Sweden's property sector faces mixed outlook for 2021

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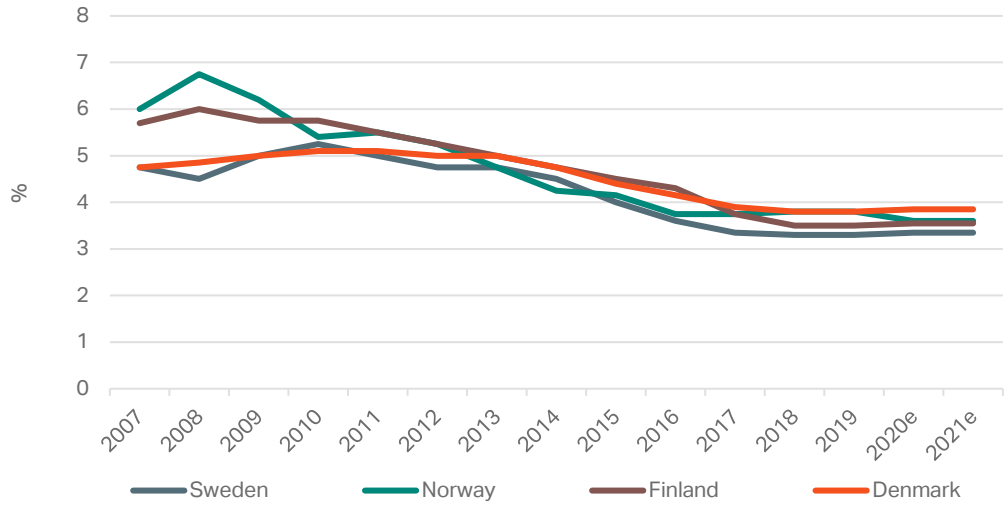
The economic turmoil of 2020 caused by the COVID-19 pandemic has had a range of effects on the Swedish real-estate sector, increasing the differences between property segments. As a result of the slump in tourism, hotels have joined retail as a sector shunned by investors. The office sector, which experienced something of a boom before coronavirus hit, has cooled due to uncertainty over future demand for office space. Logistics properties, on the other hand, have been very much in favour among investors as growth in e-commerce, accelerated by the pandemic, increases the need for logistics facilities. Residential and community service properties have experienced steady development, despite a challenging year overall.

In 2021 we expect reduced demand for office space and resulting pressure on rent levels. We see retail properties experiencing further challenges as growth in e-commerce continues. The logistics segment stands to benefit from this development, although we view a supply shock of new logistics properties as a risk to watch for over the next few years. We foresee a challenging 2021 in the hotel and restaurant segments as we believe it will take time for the economy as a whole, as well as tourism and travel, to recover. We view the residential and community service segments as the least risky in 2021.

OFFICE SPACE FACING REDUCED DEMAND

The office sector has benefited from benign economic conditions, falling interest rates, steady yield compression and increasing rent levels in recent years, especially in the Stockholm Central Business District (CBD), where rents have increased by over 40% since 2015. However, the future of office space has come into question in 2020 as employees have embraced working from home during the pandemic. We expect reduced demand for office space, putting pressure on rent levels in the sector. We also anticipate that office tenants will request more flexible contract structures, possibly reducing average contract lengths (see Swedish property managers face shift in customer demand, published 6 Nov. 2020, and Swedish office property managers set to survive lower rents, published 24 Nov. 2020).

Figure 1. Nordic prime office yields, 2007–2021e

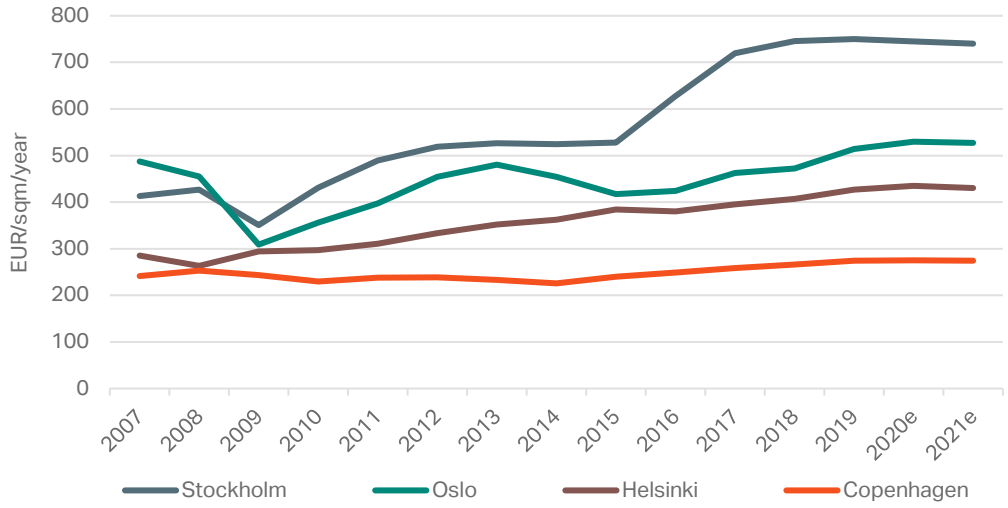


Source: Pangea Research. e–estimate.

Pangea Research expects 150,000sqm of new office premises to be completed in Stockholm in both 2020 and 2021, which is roughly in line with recent annual averages. By 2030, Pangea Research expects around 1 million sqm to be added to the Stockholm office stock, including prestigious projects such as Dockworks by Niam and Origo by Humlegården. Although we foresee lower demand for office space, we do not expect the office market to be significantly oversupplied or saturated in the near term, as

new completions are in line with historical averages and the majority of near-term completions are pre-let.

Figure 2. Nordic prime office rents, 2007–2021e



Source: Pangea Research. e–estimate.

RETAIL UNDER PRESSURE FROM E-COMMERCE

The retail segment was already struggling before the coronavirus crisis struck, as noted in our report Retail properties under pressure, published 5 Sep. 2019. According to HUI Research AB, the number of retail stores in Sweden decreased by 6%, or 2,000 stores, between 2017 and 2019. The COVID-19 pandemic, and related social-distancing measures, has accelerated the trend of increased e-commerce, reducing the need for traditional retail stores. According to PostNord Sverige AB, Swedish e-commerce grew by 49% in the second quarter and 39% in the third quarter of 2020, both compared with the corresponding quarter a year earlier. The largest year-on-year increases were recorded in groceries/essential goods (+101%) and furniture/furnishings (+73%). However, we note that e-commerce's share of groceries and furniture is starting from relatively low levels. We believe the trend of increased e-commerce will continue, with a negative impact on bricks-and-mortar retail. We also expect essential goods such as groceries to continue seeing stable demand in physical stores, accentuating the differences between retail segments.

LOGISTICS BUOYED BY ONLINE BOOM

While bricks-and-mortar retail is one of the apparent losers to increased e-commerce, logistics is one of the winners. This favourable macro trend has led to a relatively large development project pipeline. CBRE Research expects newly completed logistics properties in the Stockholm-Gothenburg-Malmö triangle to amount to 700,000sqm in 2020 and 880,000sqm in 2021. Although most developments are pre-let, the substantial rise in volumes increases the risk of older logistics properties becoming less attractive to tenants. In addition, we expect a greater focus on automation and carbon emissions to drive developments in this segment. Wider use of technological solutions and electrically powered transport will boost demand for clean energy near these kinds of properties.

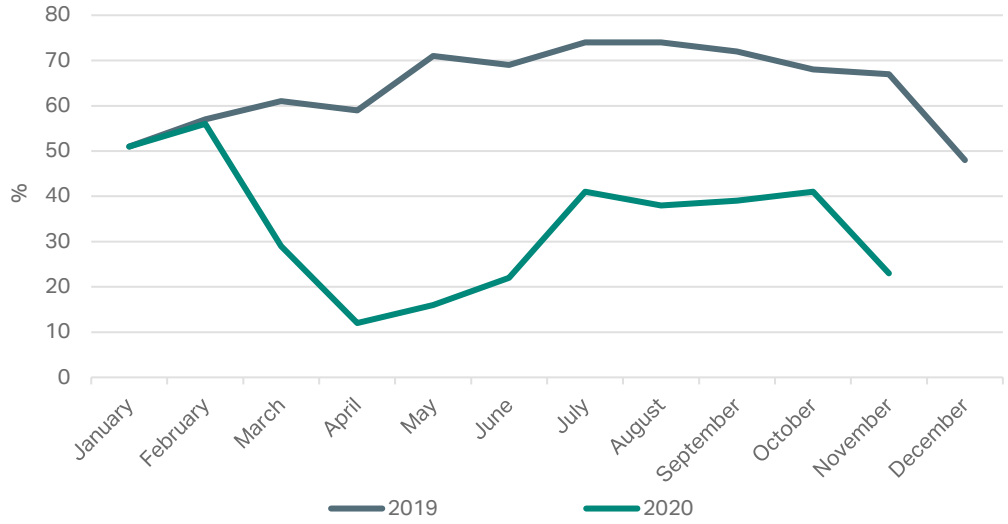
The development of light industry and warehousing largely depends on the recovery of the Swedish economy. Moreover, the growth in e-commerce may in the long run lead to significant changes in the warehousing segment as e-commerce fuels the need for urban storage closer to end customers. The previous trend in the sector was centralisation, with many retailers replacing national warehouses with larger facilities covering the entire Nordic region. However, we expect a decentralisation of warehouses as e-commerce grows. In addition, we foresee a greater focus on environmental, social and governance (ESG) issues to present implications for the light-industry segment, as adaptions to a low-emissions future could affect the long-term viability of a range of tenants within this sector in its current form.

HOTELS AND RESTAURANTS COULD TAKE TIME TO RECOVER

According to the Stockholm Chamber of Commerce, the average occupancy of Swedish hotels was 23% in November, compared with 67% a year earlier. Occupancy in Stockholm was even lower at 19%, compared with 72% a year earlier. This puts current occupancy levels not far off the levels seen in April, when occupancy rates bottomed out at 12% in Sweden and 10% in the capital. We expect hotel operators to continue to face difficulties in 2021 as it will take time for travel patterns to recover, even with an effective vaccine, and we believe the industry is in need of a rebound in summer travel similar to that of 2020.

For the restaurant industry, the Stockholm Chamber of Commerce reports an average 75% yearly decline in revenues for a sample of 600 restaurants in Sweden in November. The decline for a sample of 170 restaurants in Stockholm was 83%, underlining the negative impact on the sector. As with hotel operators, we expect it to take time for the restaurant industry to recover, but believe it has a greater chance of a swift recovery.

Figure 3. Occupancy rates in Swedish hotels, 2019–2020



Source: Stockholm Chamber of Commerce.

RESIDENTIAL AND COMMUNITY SERVICE SUPPORTED BY GROWING POPULATION

Residential and community service are the two property segments in Sweden in which NCR sees the least downside risk in 2021. The residential sector benefits from regulated rents, suppressed supply and high demand among both tenants and investors. We expect occupancy rates in these sectors to remain stable in most regions, especially in those with favourable economic conditions, strong population growth and long housing queues. Statistics Sweden expects Sweden's population to reach 11 million by 2028, but there are significant differences in growth between municipalities.

Statistics Sweden projects particularly high population growth in the age groups of over 65 and under 20. As the dependent population grows, we expect a greater need for municipalities to invest in the community service sector, which strengthens the business case for community service property management companies. Moreover, community service properties benefit from long contracts, typically with stable government-funded tenants. The predicament facing the segment is that many Swedish municipalities would struggle to cope financially without support from central government. Possible difficulties among tenants constitute a long-term risk in the sector, but they could also lead to more sale-leaseback transactions, generating opportunities for property managers in the sector. This segment is attracting growing interest from international buyers, which supports property valuations but also affects acquisition prospects for several domestic property managers.

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