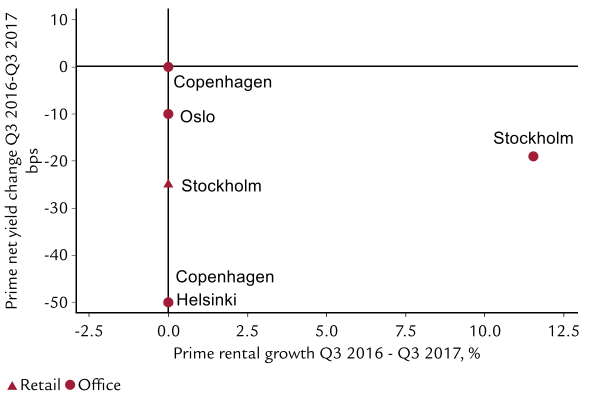
Real Estate House View
Norway, Sweden, Finland, Denmark

First half of 2018

Key takeaways

- After significant differences in recent years, economies and real estate markets in the Nordic countries have increasingly converged: momentum in Sweden is weakening while other countries are recovering.
- The office markets have moderate potential for rental growth: while Stockholm's previous dynamic wanes, Helsinki is lagging behind the overall upward trend; Oslo and Copenhagen are more balanced markets with some upside potential.
- The sharp rise in office rents in recent years is pushing up construction activity in Stockholm, such that rental growth is likely to significantly decline.
- Prospects for rental growth in Helsinki continue to be hampered by a high vacancy rate and insufficient additional demand for space.
- Driven by strong consumer spending, the outlook for rental growth in retail remains positive for both shopping centres and high street areas – but again, Finland is lagging behind the neighbouring markets.
- Residential letting and investment markets were on a strong upward trend over the past year. Increasing construction activities are starting to dampen these trends, so the outlook is rather subdued.
- Expectations for further yield compression are muted and only relate to market segments that still have relatively higher yields in a European context, such as the Helsinki office market.

Chart in focus



Source: PMA

Looking at the investment markets, there was an ongoing but slowing yield compression in the first quarters of 2017. The Stockholm market in particular is characterised by low yields but is bottoming out. Notable feature: yields declined while rents remained largely stable.

EU members Sweden, Denmark and Finland all became laggards in Europe's fundamental reform progress over the past couple of years. Yet, by 2017, Finland in particular has finally undertaken significant adjustment measures, with unit labour costs dropping significantly of late. The result is a substantial improvement in global competitiveness. All four economies are strongly benefiting from the global upswing. Sweden in particular is in a favourable position, with the Krona devaluing substantially versus the Euro. Macroprudential measures implemented by Sweden's Riksbank have started to cool the housing market there. Currently, we see no risk of severe spillovers into Sweden's real economy.

Stockholm office market slowing

The Swedish office market has performed very well in recent years. In Stockholm, take-up reached record levels in 2016 but slowed down to average levels in 2017. Demand is focused on non-central locations where new developments are concentrated. Stockholm is benefiting from ongoing employment growth. This is pushing up rents in central areas but there is a risk that rising construction will dampen the market. Overall, moderate rental growth is likely for prime office property, e.g. offices in central areas through the modernisation of space formerly let to large tenants which are subsequently rented to consultants, lawyers or IT companies. In contrast, letting markets in the other Nordic countries have started to recover, with robust demand and take-up as well as declining vacancies. However, rents have barely risen at all in Copenhagen or Oslo. Helsinki still lags behind in the cycle: demand remains weak as many occupiers are demanding smaller, more efficient space resulting in negative net absorption and rising vacancies. The outlook remains subdued, as the high vacancy level is limiting rental growth. There is some uplift potential for quality stock in central areas. In Copenhagen, robust demand and limited supply are expected to push up rental growth, albeit to a limited extent. Oslo presents itself as a balanced market with moderate availability, offering some rental growth in the short and medium term.

Retail remains robust

The strong economy boosted growth in retail sales in Sweden to 3–5% in recent years but the other countries, too, have seen significant growth in retail sales. On the other hand, the Nordic countries are at the forefront of e-commerce with growth rates of circa 15% p.a. Following some strong rental growth in recent years, high street prime rents were stabilising in 2017, e.g. in Oslo and Copenhagen. In contrast, as a result of the weakening economy in Finland, rents in Helsinki were under pressure and could only recover slightly in recent quarters. The expectations for high street rents remain positive for the capitals as these cities remain the entry points for international retail chains in the respective markets. In addition, tourism plays a crucial role, especially in Copenhagen and Stockholm. There is a similar picture for shopping centres as an anchor for retail in the Nordics: rental forecasts for large, well-established centres are based on the moderate positive trend continuing, whereas stagnation and possibly rent reductions are expected for less competitive units.

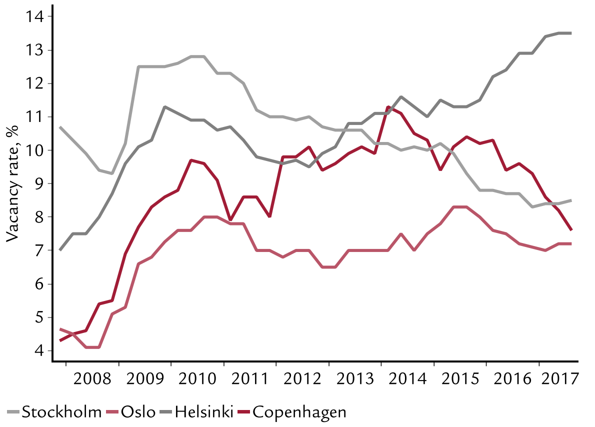
Residential peaking?

The housing markets are an important part of the institutional real estate investment market in the Nordics. Demographics by internal and external migration are driving housing markets: a shortage of supply has driven up house prices and rents in recent years and construction activity has picked up - especially in Sweden. In addition, the booming market has encouraged more and more property owners to convert elderly office or other commercial buildings to residential usage. Due to upcoming supply there are initial signs of muted growth in rents and prices.

Ongoing high investment levels

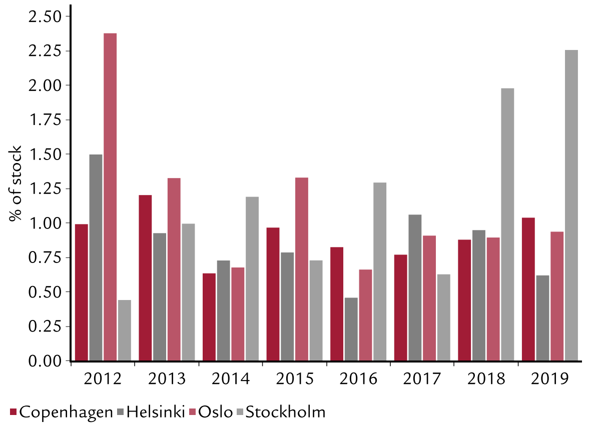
Strong demand and persistently high transaction volumes of about EUR 20 bn characterised the Nordic investment markets in the first half of 2017. The residential sector is of particular note, accounting for around a quarter of the investment volume. Following strong yield compression in 2016, prime yields remained relatively stable in 2017 after a decline at the beginning of the year. Finland and Helsinki are an exception as yield compression has been less pronounced over recent years than in other European countries. Overall, the yield movement in the Nordics points to a bottoming out and sideways movement for the next quarters.

Chart 1: Office vacancies in major Nordic markets



Source: PMA

Chart 2: Office market starts to developments



Source: PMA

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