The investor focus will gradually shift towards the office sector due to attractive yield levels

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The transaction volume summed up to a total volume of SEK 44.7 billion during December and January (SEK 37.1 billion in December and SEK 7.6 billion in January).

This is below the SEK 50.2 billion that took place during the same two-month period last year, but is still a historically high volume. The transaction volume ended up at SEK 225 billion for the full-year 2021 (only counting direct transactions, not deals involving acquisitions of shares in listed property companies). The rolling 12-month transaction volume increased further in January and now stands at SEK 228.5 billion. The transaction volume has been in an uptrend since mid-2018, driven by a slight increase in the number of deals and massive increase in the average deal size. The all-time peak in the rolling 12-month volume was, however, reached in September 2021 with a volume of SEK 230.5 billion.

The number of deals exceeding SEK 80 million ended up at 82 deals during the two-month period December/January. This is below the 98 transactions that took place during the two-month period last year. The rolling 12-month number of deals peaked in October 2021 (at 417 deals) and has fallen back since that to 394 deals in January. This has been combined with a soaring average deal size. Historically this combination has been an early sign that the market is closing in on a major shift. It is not unlikely that this is a sign that the market will now slow down as it adjusts to less support from the monetary authorities and gradually higher long-term interest rates. Our main scenario is, however, that real interest rates will remain negative and that will keep on supporting the transaction market.

The institutions were the single largest net-investors on the Swedish property market during 2021 and they have been net-buying property for SEK 60.2 billion during the last 12 months. Simultaneously, the listed property companies have slowed down their net-acquisitions. Their rolling 12-month net-acquisitions now stand at SEK 20.9 billion, down from the peak of 38.8 billion in September 2021. Funds were (along the institutions) among the largest net-buyers on the market last spring, and their rolling 12-month net-acquisitions peaked at SEK 21.9 billion in April 2021 but has since then fallen back to SEK 7.2 billion in January 2022. Foreign investors have also slowed down their investment activity lately. Foreign investors acquired properties in Sweden for SEK 22.4 billion for the 12 months to January. This is within the interval of SEK 20–30 billion that has prevailed over the last decade. The number of deals done by foreign investors has in fact declined during the last decade (as property values have increased). There are, however, lots of foreign investors hoovering the market looking for deals, but competition has just been too fierce.

The listed property companies have gone through a correction since late November due to increasing real interest rates and has underperformed the OMX Stockholm 30 so far in 2022. Despite this setback, however, the average equity price for 36 of the largest listed property companies is still up around 40 per cent since early 2021 (compared to around 24 per cent for the OMX Stockholm 30). The average premium to all capital employed for 12 of the largest property companies is currently just below 12 per cent. There are major equity market premiums on companies that focus on mix industrial properties, well located logistics, residential rental properties and/or public properties. There are, however, discounts for several of the companies with a focus on retail and/or office properties. As a result, the equity market is still indicating a pressure downwards on property yields during the coming 6–12 months, where the largest pressure downwards is for logistics/industrial properties and offices in secondary locations in the Stockholm region.

The equity price development has been extremely strong for the listed property companies focusing on logistics/industrial properties during the last year. The equity prices for these companies are up over 50 per cent in average since early 2021. This also corresponds well with the development on the transaction market, where investor demand has been (and remains) extremely strong. There are, however, large differences within the logistics/industrial segment. Catella recently presented a focus report including an in-dept analysis of the properties and tenants included in all Swedish logistics/industrial transactions made during 2016–2021 (split up by sub-segment and risk level). The price growth for manufacturing facilities and warehouse/freight terminal properties was entirely driven by declining yields during 2016–2021. The yield declines were strongest for the low/medium risk properties (properties located in large cities with strong macro fundamentals), while the yield development was flat for high-risk properties. Rental incomes actually contributed negatively to the price growth for the manufacturing facilities and warehouse/freight terminal properties during 2016–2021. The average rental incomes for the manufacturing facilities and warehouse/freight terminal properties included in transactions fell with around 3–10 per cent per year in average depending on location and property type (the declines were steeper for warehouse/freight terminal properties than for manufacturing facility properties). The dynamics were entirely different within the sub-segment mix industrial properties (which include properties with a variety of tenants within different business sectors, often also including office and retail premises). For these properties price growth was strongest for high-risk properties (properties located in smaller municipals with weaker macro fundamentals). The average rental income growths were in most cases positive for the mix industrial properties and were in the interval 0–5 per cent per year in average depending on location.

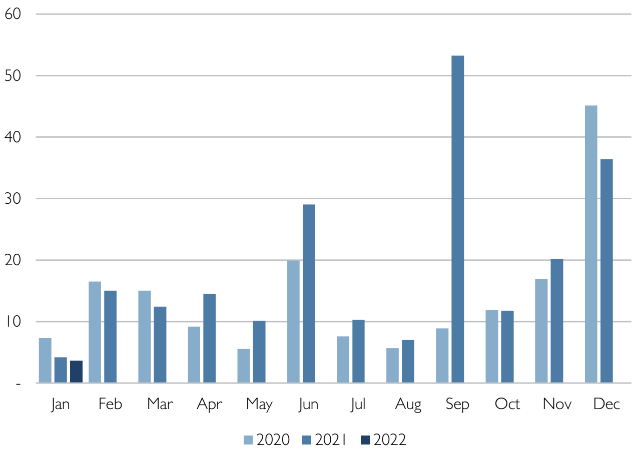
The rental development within the logistics/industrial market goes hand-in-hand with the composition of economic growth in Sweden. The Gross Value Added is a measure of the contribution to GDP made by individual economic sectors. The manufacturing sector is the largest sector in the economy and the sectors contribution to GDP is expected to be around SEK 630 billion in 2021. The transportation & storage sector is a rather small sector, with an expected contribution of around SEK 170 billion to GDP in in 2021. The real growth in value added within the manufacturing and transport & storage sectors has been just above the zero-mark during 2011–2021. The total employment growth within these sectors has also been stagnant since 2010, indicating a fast technological development that has generated a pressure downwards in output prices. This corresponds well with the declining average rental incomes that have occurred on the transaction market for manufacturing facilities and warehouse/freight terminal properties during recent years. The mix industrial segment, on the other hand, has tenants within a wide range of economic sectors. However, large parts of the tenants are within the sectors professional, scientific & technical activities, wholesale & retail trade and financial & insurance activities (this later sector mainly consists of corporate headquarters). The real GVA growth has been relatively strong within these sectors during the recent years. In fact, the tree sectors with the strongest growth rates during the last decade were information & communication, professional, scientific & technical activities and financial & insurance activities (all sectors with generally high levels of office use in the major cities). This corresponds well with the growing average rental incomes that have occurred for mix industrial properties during recent years. Other factors are of course also contributing. The mix industrial properties are in some cases located in relatively good locations in the major cities, which corresponds well with the growing average rental incomes. In addition, industrial areas in the major cities are in many cases being converted into other use (often into new residential areas). This is creating a favourable supply/demand balance within the mix industrial sub-segment that are pushing up market rents.

The weak real GVA growth in the manufacturing and transportation & storage sectors, in combination with a high level of new production of especially warehouses/freight terminals, may hamper market rental growth during coming years. There is a risk that the market rents in these sub-segments will not be able to keep up with inflation. It is quite markable that investors are currently so focused on segments of the property market that connects to parts of the overall economy that barley have produced any output growth at all during the last decade (measured in SEK, I'm sure that there has been significant growth in the flow of goods etc.). Simultaneously, many investors remain somewhat hesitant to office properties due to a looming structural shift involving more work-from-home and expectations of future improvements in space efficiency. Several of the listed companies focusing on office and retail properties still have quite substantial equity market discounts. Although the number of transactions and transaction volumes for office properties bottomed-out during the autumn 2021, transaction volumes are still significantly below their pre-pandemic highs. The yield compression for logistics/industrial properties (as well as for mix commercial properties and residential/public properties) has been massive since early 2020, driven by negative real interest rates that have produced a massive flow of capital into alternative assets. Simultaneously, yields for office properties in Stockholm inner city and prime suburb locations are pretty much in line with their pre-pandemic levels (before the last 24-month of central bank largesse). All in all, this creates opportunities. It is not unlikely that we will see a shift on the market going forward where the office transaction volumes pick up markedly. It is not unlikely that this partly will be driven by the listed office/retail property companies. As a group, these companies have been net-sellers on the property market during recent years. The recent 12-month property value growth in combination with a reasonably good access to financing are now creating needs to invest again.

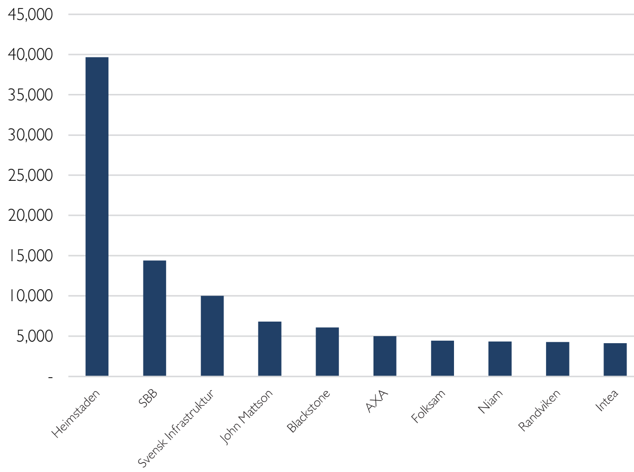
It is likely that Omicron is the last phase of the pandemic. The disease will instead be defined as endemic going forward. Although there will be less monetary and fiscal stimuli from now on, this will likely support economic growth in most countries. However, this may not cause the supply side to recover to the extent where inflation falls back to the levels that prevailed before the corona pandemic. The nominal economic growth rate is currently around 8 per cent year-on year in Sweden and around 9 per cent year-on-year in the USA. Short-term interest rates are around the zero mark in both economies. These are extremely low nominal interest rates ▶

in relation to the economic growth rate (even if the US growth rate will be reduced by less fiscal stimuli in 2022). Under normal circumstances, short-term interest rates should be close to the nominal growth rate of the economy. To slow down economic growth to just below the growth potential (around 2 per cent real GDP growth plus 2 per cent inflation), the central banks would need to increase rates and/or reduce their balance sheets quite forcefully. The problem is that asset prices have become addicted to negative real interest rates (created by asset purchases and low policy rates). It has become very hard for central banks to reduce support in a way that slows down economic growth/inflation, and still support asset prices enough to keep it from collapsing (which would create a credit crunch and a deep recession). In other words, central banks may be forced to accept an inflation/wage spiral from late 2022 and onwards. According to Catella's main scenario, inflation and interest rates will follow a gradual uptrend from late 2022 until the next recession. Real interest rates will, however, likely remain low. This will support the property market and keep transaction volumes at reasonable levels. ■

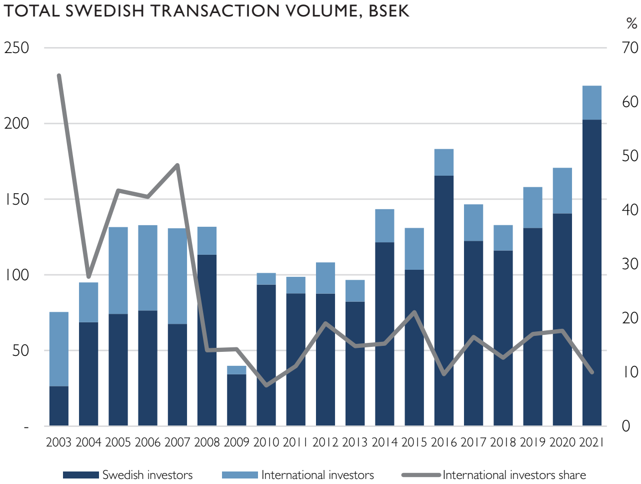
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTH VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION