Real Estate House View

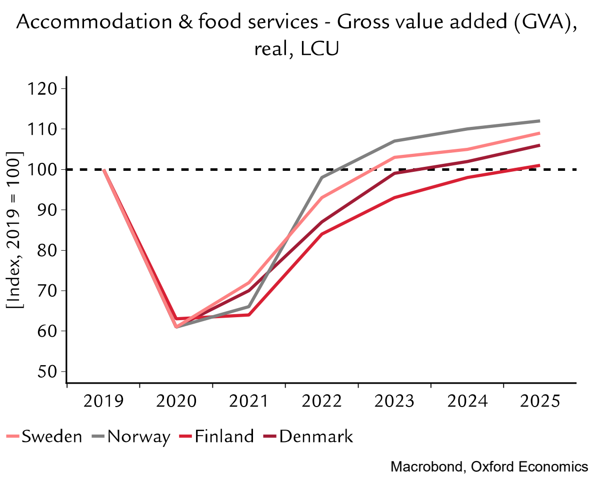
Norway, Sweden, Finland, Denmark

Second half-year 2023

Key takeaways

- **Window of opportunities opening:** With interest rates expected to stabilise, prime yields in most sectors and markets are also expected to stabilise by the end of 2023 to forecasts for end-2024. Thus, the pricing window for opportunities is about to open in H2 2023 – for both local and cross-border investors.
- **Sound occupier market fundamentals:** The fundamentals relevant for the letting market show signs of stability to growth in 2023ff. For instance, office employment will expand in all Nordics, the transportation & storage sectors' GVA in Norway and Sweden will increase already in 2023 and overall, more households are renting.
- **Investors' preferences:** The trend towards renting and the strong fundamentals of the logistics sector, e.g. the increase in the share of online sales to 25% by 2027, justify the hardening trend in investors' preferences: residential and logistics nowadays account for over 50% of the total investment volume.

Chart in focus



The recovery of the hospitality sector is a tailwind, supporting not only the hotel real estate sector itself but also retail. The imminent return of Chinese travellers in particular is a stabilising factor. In Norway and Sweden, the accommodation and food services sector will surpass pre-Covid GVA (real, LCU) values already this year. Denmark will follow in 2024, Finland in 2025. The positive development is also reflected in the share of hotel investments in the total investment market (H1 2023 up to 4%; see figure 1). However, the hotel real estate investment market has become incredibly local since the pandemic. On average, cross-border capital accounts for only 18% of the investment volume since 2020 to 37% on average between 2015 and 2019.

The economic situation in the Nordic countries remains different. As elsewhere in Europe, the industrial sector is particularly affected by the combination of increased financing costs and higher fossil energy prices. Accordingly, these sectors are showing signs of declining momentum. Sweden, like Germany and the UK, is one of the European countries that faces a greater risk of recession. Similar to the United Kingdom, inflationary pressures in Sweden are easing only very slowly, which suggests that the Riksbank should continue to pursue a restrictive monetary policy.

Investments partly ticking up

As in the rest of Europe, all Nordic countries also saw a steep decline in 2022, from -82% in Q4 2022 compared to a year before in Finland to -60% in the same period for Norway. First numbers for Q2 2023 indicate that transaction volumes are slowly recovering in Sweden and Finland, while Denmark and Norway still exhibit decreasing numbers. Yet volumes in both Sweden and Finland seem to be strongly driven by the residential market. This development is backed by the fundamental assumption that higher interest rates nudge more people into the rental residential sector – as in the rest of Europe. Yet the Nordic markets, especially in Finland and Sweden, already have a track record of being mature residential markets. This is further supported by the fact that many residential contracts are CPI-linked and hence lead to a positive income outlook in this sector.

Office: quality over quantity

The outlook is also positive when we look at the office employment growth rates in the Nordics, especially in Oslo and Stockholm, where figures exceed GDP growth. However, various factors, such as a relative cooling of the economy and a (s)lower than expected rate of return to the office, are causing tenants to downsize floorspace and optimise in favour of quality. In 2022, one employee occupied 21.9 sqm on average, (vs. 22.5 sqm in 2021 and 23.5 sqm in 2019). By 2026, it will be 21.1 sqm. As tenants still favour modern stock in top locations, prime rents remain in an uplift across all Nordic capitals. While we expect relatively stable yield developments in the prime sector and a renewed yield compression starting in 2026 due to a lack of high-quality supply, the picture for secondary assets in secondary locations may look different.

Retail: an exception

The retail sector has seen an additional crunch in transactions, although partially supported by some local investor interest. Rental growth is expected to be relatively flat; yields are not believed to rise much going forward as they were already at relatively elevated levels compared to other segments. As retail spending (2024: 3.6%; 2024-2026: 7.9%) and real GVA (2024: 4.1%; 2024-2026: 10.5%) will exhibit positive growth rates, we believe that the sector will see some more activity going forward.

Logistics: opportunities ongoing

The share of logistics in the overall investment volume is at an all-time high (H1 2023: 28%), despite the absolute volume being down. Investors' preferences for the sector are based on strong fundamentals. For instance, in Denmark the manufacturing industry will show strong GVA growth rates especially in 2023 (+12%; 2024: +3%). The transportation and storage sector will exhibit particularly strong GVA growth rates in Norway (2023: +6%, 2024: +8%), though the sector will also see growth rates in the other Nordics from 2024 onwards. Given that demand faces relatively low supply, also indicated by low volumes of speculative completions, prime rents will show further rental growth. We therefore assume that yields will decrease again starting in 2026 in all Nordic markets (-25bsp) before levelling out again. Warehouse and light-industrial are seen as "defensive", while in the Nordic countries too, solutions for last-mile logistics are in high demand.

Local markets for local investors?

On average, the Nordic countries are historically driven by local buyers and sellers. This might also explain why Nordic investors are focusing on real estate company performances in terms of overall real estate market sentiment. When we do the same, it seems there is still some room for improvement, as most of the real estate funds we are tracking are still in negative territory for the year to date. We also believe that the listed sector is 6-9 months ahead of the direct market. Yet stabilising inflation and interest rates, and the described stable underlying fundamentals – especially for the sector's prime segments – are boosting our convictions for all sectors in all markets – also for non-Nordic investors.

Figure 1: Nordic countries, share of investment volumes by sector.

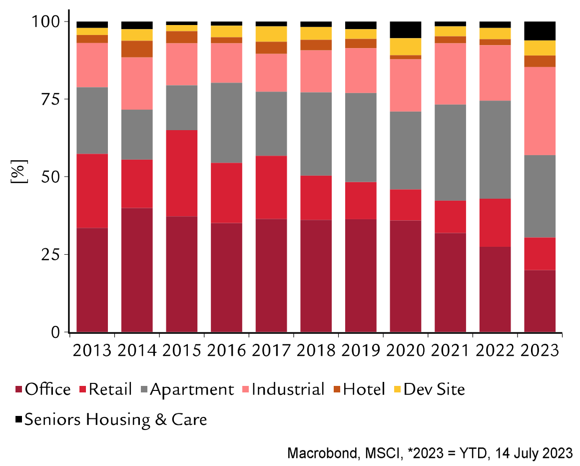
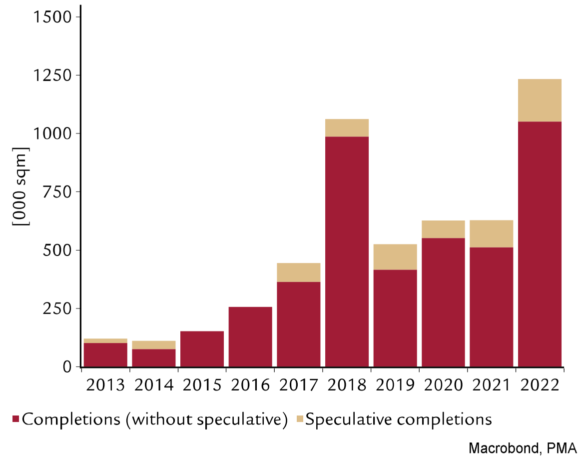


Figure 2: Logistics, completions > 10 000 sqm



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