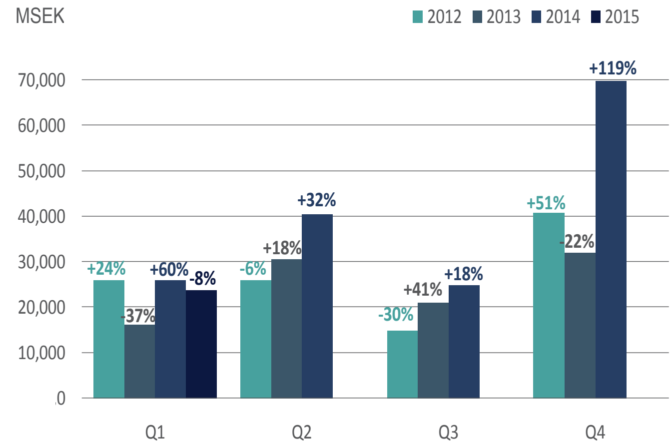
Market report
Sweden Investment

Q1 2015

GRAPH 1

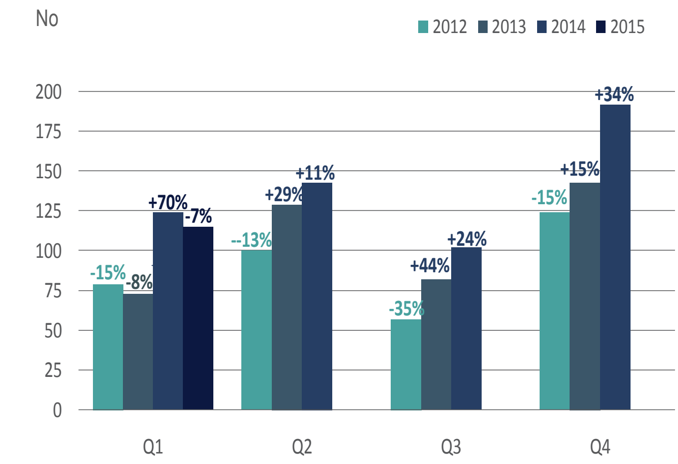
Investment volumes Modest start in 2015 following an exceptionally strong Q4



Graph source: Savills

GRAPH 2

Number of deals Fewer deals have closed so far in 2015



Graph source: Savills

SUMMARY

Strong investment across all geographic submarkets and all segments

- Following an exceptionally strong fourth quarter with an investment turnover of SEK 70bn, it was no surprise that 2015 started in a more modest pace.

- Prime assets remain favoured by a majority of investors, but the lack of seller interest is likely to limit supply and many investors are likely to widen their investment requirements in terms of sub-segments as well as asset quality.

- The interest for alternative financing, such as bonds and preferential shares, has continued to grow and is expected to grow throughout 2015.

- Prime yields could move in further, but the lack of prime assets is likely to push secondary yields downward resulting in a reduced yield gap between prime and secondary.

- The increased appetite for property lending among banks has led to a competitive climate among lenders, which in turn has led to more favourable terms for property owners.

"Investment turnover is expected to remain high throughout 2015 due to the strong investor appetite and as interest rates are expected to remain at historically low levels during 2015 and early 2016."

Peter Wiman, Head of Research Savills Sweden

Economic background

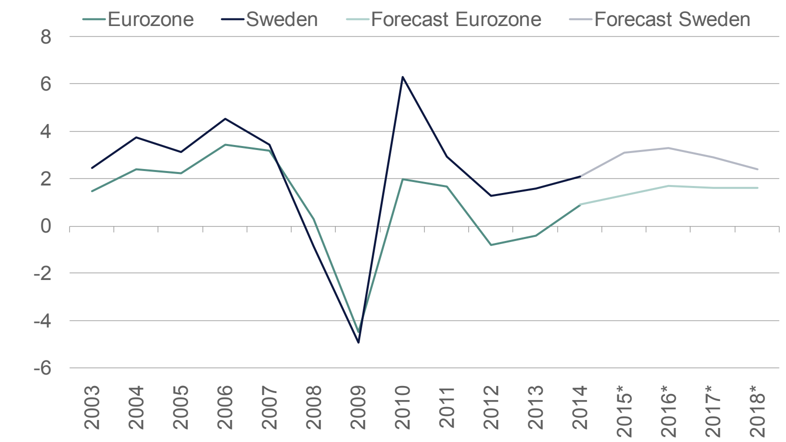
The Swedish economy grew by 2.1% in 2014, which was slightly weaker than most forecasts but is still a strong growth figure compared to many European countries. The recovery within the manufacturing sector has remained disappointing and exports have not been a significant contributor to the GDP. Instead, the growth has mainly been driven by domestic demand as well as investments into residential development schemes across the country. Consensus Forecast indicates an expected growth of just over 2.5% for 2015 and 2016. Forward looking indices such as ESI and PMI vary and the volatility has been unusually high, but the indices all indicate growth rather than a contraction of the economy.

However, the Bank of Sweden remains worried about the economy and has continued with conveying a dovish line by cutting the repo rate to -0.25% in late March and launching a small QE program. The BoS expects inflation to remain low in the short term and most forecasters expect the lending rate to remain low throughout 2015 and well into 2016.

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 signs for the economy. Household savings ratios have remained on high levels, but consumer spending has picked up. Our prediction is that Sweden will outperform in Europe in the short and medium term.

GRAPH 3

GDP growth Above the Eurozone average



Graph source: Savills

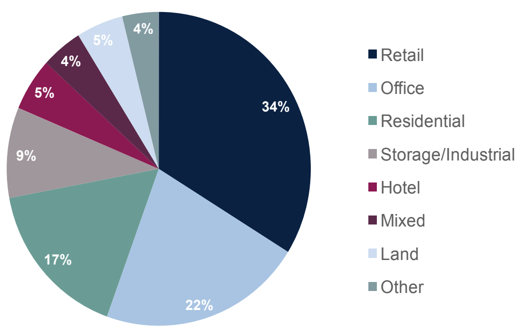
Investment activity

The transaction turnover amounted to SEK 24bn for the first quarter, which was a slight decrease of approximately 8 % compared to the corresponding quarter 2014. The slight drop in turnover should not be interpreted as a sign of a weakening market, but is likely a direct result of Q4 2014 being an exceptionally strong quarter. The strong quarter was most likely due to a number of active investors busy merging acquisitions into their portfolios and advisors filling up with new mandates. The number of recorded transaction amounted to 115, which was a slight drop compared to Q1 2014, but is still a relatively strong Q1 figure.

The main driver behind the strong market situation is the sufficient amount of 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. Banks are becoming more interested in lending against properties and are in some cases competing, which has led to improving lending conditions with more favorable terms for property owners, such as higher LTVs and lower margins. Alternative financing in the form of bonds also offer an attractive alternative for investors wanting to achieve higher returns through financial leverage.

GRAPH 4

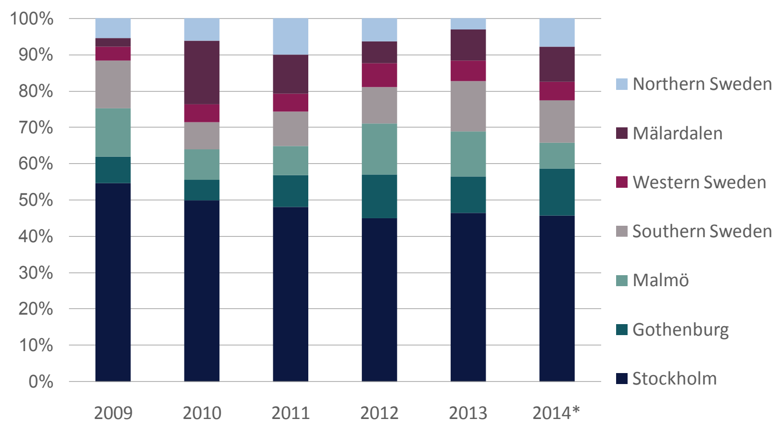
Breakdown per asset Retail prevailed in Q1 2015



Graph source: Savills

GRAPH 5

Breakdown per location Stockholm remains the most sought after location



Graph source: Savills

> "The increased appetite for property lending among 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

The cross border activity was relatively strong in the quarter and amounted to approximately SEK 10bn. However, this is not an indication of lack of investor interest from international investors, but rather a result of foreign investors failing to outbid domestic investors in structured processes. Going forward we expect transaction volumes to pick up as the interest for property investments is exceptionally strong from all types of investors.

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. Although investor interest is still focused on prime assets primarily in Stockholm, the shortage of prime products in Gothenburg and Malmö has led to a wider interest for secondary assets for all property types.
Prime yields have hardened at a slower pace and secondary yields have hardened across most segments as investors are chasing investment options and also higher returns. We expect yield gaps to continue to shrink across all segments in 2015.

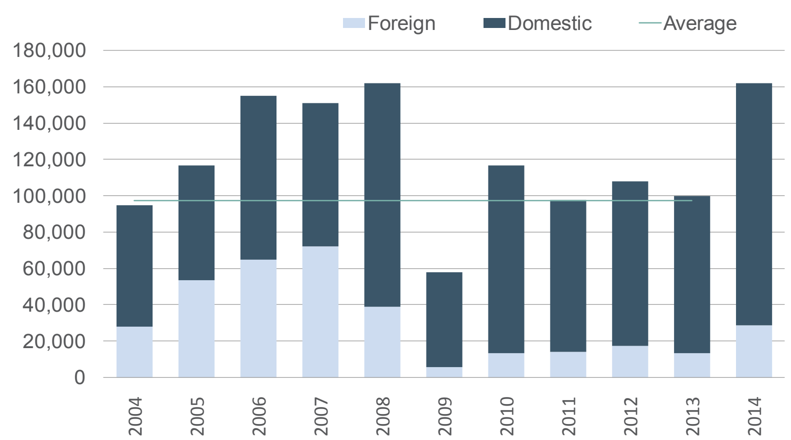
Outlook for the remainder of 2015 and 2016

Most forecasts indicate fairly strong growth figures for Sweden for 2015 and 2016, at least when compared to most other European economies. However, the export oriented manufacturing industry is still facing challenges and exports are not expected to grow fast in the short term. Growth is primarily expected to come from consumer spending and investments into housing development. 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.

The recent cuts of the repo rate along with QE measures from the Bank of Sweden indicates that Sweden is likely to be in a low interest rate climate in the short term and most forecasters do not expect interest rates hikes until mid-2016. It is therefore likely that the amount of equity targeting property will continue to increase and bank financing is also readily available at attractive rates. As the manufacturing industry is hesitant to initiate investment programs, banks are

GRAPH 6

Breakdown per origin of investor Continued predominance of domestic investors



Graph source: Savills

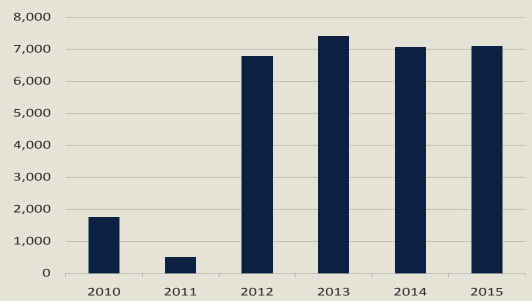
BOND FINANCING

Alternative financing has become an increasingly attractive option

Bond financing has grown in popularity in the last few years and the average yearly volume issued by the listed companies during the last three years amounted to approximately SEK 7bn. The trend has continued into 2015 and during the first four months the listed companies emitted a bond volume of SEK 7.1bn, which is a strong signal of the interest for bond financing.

GRAPH 7

Bonds issued by listed property companies (SEK m)

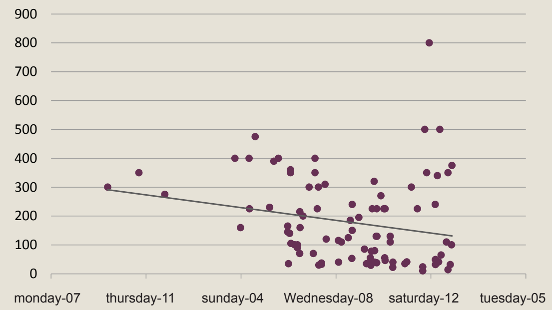


Graph source: Focus Economics & NIER

For state-backed property companies and institutionally owned property companies, bond financing is an attractive alternative to bank financing and can in many cases offer lower financing costs compared to what banks can offer.

GRAPH 8

Buyers of residential assets (SEK m) Excluding Housing Co-Ops



Graph source: Focus Economics & NIER

For medium to high-leveraged listed property companies, bond financing is not a replacement for traditional bank financing as financing costs (spreads) are higher with bonds. It is instead a means to achieve higher financial leverage as most banks are still restrictive on allowing high LTV-loans. We expect that bond issuances will be an attractive option and that volumes will grow in the near future.

likely to increase their exposure towards real estate.

Prime yields could harden further as the competition for prime assets is fierce and prime remains the favored investment for institutional investors. The shortage of supply alone is likely to result in a stronger interest for secondary assets within all segments and the yield gap will continue to shrink.

International investors are struggling to outcompete domestic institutions for prime assets as they are not willing to meet the yields necessary. Furthermore, many have increased transaction costs as they 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.

> "The proposed new corporate tax system could have a 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"
> Peter Wiman, Head of Research Savills Sweden

Prime yields	Q1 2014	Q3 2014	Q1 2015
Stockholm offices	4.50%	4.50%	4.25%
Gothenburg offices	5.00%	5.00%	4.75%
Malmo offices	5.50%	5.25%	5.00%
Retail warehouse	5.50%	5.50%	5.5%
Shopping centres	5.25%	5.25%	5.15%
Logistics	6.50%	6.50%	6.25%

OUTLOOK

Fierce competition for prime assets could result in higher competition for secondary assets and the yield gap is expected to shrink

- Prime commercial assets in Stockholm, Gothenburg and Malmö are still the most preferred asset class with many investors, but lack of supply will open up for a stronger market for secondary assets.
- Funds and opportunity investors might take advantage of the strong market and dispose of their holdings.
- Uncertain effects from the proposed change to corporate taxes, which could very well be significant for the property market. However, the scheduled change has been pushed forward and will take place in Jan 2017 at the earliest.
- Oversupply risks are limited in most segments and speculative builds are only present in balanced markets or markets with a shortage of supply.
- The transaction pace is expected to remain high in all property segments.
- The general elections have resulted in a new political map, but in spite of this we expect sales of public assets and residential assets by the municipalities to continue.

Savills Sweden

Please contact us for further information

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

Fredrik Östberg
Head of Investment
+46 (0)766 27 91 00
fostberg@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 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.