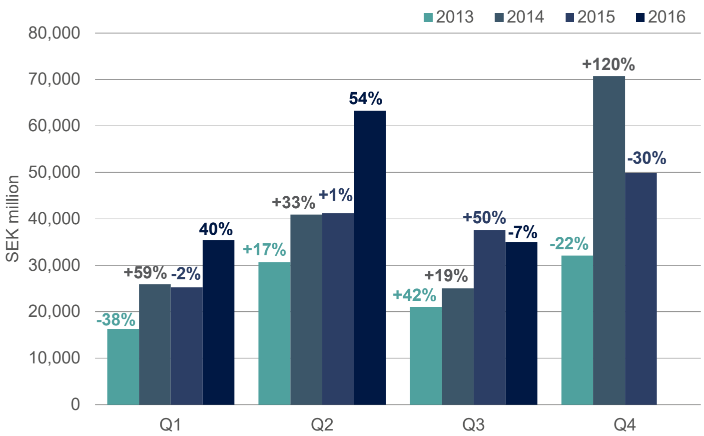
savills

Market report
Sweden Investment

Q3 2016

GRAPH 1

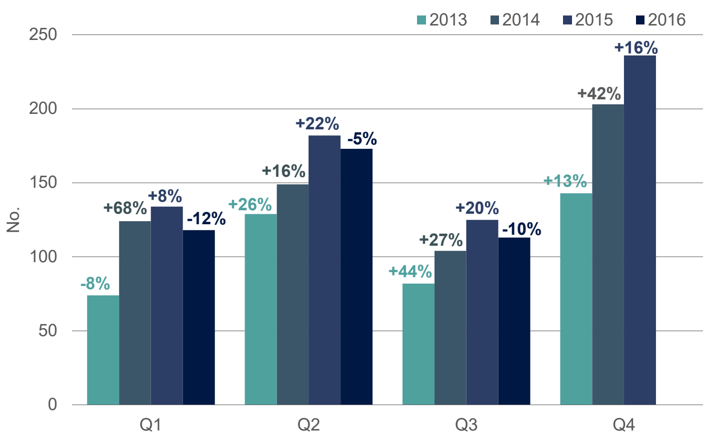
Investment volumes Exceptionally strong first three quarters of 2016



Graph source: Savills

GRAPH 2

Number of deals Higher average transaction volume has led to a decrease in the number of transactions



Graph source: Savills

SUMMARY

Sweden is heading for an all-time high transaction volume

- The Swedish GDP is expected to increase by 3.3% in 2016 and current low interest rates will continue to be favourable for the property sector as financing costs are at historically low levels.

- The first three quarters of 2016 finished extremely strong with an investment turnover amounting to SEK 134bn, which is in line with the all-time high Q1-Q3 investment volume in 2008.

- Office properties, followed by residential properties, were the two largest sectors in terms of transaction volume during the first three quarters of 2016.

- The transaction pace, measured as the number of transactions carried through, decreased 9% during the first three quarters of 2016 compared to the same period in 2015.

- Investor appetite in the residential sector is strong and we expect an increased investment volume over the coming years due to an increasing construction pace and an overall housing shortage.

- The high demand for properties has contributed to historically low yields across all property sectors and geographical markets.

"Despite demand far exceeding the supply coming onto the market, we expect 2016 to be a record year in terms of transaction volume." Peter Wiman, Head of Research Savills Sweden

Economic background

The Swedish economy slowed during the first half of 2016 compared to the exceptionally strong growth in 2015. According to the National Institute of Economic Research, the Swedish economy is expected to grow by 3.3% in 2016. The previously strong domestic household consumption slowed and economic growth is mainly driven by investments into residential development schemes. The weakened Swedish krona contributed to an increase in exports in 2015, but Swedish exports decreased during the first half of 2016 and had a negative impact on GDP.

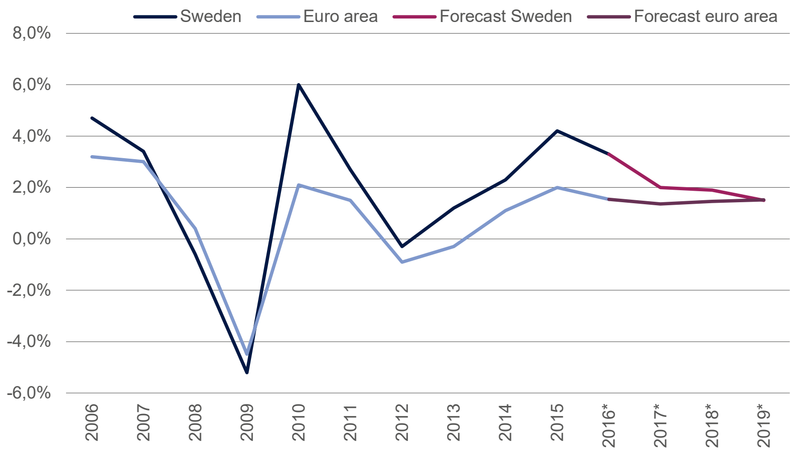
The Swedish labour market remains strong despite weak economic growth. The employed workforce is growing, the unemployment rate is expected to decrease in the short-term, and the number of bankruptcies is at low levels.

The Swedish inflation rate continued to grow in 2016, although at a slower pace than anticipated and the long-term target of 2% is expected to be reached in 2018. The Bank of Sweden decided to leave the repo rate unchanged at -0.5% in September 2016 and a first repo rate hike is expected to occur during the second half of 2017.

On a global level, the political and economic development remains uncertain. Brexit had substantial effects with falling stock markets and interest rates. However, most stock markets recovered quickly but bond yields are in many cases lower than they were before Brexit. The global growth is expected to increase by just over 3% in 2016 and 2017, with a modest growth in the euro area (Graph 3).

GRAPH 3

GDP growth & forecast Sweden is characterised by a healthy economy despite a weakened growth in 2016



Graph source: NIER & Focus Economics

Investment activity

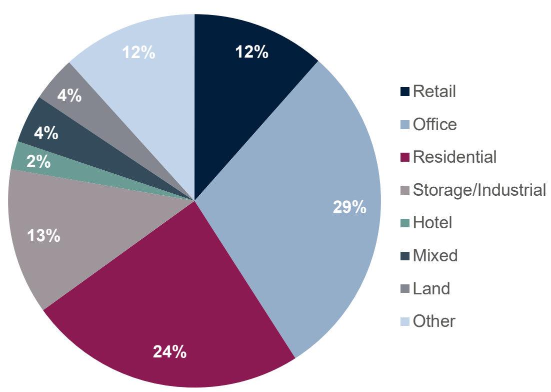
The investment market in Sweden has been extremely strong over the past two years. An all-time high transaction volume and an all-time high transaction pace was noted in 2014 and 2015 respectively.

The strong market has continued in 2016 with a transaction volume amounting to SEK 134bn during the first three quarters. The volume is 29% higher than the first three quarters in 2015 and in line with the previous Q1-Q3 record in 2008. The main contributor to the high transaction volume was Castellum's acquisition of Norrporten, a deal amounting to SEK 22bn for the Swedish portfolio. However, excluding the Norrporten acquisition, the transaction volume during the first three quarters of 2016 is still 7% higher compared to the same period in 2015.

The transaction pace, measured as the number of transactions carried through, slowed in 2016 compared to 2015. Just over 400 transactions were completed during the first three quarters; 9% less than the same period in 2015. Due to fewer transactions and the high transaction

GRAPH 4

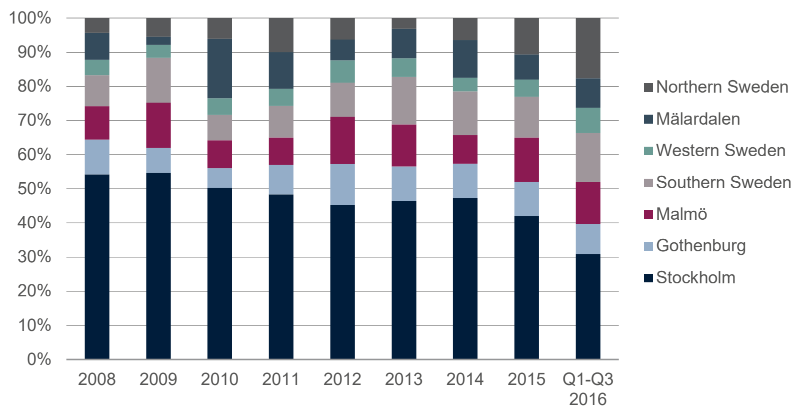
Breakdown by asset class Strong office and residential sectors in Q1-Q3 2016



Graph source: Savills

GRAPH 5

Breakdown by location Stockholm's market share has declined due to a lower supply



Graph source: Savills

"Brexit has led to a prolonged period of low interest rates which will continue to be very beneficial for the property market."
Peter Wiman, Head of Research Savills Sweden

volume, the average deal size amounted to SEK 331m; 27% higher than the 10-year average deal size.

Office properties, followed by residential properties, were the two largest sectors in terms of transaction volume during the first three quarters of 2016. The investment volume in the sectors amounted to approximately SEK 39bn and SEK 32bn respectively, together accounting for 53% of the total transaction volume.

The share of foreign buyers has decreased in 2016. Foreign investors accounted for 14% of the total investment volume during the first three quarters, which is significantly lower compared to 2015 when foreign investors represented 21% of the total transaction volume. However, the significant drop in market shares can to some extent be explained by the Norrporten acquisition. The foreign investor interest is somewhat misleading by looking solely on net purchases as foreign investors have been very active as both sellers and buyers. The cross border volume for Q1-Q3 amounted to SEK 43bn which was in line with the same period in 2015.

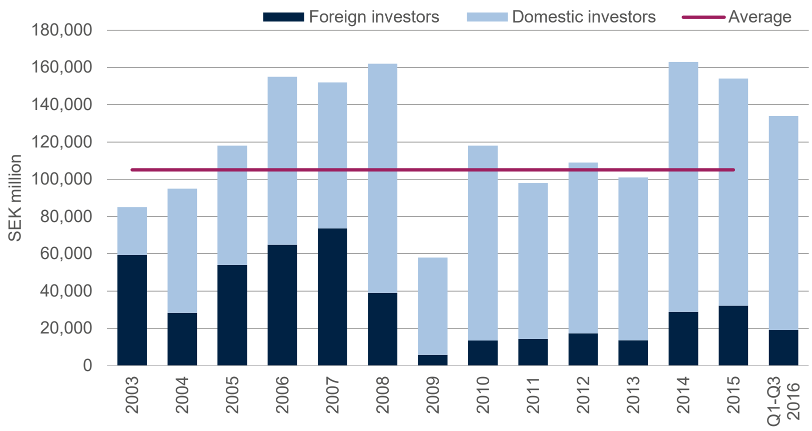
Yields

The main drivers behind the strong investment market are that the market is extremely well-supplied with equity along with favourable lending conditions. With bond yields at historically low levels and lack of alternative investments, domestic institutions have increased their exposure towards properties chasing higher returns.

The favourable market situation has led to a highly competitive market where demand by far surpasses the supply. The high demand for properties has contributed to historically low yields across all property sectors and geographical markets. Prime yields have remained firm in 2016 with a slight downward pressure across a few sectors. The continued shortage of prime assets primarily in Stockholm, Gothenburg and Malmö has forced investors to secondary assets and other geographical markets.

GRAPH 6

Breakdown by origin of investor Domestic investors are still dominating the Swedish market



Graph source: Savills

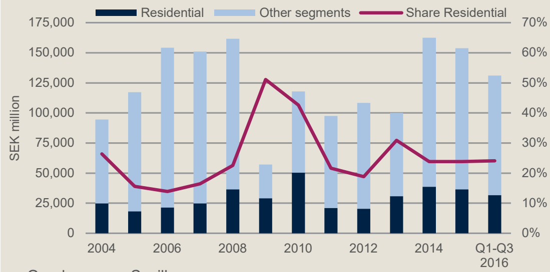
Residential properties

Expected increase in the transaction volume in coming years

There is currently a high demand for residential properties. The investment volume in the sector amounted to SEK 32bn during the first three quarters of 2016 and the sector had a market share of 24%. The investment volume is 52% higher than the same period in 2015 and is already in line with the annual 10-year average volume.

GRAPH 7

Investment volumes Strong interest for residential properties in 2016

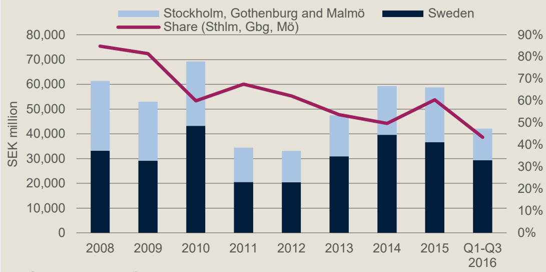


Graph source: Savills

Ever since the financial crisis in 2008, the market share of the transaction volume in Sweden's three major cities (Stockholm, Gothenburg and Malmö) has decreased. The decrease is mainly driven by an overall lack of supply in the major cities as well as an increased investor appetite for assets in secondary markets which offer higher yields.

GRAPH 8

Residential investment volumes



Graph source: Savills

Market fundamentals, such as the current housing shortage in Sweden and increasing construction pace, indicate a bright future for investment opportunities in the sector. The construction pace increased rapidly in 2015 and a further increase is expected in 2016 and 2017. The high construction pace is likely to have a significant effect on the transaction market. We expect an increased transaction volume over the coming years as developers continue to sell off projects from their production pipeline, and municipality owned housing companies disposing of assets to finance new builds and sizeable renovation schemes.

Outlook for the remainder of 2016 & 2017

Despite slower economic growth in Sweden, the overall economy is healthy and consensus forecast indicates a GDP growth of 2.1% in 2017 and 2.0% in 2018. Sweden has good prospects to retain a high growth of the economy in the long-term. Government finances are solid, the labour market is strong and businesses are competitive. Swedish exports are expected to increase at a moderate pace while import growth is expected to remain at a high level thanks to the strong domestic demand.

Brexit led to a prolonged period of low interest rates and the repo rate is expected to increase slowly in the second half of 2017. Low interest rates have historically acted as a fuel for property investments. The property sector has performed well in the stock market and has one of the strongest growths across all business sectors so far in 2016.

The low interest climate and lack of alternative investments will continue to drive the interest for properties as they offer an attractive return. It is highly likely that 2016 will see an all-time high investment volume and the interest for properties will remain strong in 2017 as well.

Bond financing has grown rapidly in popularity and the average yearly volume over the last four years amounts to SEK 8.3bn. The trend has continued in 2016 and during the first three quarters, listed property companies emitted a bond volume of 10.3bn, a strong indicator of interest for bond financing. We expect that bond issuance will continue to be an attractive option to increase financial leverage and volumes will increase in the near future.

Prime yields across most property sectors are expected to remain stable. 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.

Prime yields	Q3 2015	Q1 2016	Q3 2016
Stockholm offices	4.00%	3.75%	3.75%
Gothenburg offices	4.50%	4.25%	4.00%
Malmö offices	4.75%	4.25%	4.25%
Retail warehouse	5.25%	5.25%	5.25%
Shopping centres	5.00%	4.75%	4.50%
Logistics	5.75%	5.50%	5.50%

OUTLOOK

Shortage of prime assets is likely to lead to a yield compression between prime and secondary assets

- The transaction volume is expected to remain high across all property sectors.
- Prime assets in Stockholm, Gothenburg and Malmö are still favoured, but the substantial lack of supply will open up for a stronger market for secondary assets.
- Public assets are in high demand due to the perceived lower risk and capital targeting public assets is increasing.
- The strong market conditions are likely to incentivise developers to dispose of their development projects on forward commitment or forward funding basis across all sectors.
- Historically low prime yields across all property sectors are expected to remain stable, whereas secondary yields are expected to harden.

Savills Sweden

Please contact us for further information

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

Christian Sahlström
Analyst
+46 (0)739 81 70 42
csahlstrom@savills.se