Yield-starved investors pile into Swedish property, but how long will the Goldilocks scenario last?

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The transaction volume was high on the Swedish property market during the end of the last year and the full year volume ended up at around SEK 158 billion (just above SEK 200 billion if indirect transactions are included), which is a historically high level.

However, the combined volume in December and January was slightly lower than during the same period one year earlier (SEK 33 billion compared to SEK 39 billion). Over the last 6–9 months, the transaction activity on the Swedish property market has been concentrated to well-located office properties in Stockholm and large property portfolios throughout the country. There has been a number of large indirect transactions lately, where SBB's acquisition of the property company Hemfosa is the largest one (with an underlying property value of around SEK 40 billion). Following this deal, SBB also signed letter-of-intents regarding two sub-portfolios amounting to around SEK 11 billion in total (with Nyfosa and another undisclosed investor). Other big portfolio deals were Nyfosa's purchase of a SEK 4 billion commercial portfolio from Randviken (parts of the payment was shares in Nyfosa) and Trenum's acquisition of a SEK 1.8 billion residential property portfolio from Serneke. Apart from that, there have been a number of large office deals in Stockholm during recent months. In December, Humlegården acquired the CBD property Landbyska verket from Midroc for around SEK 2.3 billion.

There has been an important shift in the investors' view of the outlook for the global economy since mid-2019. The consensus view has tilted towards a scenario where the global economy is stuck in a Japan-style stagnation scenario, with sluggish economic growth, low inflation and low interest rates for years or decades to come. Property becomes very attractive in relation to other asset types in this scenario, and investors have started to re-price property. As a result, the yield spread between financing costs and prime office yields in Stockholm has declined by around 25–30 basis points since the summer. The demand for property exposure is especially large among yield-starved institutional investors (one factor behind this is that the global mound of negative yielding debt is back over USD 13 trillion). The equities of the listed Swedish property companies have shown a total return of around 70 per cent over the last 12 months (the average premium on NAV is around 47 per cent). There are, however, major differences between the property segments. When it comes to core assets in Stockholm (prime properties with limited development potential), the demand is almost entirely driven by institutional investors (international core/core-plus funds, and a number of Swedish pension funds). The listed companies are generally not competitive in these locations; in fact, the equity market has been indicating a slight discount on prime offices in Stockholm during recent quarters. Instead, the difference between book yields and implicit yields on the equity market are higher the further out on the risk-scale you are going. Property companies with commercial, residential, or public properties in regional or smaller cities have large equity premiums. The implicit equity market yields in these segments are in many cases 100–150 basis points lower than book yields (indicating a continuous pressure upwards on property values going forward).

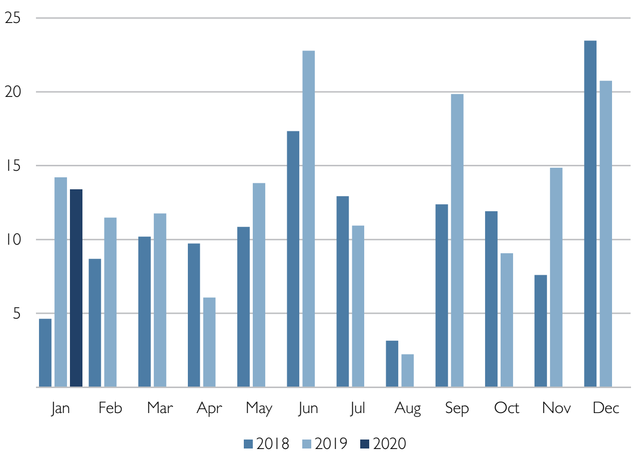
Globally there were 71 rate cuts by 49 central banks during 2019 and IMF calls it the most synchronized monetary easing since the financial crises (last year's rate hikes by the Riksbank is an exception in this context). The Fed has increased its balance sheet from USD 3.8 trillion in spring 2019 to almost USD 4.2 trillion in late January by buying short-dated Treasury bills (although this is not labelled quantitative easing, the perception in the market is just exactly that). Economic growth is slow in practically all major economies. In the USA, the full-year GDP growth came in at 2.3 per cent in 2019, down from 2.9 per cent in 2018. Both weak household consumption and falling business investments where factors behind the slowdown. In China, the GDP grew 6.1 per cent in 2019, its slowest pace in 29 years. The corona virus will have a significant impact on the economy during Q1 and the government has announced stimulus measures as a counterweight. The economy in the euro area expanded by merely 0.1 per cent quarter-on-quarter in Q4, with contracting growth in both France and Italy. However, leading indicators have stabilized during recent months. The commission's economic sentiment indicator improved from 101.3 to 102.8 in January, mainly driven by an improving outlook for companies in Germany. Also in Sweden, leading indicators have shown signs of bottoming out. The Manufacturing PMI improved to 51.5 in January from 47.7 the month before. Although the Swedish consumer confidence indicator has been well below the historical average during the last 12 months, retail trade turnover has trended upwards lately and grew by 3.4 per cent year-on-year in December. One factor behind the slightly brighter macro outlook has been ▶

the phase-one trade agreement between the USA and China signed in January. In Sweden, the recent year's recovery on the housing market has been a positive factor for domestic demand. As a result, the Swedish 10-year government bond yield increased from a nadir of -0.42 per cent in August to around 0.20 per cent a few weeks ago (before concerns on the financial markets about the corona virus outbreak pulled it back below the zero-mark again).

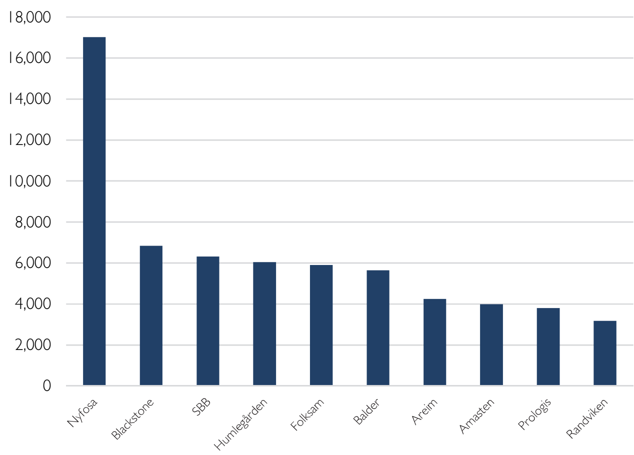
Currently, the major equity markets have a significantly higher correlation to central bank liquidity than to economic growth (according to ECR Research, the correlation between the global equity market performance and money supply has been 65 per cent during the last quarter, versus a correlation of 6 per cent to economic growth). Although the macro economic outlook has brightened lately, the total debt levels in relation to GDP (government, corporate and household debts) are at historically high levels in all major economies. The combined total debt in the USA, the EU and Japan currently equals around 300 per cent of GDP, compared to around 240 per cent in the early 2000s. If the recent decade's debt build-up had been the result of investments in income generating, productive assets (like infrastructure, more effective machines and technology) this would not be problematic. However, this has not been the case. The debt growth has mainly driven up global asset prices (like property and equities) and productivity growth has declined in most major economies during the recent decade.

A large correction on the equity markets could be enough for the global economy to end up in a recession and a following deflation spiral (the corona virus could prove to be such a setback if it continues to spread). The authorities in the major economies would in that case need to respond with significantly more stimulus. Because virtually all central banks have limited amounts of dry powder, the pressure would increase on politicians to take action through lower taxes and/or higher spending (directly or indirectly supported by central bank purchases of government bonds). One problem is that the high debt loads will make it very hard for central banks to hike rates if inflation would start to increase. There is a risk that the markets would interpret coordinated fiscal and monetary stimulus as an early sign of an upcoming stagflation scenario (the combination of increasing inflation and low economic growth). Over the coming 12–18 months, however, the property market will benefit from the low interest rates and not too weak growth, with continuously declining property yields in combination with stable rental markets in the larger cities.

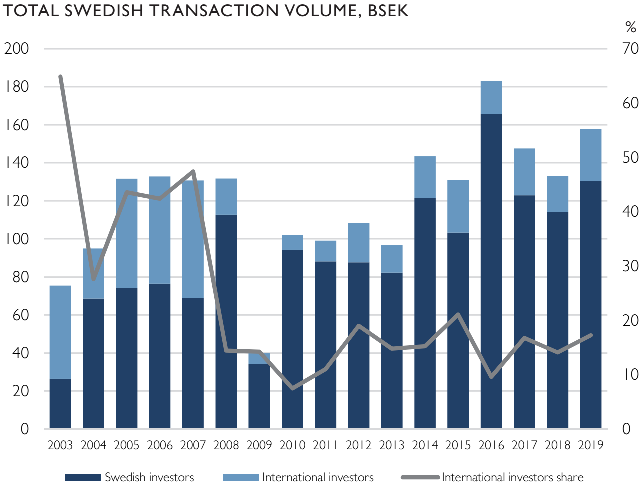
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION