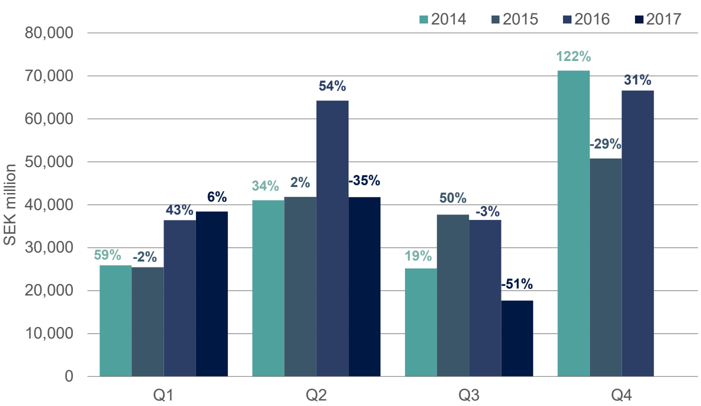
Market report
Sweden Investment

Q3 2017

GRAPH 1

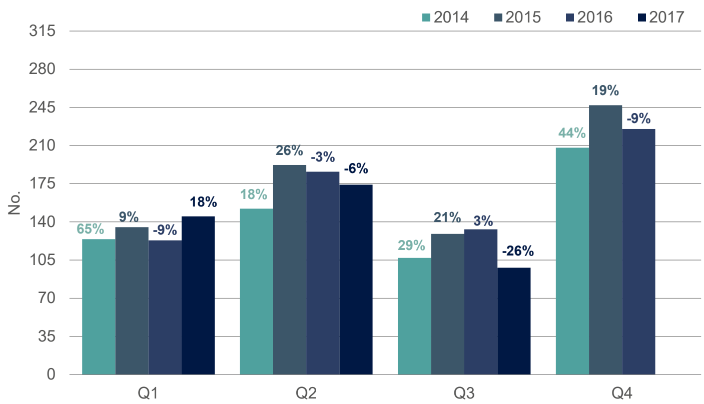
Investment volumes An overall strong investment market so far in 2017



Graph source: Savills

GRAPH 2

Number of deals Weakened transaction pace in Q3 2017



Graph source: Savills

SUMMARY

Transaction volumes remain at historically high levels

- Sweden is characterised by a strong expansionary monetary policy and the Swedish economy is expected to grow by 3.0% in 2017.
- The first three quarters of 2017 finished strong with an investment volume reaching SEK 99bn (€10.4bn).
- We noted a drop in investment volume and transaction pace during the third quarter.
- So far, prime yields have remained at historically low but stable levels in 2017, driven by continuous high demand for properties.
- International investors have increased their presence in Sweden and accounts for approximately 28% of the total investment volume. 2017 is the first time since the financial crisis where international investors have acted as net buyers.
- Residential properties remain the most sought after asset class and has accounted for 28% of the total investment volume so far in 2017.

"The Bank of Sweden has chosen to keep the repo rate at low levels which will continue to be very beneficial for the property market." Peter Wiman, Head of Research, Savills Sweden

Economic background

Despite political turbulence and several uncertainties, the global economy is strong. All OECD countries are growing for the first time since the financial crisis. The Swedish economy remains strong and most forecasters have positively adjusted their growth expectations. The consensus forecast indicates a growth of 3.0% in 2017 and 2.5% in 2018, which is stronger than most mature economies in Europe.

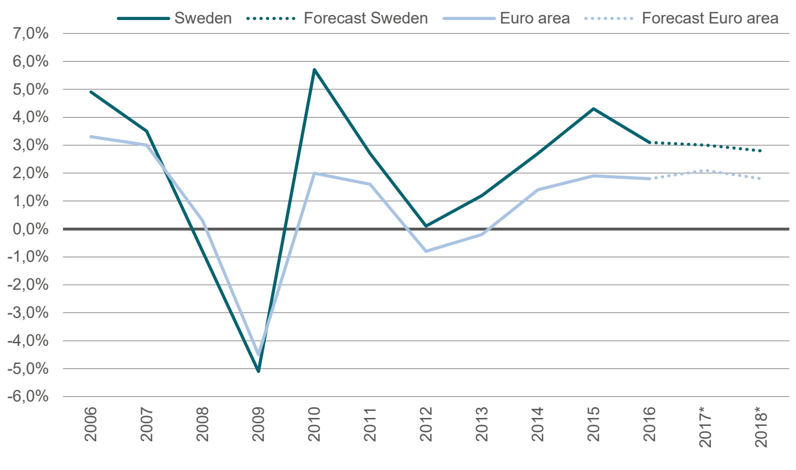
The main drivers of growth have been domestic demand due to stimulations by expansive fiscal and monetary policies, and also increased exports driven by a weaker krona. Record high housing investments remain the primary economic driver. During the first half of 2017 construction of approximately 37,600 apartments were initiated, which is an increase of 24% compared to the same period in 2016. The previously strong public consumption slowed down in 2017, mainly due to fewer asylum seekers which has resulted in a reduction of government spending.

Swedish inflation is close to the target of 2%. In order for the inflation to remain close to the target in the future, the Bank of Sweden decided that monetary policy must remain expansionary and left the repo rate unchanged at -0.5% in September as well as prolonged the QE-programme. Most forecasters expect the repo rate to remain at low levels throughout the year and a first hike is expected to occur in the second quarter of 2018.

The employment rate is the highest since the early 1990s, but due to the large increase in the labour force from immigration, unemployment is declining slowly. The labour market is very strong and the outlook is positive since, amongst others, business hiring plans reached historical peaks this summer.

GRAPH 3

GDP growth & forecast (calendar adjusted) Stronger growth than most forecasters expected



Graph source: National Institute of Economic Research

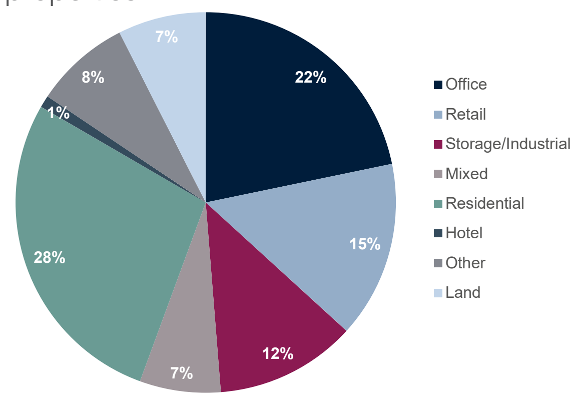
Investment activity

Following a record year in 2016, the strong investment market has continued in 2017. The total investment volume for the first three quarters of 2017 amounted to SEK 99bn (€10.38bn), which is a decrease of 28% compared to the same period in 2016. The decline in the investment volume is explained by the exceptionally high investment volume in 2016, primarily due to Castellum's acquisition of Norrporten, a deal contributing SEK 22bn (€2.3bn) to the volume. So far in 2017, the investment volume is still 8% higher than the long-term Q1-Q3 average and demand is estimated to far outweigh supply.

The transaction pace, measured as the number of transactions carried through, has slowed in 2017 compared to 2016. Approximately 420 transactions were completed during the first three quarters of 2017; 6% less than the same period in 2016. The decline in the transaction pace should not be seen as sign of a weakening market, but rather that there is a limited supply of properties. It is worth noting that so far 2017 the transaction pace is approximately 14% higher than the Q1-Q3 average over the last decade.

GRAPH 4

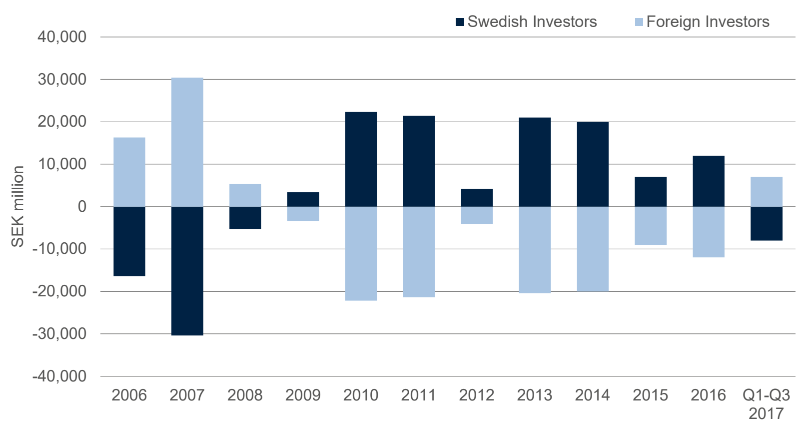
Breakdown by asset class (Q1-Q3 2017) High demand for residential properties



Graph source: Savills

GRAPH 5

Net transactions First time since the financial crisis foreign investors have acted as net buyers



Graph source: Savills

With a total investment volume of SEK 27bn (€2.83bn), residential properties represented the largest market share (28%) across all property sectors. Office properties were the second largest property sector with a total investment volume of just over SEK 21bn (€2.2bn) and a market share of 22%. Land properties, mainly intended for property development, have seen a significant increase in the investment volume and so far in 2017 they accounted for 7% of the market which is significantly higher than the long-term average of approximately 3%.

The share in the number of portfolio transactions carried out has shown an upward trend since 2009 and reached 35% during the first three quarters of 2017; a figure higher than the strong investment years prior to the financial crisis and normally an indicator of a booming market.

The Swedish real estate market seems to have been completely unaffected by prevailing global uncertainties, and Brexit may even have strengthened Sweden as an investment option for international investors. Foreign players have been very competitive and have won the bidding in the last two office deals in the Stockholm CBD. During the first three quarters foreign investors bought properties for SEK 27bn (€2.83bn) and thereby represents 28% of the market. 2017 is also the first time since the financial crisis where foreign investors have acted as net buyers (graph 5).

Yields

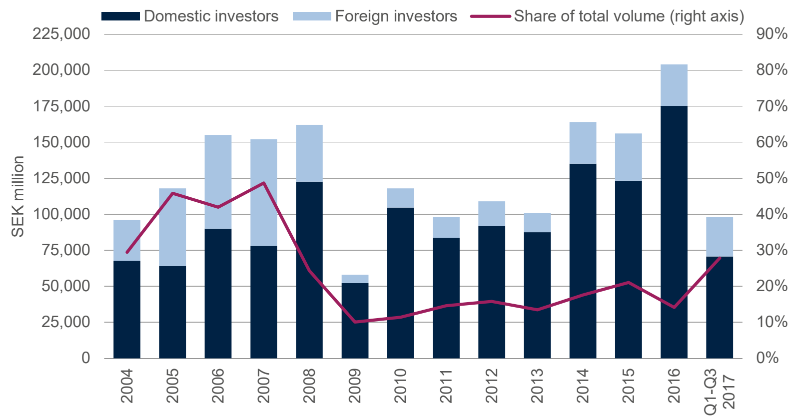
The property market in Sweden is highly competitive with a demand surpassing supply by far, and yields have reached historically low levels across all property sectors. Yields have remained rather stable across most property sectors throughout the year with a slight downward pressure across a few sectors and geographical markets.

The high investment volume indicates that the market is still extremely well supplied with equity and the availability of bank financing is still strong. The lack of alternative investments, low bond yields and a volatile global stock market has forced investors to increase their exposure towards the property sector in order to reach higher returns.

Although investor interest is still primarily focused on prime assets in Stockholm, Malmö and Gothenburg, the shortage of products has led to a wider interest for secondary assets or assets located in what are generally considered weaker markets.

GRAPH 6

Breakdown by origin of investor Increased demand from foreign investors



Graph source: Savills

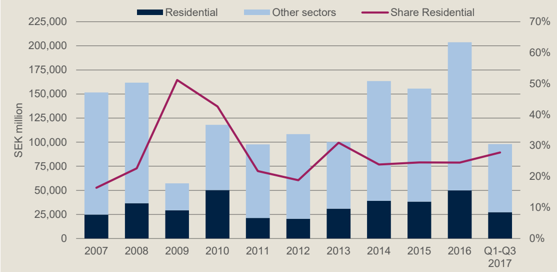
Residential properties

High demand for residential properties

Residential properties were the largest property sector during the first three quarters of 2017 with an investment volume of SEK 27bn (€2.83bn) and a market share of 28%. The investment volume is 19% lower compared to the same period last year, but 2016 was a record year for residential properties and the investment volume is still significantly higher than the 10-year average.

GRAPH 7

Investment volumes Strong interest for residential properties

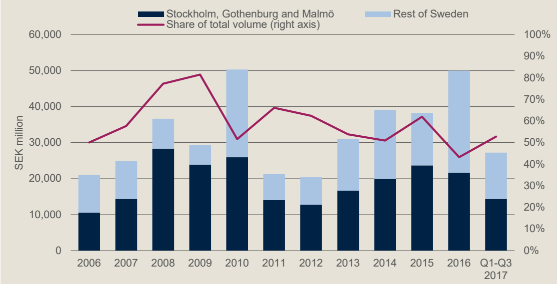


Graph source: Savills

The investment volume in Sweden's three largest cities (Stockholm, Gothenburg and Malmö) has seen a steady decrease in market share over the past decade. The decrease is mainly explained by the overall lack of supply as well as an increased investor appetite for assets in secondary markets which offer higher returns.

GRAPH 8

Residential investments volumes



Graph source: Savills

The housing construction pace in Sweden is currently at the highest level since the beginning of 1990s, and we see that a lot of projects are being sold before completion or even before the construction starts. The rapid population growth and an overall housing shortage (255 of 290 municipalities reports a housing shortage) are both beneficial factors for property owners, and we expect that investment volumes will continue to remain high as market fundamentals are indicating a bright future.

Outlook for the remainder of 2017

It is a unique situation in the Swedish economy; the economy is strong while economic policy is very expansive. The outlook for the economy is rather bright but domestic drivers of the economy are expected to have lesser influence on the economic growth than they had during previous years. Instead, exports and business investment are believed to contribute to the economic growth. The continued need for housing means that new developments will continue to increase, but the large labor shortage will slow down the growth rate in the coming years.

Savills has noted a significant decrease in the investment volume and transaction pace in Q3 2017. The investment volume during the third quarter only amounted to SEK 18bn (€1.9bn), which is the one of the weaker third-quarter volumes noted over the past decade. The number of transactions amounted to 98 which also is a fairly weak number. However, it is difficult to determine whether this is a just a temporary drop or if Sweden is heading towards a more cautious investment climate. We have also noted that, unusually, many buyers and sellers are choosing to keep the purchase price confidential; the decreased transparency may also be considered an indicator of a more uncertain future.

There are a lot of economic and political uncertainties across the globe but we believe that this will strengthen Sweden as an investment market for international investors, rather than having a negative impact. The largest domestic concerns are likely to be the changes in the real estate market rules that have been put forward. Partly, in the form of the so-called "Paketeringsutredningen" regarding capital gains taxation, and partly the proposed limitation on the deduction possibilities for interest costs.

Prime yields across most property sectors are expected to remain stable throughout the year. Due to the lack of supply for prime assets, investors will look towards secondary markets when chasing higher returns. We expect that secondary yields will continue to harden and the gap between prime and secondary yields will decrease.

Retail parks are one type of asset in which are acting differently from other asset classes. We have noted a slight yield increase in 2017, which may be a result of increasing cautiousness and uncertainties due to the rapid growth of e-commerce.

OUTLOOK

A continuous strong investment appetite is expected throughout the year

- Despite a weakened transaction market in Q3 2017 we expect that transaction volumes will remain at high levels throughout the year. The year-end transaction volume is likely to exceed SEK 150bn (€15.7bn).
- The strong market conditions are likely to incentivise developers to dispose of their development projects on a forward commitment or forward funding basis across all sectors.
- The historic low prime yields across most property sectors are expected to remain stable throughout the year.
- Retail park yields are expected to soften, mainly due to uncertainties related to the rapid growth of e-commerce.

Prime yields	Q3 2016	Q1 2017	Q3 2017
Stockholm offices	3.75%	3.50%	3.50%
Gothenburg offices	4.00%	4.00%	4.00%
Malmö offices	4.15%	4.15%	4.15%
Retail warehouse	5.25%	5.25%	5.50%
Shopping centres	4.50%	4.00%	4.00%
Logistics	5.50%	5.40%	5.50%

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