

Sweden's property sector wraps up strong 2021 marked by consolidation

ANALYSTS

Marcus Gustavsson
+46700442775
marcus.gustavsson@nordiccreditrating.com

Ylva Forsberg
+46768806742
ylva.forsberg@nordiccreditrating.com

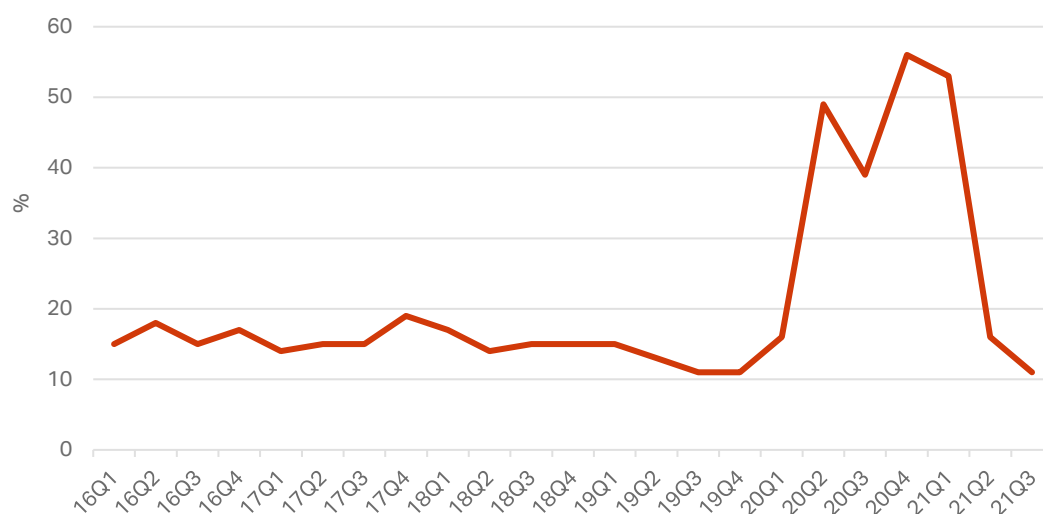
The 2021 real-estate year has seen a strong trend of consolidation in the sector, pushing transaction market volumes far beyond previous record levels. The low interest rate environment and declining property yields have continued to benefit the sector. COVID-19 has had a material impact on trends in 2021. The retail and hotel property segments have seen weak, albeit improving, market sentiment, while increased e-commerce has provided a continued tailwind for logistics properties. The future of office space has remained a hot topic, following increasing vacancies in the segment, while prime rents have stayed at high levels.

In 2022, we expect generally stable performance in the sector. We believe current macro trends, such as the e-commerce boom and changes in business travel patterns, will continue to impact the retail, logistics and hotel segments. We expect the residential subsector to remain low risk, although the scrapping of a newbuild investment grant, combined with a potential surplus of apartments, will pose challenges. We believe environmental, social and governance (ESG) factors will become even more important in 2022, as real-estate companies endeavour to reduce their environmental footprint and improve their ESG reporting. Lastly, we expect inflation and interest rates to remain low, although if the currently high inflationary pressure persists, it could have a major negative impact on the Swedish real-estate sector as a result of higher interest rates.

E-COMMERCE BOOM MEANS CONTINUED HEADWIND FOR RETAIL, TAILWIND FOR LOGISTICS

Swedish e-commerce has grown rapidly since the COVID-19 pandemic struck in early 2020, with year-on-year growth for the first four quarters of the pandemic averaging 50%, according to a quarterly report from PostNord Sverige AB. In 2021, the increase has returned to more normal levels, although the most recent 11% year-on-year growth in the third quarter of 2021 remains quite strong. We believe that the continued strong growth in 2021, despite the relaxation of social-distancing measures, is a watershed moment for e-commerce, putting it on a more equal footing with physical retail. We expect this trend to continue having a negative impact on bricks-and-mortar retail, but we believe that essential goods, such as groceries, and discount retail will continue to see stable demand in physical stores, accentuating differences between retail properties.

Figure 1. Year-on-year e-commerce growth in Sweden, 2016–21Q3



Source: PostNord Sverige AB.

While bricks-and-mortar retail is one of the apparent losers to increased e-commerce, logistics is one of the winners. We expect continued strong development in logistics properties in 2022. However, we

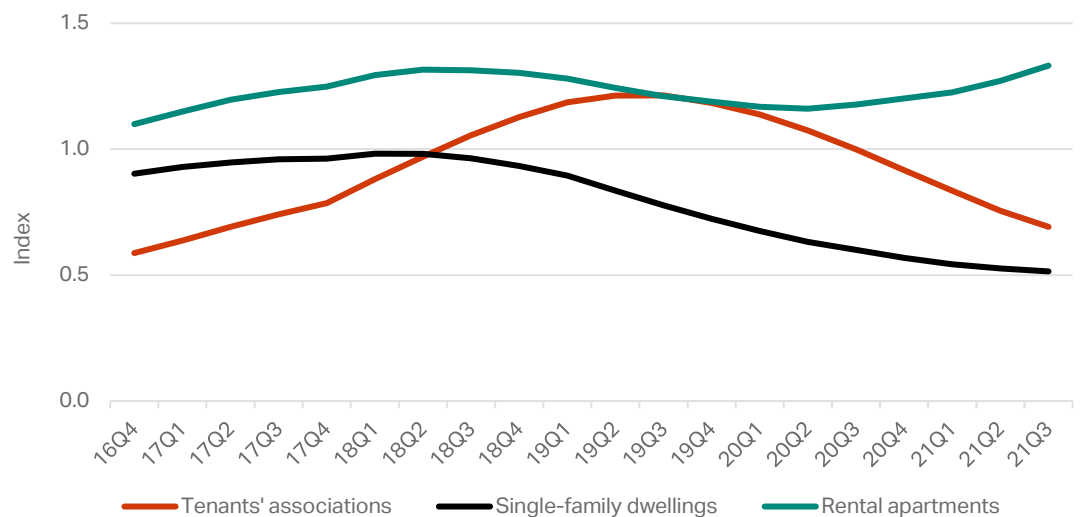
note that the currently buoyant market for logistics properties has led to a large number of development projects. Although speculative development remains relatively low, we believe that the potential oversupply of logistics properties is a risk to watch for over the next few years.

SETBACKS IN LOW-RISK RESIDENTIAL SEGMENT

We generally view the residential subsector as strong, as it benefits from regulated rents, long housing queues and high demand among both tenants and investors. We expect the operating environment to remain benign, although we consider that the forthcoming discontinuation of investment grants for newbuild residential properties, from 1 Jan. 2022, could have a negative impact on residential property developers that previously made use of this grant. However, we believe the impact will be largely offset by higher rents in completed properties, likely boosting property values instead of property developers receiving the subsidy in cash upon completion.

In 2021, concerns have been expressed about the high rate of residential development in Sweden. According to mortgage lender SBAB, a clearly visible trend towards a saturated market for residential apartments is increasing risks in this subsector, while the residential market in Västra Götaland County is already showing a clear apartment surplus. We consider that the current pace of development constitutes a risk for this segment, which has become used to very low, if any, vacancies. We believe that a surplus of residential apartments would accentuate the importance of the location of residential properties.

Figure 2. SBAB Booli Housing Market Index, 2016–21Q3

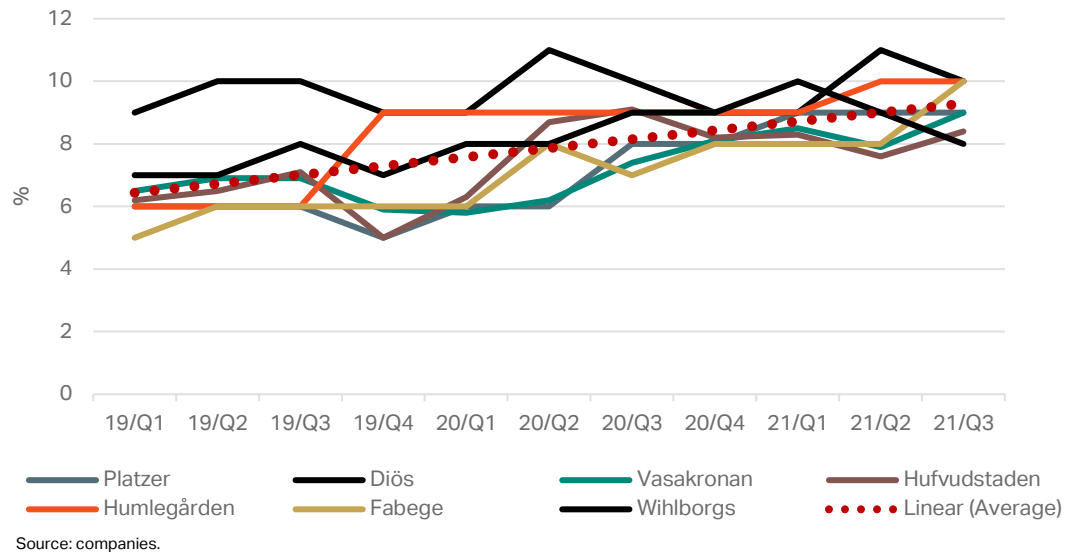


Source: SBAB Booli HMI. Index value above 1.5=surplus. Index value below 0.5=shortage.

INCREASED OFFICE VACANCIES NO MAJOR CAUSE FOR CONCERN

Since the onset of the pandemic, there has been plenty of discussion about the future of office space. At the time of writing, both prime and average rents are close to their pre-pandemic peaks, while declining property yields have further raised valuations in 2021. Vacancy rates, however, have increased steadily in both 2020 and 2021. We expect physical offices to remain important to tenants in 2022 and this subsector to remain stable. We do not expect to see material increases in vacancy rates from current levels.

Figure 3. Office vacancy rates in Sweden, 2019–21Q3

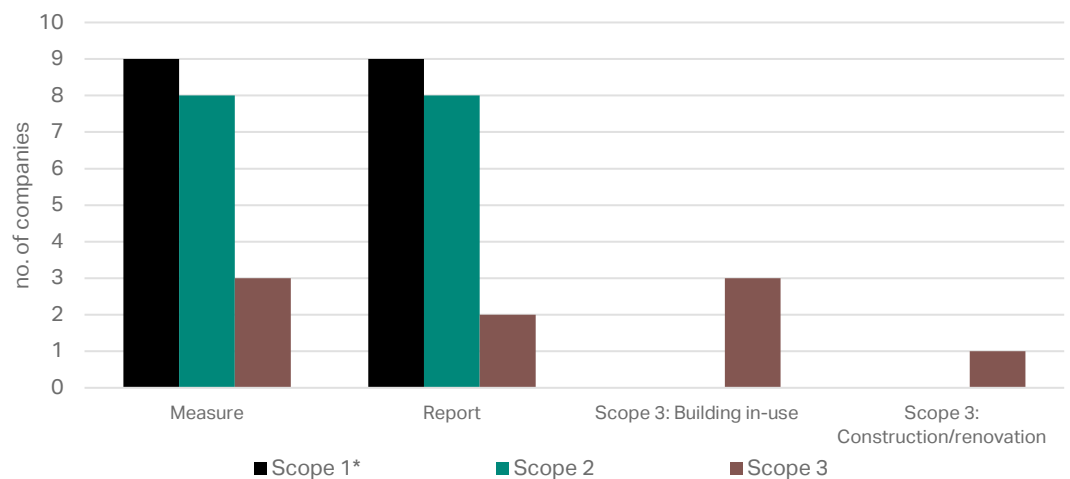


INCREASED ESG FOCUS IMPROVES COMPARABILITY

Over the past few years, property managers have increased efforts to reduce their environmental footprint, typically focusing on reducing energy usage and CO₂ emissions. Action on ESG issues often leads to lower running costs and more attractive properties, while improving access to financing. Real-estate companies' green financing has consequently increased; green bonds as a share of total real-estate bond volumes were 38% as of mid-December 2021, compared with 14% at year-end 2017. Despite increased efforts, ESG reporting in the real-estate sector is often far from comprehensive. Many property managers currently report only Scope 1 and 2 CO₂ emissions, while most emissions are associated with indirect Scope 3 emissions, which are more difficult to measure.

In 2022, we expect real-estate companies' ESG reporting to improve as more companies cover at least part of their Scope 3 emissions in measuring, reporting, and target-setting. Comprehensive reporting is important to stakeholders not only for comparability, but also to provide confidence that companies are aware of the full extent of their emissions and are setting targets where they matter most.

Figure 4. NCR-rated Swedish real-estate companies' CO₂ emissions, 2020



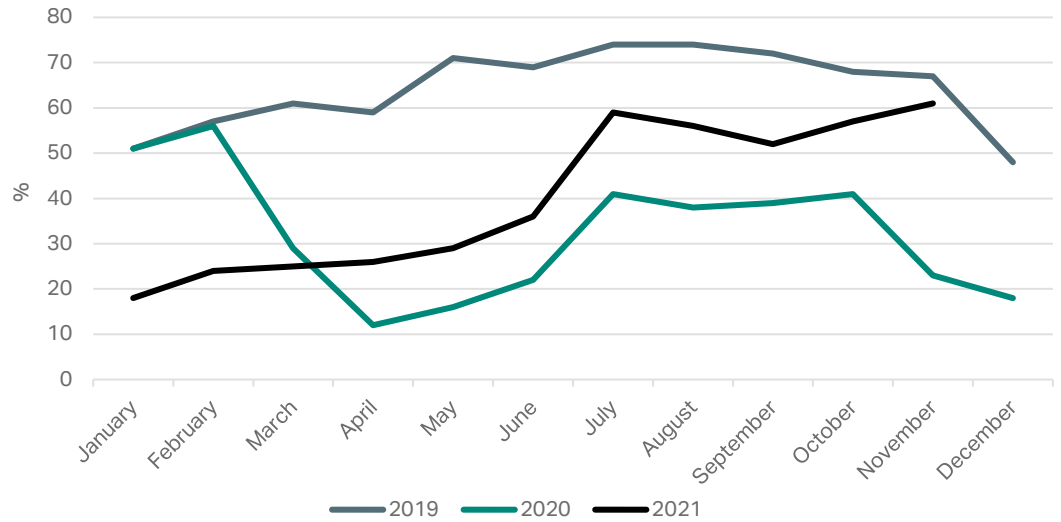
Source: companies. Compiled from 12 published issuer ratings. Scope 1–3 refers to greenhouse gas emissions, where Scope 1 is the most direct emissions, and Scope 2 & 3 are indirect emissions. *Includes companies that report CO₂ emissions without defining scope.

CHANGING BUSINESS TRAVEL PATTERNS AFFECTING HOTEL OPERATORS

According to the Stockholm Chamber of Commerce, the average occupancy of Swedish hotels was 61% in November, compared with 23% 12 months earlier and 67% in 2019. While this would suggest the

hotel industry has almost recovered to pre-pandemic levels, hotels in Stockholm are lagging behind this development. We believe this is because of reduced international tourism and a change in business travel patterns, which will potentially have a lasting impact on the hotel industry. In 2022, we expect hotel operators, especially in Stockholm, to continue to face a relatively soft market.

Figure 5. Swedish hotels' occupancy rates, 2019–2021

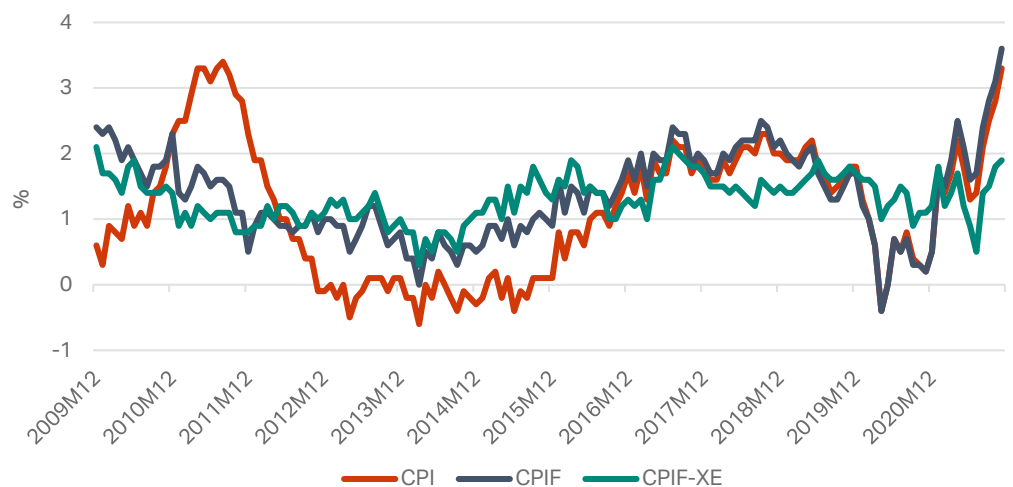


Source: Stockholm Chamber of Commerce.

POTENTIAL INFLATION RISK AHEAD

Following several years of subdued inflation and low interest rates, the current supply disruptions and increased energy prices in the global economy have led to inflation increasing worldwide. In Sweden, inflation – measured by fixed interest rates and excluding energy prices – remains below the central bank's 2% target, although unadjusted figures significantly exceed this target. Most market experts expect high inflation rates to be temporary and that inflation and interest rates will remain low. We generally concur but, nevertheless, believe that inflation risk is something to look out for in 2022, as higher inflation would likely lead to higher interest rates, which could become a major source of concern for the real-estate sector. Higher interest rates would likely have a material adverse impact, as they would affect both the valuation of real-estate assets and interest costs in the capital-intensive real-estate sector.

Figure 6. Swedish inflation rates, 2009–2021



Source: Statistics Sweden. CPI–consumer price index. CPIF–consumer price index with fixed interest rate. CPIF-XE–consumer price index with fixed interest rate – excluding energy.

NCR-RATED PROPERTY MANAGERS

Figure 7. NCR ratings on Swedish property managers

Issuer	Primary property type(s)	Long-term issuer rating	Outlook
Axfast AB (publ)	Offices	BBB	Stable
Bonnier Fastigheter AB	Offices	BBB	Stable
CA Fastigheter AB	Residential	BBB-	Stable
Catena AB (publ)	Logistics	BBB-	Stable
Fastighets AB Stenvalvet (publ)	Community service	BBB+	Stable
Heba Fastighets AB (publ)	Residential	A-	Negative
Intea Fastigheter AB (publ)	Community service	BBB+	Stable
LSTH Svenska Handelsfastigheter AB (publ)	Retail	BBB-	Stable
NP3 Fastighets AB (publ)	Industrial/warehousing	BB	Stable
Offentliga Hus i Norden AB (publ)	Community service	NR	-
Platzer Fastigheter Holding AB (publ)	Offices	BBB-	Stable
Stendörren Fastigheter AB (publ)	Industrial/warehousing	BB-	Stable
Stenhus Fastigheter i Norden AB (publ)	Retail/industrial	BB	Stable
Svensk FastighetsFinansiering AB (publ)	Offices	BBB+	Stable
Vacse AB (publ)	Community service	A-	Stable

See NCR's [company reports](#) for details.

DISCLAIMER

Disclaimer © 2021 Nordic Credit Rating AS (NCR, the agency). All rights reserved. All information and data used by NCR in its analytical activities come from sources the agency considers accurate and reliable. All material relating to NCR's analytical activities is provided on an "as is" basis. The agency does not conduct audits or similar warranty validations of any information used in its analytical activities and related material. NCR advises all users of its services to carry out individual assessments for their own specific use or purpose when using any information or material provided by the agency. Analytical material provided by NCR constitutes only an opinion on relative credit risk and does not address other forms of risk such as volatility or market risk and should not be considered to contain facts of any kind for the purpose of assessing an issuer's or an issue's historical, current or future performance. Analytical material provided by NCR may include certain forward-looking statements relating to the business, financial performance and results of an entity and/or the industry in which it operates. Forward-looking statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words "believes", "expects", "predicts", "intends", "projects", "plans", "estimates", "aims", "foresees", "anticipates", "targets", and similar expressions. Forward-looking statements contained in any analytical material provided by NCR, including assumptions, opinions and views either of the agency or cited from third-party sources are solely opinions and forecasts which are subject to risk, uncertainty and other factors that could cause actual events to differ materially from anticipated events. NCR and its personnel and any related third parties provide no assurance that the assumptions underlying any statements in analytical material provided by the agency are free from error, nor are they liable to any party, either directly or indirectly, for any damages, losses or similar, arising from use of NCR's analytical material or the agency's analytical activities. No representation or warranty (express or implied) is made as to, and no reliance should be placed upon, any information, including projections, estimates, targets and opinions, contained in any analytical material provided by NCR, and no liability whatsoever is accepted as to any errors, omissions or misstatements contained in any analytical material provided by the agency. Users of analytical material provided by NCR are solely responsible for making their own assessment of the market and the market position of any relevant entity, conducting their own investigations and analysis, and forming their own view of the future performance of any relevant entity's business and current and future financial situation. NCR is independent of any third party, and any information and/or material resulting from the agency's analytical activities should not be considered as marketing or a recommendation to buy, sell, or hold any financial instruments or similar. Relating to NCR's analytical activities, historical development and past performance does not safeguard or guarantee any future results or outcome. All information herein is the sole property of NCR and is protected by copyright and applicable laws. The information herein, and any other information provided by NCR, may not be reproduced, copied, stored, sold, or distributed without NCR's written permission.

NORDIC CREDIT RATING AS

nordiccreditrating.com