We are in the midst of a structural shift on the property market and yields may keep on declining in segments that are prioritised by the institutions

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The transaction activity held up relatively well in June. In total, transactions amounting to SEK 16.6 billion took place, compared to SEK 17.4 billion and approximately SEK 22.8 billion during June 2018 and 2019. There were 31 transactions exceeding SEK 80 million during the month, which can be compared to 58 and 51 transactions during the same month in 2018 and 2019.

The largest transaction in June was Nyfosa's acquisition of a SEK 4.9-billion portfolio spread throughout Sweden (mainly offices) from SBB. The second largest deal was SBB's divestment of a SEK 1.2 billion portfolio located in Halmstad and Borås including mainly office premise (with mostly public tenants) to Offentliga Hus. The third largest deal was the municipal company Trelleborgshem's divestment of a residential portfolio (located in Trelleborg) to Klarabo for SEK 1.1 billion. Heimstaden acquired a residential rental project in Sundbyberg from Magnolia for SEK 1 billion (total value of the finalised project). In addition, Barings bought a logistics property from PostNord in a sale-and-leaseback deal for SEK 960 million and Stadsrum acquired two mix properties located in Stockholm inner city from Centria (Åhmans).

The liquidity on the property market, measured as the rolling 12-month number of transactions, remains low at just below 300 deals in June (the number of deals has remained at or below 330 since July 2019). This is well below the long-term average of 370 deals, and below the interval of 330–400 deals that the market has normally fluctuated within during the last 15 years. Despite the low number of deals, the rolling 12-months transaction volume has remained stable/high within the interval SEK 140–160 billion since mid-2017 (the volume was SEK 141.7 billion in June). As a consequence, the average deal size has gradually increased over the recent years (which is well in line with the increasing property values). Institutional investors have taken a great leap forward since the corona crises erupted and gone from net-selling properties at an annual pace of around SEK 5 billion (from early 2019 until early 2020), to net-buying properties amounting to SEK 24 billion during the 12 months to June 2020. The main institutional buyers during the first half of 2020 was Stadsrum, Heimstaden, KLP, Willhem and Trenum. The listed property companies, on the other hand, have gone from net-buyers to net-sellers. From early 2017 until early 2020 the listed companies were net-buying properties at an annual pace of around SEK 10–30 billion. For the 12 months to June, however, they have net-sold properties for SEK 5 billion. SBB, Magnolia and Atrium Ljungberg together sold properties for over SEK 22 billion during the first half of 2020. Nyfosa, Cibus and Amasten were the largest net-buyers among the listed companies during the period, but they only acquired properties for SEK 7.8 billion. The Swedish property market was entirely dominated by domestic investors during the second quarter (only two deals with international investors took place during the quarter). However, the rolling 12-month acquisition volume by international investors still stand at SEK 15.4 billion in June, which is within the SEK 15–30 billion annual gross-acquisition volume that has been present since 2016 for this investor group.

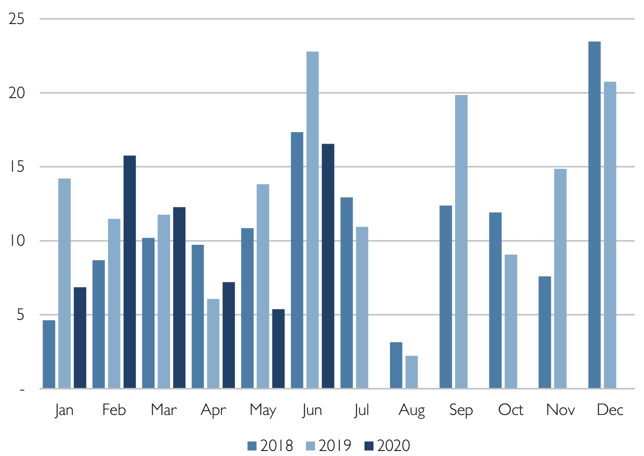
There have been major changes in demand and activity between the property segments since the pandemic erupted. The investor demand is currently tilted towards well-located properties in the major cities within the public property, residential rental property and prime logistics segments. Investors demand stable cash flows where rental growth follows inflation and the vacancy risk is low. The rolling 12-month transaction volume for residential properties has been stable at around SEK 30 billion since early 2018, but the number of deals has declined from 100 deals in 2018, to 80 deals in 2019 and 75 deals during the 12-month period up to June 2020. Residential rental properties are a clear focus for both institutional and private investors and there is a strong demand for all property types located in reasonable good locations in the major cities (from million programme properties to newly constructed buildings and projects). The public property segment (like care homes, schools and public buildings) is generally a small and rather illiquid segment. The rolling 12-month transaction volume has been in the interval SEK 10–15 billion since early 2018, and the number of transactions has declined from 38–40 deals per year in 2018–2019 to 26 deals for the 12 months to June 2020. The main investors within the segment are private companies and institutions. For logistics/industrial properties the rolling 12-month transaction volume has been stable in the interval SEK 12–20 billion since early 2017, except for a peak of SEK 30 billion during the autumn 2019 due to a number of large acquisitions by Blackstone, Prologis, Allianz and GLL. The number of deals has gone from 50–55 deals per year in 2018–2019 to 44 deals for the 12 months to June 2020. For office properties the transaction volume doubled between 2017 and 2019, from an annual volume of around SEK 20 billion during the autumn 2017 to SEK 40 billion in early 2020 (and the volume has been stable since then). The number of transactions has been rather stable too and there were 48 deals in 2018, 41 deals in 2019 and 38 deals for the 12 months to June 2020. Investors have become increasingly concerned regarding the office market outlook both from a cyclical and a structural perspective. The main question is whether or not we are in the early stages of a global structural shift in corporations' use of office premises (which seems quite likely). There are currently especially large insecurities among investors regarding the trajectory for market rents/vacancies in the prime office segments in Stockholm. The office market has, however, remained quite liquid since the corona crises erupted and 14 office transactions were done during the second quarter (compared to 17 and 11 deals during the same quarter in 2018 and 2019 respectively). Most deals during the second quarter, however, took place in regional cities where rental growth tend to be stable and follow inflation (SBB was a major seller during the quarter). For retail properties the transaction volume has followed a declining trend since the spring 2017, from a rolling 12-month volume of around SEK 25 billion to around SEK 8 billion in early 2020. Since then, however, liquidity has increased in the rolling 12-month volume to the interval SEK 11–14 billion during the first half of 2020, mainly driven by acquisitions by Stadsrum and Cibus. There is a clear focus among investors on grocery store properties and well located big-box properties with strong grocery anchors.

The low number of deals and the large average deal volume implies that we are in the midst of a structural shift on the property market. The consensus macro view among both Swedish and international investors alike is for low growth, low inflation and stable/low interest rates for years or decades ▶

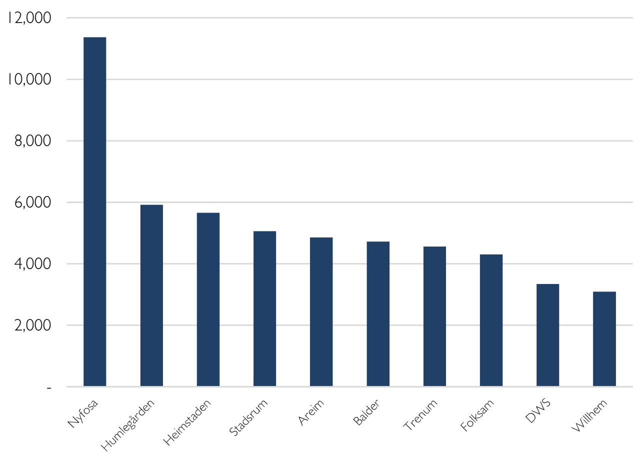
to come. This macro view has been well anchored since at least 12 months ago and has only been strengthen by the Covid-19 development and the fiscal and monetary response to the crises. Investors are now adjusting their yield expectations for all types of assets according to their long-term macro view. The OMX Stockholm 30 has had a staggering recovery over the last months. The price index is only around 11 per cent below its (all time) peak from February 21 and around 5.5 per cent below its level at the start of 2020. Also, S&P 500 is only around 8.5 per cent below its February peak and around 4 per cent below its level at the start of 2020. Many large companies have reduced or cancelled their dividends over the last months (the dividend yield on the Stoxx Europe 600 index has dropped to 3.13 from 3.45 at the turn of the year) and the forward price/earnings multiple of US stocks has risen to 24 (which is at dot-com era levels). This happened simultaneously as the 30 year real US Treasury yields (the yield adjusted for inflation) has been stuck below the zero mark since April, which is a troubling signal of weak/stagnant global economic growth (and corporate profits) for decades to come. The average equity price for ten large Swedish listed property companies* is still 37 per cent below its February peak and only 16 per cent up from the nadir in late March. The reason for this is that these ten companies are heavily exposed to the office and retail segments in the major cities – segments that not are the flavour of the day for investors to put it mildly. If one look broader to all listed property companies there are equity market discounts to NAV for companies with a focus on hotel, retail and/or office properties (especially regarding offices in prime location in Stockholm), while there are significant premiums on companies with mix industrial properties, well-located logistics and residential rental properties in their portfolios. In fact, the implicit property yields based on the equity market valuation are well in line with the average valuation yields in most property segments. The property segments that stands out are prime offices, shopping centres and big-box properties (where the implicit yield levels are 50–100 bps higher than the average valuation yields), prime logistics and industrial properties (where the implicit yields are 50–100 bps lower than the valuation yields) and residential properties (which are having 20–30 bps lower implicit yield levels than the valuation yields).

The average property yields for the ten large Swedish listed property companies* have a strong correlation with the development of the companies' financing costs over time. However, over time 100 bps lower financing costs has only resulted in around 60 bps lower property yields in average. This has resulted in a gradually higher yield gap between long-term interest rates and property yields over time – and made property increasingly attractive as an asset class. Institutional investors around the world has gradually increased their allocation to alternative assets (including property) over the last decade and this is expected to continue as long as this consensus macro view of low interest rates prevails. Many investors fear that broad equity markets have gone well above fundamentals, and it is quite likely that we will see a major equity market correction during the coming weeks or months. If this correction ends up at around 20–30 per cent, the authorities will need to respond with even more fiscal and monetary support (otherwise the global economy may end up in a deflation spiral and collapse under its debt load). The property market responds very well to central bank liquidity, even better than the broad equity markets. Over the last ten years, the rolling 12-month average yield level for Swedish office transactions is almost perfectly correlated to the total central banks assets for six large central banks (the Fed, ECB, Bank of England, BoJ, PBoC, and the Riksbank). In other words, property will likely remain a highly attractive asset class also during the coming 6–12 months and yields for the segments that are prioritised by the institutional investors may even keep on declining. However, the ongoing investor rotation between segments will continue and even grow stronger. ■

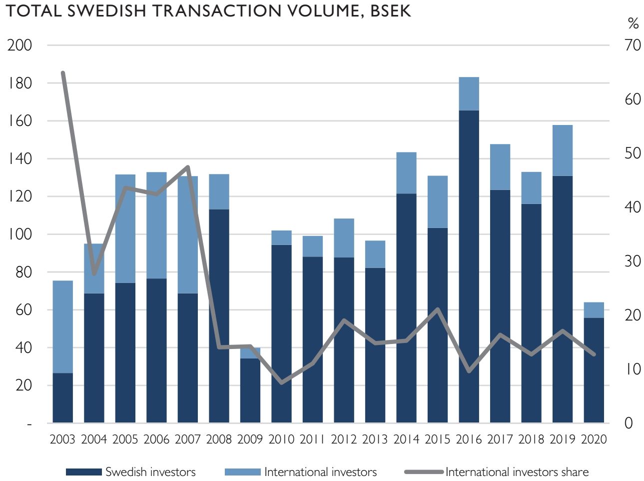
TRANSACTION VOLUME PER MONTH, BSEK



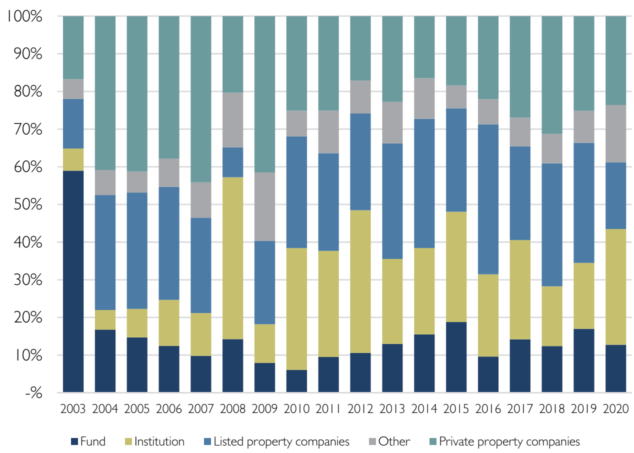
TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION



* Atrium Ljungberg, Castellum, Diös, Fastpartner, Fabege, Hufvudstaden, Klövern, Kungsleden, Wallenstam and Wihlborgs