CATELLA

The property sector may face a number of major challenges going forward, but it seems like we have at least a few more easy quarters to go

ARVID LINDQVIST
Head of Research

arvid.lindqvist@catella.se

Transactions amounting to SEK 9.9 billion took place in May, compared to SEK 13.8 billion and SEK 5.5 billion during the same months in 2019 and 2020. The rolling 12-month transaction volume has been in an uptrend since mid-2018 and increased to SEK 171.5 billion (from SEK 167.1 billion in April).

The number of deals exceeding SEK 80 million ended up at 18 in May, less than the 33 and 22 deals that took place during the same month in 2019 and 2020. As a result, the rolling 12-month number of transactions fell back somewhat to 380 deals (to just above the long-term average). Two SEK 2.5-billion-deals took place on the Swedish transaction market in May. The first deal was Heimstaden's acquisition of a residential rental property portfolio in Linköping from the municipal company Stångåstaden. The other deal was SBB's acquisition of six elderly care properties in the Greater Stockholm area as well as a number of residential and elderly care properties in Helsingborg from Svenska Stadsbyggen. Another major deal during May was SBB's divestment of a SEK 1.1 billion-portfolio to an unknown buyer. Another major deal was Vatne Real Estate's acquisition of a property in Borås (containing the retail company Ellos' HQ and central warehouse) from Bosjö Fastigheter (a single purpose vehicle set up by Pareto in 2016) for around SEK 900 million.

The transaction market continues to be dominated by institutions and funds, which has been the case since early 2020. The funds have taken the driver seat during the last months and their rolling 12-month net-acquisition volume has increased to SEK 22 billion in May, from SEK 18.2 billion in January. Blackstone and Niam have been the largest buyers within this investor category so far in 2021. The rolling 12-month net-acquisition volume for institutions hit a peak in January 2021 at around SEK 32 billion, which is in line with the previous peaks from February 2016 and July 2017. The institutional volume has, however, fallen back during the spring and stands at SEK 22.6 billion in May. The listed property companies' net-acquisitions have been fluctuating around the zero-mark since the first quarter 2020. Their net-acquisitions have, however, increased somewhat lately and ended up at SEK 5.5 billion in May. SBB is by far the largest buyer within the listed sector, while Castellum is the largest seller. The activity on the property transaction market is continuously focused on residential rental properties and logistics/industrial properties, where the recent year's increasing trends in both volumes and number of deals continue.

The listed property companies have had an extremely strong development over the last months and the average equity price for 39 of the largest listed property companies has recovered almost all ground lost against the broad equity market during the first quarter this year. The average equity price for the 39 listed property companies is up around 19.6 per cent so far in 2021, compared to 20.8 per cent for Stockholm OMX 30. There are, however, large differences between the companies/segments. The average equity price for the companies with a residential/public property focus is up 23.7 per cent YTD, surpassing the Stockholm OMX 30 with a good margin. The companies focusing on logistics/industrial and mix commercial properties are up around 25.5 and 22.9 per cent respectively YTD. By far the weakest performers are the office/retail companies, the average equity price for these companies is up only just below 7.4 per cent in average YTD.

One important reason behind the strong performance of the listed property companies is that the long-term real interest rate has been in a downtrend since late March. The long-term real interest rate, measured as the 30-year inflation linked US Treasury Bond (TIPS), increased from an all-time low of almost -0.5 in August 2020 to over 0.2 in mid-March 2021. This massive 70 basis point increase hit hard on the property sector as a whole, and especially on the listed property companies with focus on residential/public properties (these companies are generally very sensitive to changes in the real interest rate). The average equity price for these companies had a flat development from September 2020 to late March 2021. After that, however, the latest downtrend in long-term real interest rate took off and the 30 years TIPS yield fell below the zero-mark again to -0.05 now. This has been rocket fuel for the residential/public property companies. These companies have had an average equity price increase of over 23 per cent during the two months since early April. Based on the strong equity price development of the companies focusing on residential/public properties, as well as the logistics/industrial and mix commercial properties, there will continue to be a major inflow of ▶

capital into these property sectors at the transaction market for at least six months ahead.

The property market, however, may face several challenges going forward. To start with the market is very dependent on the trajectory for long-term interest rates, and especially the real interest rates. As mentioned above, the increase in long-term interest rates that took off on the back of new vaccines and expectations of an economic recovery during the autumn 2020 has been on pause since late March. However, the underlying macro factors that where driving the interest rate upwards are still in place. OECD recently upgraded their forecast for the global GDP growth in 2021 to 5.8 per cent growth (from 4.2 per cent in its December forecast). Combined with a global GDP growth rate of 4.4 per cent in 2022, this would bring most of the world back to pre-corona levels by then according to the organisation. In Sweden the GDP grew by 0.8 per cent during the first quarter 2021 compared to the quarter before, mainly driven by public and private consumption, exports, and stock rebuilding. According to Catella Macro Index (which includes a mix of forward looking macro parameters including the stock market, the CPI inflation, the interest rate difference between long- and short-term bonds as well as PMI-figures for a number of leading economies) the Swedish economy will keep on accelerating until October this year, when the GDP growth rate will peak at around 4 per cent year-on-year. In addition, inflation rates are now starting to pick up significantly in many large economies. In the US, the commerce department's core personal consumption expenditure index (which strip out volatile food and energy costs) rose by 3.1 per cent year-on-year in April. The broader US CPI inflation was up 4.2 per cent compared to a year ago during the same month. In the Euro area the inflation rate hit 2 per cent in May, surpassing the ECB target for the first time in two years. In Sweden, CPI inflation hit 2.2 per cent in April, while the KPIF (the inflation rate with fixed interest rates) was up 2.5 per cent year-on-year. Base effects are a major driver behind the higher consumer prices (due to the large consumer price drops that occurred during last spring on the back of the corona pandemic). However, other main contributing factors to the higher consumer prices are supply chain problems, soaring commodity/energy prices and also lack of labour which generate wage increases (especially in the USA, this although the unemployment rate is still extremely high).

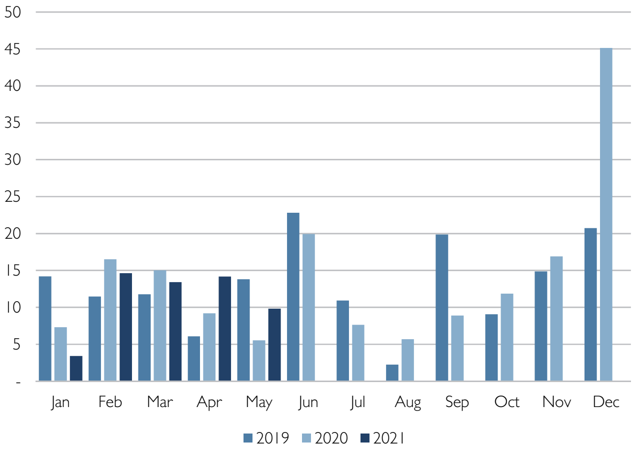
The financial markets are now speculating in how much inflation overshoot the major central banks will actually tolerate before starting to reduce their monetary stimuli. The Bank of England and the Bank of Canada have already announced that they are reducing/slowing-down their asset purchases. The combined balance sheet of six major central banks (Fed, ECB, Bank of England, Bank of Japan, People's Bank of China and the Swedish Riksbank) has had a tight correlation with the 12-month rolling average property yields in Swedish logistics/industrial and residential property transactions over the last decade. When these large central banks start to taper their asset purchases, this will reduce the volume of capital that is heading for the property market. This will also be a factor that will reduce transaction volumes and (if/when the balance sheet starts to decline) push the property yields higher. If these central banks, on the other hand, choose to tolerate higher inflation, there is a great risk that this will be interpreted by the financial markets as a move towards an inflation scenario (where politicians and central banks try to inflate away the large debt levels). In this case long-term interest rates would increase and drive up both nominal and real interest rates in the process (real interest rates because financial markets are forward looking and will likely prefer a buffer for soaring inflation going ahead). In other words, if central banks tolerate above-target inflation, long-term interest rates (and also real interest rates) will increase and push up property yields. If they, on the other hand start to taper their asset purchases, less capital will flow into assets in general (and also the property sector) – a kind of a lose-lose situation for property in general. The only real good macro outcome for the property sector is if the current economic recovery is just temporary, in other words, if the current economic growth and inflation upshoot go on for a few quarters before entering the old lull with weak real GDP growth, low inflation and low real (and nominal) interest rates. This stagnation scenario is, however, really bad for the society as a whole. We have the largest global debt load since at least the Second World War and inequality, misallocation of capital and social tensions would only increase in this scenario until reaching the boiling point. It is not very likely that politicians would dare to allow this.

The abundance of cheap/free money leads us to another upcoming challenge for the property sector – the supply/demand balances on the property markets. Low interest rates and asset purchases by central banks have pushed massive amounts of capital into the property sector during recent years. During the last 12–18 months, the capital has also been targeting a rather thin part of the market (the main focus has been residential rental properties, logistics/industrial properties and to some extent public properties in relatively large cities). This hunt for assets has generated a major upswing in new construction projects, especially in the residential market. In the Greater Stockholm region, the residential new construction will increase from around 16,000 apartments finalised per year in 2020–2022 to around 36,000 apartments per year in 2023–2024. The share of rental homes in the new construction has simultaneously increased from below 20 per cent of the new production during 2015–2019, to 43 per cent in 2020–2022, into a peak of almost 50 per cent during 2023–2024. The residential new production has simultaneously shifted from a focus on condominiums in middle/high-income areas during 2015–2019, to rental homes in low/middle-income area from 2020 and onwards. Most of these projects that are expected to enter the market in 2023–2024 are already financed (either ▶

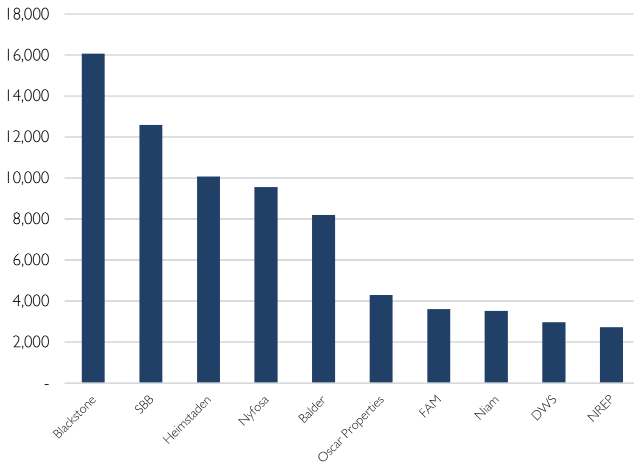
through forward finance/forward purchase deals or by being developed by the long-term holders themselves). There are within the low/middle-income segments the population growth will likely take place during coming years (immigration of low-income persons has been the major source for population growth in Sweden for years). However, new production on the Stockholm residential market will likely be around 2.5 times bigger than the demand growth (based on population forecasts) during 2023–2024. The effects might be higher vacancies, especially in newly produced residential buildings with high rent levels in less good micro locations. This is just one of several examples and is not what most investors are expecting – but it is an effect of too much capital chasing too few assets.

Property investing has pretty much been a one-way bet during the last decade. Gradually lower interest rates and asset purchases by central banks have made it all about jacking up leverage and buy/invest as much as possible to build volume (increasing property values have made the LTVs look really healthy, so no worries there…). It is not unlikely that it will be a lot tougher going forward, but it seems like we have at least a few more easy quarters to go first. ■

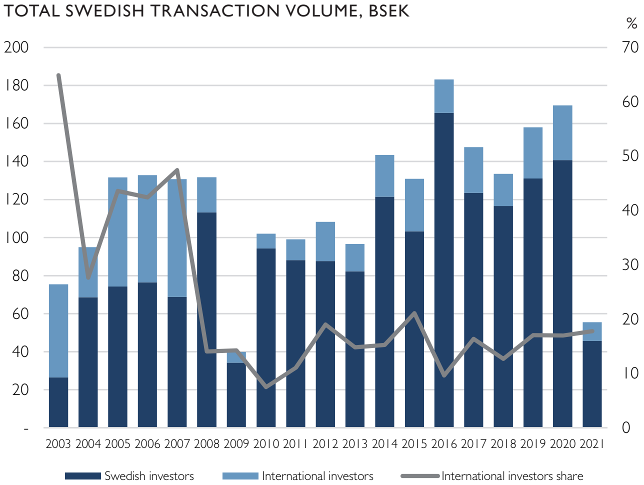
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTH VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION