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# Signs of rotation between the property segments due to new vaccines introduction

ARVID LINDQVIST
Head of Research

arvid.lindqvist@catella.se

The transaction activity in November was strong and in total transactions amounting to SEK 15.2 billion took place during the month. This can be compared to SEK 7.6 billion and approximately SEK 14.9 billion during the same month in 2018 and 2019.

Activity has also been strong during the first days of December with several large deals, hinting of a strong end of the transaction year 2020. There were 33 deals exceeding SEK 80 million during the month, which can be compared to 28 and 32 transactions during the same month in 2018 and 2019. The rolling 12-months transaction volume was around SEK 134.6 billion and the rolling 12-month number of deals remains just below 300 deals (both figures are well in line with the previous month). This is well below the interval of 330–400 deals that the market has normally fluctuated within during the last 15 years up until mid-2019. The largest transaction during the month was SBB's acquisition of Sveafastigheter Bostad, including a residential property portfolio. In addition, Willhem acquired 405 residential rental apartments in central Malmö from a private property owner. Another large deal during November was SBB's acquisition of a residential and public property portfolio including 766 rental apartments and 126 care apartments in Skellefteå from the municipal property company Skebo for SEK 1.3 billion.

The property market is currently in an interesting and unusual macroeconomic position. Up until November the financial markets have been driven by fiscal and monetary stimuli, while the underlying economic fundamentals have been weak and unsecure. Both short- and long-term interest rates were low already before the coronavirus pandemic erupted. As a result, the major central banks were not able to lower their policy interest rates very much as a response to the economic slump, and thereby stimulate increasing investment activity (as they should according to the textbooks). The only option left was to push investors further out on the risk scale by acquiring both low and higher risk bonds. This was, however, not close to enough counter the magnitude of this crisis. The solution was central bank stimuli combined with extremely expansive fiscal expansion. This was very potent medicine as it in effect was traditional monetarisation of public debt. Governments distributed newly printed money directly to consumers, something that has occurred countless times throughout the centuries (usually by kings/leaders to finance wars) and is something that usually end up in soaring inflation. The property market has benefitted heavily from these policies. Properties in general have stable cash flows over time and (in relation to the bond market) very attractive yield levels (mainly because it is an illiquid asset type in comparison). These are attributes that have been highly appreciated by investors in the current macro environment with an abundance of cash.

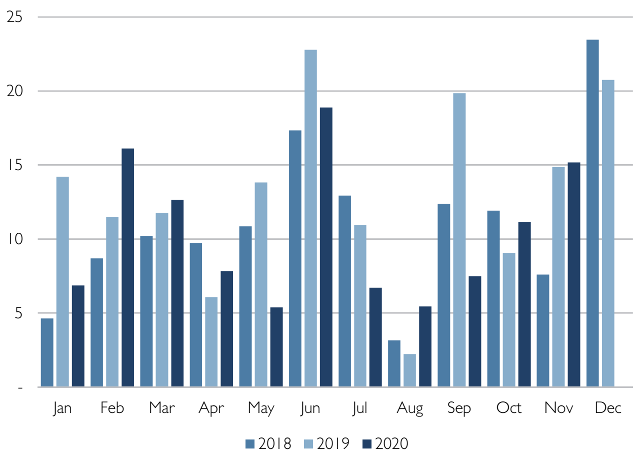
The problem with the policy response to the crisis is that it does not stimulate investments in effective and productive projects that enhance long-term economic growth. Instead it mainly stimulates consumption and interfere with the financial markets' ability to price and assess risk (the central banks are artificially pulling down credit spreads on relatively high-risk bonds). In addition, the low interest rates are destroying the natural process of creative destruction in the economy. In normal circumstances, companies that produce old and/or obsolete products should vanish from the market and free up production resources to better suited companies that produce better products in a more efficient way. When this creative destruction process in put out of order, more and more zombie companies are emerging (companies that barely can cover their interest payments with their free cash flow). In fact, there are currently a few property companies in Europe, mainly with a focus on retail and shopping centres that are at risk of ending up as living dead in a not too distant future. This process is hampering economic growth (and thereby real inters rates) and is pulling down inflation rates because the zombies are flooding the market with unwanted goods at discounted prices. Central banks are countering the low inflation with more monetary stimuli, which in turn is pushing down nominal interest rates even further. At this point the process enters a self-enforcing downward spiral. As a result of this, more and more debt is needed to keep up economic growth at reasonable levels. Central banks need to closely watch the financial markets and quickly respond to any setback (as the economy could easily slip down into recession if asset prices would decline too much). Investors are starting to anticipate these central banks' puts and correspondingly increase their risk taking. The Institute of International Finance did recently warn of a coming "debt tsunami" hitting the global economy. The total level of global debt has increased by USD 15 trillion this year, leaving it on track to exceed USD 277 trillion in 2020. This represents an increase from 320 per cent of the global economy in 2019 to 365 per cent in 2020.

New vaccines are now well on their way and several countries will start their vaccination process within days or weeks. The consensus short-term macro view is a relatively sharp drop in economic growth during Q4 and Q1, followed by a strong recovery phase ▶

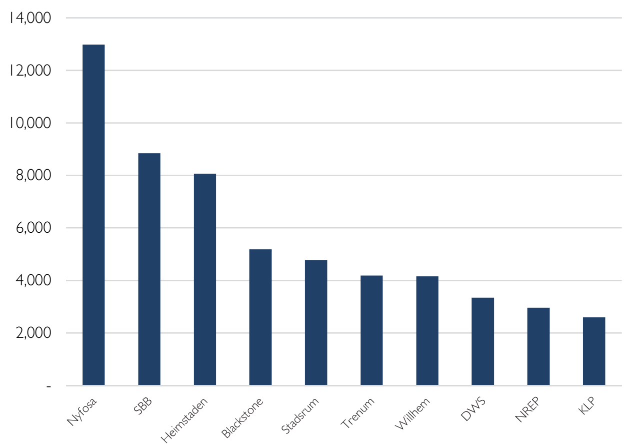
from spring 2021 and onwards. This recovery is driven by a large pend-up demand as consumers in both the USA and Europe have hoard substantial amounts of savings during the pandemic. The recovery will also likely be supported by upcoming fiscal support packages in Europe and the USA (if the Democrats win the January run-off in Georgia the fiscal support package could be even larger) and continuously supportive central banks. The problem is that the central banks will have their hands tied behind their backs when the economic recovery finally takes hold and growth and inflation start to increase. Asset prices and debt levels are now so high that the economy cannot sustain higher real interest rates. If central banks remain supportive in an early recovery phase, real interest rates can be kept negative although growth and nominal interest rates are increasing. However, it will be very hard for them to stop stimulating the economy when this positive spiral keeps on evolving – if real interest rates increase back over the zero-mark, there is a major risk that the economy implodes under its own debt load and we end up in a new financial meltdown. It is therefore a real risk that the authorities will not be able to stop inflation once it takes hold.

The Swedish property market will likely keep up its strong performance up until the central banks start to slow down the economy (probably in 18–24 months). Economic growth will drop back significantly during the coming six months, and vacancies will likely increase especially within the hotel and retail sectors as many tenants have very thin margins after almost a year of disruptions in their businesses. Prime office rents have already shown signs of declining, and the pressure downwards will continue during the spring 2021. However, the new vaccines are a real game changer. Now there is a light in the tunnel for investors. There is a real economic recovery at the horizon, and as a result there are signs of rotation between the property segments. The average equity price for 28 of the largest listed Swedish property companies has increased by 13 per cent since October 30. However, while the average equity price for companies that focus on residential and public properties has increased by around 11 per cent, the average equity price for companies with an office, retail and hotel focus has increased by 15 per cent in average (where Pandox stand out with a 66 per cent price increase from a low level). Although the access to bank financing has deteriorated slightly during recent months, the bond market is wide open with credit spreads that are almost in line with the levels before the pandemic. Add to this the significantly lower market interest rates, and financing costs are at absolutely historic lows. Investors that want to be active on the market have no option but to adopt to the current macroeconomic environment. Although we are currently in an unusual macro environment, it seems like the music will keep on playing for another while at least. ■

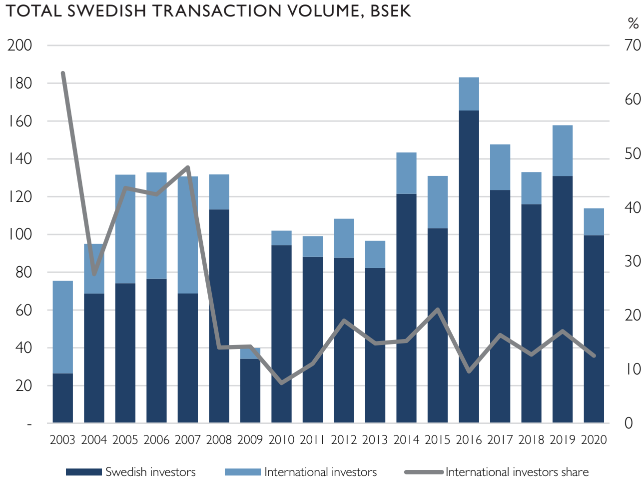
TRANSACTION VOLUME PER MONTH, BSEK




TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK




TOTAL SWEDISH TRANSACTION VOLUME, BSEK




INVESTOR TYPE AND REGION