Sweden’s real estate sector rebounds amid rate cuts

Rate cuts are having a positive impact on Sweden's commercial real estate sector, which was hit hard by high interest rates. Funding costs are coming down, property valuations are stabilising, and investor sentiment is improving. We still see a few lingering risks for the sector, but the outlook is a lot brighter than it has been in recent quarters

This year's rate cuts are easing some pressure on Swedish real estate. Some risks still remain, but funding costs, stabilising valuations and improved sentiment are brightening the outlook

Rate cuts ease pressure on the real estate sector

Rate cuts and a more dovish outlook for interest rates seem to be having a positive impact on Sweden’s embattled commercial real estate sector, one of the hardest hit in Europe since the start of the rate hiking cycle. The sector has been impacted due to its particularly sensitive exposure to interest rates, relatively high leverage and a high share of short-term and/or floating-rate debt. As a result of rate cuts, there are growing signs that the Swedish real estate sector is recovering some of the lost ground from recent years.

The Riksbank – Sweden's central bank – cut interest rates in early November by 50 basis points, leading to a new policy rate of 2.75%. This was already the fourth rate cut in 2024, and the central bank has indicated that rates may also be cut in December and during the first half of 2025.
The European Central Bank's rate cuts also help the sector as Swedish real estate companies have

relatively large debt exposures in euro.

Funding costs have therefore come down meaningfully, while bond markets have rapidly rebounded. In addition, market participants have become more comfortable with the outlook for the sector as valuations are stabilising and transaction volumes are slowly picking up. We see good reason for sentiment to improve further.

Relief for funding costs and credit metrics

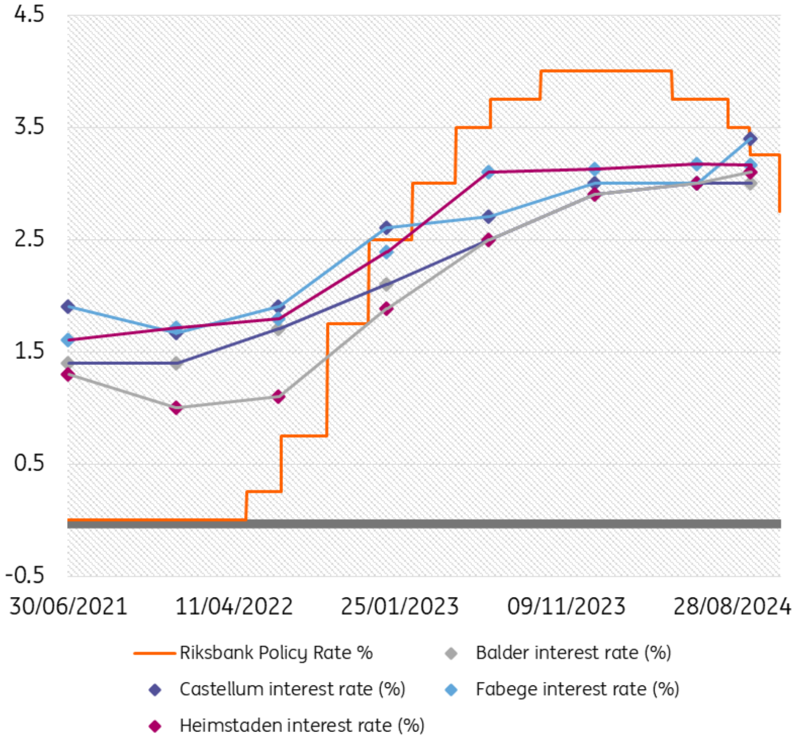
As mentioned above, Sweden's real estate sector in particular employs relatively high leverage, while the use of short term and floating-rate debt is also higher compared to many other European countries. According to MSCI Real Capital Analytics, around 60% of Swedish krona-denominated bond issuance from real estate companies in 2020-2021 was floating rate, with a large part consisting of shorter maturity debt, often three years or less. For context, the Riksbank's policy rate was at or around zero during that period, making funding very cheap. The central bank started a rapid rate hiking cycle in 2022, and this quickly led to elevated funding costs and bond spreads with significant knock-on effects for the sector.

To demonstrate this transmission effect, we highlight the impact on funding costs, interest coverage ratio (ICR) and property valuations for four Swedish landlords (Fastighets Balder, Castellum, Fabege and Heimstaden Bostad). We also show that the outlook for Sweden's real estate sector has improved, largely a result of significant interest rate cuts.

Cost of funding coming down

As we show in the figure below, the average cost of debt for the four companies has seen a material increase since mid-2022. The Riksbank policy rate increased to a maximum level of 4%, and the average increase in the cost of debt increased by around 170bp. While for these companies the proportion of Swedish krona denominated floating-rate debt differs, the impact has been faster than for their EUR-denominated debt. However, the increase in the average cost of debt was marginal in the third quarter of this year, with many companies also noting that they expect limited to no further increases to their average cost of debt.

Riksbank policy rate and Swedish real estate companies average interest rates



Source: Riksbank, company reports

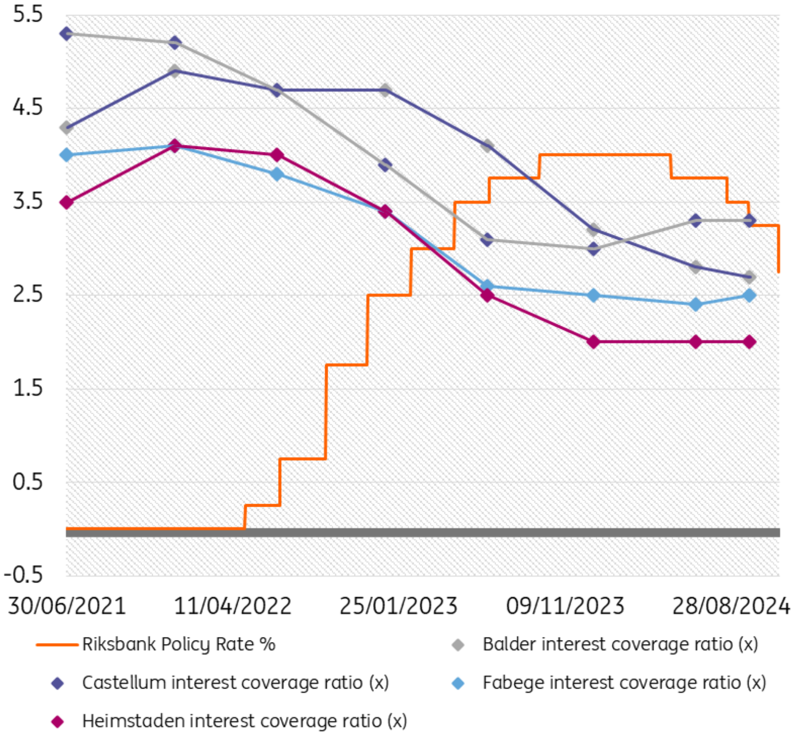
Financial health is slowly stabilising

The interest coverage ratio is an important metric for companies. It shows debt servicing capability as it compares the cost of debt to operating income before depreciation and amortisation. Another indicator of financial health is related to the valuations of assets and the amount of debt, as we'll discuss more below.

Interest coverage ratio, normally calculated as last 12-month EBITDA/Interest expense, has generally declined for Swedish real estate companies in recent years – a negative indicator for financial health. On average for the four companies in the chart below, the level has declined by c.2.0x since FY2021, from around 4.6x in 2021 to 2.6x by the third quarter of this year. As a rule of thumb, a company would want an ICR of at least 1.5-2.0x, to indicate that earnings can continue to meet interest obligations. Several companies have seen their interest coverage ratio decline towards this minimum level (including Heimstaden Bostad = 2.0x; Fabege = 2.5x; Balder = 2.7x).

However, this metric has stabilised this year, with companies reporting unchanged to even slightly higher metrics in recent quarters (such as Fabege, which saw a 0.1x increase in the third quarter to 2.5x). This is driven by lower interest costs and credit spreads, while earnings growth has remained strong. As we expect interest expenses to remain broadly flat while earnings growth remains fairly strong, we expect this metric to stabilise further, with potential for it to increase again in 2025. This should improve the financial health of companies, in turn reducing some of the pressure on balance sheets and ratings.

Interest coverage ratios of Swedish real estate companies



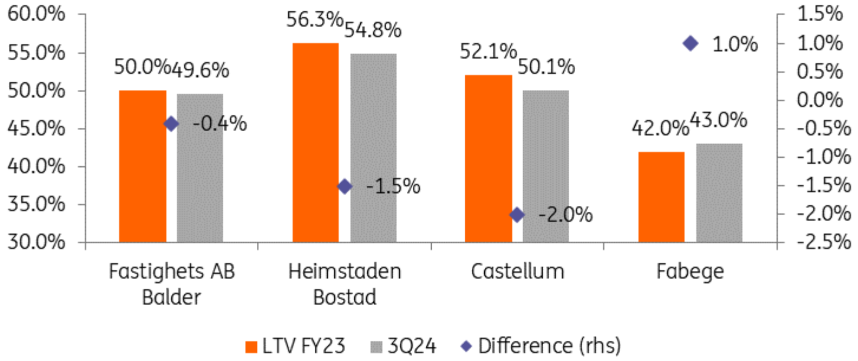
Source: Riksbank, company reports

Leverage ratios seem to be turning a corner

Another important financial metric for real estate is the loan-to-value ratio (LTV). This is an indication of the leverage or indebtedness of companies, showing the ratio of debt to portfolio assets. As a result of declining property valuations (as discussed more below), this metric increased in recent years, which is a negative as companies become more indebted. However, this year LTV levels have reversed the upward trend and even declined as property valuations have stabilised and companies have been able to reduce debt.

As shown in the figure below, three out of the four companies in our example have seen their LTV ratios decline this year – a positive sign. Fabege was the only company to report a further increase in their LTV (+1%) this year, but this is very small compared to previous years and is also expected to stabilise in the coming quarters.

Loan-to-value levels

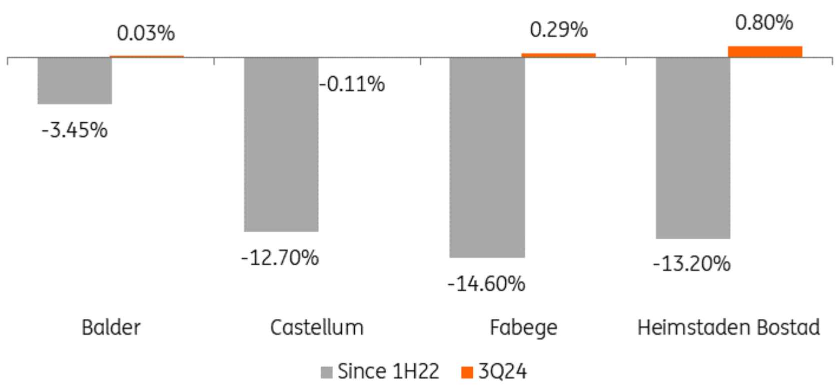


Source: EPRA

We see good reason for property valuations to improve

Looking at property portfolio valuations, there are also more positive signs for a potential recovery. Valuations have sharply declined since the peak in 2022, as shown in the chart below – but the most recent data for the third quarter of 2024 suggests that underlying property valuations have potentially reached a trough, and even increased again in some cases. This shift in pricing has been quite swift and, while concerns for further declines remain, points to an improved outlook for property valuations, also driven by interest rate cuts. Indeed, as we have seen in previous cycles, Nordic property valuations often rebound quicker than in other European countries, which is positive for transactions and for leverage metrics.

Property valuations are improving

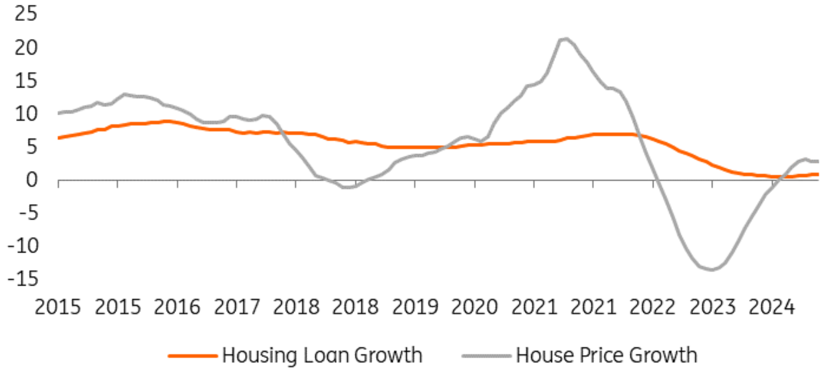


Source: Company reports

Housing markets are also on the up again

House prices have also seen a resurgence in Sweden following a large decline from 2021 to 2023. House price growth has turned positive in recent quarters, with a roughly 2% positive growth this year. In fact, house prices increased by 2.3% quarter-on-quarter in the third quarter of this year. This supports residential real estate landlords that have suffered from significant valuation declines amid rising yields, and a regulated rental market where rent growth has lagged the rapid rise in interest costs in recent years.

Swedish housing markets are rebounding



Source: Macrobond

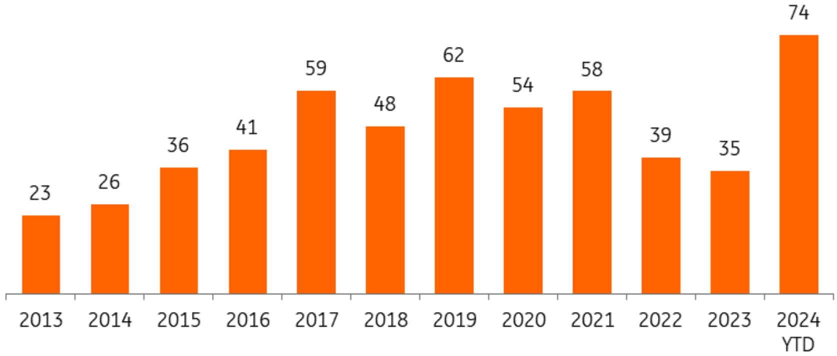
Bond investor appetite has returned as the outlook improves

The improved market and sector outlook has also led to a significant increase in bond issuance this year. The SEK-denominated bond market was largely closed in 2022 and 2023 for many companies, as refinancing was costly due to elevated interest rates and credit spreads. In 2024, the bond market has seen a surge in new issuance with falling interest rates and lower spreads. This has helped ease concerns for refinancing, although bond maturities remain high for the next few years. This includes maturities in the EUR market, which are a significant portion of Swedish landlords' debt.

We have also seen Swedish landlords return to the EUR bond market this year again, following a few years of absence. These deals have generally been well received by the investor community, and have demonstrated renewed market access for the sector as the outlook has improved. Recently, we have also seen EUR issuance from lower rated names including Castellum and Heimstaden Bostad, with the latter also issuing tendering for one of their outstanding hybrid bonds and replacing it with a new hybrid bond. This has been a good test of sentiment for Swedish real estate companies, and shows that investors have renewed confidence in Swedish real estate.

At the same time, bond maturities remain significant in the next few years, and the fight against inflation has not been won yet – including in Sweden. A resurgence of inflation and a strong economy could lead to higher-for-longer rates than the market currently expects. This could in turn lead to a renewed increase in credit spreads, which could make the refinancing picture more challenging again.

Swedish krona bond markets reopen with a bang



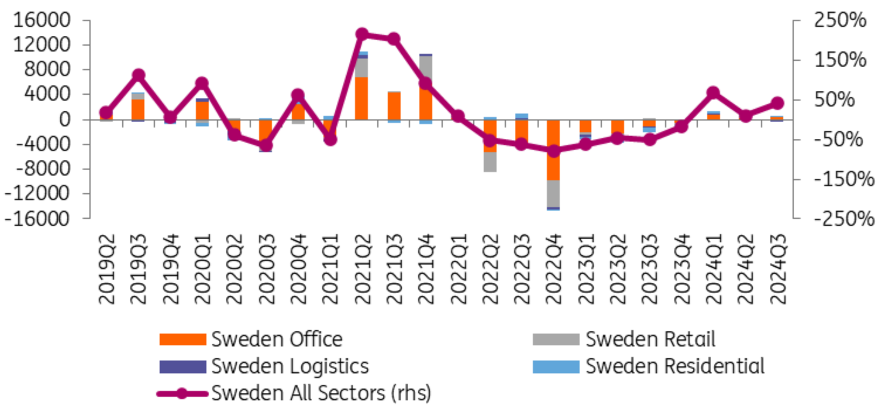
Source: Refinitiv

Transaction volumes pick up amid stabilising property values

Transaction volumes in Sweden have also increased. While volumes remain very low in a historical context, there is a marked turnaround in the direction after the record low levels of transactions in 2022 and much of 2023. Absolute volumes remain low, but the direction of travel is positive – a good indicator that market participants are becoming more comfortable with transactions.

Transaction volumes have picked up on the expectation that valuations have reached a bottom, while occupancy rates have remained quite stable in recent periods and yields are once again more attractive, particularly in a declining interest rate environment. With higher transaction volumes, this can also lead to better price discovery for buyers and sellers of property, which can then lead to a further stabilisation in property valuations.

Quarterly transaction volumes in Sweden



Source: CBRE

The outlook has improved, although risks remain

After a few challenging years for Sweden's real estate sector, the tide has clearly begun to turn. The improved sentiment from interest rate cuts and a solid economic outlook for Sweden have spurred increased investor demand in the Swedish commercial real estate sector. The outlook for credit metrics is slowly improving as well.

That being said, we're not out of the woods yet; structurally higher interest rates coupled with high leverage and bond maturities still pose risks. Rising vacancy levels in some segments, such as retail and offices, also pose a challenge. In addition, maintaining strong rental growth may become more difficult. However, the outlook for the sector looks a lot rosier than it did just a few quarters ago.

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