

The future holds investment opportunities for well-consolidated investors



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Activity has been fairly slow on the transaction market in September with a total transaction volume of approximately SEK 8.5 billion, compared to SEK 16.2 billion and SEK 8.4 billion for the same month in 2016 and 2017, respectively.

Two of the top-three transactions this month took place in the non-cyclical segments of grocery store/non-durable goods properties and public properties. The largest deal was Tre Kronor's purchase of a grocery store portfolio with ICA as the largest tenant from Partners Group for approximately SEK 900 million, and the second deal was Stenvalvet's purchase of a portfolio from municipally owned Örebroporten, which had mainly governmental, municipal and county council tenants.

In 2018, Swedish pension funds have reduced their net investments in the property market significantly, and have in particular been selling off office assets in Stockholm. Several Swedish institutional investors are currently working on lowering the risk in their portfolios by selling cyclical assets such as office properties in larger cities and cyclical retail properties such as big box and shopping centres, and are instead focusing on older residential

properties (with low rent), non-durable goods properties and public properties. In other words, they are focusing on diversified portfolios in large and mid-size cities with stable net operating income over time.

In recent years, the market for office properties in attractive locations in larger cities has mainly been driven by private companies, listed property companies and international funds. Foreign core investors such as Allianz, Barings and Union have all acquired centrally located office properties in Stockholm in the past 6–12 months. These actors have considerable purchase power and a positive view of the office rental market, and have entered the space that was created when Swedish institutions reduced their net acquisitions and started to sell. An important reason for Swedish listed property companies' recent competitiveness in bidding processes is their strong performance on the stock market in the past 6–9 months as well as having access to extremely affordable debt financing. In particular, interest rate margins on the bond market have fallen significantly in the past 9–12 months for companies with higher-risk business plans. Combined with property segments that have relatively high returns, this makes for extremely potent leverage. As such, property companies are able to drive the markets (and market values) in their own prioritized segments.

Increasingly more market actors are now questioning the sustainability of the historically high office rents, espe-

cially those in Stockholm. At the end of 2018, we are entering a period where the dynamics of the office property market may change. New construction of office properties has been low in the past 3–5 years, with the Stockholm market only seeing around 75,000 square metres of new office space per year.

While new construction has been low, the economy has been strong and office-based employment has grown by an average of 8,000–10,000 people per year in the region. The surplus demand has resulted in low vacancies and strong rental growth in Stockholm CBD and attractive inner city locations.

In Stockholm CBD, the market rent has increased by 50–60 per cent over the past three years. At the same time, new office projects that have been under construction in recent years are now nearing completion. Between 2018 and 2021, approximately 175,000 square metres of new office space will be added to the Stockholm market every year. At the same time, the economy has hit the capacity ceiling and unemployment among educated people in the Stockholm region is non-existent. The majority of the population growth of working-age people in the region are immigrants with mostly low or no education, meaning that they lack, in the short term, the means to pursue office-based employment. This means that the expected growth of office-based employment is expected to fall back to just above 4,000 people per year. This will, in turn, increase



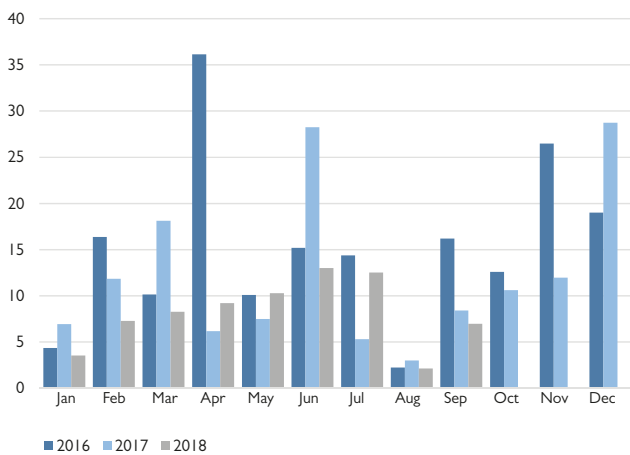
the risk of corrections in the rental market and will likely result in weak rental growth over the next five years. This development will be particularly apparent for less efficient office properties in non-prime locations that lack good transportation options, where vacancies might increase while interest among investors declines.

Taken as a whole, it is mainly cheap money that is keeping investors far out on the risk scale. The direction going forward is gradual rate hikes from the large central banks, who will also

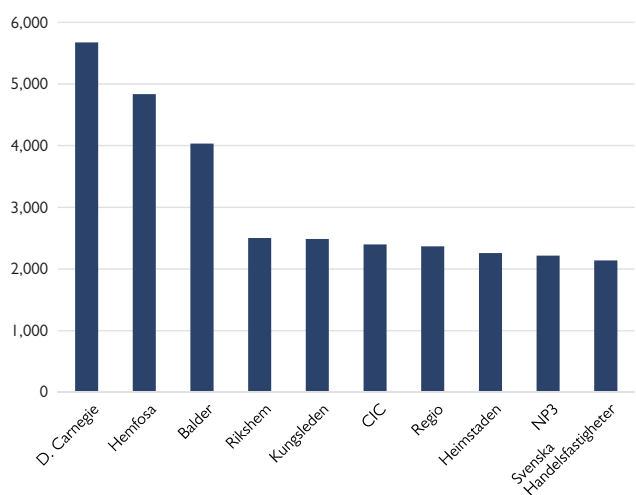
reduce their purchasing of securities (resulting in less liquidity in the financial systems). For property investors, this will entail a combination of slightly higher market interest rates and wider interest rate spreads between companies with different credit ratings, as bond investors are demanding a higher return for risk. As such, it appears that the challenge going forward will be that financing becomes more expensive for certain actors while rents have a weaker development and the risk of vacancies increases (normally, a weaker

development of rents is compensated by lower interest rates). Well-consolidated investors with good access to the credit market and good knowledge of properties will probably be able to find good investment opportunities on the Swedish property market in the coming years. ■

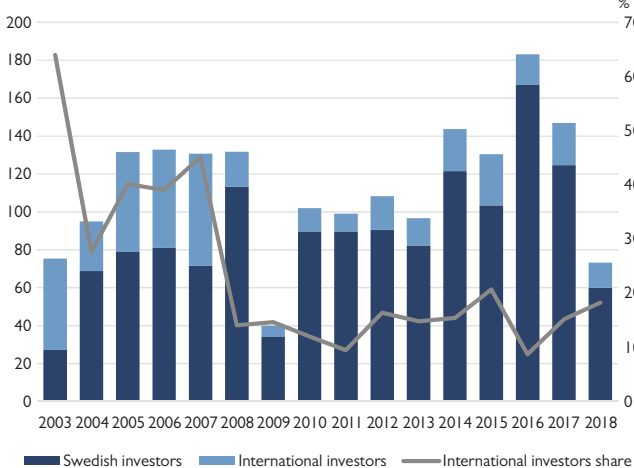
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION

