A shift downwards in long-term real interest rates over the summer is heralding a property market rally this autumn

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The transaction activity fell back in July and August. In total, transactions amounting to SEK 10.5 billion took place during the two-month-period, compared to SEK 16.1 billion and approximately SEK 13.1 billion during the same two-month-periods in 2018 and 2019. There were 23 transactions exceeding SEK 80 million during the months, which can be compared to 35 and 24 transactions during the same months in 2018 and 2019.

The rolling 12-month number of deals remains just above 300 deals. 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. The largest transaction during July and August was Folksam's (KPA Pension) acquisition of a portfolio of new production projects including 600 rental apartments located in Malmö, Lund, Helsingborg and Ängelholm for around SEK 1.5 billion. (to be completed over the years 2021–2024). The second largest deal was NREP's acquisition of the hotel property Piperska Muren 2 in Stockholm (where Clarion Hotel Amaranten is located) from Strawberry Forever at a price of around SEK 1.5 billion. The third largest deal was Sagax's purchase of a 37-property portfolio with Beijer Byggmaterial as tenant from Lone Star for SEK 1.4 billion. Apart from that Regio bought two office properties in Mölndal for just above SEK 1 billion from Nyfosa. Fabege did also acquire an industrial property located in a future developing area in Flemingsberg from WA Fastigheter for SEK 760 million. In addition, Blackstone signed a letter-of-intent to acquire a logistics portfolio from Nyfosa for SEK 2.1 billion with the intention to sign a binding agreement in September (the deal is not included in the transaction volume).

The development on the financial markets has been extremely strong during the summer. The MSCI World index of stocks in developed countries increased by 6.6 per cent in August, which was the strongest performance for that month since 1986. S&P 500 has passed 3,500, which is around 4 per cent above the recent all-time-peak from February. The development is, however, strongly concentrated to a few large companies. Share prices for a fifth of the S&P 500 companies are more than 50 per cent below their peak and the average company in the index is around 25 per cent below its peak. In Sweden the equity market development has also been strong. OMX Stockholm 30 is, however, still around 5 per cent below its February peak. The average equity price for ten large Swedish listed property companies* is still 38 per cent below the February peak and only 15 per cent up from the nadir in late March. There are, however, large differences between the property companies, where companies with large exposure to the retail and office sectors have suffered, while companies with more residential or public property exposure have had a rather strong performance. Some of the companies with clear residential focus have actually beaten the Stockholm OMX 30 Index since late February.

While the equity markets are soaring, the world economy is in the midst of the deepest recession of a century. The GDP in the Euro area fell by 12.1 per cent quarter-on-quarter during the second quarter, while the US economy contracted by 9.1 per cent. The Swedish performed somewhat better and did only contract by 8.3 per cent. However, the other Nordic countries actually performed better than Sweden despite imposing lock-downs (Denmark contracted by 6.9 per cent, Norway by 5.1 per cent, and Finland by 4.5 per cent during Q2). Although, consumer confidence in Sweden is still well below the historic average, retail sales were up 4.8 per cent year-on-year in July. Both Swedish and Euro area Manufacturing PMIs have been well above the 50-mark since July but the recovery in exports seems to be sluggish despite this. The Swedish exports were down 15.4 per cent year-on-year in July and world trade volumes was still down 10 per cent year-on-year in June (they have, however, recovered from the nadir of -17.9 per cent year-on-year in May). As it looks now the economic recovery seems to have lost some momentum in Europe since July as new waves of Covid-19 infections are hampering the development (especially in Spain).

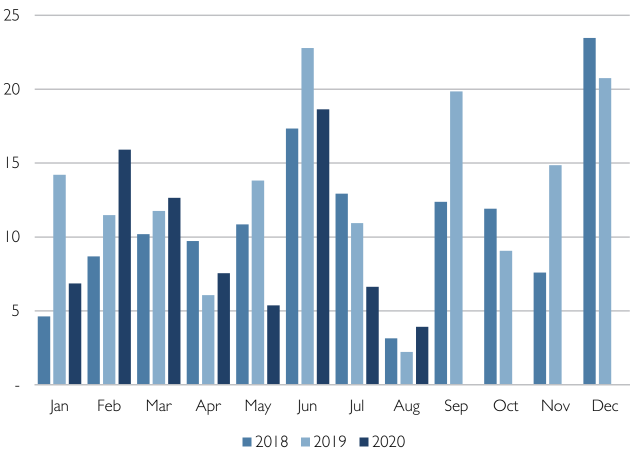
The central banks response to the corona crisis have been astonishing. In total six of the largest central banks (the Fed, ECB, Bank of England, BoJ, PBoC, BoJ and the Riksbank) have increased their total balance sheet from USD 21 trillion in March to USD 27 trillion in mid-August. Over the last 12 months, the six central banks have added almost USD 7 trillion into the financial markets, and this liquidity has been instrumental in the recovery on the financial markets. The S&P 500 index development has been tightly correlated to the total central bank assets over the last decade (where the development of the central banks' balance sheets are around four months ahead of the equity markets). Today's level of central banks' balance sheets indicate that a further increase towards the 4,000-level for S&P 500 during the autumn is not unlikely. Also yields on the Swedish property market are strongly correlated to the central bank liquidity, where the combined volume of the central banks' balance sheets are around four months ahead. The balance sheets expansion since April indicate a further pressure downwards in average Swedish ▶

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

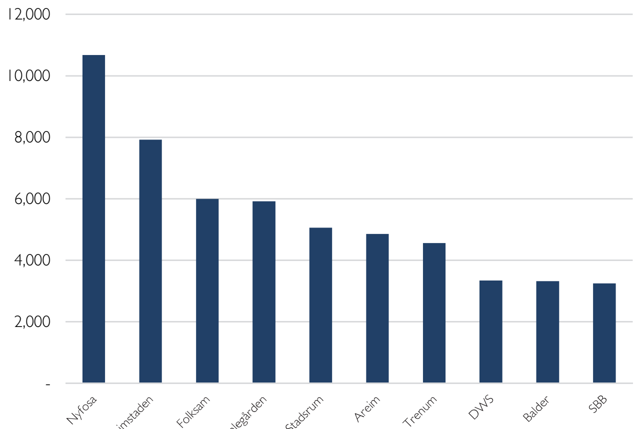
office yields from today's level of around 4.5 per cent to around 3.7 per cent. A counterweight to this is the growing insecurity among investors regarding whether or not we are in a structural shift where companies and employees change their office demand as a result of the corona virus. Regardless of this, however, there is a strong correlation between property yields and central bank liquidity and the recent six months' record central bank injections are having a direct impact on the property pricing.

The long-term investor demand for property has a lot to do with the development in long-term real interest rates. From mid-2013 until the summer 2019 the yield levels of the 30-year US inflation linked bonds were fluctuating relatively stable around 1 per cent. A shift downwards occurred during the spring of 2019, when the US 30-year real interest rate fell to the 0.50 per-cent-level. This 50 bps drop in long-term real interest rates was clearly visible at the Swedish property market as capital flew into the market and yield spreads between financing costs and property yields started to compress. This was especially visible for prime offices in Stockholm, well-located residential properties, as well as high-quality public properties and logistics. When the corona crises erupted in March there was a lot of volatility on the bond market. In April, however, the 30-year real interest rate stabilised around the zero mark, which was 50 bps below its pre-corona level and a new historic low. Well-located properties with stable cash flows (mainly residential, public and logistics/industrial properties) became very attractive to yield starved investors and the activity on the property market was relatively high. In mid-June another shift downwards occurred in the real interest rates. This time it was not due to declining nominal interest rates, instead inflation expectations started to increase. The increasing inflation expectations are due to the extensive money printing of central banks in combination with extremely expansive fiscal policies in virtually all developed economies. These expectations were further encouraged by the Fed announcement last week that it desires to overshoot the 2 per cent inflation target for an (unspecified) period of time when the economic recovery finally takes a hold. By late July, the 30-year real interest rate was down another 40 bps and has fluctuated around the -0.30 per-cent-level during August. The result of this is that the yield spread between financing costs and property yields now stands at historically high levels (as credit spreads for property companies have been declining too). It is quite likely that we will enter another period of yield spread compression between property yields and financing costs during the autumn as investors move out on the risk scale in their hunt for yield. In the longer term, however, there is a high risk of new bubbles emerging as developers now are doing all they can to supply the investor market with new projects. ■

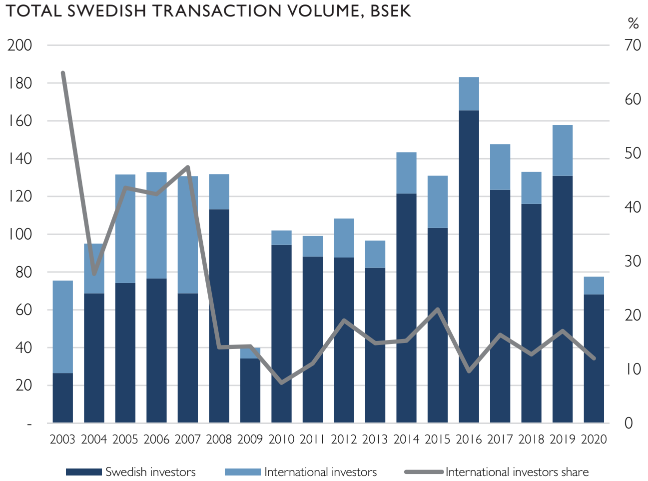
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION