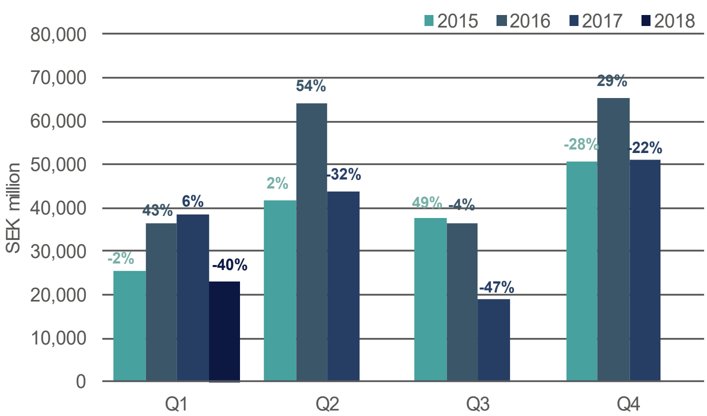
Market report
Sweden Investment

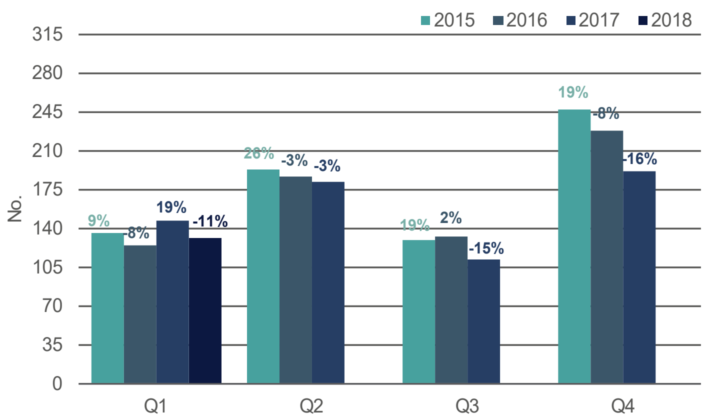
Q1 2018

GRAPH 1
Investment volumes Weakened transaction volume during Q1 2018



Graph source: Savills

GRAPH 2
Number of deals Transaction pace remains fairly stable



Graph source: Savills

SUMMARY

Continued high investment appetite in Sweden despite a weakened transaction volume

■ The Swedish economy remains strong and most signals continue to indicate strength. The Swedish GDP is expected to grow by 2.6% 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.

■ The first quarter of 2018 opened with a decrease in the investment volume compared to the same period in 2017, however, the transaction volume during the first quarter is still in line with the long-term average.

■ Office properties were undoubtedly the favourable asset class during Q1 2018 with an investment volume amounting to SEK 8bn (€0.77bn), representing 32% of the market.

■ Prime assets in Stockholm, Gothenburg, and Malmö are still very attractive from an investment perspective, corresponding to approximately 73% of the total investment volume.

■ Foreign investors continue to show interest for commercial real estate investment in Sweden and represented 24% of the market in Q1 2018, which is the highest noted market share since the financial crisis in 2008.

"The demand for properties is still high and the lower transaction volume during the first quarter is mainly explained by a supply shortage."
Peter Wiman, Head of Research, Savills Sweden

Economic background

The global economy has performed impressively in recent times and got off to a good start to 2018. In the short-term there is reason for optimism surrounding continued growth. The Swedish economy remains strong and most signals continue to indicate strength. Even though the housing market recently has shown increased uncertainty, the economy appeared resilient. The most visible effect of the housing market slowdown is the deceleration of construction activity. However, a strong global activity and a weak krona are pushing export growth and industrial investments, supporting domestic GDP growth. Consensus forecast indicates a continued GDP growth of 2.6% in 2018 compared to last year's growth of 2.4%. Swedish households remain optimistic, despite falling housing prices. This reduces the probability that a weakened housing market will expand into a broader economic downturn. Most households seem to interpret lower housing prices as a natural and welcoming correction.

The Swedish labour market keeps gaining strength. Employment has increased sharply over the last years combined with high levels of labour shortage. Yet wage growth is lower than expected, holding down inflation pressure. The long-term unemployment rate among Swedish-born persons was 0.9% last year compared to 5.5% for foreign-born persons.

Swedish inflation for Q1 2018 is likely to land close to the target of 2%, however, forecasts for inflation in the coming year have been revised downwards slightly. 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%. Most forecasters expect a slow repo rate hike to be initiated later this year, followed by further hikes in 2019.

Investment activity

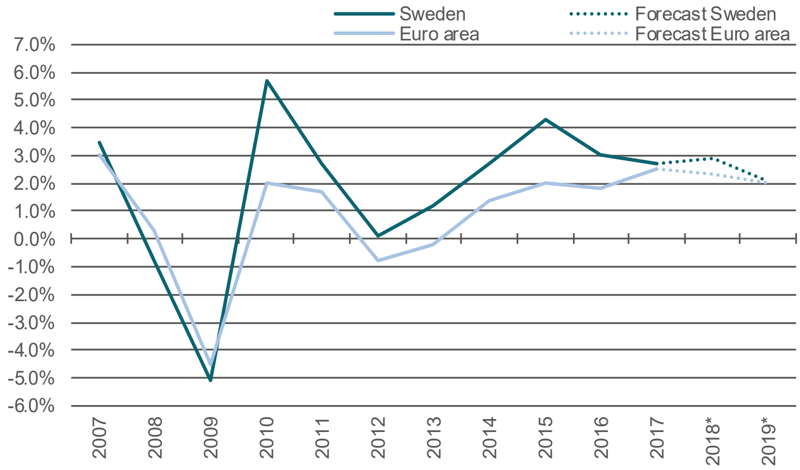
2017 ended with a strong recovery of the investment market and the total investment volume for 2017 amounted to SEK 152bn (€15bn). The first quarter of 2018 ended with an investment volume amounting to SEK 25bn (€2.4bn), which is a decrease of 36% compared to the same period in 2017. The decline in the investment volume is mainly explained by the exceptionally high investment volume in Q1 2017, nevertheless this quarter amounted to the same level as the long-term Q1 average.

The transaction pace, measured as the number of transactions carried through, decelerated slightly in Q1 2018 compared to Q1 2017. A total of 131 transactions were carried through during the first quarter of 2018 with an average deal-size of SEK 189m (€18.2m).

Office properties were undoubtedly the favourable property sector during Q1 2018, with an investment volume amounting to SEK 8bn (€0.77bn), representing 32% of the market. Residential properties placed second with a market share of 20%, followed by industrial, warehouse and

GRAPH 3

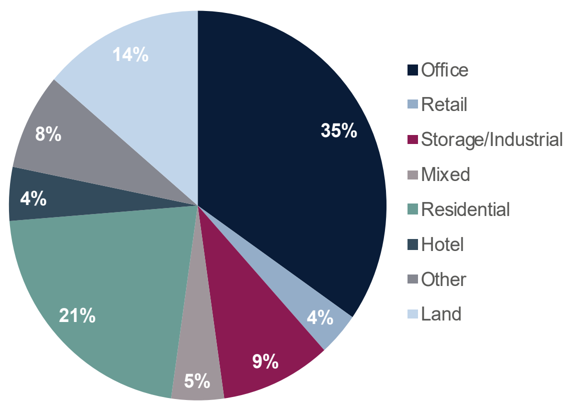
GDP growth & forecast (calendar adjusted) The fairly stable economic growth is expected to continue



Graph source: National Institute of Economic Research

GRAPH 4

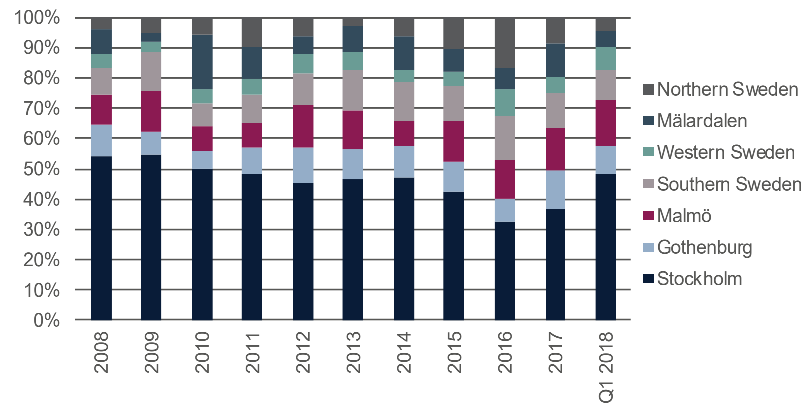
Breakdown by asset class (Q1 2018) High demand for office properties



Graph source: Savills

GRAPH 5

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



Graph source: Savills

logistics, covering 9% of the market. Noteworthy was that residential properties experienced the highest transaction pace across all sectors, with 21% of the total number of transactions during the first quarter. The total number of portfolio transactions decreased during the first quarter of 2018. A total of 32 portfolio transactions were executed, corresponding to a market share of 25%, which is lower than the 5-year average of 32%.

Prime assets in Stockholm, Gothenburg, and Malmö are still very attractive from an investment perspective, corresponding to approximately 73% of the total investment volume.

Yields

The Swedish investment market is booming and the high demand surpasses the supply, causing a highly competitive market. The existing market is well-supplied with equity and favourable lending conditions. Yields have reached historically low levels across all property sectors no matter geographical location. During the first quarter of 2018, yields remained rather stable across most property sectors. Noteworthy is a slight yield increase noted for secondary assets in the retail park sector over the last six months, which may be a result of increasing cautiousness and uncertainties due to the rapid growth of e-commerce.

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 risk adjusted return. While investors still favour prime assets in Stockholm, Gothenburg and Malmö, 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.

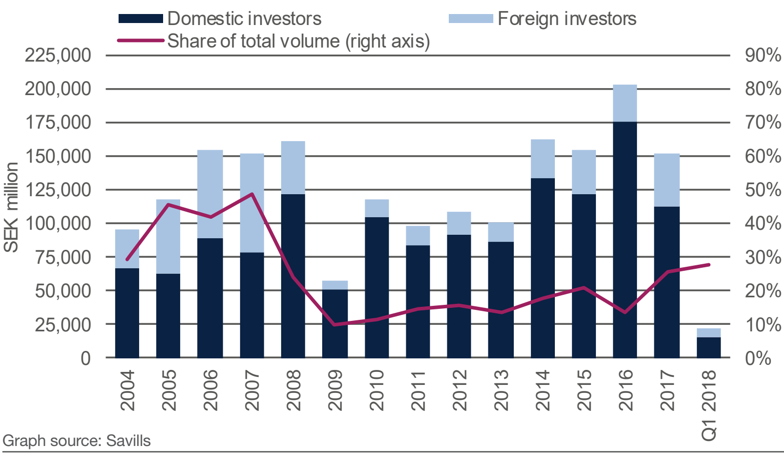
Outlook for the remainder of 2018

The outlook for the economy is positive and dominated by two elements, domestic uncertainty surrounding the housing market on the one hand and strong global activity on the other. The slowdown in construction activity will affect GDP growth negatively but the effects should be dampened by the exceptionally strong global growth favouring export industries. Consensus forecasts confidently indicate a GDP growth of 2.6% 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 has enhanced a flourishing business climate in Stockholm and increased demand for office space. The favourable market conditions have benefited property owners in the office segment through the positive development of rental levels, due to historically low vacancy rates where the high demand surpasses the supply. We expect demand for office space in Stockholm to remain high and both the office rental and investment market to remain strong.

GRAPH 6

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



Graph source: Savills

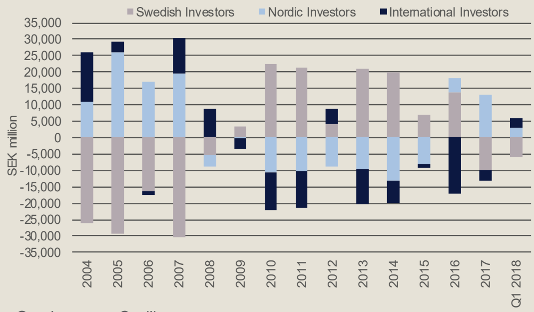
Foreign investors

Sweden remains a sought after location

Foreign investors (international + nordic) have increased their activity in the Nordic region, with Sweden as the largest property market in terms of volume. In Sweden, the market share has increased steadily over the years, and was particularly high during the first quarter of 2018, where foreign investors accounted for 24% of the total investment volume, which is the highest share since the financial crisis (Graph 6). Investors are targeting Sweden as it is seen as a safe haven/secure market for real estate investments. Noteworthy, in the first quarter, the office sector accounted for the largest foreign investment share.

GRAPH 7

Net investment volume

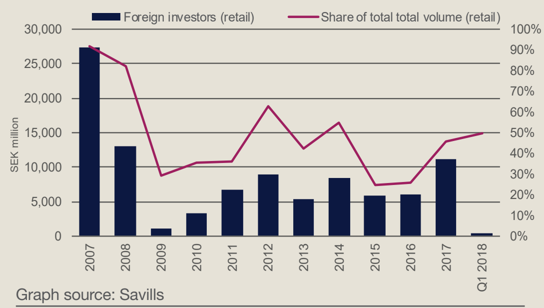


Graph source: Savills

The retail segment is one of few segments where foreign investors have been able to out-bid domestic investors. Foreign investors have on average during the last five years accounted for approximately 40% of the investment volume in the retail segment, which is significantly higher than other segments, where foreign investors have represented 15% of the market.

GRAPH 8

Retail investment volume



Graph source: Savills

Last year was the first time foreign investors acted net buyers since the financial crisis, and the trend has continued during the first quarter. Mainly we have seen nordic investors act as net buyers in the Swedish market but during the first quarter of 2018 non-Nordic international investors have invested more than they divested (Graph 7).

Looking to the residential sector we see some risks regarding decreased investment volumes. 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.

The prevailing uncertainty in the housing market has made buyers passive, and Sweden has experienced a significant decrease in house prices since mid 2017. However, it is not very likely housing prices will drop much further, as mortgage rates are stable at low levels and housing supply growth will decelerate.

Investors in the retail sector are no different from other sectors where demand for stable and secure cash-flows is high. Digitalisation affects the retail market in a number of ways and inevitably property owners. New consumer behaviours due to e-commerce have changed market conditions for retail and grown to a major challenge. Secondary retail parks is one asset class where Savills has noted a slight yield increase during the last six months, which likely is connected to uncertainties and cautiousness regarding new consumer behaviours due to e-commerce growth.

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.

"The shortage of prime assets is likely to lead to a yield gap compression between prime and secondary assets."

Peter Wiman, Head of Research, Savills Sweden

OUTLOOK

Continued high transaction volume is expected

- Prime yields across most property sectors are expected to remain stable throughout the year, and investors are expected to broaden their investment horizon to secondary assets or geographical markets.

- We expect demand for office space in Stockholm to remain high, and both the letting and the investment market to remain strong.

- Large property companies and institutions are heavily invested in the residential and land sector, and are expected focus on developing existing building rights rather than acquire new projects. This can potentially contribute to decreased investment volumes in the residential sector.

- Retail park yields are expected to soften, mainly due to uncertainties related to the rapid growth of e-commerce.

Prime yields	Q3 2015	Q1 2016	Q3 2016	Q1 2017	Q3 2017	Q1 2018
Stockholm offices	4.00%	3.75%	3.75%	3.50%	3.50%	3.50%
Gothenburg offices	4.50%	4.25%	4.10%	4.00%	4.00%	4.00%
Malmö offices	4.75%	4.25%	4.15%	4.15%	4.15%	4.15%
Retail warehouse	5.25%	5.25%	5.25%	5.25%	5.50%	5.50%
Shopping centres	5.00%	4.75%	4.50%	4.00%	4.00%	4.00%
Logistics	5.75%	5.50%	5.50%	5.40%	5.50%	5.25%

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