

# Real Estate House View

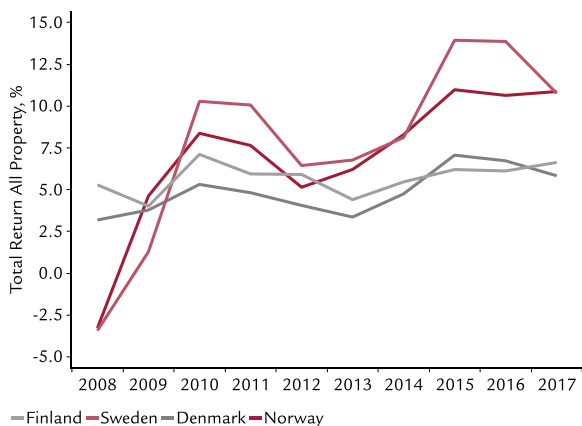
## Norway, Sweden, Finland, Denmark

Second half-year 2018

### Key takeaways

- The convergence of economic growth is increasingly reflected in the dynamics of the real estate rental and investment markets in Northern Europe.
- Northern Europe attracted a large amount of capital in 2017, visible in increasing transaction volumes. Demand shifted from the core market of Sweden to the higher-yielding market in Finland and also to the logistics sector in the whole region.
- The pressure on prime initial yields has eased in recent months. However, further slight compression is possible in coming quarters. Sweden is the exception due to the price levels already achieved.
- Due to the rise in employment, the office markets offer further potential for short-term rental growth. This potential recedes in the medium term as completions increase, especially in Stockholm.
- In the retail sector, the prospects for rising rents are limited to a few prime locations of inner-city shopping streets and large, dominant shopping centres.
- After strong price increases, the housing markets may face a slowdown as a result of increased completions.

### Chart in focus



Investors have benefited from the strong performance of Swedish real estate in recent years, underscoring the strength of the economy and the office letting markets. Norway has also performed well: the total return for all types of property of 9.4% over the last 5 years is only slightly below the 10.7% figure for Sweden. Finland and Denmark lag significantly behind with 5.8% and 5.5% returns respectively.

The Nordic economies show signs of moderating dynamics. Sweden's manufacturing purchasing managers index (PMI) recently fell to its lowest reading since August 2016. The same indicator for Denmark dropped below the 50 points threshold for the first time since 2014. With the exception of Finland, the steady decline of unemployment rates in the region came to a halt in Q1 2018. Nevertheless, already tight labour markets suggest growing risks of wage inflation. Significant adjustment measures in Finland result in improved global competitiveness. In the medium term, the country's exposure to Russia remains a structural risk as long as sanctions against Russia persist. Norway is a main European beneficiary of the high oil price. This increases the risk of faster-rising inflation and earlier central bank intervention than currently anticipated.

## Office markets remain robust

Take-up in the main office markets benefited from the economic upswing in all countries in 2017, which was accompanied by a noticeable increase in office employment. Combined with low completions, this led to sizeable net absorption and falling vacancy rates in the first quarter of 2018. Rents thus showed a clear upward trend, especially in Stockholm. The positive momentum is likely to continue, with further construction activity having a decisive influence. While moderate expansion of space and stable vacancy rates are expected in the other markets, completions in Stockholm will increase significantly from 2018, which should lead to rising vacancy rates. Rental growth in Stockholm should weaken and a correction is possible if the economy slows. For the other markets, we expect moderate rental growth in the short and medium term.

## Retail in a holding pattern

In contrast to the office sector, retail development is subdued. The Nordic markets are subject to various macro conditions including robust consumer confidence, rising retail sales and a high share of online shopping. Notwithstanding this, little noticeable rental growth is anticipated. Rents in prime locations are at a high level. We see moderate growth potential for the prime high street areas of the capitals because new chain stores are constantly entering the market

and tourists are generating further demand. Our expectation for shopping centres is subdued. Only areas in dominant centers offer prospects for rental growth.

## House prices starting to decline

Residential markets performed best in the Nordic countries in the early market cycle, but have lost momentum since 2016 according to MSCI. Nevertheless, a total return of 7.8% was achieved in 2017. The return underscores the significant rise in house prices observed in recent years, with particular momentum in Sweden and a much lower level in Finland. According to Statistics Sweden there has been considerable expansion of construction activity; the volume of completions for multi-dwelling buildings is at the same level as in the boom in the early 1990s. On this basis the markets are expected to cool. The house price index of the Bank for International Settlements shows declining values for all markets at the end of 2017.

## Shift in investment demand

Transaction volumes in the Nordic countries remained high in 2017. The volume of commercial real estate transactions increased by more than 10% year-on-year to approximately EUR 35 billion. The focus of investors has shifted somewhat in the region. In Sweden the investment volume decreased by around 20% in 2017 whereas Finland enjoyed a strong increase with a doubling of the investment volume to roughly EUR 9 billion. Denmark and Norway recorded modest growth of around 20% and 15% respectively. In addition, the residential sector is of great importance for institutional investments in the Nordics. This is particularly true in Denmark, where assets of around EUR 5 billion were traded in 2017, achieving a market share of 40%. Investment volumes are reflecting the trends in prime initial yields in recent quarters. In Sweden, yields have bottomed out at levels around 3.25% in the main sectors. Yields in the other countries have remained under pressure in 2017, especially in the logistics sector. Finland is particularly noteworthy with regard to yield compression. Yields in the Helsinki office market fell by around 40 basis points in 2017 and continued to decline in the first months of 2018. We expect yields to fall slightly in 2018 and to stabilise subsequently at a low level.

Chart 1: Prime office rents

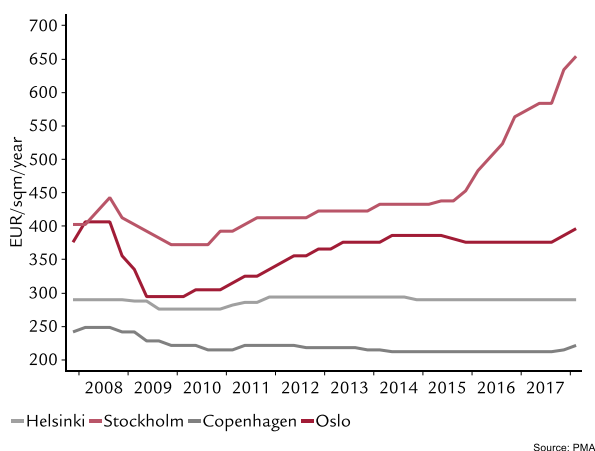
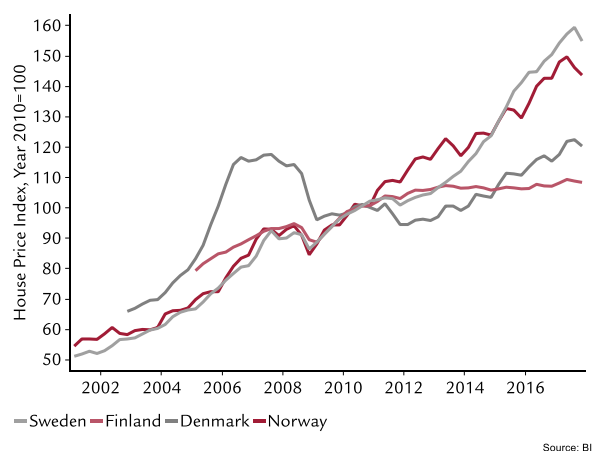


Chart 2: Residential property prices indices



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