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Growing financial anxiety will have an impact on the property market

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Activity on the transaction market in November was low with a transaction volume of approximately SEK 5 billion, compared with SEK 12 billion in November 2017 and SEK 26.5 billion in November 2016.

Transaction activity has slowed down considerably during the autumn, and investors have become increasingly selective with regard to the location and quality of the properties. An important change to the dynamics in the past year is that Swedish institutions have gone from being net buyers to net sellers, and they are mainly selling office properties in good locations in Stockholm. The timing to sell is good as demand for this type of object has gone from high to extremely high in recent months. International investment managers are leading the bidding rounds, but Swedish private and listed actors are also staying competitive. The demand for office properties is strengthened by the notion, promoted by the media, that there is a shortage in offices in Stockholm and that the rental market has more to give in the coming years.

However, opinions differ on this matter. First of all, there is an ongoing trend of making more efficient use of existing office premises, meaning that the supply is constantly increasing within the existing stock. In addition, we are entering a phase where the supply and demand balance in the Stockholm market is rapidly changing. There has been a noticeable rise in the number of new constructions in recent years, and these are now being finalized (new construction of office properties will increase from approximately 75,000 sq.m. per year over the past five years to approximately 175,000 sq.m. in 2018–2021). At the same time, unemployment among people with higher education is at a record low, and population growth within the working population with relevant education is weak (i.e. people who are intended to work in the new offices). Moreover, the economy is becoming weaker, both domestically and globally. Catella's assessment is that the growth of office-based employment will fall from approximately 8,000–10,000 jobs per year in recent years to approximately 4,000 jobs per year in 2018–2021. At the same time, a growing number of co-working actors have gained a larger share of the take-up (total office leases) in recent years, which has had an impact on office rents. Tenants are demanding increasingly more flexibility in their office use, and many of the co-working actors have business models that make them well-equipped to meet this demand going forward. However, the development and growth in this segment has been rapid and competition is very tough. The market rent levels in Stockholm's office market have exceeded underlying fundamentals, and the risk for a correction in the market has increased. Catella has forecast more or less zero growth in market rents in Stockholm CBD in the coming years, as the underlying macroeconomic fundamentals need time to catch up with the current market rent. However, the effect will become the most apparent outside the most attractive sub-markets, where vacancies are at risk of increasing and where rental growth will be slow for the foreseeable future.

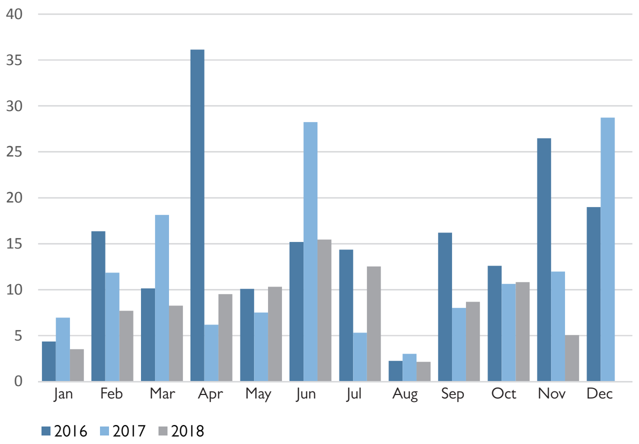
The development on the property market mirrors the development on the stock market, lagging approximately 12–18 months behind the stock market. The global stock markets are now likely facing an extended bear market (this does not, however, necessarily imply a market crash) as the Fed's previous tightening of its monetary policy is starting to take effect at the same time as the positive effects of the Trump administration's tax cuts and the global economic growth are becoming weaker. An important change that has taken place in 2018 on the S&P 500 is that the strategy of "buying the dip" (i.e. buying after a marker correction) no longer works. In 2003–2017 was a profitable strategy to always buy stocks directly after a period of negative development on the stock market. The average daily returns on S&P 500 during the days when the previous week return was negative were in the interval of 4–18 per cent in the years 2003–2017. In 2018, this average daily return has been negative, which has not happened since 2002. In fact, this return has only been negative during years with an ongoing or impending bear market. The market is now turning to the strategy of "selling the highs" (i.e. selling when the stock market has gone up), which completely changes the market dynamics and leads to gradually lower ▶

highs and lows. The development on the American stock market will probably affect the Swedish property market in the future.

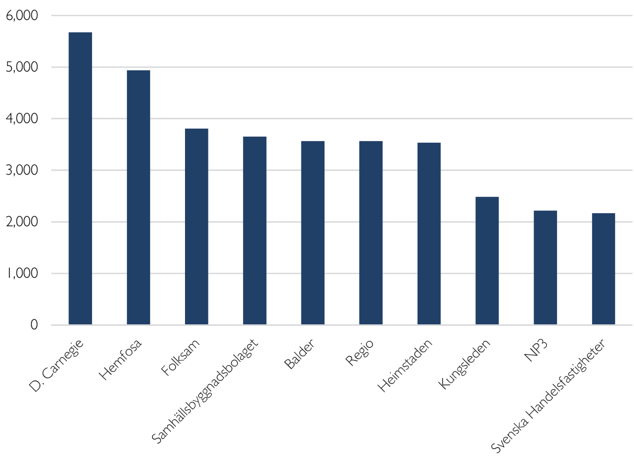
In recent weeks, investors have become increasingly more sceptical of high-risk corporate bonds and have sold ETFs that track the high-yield bond market in the US, while the cost of insurance against defaults has increased. Both high-yield and investment-grade credit default swap indices have in recent weeks risen to their highest point since late-2016. There are now signs that this has affected the market for Swedish corporate bonds, where interest rate margins have risen in a number of large issues over the past weeks.

Taken as a whole, the financial markets are showing several signs of weakness. Consequently, the market has become increasingly more doubtful with regard to how much the large central banks (in particular the Fed and the ECB) will actually tighten their policies going forward. There is a belief that, after all, capital will continue to be fairly affordable in the future. However, we will probably have to assume that the direction for the Swedish property market will be a combination of weaker economic growth, gradually higher interest rates and reduced asset purchases from the large central banks. For property investors, this means slightly higher interest rates and probably a wider gap in interest rate margins between companies with different credit ratings. However, the weak economic growth will probably entail continued low interest rates for an extended period of time, which creates a relatively high floor for property prices. Well-consolidated investors with good access to credit and good knowledge of properties are likely to be able to find good investment opportunities on the Swedish property market in the years to come. ■

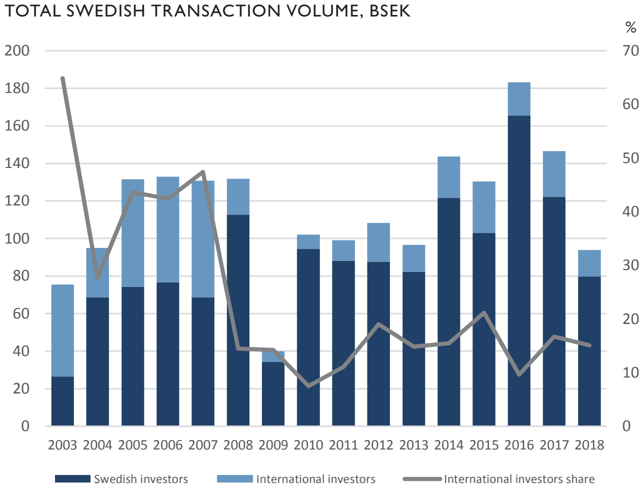
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION