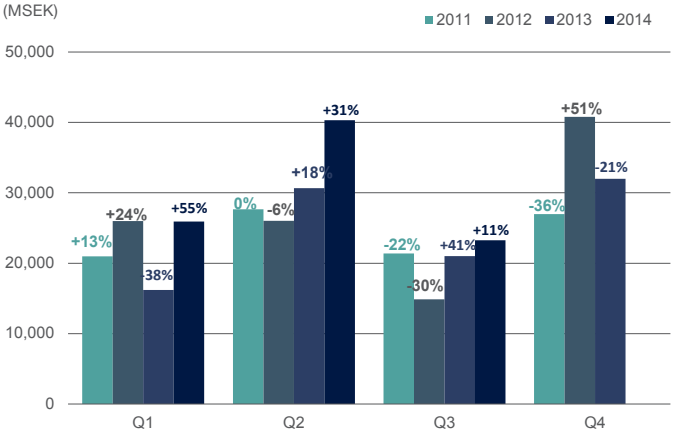
savills

Market report
Sweden Investment

Q3 2014

GRAPH 1

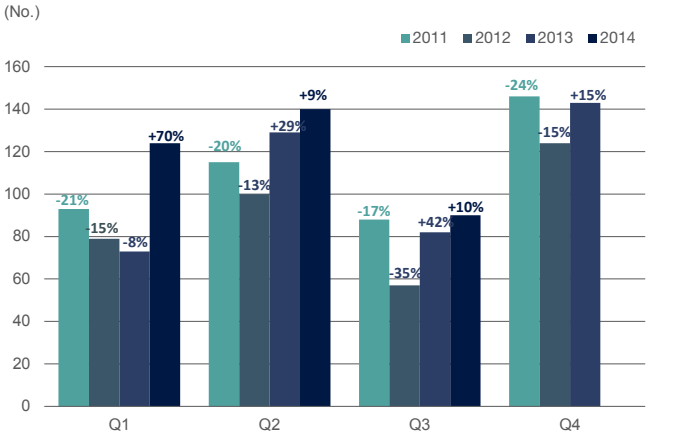
Investment turnover Continued turnover growth during Q1-Q3 2014



Graph source: Savills

GRAPH 2

Number of transactions Continued growth in transaction pace



Graph source: Savills

SUMMARY

Strong investment market across all geographic submarkets and segments

■ Looking back at three strong quarters we expect a strong fourth quarter as well, with a yearly transaction volume being in line with the years prior to the 2008 financial crisis.

■ Prime yields are expected to remain firm, and in some segments harden. We expect a lower spread between prime and secondary yields due to the shortage of products on the market and the increased willingness to achieve higher returns through more risk.

■ Sweden remains a priority market for many international investors, but they struggle to secure investments and are often outbid by domestic investors.

■ The Swedish economy is still recovering slowly but growth is expected to pick up. It is likely that Sweden will outperform most mature markets in Europe in the short term and the government has stable finances, which can allow for higher spending if it is deemed necessary.

■ The proposed new corporate tax system could have significant impact on the property market but effects are hard to estimate before a new proposed law is presented. The current proposal could incur significantly higher tax burdens for highly geared investors.

■ The change in government could lead to lower transaction volumes for primarily residential and public assets sold by the municipalities.

"Prime assets remain the favoured investment class in general, but fierce competition and aggressive pricing has led to a renewed interest for secondary assets and value-add opportunities." Peter Wiman, Head of Research Savills Sweden

Economic background

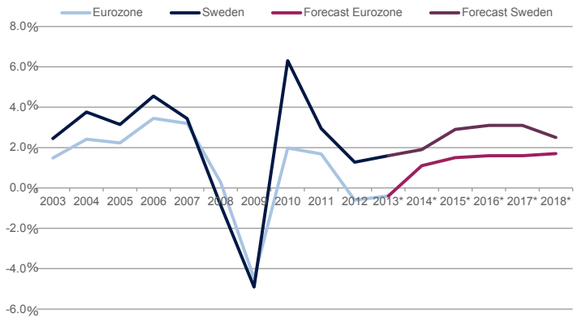
The Swedish economy has grown at a moderate pace, but GDP growth is expected to improve towards the end of the year. Most forecasts have gradually been downgraded throughout the year, mainly due to lower exports and lower capital investments than expected. In spite of the modest growth situation Sweden has outperformed most countries in Europe and also has had the benefit of having sound and strong public finances. From a risk perspective, Sweden is a small and open, export-driven economy and is as such highly susceptible for negative changes in the general economic climate and even more so when it concerns Northern Europe.

Forward looking indices such as ESI and PMI vary and the volatility has been unusually high, but the indices indicate growth rather than a contraction of the economy. Other macro-economic figures are moving in a positive direction, unemployment is decreasing, employed workforce is increasing and bankruptcy rates have continued to drop, all of which are positive signals for the economy. The general election resulted in a new government, which could lead to tax increases for the wealthier parts of the population, but no significant effect is estimated to take place in the short term. Household savings ratios have remained on high levels, but consumer spending seems to have picked up. The current state of the economy and low inflationary pressure indicate that the Bank of Sweden will keep lending rates on low levels throughout 2014 and 2015. Our prediction is that Sweden will outperform in Europe in the short and medium term.

"The increased appetite for property lending among the banks has led to a competitive climate among lenders, which in turn has led to more favourable terms of property owners." Peter Wiman, Head of Research Savills Sweden

GRAPH 3

GDP Growth and forecast



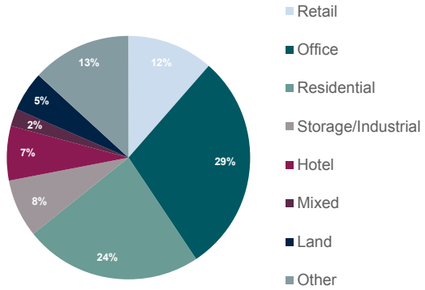
Graph source: Focus Economics / NIER

Transactions

The transaction turnover amounted to SEK 90bn for the first three quarters, which was an increase of approximately 32% compared to the same period in 2013. The turnover in the last quarter was just under SEK 24bn, which is a strong figure considering that Q3 is normally the weakest quarter of the year and marked an 11% increase compared to Q3 2013. Not only are the volumes picking but also the general transaction pace, measured as the number of transactions carried through. The number of transactions in the last three quarters increased by 25% and by 11% in the last quarter compared to the corresponding periods in 2013. Both figures are good indicators for the very high interest for property investments amongst all types of property investors.

GRAPH 4

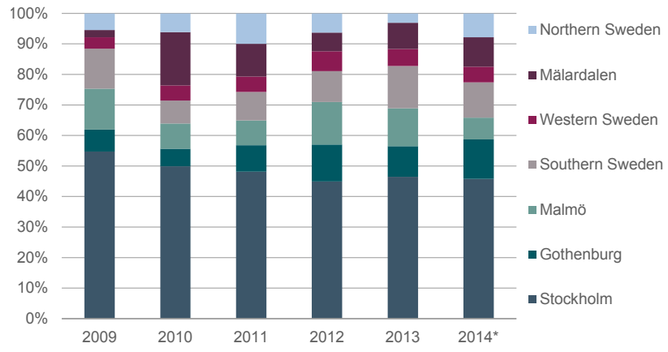
Breakdown of the volume in 2014 by asset class



Graph source: Savills

GRAPH 5

Breakdown of the volume by location 2014



Graph source: Savills

The main drivers behind the strong market situation are that the market is extremely well-supplied with equity available for all types of property investments. With bond yields at low levels domestic institutions have increased their exposure toward properties chasing higher returns and significantly increasing the supply of equity on the market. The banks are becoming more interested in lending against properties and are in some cases competing, which have led to improving lending conditions with more favorable terms for property owners, such as higher LTVs and lower margins.

The cross border activity in the first three quarters amounted to approximately 38% compared to 44% for the full year 2013. The high cross border figures is a direct result of Nordic and international investors disposing of assets and during Q1 – Q3 they sold assets for approx. SEK 18bn, which was almost as high as the full year 2013. However, this is not an indication of lack of investor interest from international investors, but rather a result of foreign investor failing to outbid domestic investors in structured processes.

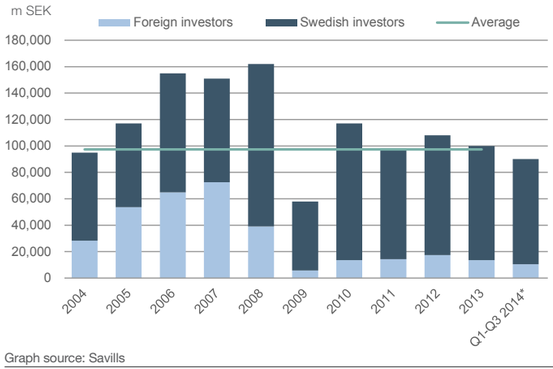
Yields

The market is still extremely well supplied with equity and the availability of bank financing has led to a highly competitive market where yields have continued to harden. Whilst the investor focus is still prime assets in primarily in Stockholm, Gothenburg and Malmö the shortage of products on the market has led to a wider interest for secondary assets and for all property types. Prime yields have remained firm across all segments and secondary yields have started to harden in some property segments, such as offices. We expect yield gaps to continue to narrow across most segments in the near future.

"Most market fundamentals look stable regarding rents, supply and demand on most submarkets and speculative builds are still fairly uncommon which indicate a stable property market in the near future." Peter Wiman, Head of Research Savills Sweden

GRAPH 6

Transaction volume 2014 is likely to be in line with pre-2008 levels



Graph source: Savills

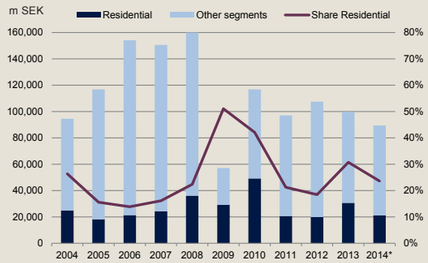
Residential remains an attractive investment class

Uncertain effects from the general elections

The recent general elections resulted in a change of national government and changes in many municipalities as well. It is likely that sales of residential properties and public properties will become much more of a political issue and that many planned sales will be halted. This could possibly lead to lower supply of assets being sold and would result in a higher competition for the assets that are being put on the market in the short term and the number of properties sold to housing co-ops is likely to continue

GRAPH 7

Residential transaction volume



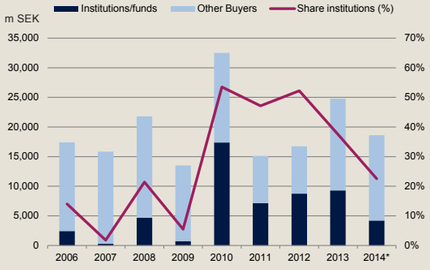
Graph source: Savills

However, many municipalities have financially weak public housing companies and many do need to sell off assets to finance refurbishment projects and new developments and supply should therefore increase in the long term.

GRAPH 8

Buyers of residential assets [SEK m]

Excluding Housing Co-Ops



Graph source: Savills

The institutional investors have to some extent shifted their focus from residential assets to public properties and most assets are being bought by listed companies along with private property companies. In spite of the risks residential properties remains a core asset class for a wide range of investors.

Outlook for the remainder of 2014 and 2015

The Swedish economy is performing satisfactory in spite of the moderate growth, especially compared to most countries around Europe. The growth prospects looking forward looks more positive as well. The new government has announced that they will not allow a spending deficit, but if the economy worsens Sweden has the capacity to increase spending to support the economy.

Taking the low interest rate climate into account it is likely that the supply of equity targeting real estate will continue to grow. The availability of bank financing is also expected to grow as banks need to increase lending and could lead to even better terms for investors.

Prime yields are expected to remain firm in the near future and currently stand at historically low levels in some segments. With supply being highly limited and the competition fierce it is expected that we will see a yield compression for secondary assets with a reduced yield gap between prime and secondary.

International investors are struggling to outcompete domestic institutions for prime assets as they are not willing to meet the yields necessary and many international investors also have increased costs in the transactions as many tend to hedge the currency risks. However, we expect international investors to be more successful in segments where yield compression has been less aggressive, such as retail and logistics, where returns are higher.

Prime yields	Q3 2013	Q1 2014	Q3 2014
Stockholm offices	4.50%	4.50%	4.50%
Gothenburg offices	5.00%	5.00%	5.00%
Malmo offices	5.50%	5.50%	5.25%
Retail warehouse	5.75%	5.50%	5.50%
Shopping centres	5.25%	5.25%	5.25%
Logistics	6.50%	6.50%	6.50%

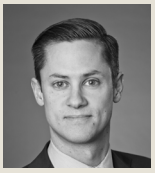
OUTLOOK

Continued dominance from domestic buyers, especially in the larger metropolitan areas

- The shortage of prime assets is likely to lead to a yield compression between prime and secondary assets.
- Prime commercial assets within the larger cities are likely to be the preferred investment for many investors but more risk-willing investors is likely to look more actively at assets outside of the major markets.
- In spite of speculative development taking place in primarily Gothenburg and Malmö, and to some extent in Stockholm, we see few risks in any market becoming oversupplied.
- The changed political map could lead to less residential and public assets being put on the market, which would lead to higher competition for the assets within these two segments.
- The transaction pace is expected to remain high in all property segments.

Savills team

Please contact us for further information



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