Recent months' falling interest rates will continue to drive the property market in 2019–2020

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The activity on the Swedish property market has been strong during the spring and by late April, the rolling annual transaction volume was just over SEK 145 billion, a substantial increase from the 2018 full-year volume of around SEK 133 billion (excluding indirect transactions).

The largest deal during April was Intea's purchase of a public property in Lund from Wihlborgs, fully leased to Region Skåne, for around SEK 1.4 billion. The second largest deal of the month was Wihlborgs' acquisition of an office property in Helsingborg from Alecta for around SEK 1.3 billion. The third largest deal was Deka's acquisition of two big-box retail properties in Norrköping for SEK 680 million. The investor interest of prime properties in the major cities is strong – and Swedish listed and private property companies as well as foreign funds are currently driving the market. However, both Swedish and foreign investors are selective and are prioritising commercial properties (mainly offices and logistics/industrial properties) in the three main cities, as well as in the larger regional cities. (The European core funds, however, are almost entirely focusing on the Stockholm region.) Well-located residential and public properties are also particularly interesting for investors. However, the Swedish institutions have gone from net-buyers to net-sellers over the last 6–12 months and have recently been selling offices in the major cities. The Swedish institutions are instead focusing on investments within the residential and public property segments.

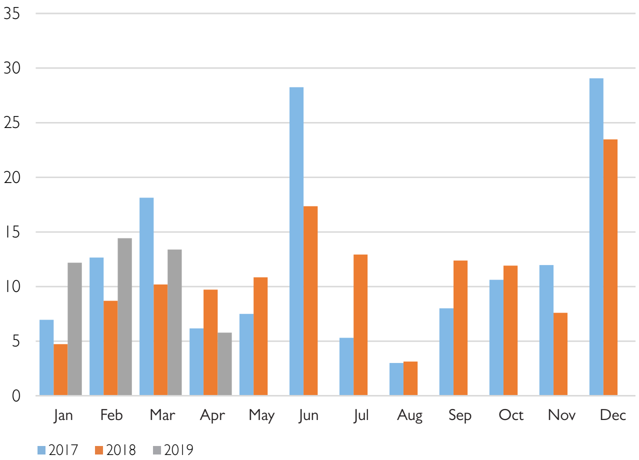
The cost of credit (market interest rates and interest rate spreads) is one of the main macro factors driving the property market and there is an almost perfect correlation between the listed property companies' average cost of financing and the reported yield levels of their property portfolios. Since the ten largest listed companies have a fixed interest term of around three years in average, changes in the underlying market interest rates and credit margins are rolling through the companies' average interest expenses slowly. During the five-year period since late 2013, the average interest expense for ten of the largest listed Swedish property companies has declined from around 4.0 to 1.6 per cent. During the same period, the reported yield levels of their properties have declined from around 5.5 to 4.2 percent. By the end of 2018, it appeared as if the underlying market interest rates and the interest margins were on the rise, with Fed's winding down its monetary stimuli (through interest rate hikes and quantitative tightening). This was also leading to increasing long-term interest rates in Europe, a trend that strengthened further when ECB ended their quantitative easing in late 2018. However, as a result of the stock market declines during the second half of 2018, political uncertainty (among other things driven by Brexit, the US government shutdown, the development in Italy and the US/China trade conflict) and weaker global economic data, the Fed made a U-turn in January and started to signal a more accommodative monetary policy going forward. In March, ECB followed suit by signalling continuously low interest rates and a new programme of liquidity support to the European banks. In Sweden, the Riksbank lowered their interest rate path at their meeting last week, and at the same time, they did announce further purchases of government bonds (quantitative easing) during 2019–2020.

Both long-term interest rates and interest rate margins have declined significantly since January and by late April, the Swedish 10-year bond yield was around 15 basis points (down from about 72 basis points in October 2018), which is close to the historical nadir from August 2016. At the same time, the yield spread between high and low-risk corporate bonds on the US bond market has declined significantly from the three-year peak in January. On the financial markets, the response to the dovish signals from the major central banks is that investors are again moving out on the risk scale. The U-turns of the major central banks during the first quarter of 2019 will have a significant impact on the Swedish property market during 2019–2020. The average interest rate costs of the Swedish property companies will likely continue to decline gradually during the coming 12–18 months, which will continue to push down prime property yields in the major and regional cities.

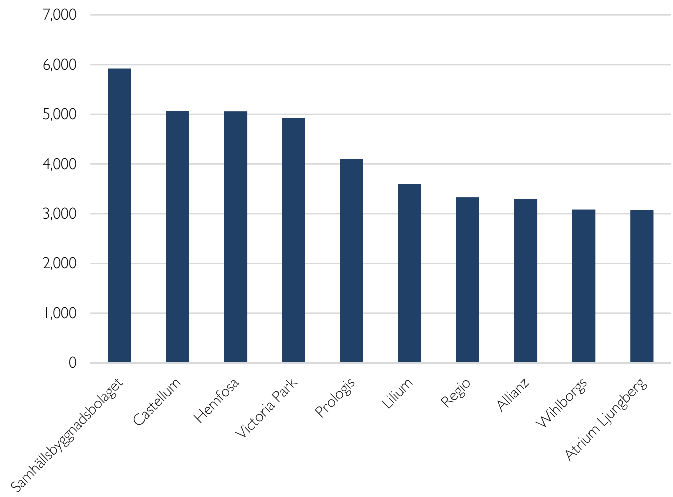
Simultaneously, the Swedish economy is slowing down rapidly in 2019, which is spilling over to the rental markets for commercial properties. The number of completed office new production projects in Stockholm will be rather high during coming years, while the growth rate in office bound employment are just about to slow down significantly (due to the low unemployment among highly educated and the ongoing economic slowdown). Furthermore, space efficiency is also improving rapidly in the existing office stock, which further inhibits the rental growth (as it increases the office supply within the existing stock). As a result, total return on the property market will likely remain strong in 2019, but value growth though continuous yield compression will be an important driver.

The fact that investors have generally become increasingly selectivity towards a number of property segments and locations during recent years creates opportunities for well-informed investors with market presence and access to financing. One example is well-located retail properties in the major and regional cities, which are currently viewed in a negative light by Swedish and foreign investors alike. The competition on the transaction market is currently limited for this type of properties, while there are many willing sellers at the right prices. Investors can currently buy well-located shopping centres in regional cities with stable net operating income growth below replacement cost, at yield levels of about 5–5.5 percent. This compared to prime offices in Stockholm where the initial yields are currently around 3.25–3.5 percent and prime logistics properties that are currently yielding around 4.5 percent.

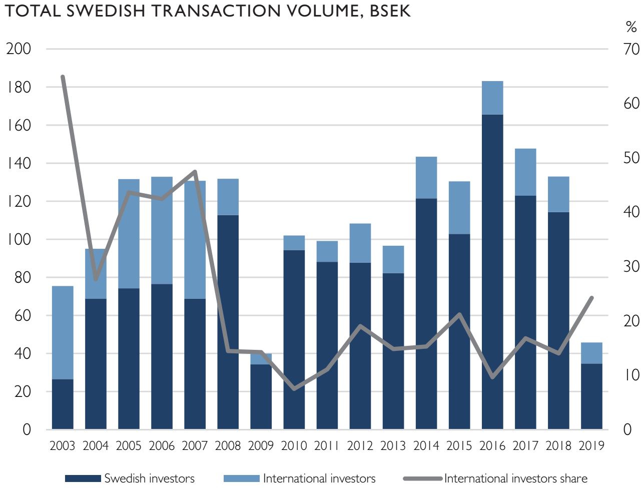
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION