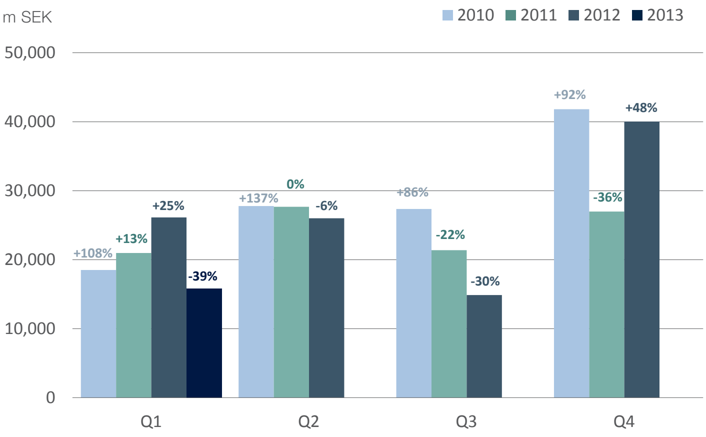
Market report
Sweden Investment

Q1 2013

GRAPH 1

Investment volume per quarter

Weak start in 2013 after a strong fourth quarter

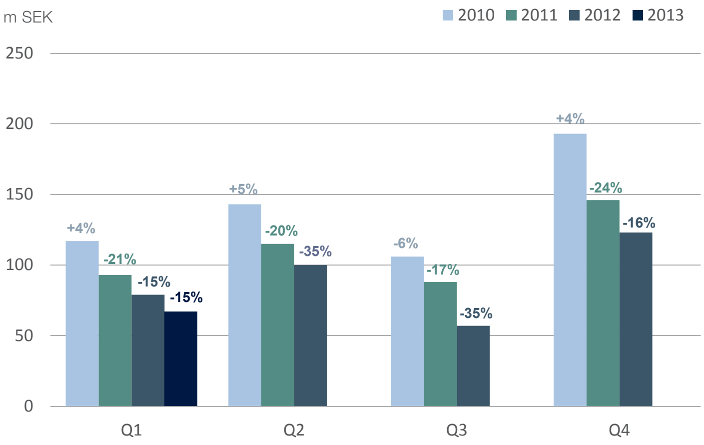


Graph source: Savills

GRAPH 2

Number of transactions per quarter

Continous decrease in the number of transactions since 2010



Graph source: Savills

SUMMARY

Overview

■ Following an exceptionally strong fourth quarter 2012, the transaction volume in Q1 was relatively weak and amounted to SEK 16bn.

■ There is a shortage of prime assets on the market and we expect to see investment volumes picking up as financing has become easier.

■ The risk averse attitude has led to a focus towards prime assets such as prime offices in Stockholm, Gothenburg and Malmö as well as residential and public properties that offer secure cash-flows.

■ In line with most economies in Europe Sweden's economy has experienced a mild downturn. However, Sweden's solid public finances allows for an expansionary public policy in order to support the economy.

■ Bank lending is still scarce but lending is picking up and margins have been reduced slightly, but the shortage of lending has led to a strong interest for alternative financing.

"Yield spreads between prime and secondary have continued to grow, but the shortage of prime assets on the market could force investors into looking at the prime portion of secondary assets". Peter Wiman, Head of Research Savills Sweden

Economic background

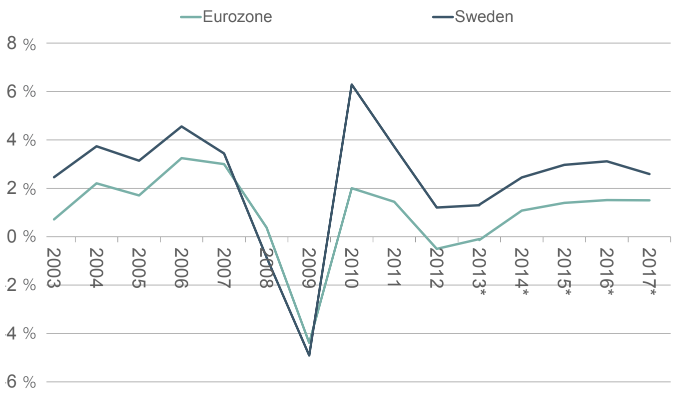
Along with most of the European economies Sweden has entered a slow-down of the economy. However, recently revised GDP figures indicates that the Swedish economy grew by 0.8% in 2012, which is strong from a European perspective. A number of economic indicators have moved in a negative direction in the second half of 2012, such as unemployment, bankruptcy figures, increased lay-offs and number of new jobs created. Forward looking indicators such as PMI and ESI have started to improve in the first quarter of 2013. These indicate that there is a negative sentiment with regards to the current situation, but with more positive expectations for the near future. Consensus forecast for Sweden indicates a GDP growth of 1.3% in 2013 and 2.6 in 2014 with a high spread between the different forecasts.

Being a small export driven nation with the Euro area as its main market gives some thoughts for concern as dose the strong currency. On the positive side are a number of factors, such as, that consumer confidence is picking up which could fuel domestic spending, strong public finances that allows for increased public spending if deemed necessary. Because of the decline in the economy combined with the low pressure on inflation, it is likely that the Bank of Sweden will keep interest rates low during 2013 and 2014. In spite of the slowdown most forecaster predict that Sweden will outperform in Europe in the short term.

“Swedens strong public finances can allow for increased public spending in order to support the economy” Peter Wiman, Head of Research Savills Sweden

GRAPH 3

GDP Growth



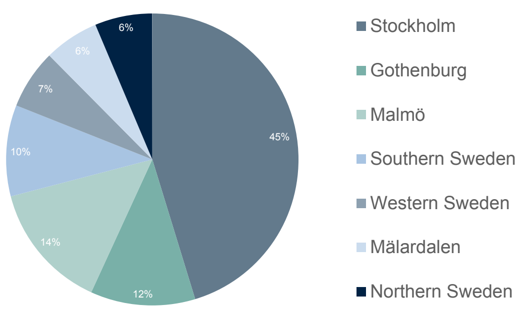
Graph source: Focus Economics / NIER

Transactions

The investment market finished with an exceptionally strong fourth quarter and the investment volume amounted to SEK 107bn in 2012, which was an increase of 9% compared to 2011 and is therefore still to be regarded as one of the top-five markets in Europe ranked by investment turnover. The first quarter in 2013 was weak both in volume and number of transactions with a transaction volume amounting to SEK 16bn, which was 40% less compared to Q1 2012. The transaction volume in Q1 2013 was boosted by large sales of residential assets, but in spite of this the average deal size dropped by approx. 20% to just under SEK 250m. A more distressing trend is that, in spite of the high transaction volume, the number of transactions carried through decreased by 20% year-on-year in 2012.

GRAPH 4

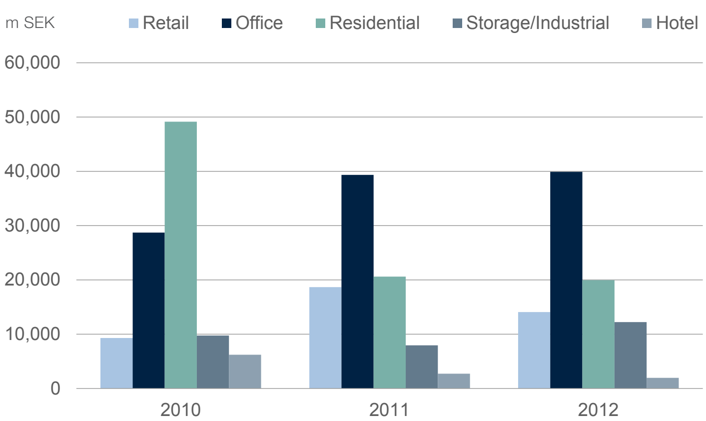
Breakdown of the volume per location for 2012



Graph source: Savills

GRAPH 5

Breakdown of the volume per type of asset



Graph source: Savills

In spite of a strong international interest in Swedish real estate the market was dominated by domestic investors who accounted for 84% of all acquisitions. Domestic pension institutions and funds represented more than 40% of the buyers in 2012. The low cross-border activity is not a result of a lack of international interest, but rather that international investors have, by and large, been unable to compete for the most attractive assets on the market. International investors have however been successful in acquiring shopping centres, retail parks and logistics during 2012.

In spite of a weak first quarter our outlook for 2013 is positive as bank financing has become more readily available and alternative financing forms are increasing. We expect transaction volumes to pick up with a strong competition for prime assets and increasing demand for secondary assets. However, the difficulties in securing financing for secondary assets are likely to prevail in the near future.

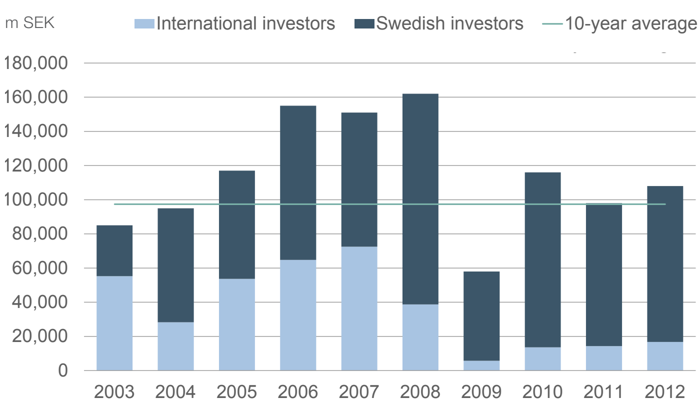
Yields

The continued strong interest for prime assets within all property segments has led to a strong competition for the few assets being put on the market, leading to stable yields for prime assets. The market for secondary assets is more fragmented, with relatively stable markets in the larger cities. However, the difficulties in securing financing for secondary assets combined with an increasing yield spread between prime and secondary has affected the secondary market negatively. The shortage of prime asset could very well lead to investors taking more risk which would affect the secondary market in a positive way.

"The amount of equity targeting prime assets as well as demand is still very strong, which indicates that prime yields will remain stable in the near future. For secondary assets the future is significantly more uncertain and a scenario with yields softening is not unlikely." Peter Wiman, Head of Research Savills Sweden

GRAPH 6

Transaction volume



Graph source: Savills

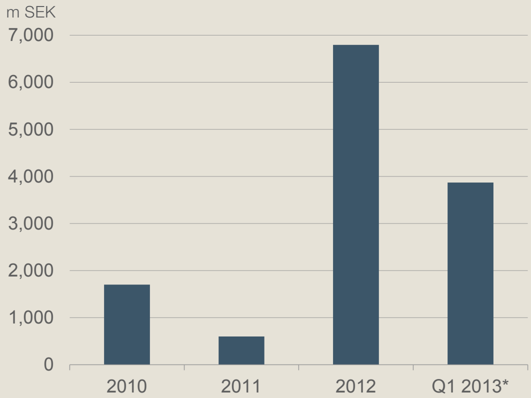
Booming market for property bonds

Sharp increase in issued bonds

The scarcity of financing has led to an increasing interest for alternative ways of securing financing. Some of the alternative forms are seller financing, paying with own stock, issuing preferential shares and bond issuances. Seller financing is very commonly up for discussion in many transactions, especially regarding secondary asset as is the alternative of paying with shares or preferential shares.

GRAPH 7

Issued bonds Volume of corporate bonds issued by listed property companies



Graph source: Savills / * to Q1

Up until 2012 bond issuances were mainly used by pension-fund backed Vasakronan and the government-sponsored entities such as Akademiska Hus and Specialfastigheter. For these companies the bond market was an option to access a wider range of financing sources, but as bank financing became scarcer and difficult to secure they increased their bond market programes and in many cases these bonds had lower margins compared to traditional bank financing.

Following the financial crisis in 2008 the listed property companies, who up to this point had mostly used preferential shares as the main source of alternative financing along with using their own shares, started issuing bonds which increased continuously and peaked in 2012 when the listed companies issued bond for a total amount of SEK 6.8bn. The high bond issuance pace continued into 2013 where in first quarter alone bond for an amount of SEK 3.9bn was issued.

The majority of the bonds issued by the listed companies are non-covered bonds, which means that this financing form is in many cases to be regarded almost mezzanine or junior loans with margins being in the 200 – 400bp range over STIBOR. Covered bonds have also increased significantly in volume in 2012 and 2013.

Outlook for the remainder of 2013

Despite the negative macroeconomic environment, the outlook for Sweden is still more optimistic than the majority of other European markets, mainly due to stable public finances which can allow for an expansionary economic policy. Our assessment is that the risk-averse climate will result in a continued focus amongst investors towards the larger metropolitan areas and prime properties where we expect yields to remain stable.

We have started to notice that property lending is slowly picking up, and particularly so for prime assets where margins have dropped continuously since end of summer 2012. For assets not regarded as prime, bank financing is still scarce which has led to a strong interest for different methods of alternative financing.

Interest rates are at historically low levels and are expected to remain low in the near future as the Bank of Sweden is likely to keep the lending rate low in order to support the economy. Considering the low yield on government bond property offers an attractive risk-adjusted return for a wide range of investors, and we expect more capital to be targeting property investments throughout the year.

The market for prime assets is very strong and is likely to be dominated by domestic institutions and especially the Swedish pension funds as they tend to be risk averse and at the same time experience less competition from investors that are dependent on leverage. The interest from foreign investors is strong but so far they have been unable to compete with domestic investors for prime offices, but they have been successful in acquiring prime retail warehousing, logistics and shopping centres.

Prime yields	Q1 2012	Q4 2012	Q1 2013
Stockholm offices	5.00%	4.75%	4.75%
Gothenburg offices	5.00%	5.00%	5.00%
Malmoe offices	5.25%	5.50%	5.50%
Retail warehouse	6.00%	5.75%	5.75%
Shopping centres	5.25%	5.25%	5.25%
Logistics	6.75%	6.50%	6.50%

OUTLOOK

Continued strong interest for prime properties in the larger metropolitan areas

- Strong interest for prime assets and a lack of properties on the market will keep prime yields stable.
- Alternative forms of financing are starting to have an impact and could lead to a higher transaction pace.
- Bank financing is easing up and margins are shrinking.
- A slower pace on the transaction market is likely to result in a smaller average deal sizes.
- Institutions and pension funds are likely to keep pursuing prime investments and focusing on assets with secure cash-flows and strong covenants.
- A lack of prime properties put on the market could push investment volumes in the secondary segment.
- Residential and public properties will continue to be preferred by a number of investors.

Savills Research team

Please contact us for further information

Peter Wiman
Head of Research
+46 (0) 733 58 64 22
pwiman@savills.com

Johan Bernström
Head of Investment
+46 (0) 8 545 85 899
jbernstrom@savills.se

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