Investors' expectations of long-term low interest rates will benefit properties with stable cash flow

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The transaction market was reasonably liquid in April, and there were just below 20 transactions exceeding SEK 80 million during the month. Also the transaction volume was fairly high due to a couple of large deals. In total, transactions amounting to SEK 6.9 billion took place in April, compared to SEK 9.7 billion and approximately SEK 6.1 billion during the same month 2018 and 2019.

The lion's share refers to two major residential transactions. Trenum acquired a portfolio of 900 newly constructed residential apartments in Karlstad from Magnolia for SEK 1.7 billion, and Amasten acquired 1,300 residential apartments in Tranås, Motala, Karlstad and Skövde from SBB for approximately SEK 1.5 billion. Most of the other transactions also consisted of either residential or public properties, except for Bonnier's acquisition of an office property in Uppsala, and Regio's acquisition of four properties, comprising office and commercial premises, from MLT and Reimnor.

The Swedish and global economy will end up in a historically deep recession during 2020, and analysts have gradually adjusted their forecasts downwards during spring. The IMF expects the global economy to contract by about 3 per cent in 2020 (from a growth rate of 2.9 per cent in 2019). This is a revision downwards from the January forecast of 3.3 per cent growth in 2020. The Riksbank is expecting a GDP contraction of between 6.9 and 9.7 per cent in Sweden for the full-year 2020. At the same time, Konjunkturinstitutet expects GDP to decline by 7 per cent in 2020 in their revised forecast. The unemployment rate will probably rise to 10–12 per cent during next 6–9 months. The inflationary pressure has decreased during the last few months and it is not unlikely that we will experience deflation during the second half of 2020. This is the deepest recession since the 1930's, and many investors predict that there will also be a slow recovery. It is hard to predict a full economic recovery until we reach herd immunity (60–70 per cent of the population is infected and recovered), or a reliable vaccine, which in best case can be realised in 18 months. ECR Research shows that in the past, the time for developing and introducing a well-functioning vaccine for previous unknown diseases, has been between 10 and 100 years (hopefully the process will be a lot faster this time).

The fiscal response to the crises has been massive. Globally, net public debt will increase from 69 to 85 per cent of GDP during 2020, according to recent research by the IMF. The IMF also highlights concerns that private and institutional investors may not be willing to finance these increases in government debt (which could lead to higher interest rates going forward). The U.S. has announced fiscal stimulus packages amounting to approximately USD 2 trillion, which is generating the fastest increase of their national debt in relation to GDP since the Second World War (and the strongest ever in peacetime). Moody's expects that the U.S. national budget deficit will increase from 4.6 per cent of GDP in 2019 to 15 per cent this year. Central banks throughout the world have also announced massive stimulus and are currently financing large parts of the current debt growth. The combined balance sheet of Fed and ECB now amounts to approximately 13 per cent of global GDP and will continue to grow further. Both Fed and ECB are currently buying government bonds as well as corporate bonds. This also includes corporate bonds from non-investment grade companies (which is exceptional), and hence financing costs for high risk companies have dropped lately. Also the Swedish Riksbank are investigating how to acquire corporate bonds going forward.

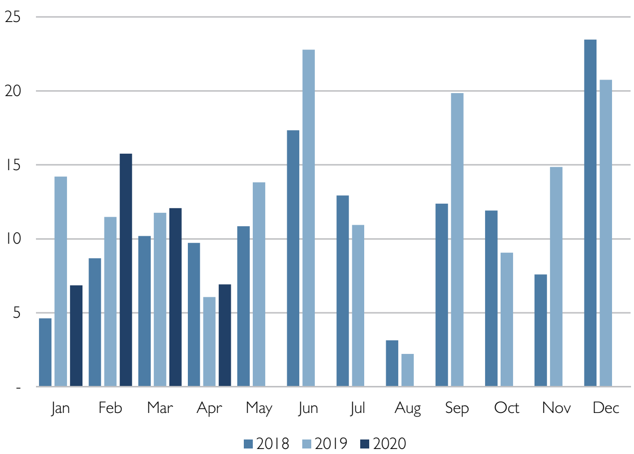
When the global economic recovery finally starts, most Western countries will have around 15–20 per cent higher total debt in relation to GDP than before this crisis. Although central banks will continue to buy bonds for a long time to come, government will need to reverse their fiscal stimulus when the global economy starts to recover as debt levels would otherwise increase out of control. This will slow down the economic recovery. In addition, asset prices in all segments and geographies are more or less completely dependent on central bank liquidity, which will make it very hard to tighten monetary policies when the recovery finally takes hold. As an effect, the authorities will be restrained in using both fiscal and monetary policies going forward. If weak growth, an ageing population and ongoing technical progress take the upper hand of the economic development going forward, we will stay in a macro environment with low inflation and low interest rates (and growing social gaps) for a very long time to come. If instead, the diminishing production capacity, deglobalisation and debt monetisation take the lead, the result will instead be continuously weak economic growth but increasing inflation (stagflation).

Despite the gloomy macro forecasts, the development on the stock ▶

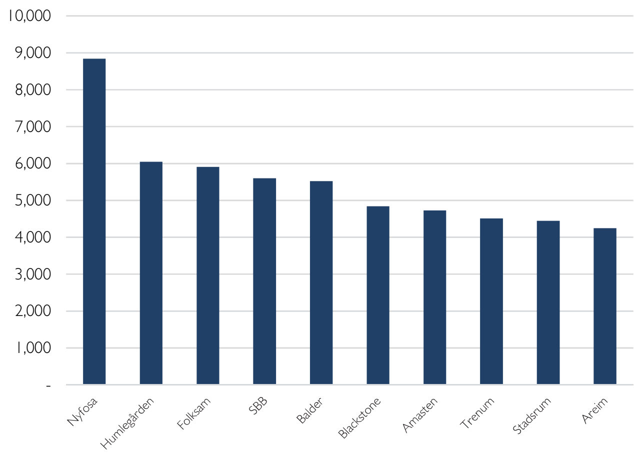
market has been extraordinary strong during the last six weeks. From the 21 February to the 18 March, the OMX Stockholm 30 fell by just below 30 per cent, while the share price for the ten largest listed property companies* fell by around 45 per cent in average. The equity prices for the property companies bottomed out 18 March, while the stock market as a whole bottomed out on 23 March. Since its nadir, the development on the OMX Stockholm 30 has been extremely strong with an increase of around 20 per cent. On 9 April, the property companies reached a temporary peak with a rise of around 25 per cent since the bottom, but have decreased since that. The total equity price increase since the nadir on 18 March is merely 15 per cent. Investors are concerned about property companies' high property values, relatively high debt levels, rather short credit maturity, and increasing vacancy risks and unpaid rents going forward. Investors are also becoming more sceptical regarding office properties, and some investors are questioning if the current prime rents in Stockholm are exceeding fundamentals. Furthermore, some investors (in particular foreign investors), are considering whether we are facing a structural change in how companies are using their office premises, and whether more people will go on working from home in the future.

The recent strong development on stock market is due to investors lowering their yield expectations. The P/E ratio of S&P 500 is for example on the same level as in October 2019 (well above the ten-year average). Lower yield expectations is probably due to expectations among investors that we are facing a macro scenario with deflation, weak economic growth and extremely low interest rates for years or decades to come. This macro view also seems to be the consensus on the Swedish property market. Catella recently compiled a survey amongst the largest investors on the Swedish property market and nearly half of the respondents currently expect such a macro scenario going forward. Property segments with low risks are benefitting from this as the spread between property yields and financing costs is on historically high levels (this does not apply to high risk segments/companies as credit margins here are rising fast). It is not unlikely that the yield spread compression that we saw during autumn 2019 will appear again in low-risk property segments. Investors are currently focusing on stable cash flow in larger cities – and primarily residential properties, public properties and warehouse/logistics properties in good locations. The rent development in these segments also follow inflation over time, which is an advantage if the consensus view among investors turns out to be wrong and that we instead are heading towards a macro scenario with weak growth and higher inflation. ■

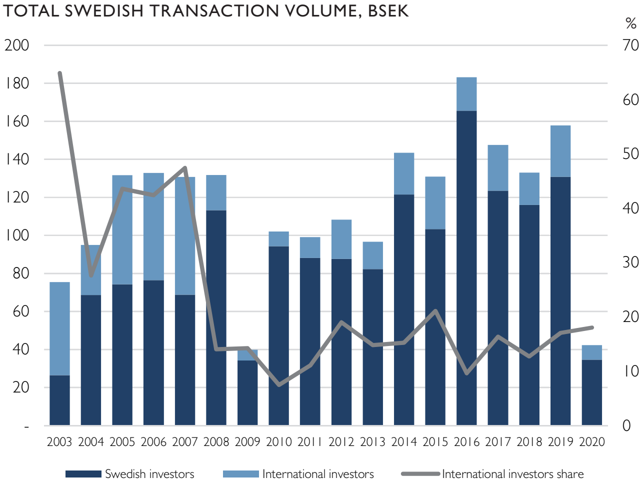
TRANSACTION VOLUME PER MONTH, BSEK



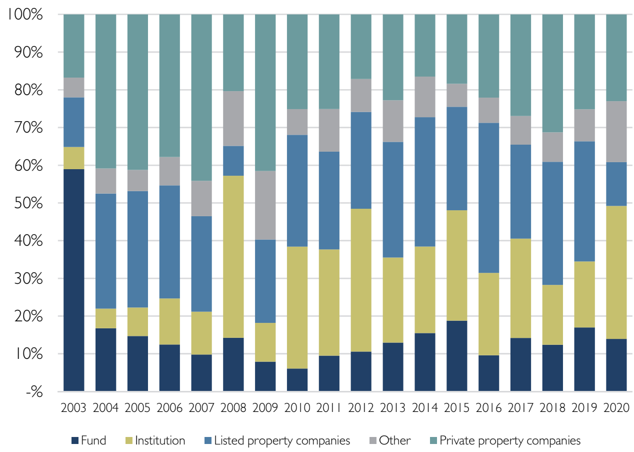
TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION



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