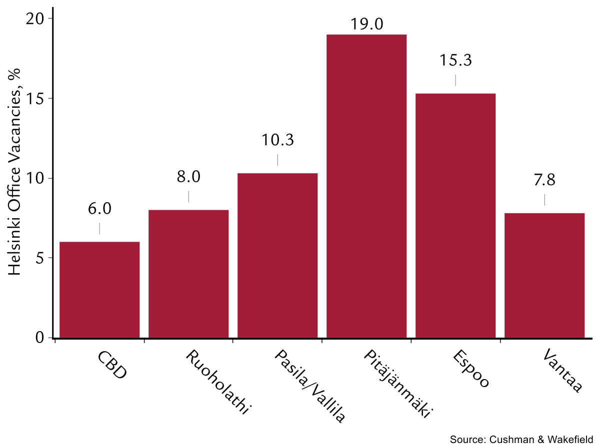
Real Estate House View
Norway, Sweden, Finland, Denmark

First half-year 2019

Key takeaways

- The investment markets in the Nordic countries are losing some momentum. Sweden, in particular, is facing declining transaction volumes.
- Initial yields have bottomed out, even though marginal reductions in individual markets cannot be ruled out in the coming quarters. We expect sustained low yields in the medium term.
- The office markets offer ongoing, albeit slowing, rental growth, as healthy demand can be expected. At the same time, rising completions have a dampening effect on market sentiment. With the exception of Stockholm, coworking is not widespread in the Scandinavian markets.
- The retail markets in the capitals attract international brands and suppliers of luxury goods, generating sustained demand. At the same time, the locations are losing their individual character as domestic retailers are increasingly being squeezed out.
- Robust consumer sentiment and rising retail spending provide prospects for future rental growth in the prime locations of major cities and at the major shopping centres.
- The housing markets remain of interest to institutional investors. However, strong construction activity suggests a slowdown or reversal of rental and price growth.

Chart in focus



The Helsinki office market is representative of many (northern) European office markets and illustrates the wide spread in the performance of individual submarkets. Companies prefer the city centres in order to offer their employees an attractive environment and good accessibility. Peripheral office locations are thus coming under pressure. The subdued demand means that vacancies remain at a high level and rents offer limited room for growth.

In contrast to comparatively firm purchasing managers' data, Sweden's gross domestic product contracted in the third quarter on the back of weak private consumption numbers. Retail sales disappointed for most of 2018, while car sales collapsed in the third quarter due to changes in tax rules and international emissions tests. Real wage growth is flat, suggesting that private demand is unlikely to rebound fast in coming quarters. The weak economic performance is likely to make the Riksbank rethink its idea of gradually normalising its monetary policy and moving away from negative interest rates. Finland on the other hand continues to catch up relative to economic performance elsewhere in the region. The country's exposure to Russia remains a structural risk for the economy.

Yields reach the bottom

The shifts in momentum among the Nordic economies are reflected in the investment markets. On the one hand this is a reaction to economic fundamentals; on the other, it is due to the availability of investment opportunities and price expectations of buyers and sellers. As in the previous year, transaction volumes in Sweden continued to decline in the first half of 2018, while in Finland in particular, demand remained strong. Foreign investors took advantage of the positive yield spread of the Finnish market, which meant that the yield compression has continued over the past quarters. Even if a further marginal decline is possible in some places, we expect yields to remain more or less stable in 2019.

Office markets remain robust

The main office markets in Scandinavia recorded positive momentum over the course of 2018, with robust demand for space, falling vacancy rates and an upward trend in rents. As in many other European office markets, there are noticeable differences within the markets. At many companies, the demand for space is focused on attractive inner-city areas, while peripheral submarkets are suffering. For the technology-oriented Nordic countries, it may be surprising that coworking spaces have not yet become very established. Although Stockholm is one of the European markets with strong demand from providers of flexible offices, its share in Helsinki and Copenhagen is very low. The office markets offer further upside potential in terms of rents for 2019, but this is likely to decline in subsequent years as completions pick up.

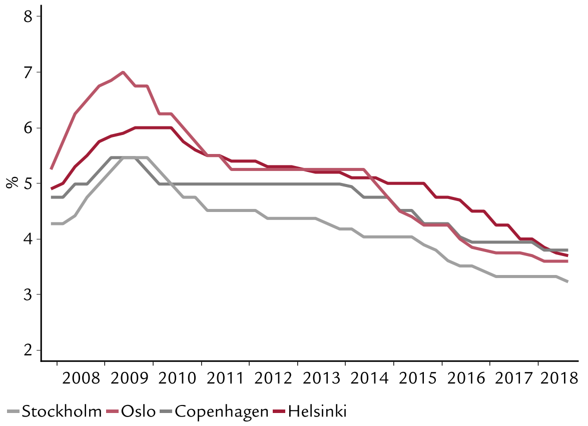
Retail reliant on top locations

With the economic environment weakening, consumer confidence has deteriorated slightly while retail sales volumes have declined, thus dampening the outlook for the retail markets. The polarisation of locations and properties is intensifying: the top locations in the capitals are benefiting from demand from international retailers and luxury brands, especially in Stockholm and Copenhagen as popular tourist destinations. Secondary locations and ordinary shopping centres and retail parks are weakening more and more. At the same time, local, owner-managed stores are increasingly being squeezed out, with negative effects on the diversity and vitality of the retail landscape. In addition, international brands are more price-sensitive. However, the forecasts for retail spending growth in the Nordic countries remain above the European average, providing room for further slight rental growth in the prime locations of major cities and well-established shopping centres.

Are housing markets turning?

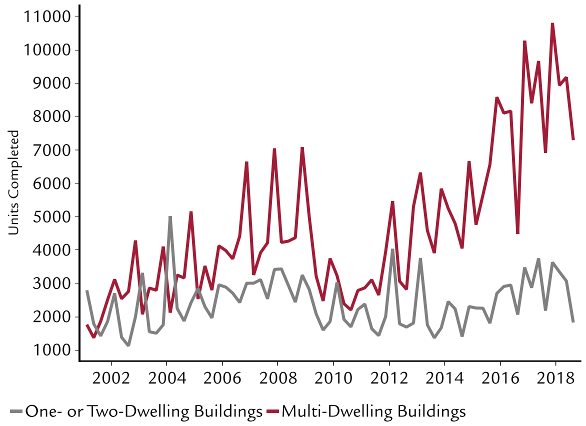
The Nordic countries are among the most mature residential investment markets in Europe. In the first quarters of 2018, institutional investors continued to invest signifcantly in this sector. However, the fundamentals in the housing markets are weakening. In recent years, rising demand for residential space in the metropolitan areas (a result of both domestic and foreign immigration) has pushed up rents and house prices on the one hand and construction activity on the other. The significant increase in supply – not only in Sweden, but also, for example, in the Helsinki and Copenhagen conurbations – puts pressure on expectations for further rental growth, especially as the rise in house prices has stalled. For instance, the house price indices of the Bank for International Settlements for Norway and Sweden had already indicated a decline at the end of 2017. For 2018, however, the indices show a slight recovery from this slump. On the other hand, the markets have responded: according to Statistics Sweden, the completion of apartments in the first nine months of 2018 fell by approximately 15% compared to the same period last year.

Chart 1: Prime office yields



Source: PMA

Chart 2: Residential completions in Sweden



Source: Statistics Sweden

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