Real Estate House View

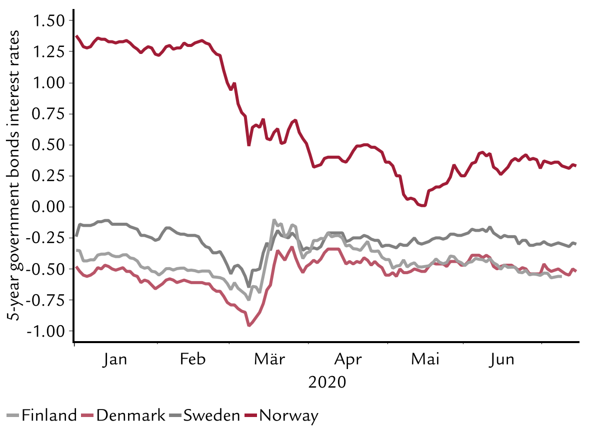
Norway, Sweden, Finland, Denmark

Second half-year 2020

Key takeaways

- **Safe, safer, Nordics?** Solid fundamentals, such as above average GDP growth, strong public finances and growing populations lead to positive investor sentiment towards the Nordics. They are considered safe havens. Nevertheless, all Nordic economies are expected to enter recessions in 2020 due to COVID-19.
- **Even safer: Residential**: The sector has seen the least adverse impacts from the corona crisis and is consequently attracting significant interest from investors who are realizing the benefits of residential real estate.
- **What remains**: Despite the impact of COVID-19, old dynamics in the investment market continue to apply. Due to a lack of alternative options, demand remains much higher than supply. Combined with an investor flight to quality and core triggered by the pandemic, overall transaction volumes are falling.
- **No risk, no return**: The corona crisis has acted as an amplifier of dynamics that were already in place, meaning that retail has been badly effected requiring related investments to have a higher risk premium.
- **Logistics is top**: In the medium term, logistics should benefit from rising e-commerce and urban logistics demand. In the short term, even logistics is pressured by interrupted supply chains and changing demand for goods.
- **When less is more**: Lower interest rates are increasing the attractiveness of Norway's real estate market to domestic investors.

Chart in focus



Source: Macrobond

The Nordic investment market has proven to be relatively crisis robust. Combined real estate transaction volumes in H1 2020 are only 6% below last year's comparison period and comparable to the 5-year average (Source: RCA). In total, EUR 16 bn has been placed into the Nordics during H1 2020. Denmark has performed particularly well, absorbing a 70% increase in investment volumes. Investor surveys show that the drop in the Norwegian interest rate is increasing preferences towards Norwegian investments. In a reversal of the usual trend, Norway is considered more attractive than Sweden.

The COVID-19 pandemic has resulted in a large hit to economic activity in Europe's north. Sweden's unique approach to containing the virus spread resulted in a slightly shallower decline than elsewhere. As a consequence, the short-term potential for an economic recovery in the second half of the year is limited. In July, authorities in Finland were forced to withdraw earlier easing steps in their containment policies. According to data published by Oxford University, Denmark is the most reluctant of the four countries with respect to re-opening its society. In addition to the severe impact of the global pandemic, Norway's economy is additionally suffering from reduced activity in those sectors related to the oil industry.

Office – yes, no, maybe?

The picture is mixed – not only because of COVID-19 and new home working dynamics. Stockholm and Copenhagen's investment market ought to perform relatively robustly with stable prime yields due to enduring demand from domestic investors. From an occupational perspective, low vacancy rates in Stockholm led to stable rents whereas completions in Copenhagen are pushing rental growth down slightly. The Finnish investment market has weakened due to an absence of foreign investors. Consequently, prime yields are predicted to increase. Forecasts for the Finnish letting market and rental performance are also negative given a relatively weak economy coupled with high vacancy rates. The Norwegian office market is facing high oil prices and dependency on exports, but it is backed by a strong and supportive government. Prime yields should also remain firm. A *modest prime rental* decline is anticipated for Oslo, despite heightened levels of completions, due to low vacancy rates.

Retail – will it ever get better?

Retail remains the weakest performing real estate sector. Even before COVID-19, the outlook was negative for retail in Sweden and Finland and slightly negative in Norway and Denmark. Weaker economic outlooks will decrease consumer spending, putting even more pressure on the sector. Thus, prime yields are expected to move out for all except absolute prime locations. This is likely to mean a reduction in liquidity. For top prime locations vacancy rates are and will remain low. Overall rental growth is forecast to decline sharply this year by 4 to 5%. The Norwegian letting market constitutes an exception, though, as the government is partly covering fixed, unavoidable expenses that retail companies incurred during the pandemic. Hence, the forecast for Oslo's occupational market is less negative.

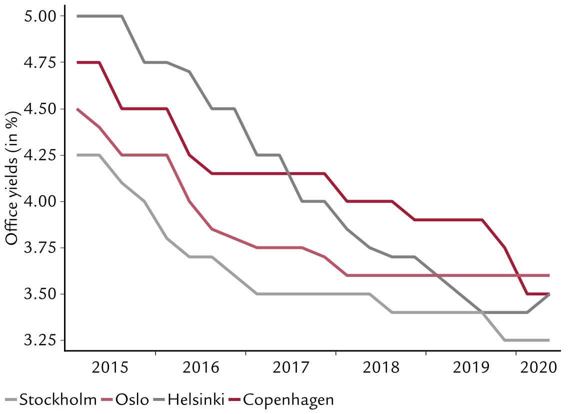
Logistics – part-time profiteer

The coronavirus acted as an amplifier for e-commerce penetration, which was already on the rise in the Nordics. Logistics is benefiting from the current trend of increased internet retailing, which is resulting in a growing demand for warehouse space. Despite this trend and overall low vacancy rates, logistics have still been negatively affected by COVID-19. This is because supply chains have been impaired and consumer demand for most goods has weakened. Hence even logistics will absorb the economic consequences of Covid-19 resulting in weaker mid-term rental growth. Prime yields will remain stable.

Residential – flight to safety

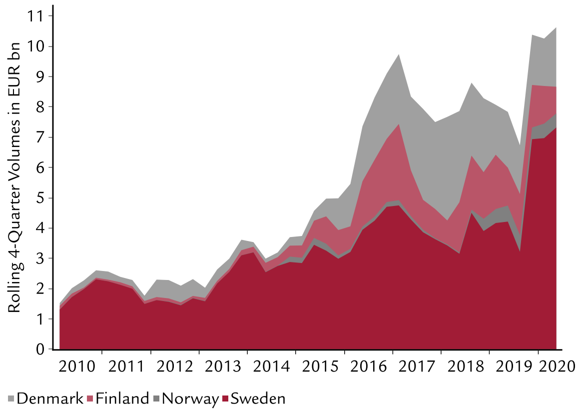
During the pandemic, default rates of residential tenants have been relatively low which has made it very attractive to investors. As residential rental growth generally follows inflation it is also not correlated with cyclical economic trends making it more resilient. In combination with already low vacancy rates and limited construction, which are serving to stabilize rents, residential investments are gaining popularity. The market remained liquid in H1 2020 despite an overall reduction in real estate transaction volumes. The flight to safety through residential is expected to continue in H2 2020 with Sweden benefiting the most. Even during lockdown, the Swedish residential investment market experienced increasing demand from both foreign and domestic investors. Prices will remain high and prime yields stable. Finland's investment market, which is usually dominated by foreign investors, has been adversely impacted by the absence of cross-border capital. As a result, outwards prime yield shift is expected in the short term.

Chart 1: Office prime yields in major markets



Source: PMA

Chart 2: Residential rolling 4-quarter investment volumes



Source: RCA

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