the risk scale you get (in smaller cities and more secondary locations in the major cities).

Also, the transaction volume for logistics/industrial properties has increased significantly recently. The rolling 12-month volumes fluctuated with the interval SEK 5–20 billion during the period 2010–2018, it increased to SEK 29.2 billion in 2019 and then hit fresh new peak of 36.4 billion in February 2021. The rolling 12-month volume for March remains at historically high at SEK 34.9 billion. Within the logistics/industrial segment, the increasing transaction volumes are due to a combination of a larger number of deals and increasing average deal sizes. The rolling 12-month number of deals within the segment fluctuated within the interval 30–40 deals from 2010 until early-2017, in mid-2017 the trend broke upwards and hit an all-time high of 65 deals in the preceding 12 months to March 2021. During that period, the average deals size also increased to an all-time high of SEK 596 million in February 2021 (it fell back somewhat in March). The market is driven by investors with a clear focus on building volume and Blackstone stands for the major share of these investments.

Although the investor demand is strong, public properties have not seen the same increasing transaction volumes as residential and logistics/industrial properties during the last 12 months. Instead, the rolling 12-month ▶

transaction volume has followed a declining trend since 2013, with high volatility and gradually lower peaks (the segment hit volume peaks of around SEK 20 billion in 2013 and 2015 but has remained at or below SEK 15 billion since 2017). Simultaneously the rolling 12-month number of deals has followed an increasing trend from around 25 deals in 2013 to around 40 deals during the recent years. The low transaction volume is mainly due to a trend of gradually declining average deals sizes, which has gone from an average of SEK 413 million during 2012–2017 to an average of SEK 317 million since 2018. There is a clear lack of assets on the market and it is hard for investors to build volume within the segment. Many investors are focusing on new production and project development to increase their public property exposure.

When it comes to office properties, there has been an astonishing decline in transaction volumes over the last 12 months. The rolling 12-month volume has declined from around SEK 40 billion in early 2020 to around SEK 15 billion in March 2021. However, the rolling 12-month number of deals has remained relatively stable. There was a lack of office assets on the market before the coronavirus pandemic erupted, and the 12-month number of deals has been stuck at the historically low level of around 40 deals per year since early 2018. Despite this, there was a trend of increasing office transaction volumes from mid-2009 until early-2020 almost entirely driven by increasing average deals sizes. The average deal size peaked in March 2020 at around SEK 1.1 billion, and has since slumped to around SEK 400 million in March 2021. Investors are generally concerned about whether or not we stand in front of a structural shift on the office market with more work-from-home going forward. Property owners are also unwilling to sell in the current market climate, and there are no forced sellers as financing costs are low and vacancies have not increased too much yet. One way of getting a picture of where office yields are heading is by looking at implicit property yields based on the equity market pricing of the listed property companies (the implicit yields tend to be two or three quarters ahead of the direct property market). There is currently a significant pressure upwards on office yields in prime locations in the major cities (especially in Stockholm). Simultaneously, there is a slight pressure downwards at yields in secondary locations in the major cities and in smaller cities (these locations may have more in common with the mix commercial/industrial segments than the prime office locations).

The listed property companies have lagged behind the broad equity market performance so far in 2021. While the price index for OMX Stockholm 30 increased by almost 19 per cent since January 1st, the average price development for 39 listed Swedish property companies' shares has increased by mealy 2 per cent. The companies with a logistics/industrial and mix commercial property focus have had a more positive development, but these company groups are still up only 5.3 and 6.6 per cent respectively in average (well below the broad equity market). The companies with a residential and public property focus are up only 0.5 per cent, while the companies with office and retail focus are down 2.3 per cent. Although the development for the office and retail companies are down for the whole year, they have followed a positive trend since late February. The rental incomes for these companies have a stronger correlation to the GDP growth than other companies (especially the residential and logistics/industrial companies). It is not unlikely that an upswing in economic growth during coming quarters will push equity prices for these companies further upwards during the rest of the spring.

The main reason behind the weak equity market development for the property companies is the turnaround on the global bond markets that appeared in late January. The consensus macro view has shifted forcefully during recent months towards a massive rebound in global growth in the second half of 2021, driven by the US economy. Not only has President Biden's stimulus package of USD 1.9 trillion (around 9 per cent of GDP) been put into action, the next step is a USD 2 trillion infrastructure investment plan that will be implemented over the coming eight years (which is partly to be financed by higher taxes though). The US government increased its debt by USD 5.8 trillion in 2020 (28 per cent of GDP) and ran a budget deficit of over 15 per cent of GDP. Simultaneously the Fed flushed the market with liquidity, buying USD 120 billion of securities a month (around 7 per cent of GDP). The Fed increased its balance sheet by around USD 3.2 trillion in 2020, which represents around 55 per cent of the government debt increase. In Sweden, the fiscal response has been much more moderate. Government debt increased by around SEK 73 billion or around 2 per cent of GDP in 2020. However, the Riksbank acquired around SEK 72 billion during last year, amounting to almost the entire debt increase. So, even if the Swedish government debt has increased at a much more moderate pace, the central bank has swept up a larger part of the debt increase than in the USA. When governments emit massive amounts of debt simultaneously as the central banks mop up this amount of bonds, it comes very close to actual monetarisation of debt. History has taught us that this is very inflationary.

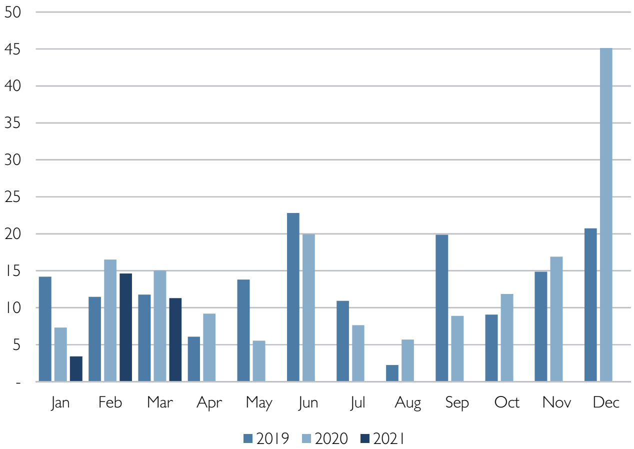
The result of the massive fiscal and monetary stimuli has been higher interest rates, both nominal and real. The Swedish 5-year swap rate has gone from 0.08 per cent in late January to 0.30 per cent now. In the USA, the 10-year government bond yield has moved from below 1 per cent in early January to 1.66 per cent now. Also, the long-term real interest rates have increased. This is partly due to higher inflation expectations, the US 10-year break even inflation has increased by over 120 basis points since April 2020 to 2.40 per cent. The nominal interest rates increase is, however, also due to higher real interest rates. The 30-year US inflation linked bond yield has increased from about -0.39 per cent in early January to around 0.10 per cent now. This increase of almost 50 basis points will be a real ▶

game change for the property market if it is sustained.

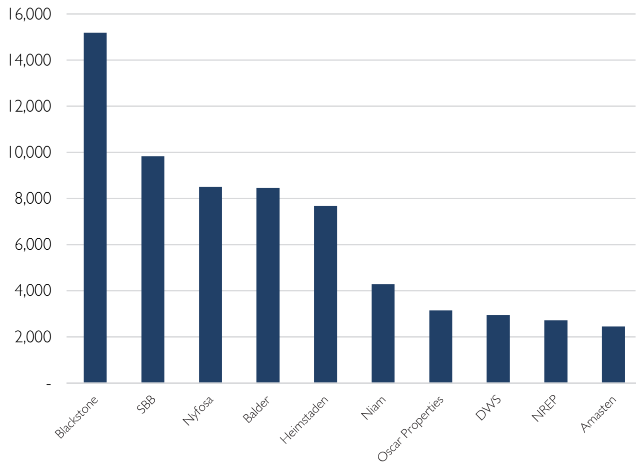
Residential, logistics/industrial and public properties are quite effective inflation hedges and can cope with higher nominal interest rates relatively well – as long as the higher interest rates are due to higher inflation – as the rental incomes within these property segments tend to follow inflation. Increasing real interest rates are, however, not positive for these segments at all as it leads to higher financing costs that are not compensated for by higher rental incomes. Prime office rents, on the other hand, tend to follow GDP growth quite well. If we have a healthy economic recovery where stronger long-term economic growth drives up the real interest rate, prime offices can still manage quite well as they get compensated through stronger rental growth. The development for the listed property companies are a good leading indicator of the direct property market, two or three quarters ahead. Investors on the equity market are concerned about the increasing real interest rates.

If real interest rates keep on increasing during coming weeks and months, this will trickle down to the property transaction market. It is quite likely, however, that the bond yields will fall back again during coming weeks or months if the higher interest rates start to bite too much on asset prices (and the central banks are forced to step up their stimulus efforts). Instead, we may see a gradual shift towards higher nominal interest rates driven by higher inflation – a scenario that is not too bad for property. ■

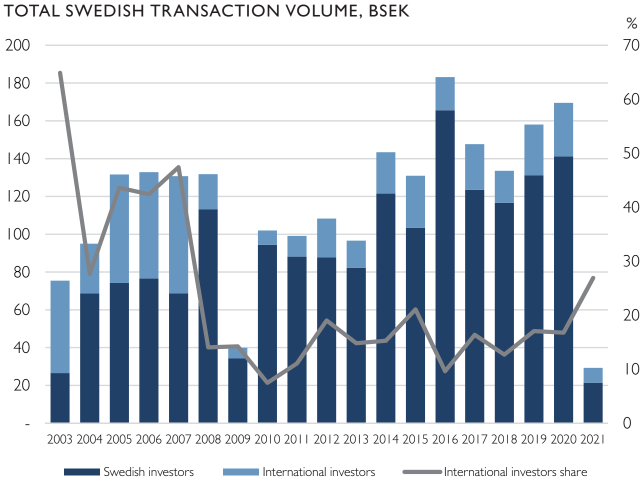
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTH VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION