Real Estate House View

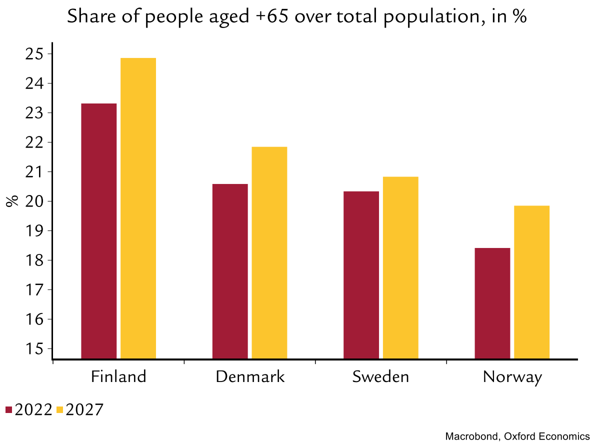
Norway, Sweden, Finland, Denmark

First half-year 2023

Key takeaways

- **Economically robust:** At the start of 2023, economic conditions in the Nordics are heterogenous: while export-oriented Sweden is in a technical recession, neighbouring Norway continues to expand, and the economies in Finland and Denmark are temporarily stagnating. Yet medium-term forecasts indicate solid fundamentals, e.g. positive office employment projections, a rise in retail spending, and more households renting. Thus, the region exhibits…
- **… a relatively resilient letting market:** Low availability of stock in certain sectors and markets, including offices in Oslo and logistics in Helsinki and Copenhagen; CPI-indexed commercial rents causing positive cash flow expectations; and the above-mentioned healthy economic fundamentals, which are underpinning a relatively resilient letting market.
- **In the medium term, back to safe haven status:** For the Nordic investment market we expect the earliest turning point for a settlement in price adjustments and expectations to come in H2 2023, leading to an uptick in investment activity in H2 2023 and ultimately a return to the region's former safe haven status.
- **In the short term, opportunities are emerging:** In H1 2023, we are continuing to assess the market environment for investment opportunities, as some real estate companies may face financing issues due to increasing interest and financing rates. As a result, they might release attractive properties onto the market.

Chart in focus



In the Nordics, healthcare is subsumed under public properties. In Norway, the government keeps this sector public. Thus, it is hardly accessible for private investors. By contrast, in Finland, the current reform of the health and social services sector is causing municipalities to sell their properties, so investible stock is rising. Finland is also the region's country with the highest current and future share of people aged +65. Moreover, 2022's repricing of Finnish nursing homes (4.85%, +70 bps) makes respective investments attractive; the same as in Sweden (4.25%, +100 bps), which has the highest number of elderly people (2.1 million).

The Nordic countries are affected to varying degrees by the issues of energy supply and recession risks. While Norway plays an important role as an energy supplier, Sweden is facing declining demand for its export goods. Accordingly, the purchasing managers' index for Sweden's industry has been below the growth threshold since August 2022. Norway's GDP is expected to grow by around 1.2% in 2023, while Sweden's is expected to contract by around 0.5%. Stagnation is the most likely scenario for Finland and Denmark. Positive impulses will come from the opening of the Chinese economy over the course of 2023. It can also be expected that the interest rate hikes by the responsible central banks will reach their conclusion in the first half of 2023. Borrowers and investors should thus regain increased planning certainty.

(Prime) office: solid and in demand

The Nordic office market fundamentals remain solid. In 2023, new stock (+0.7% on average) is not expected to keep pace with office employment (+1.6% on average), causing the average vacancy rate to decline (2022: 8.7% -70 bps year-on-year). In Oslo, the low number of net additions in 2023 will result in a further reduction of vacant space (2022: 6.0%, -70 bps year-on-year). This ratio imbalance between office-based employment and stock will prevail in the medium term. Prospective tenants remain focused on modern high-quality offices, as such prime rents are expected to rise – not only because it is standard practice that office rents in the Nordics are CPI-indexed. Oslo is a good example where (prime) office scarcity can lead to rent increases (2022: +13.3% year-on-year), even beyond inflation figures (Norway's CPI 2022: +6.2%).

Retail: comparatively resilient

From 2024, retail fundamentals in the Nordics will – literally – turn positive: real retail spending (2024: 3.6%; 2024-2026: 7.9%) and real gross value-added (2024: 4.1%; 2024-2026: 10.5%) will exhibit positive growth rates. In 2023, elevated inflation and (temporary) adjustments in consumer spending are supporting the performance of retail parks as their product range is most resilient to economic turbulence: i.e., discount and grocery goods that benefit during subdued economic periods. On the investment market, yields in the Nordics have been relatively resilient, too, especially compared to other European markets. For example, during the pandemic (2019-2021) high street prime yields in the Nordics increased by just 10 bps (compared to 50 bps in Europe). In 2022, the year of rising interest rates, high street prime yields in the Nordics rose by 20 bps (to 3.5%) compared to 40 bps in Europe (to 3.9%). Given the outlook for the sector fundamentals, this comparative resilience is expected to remain.

Logistics: opportunities ahead

The repricing in the Nordics logistics sector that was observed in 2022 (+75 bps to 4.6%) already allows for selected investment opportunities in 2023. Investors are aware of these opportunities as reflected in the Q3 2022 PMA survey, in which the Nordics received the highest preference score among the European logistics markets. Investment intentions are supported by strong letting fundamentals, where demand still outstrips supply. This is apparent in reduced availability indexes. The average availability index for the Nordic logistics sector stood at a value of 61 in H1 2022 (latest available figure) compared to the five-year average of 94. Rising land values, CPI-indexed rents and positive (real) gross value-added forecasts, both in the short (2023: +3.7%) and medium term (2024-2025: +13.4%) support rental growth (2022: +7.0%, year on year).

Residential: rise in tenantship

Increasing financing costs are supporting the ongoing trend towards more Nordic households renting. Within the last five years, the share of tenants has risen remarkably (+6.0%), especially in comparison to the EU (2021: 30.1%, +0.7% compared to 2016). In Denmark, 40.8% of households were tenants in 2021 (+6.5% compared to 2016). In Norway, though the overall rate is low (2020: 19.2%, latest available figure), it has risen by 11.6% since 2015. Unsurprisingly, multi-family investments in the Nordics scored highly in PMA's latest investor sentiment survey. This preference is also supported by the fact that, especially in Finland and Denmark, residential rents are CPI-linked and offer an inflation hedge. In Denmark this link has been suspended in 2023. Due to inflation expectations, rents have been capped by the government to a maximum increase of 4%. From 2024, the CPI link is expected to take effect again and to offer positive real cash flows.

Figure 1: Logistics Prime Availability Index

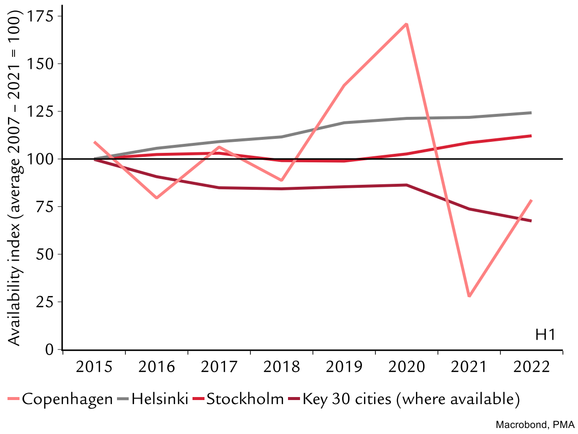
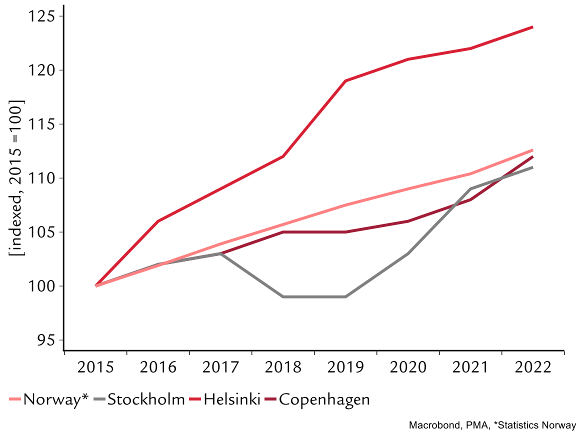


Figure 2: Average residential rent development



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