Real Estate House View

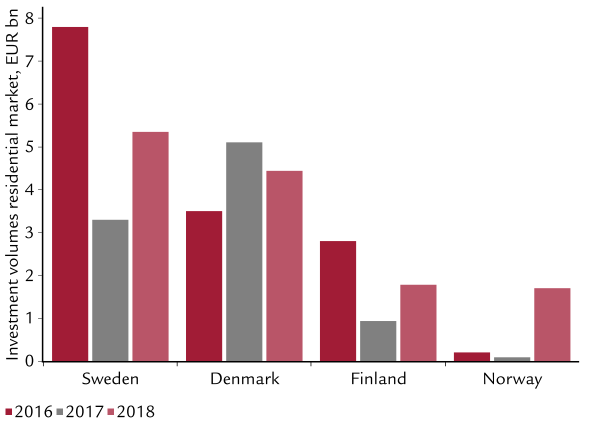
Norway, Sweden, Finland, Denmark

First half-year 2020

Key takeaways

- The investment markets in the Nordic countries continue to achieve high transaction volumes. Due to the lack of supply, however, they hardly reach the levels of previous years.
- The renewed widening of the easing monetary policy by the major central banks and ongoing high investor demand kept the initial yields under pressure in 2019. There are no signs of a reversal at present or in the foreseeable future.
- The office markets are facing a change of sentiment, as the decline in vacancies ends due to increasing construction activity. However, completions are expected to remain limited so that rental growth is likely to continue, albeit at a more moderate pace.
- The turmoil in store-based retail is reflected in declining rents for the majority of space in high street locations and shopping centres. The top locations are able to buck the trend and generate sufficient demand and still some rental growth.
- Demand for logistics properties is driven by requirements generated by e-commerce, but also by the manufacturing sector and its logistics service providers. Rents remain on an upward trend, and so do the prices for logistics assets.

Chart in focus



Source: Catella, JLL

Residential real estate is a long-established investment of institutional investors in the Nordic countries, especially in Denmark and Sweden. In Finland, the share of the housing sector in the institutional investment market is also increasing. All these markets are benefiting from the expanding demand for apartments to rent in the metropolitan areas. Norway, on the other hand, features a very high home ownership rate of over 80%, thanks to government support for home ownership. The investment market is thus lagging behind the broader trend in the Nordic countries.

Economic conditions in Sweden clearly deteriorated in the final quarter of 2019, with the manufacturing purchasing managers’ index temporarily falling to a seven-year low. In contrast to other European economies, where spill-overs from ailing manufacturing industries into the domestic economies remains limited, Sweden’s services sector is also approaching recession. Consequently, unemployment started to rise in 2019 and is expected to continue into the first half of 2020. The labour market conditions are also likely to deteriorate in Finland, Norway and Denmark in the quarters ahead. A north European particularity is the current stance of monetary policy: Norges Bank and Sweden’s Riksbank belong to a very small group of central banks which raised interest rates in 2019.

Strong investment markets

The investment markets in the Nordic countries remained in good shape in 2019, even though transaction volumes tended to decline. Sweden was one of the few European markets to achieve rising transaction volumes in the first half of 2019. In the other markets, volumes decreased and lower levels than in the previous year are to be expected for the whole year. Ongoing strong investor demand is pushing yields further down. However, there are clear differences between the sectors. In the logistics sector, yields continued to fall quite sharply in the first quarters of 2019, while they remained stable in the retail sector with an upcoming upwards trend. In the office sector, there is still downward pressure, but prime yields have largely moved sideways in the major markets, except for Helsinki. In particular for the office sector we expect yields to continue to fall, while they are likely to remain unchanged for prime retail properties.

Changing office markets

The office markets show signs of some cooling. Demand for space is decreasing compared to previous years, while construction activities are picking up. Office vacancies are hardly declining anymore and even rose somewhat in the course of 2019 in Copenhagen. In Helsinki, on the other hand, the overall high level of vacant space continued to decline. As completion figures for 2019 and 2020 are expected to exceed the levels of previous years significantly, vacancy rates are likely to pick up slightly in the coming years, especially in Oslo. In contrast to earlier market cycles, project developers are much more reluctant and bring fewer new properties onto the market. The availability of land and number of properties for refurbishment is low and capacities in the construction industry are limited, which dampens the dynamics of new construction. Given the persistent shortage of modern space over the short and medium term, there remains room for additional rental growth, yet at a declining pace.

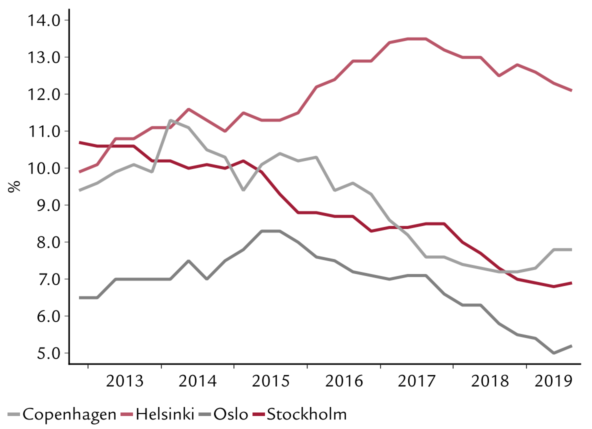
Top retail still in demand

Retailers in the Nordic countries are suffering similar to other western European countries, as a result of the expansion of e-commerce and customers' desire for more convenience when it comes to shopping. In Nordic countries, shopping facilities are traditionally of considerable importance as meeting places and for leisure activities. Nowadays, a clear polarisation of the retail locations and properties is becoming apparent. Demand for new retail space is restricted to the very best locations in high streets and dominant regional shopping centres, leading to zero vacancies and upsides in rents. Retail parks were able to buck the downward trend, with sufficient demand and rents under some upwards movement. However, the majority of retail space is suffering, and rents were falling in the course of 2019. Overall, we expect scarce potential for rent increases in the medium term, even in top locations. The state of the letting market is impacting the investment markets. A growing pricing gap between buyers and sellers is becoming obvious and prospects are holding back in anticipation of yields continuing to rise.

Logistics on track

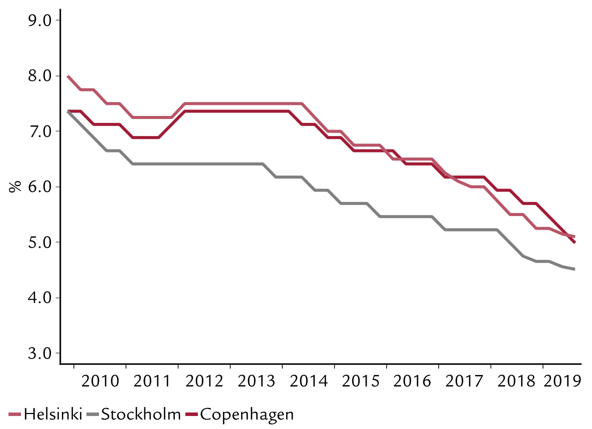
The logistics sector is the preferred sector of many investors. E-commerce is obviously the main driver, even though traditional retail and the manufacturing sector are currently taking large amounts of space. In all countries, the logistics sector accounts for a growing share of transaction volume and, above all, demand. At 4.5% to 5.0%, yields for prime properties remain noticeably above the level for prime office or residential assets. Strong occupier demand combined with controlled new supply fuels rents, albeit to a moderate extent.

Chart 1: Office vacancies in major markets



Source: PMA

Chart 2: Logistics prime yields



Source: PMA

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