European Commercial – December 2019

SPOTLIGHT
Savills Research

Nordics Investment
The green recipe for success?

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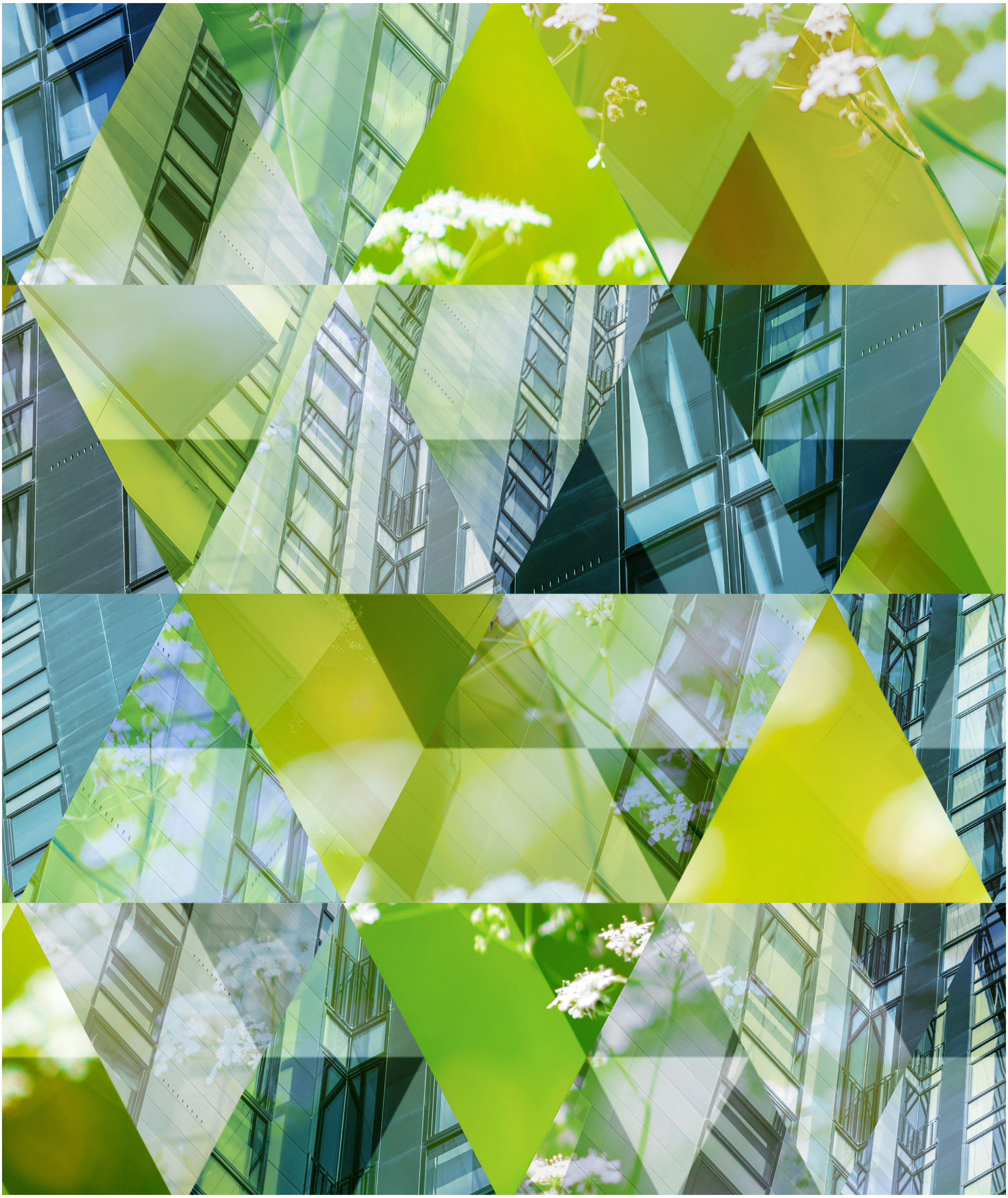


● Another strong year ● Cross border investment ● Green: a plus

> “Solid economic, demographic and property fundamentals are making the Nordic region an appealing investment-friendly destination.”

Q1 to Q3 2019 key figures

€29bn of investment transactions.

22% growth of cross border activity (€9bn).

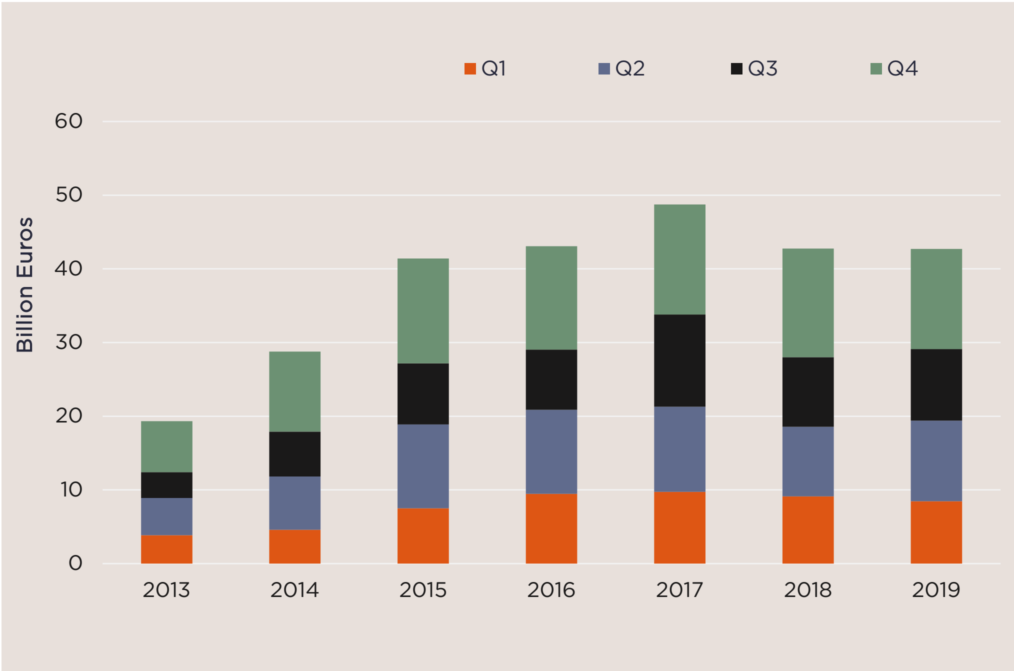
37% is the share of office investment, +14% compared to Q1-Q3 2018.

27% is the share of multifamily investment, +16% compared to Q1-Q3 2018.

Logistics investment (€4bn) increased by 8% compared to Q1-Q3 2018.

9% is the share of retail investment, -17% compared to Q1-Q3 2018.

Investment volume in the Nordics



Source: Savills Research /*Q4 2019 forecast

On track for another strong year in 2019

Investment volume in the Nordics totalled €29bn during the first three quarters of the year. This is 4.1% up compared to the same period last year off the back of peak turnovers recorded during the past two years and still a better performance than at pan European level (-5.6%). Based on further investment bustles witnessed since September, we anticipate the full-year volume to reach approximately €42bn, in line with the high volume achieved in 2018.

Over the past five years, the region has been attracting rising amounts of foreign capital. Between January and September, cross border investment totalled €9bn, reflecting an increase of 22% compared to Q1-Q3 2018. This represents 33% of the total volume invested this quarter, compared to 26% to last year. Excluding cross border investors from the Nordic region itself, interest from international investors is increasingly coming from Germany and the UK, whilst activity from US investors has been slowing down over the past two years. At the same time, the Nordic region caught Asian investors's attention, notably Korean investors mainly focusing on office properties.

In line with the pan European trend, the office sector is the big winner of all assets types. Some €10bn were invested in Nordic offices between Q1 and Q3 2019, reflecting a 14% increase on last year. Hence offices, accounted for 37% of all investments, compared to 32% last year. The sector is fuelled by strong fundamentals; healthy labour market, solid business expansion, low vacancy rate and positive rental growth. On average over the next five years, office-based employment growth is forecasted to grow by 1.8% pa in Stockholm, 1.7% in Copenhagen and 1.6% in Gothenburg and Malmo. This places four Nordics cities in the top 10 best future office-based employment markets in Europe.

Logistics investments in the Nordics totalled €4bn, 8% up on last year, which is mainly thanks to a record level of activity in Sweden. The sector accounts for 15% of the total Nordic investment volume, against 13% last year. The overall strong e-commerce penetration rate in the region (77% compared to 53% on average in Europe) is driving demand for logistics space.

This comes at the expense of the retail sector, for which lacklustre investors' interest is deepening.

Nordics retail investments totalled €2.4bn during the first nine months of the year, 17% down on 2018. Hence, the retail market share in the Nordics is currently 9%, compared to 15% in Europe. Relatively high levels of retail floor space per capita in the four countries (1.38 sqm/capital – 1.16 on average across Europe) and strong growth of online sales compared to the European average are particularly restraining retail activity in the region.

Multifamily has lost some ground so far this year. Residential investments amounted to €7.4bn, 16% down on last year's three first quarters. This is mainly due to a lack of supply notably in Denmark. Yet, the sector remains the second preferred assets type after offices, accounting for 27% of all investments. The Nordics population is highly urbanised compared to other European countries. On average the share of the urban population is 85.5% against 75.7% across Europe.

Narrowing the analysis at country level reveals a patchy canvas

Sweden is clearly standing out of the Nordics picture. Approximately €13.5bn (SEK 152bn) were invested in the country between January and September. This is a record level for the first three quarters of the year and 37% up compared to last year, notably thanks to large and portfolio deals. Hence Sweden is accounting for nearly half of the Nordics investment volume. Whereas investment activity in the country increased across all sectors, logistics investments nearly tripled. But multifamily remains the preferred assets class in Sweden, accounting for 34% of the total invested volume, followed by offices (26%).

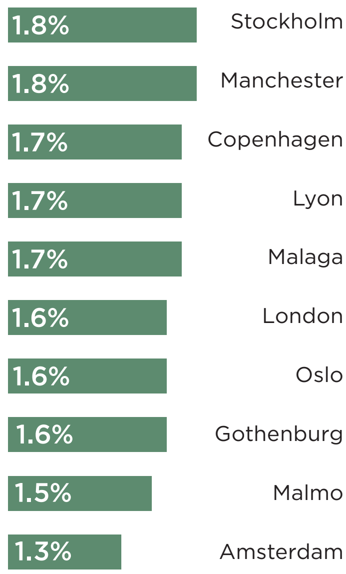
In Norway, which is the second-largest market of the region, invested amounts accumulated during the first nine months of the years totalled €5.3bn (NOK 51.2bn). This is 6% lower than last year, in line with the European trend. Whilst office investments grew by 43% from Q1-Q3 2018 to Q1-Q3 2019, the lack of investable property have dragged down both logistics and residential volumes.

The investment volume in Finland reached €4.7bn during the first three quarters of the year. A decline of 16% compared to the same period last year as a result of a small number of large scale transactions. Overall, investors' demand remains high but often face a lack of suitable supply hence restraining the activity. Offices and residential units are the most transacted properties. Alternative sector such as public use properties has been popular as well.

Following two peak years, with particularly strong cross border activity, the Danish investment market has geared down too and is adjusting back to the investment level seen in 2016. Some €5.7bn(DKK 42.8bn) was invested in Denmark over the course of the past nine months, representing a drop of 20% compared to the same period last year. This is mainly due to the shortage of supply and investors' reluctance to meet sellers' asking prices.

Office-based employment

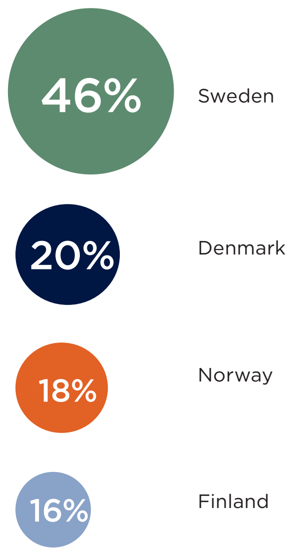
Average annual growth between 2019 and 2024 - Top 10 cities



Over the next five years, office-based employment is set to grow by 1% on average across 52 european cities.

Source: Oxford Economics

Share of each country of the total Q1-Q3 Nordic investment volume



Source: Savills Research

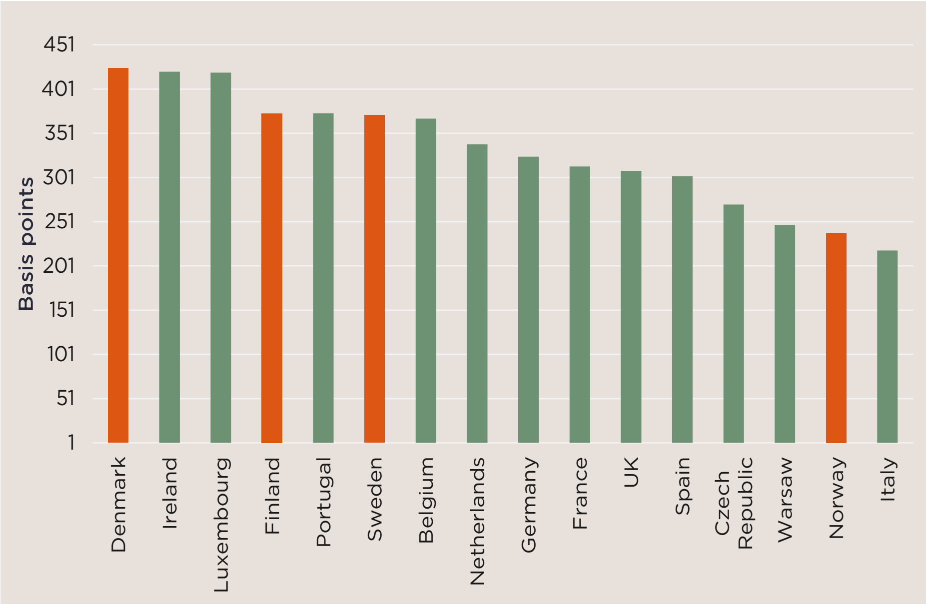
COMPRESSING YIELDS BUT STILL COMPETITIVE

Over the past four years, growing investors' appetite for the Nordic property market has applied strong pressure on prime yields.

In Q3 2019, the average prime Nordics CBD-office yield moved in by 9bps annually and currently stands at 3.60%, compared to 3.22% on average in core countries. Denmark, Finland and Sweden also offer attractive office yield spreads with long term interest rates compared to other European countries (424bps, 373bps and 371bps respectively).

Industrial prime yields hardened by an average of 29bps over the third quarter to 5.15%. This compares to 4.05% for the average prime Core industrial yields. The average prime residential yield remained stable over the past year, now ranging between 2.75% and 3.5% across the region. Whilst, on the other hand of the spectrum, in Q3 2019 the average prime retail yield moved out by 7bps yoy to 4.55%.

Prime office yield vs long term interest rate



Source: Savills Research / OECD

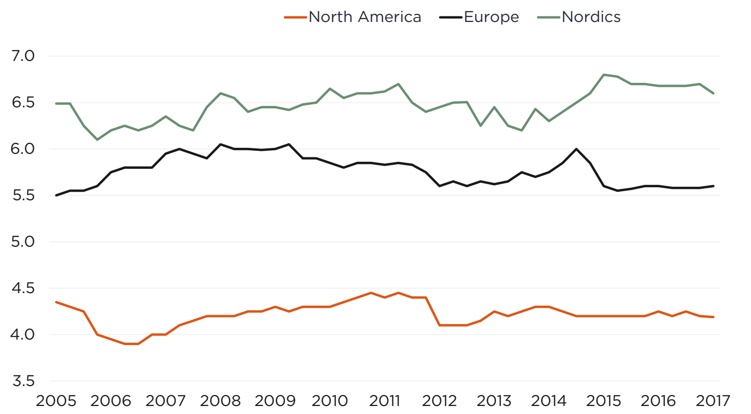
All the lights are green

The Nordics countries benefit from a stable political climate in contrast with the rest of Europe. Brexit uncertainty, Italian economy fears and rising protectionism across the European Union have been strengthening the position of the Nordic countries as a safe haven.

The economic landscape is also strong although less homogenous across the four countries. The winners are Sweden and Norway, with above EU28 average growth figures expected in the next two years in terms of GDP, employment and retail sales. Norway also benefits from one of the lowest unemployment rates in Europe (3.6%).

On the demographics side, in the overall European ageing population context, the young and the working-age populations are expected to grow substantially in the next five years in Sweden (4.5%), Norway (3.1%) and Denmark (1%) whereas it is expected to decrease in Europe (-1.8%). Additionally, Nordics citizen are amongst the wealthiest of all European populations with an annual disposable income per household of €52,300 (€70,500 in Norway) compared to €39,600 in Europe.

Average ESG score per region



Source: MSCI ESG

...and a green-friendly environment is a plus

The Nordic region is also well-known for its stringent position on green growth. Local authorities and population have long taken and adopted a sustainable transition path. Decades of targeted environmental initiatives have improved the status of the environment in many areas such as transport, housing construction, product development and production of renewable energy.

The Nordic region has substantial clean energy resources, especially hydropower and wind. Over a third of the Nordic region's supply comes from renewable sources. The Nordic countries generate only moderate emission levels of greenhouse gases. The carbon intensity of Nordic electricity is under 60gCo2/kWh, compared to the global average of over 500.

The Nordic countries also engaged in socially sustainable development from an early stage. Their welfare model is based on all people having equal value, respect for human rights, justice, equality, low level of corruption, democracy, and promotion of health and wellbeing.

Hence, in an era of growing concerns over Environmental, Social and Governance (ESG) policies, investment in Nordic properties looks more likely to meet some of the ESG credentials. In fact, according to MSCI Nordic companies have consistently been superior on ESG performance.

OUTLOOK

- Based on the healthy economic horizon for 2020 and 2021, we expect the Nordic property market to keep attracting capital, especially since the region offers competitive yields and wide yield gaps with long term interest rates. As environmental, social and governance policies are slowly gaining ground on investors' radar, the region is also likely to attract a growing number of investors looking to achieve good ESG performances.
- Overall, the office sector will continue to prevail back by above-average economic expectations, whilst multifamily will remain the second preferred asset type fuelled by positive demographic background. Resulting from the strong growth of online retail sales, logistics assets will continue to capture a growing share of total investments, at the expense of retail investment.
- The main drag on future investment activity in the Nordics will remain the lack of available property on the market - a situation which is not peculiar or worst in the Nordic region than in core countries but one that can be more challenging for investors in smaller than in larger markets, especially for big-ticket investors.

Savills Commercial Research
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