Real Estate House View

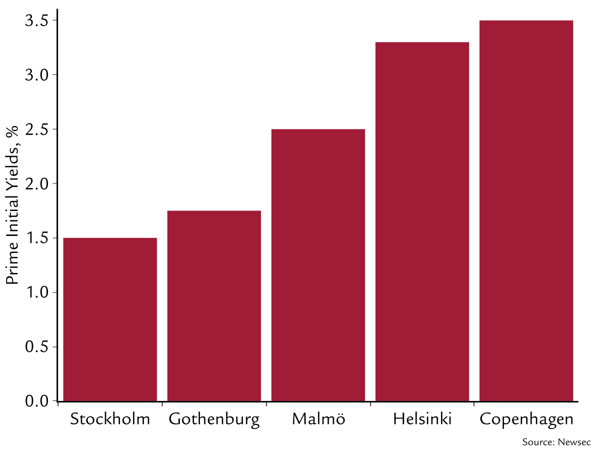
Norway, Sweden, Finland, Denmark

Second half-year 2019

Key takeaways

- The investment market in the Nordic countries once again proved to be very liquid in 2018, despite a restrained start to the year. International investors are increasingly taking advantage of the highly professional market environment.
- Yields in the office and retail sector have bottomed out overall, but in logistics the yield compression continues.
- We expect a sideways movement in yields in the medium term. The exception is Norway, where a rise in key interest rates is already pointing to a slight rise in yields in the short term.
- The office markets remain healthy. Robust demand meets limited supply and is boosting rents. This will continue in the coming quarters but is likely to weaken in the medium term due to rising completions.
- The retail sector is suffering from slowing growth in private consumption and retail spending. Moreover, expenditures are shifting more towards e-commerce and are weakening the store-based retail segment. Thus, the outlook for rental growth even in the high streets remains subdued in the short to medium term.
- The booming e-commerce sector is driving demand for logistics real estate from tenants and, thanks to the prospect of further rent and price increases, also from investors.

Chart in focus



The Nordic countries, especially Sweden and Denmark, are well-known for their established residential investment markets and strong investor appetite. It is therefore not surprising that initial yields are fairly low in a European context. Nevertheless, prime initial yields in Sweden's main cities are exceptionally low, dropping below 2% compared with 3% to 4% in other countries. In Sweden, domestic investors can still achieve adequate returns, as tax subsidies compensate for the performance achievable in the market.

Northern Europe is resilient to the global trade tensions. The Purchasing Managers' Indices (PMI) for Denmark, Sweden and Norway are all holding up above the 50-points expansion mark. Among all European countries for which PMIs exist, the above-mentioned all ranked in the top four by the end of Q2 2019. Except for Finland, consumer confidence stabilised or even improved in the second quarter as unemployment continued to fall. Unlike in central Europe, consensus forecasts for GDP growth in 2019 barely changed in the first half of 2019. In contrast to developments elsewhere, the central banks in Norway and Sweden are continuing to normalise monetary policy. Norges Bank has raised its deposit interest rate twice in 2019, while Sweden's Riksbank still aims to abandon its negative interest policy later in 2019.

Offices enjoying good momentum

The main office markets in the Nordics are benefiting from the robust economy and employment growth, while at the same time the availability of space in central locations is low. With a persistently high – but falling – vacancy rate, Helsinki does not correspond to the overall picture, but large parts of this space are obsolete while the vacancy rate in the CBD is 4%. Overall, many companies are seeking central locations to attract employees. Some tenants are being squeezed out, but others (mainly technology firms) are consciously choosing modern offices in the suburbs, such as in Stockholm's Solna area. Rents in all major Nordic markets rose in 2018 and there are no signs that this trend will change in 2019, but the risk of a dampening effect due to increasing completions is growing. We are particularly cautious about Stockholm, where prime rents are reaching all-time highs, but the momentum may continue to fuel rental growth for some time yet.

Retail suffering from e-commerce

Consumer confidence in the Nordic markets weakened in 2018 and growth in retail spending also slowed down. It is not only the economic situation, however, but increasingly also the rapid growth of e-commerce that has a negative effect on store-based retail. Demand is slowing and increasingly focussing on prime high street areas. As a result, rents in secondary areas are falling, while moving sideways in prime locations. There is little prospect of additional rental growth in the short term. Stronger integration of online and offline business may strengthen retailers and thus brighten the outlook for the medium term again. The growing challenges for investors in the retail sector are reflected in performance figures. In 2018, total return in Finland achieved 2% while in Norway and Sweden it reached 5.5% and 7% respectively – in each case well below the performance for the market in total. In Denmark, on the other hand, total return in the retail sector equalled the market average of 8%.

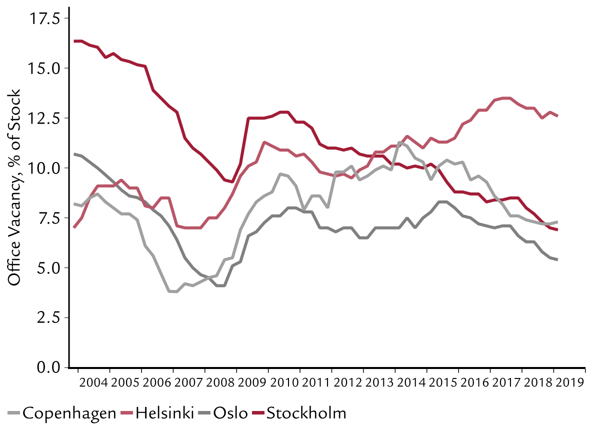
A closer look at logistics

The Nordic countries may not possess a central location for international transport or large population numbers, but e-commerce creates additional demand for logistics properties – and enjoys intense investor demand. With a prime yield of 5%, or less in Stockholm and Gothenburg, logistics offers a margin of approx. 150 basis points compared to prime offices. However, rental growth remains modest compared to core Europe, partly because the availability of land is higher and is leading to several speculative developments. Looking at the performance, the logistics sector in Sweden and Denmark achieved an above-average total return of 14% and 12% respectively in 2018. In Finland and Norway, which are less important logistics markets, returns remained close to the market average.

Yields bottom out

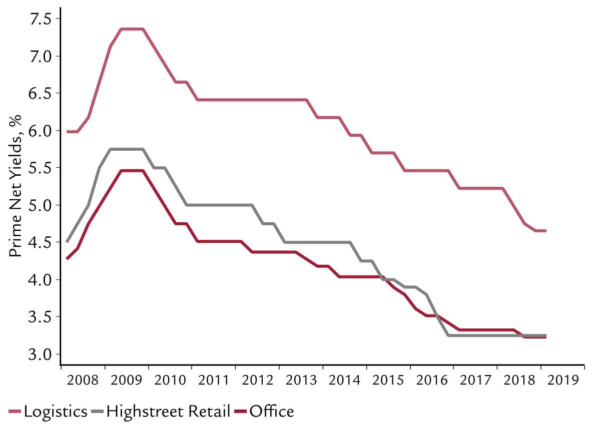
At more than EUR 40 bn, the institutional investment market in the Nordic countries' result for 2018 was very good again but slightly weaker than in 2017. Capital from the Nordic countries, invested at home or in neighbouring countries, dominates the market. However, over a third is international capital, not only from European but also increasingly from American and Asian sources. Investor demand remained strong in the first months of 2019 and was associated with inadequate supply. Initial yields fell again in 2018 due to strong investor demand, especially in Helsinki, where yields edged down again in the first few months of 2019. We do not rule out a slight fall in yields in some areas, but in the medium term we expect them to remain largely stable at current levels.

Chart 1: Office vacancies in major markets



Source: PMA

Chart 2: Stockholm prime yields by sector



Source: PMA

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