Creating Resilience

Market Outlook 2023

REPORT

SWEDEN
REAL ESTATE

CBRE RESEARCH

In 2022, the Swedish central bank, the Riksbank, increased the interest rate, directly impacting the 5-year swap rates affecting real estate transactions as all-in debt costs increased and leverage was reduced.

Photo: Holger Ellgaard.

Global Overview

Our RISE-values

Respect Service
Integrity Excellence

$30.82B	#126	105,000+
2022 Income	2022 F500 Ranking	Employees globally
115 years	90+	~500
Operational in US (22 in Sweden)	of Fortune 100 are our clients	Offices globally
100+	#1	
Number of countries where CBRE assist clients	Fortune Most Admired Real Estate Company (2022, 2021, 2020, 2019)	

Contents

The real estate market in Sweden has had an unusual year with many economic challenges in the second half of 2022 continuing to create short term uncertainty in 2023.

Introduction

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Year 2022 was eventful with many challenges for the global and Swedish real estate sector.

Focus on the economic impact of the pandemic was quickly redirected with the invasion of Ukraine, economic effects from energy prices climbing and rising inflation.

With all such extreme external events it is especially important for investors to get an understanding of potential consequences, both in the short and long term.

Analyzing is key in 2023 and CBRE has the full width of professionals ready to guide you to do the best possible business ahead.

The Swedish economy enters 2023 with a declining GDP and continuing high inflation. Inflation is positive for rental levels yet also effecting interest rates which makes financing one of our main themes in this year's edition of the Outlook. On the positive side bank financing is still restrictive yet again active and as 2022 ended slow for real estate investments in Sweden, we expect the investment market to pick up in the second half of the year.

Another topic of great importance is how resilience and risk minimization is created through focusing on practically addressing ESG. CBRE has a strong team both locally and globally who can guide you on making the best possible decisions to reap the benefits for your portfolio.

Both office and logistics leasing markets is expected to remain stable with low vacancy rates and high occupier demand. However, we do notice the attraction of primary and secondary assets to diverge as both tenants and investors lean towards quality.

We look forward to work together with you to optimize real estate investments in 2023. Please enjoy the report and let us know how we can assist your business.

01

Economy

The Swedish economy is expected to have a moderate recession in 2023 and GDP is expected to fall by 0.6% according to CBRE House view. A continued high inflation and increase in interest rates are slowing down the economic activity.

Key Takeaways – Economy

01

SWEDEN START OFF 2023 WITH A STAGFLATION ECONOMY

With high inflation and declining GDP Sweden starts the year in an unfavorable situation. Real estate is a good alternative investment as cash flowing assets are beneficial when the economy slows down. The positive turn is expected in 2023 and GDP growth in Sweden is expected already in 2024.

02

HIGH INFLATION EXPECTED TO TURN BACK DOWN IN 2023

Energy prices have affected other prices and sectors and together with a post-pandemic restarting industry pushed inflation upwards in 2022. The sticky inflation this winter is expected to fall back down again later this year. On a positive note, high inflation is having a positive effect on rents.

03

UNEMPLOYMENT EXPECTED TO DECLINE IN COMING YEARS

The Swedish unemployment is turning up slightly in 2023 and expected to have a falling trend in 2024 and the following years to come, providing a stable occupier demand for real estate.

A volatile economy gives an uncertain start to 2023

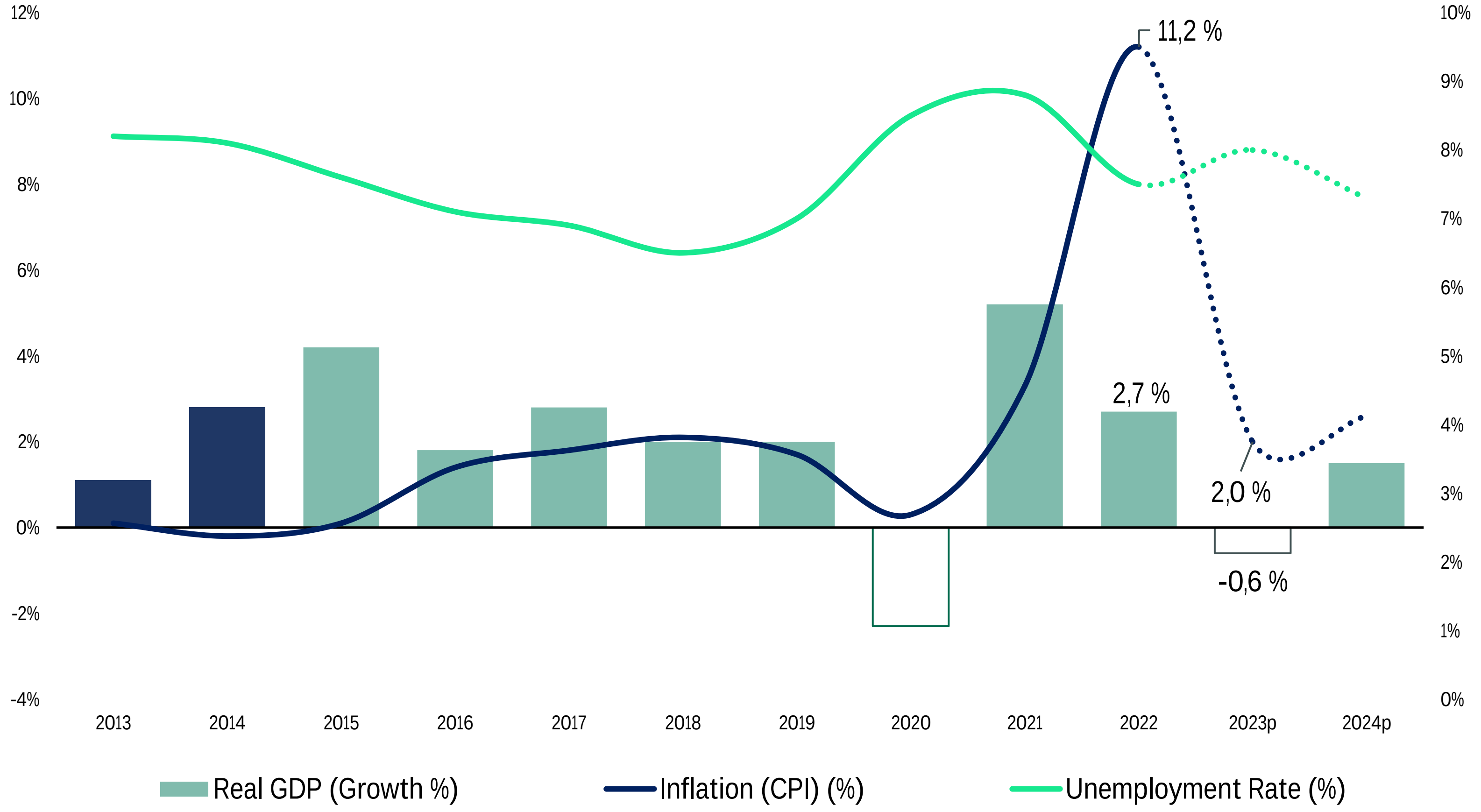
Post-pandemic rebound with an inflation hit

The Swedish economy had a strong rebound after the pandemic with GDP growing by 2.7% in 2022 and 5.2% in 2021. Unemployment also decreased to 7.5 % in 2022. The CBRE House view states that the Swedish economy is expected to slow down with -0.6% this year. The prognosis is based on high inflation with decreasing business and consumer demand impacting together with tight financial conditions. The situation is expected to improve during the year with a turn in the second half and return to an expanding economy again in 2024.

Inflation saw a large uptick during 2021 and 2022 with the recovery from the pandemic, supply bottlenecks and rise in energy prices driving prices higher. The inflation rate rose to 11.2% in 2022. The development according to global CBRE House view is expected to settle down towards the end of 2023, with tighter monetary policy and easing of the energy crisis impacting the inflation. There is high uncertainty in the prognosis with the complexity in the current economy and the inflation may stick longer than anticipated.

The labour market is expected to slow down slightly in 2023, reaching 8.0% and improve again in 2024 to 7.3% and continuing to have a positive trend from there.

Figure 1.1 GDP growth, inflation and unemployment rate



Source: CBRE House view, February 2023

02

Investment

Real estate investment volumes reached SEK 160 billion in 2022, a decrease of approximately 51% from the record levels of 2021. The transaction market this year has had a hesitant start, the financing situation has however improved since the later part of last year.

Key Takeaways – Investment

01

FINANCING AVAILABLE YET MORE TIME CONSUMING

After a slow ending to 2022 the financing possibilities improved early 2023, creating optimism for deals to close as buyers and sellers agree on price.

02

CONTINUING REPRICING AHEAD

Rising interest rates and financing costs push yields upwards. As the Swedish Central Bank monetary policies increased financing costs, this development impact the margin for low yielding assets with following prime yield decompression.

03

STRONG DEMAND FOR CORE ASSETS AND ESG

According to CBRE Investor Intentions Survey 2023, 81% of investors will continue to adopt ESG criteria in all investment decisions despite macro-economic headwinds and a challenging geopolitical landscape.

Domestic investors in majority

Hesitant end to 2022 and beginning 2023

Transaction volume for 2022 sums up to approximately SEK 160 billion, a decrease of about 51% from the record levels of 2021. The transaction volume is the lowest on a yearly basis since 2018. For the last quarter 2022 the volume sums up to ca SEK 31 bn, a decrease of approximately 76% from the corresponding quarter in 2021.

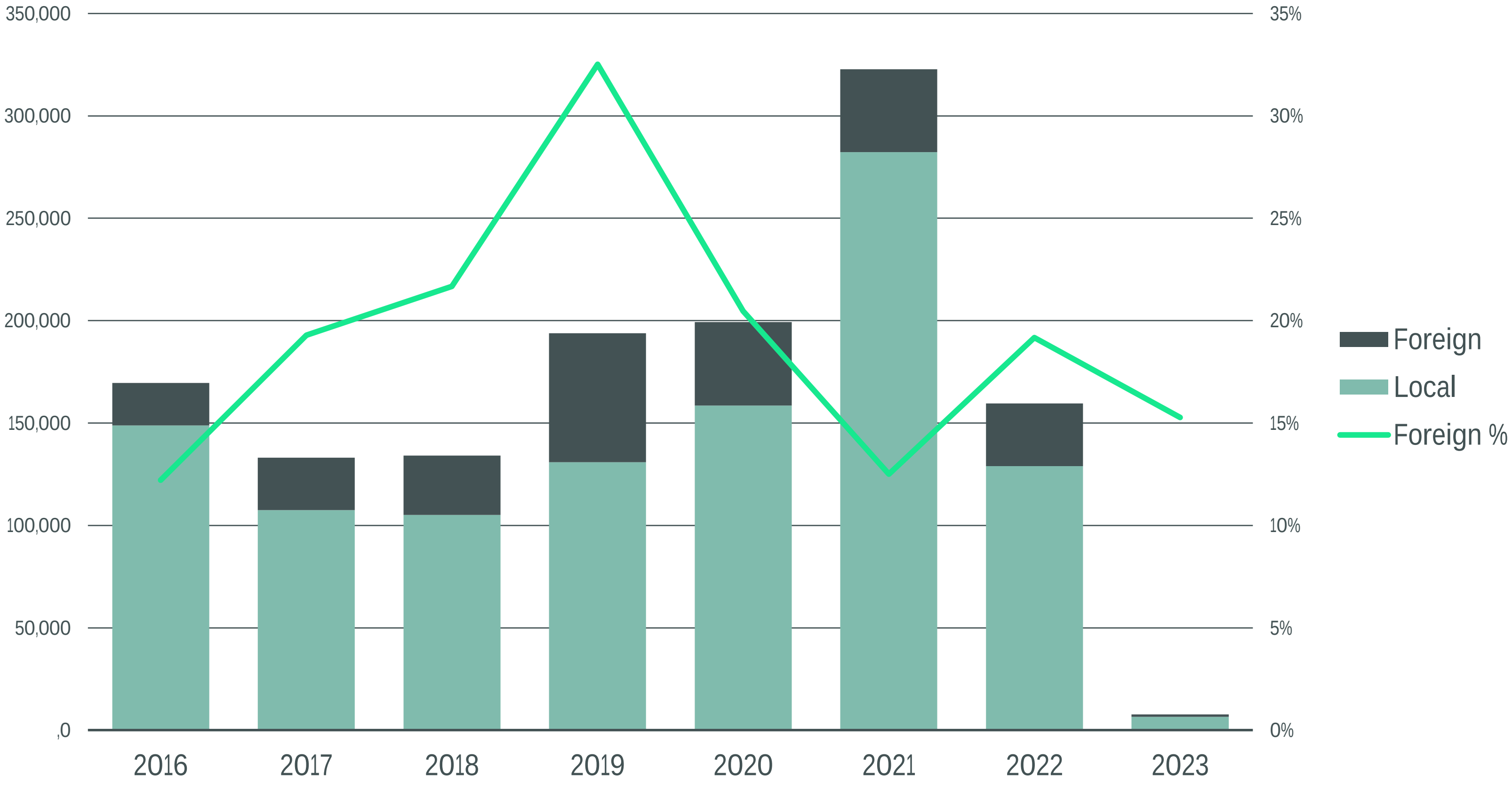
After a stable start in the early stages of 2022, the transaction market weakened with a steadily slow in the fall and early stages of the winter. Several deals took place again in the second half of December. 2023 has started off very slow with unusually few transactions. So far, in February, a little over SEK 7.5 bn in deals have transacted.

CBRE expect global transaction volumes in 2023 to be at least -11% lower compared to the year before. Sweden may have a reduction larger than that due to the underlying volatility in the economy, and lower in the first quarter. Traditional sales of properties and portfolios are expected to decrease with potential for structured deals. Limited financing may also have a negative impact on the total volume.

Majority of domestic investors

Domestic investors accounted for a clear majority of the volume, roughly 81% of the transaction volume. Approximately 19% of the deals involved a cross-border investor, which during the last 10 years also has been the average share on a yearly basis. So far this year 15% of acquisitions have had cross border investors, with a majority still being local capital. International investors are active in most of the segments, with a primary focus on larger logistics portfolios, offices in prime locations, as well as large retail units.

Figure 2.1. Investment volumes and cross-border share, mSEK (excl Vasakronan in 2008 & SBB in 2022)



Source: CBRE Research, February 2023

High yielding assets was gaining momentum in 2022

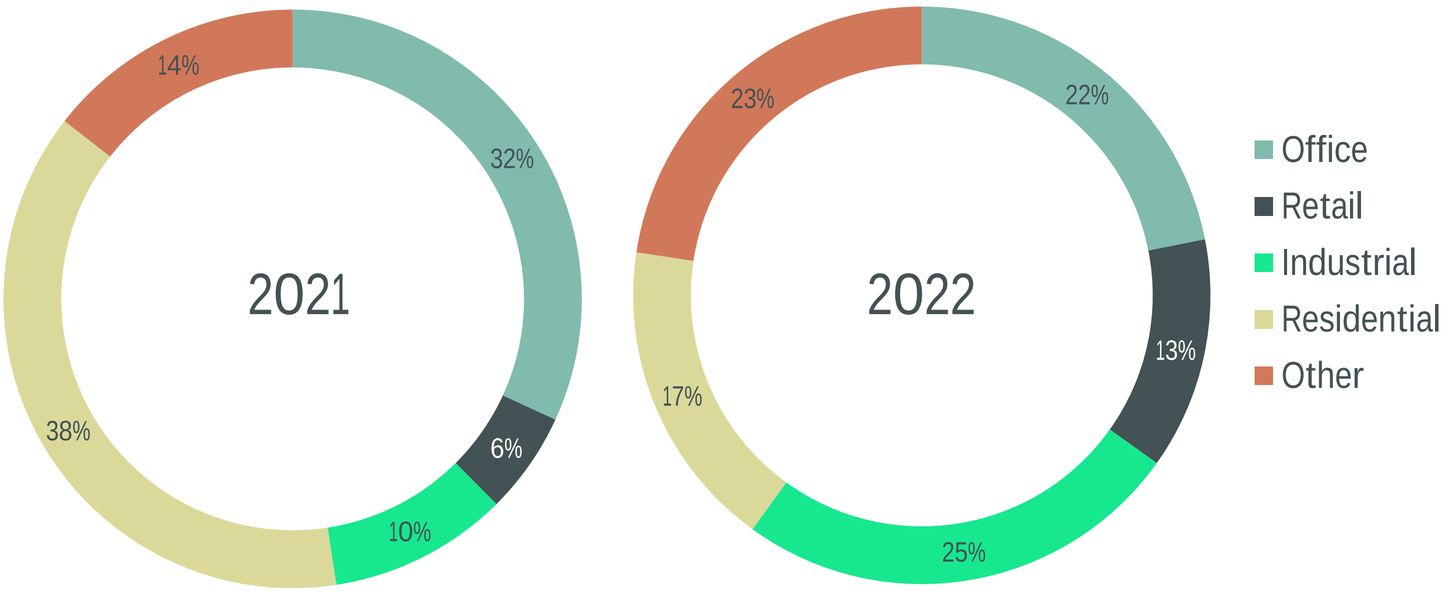
Several large-scale transactions in 2022

The largest segment during 2022 was Industrial, including logistics and warehouse assets. This segment accounted for a larger share of the total volume compared to previous years at approximately 25% of the total volume. The corresponding percentage in the preceding year was around 10%.

2022 entailed significantly different market conditions compared to previous years, which mainly impacted low yielding products. The industrial segment with generally higher yields was not equally impacted with transaction volumes in this segment remaining at similar levels to previous years.

It is evident that the residential segment have had a year with low activity on the transaction market. The segment represents under 20% of the total volume for the first time in the last five years. Residential properties have been the single largest segment each year in the same time period, with an average of over 30% per year. This indicates how complicated it has been to finalize deals with low yielding products during 2022.

Figure 2.2 Investment volumes by segment yearly composition



Source: CBRE Research.

Prime yield decompression due to increasing interest rates and cost of capital

Repricing and valuation shifts in 2022

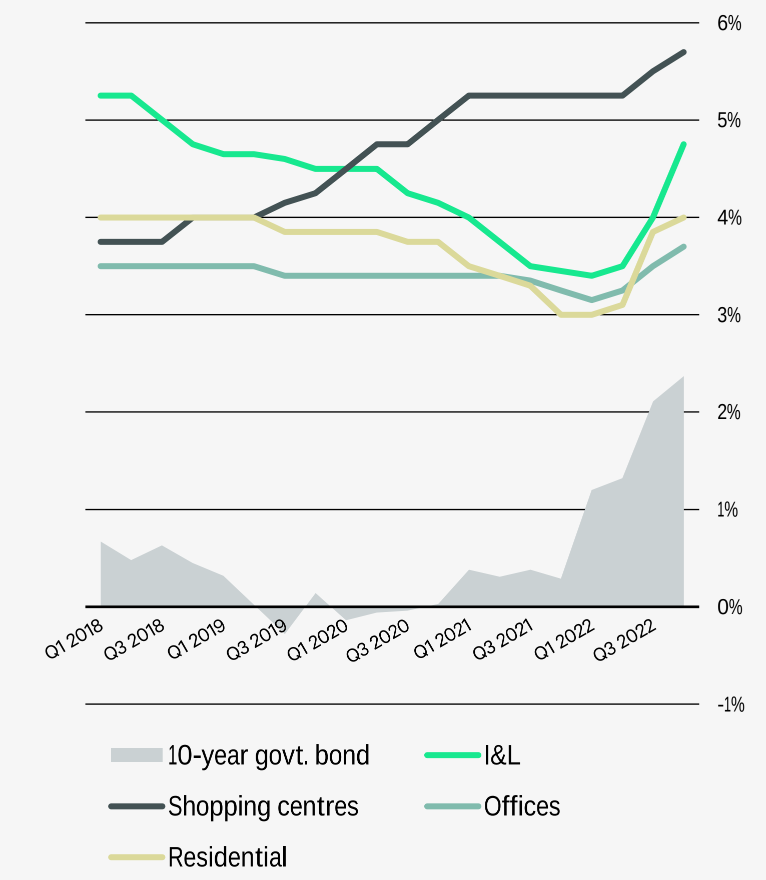
Prime yields decompressed due to increased financing costs and rising interest rates in 2022. The trend is correlating well with the development of the 10-year government bond. Office and residential prime yields decompressed 45 to 100 basis points and stood at 3.70% and 4.00% at the end of the year. Offices are yet again the prime real estate in Sweden with residential fallen back from that same position.

Industrial and logistics sector was one of the sectors most influenced by the shift in pricing dynamics and prime logistics yield moved to 4.75%, up 130 basis points year-over-year. Prime yield for shopping centres have moved up 45 basis points to 6.25%.

The mismatch in buyer and seller pricing expectations, tighter lending conditions and recession fears made it more difficult to close deals in the second half of 2022. These were the main challenges cited by investors in the CBRE Investor Intentions Survey 2023.

Survey respondents signaled a willingness to sustain transaction activity as well as maintain or increase allocations to real estate. When putting capital to work, investors favour opportunistic and distressed strategies as they seek to capture attractive yields. These findings provide a degree of optimism for the real estate investment activity despite a challenging economic backdrop.

Figure 2.3. Prime yields & 10 year government bond



Source: CBRE Research.

ESG and green credentials in 2023 spotlight

According to CBRE Investor Intentions Survey 2023, over 80% of investors affirmed that they would continue to apply ESG criteria to all investment decisions, and the most popular ESG strategy is to upgrade existing assets to meet the standards of sustainability certifications. Additionally, one-third of investors surveyed stated that they were willing to pay a premium to acquire ESG friendly assets. More than half of those willing to pay a premium said the premium could be more than 20%.

Opportunities arise as asset pricing stabilises

CBRE forecasts that 2023 European investment volume will decrease 5-10% relative to 2022 levels, and Swedish real estate is expected to have a similar trend. However, current market environment will present opportunities as asset pricing is expected to stabilise in 2023. A recovery may commence in the second half of 2023 as macroeconomic challenges improve.

The continued central bank interest rate hikes and the cost of financing will be key themes for the next 12 months.

03

Financing

Debt markets stabilised in Q4 2022 after a volatile year. Credit ratings will likely continue to be a key focus for the year, as significant amount of corporate real estate bonds will need to be refinanced in 2023 and 2024.

Key Takeaways – Financing

01

LOWER LTV AND HIGHER FINANCING COSTS

Observed LTV is down 5–10% in Q4 2022, compared to the start of the year. The lower leverage is partly a result of higher cost of borrowing (swap rates and margins), which limits the serviceable amount of leverage, as well as banks applying lower values to the underlying assets.

02

STABILISING DEBT MARKET

The debt market stabilised in Q4 2022, with senior lending terms for prime asset similar to Q3 2022 across asset classes.

03

FLIGHT TO QUALITY

Lenders are placing more emphasis on the quality of assets and the issuer, with stronger liquidity for top-quality sponsors. ESG considerations are also becoming more central in discussions.

High inflation following years of quantitative easing

Following the low interest rates and quantitative easing that started after the Great Financial Crisis in 2008 and rapidly accelerated during the Covid-19 pandemic, the inflation reached over 4% in Sweden in 2022 for the first time since 2009. During 2022, inflation climbed to 10.2% (measured as CPIF) while the Swedish central bank, the Riksbank, increase the interest rate from 0.0% to 2.5%. This had direct impact on the 5-year swap rates which rose by c. 320 bps during 2022, which in turn affected real estate transactions as all-in debt costs increased sharply and leverage was reduced in order to satisfy ICR covenants.

Interest rates expected to peak in 2023

The forward Euribor indicate that interest rates are expected to peak during 2023 as the Euro area is forecast to enter a recession. However, we see some risk with the current pricing as inflation tends to be very sticky once it has climbed of 5%. Historically, the average time, in developed economies, for inflation to decline to 2%, after it has reached above 5%, is c. 10 years. The Riksbank forecast a inflation of 2% by end of 2023. Our view of a more sticky inflation is also held by several macro hedge funds that are actively betting on higher inflation for longer.

Figure 3.1 5-year swap rates in the Nordics and Euro area, 2017–2022

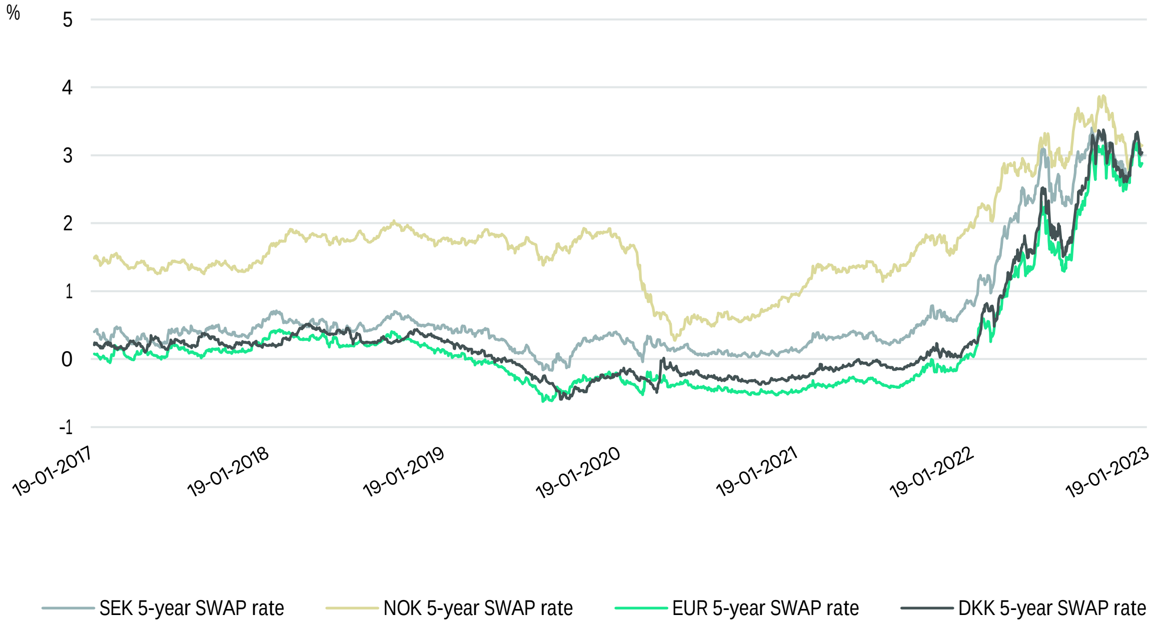
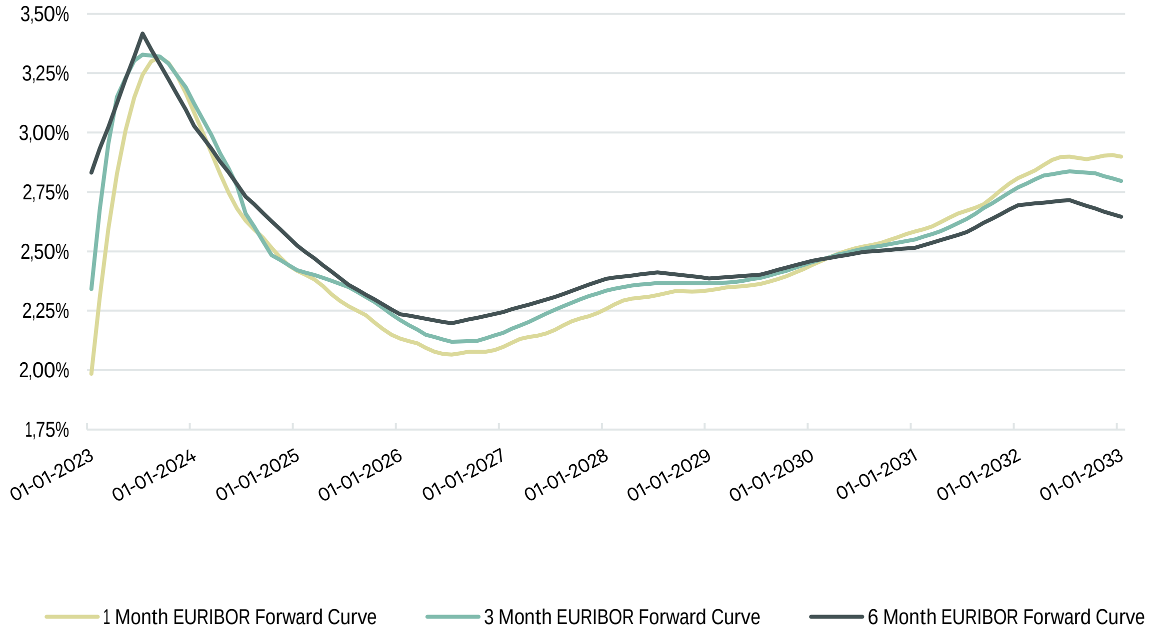


Figure 3.2 Euribor forward curve, 2023–2033



Source: CBRE Research.

Debt market stabilised in Q4

Despite the increasing swap rates throughout 2022, the senior key terms for prime assets stabilised in general in Q4 in many European geographies. LTV and margins remained similar to Q3 levels for all prime asset classes in the Nordics. In the G7 Group, all prime asset classes experienced slightly lower LTV and higher margins, except for retail, where margin decreased by 5 bps compared to Q3.

Until mid-February 2023, SEK 6.3bn of bonds have been issued, whereof c. SEK 5.3bn (EUR 480m) relate to Balder's convertible bond. The coupons rates range from 3.50%–3.99%. The bonds have been issued with fixed coupon rates, except one with floating rate of 3M STIBOR + 0.9%.

Higher liquidity for top-quality sponsors

Following the market uncertainty, with higher inflation and increasing financing costs, lenders tend to focus more on the quality of the issuer as well as the assets, with significantly stronger liquidity for top-quality sponsors. In addition, ESG aspects are becoming more central in lending discussions.

According to Moody's, SEK 300bn of corporate real estate bonds need to be refinanced in 2023-2024. However, the companies' cash position is relatively strong, with cash equivalents on the balance sheet accounting for 50% of the nominal amount that needs to be refinanced. We therefore believe that the private debt markets (banks + insurance + debt funds) combined with the public bond markets will function well and absorb the refinancing need.

Figure 3.3 Senior lending key terms for prime assets, Q4 2022

	Prime Office		Prime Retail		Prime Logistics		Prime Residential	
	LTV	Margin	LTV	Margin	LTV	Margin	LTV	Margin
G7 Group	55.0	1.61	52.5	2.19	55.0	1.59	55.0	1.55
France	55.0	1.40	55.0	1.40	55.0	1.50	55.0	1.60
Germany	55.0	1.40	55.0	1.60	55.0	1.40	60.0	1.40
Italy	55.0	2.00	50.0	3.00	55.0	1.80	-	-
UK	55.0	1.65	50.0	2.75	55.0	1.65	50.0	1.65
Nordics	51.7	1.42	51.7	1.50	51.7	1.58	55.0	1.75
Denmark	50.0	0.90	50.0	0.90	50.0	1.25	50.0	0.90
Finland	55.0	1.75	55.0	1.80	55.0	1.90	55.0	1.75
Norway	55.0	2.30	55.0	2.30	50.0	2.30	55.0	2.30
Sweden	50.0	1.60	50.0	1.80	50.0	1.60	50.0	1.60

Source: CBRE Research, Bloomberg.

Outlook for financing 2023

CHALLENGES

- Yield gap narrowed
- Financial covenants (LTV, ICR)
- Liquidity in public bond markets challenged
- Cost of debt increased
- Refinancing risk / Maturity wall

MITIGATING FACTORS

- Leverage significantly lower than GFC
- Nordic banks well capitalised and funding spreads lower than rest of Europe
- Hedging has mitigated mark-to-market losses on CRE
- Cash position of public real estate companies

Financing

Cost of financing has rarely been an issue for most real estate companies in the years leading up to 2022, with a number of listed players borrowing at a negative interest rate in the bond market. However, following the rapidly increasing interest rates that occurred during 2022, financing and leverage has become a differentiator in the market. Greater emphasis is placed on finding an optimal debt level and structure with sustainable cost of financing. The higher interest rates have forced companies to quickly shift the focus from growth to profitability with sustainable debt levels from quality sources, e.g. replacing bond financing with bank debt.

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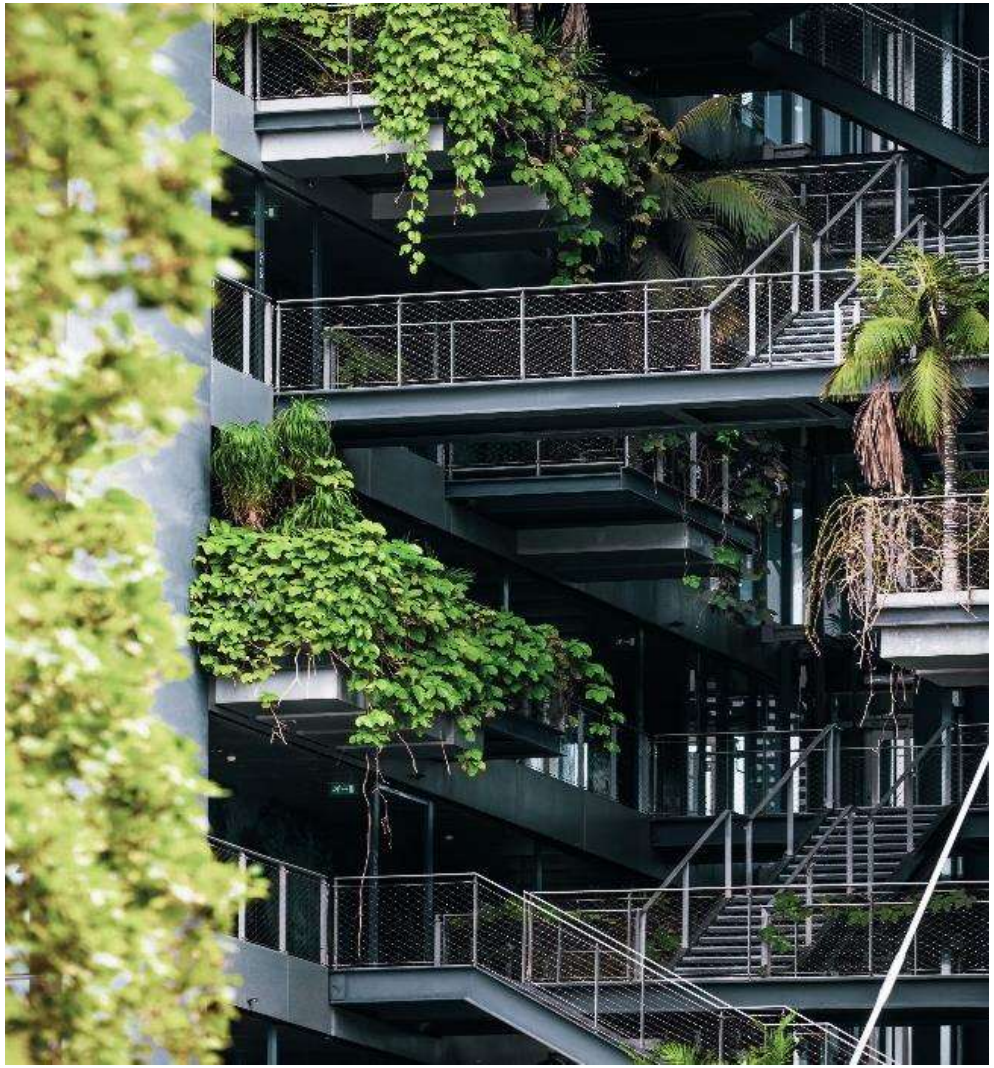
04

Sustainability

According to CBRE Investor Intentions Survey 2023, over 80% confirmed they would continue to apply ESG criteria to all investment decisions. Most popular strategy is upgrading existing assets to meet the standards of sustainability certifications. ESG focus will continue to intensify during 2023.

Key Takeaways – Sustainability



01

RENTAL PREMIUM FOR CERTIFIED OFFICE BUILDINGS

When effects of building size, location, age and renovation history are accounted for, buildings with sustainability certification command a 10% rental premium in Stockholm, more than in overall Europe at 6%. Premiums will appear in other sectors as occupiers start demanding higher levels of environmental performance.

02

LOWER VACANCIES IN CERTIFIED BUILDINGS

Certified buildings command lower vacancy rates compared to non-certified stock in Stockholm, according to the CBRE report *Is Sustainability Certification in Real Estate worth it?* Real estate portfolio resilience is therefore created by focusing on having documented sustainability work.

03

INCREASED INTEGRATION OF SUSTAINABILITY DATA IN VALUATIONS

A better understanding of the value of sustainability features is established as sustainability data is integrated into asset valuations. This allow measurement of how green features can protect against value depreciation and insulate assets from transition risks.

Source: CBRE Research, Is Sustainability Certification in Real Estate worth it?, November 2022

Everything comes with a price – including the future of the real estate sector

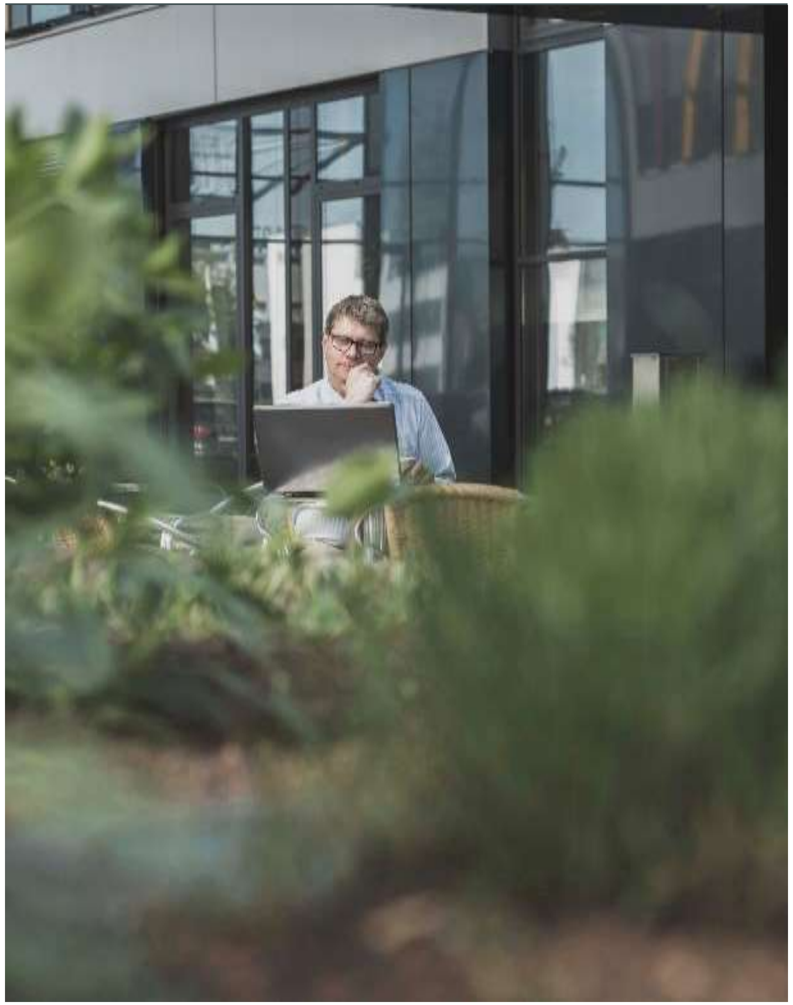
Taxonomy is putting pressure on real estate

Achieving the 1.5°C climate target seems challenging, unless significant progress is being made in three primary sectors that drive emissions: energy, transport and real estate. The European Commission has proposed in the Climate Target Plan 2030 to cut net greenhouse gas emissions (GHG) in the EU by at least 55% by 2030 compared to 1990.

An essential component for action is energy efficiency, with the building sector being identified as one of the areas requiring efforts to be ramped up. The current approach applied within the commercial real estate (CRE) industry is being viewed as somewhat efficient but too slow, holding CRE stakeholders accountable for aspirational goals rather than specific achievements.

For the CRE industry to scale up the sustainability agenda, a business case around sustainable buildings needs to be clear. Currently, the discord lies between the perception that sustainable buildings generate positive value benefits, and the evidence base to keep up with this perception.

As sustainability certifications are often being used as a proxy for sustainable buildings, they have drawn much attention in empirical sustainability property investment research. Their further alignment with the EU Taxonomy is expected, proving new points for analyzing impact on value creation. However, much of the existing research has been heavily focused on US and UK, with only limited, country based European evidence.



CBRE comprehensive analysis in 2022

CBRE has now repeated a pan-European analysis it first undertook in 2021, building on data from 18 European countries (38 cities). To our knowledge this is one of the most comprehensive European analyses ever performed. Conclusions presented in this report show a significant correlation between sustainability certificates and buildings' market value. Most importantly, the analysis has revealed that a rental premium exists for certified office buildings, regardless of building year. Meaning that certifying both new and existing buildings ensures higher office rents compared to non-certified stock. This is very supportive of the retrofitting challenge outlined by the European Green Deal.

Key highlights in CBRE report

- Environmentally certified office buildings represent a growing share of the office market - 20% (mid-2022, compared to 14% in 2019)
- Certified office take-up has risen from 30% of the market in 2019 to 32%, confirming trend that leasing activity is increasingly focused on certified buildings
- Certification can be a significant factor in lowering vacancy risk - in the majority of cities analysed, certified buildings command lower vacancy rates compared to non-certified stock

In the context of dramatically increasing energy prices and ongoing climate change, sustainability concerns have never been as much on the agenda as in 2023. Investors and occupiers are becoming more aware of the benefits of certified assets in limiting risks, attracting talent and improving financing. The trend is intensifying the gap between primary and secondary assets. The existence of premium is clearly apparent in some sectors and the demand for stock with the highest sustainability ratings is more robust[1].

Looking ahead

Sustainability and ESG concerns continue to impact investment committees and corporate decision-making in 2023. Companies and policymakers will focus on new or impending directives in 2023 including:

- Implications of 2030 net-zero (or carbon reduction) targets,
- European Union's Sustainable Finance Disclosure Regulation (SFDR),
- Corporate Sustainability Reporting Directive (CSRD).

Contrary to narratives regarding the "stranding" of secondary assets, CBRE believes that 2023 will bring significant opportunities for "brown-to-green" refurbishment, particularly in offices. Falling secondary prices significantly increase the viability and potential returns of certification projects.

1. Source: CBRE Research, Is Sustainability Certification in Real Estate worth it?, November 2022

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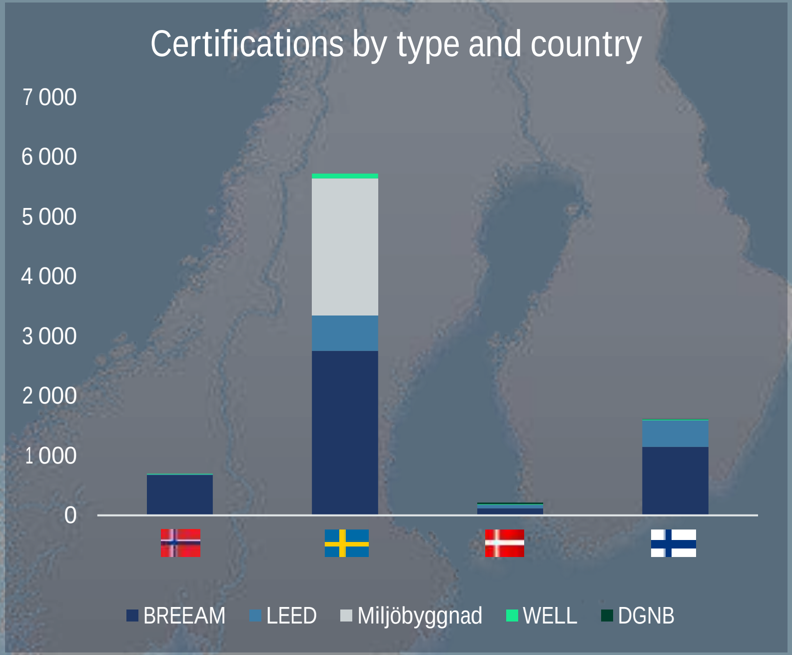
CBRE

The importance of ESG is increasing every year, noticeable in the steadily rising number of green building certifications, amongst other parameters.

Landlords, occupiers and owners will focus on refining strategies to prepare for a carbon-constrained legalization.

The "S" ensures a social development where health and wellbeing are top priorities.



05

Industrial & Logistics

Low vacancy rate in combination with high occupier demand for logistics assets in prime locations support continued investor appetite. Current occupier demand is dominatingly backed by 3PL companies.

Key Takeaways – Industrial & Logistics

01

LOW VACANCY AND STRONG OCCUPIER DEMAND SUGGEST STABILITY

Investment sentiments remain stable with occupier demand for prime assets in favourable locations. Vacancy levels in Sweden's main logistics hubs are record low with continued strong demand for premises in last mile locations.

02

ENVIRONMENTAL ASPECTS BECOME A PRIORITY FOR OCCUPIERS AND LANDLORDS ALIKE

Due to increased automation and robotics, the requirements for green power on logistics sites increase. Solar power situated on roof tops are becoming increasingly common. Automation requires modern buildings suggesting increasing demand for prime assets.

03

RENTAL GROWTH IN PAST YEARS EXPECTED TO STABILIZE AHEAD

After many years of stable rents, due to higher vacancy rates, there has been a sharp increase in prime rents in past years. This is partly driven by relocation from older stock to newly constructed assets. With a challanged economy vacancies are expected to be impacted ahead with a somewhat slower rental growth as a consequence.

Record year in 2022 for industrial and logistics

Several strong deals led to new record volume

The investment volume for 2022 came in at SEK 44.6 bn, supporting the continuously robust interest in investing into the sector. Share of total investment volume increased from 10% in 2021 to 28% in 2022. Cross border investments increased y-o-y by 14% to SEK 7.9 bn in the last quarter. Annual total volume was high, however the share of prime assets was lower than usual. First half of 2022 had strong investor demand and a shortage of supply with the second half shifting focus to secondary assets with higher yields and rental growth potential.

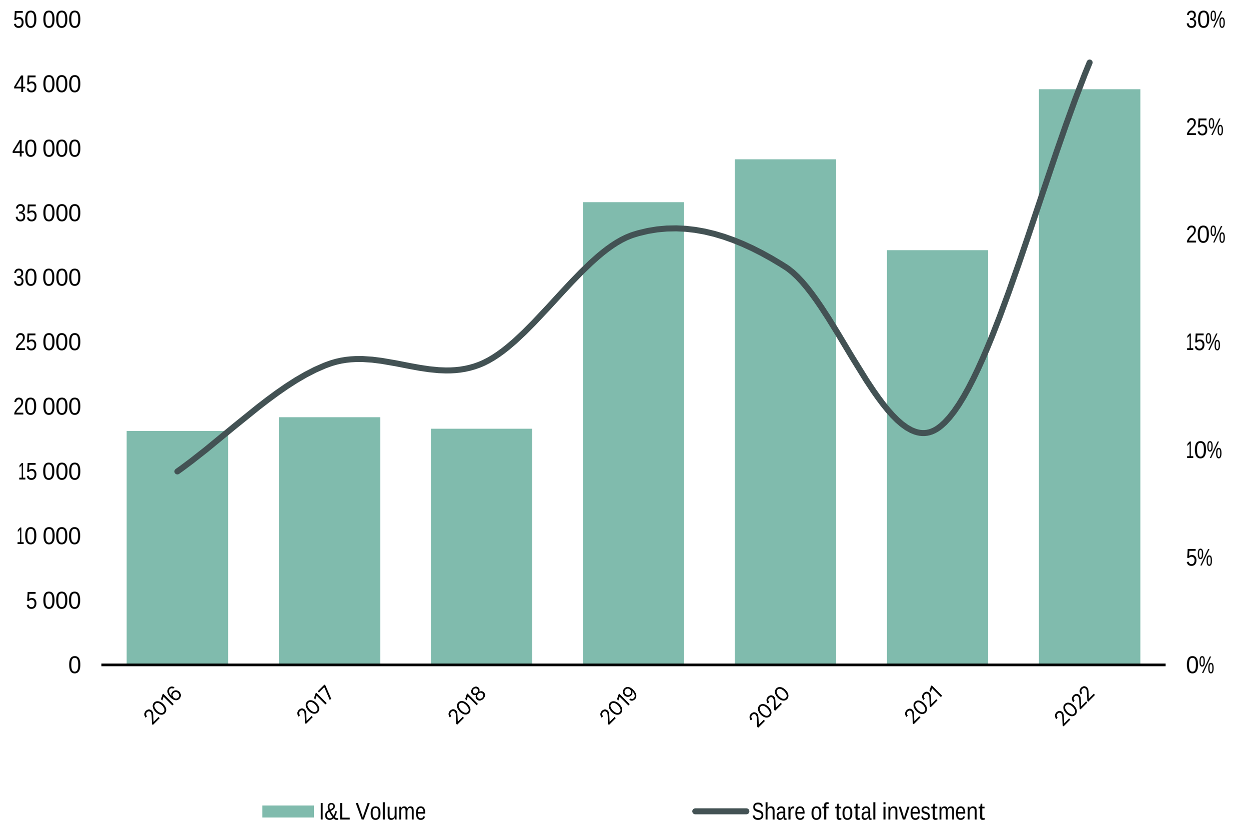
The most notable deal during the fourth quarter was the Corem divestment of 47 assets in Stockholm, Gothenburg, Malmö, Jönköping and Västerås. The underlying property value was SEK 5.35 bn and the portfolio was acquired by Blackstone. It is also one of the largest deals in 2022. CBRE advised on behalf of Blackstone.

Another notable deal was ICA Fastigheter's divestment of two prime logistics assets strategically located in Upplands-Bro and Gothenburg. The properties were acquired by Catena for SEK 0.5 bn with the asset in Gothenburg being the first warehouse in Sweden to achieve a Breeam Outstanding certificate. CBRE acted as advisor on behalf of the seller.

Intense competition for the right type of products

Prime logistics yields have risen during the quarter to reflect the new financing costs, reaching a level of 4.75%. Investors are continuing to focus on quality in strong locations with a growing population. Assets with rents below market value and shorter contracts are attractive due rental potential ahead.

Figure 5.1 I&L investment volume and share of total investment (billion SEK)



Source: CBRE Research.

4.75%

Prime I&L Yield (Q4 2022)

79%

Cross-border share of total I&L investment in 2022

Relocation and 3PL Occupier Demand

Low vacancy gives segment stability

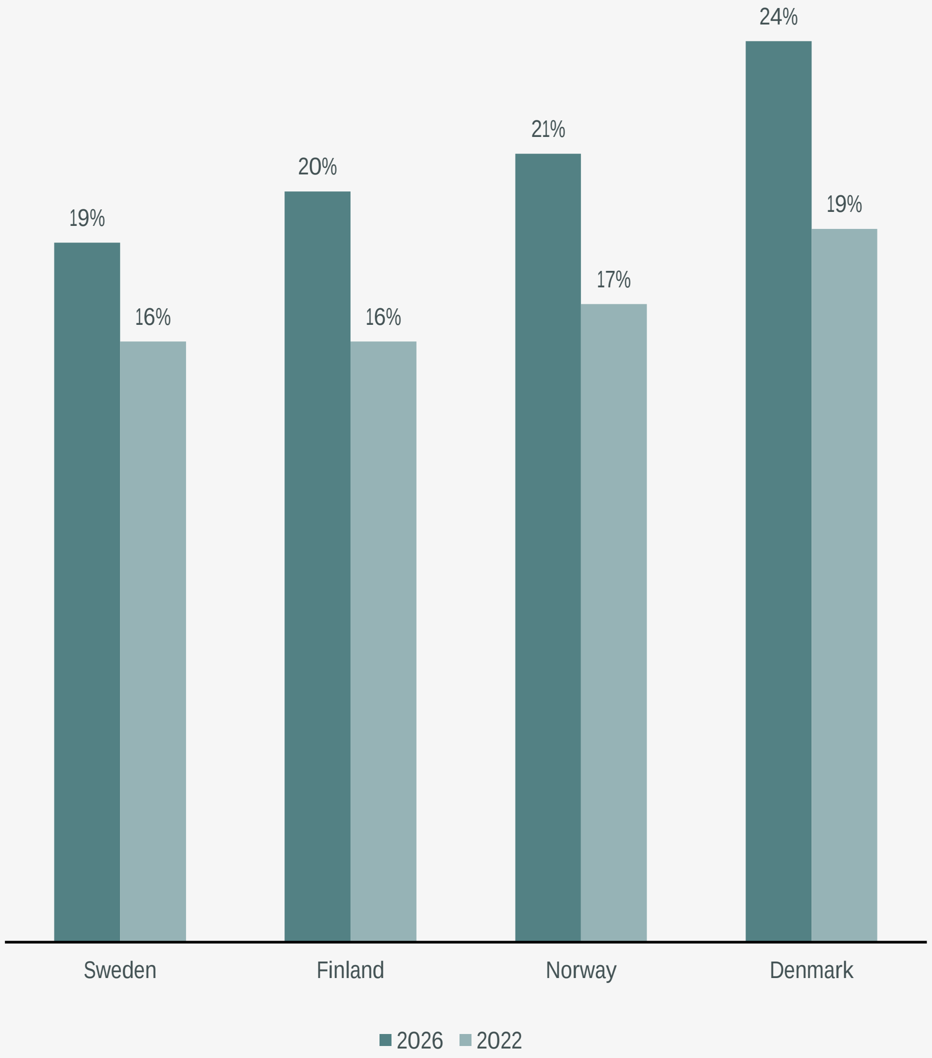
The occupier market continues to show strength with a prime asset vacancy rate at 1% and this despite record high construction volumes. There is a high demand for modern industrial and logistics properties across various industries and sub-sectors in prime locations. This is driven by a wide range of demand with maturity in e-commerce driving especially pharmacy companies sourcing suitable properties to expand operations, as online orders continue to grow as share of total consumption and package handling requiring more space. Additionally, industrial and manufacturing companies have built up inventories to mitigate the impact of supply and material shortages. Companies from various industries are seeking more warehouse and logistics space to meet their needs, and in some cases, settling for older stock as new developments cannot keep up with the demand. Near shoring is a trend as companies are moving production and stock to limit supply chain disruptions.

Fundamentals of growth remain and the increased share of online shopping and the rise in parcel shipments drives demand for logistics properties, especially 3PL. The structural growth of e-commerce share in Sweden is expected to increase from 16% 2022 to 19% in 2026. Occupier demand continues on a high note, and lack of modern warehouse and last mile logistics space is evident in the capital city region. Strong occupier demand drives rental growth expectations in 2023, however impact is expected ahead with a less strong demand due to effects from a challanged economic situation impacting end consumer spending.

Pipeline decrease in 2023

The pipeline for 2023 is expected to be smaller than the years before, and with a higher degree of speculation. A total of 681,600 sqm were completed in the fourth quarter 2022, and net absorption estimated to 646,000 sqm. The forecasted completions for Q1 2023 totals 145,000 sqm, which is considerably lower than for the fourth quarter.

Figure 5.2 Share of e-commerce in the Nordic countries



Source: Euromonitor, CBRE Research



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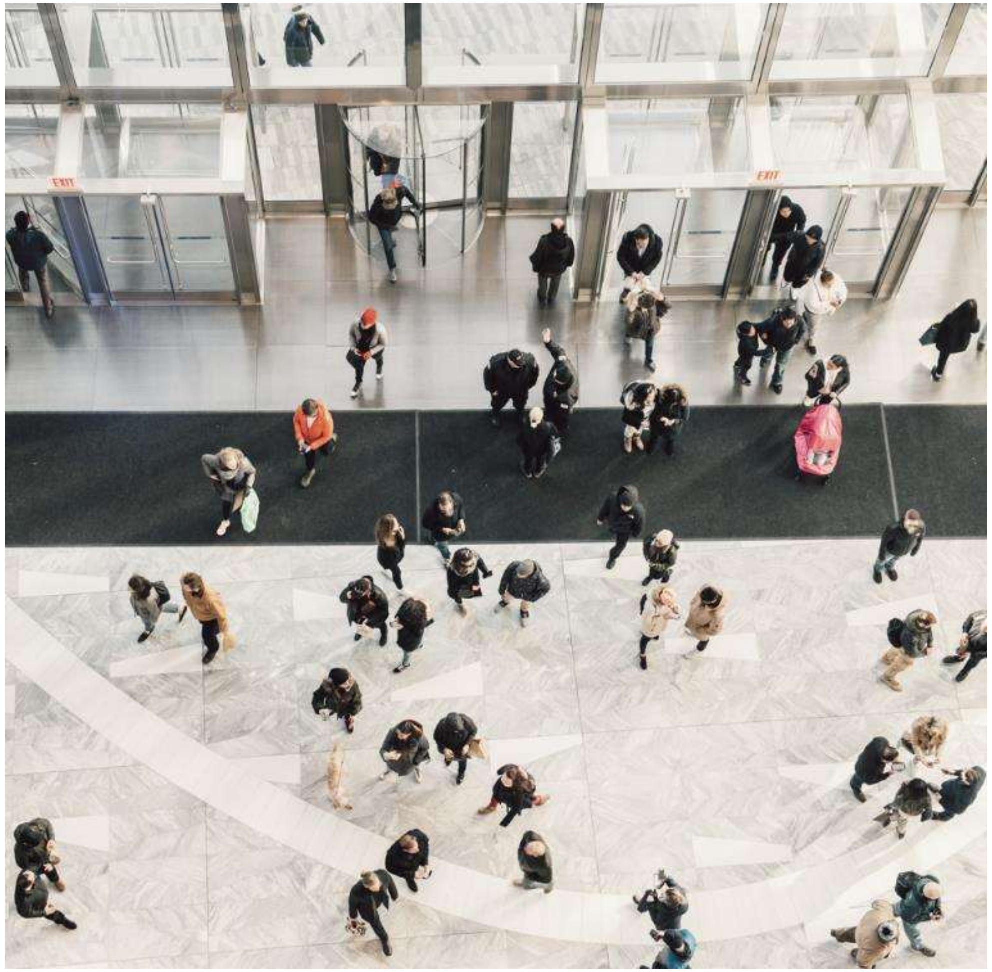
"After a record year in terms of I&L investment volume, the outlook for 2023 is cautiously optimistic. There is still capital to deploy into the sector and investor appetite supported by continued rental growth"

06

Retail

Retail had the strongest investment year in 2022 since 2016, an increase with 12.5% compared to 2021. Increase in interest rates are making cash flow generating assets appealing.

Key Takeaways – Retail



01

STRONG RETAIL INVESTMENT MARKET IN 2022

The retail transaction volume increased with 12.5% in 2022 and was particularly strong for supermarkets and shopping centres. Increasing interest rates together with pandemic reopening effects and beneficial CPI adjustment clauses in leasing contracts is appealing to investors looking for returns.

02

DECREASING VACANCIES IN 2022 IN ALL THREE MAJOR CITIES

Stockholm, Gothenburg and Malmö all noted decreasing vacancy rates in Q4 2022. Rental levels have been stable in all markets except for Gothenburg where a 2% decrease in prime rent was noticed compared to the year before.

03

CONSUMER SENTIMENT AT A LOW, CHALLENGING YEAR AHEAD

As inflation is eroding purchasing power, necessity-based retail sectors such as groceries are traditionally found to be more resilient. Lower purchasing power might create a more uncertain market for consumer demand.

A strong year for retail investments

Large-scale retail transactions boosted activity

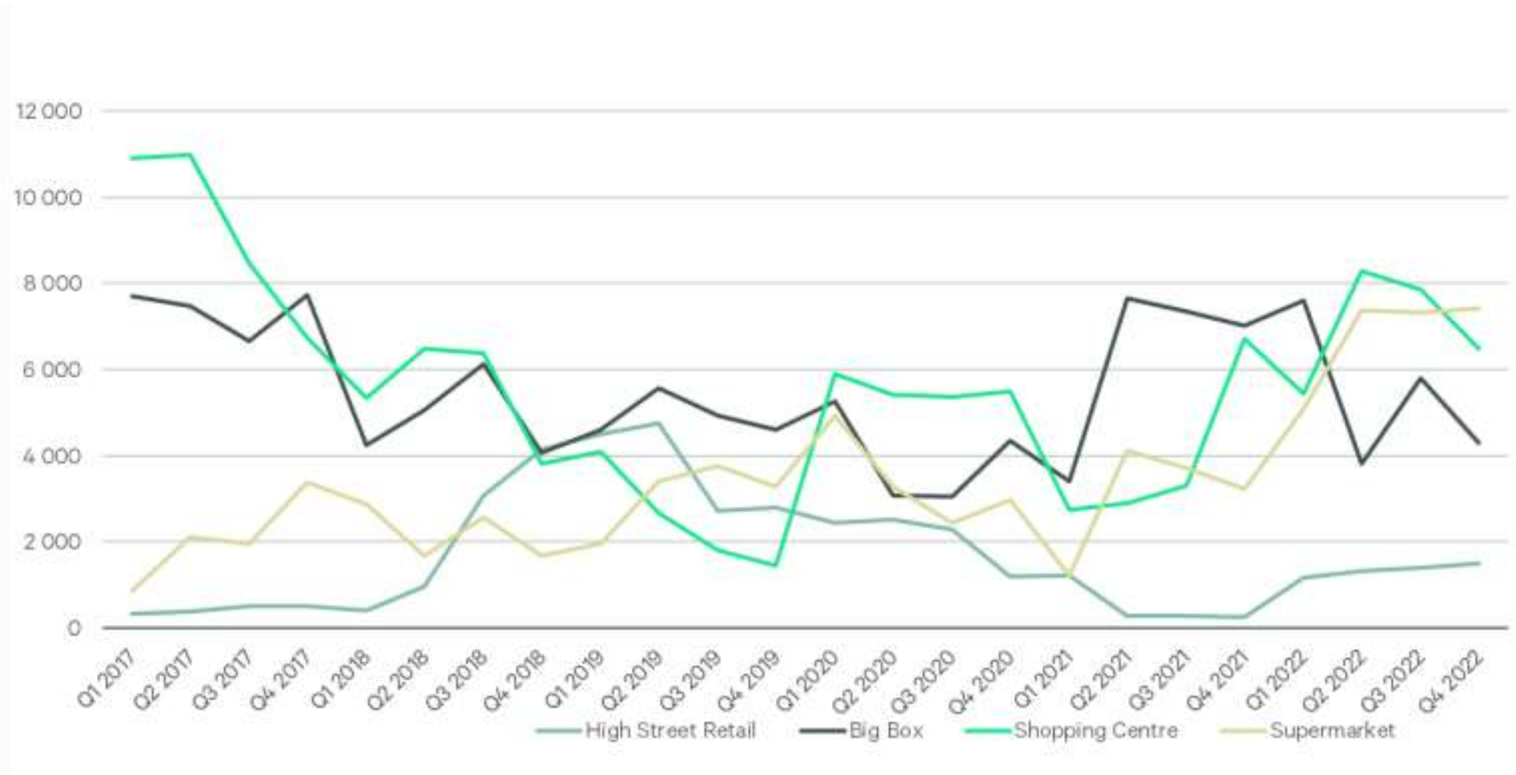
The 2022 Swedish investment market for retail had the strongest year on record since 2016 with SEK 20.6 bn. The annual incease from 2021 was 12.5%, compared to the total market which decreased with 42%. Retail was one of only two segments with increasing transaction volumes in 2022, the other one being hotels.

Notable deals were the sale of Nova Lund shopping centre in the south of Sweden. The shopping centre comprises of 26,000 sqm GLA and 70+ stores, including H&M, Clas Ohlson, Stadium, Jysk, Ikea and Bastard Burgers. CBRE advised the seller Nuveen with the Swedish institution Skandia Fastigheter being the purchaser.

CBRE also advised Castellum on selling a grocery store anchored retail park portfolio for SEK 219 mn in Halmstad, Västerås, Alingsås and Uddevalla. The portfolio comprises 12,200 sqm and is anchored by ICA and Willys.

The last quarter of 2022 saw only domestic buyers as constraining credit market made many foreign investors face difficulties in securing financing. The year was particularily strong for supermarkets and (surprisingly) shopping centres, which both saw strong investor appetite. Rapidly increasing interest rates drew many investros' attention to properties with stable cashflows and relatively high risk-adjusted returns.

Figure 6.1 Moving 4-quarter volumes in retail sub-sectors (billion SEK)



Source: CBRE Research.

Repricing and consumer demand

Shopping centres and supermarkets most popular segments in 2022

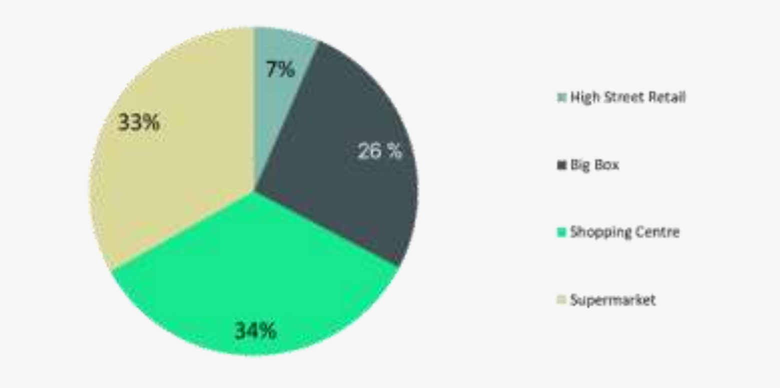
Shopping centres, supermarkets and big box counted for the large majority of deals in 2022. The share of total retail investment is currently up to 33% and expected to increase ahead. Higher financing costs and rising interest rates have pushed prime yields higher during 2022 and further repricing can be expected in all sub-sectors, with supermarkets being the most resilient.

Retail sales volume have shown stability

The European consumer confidence numbers dropped significantly in the end of 2021 and have continued a downward trend throughout 2022. At the same time, retail sales volumes remained on a more stable note. Low-cost retailers enjoyed a booming market environment during the pandemic and have continued to show positive sales since. Also luxury goods have grown rapidly, putting most pressure on the mid-market and fast fashion segments.

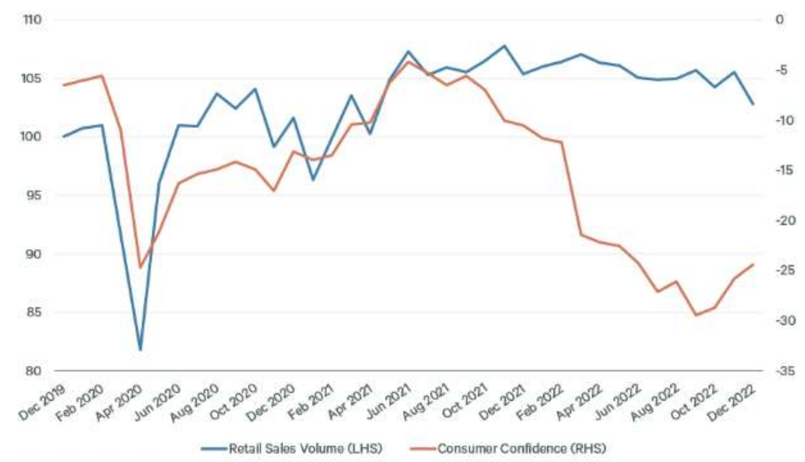
The market has shifted, results are not expected to come in as strong this year. High inflation rate and rising costs of housing will most likely affect household spending and the retail market in general.

Figure 6.2 Retail sub-sector investment shares in 2022



Source: CBRE Research.

Figure 6.3 EU Retail Sales Volume Index (12/2019=100)



Source: Eurostat, January 2023

Higher costs impact all retailers

Retailers are currently affected by higher costs due to price increases on stock, increasing operating costs and rent increases due to CPI adjustment clauses.

Low-cost retailers such as Dollarstore and Rusta show continuing positive sales activity, yet the financial result is being negatively impacted by the current economic environment.

Occupiers focused on durable and capital-intensive goods such as home furnishing, electronics and DIY are the first to experience effects of decreasing purchasing power. This will most likely have an impact on shopping centres and big box assets in attractive locations with relatively high rents. Shopping centres and high street retail is where consumer activity is expected to fall the most, with groceries expected to show more resilience.

Defensive asset types will lead retail in 2023

As consumer sentiment is at historical lows, the retail rebound is expected to fade in 2023 and consumption is targeting the defensive and counter-cyclical subsectors. Investors continue to prefer necessity-driven and defensive asset types, with grocery-anchored retail expected to be the most resilient in 2023.

“Strong locations, affordable rents and tenants of good covenant strength are the key words investors will be looking for when investing in retail in 2023. The right assets will award investors with excellent risk-adjusted return profiles"

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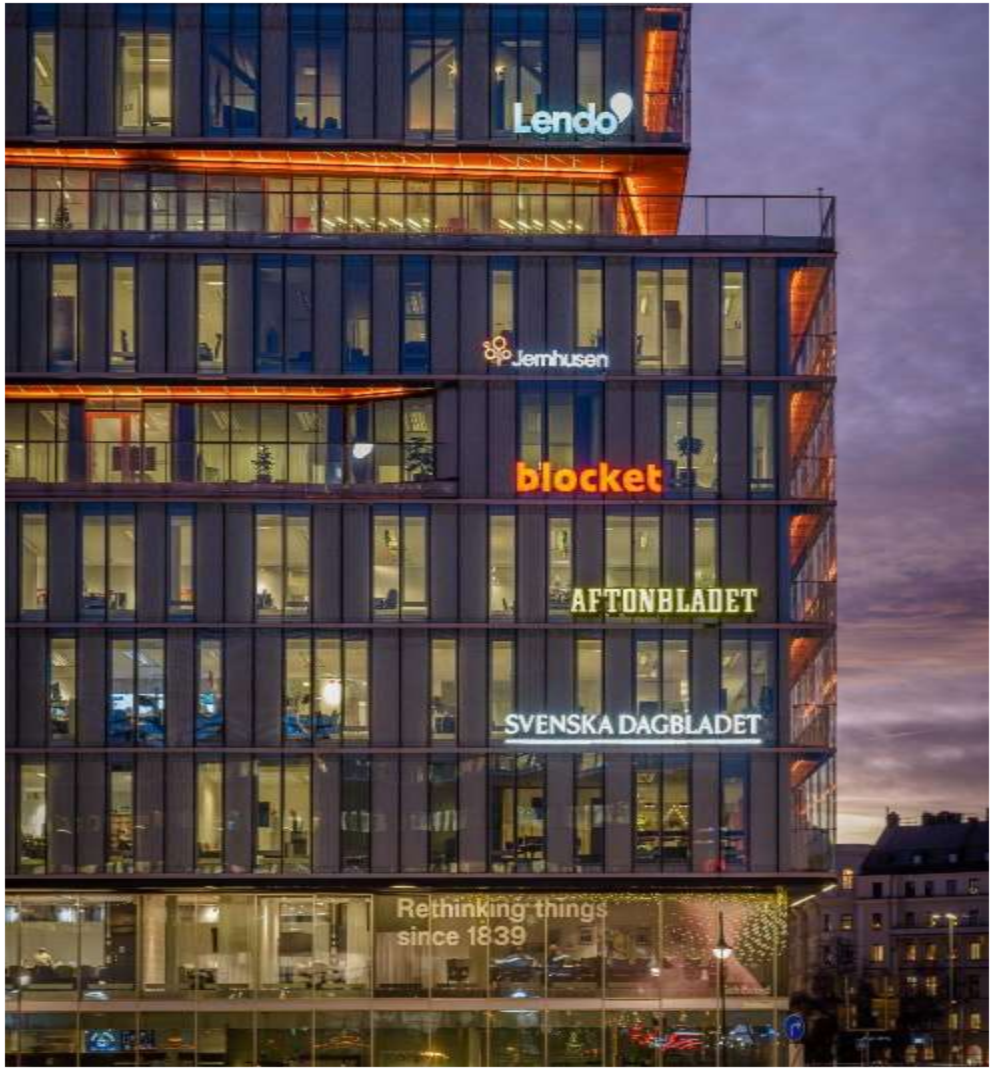
07

Offices

Investors and occupiers alike are focusing more on higher quality properties in prime locations. This flight to quality trend are together with sustainability continuing key themes for 2023.

Key Takeaways – Offices



01

INVESTOR DEMAND CENTRED TOWARDS CORE OFFICE PROPERTIES

More focus is being placed on environmentally certified assets in accessable and established locations with robust tenant credits. Second tier assets are falling behind.

02

OCCUPATIONAL DEMAND STRONG IN CENTRAL LOCATIONS

Leasing activity is centred in prime locations and other strong submarkets as companies are fitting the needs of hybrid work.

03

RESTORING THE CONNECTION

As employees returned to the physical workplace a growing emphasis on tech-enabled and wellness-capable buildings are main focus, also in order to foster a sense of community among employees.

Modest office investment volume 2022

Office investment declined and starts off 2023 slow

The investment volume for office in 2022 declined with 70% compared to 2021. A very strong M&A year in 2021, providing unusually strong comparative figures together with an increasingly more challenging investment climate in 2022 with increasing interest rates, slowed down the market activity. The office sector did however still reach volumes above 2020 and 2018 and domestic buyers continue to dominate the market.

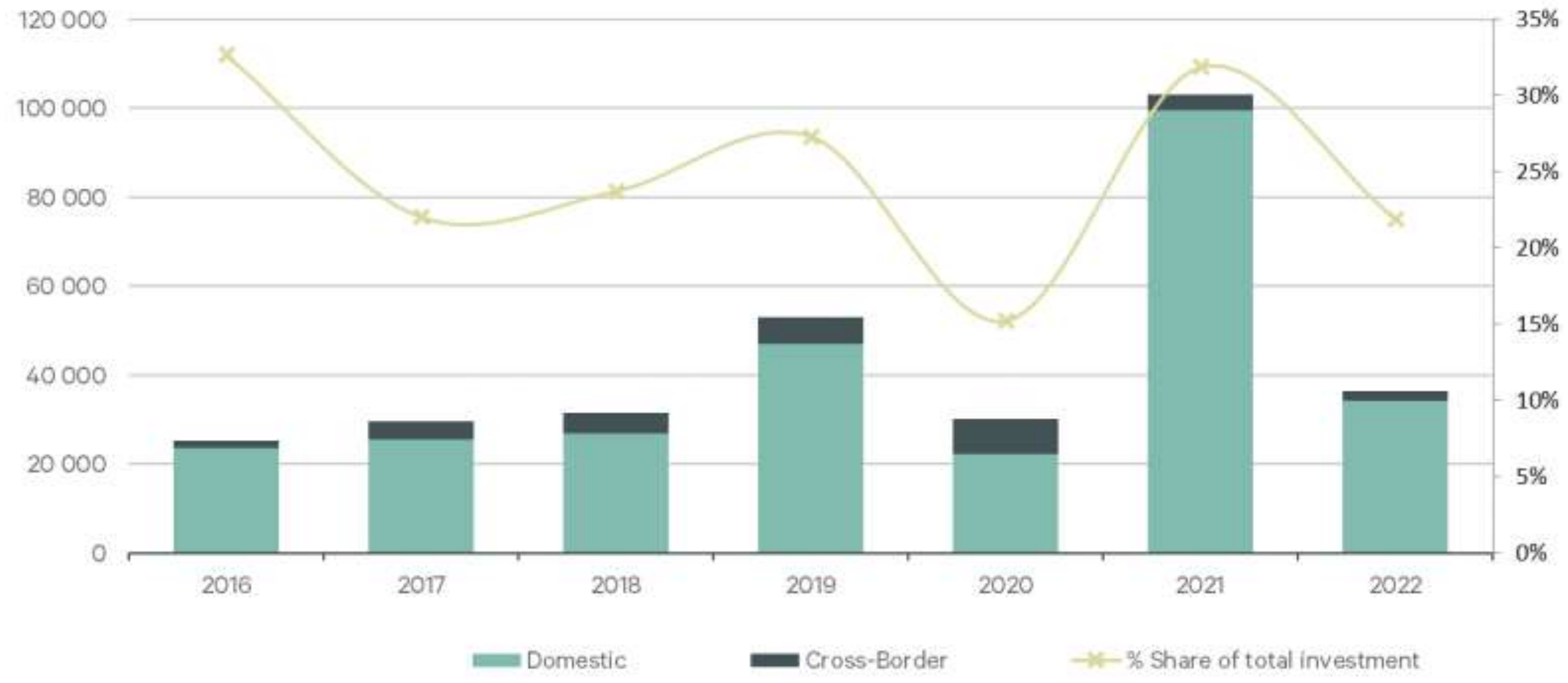
The office sector prime yield has proven resilience compared with other sectors so far but is expected to adjust to a higher degree in 2023. The occupier trend flight to quality combined with the higher uncertainty in the market is expected to widened the spread between prime and secondary assets.

The interest in investing into the office segment is strong with a lot of capital available to be allocated into the office segment. A potential hurdle is that these are dominated by value-add investors that seek higher returns than seller has been willing to accept so far.

ESG gains momentum

A growing emphasis is being placed on environmentally certified assets as investors place greater importance on ESG and sustainability factors. Ambitious sustainability targets are being set by investors, leading to higher standards for green credentials in both existing portfolios and new investments.

Figure 7.1 Office investment volumes and share of total investment, %



Source: CBRE Research.

Flight to quality prevails in office investments

Tilt towards higher quality and ESG

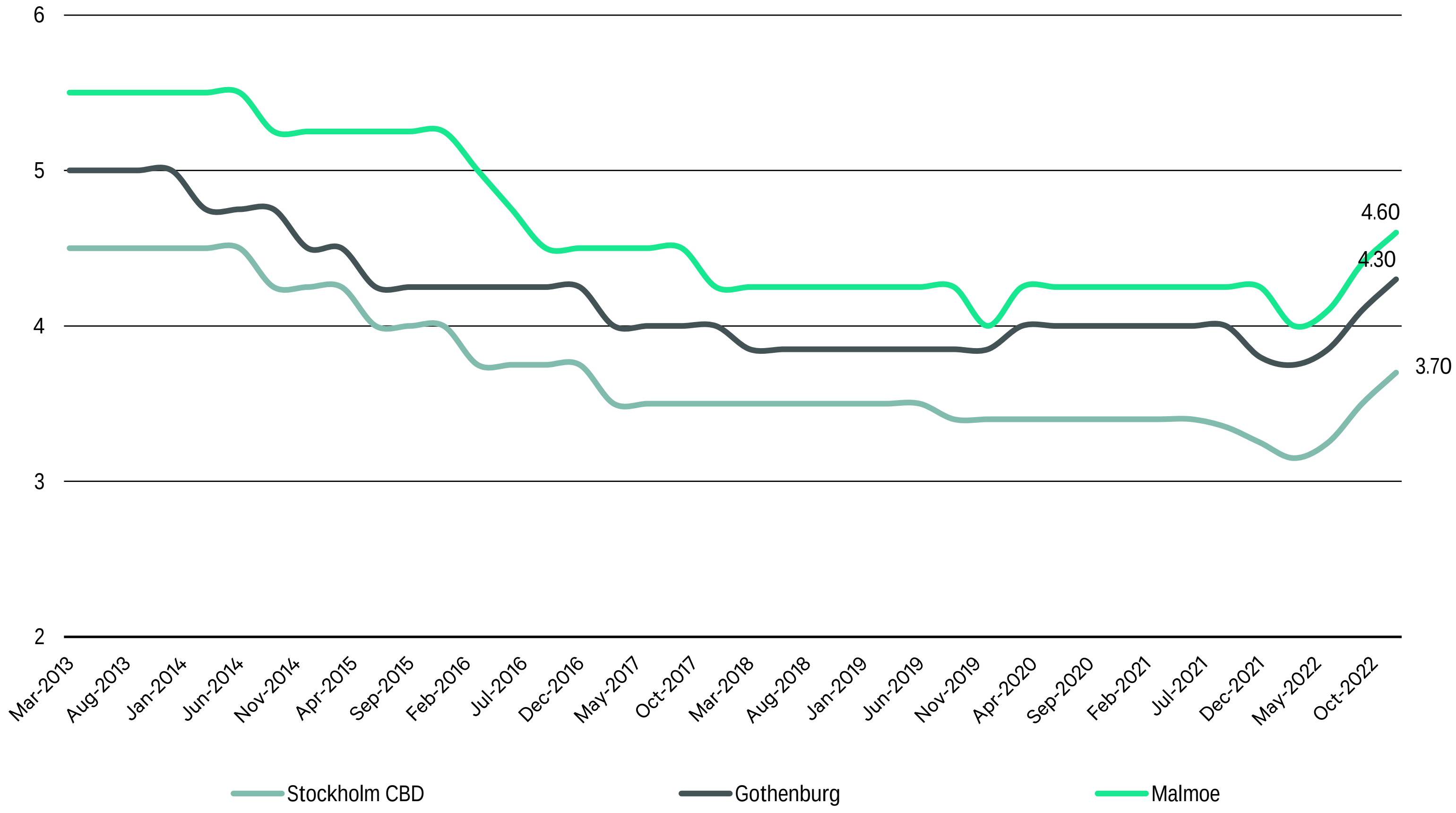
The office market is seeing a flight to quality trend, and the gap between grade A and secondary office properties and locations has become more evident in 2022. Both investors and occupiers are increasingly interested in modern office buildings with green credentials located in convenient transportation hubs and submarkets.

Prime office yields decompressed in 2022 amidst rising interest rates and higher financing costs. Prime office yield for Stockholm CBD moved out to 3.70%, prime yield for offices in Gothenburg to 4.30% and Malmoe 4.6%.

Outlook for offices in 2023

Office investment market enters the year in uncertain market conditions. Inflation is expected to remain high in 2023, which could put pressure on rental income for office properties. Despite current uncertainty in the market, the long-term fundamentals of the Swedish office market remain strong, and the office investment is expected to pick up in the second half of 2023 as investors actively look for opportunities in the market.

Figure 7.2 Prime office yields, %



Source: CBRE Research.

The Nordic office market still has energy upgrading potential

The E in ESG is expected to dominate the narrative also in 2023. Climate change is a systematic financial risk, and as such, it can not be hedged or diversified away. It must be addressed in the real economy. Therefore, the net-zero journey will be driving change in both company fundamentals and asset valuations. However, the main challenge remains the unclarity regarding how the net-zero transition will be financed.

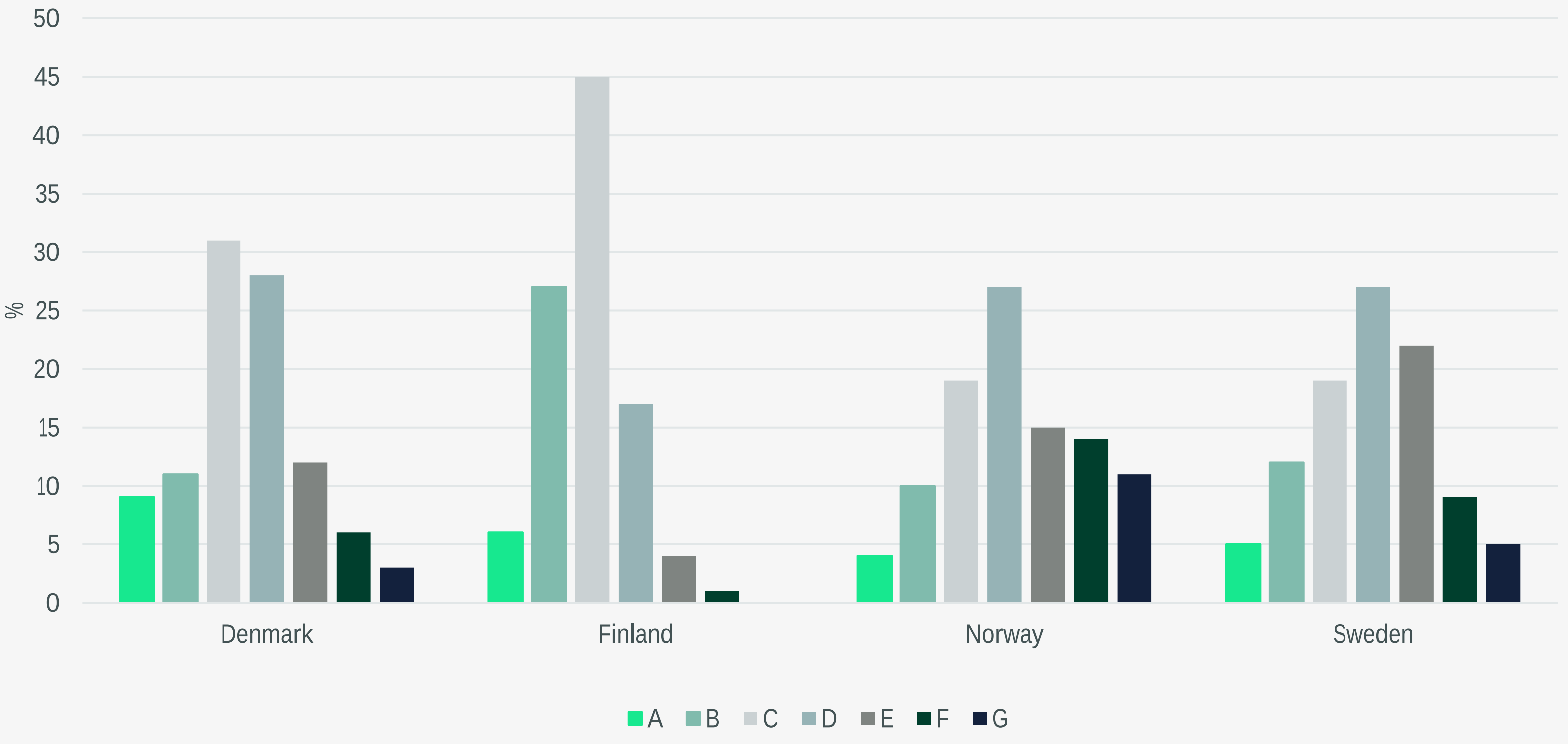
Minimalizing legalization risks ahead

Going into 2023, the market is expected to continue to speculate on the timeline for implementing regulatory frameworks related to minimum energy efficiency standards for real estate (EPC ratings). However, this attitude can prove to be dangerous as it focuses solely on regulations implemented by the government while omitting the fact that markets are also being ruled by the users of real estate.

Even if assuming that the legislation regarding minimum EPCs for real estate will first come into force in 2030, this will become irrelevant, provided a majority of occupiers increasingly choose to occupy only the most energy-efficient stock.

As both stakeholder and regulatory pressure increase, the window of opportunities for investors narrows. Adopting a proactive approach to the ESG agenda and, in particular, the net-zero transition is a huge advantage for those who do it well. The ”brown-to-green” trend is gaining interest from a return perspective.

Figure 19: EPC distribution as a proportion of office stock



Source: CBRE Research

Occupier market Stockholm

From 'wait-and-see' to active mode

Leasing activity continued to be high in the fourth quarter, however expected to slow during 2023 due to a slowing economic activity. The largest lease in CBD was Union's lease of 3,000 sqm to Ioffice, a local coworking operator. The two largest leases were made outside of the usual office markets. Fabege leased 21,000 sqm to world-renowned manufacturing company Alfa Laval in Flemingsberg, and Atrium Ljungberg renewed 20,000 sqm to another world-renowned manufacturing company, Atlas Copco, in Nacka. The largest leases in the usual office markets are Vasakronan letting 9,500 sqm to Strålskyddsmyndigheten and AMF letting 8,900 sqm to Sundbybergs stad, both in Solna/Sundbyberg.

Vacancy rate remained stable at 6% for all the Stockholm submarkets combined.

Hybrid work and cost efficiency may or may not decrease demand

The relocation activity in 2022 was high after the prior pandemic freeze in the leasing market and naturally suggesting a lower activity in 2023. With several IT companies decreasing space, hybrid work being more common and many companies looking to be more cost efficent there is a possibility that demand for new and better space continues with a highly active leasing market ahead.

Flight to quality and sustainability the key office trends in 2023

8,400

/sqm/month (SEK)
Prime rent
Stockholm CBD

3.4%

Vacancy rate in CBD
Stockholm

"We are coming from a cautious market with only a handful of closed deals but also withdrawn processes in the shifting economic environment. We experience that completed transaction shows less yield shift than we have seen in other segments. However, with a lot of capital on the side line ready to invest, activity can quickly pick-up if the sellers and buyers can agree on assumptions on yield requirements and market outlook."

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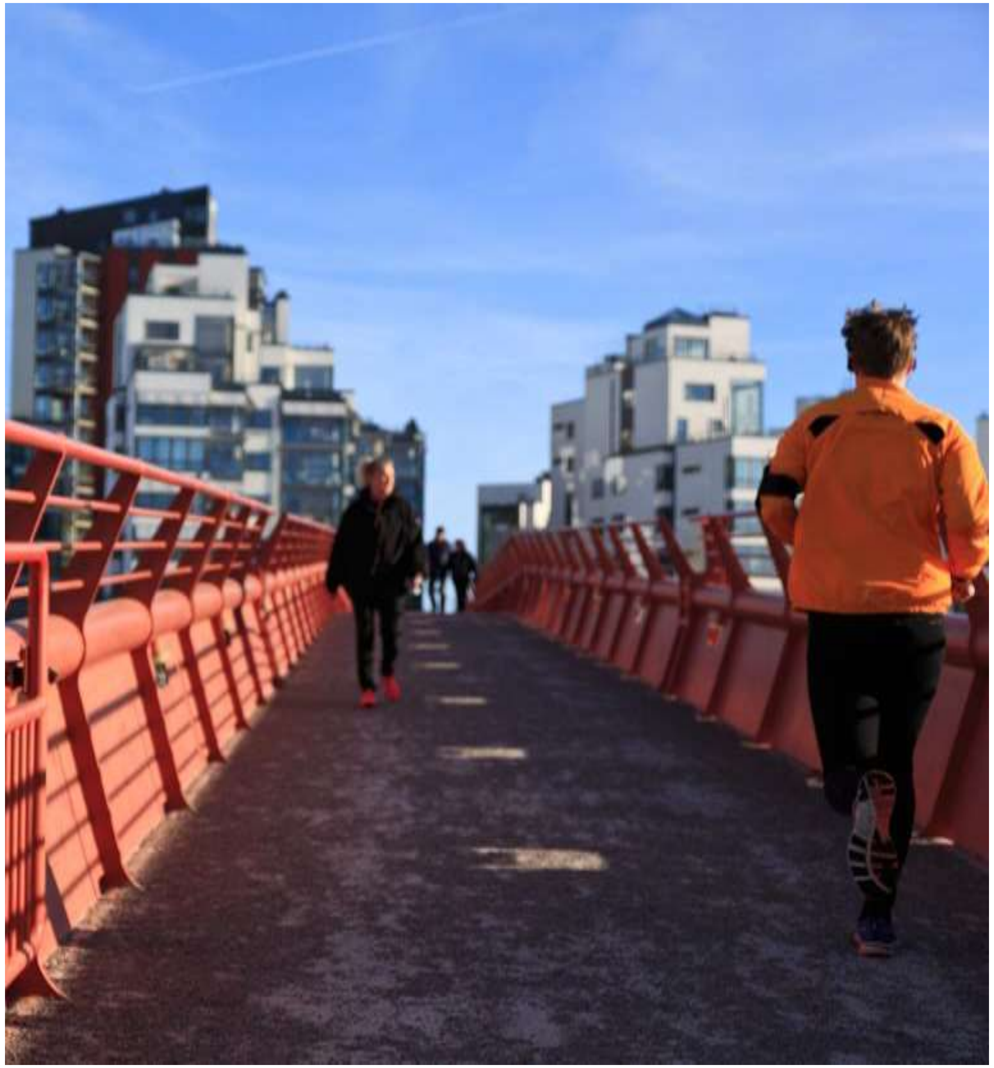
08

Residential

The Swedish residential market had a challenging 2022 with increasing construction and financing costs together with a falling demand. Construction starts are falling rapidly and the transaction market starts the year off hesitantly.

Key Takeaways – Residential



01

ALL EYES ON RESIDENTIAL

The Swedish housing market is currently of high interest. International investors entered the market in the past few years by investing in mainly forward funding new development deals. New construction starts have fallen and increasing interest rates affect purchasing power of households at the same time as decreasing margins with developers due to increased costs.

02

FURTHER YIELD DECOMPRESSION EXPECTED

Increased interest rates and financing costs led to decompression in prime yields in the Swedish market with prime residential yield moving out by 100 basis points to 4.0%. CBRE expects further decompression ahead.

03

CONSTRUCTION ACTIVITY REACHED ITS PEAK LEVEL IN 2021

The construction activity is falling back rapidly in 2023 with less new projects started in both 2022 and 2023. The question is if this may lead to business opportunities ahead with the continuingly growing population and stable employment market.

Hesitant transaction market with repricing indications

Residential segment starts off 2023 slow

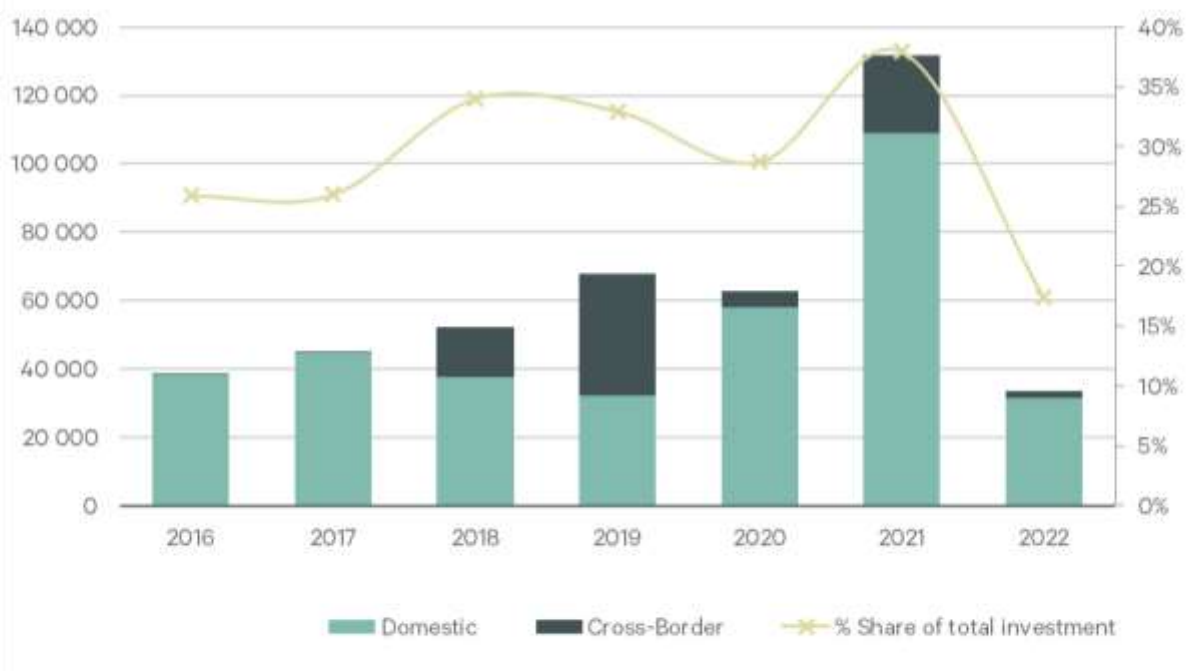
The Swedish Residential Investment market had a slow year in 2022 with volume decreasing 94% in Q4 compared to Q4 in the record year 2021. Cross border investments decreased to only domestic buyers in the fourth quarter. The 2022 investment volume reached SEK 27.76 billion. The residential investment market has been affected by increasing interest rates, increasing construction costs and new legislations. Demand is also affected as inflation continue to push living costs and interests also for households. Swedish private homeowners are exposed to high interest rates by having higher LTV and floating rates in a global comparison.

Activity in the transaction market is expected to increase again when the inflation rate and interest rates have stabilized.

Prime yield decompression

Increased cost of capital impacted new production residential yields in 2022. Residential prime yields have increased +100 bps to 4.00% compared to the year before. CBRE expect further decompression and repricing in 2023, making the future attractive for investments, with market improvements again in 2024.

Figure 8.1 Residential investment Volume and Cross border share



Source: CBRE Research.

4.00%

Prime Yield (Q4 2022)

100%

Domestic buyers in Q4 2022 transactions

Falling construction activity

Construction activity slows down further in 2023

68,100 apartments were constructed in Sweden 2021, the highest level in Sweden in over 30 years. The forecast according to Byggföretagen is that there will be a large reduction in construction starts during 2024–2025. The falling trend is already evident in the market from the second half of 2022 up until today. The reason is lack of building materials together with higher costs due to inflation, indicating that projects will not be as profitable as before.

Impact from new legislation

Investment contribution was abolished for rental apartment construction from January 1st, 2022. The investment contribution was used for 40% of the rental apartments that were constructed in 2021, with very little in Gothenburg and Stockholm. The abolished financial support combined with the current economic situation will also be visible in construction starts in 2023.

Population forecast

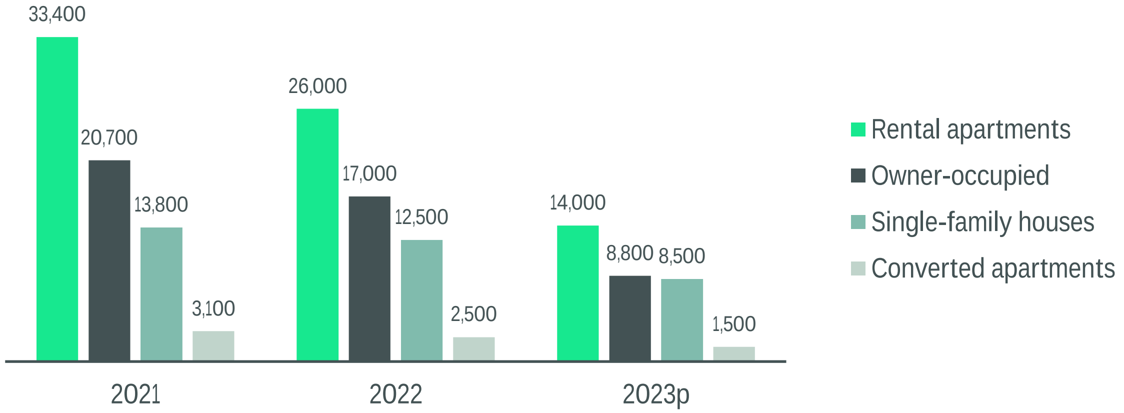
The population in Sweden is forecasted to increase to 10.6 million, or 1.8% (188,294 people), by 2025. According to the latest demographic forecast the annual population growth in the coming three years are 55,000 people. Number of people over 65 years are currently 20% and children 0–15 years are reaching almost 19% of the population.

Outlook 2023

Despite challenges in the market in the short term, the long-term fundamentals of the Swedish residential market remain. The outlook for apartment completions in 2023–2025 is weak. Adding the annual increase in population, a continued lack of housing beyond 2024 is likely, although it will vary between locations. Rising interest rates and continued high inflation remain a challenge for homeowners and investors. However, the growth drivers remain intact, and rental apartments will in relative terms become a more attractive option for housing as high interest rates impact mortgage cost on the owner-occupied market.

Figure 8.2 Construction starts per residential type

Source: Boverket, CBRE Research



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"The traditional trend of flight to quality in a falling economy is challenging for low yielding assets in an environment of climbing interest rates. The residential sector is facing challenges in the short-term with falling new constructions and limited transactions, however, the long-term fundamentals of the Swedish residential market remain, and we do see interesting deals to be made in the current climate."

9

Hotels

Number of guest nights improved during the second half of 2021 and reached in the end of 2022 close to prepandemic levels again. Transaction market was active in Q4 2022 and with two larger deals in January 2023 continuing to show positive momentum.

Key Takeaways – Hotels

01

LEISURE OVER BUSINESS STILL

Demand for business travel and tourism has picked up as people have a pent up need for leisure after the pandemic, giving a welcome boost to the hotel sector. The private turist market is still stronger than business travels and expected to be more sensitive in a falling economy, creating a bit of uncertainty during the start of the year.

02

HOTEL INVESTMENT MARKET EXPECTED TO PICK UP IN THE SECOND HALF OF 2023

The transaction market for hotels is expected to follow the other segments with higher activity later in the year. Investors are expected to focus on creating core business portfolios which may lead to odd hotel assets reaching the market.

03

PIPELINE LOW IN STOCKHOLM AND HIGHER IN GOTHENBURG

New projects are mainly focused to the Gothenburg market with new supply in Stockholm expected to be lower.

Volitile transaction activity for hotels

Starting off 2022 slow and ending strong

The transaction activity started off with three slower quarters and ended strong with a majority of the annual total SEK 3.5 billion (including the hotel part of the transaction of Kortbyrån in October 2022) in Q4. Notable deals in 2022 are Grand Hotel in Saltsjöbaden and Hotel Diplomat in central Stockholm. 2023 has started strong with two major deals in Stockholm in January.

During the last couple of years, most investors have been hotel owners, Swedish property companies and institutional investors. The leading hotel owner in the Nordics is Pandox.

Yields have moved out in the Nordics

Prime yields have moved out in the Nordic hotel markets along with the increased interest rates and higher financing costs. Nordic hotel yields decompressed by 20 to 35 basis points from the early 2022 lows, with 4.35% in Stockholm, 4.60% in Oslo, 4.85% in Helsinki and 5.30% in Copenhagen. Further decompression is expected in 2023 as central banks continue their tightening to curb the high inflation rates.

Figure 9.1 Hotel prime yields in the Nordics

Source: CBRE Research.

4.35%

Prime Hotel Yield Stockholm (Q4 2022)

22%

Stockholm share of total guest nights per county 2022.

More resilience required for hotels

Prepandemic rebound in occupancy in 2022

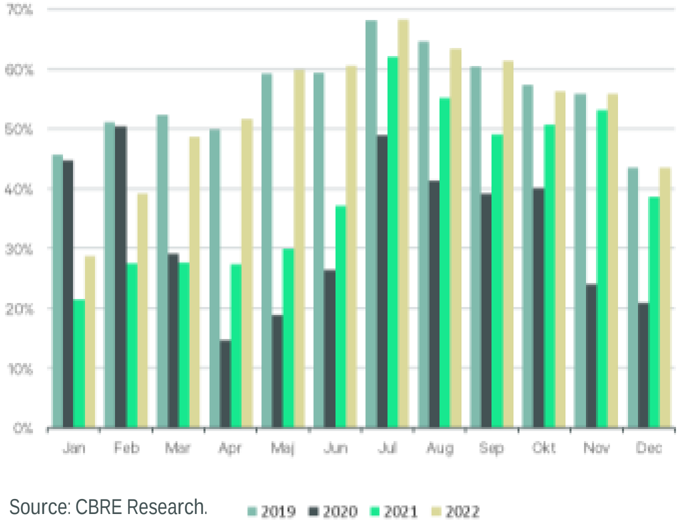
The average occupancy rate has been volatile the last few years. With the full year of 2022 summarized it is to a fairly high occupancy rate, which is a result of the abolishment of the Covid-restrictions during Q1 2022. This is visible in the chart where for Q2-Q4 2022 the occupancy has recovered and is roughly at the same levels as before the pandemic (2019).

The international tourists accounted for 14.1 million guest nights, approximately 23% of the total 60.7 million during 2022. For year 2020, the corresponding figure was 43.4 million. Before the pandemic (2019), a new record was set at 67.4 million guest nights.

In terms of geographical spread, Stockholm County is the largest market followed by Västra Götaland. During 2022 Stockholm accounted for approximately 21.6% of the guest nights in Sweden, an increase from 17.4% during 2021. Other large regions include Västra Götaland, Skåne and Dalarna County.

With an uncertain economic situation for cost sensitive leisure travelers demand ahead is hard to predict.

Figure 9.2 Occupancy rate (per month)



Source: CBRE Research.

Strong operator demand

It is common for hotel operators to rent their premises in Sweden. The hotel market is dominated by a small number of operators, mostly domestic. In general, foreign actors are unestablished on the market except for Norwegian Nordic Choice Hotels. The fact that the number of operators is small have decreased the number of operators that is seen as stable and generate less risky leases. The hotel operators are mainly interested in longer leases at least 15 years and on major markets like Stockholm and Gothenburg.

Challenges in the hotel sector remain as hotel operators are faced with high inflation affecting the payroll and operational costs, extreme energy prices and adjusted minimum rents.

“Well established hotel operators enjoy a healthy financial position again following a strong market recovery from the COVID-19 pandemic, providing real estate investment opportunities with great underlying cash-flow from hotel operations“

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