Briefing note
Nordics, the new core?

August 2017

SUMMARY

Strong investment activity notably underpinned by cross border investors

■ The investment volume in the Nordics totalled nearly €19bn in H1 2017, in line with the very high volumes recorded over the past three years.

■ In Norway the half-year turnover nearly doubled and Denmark reached a peak. Sweden failed to reach the high that was set during H1 2016 but remained 19% above the long-term-average. The lack of suitable prime opportunities in Finland restrained the activity of the market, whilst cross border interest strengthened.

■ The combined effect of stable political climate, strong economic conditions and good position in the property cycle makes the Nordic region a core target for both domestic and foreign investors.

■ Cross border investment totalled €5.5bn reflecting an increase of 23% compared to H1 2016.

■ The multifamily segment has been growing continuously over the past 10 years and accounted for 28% of all property investment in H1 2017.

■ The average Nordics prime office yield moved in by 25bps annually (3.75%), but remains more attractive than in core countries, where the average prime office yield is 3.5%.

"The low interest rates and solid property market fundamentals have led to a continued competitive property market where demand outweighs supply." Peter Wiman, Savills Investment Sweden

Strong investment activity is continuing

The investment volume in the Nordics totalled nearly €19bn in H1 2017. This is 4% below the record high reached during the same period last year but still in line with the very high volumes recorded over the past three years.

Denmark reached a peak, nearly €4.2bn (31.5bn DKK) were invested during the first half of the year, which is 19% up on the same period last year. This is mainly due to very strong investors' activity in the multifamily segment which doubled compared to last year and accounted for half of the total volume.

In Norway the half-year turnover nearly doubled to reach €4.4bn (40.1bn NOK), as a result of a surge of activity in the hotel segment, whilst strong dynamism in the logistic sector continued. Foreign investment also played a major role in the overall strong investment upswing.

In Sweden the total transaction volume for H1 2017 failed to reach the record level that was set during H1 2016 mainly thanks to one very large deal. However, the total volume amounted to a very strong €7.8bn (SEK 74bn), which is 19% higher than the average H1 volume over the past five years.

Due to the lack or prime opportunities available on the market, notably portfolio deals, the overall investment activity in Finland decreased by 32% during this first half of the year compared to last and reached €2.5bn while during the same time cross border turnover increased by 48%.

Nevertheless, Sweden remains the most liquid market generally accounting for 40% to 50% of the volume invested in the Nordic region followed by Norway, Denmark and Finland. This investment breakdown has remained relatively similar over the past five years.

Office remains the main asset class, accounting for 34% of all investments but, clearly lost some ground to the benefit of other asset classes. The share of retail investments slightly increased in all countries and accounted for 22% of the total investments in the Nordics, from 17% last year. Investment in the logistics sector remains relatively in line with last year (10%), whilst interest for alternative assets is rising, notably for the multifamily segment which has been growing continuously over the past 10 years.

Multifamily accounting for 28% of all property investment

In H1 2017 multifamily investments totalled nearly €5.4bn, 3% up on the level seen last year during the same period. This result is showing the increasing interest for the asset type, which is based on favourable and long term demographic trends.

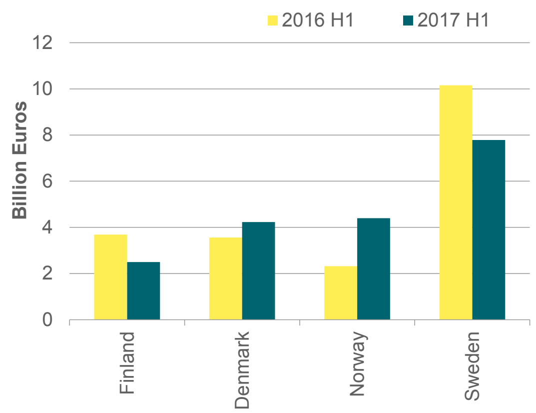
Population growth, decrease in average household size and urbanisation pose a challenge in all four countries. The Nordics population is highly urbanised compared to other European countries. On average the share of the urban population is 86% against 73.4% across Europe. According to Oxford Economics, the population of the Nordic countries increased by 7.5% between 2005 and 2015 and has now reached 26.5 million inhabitants. During the same period the population of the four capital cities of the Nordics increased twice more rapidly (16.1%).

In Finland, the multifamily stock has increased markedly in recent years offering investors some opportunities. This is notably thanks to new construction. If new non-subsidized construction is now slowing down from a record high level and rental growth is easing, demand is still strong due to demographic trends.

Denmark is the most urbanised of the four Nordic countries. In Copenhagen, there is currently an undersupply of housing and it is expected to grow at a pace of 1,000 new inhabitants per month until 2025 according to Nordicbuiltcities. In Sweden the market will be supported by municipal housing associations selling off assets during this year as 2018 is an election year. In Norway, investments in Q1 were quadruple the amount invested compared to last year.

GRAPH 1

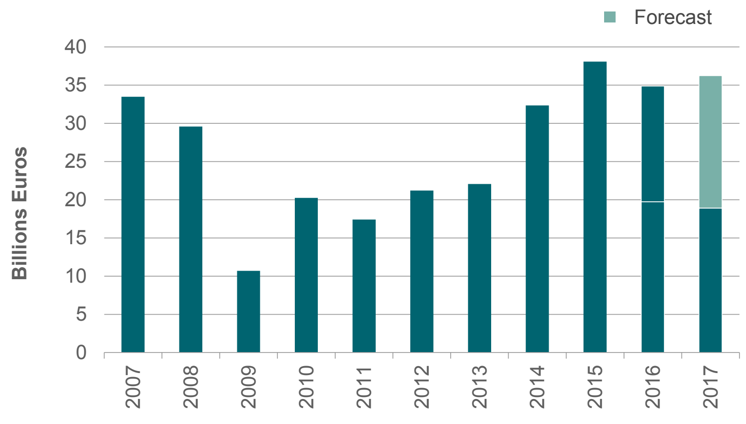
Investment per country Sweden is the largest market



Source: Savills

GRAPH 2

Nordics investment Strong performing market since 2015



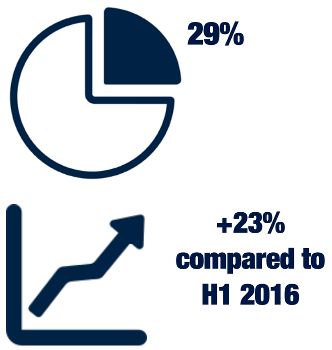
Source: Savills

Cross border investment increased by 23%

Cross border investment totalled €5.5bn reflecting an increase of 23% compared to H1 2016. This represents 29% of the total volume invested this half-year, compared to 23% to last year. Excluding cross border investments from within the Nordics, international flows of money are mainly coming from the UK, the US and Germany.

ICON 1

Cross border share in H1



Source: Savills

In spite of the strong competition of domestic listed real estate companies in Sweden and Norway, the two countries accounted for 66% of the total cross border volume.

Why such a surge for the Nordics?

It is a perfect timing in terms of political climate, economy and property cycle. The Nordic countries benefit from a stable political climate, especially in contrast with the rest of Europe. Uncertainty and political shocks following the Brexit and the elections in the Netherlands, Germany and France have been strengthening the position of the Nordic countries as a safe haven.

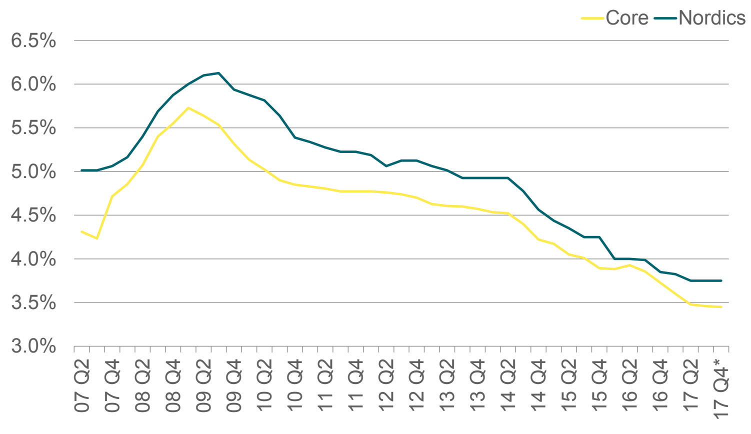
The economic landscape is also strong although less homogenous across the four countries. The winner is, with out a doubt, Sweden, with above EU28 average growth figures in terms GDP, employment, consumer spending and retail sales. Norway also benefits from a strong economic background, with notably one of the lowest unemployment rates in Europe. However turmoil in the oil industry in the past few years has had a negative impact on the country, although this is less true in the capital.

Property fundamentals of the Nordic countries are also solid. Overall office demand is growing and levels of supply are decreasing, and hence, are pushing prime rents up. The prime CBD office rent increased by 16.7% in Stockholm between H1 2016 and 2017, notably due to the very low vacancy level (3.6%). At the same time, the prime rent increased by 4.3% in Copenhagen, 2.4% in Finland and remained stable in Oslo.

Lastly, although prime opportunities are limited in the Nordics region, they are not as scarce as in core countries.

GRAPH 3

Prime office CBD yields The Nordic region remains more attractive than core countries



Source: Savills

WHERE INVESTORS SHOULD LOOK?

- Offices in secondary locations such as Gothenburg, Malmo in Sweden, Bergen and Trondheim in Norway Ruoholahti, Keilaniemi and Vallila submarkets in the Helsinki metropolitan area.
- Prime shopping centres, notably in Stockholm which is ranked 1st in our shopping centre benchmark. However, only big destination shopping centres will perform since the stock of shopping centre per inhabitant is already very high compared to other European countries whilst the share of ecommerce sales is growing fast.
- Public properties in Sweden, driven by favourable demographics and many municipalities have a need to replace older stock with modern buildings.
- Schools in Stockholm since there too few schools in the Swedish capital.
- Logistics as Nordics countries are in the top ten countries in terms of percentage of individuals who buy regularly online, notably Denmark which holds the second position (83%). Additionally, in the medium term, the Nordics should gain from an increasing use of the Arctic shipping route.
- Care homes in Finland and Denmark which both have an ageing population, combined with a limited number of long-term care beds in institutions compared to their elderly population and the highest percentage of LTC expenditure.
- Data centres driven by cloud growth and its offset need for super-sized infrastructure support. The weather in the Nordics countries is acting as a natural cooling efficiency. Additionally, the four countries benefit from high connectivity, lowepower costs, abundant resources of green energy and taxation incentives. Facebook has already built centres in northern Sweden and Amazon Web Services have acquired three sites in Sweden.
- Multifamily notably due to the strong urbanisation trend going on in the Nordics.

"The Nordic region offers investors a stable political climate, a strong economic landscape, solid property fundamentals and attractive yields compared to core countries." Lydia Brissy, European Research Director

… and yields remain attractive

Strong investor appetite in the Nordic region has put pressure on yields. In H1 2017, the average Nordics prime office yield moved in by 25bps annually, and currently stands at 3.75%. Nevertheless, prime office yields in the Nordics remain more attractive than in core countries, where the average prime office yield hardened by 44.5bps over the past year to 3.5%.

Strong activity in the shopping centre segment during the first half of the year has put downward pressure on prime yields, which hardened by 4 bps in one year on average and current stands at 4.09%. At the same time, the average prime industrial yield moved in by 19bps from 6.19% to 6%.

Strong activity in the multifamily segment is also dragging yields down. In the Nordic capital cities prime residential multifamily yields range between 2.8% and 4.8%.

Prime CBD yields Q2 2017	Office	End-year trend	Shopping centre	End-year trend	Industrial & Logistics	End-year trend
SE	3.50%	→	4.00%	→	5.50%	→
NO	3.70%	→	4.25%	→	5.40%	→
DK	4.00%	↘	4.00%	↘	8.25%	↘
FI	3.80%	↘	4.10%	↘	5.20%	→

Source: Savills

OUTLOOK

2017: another vintage year for the Nordics region

- We expect the end-year volume of investment to exceed €33bn thus representing an increase of approximate 4% compared to 2016.
- As in any other European markets, alternative assets will continue to capture a growing share of total investments, notably senior housing in Finland, Sweden and Norway, student housing in Denmark, hospitality in Norway.
- We expect appetite for residential multifamily assets will continue. The population in the four capitals is anticipated to rise by another 11.6%. Additionally, the fertility rate in the Nordics, which is amongst the highest in Europe (following France and Ireland), is rising.
- In Sweden, we anticipate an increasing number of public assets to become available on the market since municipalities and counties may consider disposing of their assets before 2018, which is an election year.
- However the office sector will continue to prevail as we still expect strong office rental growth until the end of the year.
- Prime yields are expected to stabilise during the second part of the year in the Nordics, whilst the average prime yield in core countries is expected to harden further by approximately 5bps.
- The Nordic region is definitely an alternative option to core destinations and a competitive one in terms of pricing. Yet big ticket investors may stick to the traditional core destinations due to the size of the Nordic market.

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