Real Estate House View

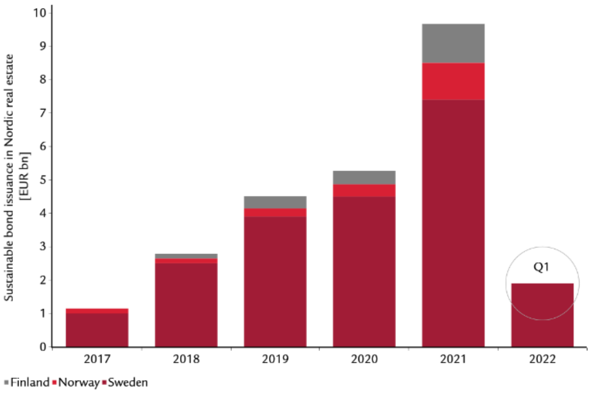
Norway, Sweden, Finland, Denmark

Second half-year 2022

Key takeaways

- **Inflation and the letting market:** As commercial real estate lease contracts in the Nordics are typically CPI-linked, higher inflation causes a rise in expected operating nets. In residential, the rent-inflation link is weaker. Also, it might be challenging to raise residential rents in line with the current inflation rate.
- **Inflation and the investment market:** With lasting inflation, central Banks are raising interest rates, causing an increase in financing costs. This is expected to have a subdued effect on the investment market and pricing, especially for assets where the spread between the yield and costs of borrowing is low.
- **Snapshot of the current situation:** In Q2 2022 the Nordic real estate investment market remained robust (EUR 11.6 bn, +4.7% y-o-y). Though this volume is mostly a result of processes that started six months ago. Some of these deals were closed at adjusted prices. We expect investment activity to cool down in H2 2022.
- **A time for opportunities?** Some listed real estate companies in the Nordics faced drastic stock market corrections. A falling stock market might offer opportunities, as pressured companies are likely to sell parts of their good/best properties. Also, it is a time for cash buyers, as financing is less easy to obtain now.

Chart in focus



Source: Nordea, no data available for Denmark

As sustainability has become a non-negotiable aspect in real estate investments, sustainable financing is on the rise. In 2021, nearly EUR 10 billion of sustainable debt was issued by Nordic real estate companies, around 80% more than in 2020 and almost three times as much as in 2018, with Sweden accounting for a large share, just over three-quarters, of the issuance. According to Pangea Partners, Sweden is the largest market for green real estate bonds in Europe, followed by France, the Netherlands and Germany. In 2021, more than 60% of all real estate bonds issued in Sweden were classified as sustainable.

The Nordic countries are moving closer together due to the ongoing crisis. The two NATO members Denmark and Norway support a membership of their neighbours. In contrast to other regions in Europe, the purchasing managers' indices for industry in Sweden, Norway and Denmark remained high in the second quarter. The Norwegian Central Bank has been countering the danger of the domestic economy overheating for a year now by raising its key interest rate. With the start of the normalisation of monetary policy in the euro area, it is expected that the financial framework will be tightened further in all four countries in the second half of 2022. Accordingly, we also expect a marked cooling of economic momentum for this region over the next twelve months.

(Prime) office: relatively solid

The Nordic office market is benefiting from the return to office trend. Especially in Norway (+6.2%) and Denmark (+6.0%) office employment is expected to increase strongly in 2022. Though the growth rate will flatten in 2023 (average across the Nordics: +1.6%, to 4.7% in 2022), it remains above the Eurozone (+0.8% in 2023, +3.6% in 2022). As office net additions remain relatively low – the average across the four Nordic capitals is +0.4% of stock in 2022 and +0.7% in 2023 – vacancy is expected to decline by 30 bps each in 2022 and 2023. Coupled with the fact that office rents are CPI-linked, an uplift in rents is forecasted. Higher financing costs are affecting investors' demand and ability to pay former price levels (Nordic average prime yield in Q1 2022: 3.0%). Yields are expected to go up, with first-class CBD office yields being more resilient. Also, investors' focus is turning to tenants' credit quality.

Retail: interrupted recovery

While fundamentals at the beginning of 2022 were showing signs of a recovery in this sector, the war in Ukraine brought the expected balance out of order again. With inflation, consumer confidence has turned negative. The continued reduced number of overseas tourists, partly due to the Russian airspace ban, is a further factor burdening the sectors' wellbeing. Overall, (real) retail spending in the Nordics is anticipated to be down in 2022 and partly into 2023. Within the sector, online sales remain a stabilising factor, while in-store spending continues to decline. Grocery retail is also projected to show stable growth. Nonetheless, the reoccurring clouds are foreshadowing a correction of rent levels in 2022 and partly in 2023. Though investors remain cautious towards the sector, they focus on segments. In Denmark and Finland, investments are dominated by food stores and big box assets. In Sweden these segments are on the rise, too. City centre retail, on the contrary, is expected to generate negative total prime returns in 2022 and 2023.

Logistics: momentum over?

With rising interest rates and increasing construction costs, the sector is facing a slowdown in investment and price momentum (average prime yield of 3.8% as of Q1 2022). Yet logistics properties remain in demand among domestic and international investors. As logistics rents in the Nordics are CPI-indexed, the current inflation is leading to a rise in rent expectations for 2022 and 2023. Also, e-commerce is projected to continue its conquest, causing strong demand for logistics space. Especially in Denmark the online share of total retail spending is pronounced: for 2022, a share of 15% is expected, while in 2024 it will climb to 20%. Finally, Nordic logistics centres are mostly geographically shielded from competition – their competition score value is 43 to 100 at the European average – allowing competitive advantages.

Residential: focused investors

The share of renters differs greatly among the Nordics: from 19.2% in Norway to 40.7% in Denmark. Weighted by the number of households, Sweden (1.7 million) and Denmark (1.1 million) exhibit the highest number of households renting. Thus, investors focus on Denmark and Sweden. Their combined share in the total residential investment volume in the Nordics is above 80%. As prime yields in Denmark are typically higher than in Sweden, the Danish share in the residential investment market has increased in recent years. Investors in the Danish market are also benefiting from CPI-indexed rents. Yet it might be difficult to raise residential rents to the same extent as inflation. Rents in Sweden are set to rise below the level of inflation due to regulation. Overall, a yield correction is expected, especially for low yielding rental residentials with regulated rents situated outside the larger regional cities. Properties in larger cities are relatively more price resilient.

Figure 1: Office net additions - % of stock, net

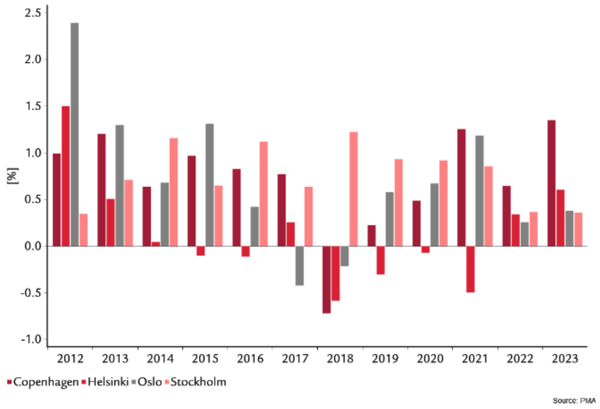
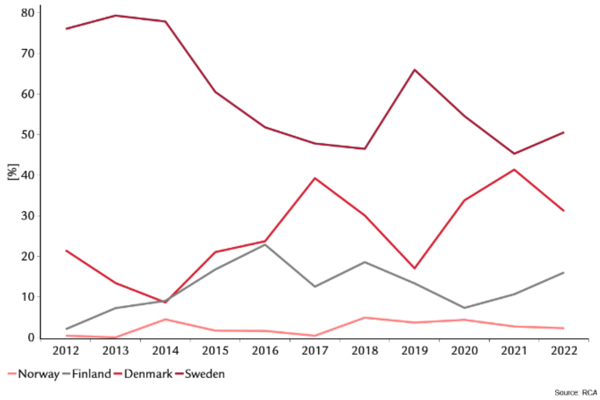


Figure 2: Country share in residential investment activity in the Nordics



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