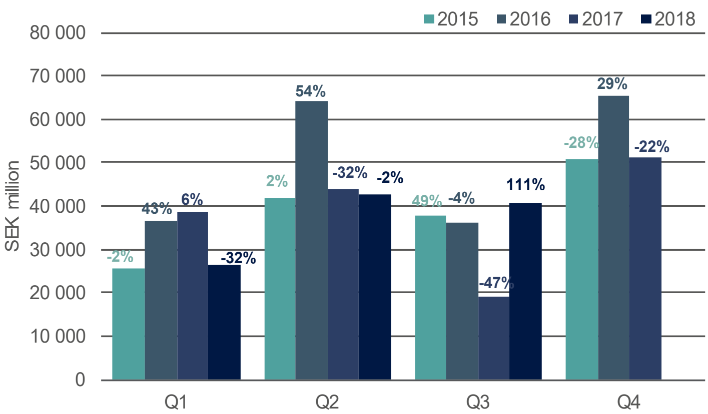
Market report
Sweden Investment

Q3 2018

GRAPH 1

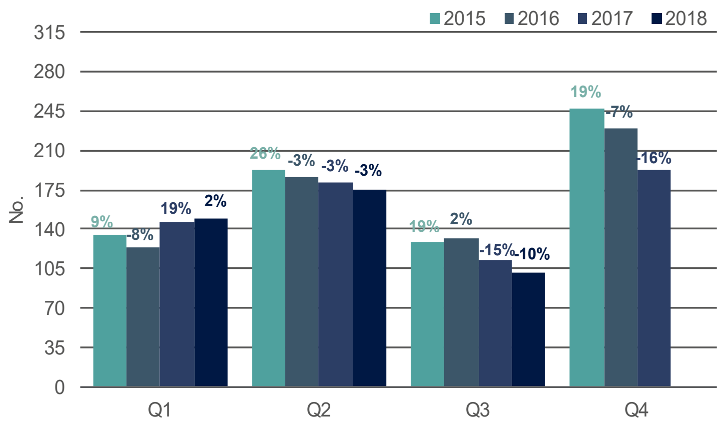
Investment volumes A historically strong investment market in Q3 2018



Graph source: Savills

GRAPH 2

Number of deals Weakened transaction pace in Q3 2018



Graph source: Savills

SUMMARY

Continued high investment appetite in Sweden

■ The Swedish economy remains strong and most signals continue to indicate strength. The Swedish GDP is expected to grow by 2.5% in 2018 and 1.9% in 2019.

■ The repo rate remains unchanged at -0.5% and a first hike is expected by the end of 2018 or early 2019.

■ The investment volume for the first three quarters of 2018 amounted to SEK 110bn (€11bn), an increase by 9 % from the same period last year. The increase in investment volume is a clear indicator of a continuous strong investment appetite.

■ With a total investment volume of SEK 38bn (€3.6m), residential properties represented the largest market share (35%) across all property sectors.

■ Prime assets in Stockholm, Gothenburg, and Malmö are still very attractive from an investment perspective, corresponding to approximately 63% of the total investment volume.

■ Foreign investors show a growing interest for residential real estate in Sweden and represented 44% of the market Q1-Q3 2018, the highest noted market share since the financial crisis in 2008.

"The investment market continues to be strong across all sectors and prime yields remain at all-time lows in many sectors."
Peter Wiman, Head of Research, Savills Sweden

Economic background

The global economy has continued with a positive momentum through 2018. Even though growth continues in a positive direction, the global economy has recently shown mixed tendencies. The euro zone slowdown lasted longer than anticipated, with a low pace of growth. Chinese and other emerging economies' indicators have also been unexpectedly week, driven by such factors as falling growth, trade disruptions and the negative effects of higher interest rates in the United States. Yet, overall the European economy's fundamentals remain positive.

The Swedish economy will most likely peak this year with a GDP growth above trend as exports and higher industrial and public sector investments offset falling home constructions. The housing market is key to domestic demand and especially households' propensity to spend. Housing prices have stabilised this year following last autumn's downturn. The probability of a soft landing in the housing market has risen, although, a large supply of housing projects come to fruition will most likely continue to compress prices due to a damped domestic demand. However, a long-term uncertainty is present due to interest-rate sensitivity. When interest-rates starts to hike, it will pose a challenge for the economy in general and the housing market in particular.

Consensus forecast indicates a continued GDP growth of 2.5 % in 2018 compared to last year's growth of 2.4 %. The Swedish labour market performs at a high level with a record high employment rate. Yet wage growth is lower than expected, holding down inflation pressure. However, employment growth will slow down this year and the next. This is partly the result of a reduced need for labour in the construction sector and decreased demand from the government sector.

Swedish inflation is currently above the target of 2 %. However, about 1 %-point of the inflation-rate is attributed to rising energy prices, making Swedish inflation fragile. In order to keep the inflation close to the target, monetary policy remains expansionary. The Executive Board of the Riksbank has therefore decided to hold the repo rate unchanged at -0.5%. The Riksbank will initiate a rate hike of 0.25 % this year in December or in February 2019.

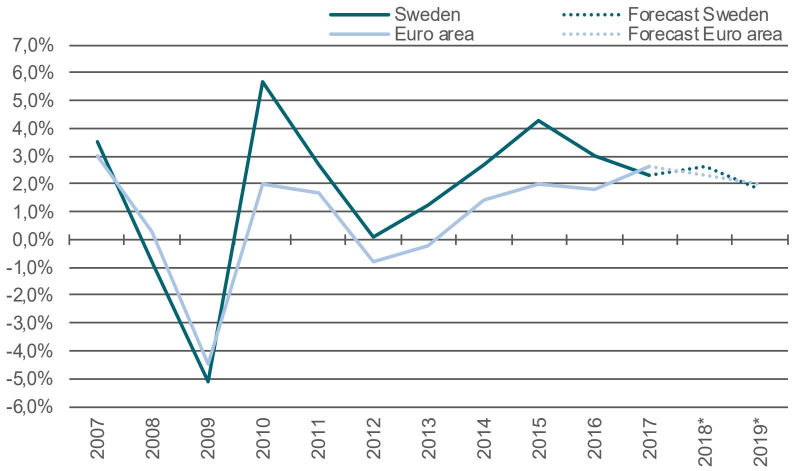
Investment activity

The investment volume for the first three quarters of 2018 amounted to SEK 110bn (€11bn), which is an increase by 9 % from the same period last year, when the volume amounted to SEK 101bn (€10bn). The increase in investment volume is a clear indicator of a continuous strong investment appetite. The third-quarter corresponded to the highest third-quarter since 2008 and the demand outweigh supply.

The transaction pace, measured as the number of transactions carried through, has slightly slowed in 2018 compared to 2017. A total of 426 transactions were carried through

GRAPH 3

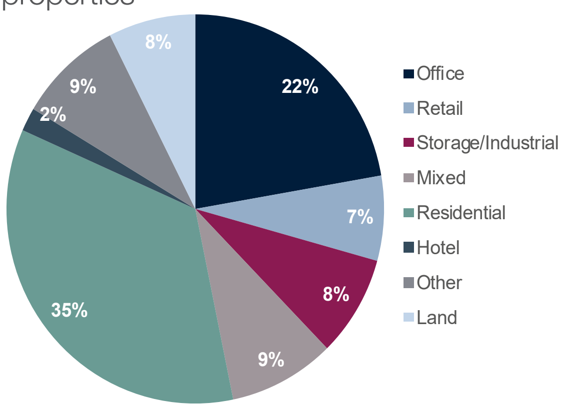
GDP growth & forecast (calendar adjusted) The fairly stable economic growth is expected to continue



Graph source: National Institute of Economic Research

GRAPH 4

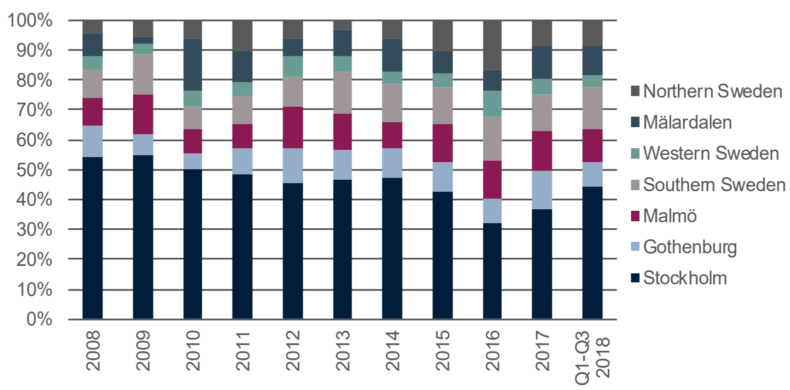
Breakdown by asset class (Q1-Q3 2018) High demand for residential properties



Graph source: Savills

GRAPH 5

Breakdown by location Increased investment volume market share in Stockholm, Gothenburg, and Malmö



Graph source: Savills

during the first three quarters of 2018 with an average deal-size of SEK 257m (€25m). It is worth noting, that so far 2018 the transaction pace is approximately 22% higher than the Q1-Q3 average over the last decade.

With a total investment volume of SEK 38bn (€3.6m), residential properties represented the largest market share (35%) across all property sectors. Office properties were the second largest property sector with a total investment volume of SEK 24bn (€2.3m) and a market share of 22%. Followed by industrial, warehouse and logistics, covering 8% of the market. Noteworthy, the large investment volume for residential properties, is mainly explained by Vonovia's acquisition of Victoria Park for SEK 14bn (€1.3bn).

Prime assets in Stockholm, Gothenburg and Malmö are still very attractive from an investment perspective, corresponding to approximately 63% of the total investment volume.

Yields

The Swedish investment market remains active and stable during 2018. The existing market is well-supplied with equity and favourable lending conditions. Yields have remained rather stable across most property sectors throughout the year with a slight downward pressure across a few sectors and geographical markets. Noteworthy, we have seen a slight yield drop for prime logistics in favourable locations.

With bond yields at very low levels and a lack of alternative investments, the demand for properties will remain high since they offer an attractive return. The yield spread between Swedish and German 10-year government bonds has widened since May. It is probably a consequence of the inability of Swedish bond-yields to follow the big downturns reported for German bond-yields. However, the Swedish 10-year yield is expected to increase from 0.75 % in the end of 2018 to 1.50 % at the end of 2019.

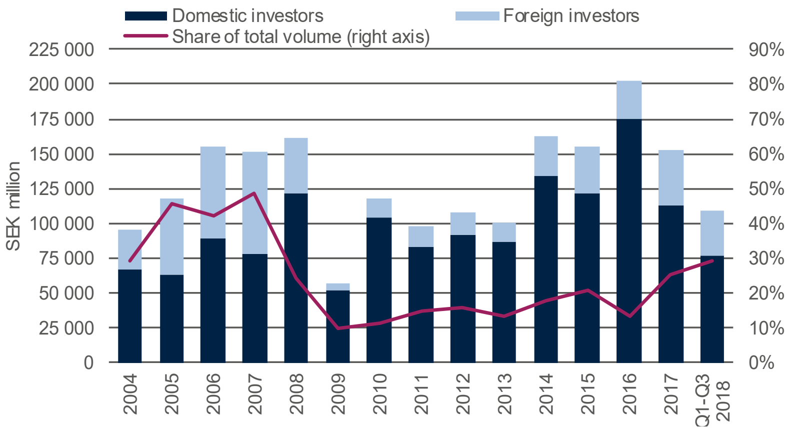
While investors still favour prime assets in Stockholm, Gothenburg and Malmö, the interest for secondary assets and markets outside the larger cities has increased over the past few years, driven by an overall shortage of products in the three major city regions.

Outlook for the remainder of 2018

The recent election pose a challenge to form a strong and decisive government. For decades, the same two established blocs has defined Sweden's politics, coalescing more recently into a more formal four-party alliance led by the Moderates on the centre-right, and a Social Democrat-Green coalition – backed by the ex-communist Left party – on the centre-left. The rise of the populist, right-wing Sweden Democrats, has irrupted the power-balance between the two blocs. Due to the outcome, it is likely that financial markets will pay more attention than usual to Swedish politics. However, there is little risk of turmoil, due to strong government finances, a high degree of consensus

GRAPH 6

Breakdown by origin of investor Foreign investors continue to take market shares



Graph source: Savills

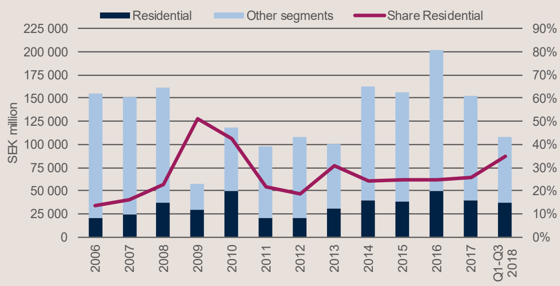
Residential properties

High demand for residential properties

Residential properties were the largest property sector during the first three quarters of 2018 with an investment volume of SEK 38bn (€3.6m), and a market share of 35 % (Graph 7). The 10-year average market share for residential properties correspond to 29%.

GRAPH 7

Investment volumes Strong interest for residential properties in 2018

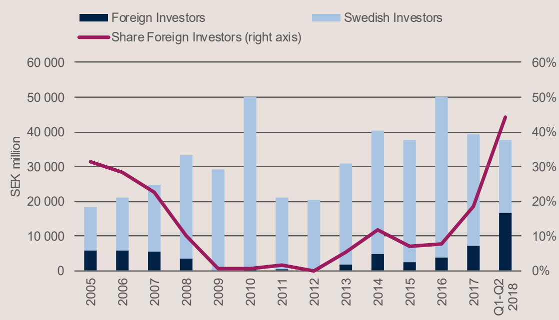


Graph source: Savills

The investment volume for 2018 is 36 % higher compared to the same period last year, which mainly is explained by a growing foreign interest and Vonovia's acquisition of Starwood's stake in the Swedish residential property company Victoria Park. The acquisition corresponded to a value of SEK 14bn (€1.3bn).

GRAPH 8

Breakdown by origin of investors



Graph source: Savills

The residential sector has been of low priority to foreign investors since the last financial crisis. However, we have seen a growing interest from foreign investors during the last five years, were foreign investors on average have represented a market share of 18% (Graph 8). Investors are targeting Sweden as it is seen as a safe haven/secure market for real estate investments.

on economic policy matters and a history of cross-bloc cooperation.

The outlook for the economy is positive and world trade should regain momentum in 2019, growing at rates in line with the historical average. A soft spot for the remainder is a risk of lower than expected export growth. Consensus forecasts confidently indicate a GDP growth of 2.5% in 2018 but will slow to 1.9% in 2019.

Stockholm is the financial centre of Sweden, corresponding to a third of national GDP, and the current boom in Swedish economy have enhanced a flourishing business climate in Stockholm. Even though a slowdown has been forecast, the economy will most likely continue to show a steady growth in GDP. Dynamic growth is set to continue in the Stockholm region, thus we expect the demand for office space in Stockholm to remain high, and both the office rental and investment market to remain strong. However, we expect prime CBD rents to remain stable after a few years of exceptional growth. It is likely other parts of the inner city will see a rental growth in order to squeeze the gap between prime and secondary rents.

Looking to the residential sector we see a lower interest from institutions. Large property companies and institutional investors are heavily invested in the residential and land sector, and are expected to focus on developing existing building rights rather than acquire new projects. This can potentially cause the investment volumes in the sector to return to the long-term average, rather than the record high volumes we have seen in recent years. However, so far have an increasing interest from foreign investors compensated the effects. Some passivity amongst homebuyers still is prevalent even though housing prices have stabilised this year following last autumn's downturn.

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. A wider investment horizon will likely continue to harden secondary yield, and the gap between prime and secondary yields is expected to decrease. Some investors may as a consequence explore new geographical markets and sectors.

OUTLOOK

Continued high transaction volume is expected

- The historic low prime yields across most property sectors are expected to remain stable throughout the year.
- We expect demand for office space in Stockholm to remain high, and both the letting and the investment market to remain strong.
- High interest in logistics properties have hardened the prime yield. A growing interest for prime objects will most likely continue to lower the yields.
- A hike of the repo-rate will likely keep homebuyers passive in the housing market.

Prime yields	Q1 2016	Q3 2016	Q1 2017	Q3 2017	Q1 2018	Q3 2018
Stockholm offices	3.75%	3.75%	3.50%	3.50%	3.50%	3.50%
Gothenburg offices	4.25%	4.10%	4.00%	4.00%	4.00%	4.00%
Malmö offices	4.25%	4.15%	4.15%	4.15%	4.15%	4.15%
Retail warehouse	5.25%	5.25%	5.25%	5.50%	5.50%	5.25%
Shopping centres	4.75%	4.50%	4.00%	4.00%	4.00%	4.00%
Logistics	5.50%	5.50%	5.40%	5.50%	5.25%	4.80%

Savills Sweden

Please contact us for further information

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

Lukas Theander
Analyst
+46 (0)739 81 70 42
ltheander@savills.se

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 650 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.