NEWSEC PROPERTY OUTLOOK

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NEWSEC

PROPERTY OUTLOOK

TO BE, OR NOT TO BE?

In the last edition of the Newsec Property Outlook we concluded that the pandemic had accelerated several developments and trends already taking place in society pre-covid-19. The concept of the office in the wake of the pandemic has been under a lot of scrutiny and we will now take a closer look at this theme. In this edition of the Newsec Property Outlook, we explore what the future holds for the office market in the Nordics and Baltics.

Over time, we have seen a gradual shift in terms of office space. The trend has been fewer square meters per person, as we have gone from working in individual rooms to open landscapes and activity-based offices. Not to mention co-working that has experienced a great hype in the last few years.

Then the pandemic struck, really putting digitalization and flexibility to the test as governments urged offices to close and everyone that possibly could to work from home. It is impressive to see the giant leap that we have taken in these last months, but I also think that this has made one point very very clear, at least for me personally... Fine, it works. But nothing more than that.

Rather, it has reenforced my belief in the importance of the office. Nothing can compete with meeting in person. What happens in the human interaction when we meet face to face is irreplaceable, whether it is about creativity, creating a sense of community or building a company culture. Some voices have been certain that the office as a concept will not survive the pandemic. I dare to state the opposite – the concept of the office will not be rendered obsolete.

In the history of humanity, the office is a relatively new phenomenon driven by our urge to enable communication, increase efficiency and fulfill the organization's goals. The office also works like a glue in sticking the individual pieces together, by offering a physical place where the members of an organization socially interact with one another to build the company culture and enforce its core values.

I strongly believe that the office will hold even more importance in terms of a company's competitiveness going forward. Having the right kind of office in the right location will be key to attracting and retaining the most sought after employees. And after all, the employees are one of, if not the most, important asset of an organization. We will surely see continued developments and new usages as our behavior changes, but I am certain that the office will continue to evolve and meet our needs. As Mark Twain put it: "the reports of my death are greatly exaggerated".

With that, I wish you an interesting read!

Max

Max Barclay,
Head of Newsec Advisory

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PROPERTY IN UNCERTAIN TIMES

Klas Eklund, Senior Economist, Mannheimer Swartling

We live in strange and turbulent times. In 2020, the economies of all Nordic countries contracted. Still, their property markets showed strong resilience – both prices and transaction volumes. The main reason was strongly expansionary policies in all countries. Asset markets – both stocks and real estate – are supported by monetary policy, in particular negative real interest rates. Thus, an analysis of future developments must factor in actions from central banks to a larger extent than usual. The basic forecast is continued strength of the property markets in 2021 and 2022 – but with downside risks in the longer run.

Wild swings

The economic development in Europe showed strong gyrations in 2020, as the pandemic spread and lockdowns followed. There was a sharp contraction in Q2, a bounce-back in Q3, and then a second slowdown in Q4, leading to a new, but milder contraction in Q1 of 2021. The pattern, consequently, has been similar to a W, with the second downturn less severe than the first.

Differences between sectors and countries have been large. Manufacturing has fared better than services. A number of countries like the UK, Spain and Italy on the one hand contracted by some 10 per cent in 2020. On the other hand, the Nordics did better, with GDP shrinking by 2–4 per cent. Bad numbers, but not as abysmal as was feared in the spring of 2020. Strong support from fiscal and monetary policy gave relief. By year-end, nominal key rates were negative in both Finland and Denmark, and zero in Norway and Sweden. Thus, real rates were negative in all countries. Central banks also pursued QE, quantitative easing, meaning they bought large amounts of bonds to press down market yields. 10-year real government bond yields are negative in all countries. In all four Nordic nations, fiscal policy also turned expansionary last year, with budget deficits rising. →

»There is a good chance that growth numbers, in particular for private consumption will be strong in 2022«

These efforts supported asset markets. After the initial fall of stock markets as the pandemic broke, monetary support made equities bounce back and stocks reached all-time highs by year-end. Real estate markets were resilient in all four countries throughout 2020, and segments of the markets reached all-time highs. Transaction volumes were also strong, in several cases also surpassing previous peaks.

Looking ahead

The outlook is uncertain. A gradual recovery is the baseline scenario, but there are upside as well as downside risks which are impossible to quantify. On the one hand, vaccines are being rolled out and pent-up demand may be unleashed as a return to some kind of normalcy ensues. On the other hand, there is a risk of a third wave of infections and lockdowns, as new forms of the virus emerge and vaccination is delayed.

While this creates uncertainty in the short to medium term, we also encounter uncertainty concerning structural changes as a result of the downturn and technical change. Digitalization has taken a leap forward, affecting shopping, working, living and commuting. This will have consequences for real estate.

A reasonable starting point is that the first quarter of 2021 will prove to be weak, and that the cycle bottoms out in the second quarter. This would imply an upturn during the second half of the year. This could be brisk as households spend more of the savings that have been amassed during the lockdowns, and as corporates increase investments again. There is a good chance that growth numbers, in particular for private consumption will be strong in 2022.

However, the expected upturn starts from a low level of capacity utilization, with high unemployment. In this respect, annual numbers for the whole of 2021 may not look particularly strong, even if growth rates per se will be high during H2. Sticky unemployment means that economic policy will remain expansionary throughout all of 2021. Key rates will stay low.

This will continue to support asset markets. The question that will arise is whether the boom has gone too far. Equity valuations are indeed very high: for the US S&P 500 the p/e ratio is now the highest since 1929 (after which came the stock market crash) and 1999 (after which followed the IT crash). No wonder some investors are starting to fret, searching for alternative investments, creating froth in subsegments of risky assets.

However, if we study historical yields, we find that this peak is different. Real bond yields are negative – at the same time as inflation is extremely low. Thus, it would seem that the key to high equity valuations is the low level of interest rates. With rates as low as today, it is not difficult to justify high equity valuations.

Inflation?

Will rates remain low? This raises the issue of inflation. For years, inflation has stayed low; in most countries (including the Eurozone) clearly below inflation targets. Now, however, the combination of a possible strong cyclical rebound and massive increase in liquidity has raised the specter of inflation. American bond yields have started to move up – albeit from low levels. A return of inflation obviously would have massive repercussions on bond yields – and real estate.

In the spring of 2021, consumer prices (CPI) are rising sharply in most advanced economies. But this is a temporary phenomenon, caused by "base effects". Firstly, the pandemic is changing the weights of different consumption items in the CPI basket. Secondly, a year ago, oil prices collapsed. Now both oil and other commodities are rising again, and as last year's negative values fall out of the 12-month statistics and are replaced by positive numbers, reported prices on an annual basis automatically rise. In several countries, CPI will reach 2 per cent or above.

But this is a one-off effect, which will ease as soon as more new numbers are incorporated into the 12-month series. The consensus view is therefore that inflation will fall back, due to low capacity utilization. So in H2, inflation numbers should be back down to low levels again. But looking further ahead – into 2022 and 2023 – raises several uncertainties.

Wages have historically been a primary driver of costs and inflationary pressure. Given that unemployment is high and capacity utilization low, it is difficult to see any rapid, cost-inflating rise in wages in the near future. A more difficult issue is that of the massive liquidity stimuli from central banks. Traditional monetary theory claims this should be inflationary. But so far, we have not seen any inflationary impulses.

Photo: iStock

How will central banks react?

That may change as capacity utilization picks up. The combination of rising capacity, liquidity and perhaps rising inflationary expectations could very well end the period of ultra-low inflation. As we move into 2022, inflationary pressures gradually may start to increase. For whatever it is worth, I believe that inflation will see a short-term spike in H1, fall back in H2 2021, but then gradually climb from 2022. This process will be stronger in the US, because of more rapid growth and more expansionary policy.

Central banks will not react to the spike in H1 by tighter policy. They will, rightly so, see the uptick as temporary. And my guess is that they also will be reluctant to hike key rates even if inflation starts to move up in 2022. The reason is the huge pile of debt which might unleash a financial crisis, should rates be hiked too rapidly. Also, the Fed and some other central banks clearly have stated that they will accept somewhat higher inflation, partly as a compensation for many years of undershooting inflation targets. Instead, they will attempt to hold down market rates via "yield curve control", which in essence means further interventions on the bond markets.

Thus, from 2022 on, I presume inflation in the US will rise somewhat, but nominal interest rates will stay low, rising only slowly. Bond yields will move higher than short-term rates; yield curves will steepen. Europe will lag, but here, too, the same forces will gradually materialize. As a result, real yields will stay negative in most countries – preserving favourable conditions for asset markets.

But there are inherent risks in this Goldilocks-situation. Inflation may suddenly pick up – and markets rate as well, threatening confidence in central banks' abilities to handle the situation.

So: my base case with regard to monetary policy is one of beneficial conditions for real estate for yet another year or two, but with increasing risks of a set-back.

Structural changes

This general picture should be complemented with a realization that real estate also will be influenced by technological and demographic trends which intensified during the pandemic.

Digitalisation took a quantum leap, with e-commerce and working from home. Travelling patterns – both long-range and commuting – changed. Sure, many office workers will come back after the pandemic, but working from home has nonetheless proved to be an efficient complement. We can therefore expect demand for extra space at home to increase. Demand for co-working space in residential areas may also increase. As a result, there will be – ceteris paribus – a movement out from city centers and smaller apartments, to bigger houses in suburbs and smaller towns.

On top of this, we have seen another, unexpected and possibly temporary effect of the pandemic. As more people work from home and have been hampered by lockdowns while services like restaurants and travelling have been restrained, some households have started to spend more on housing consumption; rejuvenating, decorating and refurbishing.

The Nordics

These trends apply also to the Nordic region. In 2020, the four Nordic countries – Denmark, Sweden, Norway and Finland – all suffered recessions, but less severe than continental Europe. Initially, Norway was hardest hit, given its dependency on oil and gas – the →

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prices of which tumbled. With regard to political reactions, Sweden was the odd man out, initially implementing weaker restrictions and more lenient lockdowns. The number of infected and dead turned out higher than in the neighbouring countries, while it is difficult to see any beneficial effects on Swedish economic performance.

With regard to monetary policy, Finland is a member of the Eurozone, while Denmark has a fixed exchange rate to the euro. Both Sweden and Norway have floating national currencies. All four countries have strong fiscal positions. As a result, they have all been able to undertake strong supporting policy measures.

Denmark

Denmark quickly chose a hard line in closing down part of its economy as the pandemic hit. That hurt both GDP and the housing market. However, both bounced back in the autumn of 2020, and the long period of rising real estate prices took a new optimistic turn.

The Danish economy managed better than most in 2020. The reasons were swift measures to prevent the virus from spreading, a diversified export sector (including both foods and pharma), and financial resilience courtesy of a strong savings buffer. Government support schemes worked well. Consumption was stimulated by one-off disbursements. At the end of the year, though, Denmark suffered a new virus scare as a mutation came from minks. New lockdowns were imposed in Q4 of 2020, which is hurting the economy going into 2021.

As vaccination spreads and if the virus is contained, pent-up demand should mean a strong rebound. As the krone is tied to the euro, but in the stronger part of the trading band, the National bank has room for a small rate cut.

As a result, the real estate market is expected to stay strong. Bubble risks are contained by a slew of macro-prudential regulations, e.g tougher credit standards and higher required down payments.

Finland

The Finnish experience is similar to the Danish. A quick and decisive lockdown in spring of 2020 contained the contagion and made a gradual opening up possible during summer. As a result, the GDP contraction was less than half that of fellow euro member states. Within manufacturing,

»In general, the Nordic countries have fared better than countries on the continent«

structural ailments in the forestry and pulp industry hurt.

Restrictions in services have held back household consumption, but as they are lifted, pent-up demand is expected to cause a strong upturn. Construction has turned up. Key interest rates remain negative and the Financial Supervisory Authority has raised the cap on home loans.

Finland is a member of the Eurozone, meaning that monetary policy is set in Frankfurt and is based on the performance of the entire Eurozone, not just Finland. More specifically, this means that the refi rate will stay low for long, even if inflation were to gradually rise.

This will contribute to another strong year on the housing market. But urbanization and migration to the Southwest is causing house prices to diverge, with asset prices and wealth rising primarily in the greater Helsinki area.

Norway
For years, Norway's housing market boomed, driven by strong demand, not least from rising incomes in the oil and gas sector. Disposable household incomes have doubled since the start of the millennium and borrowing costs have fallen. Norway is now by far the wealthiest country in the Nordic region.

Since Norway is not an EU member, Norges Bank is independent, and the krone is floating. Due to inflationary pressures from the commodities sector, key rates historically have been higher than in neighbouring countries. However, when the corona pandemic struck, a strict lockdown was rapidly enforced at the same time as commodities prices collapsed. Norway was hit by a double whammy. Construction was scaled back.

Still the housing market turned out to be strong in 2020. One reason was swift action by the central bank, which cut its key rate to zero – the same level as in Sweden. This gave a new boost to real estate and weakened the krone.

Looking ahead, Norway will probably be the first country to hike key rates, maybe even before the end of 2021. The central bank is afraid of over-heating and high debt levels. Possibly, this will mean a slower growth of real estate and house prices. An outright fall is less likely, as underlying demand growth still will be strong.

Sweden
Sweden is the largest economy in the Nordic region. Although authorities employed a lighter hand in applying corona restrictions than its neighbours, the economic outcome was roughly the same in 2020, i.e a sharp drop in Q2 followed by an autumn bounce-back. When the second wave of the virus came, at year-end, the Swedish strategy was no longer an outlier, as the government started to apply the same kind of restrictions as in the other Nordics. All in all, growth in 2020 came in at minus 3 per cent, which is the average for the region.

Fiscal policy turned expansionary. The Riksbank kept the repo rate at zero throughout the year and intensified quantitative easing. This supported real estate, which despite the pandemic showed a stellar performance, with strong price increases and record-setting transactions.

The Swedish economy is expected to rebound in H2 2021. The Riksbank is still expected to keep rates low for the remainder of 2021 and 2022. The bank has signaled it will pursue a similar strategy to that of the Fed and the ECB, i.e to allow inflation to gradually crawl up, without hiking rates in advance. This is a positive signal to the real estate market. However, the Financial Supervisory Authority has said it wants to re-tighten amortization rules which were relaxed during the pandemic. The net effect is nonetheless a continued strong real estate market.

All in all
The major European trends also characterize the Nordic region. But in general, the Nordic countries have fared better than countries on the continent. The health care systems are universal and well-funded. Public finances are sound. Low interest rates have supported asset markets in the midst of the pandemic.

Looking ahead, these trends will continue. Falling savings ratios may cause strong growth in 2022, too. The two major risks are that 1) a third wave of the pandemic will cause new lockdowns and a new recession, 2) that a bout of inflation and rising inflationary expectations would force central banks to abandon their low interest rate strategies. That seems less likely today. But the Norwegian central bank will nonetheless cautiously prepare to start raising rates from the zero lower bound.

THE DEATH OF THE OFFICE HAS BEEN GREATLY EXAGGERATED

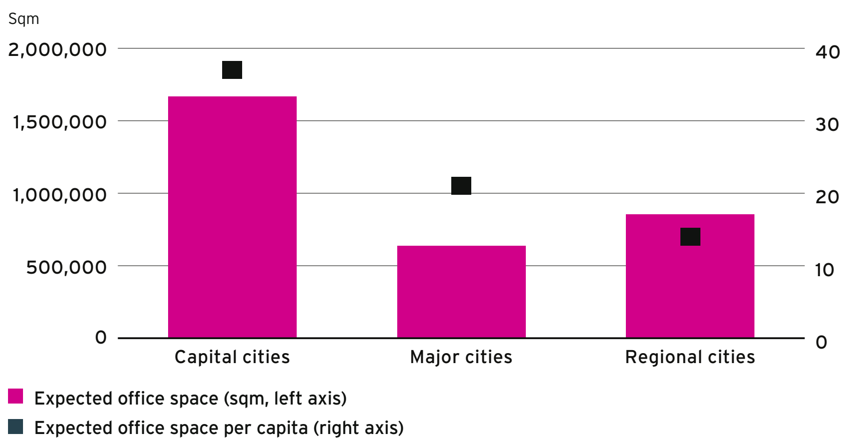
Just shy of one year ago, soon after the pandemic begun to escalate, Twitter was one of the first companies to announce that they would move to a permanent work-from-home model, which would extend beyond the end of the pandemic. Many other companies, including a number in the Nordics & Baltics, were quick to follow suit, and virtually every company in the region has adopted some form of remote working in 2020 and 2021. This has led some to believe that the suit & tie era of commuting to a physical office is under pressure, and that the future of the office market is bleak. In this edition of the Newsec Property Outlook, Newsec looks at some of the changes that the future holds for office space, and highlights a few lesser known trends that will come to impact the office market – in markedly different ways than those that are currently the talk of the town.

1. The rise of the regional city

Over the past few years, Newsec has highlighted the positive net internal migration that regional cities have been experiencing in the Nordics. Since 2016, net internal migration to the capital cities in the Nordics has been negative, and since 2019, even the Greater Metropolitan capital regions have seen negative net internal migration. Meanwhile, net internal migration to the regional cities has remained positive. In 2020 and early 2021, this trend has strengthened further, with a fall in international migration meaning that many of the Nordic capitals have seen their population decline for the first time in decades. This trend has naturally been influenced by covid-19, but in the long-term is being driven by a changing family cycle, a perceived rise in crime and lack of safety in major cities, and generally changing preferences.

Office developers have not been particularly influenced by this trend. Diagram (1) shows the office space currently under development, that is set to be completed in 2021 and 2022. The graph clearly shows that both in absolute terms, and on the per capita level, capital cities are expected to see around twice as much development as regional cities, with major cities also being well ahead of regional cities.

1. Office space under development



Definitions

Capital cities
Stockholm, Oslo, Copenhagen, Helsinki, Vilnius, Tallinn, Riga

Major cities
Gothenburg, Malmö, Bergen, Trondheim, Stavanger, Turku, Tampere, Aarhus, Odense, Kaunas

Regional cities
All other cities with a population above 50,000 in the Nordics & Baltics

This is despite many internal migrants, who tend to be more qualified and prone to office work than international migrants, flocking to the regional cities. While some of these workers will work from home, and others might commute to the head office in a larger city a few times a week, Newsec can still clearly identify a continued need for modern, attractive office space in regional cities that is not currently being met.

Of the regional cities that do have expected office space under development, cities like Lund, Vaasa, Kristiansand and Tartu come out on top, while others like Eskilstuna, Jyväskylä, Fredrikstad/Sarpsborg and

»Newsec can clearly identify a need for modern, attractive office space in regional cities that is not currently being met«

Photo: iStock

Aalborg have relatively little planned new production of office space. This is despite the latter cities generally experiencing strong inflows of internal migration, and having relatively young populations.

Further, in most regional cities, market rents are between 10-15% higher for newly produced office space than existing grade A office space, and in some regional cities can skew even higher. This is partly because much of the existing office stock is generally not as modern as in the major cities, because renovations are not substantially cheaper than in the major cities, despite rental potential in absolute terms being more limited. This in turn means that the gap in quality between the existing office stock and new production is wider. In addition, there is also more prestige attached to sitting in the few newly produced office buildings that are produced, and vacancy rates tend to be low. This results in newly produced properties often being fully let before completion, as was the case in e.g. the office and retail project in Kuopio, Finland, which Lapti sold to Aberdeen Standard Investments in early 2021, where Newsec advised the seller. Hence, there is a strong case for new production of office space in regional cities, as it is easy to rent out new space in these areas to tenants at strong rental levels.

Should more actors look to build in regional cities, the transaction market will be impacted, too. Currently, the transaction market in many ways mirrors the office development market – with the capital and larger cities being red hot, while demographically strong cities like Östersund and Oulu see little activity. As a result, there is clearly a lot of untapped potential in Nordic regional cities – for both developers and investors alike.

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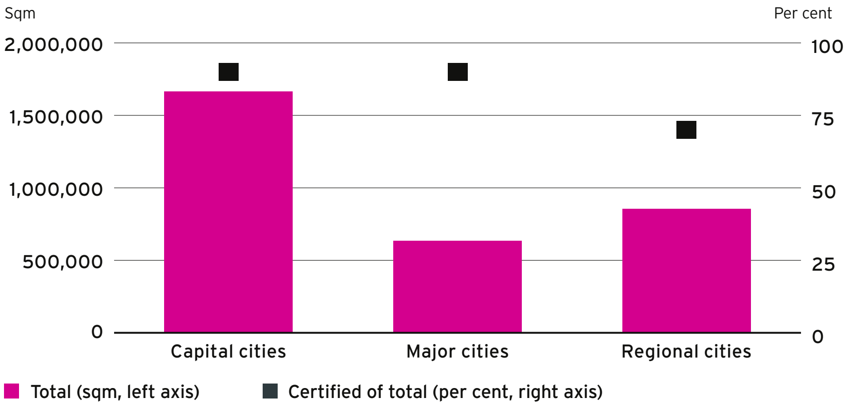
»Investors and tenants increasingly require office properties to be environmentally certified in order to even consider a purchase or tenancy«

2. Sustainability – a mainstay on the office market

While regional office markets have strong potential to thrive, other trends are also increasingly impacting the market. One such trend is environmental sustainability, with different types of environmental certifications rising substantially in popularity over the past few years, and quickly developing into mainstays on the commercial property market. This is shown in diagram (2). Today, virtually all office space being produced in capital and major cities is environmentally certified, and a lower amount (though still the majority of space) in regional cities is certified. This further increases the attractiveness of the relatively few modern, environmentally certified office buildings produced in regional cities.

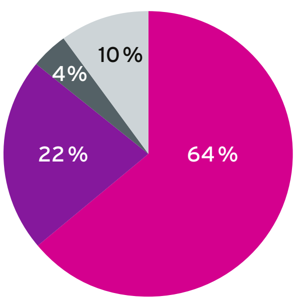
2. Environmentally certified office space under construction



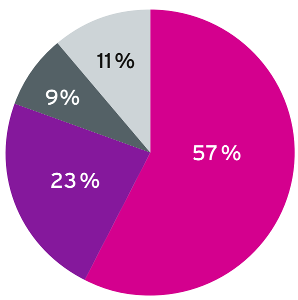
Investors and tenants increasingly require office properties to be environmentally certified in order to even consider a purchase or tenancy. Indeed, Newsec has identified a clear rise in retrograde certification of existing properties, as well as a rise in green tenancy agreements and green financing. The importance of green financing in particular has risen substantially, as sustainability-linked and other forms of green loans allow for more favourable financing possibilities. As of year-end 2020, 59 per cent of all listed Nordic property companies have issued green bonds. 62 per cent of listed companies have set up a framework for green financing, the majority having occurred in 2019 or 2020. These green loans can either be linked to specific green goals or projects as set out in a green framework (e.g. many Nordic & Baltic companies adhere to the Green Bond Principles), or linked to the company's own goals in terms of sustainability, ESG or a specific project. This has indirectly led to increased prevalence of certification among newly produced office buildings, often required to fulfill ambitious green financing requirements. As a result, in a number of the Nordic & Baltic countries, Newsec has noted evidence of a green premium being paid among large international corporations for environmentally sustainable space. As green financing and sustainability agendas continue to grow in prevalence, it seems inevitable that environmentally certified office space will continue be sold at a premium, and attract higher rents, than any non-certified grade A office space in the entire Nordics & Baltics.

Which types of environmental certifications are developers going for in the Nordics & Baltics? Of the total existing certified office stock, just over 60%

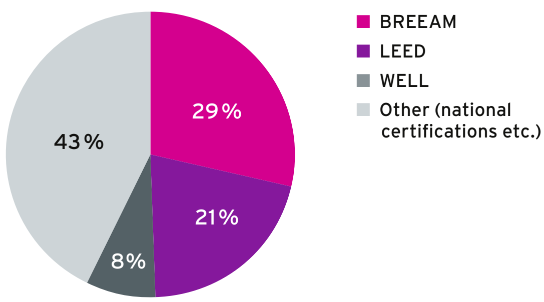
3. Capital cities



4. Major cities



5. Regional cities



»Newsec expects international certifications in particular to rise further in popularity, in step with globalization and international investor interest for the Nordic & Baltic property market«

of office properties are certified with national certifications. However, the popularity of different certifications for office properties currently under construction is shown in diagrams (3), (4) and (5). BREEAM is the most popular certification for office properties under construction in capital and major cities, while in regional cities, where perhaps the brand appeal of BREEAM and LEED is perceived to be more limited, national certifications tend to be more popular. International certifications account for 90% of certifications for coming projects in capital cities, and 58% in regional cities. The WELL health certification remains the least popular of the three major international certifications, but is rising in importance as more developers seek to both health and environmentally certify their projects. Newsec expects that certain forms of certifications will become more attractive than others to investors going forward.

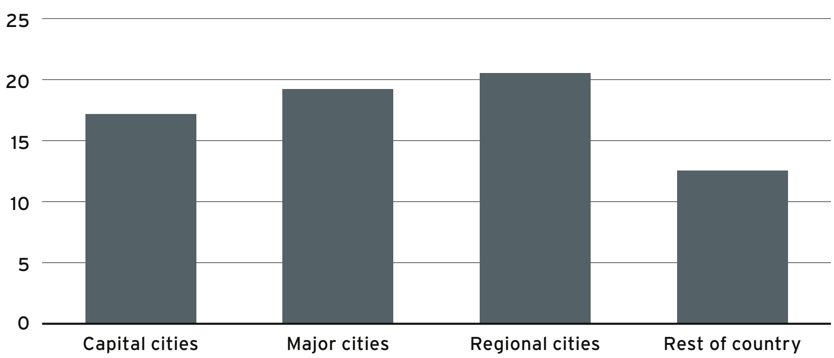
What does the future hold in terms of sustainability on the office market? Environmental certification is a product of the wider sustainability drive in society today, and this is likely to continue to intensify in the Nordics & Baltics. Newsec expects international certifications in particular to rise further in popularity, in step with globalization and international investor interest for the Nordic & Baltic property market. Among international purchasers, these certifications in particular are likely to carry an increasing green premium in the long-run. Properties with both environmental and health certifications are likely to thrive, while property owners of older properties will continue to play catch-up and invest increasingly in retrograde certification.

Photo: i Stock

3. The office market of the future

Closely connected to the sustainability of office space is the degree to which this office space is being used in efficient ways. Diagram (6) highlights the usage of office space per worker in different regions in the Nordics & Baltics. The average worker in the Nordics & Baltics has 18 sqm available to them. This is despite the most modern office space being closer to 10 sqm per office worker or lower. The average space available per worker, both overall and in modern office space, is set to decrease further in the long-run, as offices become even more efficient. Newsec notes a slightly higher amount of office space per worker in the major cities, and the highest in the regional cities, owing to inefficiency and a lot of potential to build or repurpose into more modern and effective office space. The lowest amount of office space per worker is found outside of the cities, where traditional office work is performed from home, from a makeshift office, or other non purpose-built

6. Average sqm of office space per worker



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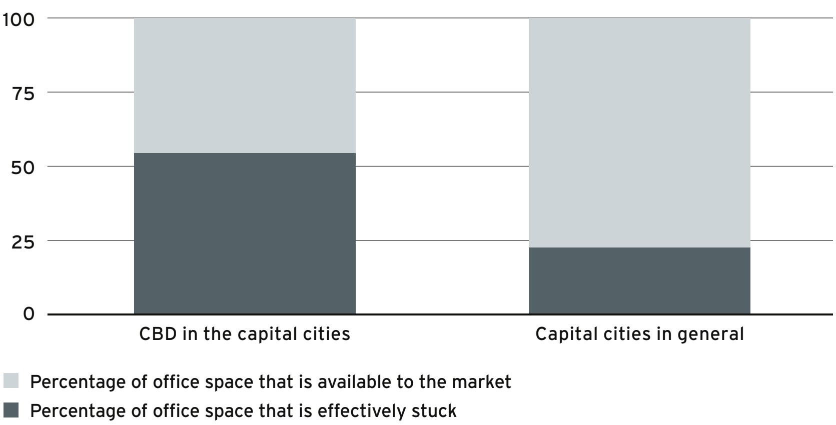
»Newsec expects that most employees will work from the office for 3–4 days a week post-pandemic, meaning that offices will continue to play a prime role in the society of the future«

commercial space. Somewhat paradoxically, as a result of missing out on many of the different waves of office development (e.g. cellular offices), office space in rural areas is in some ways the most efficient of all, in that it does not exist in abundance.

Beyond an increased drive for efficiency and sustainability, though, what does the future of the office market hold, and how will an increased propensity to work remotely impact it? Some parts of the office market will suffer. Office space in some outer suburban areas, with poor access to public transport and services or in socio-economically vulnerable areas, is likely to be increasingly consolidated or converted into other uses. Equally, Newsec believes that some office market subsegments remain underdeveloped, and that with the right market knowledge, office investors will continue to prosper. This is because the office as a concept will continue to fulfill a number of key functions, particularly in terms of allowing for the exchange of ideas, scrum space, and certain types of deskwork. However, office space needs to be flexible and adapted to match the rapidly changing needs of modern tenants. Further, shorter and more flexible leases with more meeting spaces (and less fixed workspaces) are likely to be required, as well as a number of smaller meeting rooms, to enable e.g. video meetings to take place from the office. For employers, employer branding and culture is also likely to become even more key. New office clusters are under development in all of the Nordic & Baltic countries, and where this office space meets the above requirements and has access to public transport links, it is likely to be successful. Newsec expects that most employees will work from the office for 3-4 days a week post-pandemic, meaning that offices will continue to play a prime role in the society of the future.

While the office of the future will certainly be more efficient, the office market as a whole is also likely to look different to today. The average office transaction is increasing in size, and existing property owners are growing larger, while the absolute number of office transactions continues to fall.

7. Office space available to the investment market



In 2020 and so far in 2021, institutions have been the second largest purchaser, but have accounted for a very small amount of sales. The impacts of these long-term trends are shown in diagram (7). The diagram shows the % of the office stock in the capital city CBD's, and in the major cities in general, that is effectively "stuck." This office stock is controlled by pension funds, institutions and other very long-term investors who have sold less than 10% of their office stock in the past 5 years, who are highly unlikely to divest. As can be seen, in the capital cities in the Nordics & Baltics, over 50% of the office stock is controlled by such actors (highest in Oslo at 67%, and lowest in Stockholm at 47%), while in the major cities in general (including outside the CBD), over 20% of the office stock is effectively stuck in this way.

In the future, Newsec expects long-term investors to further increase their presence on the transaction market. The allocation strategy among pension funds is likely to increase from today's ~12% to closer to 20% of capital being allocated towards properties. If allocation were to reach 20% and be proportionally spread across the segment around the Nordics & Baltics, 40-50% of the office stock will be owned by long-term actors in the capital cities, as well as almost all of the office stock in the CBD's. Since offices account for over a quarter of the annual transaction volume in the Nordics & Baltics, a change like this could lead to increased turnover of the remaining office stock. Less office properties being accessible to investors could also lead to a lower overall transaction volume, or higher transaction volumes within other segments.

»The transaction volume in the Nordics & Baltics as a whole was comparable to that noted in the UK in 2020 – despite the population in the region being roughly half of the UK«

4. Offices stand strong

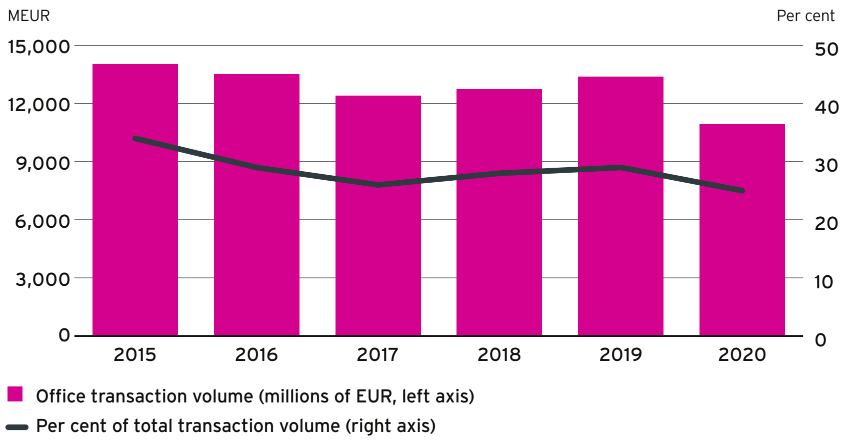
Despite all the talk of transformation and change, the office market has generally remained robust in the Nordics & Baltics throughout 2020 and so far in 2021. Diagram (8) shows the transaction volume on the office market. The volume in 2020 saw a slight decline, but still remained mostly in line with the historical average, both in absolute terms, and in terms of the percentage of the total transaction volume that the office segment accounted for in the Nordics & Baltics.

A number of large office transactions have served to drive up the transaction volume in the Nordics & Baltics in 2020, with 2021 set to bring many more major office acquisitions. A prime example of a recent major transaction is Reinvest's acquisition of the newly produced SEB HQ in the Vilnius CBD in Lithuania in December, in a record transaction for the Baltic market, where Newsec acted as adviser for the seller Lords LB Asset Management. The other Baltic markets, as well as the Norwegian market in particular have also been active in 2020 and early 2021, with 50 bps drops in yields in Norway over the past year, as well as a number of record-breaking office transactions. Investor interest for the office segment since covid-19 hit has also remained substantial in Denmark, Sweden and Finland, although single property transactions have been a little smaller in size.

In general, interest in the commercial property market in the Nordics & Baltics was very strong in 2020. The total transaction volume ended up at EUR 44.6 billion, in line with the historical average - an exceptionally strong result, given the turbulent year that 2020 was. This means that the transaction volume in the Nordics & Baltics as a whole was comparable to that noted in the UK in 2020 – despite the population in the region being roughly half of the UK. The volume in Sweden was not too far off the French transaction volume – even though France is six times larger than Sweden in terms of population. Amid all of this, early indications for 2021 are that the Nordic & Baltic market has yet another strong year ahead of it, with Newsec expecting record volumes of SEK 225 billion in Sweden, NOK 120 billion in Norway, strong volumes in the other countries, and a record EUR 50 billion in the Nordics & Baltics as a whole.

The office looks set to remain an attractive investment for a broad range of different kinds of investors going forward – as long as it is located in the right place and managed in the right way. Are you unsure of how to meet the needs of the future in your office portfolio, or are you struggling to identify which office submarkets are likely to outperform others in the long-run? Newsec, the full service property house, is always here to help you make sense of the Nordic & Baltic commercial property market.

8. Office transaction volume



Country	2020 transaction volume (bn of euros)
1 Germany	59.8
2 UK	48.7
3 France	28.2
4 Sweden	18.0
5 Norway	10.6
6 Netherlands	10.4
7 Denmark	9.3
8 Italy	8.8
9 Spain	7.7
10 Finland	6.0

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THE SWEDISH PROPERTY MARKET

AN INCREDIBLE END TO 2020 – WITH MORE TO COME IN 2021

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2020 was an unusual year for Sweden, much like for the rest of the world. The covid-19 virus had substantial impacts on the Swedish economy, which ended up contracting by 2.9 per cent – one of the best performances among the major economies in Europe. Though this was a less severe contraction than initially expected, there were still clear impacts on e.g. unemployment, which rose by around two percentage units throughout the year. The relatively light restrictions instituted in Sweden contributed to the economy outperforming much of the rest of Europe, though the other Nordic countries, which introduced more severe restrictions, performed similarly to Sweden. Inflation remains below the goal of 2.0 per cent, but the Swedish Riksbank is likely to leave the key interest rate at 0 per cent for the foreseeable future despite this. In 2021, the Swedish economy is expected to rebound and grow by around 3.5 per cent. This will entail a strong recovery, though pre-covid levels of GDP are not expected to be reached until 2022. Naturally, the strength of the recovery will continue to indirectly depend on epidemiological considerations in Sweden and abroad, as well as the success of the vaccination process and return to relative normality that follows.

Despite a shaky economy, the Swedish real estate market performed incredibly well in 2020. The transaction volume in 2020 ended up at SEK 189 billion – the third strongest year on record by some margin. Q4, with a volume of SEK 82 billion, ended up being the strongest quarter of all-time in Sweden, breaking the previous record of SEK 74 billion set in Q4 2016. As such, it is clear that market sentiment in Sweden is currently very strong. A number of major transactions have already been completed in 2021, and many more are currently being initiated and likely to be completed in Q2 and later throughout the year. As a result, 2021 is set to be yet another very strong year for the Swedish transaction market – with Newsec expecting a new record transaction volume of SEK 225 billion.

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»2021 is set to be yet another very strong year for the Swedish transaction market - with Newsec expecting a new record transaction volume of SEK 225 billion«

Interesting occurrences on the Swedish property market in 2020 and 2021

LOGISTICS STEPS UP AND BECOMES THE SECOND LARGEST SEGMENT

After a number of major investment deals were completed in Q4, logistics crept past offices and became the second largest segment on the transaction market in 2020. The segment accounted for 18% of the total transaction market, which can be compared to 16% for offices, and 33% for residential. International investors have shown particular interest in logistics and accounted for around half of the transacted volume in 2020. With further growth in e-commerce all but guaranteed, the future looks bright for logistics.

RETAIL HAS A STRONGER YEAR THAN EXPECTED

Despite the doom and gloom that perpetuates the retail sector in the media in particular, retail transaction volumes in 2020 and thus far in 2021 have been stronger than many would expect. After accounting for just 6% of the total transaction volume in 2019, the segment strengthened in 2020 and accounted for 9% of the total volume. While this is a far cry from record years of the past, it still signifies a strong recovery for the segment, despite covid-19. The strength of the segment has been particularly driven by big box and retail park investments, which have continued to attract strong interest from consumers and investors alike.

SEK 189 BILLION
Total investment volume in 2020

SEK 225 BILLION
Total investment volume expected in 2021

+3.5%
GDP growth expected in 2021

INVESTORS LOOK TO REGIONAL CITIES

As new segments have gained in popularity, so too have new investment locations around the country. "Other major cities" and the "rest of Sweden" together accounted for just shy of 50% of the total transaction volume in 2020, and have had a strong start to 2021 as well. This is largely a result of many public properties, residential properties and logistics properties being located in less traditionally core areas. As these segments continue to rise in popularity, it is likely that investment activity will persist outside of the three major Swedish cities.

INTER-NORDIC INVESTMENT REBOUNDS

After a relatively quiet 2019, so-called inter-Nordic investment was once again very strong in 2020. Foreign investment in total accounted for 27% of the Swedish transaction volume, and just shy of half of this comprised purchases made by Norwegian, Finnish, and Danish investors. This means that 13% of the total transaction volume in 2020 in Sweden was made up of Nordic investment. Newsec expects inter-Nordic interest in the Swedish market to remain strong in 2021.

M&A DEALS ABOUND

For some time now, Newsec has forecast that M&A deals will continue to rise in prominence. Indeed, in 2020, M&A acquisitions accounted for over SEK 20 billion of the total transaction volume in Sweden. While there was no single enormous acquisition in 2020, the year still saw a number of major deals, such as e.g. Fredensborg's acquisition of the Veidekke property development arm, SBB's acquisitions of Offentliga Hus and Sveafastigheter, and Balder's acquisition of Masmästaren. Looking to the future, M&A activity on the Swedish and Nordic markets is likely to intensify further.

THE NORWEGIAN PROPERTY MARKET
WHAT A YEAR IT HAS BEEN – WHAT'S NEXT FOR NORWAY?

Covid-19 had a strong impact on Norway in 2020, with the Norwegian economy contracting by 3.6% in 2020. The recovery continued until the end of the year and initial projections were outperformed, however, as the virus caught traction towards the end of Q3 and more so during Q4, the economy recovered at a slower pace than projected. In 2021, GDP growth is expected to increase substantially by 2.6%, and a strong growth is also expected in 2022. However, a full recovery of the economy is not expected until the autumn of 2022. The substantial fall in consumption that took place in 2020 will thus be offset by savings and an increased growth in the coming years. An increased activity among Norway's trade partners will lead to an increase in export and economic activity. The infection rate is expected to go down in the first half of 2021, and as vaccination is progressing, the economy will hopefully experience an accelerating recovery. The interest rate is expected to be kept at the 0% level, but increases are possible in the coming years, although not expected in 2021. Inflation has been pushed down because of the crisis but is again being driven up by growth and a weaker currency. The level of unemployment is projected to increase in Oslo and will flatten out at a level of 8%, rising from the current 7.3%.

The commercial real estate market also saw a turbulent year with a record start and a deep fall as the pandemic spread across Europe. The end of the year experienced a strong rebound and once the dust settled a transaction volume amounting to NOK 113 billion was recorded, which is slightly below the record year of 2015 when the transaction volume amounted to NOK 120 billion. The intensity on the transaction market was high and the number of transactions in 2020 was far higher than in the record year of 2015, ending with 323 completed transactions compared to 198 in 2015. This shows the high, increasing liquidity on the Norwegian real estate market. Access to capital and financing has continued to be easy, both because investors are on the lookout for alternative investments, and due to an active and functioning capital market, as well as a continued willingness among banks and other market actors to issue debt because of low interest rates. The transaction market ended 2020 red hot and going forward the projection for the transaction volume in 2021 is in line with the record year of 2015 at NOK 120 billion.

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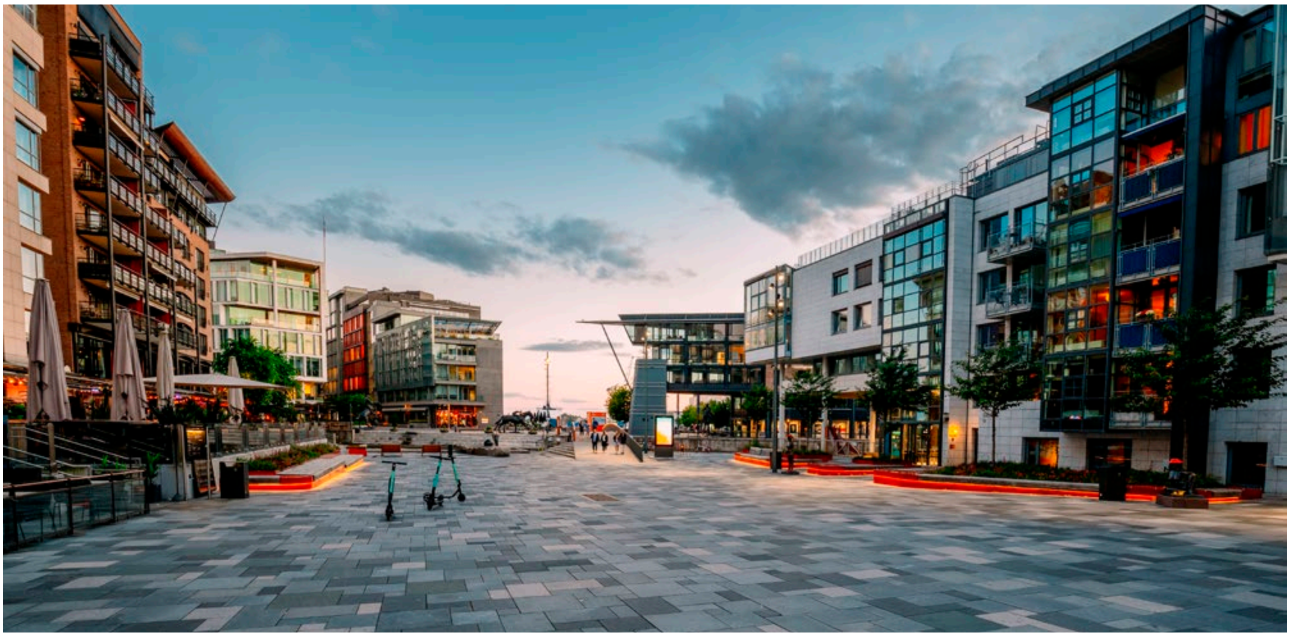

Photo: Shutterstock

»The intensity on the transaction market was high and the number of transactions in 2020 was far higher than in the record year of 2015«

Interesting occurrences on the Norwegian property market in 2020 and 2021

NOK 113 BILLION
Total investment volume in 2020

NOK 120 BILLION
Total investment volume expected in 2021

+2.6%
GDP growth expected in 2021

YIELD COMPRESSIONS ON THE OFFICE MARKET

Although the turbulent year left many offices empty, in Norway the segment did well and experienced yield compressions, which is quite an unusual occurrence when compared to the rest of Europe. In Oslo, the average office rent ended the year at the highest levels since 2008, at NOK 2,470 per square meter.

A STRONG RENTAL MARKET WITH AN EXPECTED INCREASE IN TENANT MOVEMENT

Over the past year, many contracts have been re-negotiated, with property owners giving discounts today but in return receiving higher rents and longer contracts in the future. This has pushed property values upwards. Once again, Newsec has observed that investors attach a premium to stable tenants and stable cashflows, and although returns have fallen, a lack of alternative investments has led to yield compressions. This is because a low risk investment might not yield that low of a return, meaning that relatively speaking properties as a segment are highly attractive (this applies especially to buildings in prime locations). The office market in Norway is all in all one of the most attractive and stable markets in the Nordics, after the bizarre year of 2020.

LOGISTICS IN THE SPOTLIGHT

Among the segments that experienced a strong year, one of the hottest is without a doubt logistics which has seen a yield compression and has also sent international investors on a shopping spree. This led international investors to become slight net buyers in 2020, compared to previous years when international investors have been clear net sellers.

STRUGGLE FOR MALLS AND SUCCESS FOR GROCERIES

As shopping goes digital, retail has been struggling and has been the hardest hit real estate segment in the crisis of 2020 and thus far in 2021. Parts of the segment such as malls and other retail are expected to continue to have problems throughout 2021, although areas which typically lose customers to cross-border shopping have experienced a slight increase in sales in some cases. As the crisis and the consumer behaviour shift continues, malls are expected to continue their struggle to survive. On the other side of the segment, grocery stores are doing well and supermarkets are considered highly attractive tenants, meaning an increase in transactions in that sub-segment is expected in 2021.

THE DANISH PROPERTY MARKET

STRONG RECOVERY IN Q4 TURNED 2020 INTO A SATISFYING YEAR

Photo: Shutterstock

The Danish economy contracted sharply in Q1 and Q2 and unemployment rose from 3.6% in February to 5.5% in May. Restrictions were briefly relaxed during the summer, which led to a rapid economic recovery and a drop in unemployment in Q3. However, due to a second wave of covid-19, infection lockdown was reimposed in Q4 and restrictions tightened further at the beginning of 2021. GDP is estimated to have fallen by approx. 4% in 2020. The economy is expected to start growing again in 2021 with GDP increasing by approx. 2.9%. The Danish government has financial leeway to address the situation with stimulus packages. It has adopted huge fiscal and financial schemes to support businesses and households. Danish bond yields rose and share prices fell in March as uncertainty about the impact of covid-19 spread. However, these movements were soon redressed and by the end of 2020 share prices were higher and yields lower than at the beginning of the year.

Meanwhile, the transaction volume on the Danish real estate market ended up at DKK 70 billion, up by 25% compared to 2019 and above the 5-year historical average. Investment activity was surprisingly high considering the difficult macroeconomic situation. In addition, new housing regulations for residential rental properties and changes in taxation of commercial estate caused uncertainty about the return on real estate investments. The challenging conditions impacted the market in Q2 and Q3 where investment activity was low, but Q4 saw a strong return of activity – most significantly the transaction of a residential portfolio for DKK 12.1 billion. The outlook for the property investment market in 2021 is positive as market conditions will be more favourable than in 2020.

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»The outlook for the property investment market in 2021 is positive as market conditions will be more favourable than in 2020«

Interesting occurrences on the Danish property market in 2020 and 2021

DKK 70 BILLION
Total investment volume in 2020

DKK 75 BILLION
Total investment volume expected in 2021

+2.9%
GDP growth expected in 2021

RESIDENTIAL DOMINATES

Residential properties were the most traded property type in 2020 with transactions of approx. DKK 38 billion. This was largely due to some very large portfolios and development projects being transacted. A large proportion of the buyers were foreign investors. Residential property is expected to be very popular amongst investors in 2021 too, driven by strong fundamentals in terms of demographic growth and household income.

MOVEMENTS ACROSS MANY SEGMENTS

Offices were also attractive with deals in this segment at DKK 13 billion. The buyers were primarily Danish investors. The outlook for office buildings is also strong in 2021. Many industrial properties were also traded in 2020, the majority of which were sales of smaller properties for less than DKK 100 million. The segment accounted for DKK 7 billion of real estate investments. There was a predominance of foreign buyers for properties in this segment. Modern industrial and logistics properties are scarce and will be sought after by investors in 2021. Meanwhile, trade in retail property was DKK 4 billion, while hotels accounted for only 1 billion. Retail as well as hotels are suffering from covid-19 which hit traditional shopping, tourism and business meetings hard. Market fundamentals for retail and hotels will be difficult in 2021 too, which however, may create possibilities for these segments.

INVESTMENT MARKET WILL LOOK FOR ANSWERS FROM POLICY MAKERS

In 2020, the investment market was affected by the uncertainty concerning residential rental properties due to changes in the legislation. In July 2020 the amendments to Section 5.2 of the Housing Regulations Act came into effect. In 2021, two "political" themes will be of relevance to the Danish real estate investment market. One is the change of taxation of large commercial properties with effect from 2023. Although the final legal text has not been finished yet, an effect on the investment market is expected ahead of 2023. The change in property taxation from a tax on actual capital gain to a tax on notional gain is expected to increase the effective taxation, even though the nominal tax rate is expected to remain unchanged at 22 per cent. The second theme is about the government's plans for a new model for public appraisals of commercial real estate. The proposal presented is anticipated, in its present form, to diminish transparency and market conformity.

LONGER TERM IMPACT OF COVID-19 WILL EMERGE

The economy is expected to recover rapidly in 2021 when covid-19 is brought under control. However, businesses will enter 2021 suffering from the reimposed lockdown caused by the second wave of covid-19, and the economic recovery will be uneven between industries. The short-term outlook is weak for industries within e.g. tourism and travel, while many other industries may rebound quickly. The different fundamentals between industries will present different challenges and opportunities for the various segments of the property market.

THE FINNISH PROPERTY MARKET
STRONG PEAK IN Q4 2020 – WITH SUBSTANTIAL POTENTIAL IN 2021

The Finnish economy was substantially impacted by the covid-19 virus in 2020 and thus far in 2021, with GDP dropping by -4.3% in 2020. Much like the rest of the Nordics and in Europe in general, unemployment rose in Finland, too, with relatively severe restrictions being introduced in the country. However, Finnish covid-19 death and infection rates have also been among the lowest in Europe, and a solid recovery in GDP growth of 2.9% is expected to follow in 2021. Finland also has strong state finances and is able to enact further stimulus if required. The European Central Bank is also likely to keep the key interest rate low for the foreseeable future, which will continue to support the Finnish economy.

Amid covid-19, Finland saw a real estate transaction volume of EUR 6.0 billion in 2020, in line with the historical average. The Finnish transaction volume in 2020 was u-shaped, with a very active first quarter, and a second quarter that was very quiet. In the third quarter, activity remained low, while the last quarter was more active than 2019. Shopping centre and hotel investments froze at the beginning of the pandemic, especially when the restrictions kicked in. Many investors turned to more defensive investments such as residential and logistics; with increasing urbanization and e-commerce being the main drivers. Public properties have also been seen as a very interesting segment, which has also been a trend in the other Nordic countries. Some transactions were postponed to 2021 and the beginning of the year has been active. Investors are clearly searching far and wide for property and there is still a lot of capital trying to find good investments. As a result, 2021 is expected to be a strong year for the property market.

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Photo: Shutterstock

»The transaction volume for public properties has increased clearly in the past few years. In 2020, the public properties share of the total transaction volume was 24%, while in 2019 the same figure was 14%«

Interesting occurrences on the Finnish property market in 2020 and 2021

EUR 6.0 BILLION
Total investment volume in 2020

EUR 6.0 BILLION
Total investment volume expected in 2021

+2.9%
GDP growth expected in 2021

PUBLIC PROPERTIES ARE HOT

The transaction volume for public properties has increased clearly in the past few years. In 2020, the public properties share of the total transaction volume was 24%, while in 2019 the same figure was 14%. The largest sub-segment is care properties, with the aging population being the underlying driver. The investors in the segment are mostly Nordic investors, as most international investors require larger volumes to enter the market.

POLARIZATION FOR RETAIL

The investment market for retail properties has become strongly polarized. Certain retail segments are under the microscope and there is demand for these. Grocery store properties are one example. However, investment demand for large shopping centres has dropped almost completely. Meanwhile, demand for logistics is still very strong. The yields for prime logistics have dropped and are now approaching the low levels seen in mainland Europe. There is particular investment demand for properties supporting the last mile logistics chain.

THE CONCEPT OF THE OFFICE IS CHANGING

The wellness and health demands are increasing in the office sector which is putting pressure on the older office stock. Demand and supply of different co-working concepts will increase. Investors are currently very selective, but the office is still an attractive investment segment. Demand is especially strong for core properties, but core+ properties also attract strong interest. 2020 saw an increase is core+ office transactions in Finland.

HYBRID BUILDINGS ON THE RISE

Hybrid buildings are increasingly attracting real estate investors. Hybrid concepts generate steadiness for portfolios. A good example is Citycon, which has decided to build residential units among shopping centers. Retail is a more cyclical asset class than residential. Residential apartments will bring customers to shopping centres as well, meaning the two asset classes complement one another. In addition, traditional big box retail is looking into more logistic elements, as e-commerce has increased.

INTERNATIONAL INTEREST REMAINS

In 2020, domestic investors divested residential to cross border investors. International investors are interested in the steady income from residential investments and find these to be an easy way to penetrate the market with a prepared portfolio. The investor base has diversified and there are many investors with different strategies on the Finnish residential market. One signal of the high demand for residential investments is that international investors are willing to invest as early as the building phase, or into portfolios that require substantial work. The defensive nature and urbanization support the demand for residential. The only restriction on the market is the supply of the investments.

THE ESTONIAN PROPERTY MARKET
ESTONIAN INVESTORS BELIEVE THAT THE TIME FOR NEW TYPES OF INVESTMENTS IS NOW

Photo: Shutterstock

Compared to the other Baltic States, Estonia implemented the fewest economic restrictions due to COVID-19. It is therefore likely that the Estonian economy will be among the first to recover in 2021. According to the latest assessments, the Estonian economy declined by 2.5% in 2020, and is estimated to grow by 2.9% this year. Like in other European countries, more rapid growth is expected in the second half of the year, following a successful vaccine distribution. The Bank of Estonia expects economic growth to return to the 2019 level by mid-2022. Unemployment is estimated to keep rising throughout 2021, potentially leading to 10% of the population being out of a job.

2020 saw a total transaction volume of EUR 235 million in Estonia, which was more than 2.5 times as much as in 2019, and roughly a third of the total Baltic transaction market. In the first half of 2020, Estonia attracted investors who concluded several large-scale deals. In the second half, and in the fourth quarter in particular, the market saw a greater number of smaller transactions. Active investment managers – and Estonian managers in particular – are ready to take even more significant steps forward but a lack of suitable properties prevents a more substantial growth in real estate investment transaction volumes. The acquisition of a residential portfolio consisting of 1,200 apartments in Tallinn was responsible for 73% of the overall investment volume. Investment in the office segment was more modest and constituted only 24%. The recently dominant office segment will likely become attractive to investors again once 120,000 sqm of new office space is introduced within the next two years. Many experienced developers are starting, or continuing, large-scale office projects in the country's most extensively developed Tallinn market. Though it was a relatively weak year on the transaction market for retail, at 4% of total transaction volume, the country's retail market grew the most among the Baltic States. The segment of shopping centres was highly impacted by the pandemic, with a large gap forming between successful shopping centres and those struggling to compete (e.g. those focused on large tourist foot traffic). In 2021, uncertainty continues to face the retail segment in Estonia, while other segments are thriving.

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»Deals concluded in Estonia usually stand out in the Baltic market and are often among the first of their kind, are the most innovative, or designed to test new possibilities«

Interesting occurrences on the Estonian property market in 2020 and 2021

NEW NICHE PROPERTIES ATTAIN INTEREST FROM INVESTORS

Deals concluded in Estonia usually stand out in the Baltic market and are often among the first of their kind, are the most innovative, or designed to test new possibilities. In 2020, the Estonian market saw the first deal concluded in a niche segment for the Baltics. This consisted of EfTEN Capital purchasing a retirement home currently being developed in Tallinn, whereafter they established a residential property development fund, attracting EUR 33 million in capital. Another development tendency most characteristic of the Estonian market is mixed use offices, where commercial, storage, and productive functions are consolidated within a single project. These properties, usually small in scale, attract attention both from small local investors and players managing large investment portfolios.

UNENVIABLE SITUATION IN THE NEW COMMERCIAL FACILITIES MARKET

The T1 Mall of Tallinn – built during an economic upturn, but never reaching full capacity – was struck by the pandemic. Successful shopping centres growing stronger and struggling ones growing weaker is a clear trend observed in Estonia. The retail mall belonging to the Porto Franco multi-functional project was scheduled to open in 2021. However, the property – co-funded by foreign investors and enmeshed in a scandal by its owners – will likely face further problems and will not be finished on time.

EUR 235 MILLION
Total investment volume in 2020

EUR 260 MILLION
Total investment volume expected in 2021

+2.9%
GDP growth expected in 2021

HOTEL OWNERS DIRECT INVESTMENT INTO THE RENOVATION OF THE STAGNANT HOTEL MARKET

Even though tourism accounts for only a small part of Baltic economies, recent years saw the beginning of a new stage of hotel development. In Tallinn alone, the hotel market expanded by roughly 1,000 new rooms during the past three years. Hanging on by a thread, the hotel segment – with an occupancy rate of chain-branded hotels barely exceeding 26% in 2020 – decided to stage a revival. In quick succession, the Tallink City Hotel, the Nordic Hotel Forum, Radisson Blu Sky Hotel, and others fully closed for renovation. During this period, the average planned investment per room reached 26,000–30,000 EUR. In addition, an announcement was made about a new project near Tallinn's Old Town and harbour territory – the first 168-room Hyatt Place Tallinn hotel in the Baltics, scheduled to open in 2023.

LIDL TO HAVE AN IMPACT ON RETAIL

A big challenge for the retail market is expected to come once Lidl enters the grocery store market this year. Considering the performance of this market player in Lithuania during the past several years and its impact on the market, Estonian retailers can expect positive changes and active competition.

THE LITHUANIAN PROPERTY MARKET

THE REAL ESTATE MARKET WITHSTOOD THE PANDEMIC-RELATED SHOCKS

2020 was a truly unprecedented, unique and interesting year – both for the world and the Baltic Region, including Lithuania. In 2020, the Lithuanian economy contracted by as little as 0.9%, and most economic sectors fared better than expected. Even though unemployment increased to 8.8% (estimate) and the country went under lockdown twice, wages increased by 9.2%. Despite the negative retail sales volume growth in the second quarter, the total annual growth in 2020 was 2.5%. The prospects for 2021 are slightly dimmer due to the uncertain timeline of normal economic activity resuming. Hopes for the future mostly hinge on the successful vaccination of the population. Since Lithuania's economy saw among the lowest degrees of contraction in the European Union, GDP growth in 2021 is estimated to be around 1.8–3%. A more rapid economic upturn is expected in the second half of 2021.

The intense second half of 2020 allowed the Lithuanian real estate investment segment to end the year on a high note. Rapidly growing interest in the logistics and warehousing segment, and stable demand for prime offices, were the main driving forces. In 2020, the total volume of investment deals made in Lithuania was 60% of last year's and reached EUR 265 million, over a third of the total volume in the Baltic region. Just like during the past several years, the market saw new investors and large prime office deals, while yields in the office segment reached new lows. Total market supply on the Vilnius office market increased by 16%, reaching 844,000 sqm, and according to Newsec's estimates, the market will be supplemented with another 250,000 sqm of high-quality, modern office space in 2021–2022. With market supply growing by 15% per year, on average, the vacancy level has also increased, and is closing in on the European average (6.8%). Among other segments, retail has experienced a long winter, in every sense of the word. However, e-commerce grew by 50%, with the winners being the businesses who took the long-term discussions about omnichannel sales seriously and had already invested in relevant areas. This also benefitted the logistics segment, which saw the share of investment into this segment in the Baltic States increase to 15% from the long-term average of 10%. The stable, or even rising, rental levels and the pressure put on yields increased the prices of this type of asset by roughly 10–20%.

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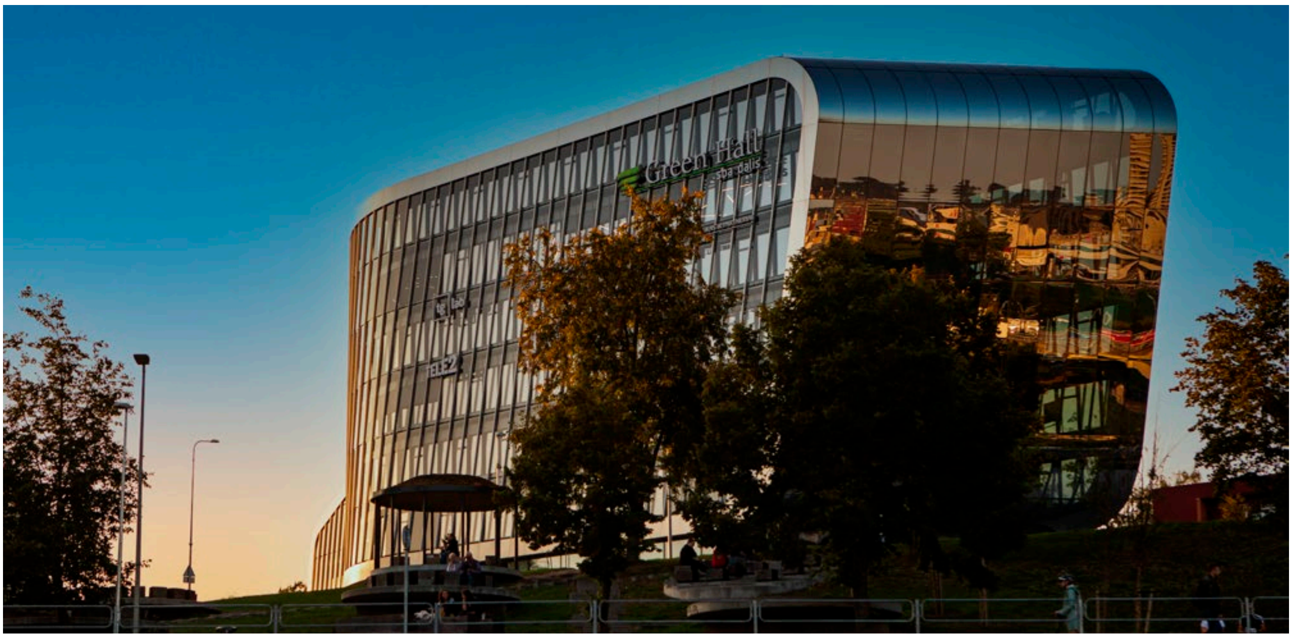

Photo: Shutterstock

»Just like during the past several years, the market saw new investors and large prime office deals, while yields in the office segment reached new lows«

Interesting occurrences on the Lithuanian property market in 2020 and 2021

EUR 265 MILLION
Total investment volume in 2020

EUR 300 MILLION
Total investment volume expected in 2021

UP TO +3.0%
GDP growth expected in 2021

THE DISRUPTED RETAIL SEGMENT WILL SEE GROWING COMPETITION

The property managers operating in the market are strengthening their positions by implementing new projects or expanding already operational retail objects. Vilnius Outlet – a new retail centre – is scheduled for opening in the northern part of the city in 2021, and in 2022 the shopping centre Olinda will expand the retail and leisure market by more than 70,000 sq. m. Property developers are interested in these parts of the city, which have been expanding for many years.

THE PRIME OFFICE SEGMENT HAS REMAINED ATTRACTIVE TO INVESTORS

Properties within the Vilnius CBD prime office segment have shined on the property investment market in 2020, just as they had in recent years. Investing for the first time in the Baltic States, REInvest Asset Management bought the 12,900 sqm SEB Bank Headquarters project, completed in 2020, from the Lords LB Asset Management fund. Following construction, the project was immediately BREEAM certified, receiving the highest Outstanding grade in the New Buildings category. 2020 also saw the execution of several previously completed office sales transactions – the transfer of the stage three S7 Office Complex into the hands of Eastnine, and the completion of the second stage of the Park Town transaction, with Zenith AM purchasing the entire project – confirming investors' faith in both the Baltic Region and the office space market.

ALL INDUSTRIAL SEGMENT CLASSES ARE IN HIGH DEMAND

Moving away from retail properties, investors are especially interested in the potential of the industrial segment, such as warehouses, logistics properties and factories. In Lithuania, most properties of this asset class are currently concentrated in the hands of their end users. In 2020, this segment saw an increase in demand from different funds and private investors active in the Baltic States.

GROWING MARKET LIQUIDITY

The growing circle of potential private investors in the Baltic States and the increasing strength of fund managers is increasing the liquidity of the Baltic real estate market. In 2020, more than 60% of investments were made by long-term investors in the Baltic States seeking to expand their portfolios.

THE LATVIAN PROPERTY MARKET

INVESTORS WERE MORE ACTIVE THAN IN 2019 IN LATVIA

Photo: Shutterstock

Despite the global pandemic, Latvia's economic decline was not as pronounced as many were expecting. In 2020, the preliminary drop in GDP was smaller than the EU average, hovering at roughly 3.5%, whereas the Bank of Latvia had forecasted a 6.5% decrease in March and a 7.5% decrease in June 2020. However, Latvia's GDP drop is the largest among the Baltic States. Latvia's unemployment rate reached 8.3% by the end of 2020. However, the unemployment rate is not critically high, increasing by 1.7% compared to 2019. At the end of 2020, inflation in Latvia was close to zero but as the economy recovers, inflation is likely to return to previous levels. The Latvian economy may recover in line with or even outperform other EU countries. A return to 2019 levels of economic growth may be achieved by 2023, although that will depend on future covid-19 scenarios.

The real estate investment market was significantly more active in 2020 than it was in 2019, and saw roughly the same in transaction volume as in 2018. The total transaction volume reached around EUR 250 million in 2020. Two office deals, both involving major banks as occupiers, were closed last year. Further, EfTEN Capital was among the most active investors in 2020, acquiring four properties – three logistics centres and an office building. The total area acquired in the industrial market exceeded 100,000 sqm, thereby breaking previous records and confirming investor interest in this segment. The retail segment also saw some significant changes in landlords, but continues to struggle, similarly to the rest of Europe. The year 2021 will be the time to absorb currently vacant spaces and to prepare for new projects. Lords LB had already started demolition work at the Presses Nams site in September 2020 and plans to deliver the first stage in 2022. SBA has started its Verde project on Skanstes and intends to deliver the first stage in 2022. All in all, the coming years are expected to be exciting for both the Latvian office and transaction market as a whole.

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»The next important office space delivery will take place in 2022, with more than 100,000 sqm scheduled to be delivered«

Interesting occurrences on the Latvian property market in 2020

EUR 250 MILLION
Total investment volume in 2020

EUR 260 MILLION
Total investment volume expected in 2021

+2.8%
GDP growth expected in 2021

NEW OFFICE PROJECTS BRING NEW TENANTS

Despite having the highest number of offices and the largest total office area, Riga's central district lacked new Class A offices. With the expansion of the Origo retail mall, its Origo One business centre was able to supply 11,000 sqm of new high-class office space at the very heart of Riga, in the busiest and most crowded part of the city. 2020 also brought to life the highest and longest-running office project – the Z-Towers, which can offer tenants 25,000 sqm of Class A office space. Z-Towers contain both office and residential areas. The next important office space delivery will take place in 2022, with more than 100,000 sqm scheduled to be delivered, 75% of which will be Class A. Two major foreign companies, Norwegian Air Shuttle and Swisscom, also opened offices in Riga in 2020.

NEW FORMATS OF SHOPPING CENTRES DELIVERED

Riga's shopping centre market is continuing to grow, with strong availability of quality investment projects. A new part of the Origo shopping centre was opened in the city centre. However, by the end of 2020, construction was still not fully completed. Two more shopping centres of an as-yet-unseen format were opened in 2020, namely – the Via Jurmala Outlet Village in Pinki, focusing mostly on wealthy shoppers, and the family-oriented Saga shopping and entertainment centre located on the outskirts of Riga in Dreilini, next to IKEA. A total of 16% of the currently available shopping centre stock was delivered in 2020.

RESILIENT SEGMENTS MAINTAIN STABLE YIELDS

The logistics and office markets were among the least impacted by covid-19. Prime office yields remained at 6.1% but are projected to decline in the coming years. The yields of the rising industrial market segment declined to 7.25%. The retail sector became subject to more risk, raising the required level of yield to 7.25%. This segment is subject to the largest degree of investor hesitation, making future development forecasts rather conservative.

GREEN CORRIDOR – POSITIVE CHANGES IN CONSTRUCTION APPROVAL

In November 2020, the Riga City Construction Board established Green Corridor, intended to facilitate the approval process. Developers will now have the opportunity to submit draft projects and receive conceptual assessment results within two weeks. The time-limit for the performance of the design conditions was shortened to ten working days. In the future, developers will also be able to submit pre-drafted parts of building projects before soliciting opinions from other institutions.

EUROPEAN PROPERTY MARKETS

2020 AND 2021 – EVENTFUL YEARS FOR THE REAL ESTATE MARKET

Since 2012, Newsec has been a BNP Paribas Real Estate Alliance Partner, which gives Newsec access to an international network of clients and relevant connections. The alliance allows for both Newsec and BNP Paribas to expand coverage, and help to advise you and drive your real estate strategy internationally.

2020: Unprepared for what was in store

2020, a year that took everyone by surprise. The European real estate market started the year with a few challenges but equally with many opportunities. Large amounts of capital continued to purse real estate opportunities and the gap between real estate yields and bond yields remained favourable. Only three months into the year, covid's impact would turn things around, making 2020 arguably the most memorable year in history. Lockdowns halted activity across Europe. Real estate like all sectors was affected. Big European markets suffered falls in investment transactions over the year, United Kingdom (-20% pa) and France (-31% pa). The CEE was the worst affected with Czech Republic (-66% pa). Germany (-3%) and Italy (-19%) less so. One common factor that prevented large falls in volumes was the degree to which countries had a strong first quarter.

Over the course of the year another emerging trend was the fall in small and mid-sized deals that were down by around a third, in comparison to large deals (€100 mil plus) which declined less than 10%. Small sized deals are the first to stop before they get going and larger deals are mostly driven by foreign investors. Travel restrictions inhibited cross border activity, especially from the US, Asia and Middle East, where activity was down by over 50% in all cases. Consequently, investment activity, particularly for large deals, was front loaded in 2020.

2021: Understanding what matters

Real estate investment will recover to strong levels of activity in the latter part of 2021. Despite most of Europe being in and out of lockdowns over the course of 2020, investment volumes fell to below their 5-year average of €168 billion in Europe, but still remained substantially above the period running up to the GFC in 2008. Total European take-up in 2019 was 15 million sq metres. In 2020 it is likely to have fallen by 41% to 8.8 million sq metres. We anticipate recovery growing in tandem with vaccination, meaning take-up will expand to 10.6 million in 2021 and 11.7 million in 2022.

To everyone's surprise pricing has been relatively unscathed in 2020. Lockdowns made valuation difficult to ascertain (itself contributing to reduced activity), and the transactions that have gone forward have seen little reduction in pricing. Nonetheless, a shock to the economy is still a shock and we expect prime initial yields to expand for Europe as a whole. Decompression is likely to prove transitory overall; with resumption in activity, yields may compress back to approximately 3.20% in 2022 and even further to approximately 3.15% in 2023.

Real estate remains part of the infrastructure of an economy and its use often reflects the type of economic activity, meaning that real estate will reorganize to adapt to the change in economic activity. Investors will be using the time during lockdowns to reflect on how they can reposition themselves and what property types will best meet their goals. Repositioning is likely to concentrate on the resilience of buildings and their adaptability. Especially important is how well they operate in the ESG framework that covid helped accelerate throughout 2020.

Retail: A year of the essential goods

Prime high street yields for Europe as a whole increased from approximately 3.45% in 2019 to approximately 3.70% in 2020. They are likely to continue expanding over the next few years as the sector continues to restructure. The yield does vary considerably across European cities and between retail types.

Gateway cities will see retail yields expand from approximately 3.20% to 3.45% in 2021. Secondary cities' yields are set to increase from approximately 3.75% to 4.10% in 2021. London increased 50 bps from 3.00 to 3.50% and Paris 2.40% to 3.00% in 2020. Milan, Italy's key retail city, moved from 3.10% to 3.30% and Madrid moved from 3.25% to 3.50% These are yields for the very best retail located in the city centres driven by luxury goods retailers.

Among the most badly damaged of all retailing types during 2020 were shopping centres. The defining retail conundrum of the year was how landlords could effectively collect rents from retailers in shopping centres that were closed. It was a universal problem across Europe.

»Investors will be using the time during lockdowns to reflect on how they can reposition themselves and what property types will best meet their goals«

Photo: Shutterstock

Investors continue to operate a 'wait and see' approach at least until the vaccine program has reached a point where there is no danger of further lockdowns occurring. Until then shopping centres are likely to see higher risk premiums attached across Europe.

Logistics: Unwavering demand
Logistics yields continued to compress over 2020 with the European average declining from 4.80% in 2019 to 4.60% in 2020. The greatest compression was seen in Vienna where yields fell from 5.40% to 4.50% in 2020, around 90 bps. Amsterdam also witnessed a large fall of 40 bps from 5.00% to 4.60% in 2020. It is likely that yields in Europe will continue to remain under downward pressure over the next few years as logistics represents a property sector with unambiguous growth prospects. The logistics sector remains a firm favourite amongst investors who are all chasing limited stock.

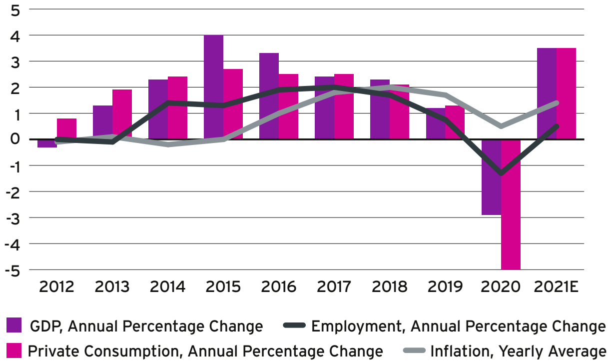
Sukhdeep Dhillon,
Senior Economist & Associate Director,
BNP Paribas Real Estate

MACROECONOMIC DATA

Sweden

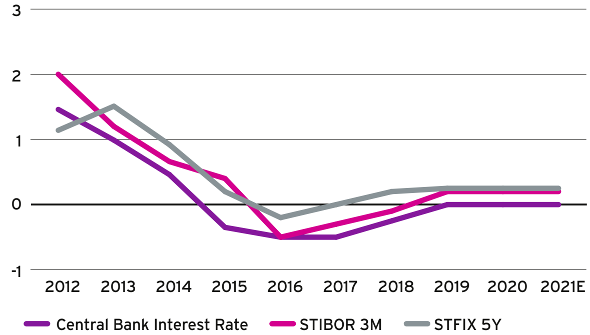
Economic Indicators

Per cent Source: Newsec



Interest Rates

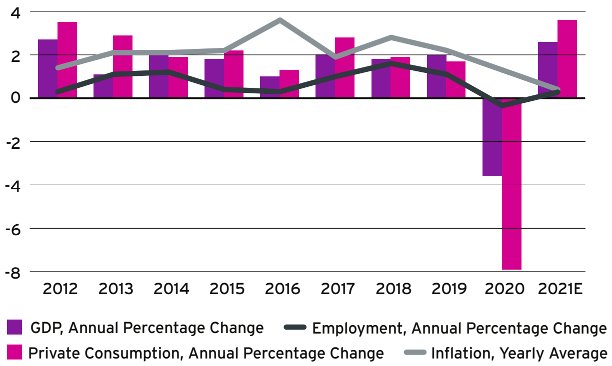
Per cent Source: Swedbank, Swedish Central Bank



Norway

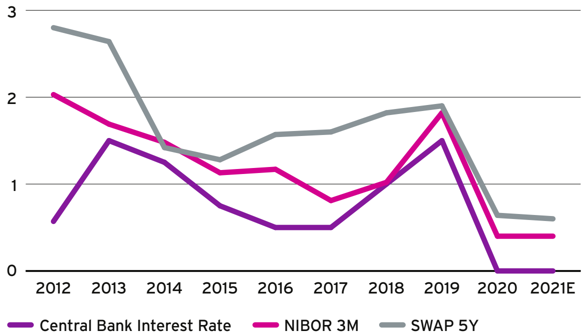
Economic Indicators

Per cent Source: BNP



Interest Rates

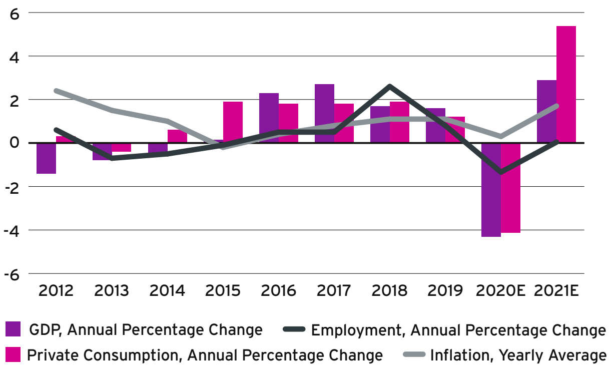
Per cent Source: BNP



Finland

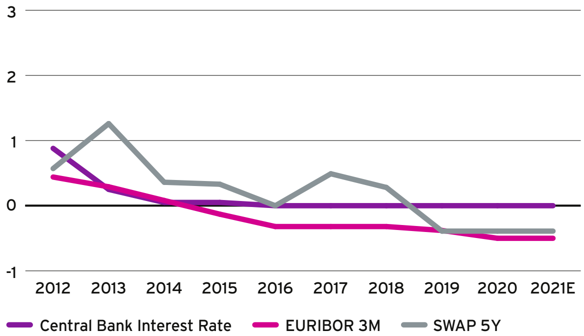
Economic Indicators

Per cent Source: BNP



Interest Rates

Per cent Source: BNP



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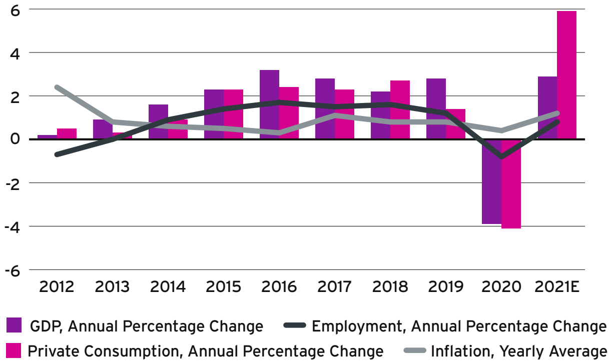
Denmark

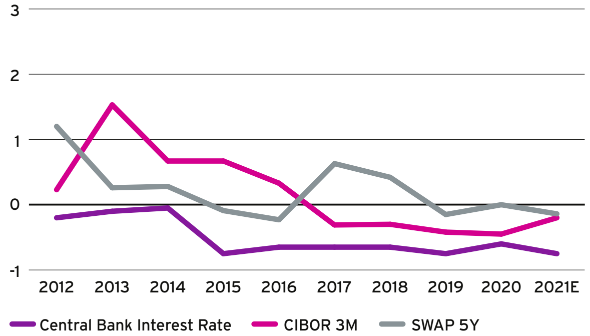
Economic Indicators

Per cent Source: BNP



Interest Rates

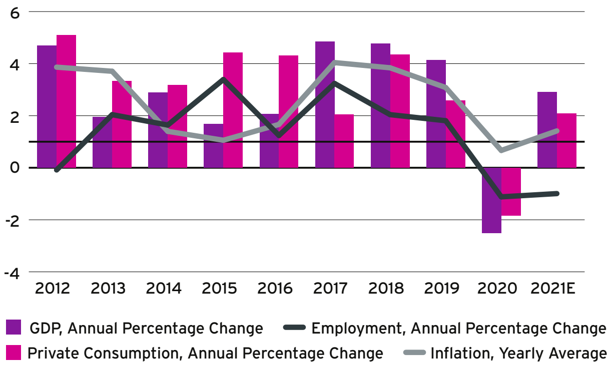
Per cent Source: BNP



Estonia

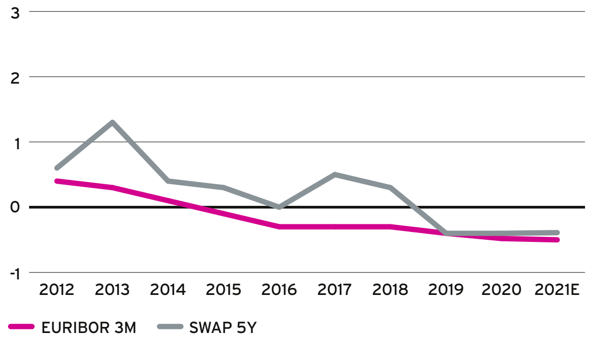
Economic Indicators

Per cent Source: BNP



Interest Rates

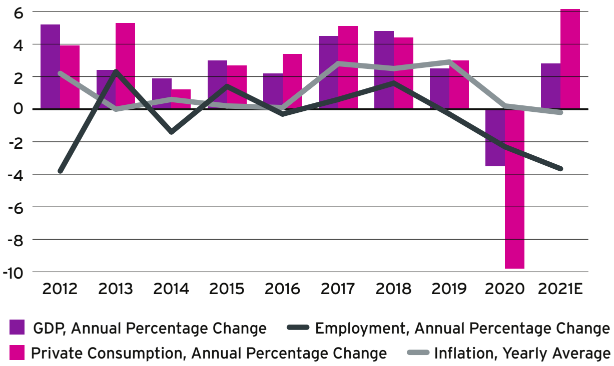
Per cent Source: BNP



Latvia

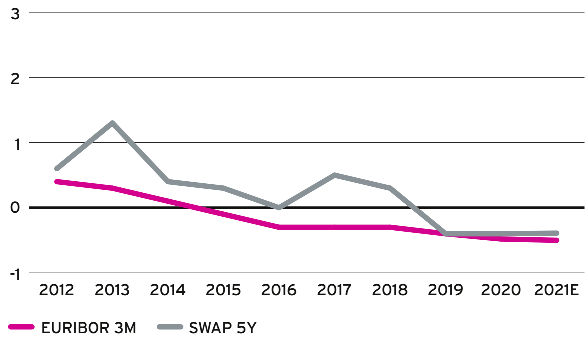
Economic Indicators

Per cent Source: BNP



Interest Rates

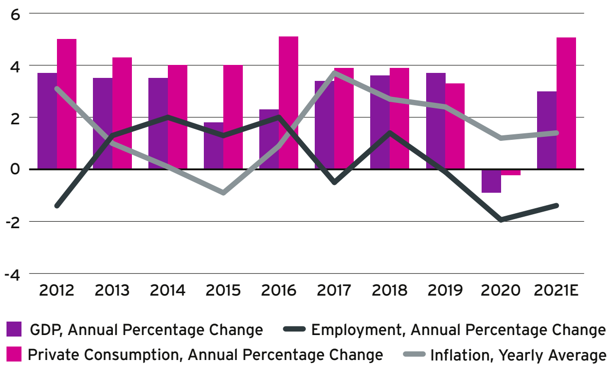
Per cent Source: BNP



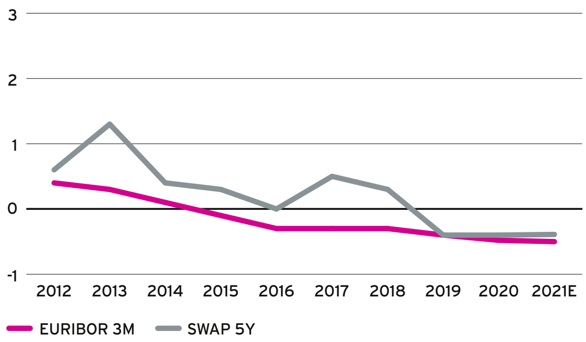
MACROECONOMIC DATA

Lithuania

Economic Indicators

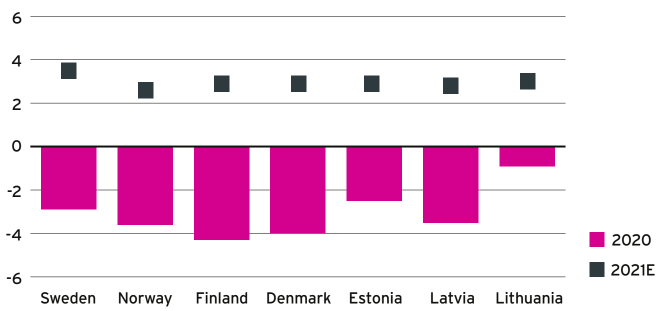


Interest Rates



GDP Growth

GDP Growth 2020-2021E



PROPERTY DATA

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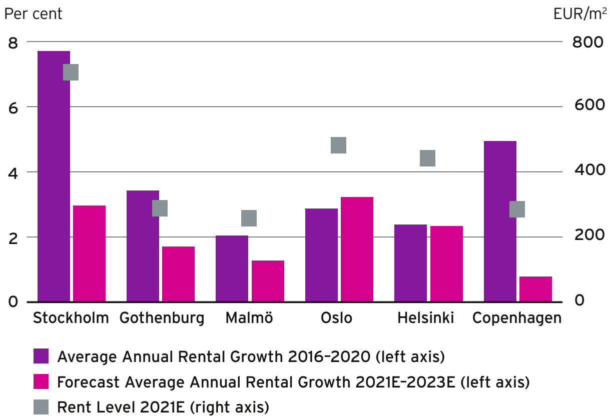
Office rents

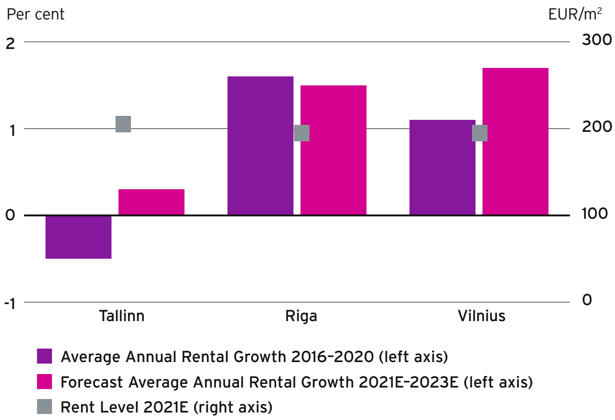
Prime Office Rents (CBD) | Nordic Region

Source: Newsec



Prime Office Rents (CBD) | Baltic Region

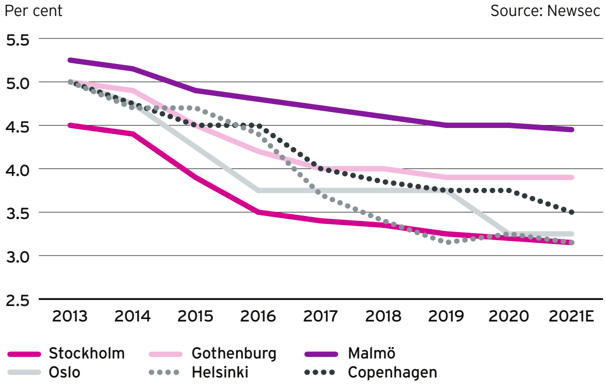
Source: Newsec



Office yields

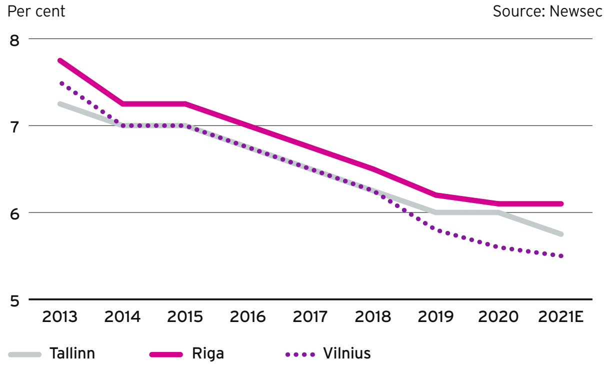
Prime Office Yields | Nordic Region

Source: Newsec



Prime Office Yields | Baltic Region

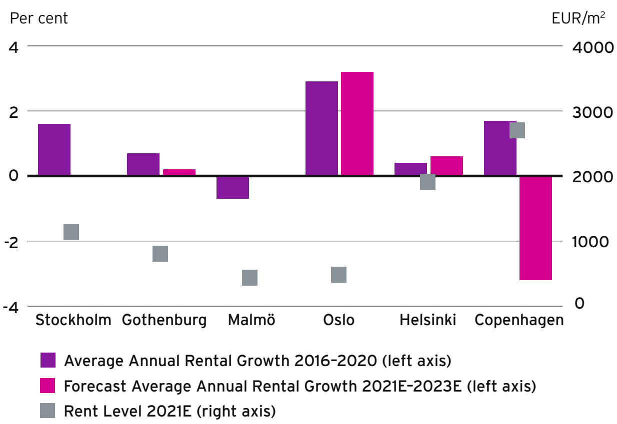
Source: Newsec



Retail rents

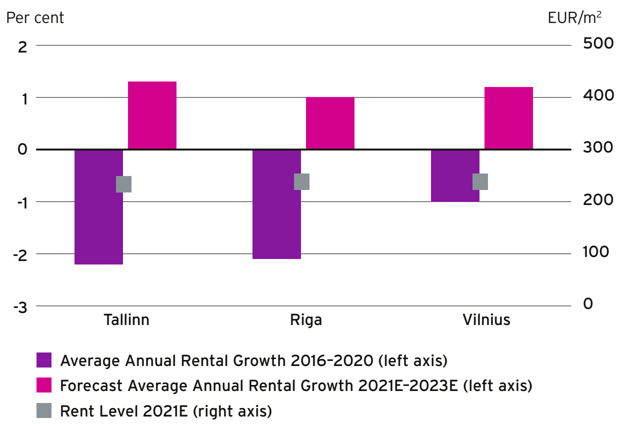
Prime Retail Rents | Nordic Region

Source: Newsec



Prime Retail Rents | Baltic Region

Source: Newsec

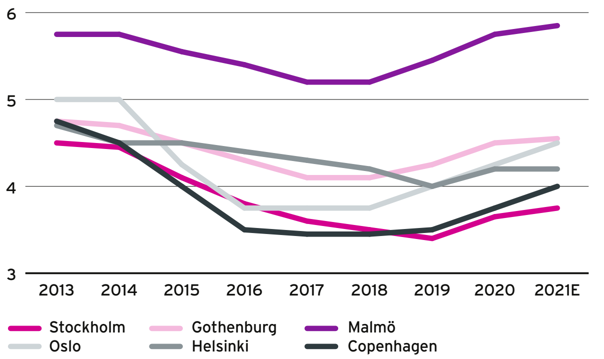


PROPERTY DATA

Retail yields

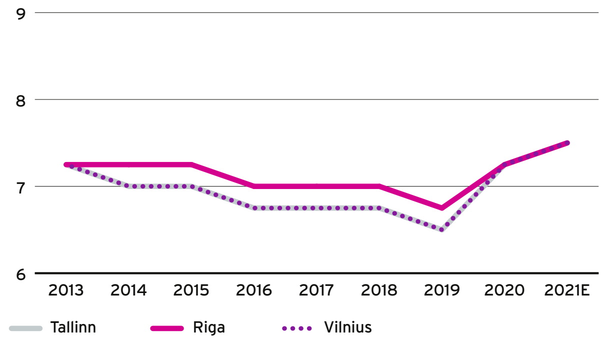
Prime Retail Yields | Nordic Region

Per cent Source: Newsec



Prime Retail Yields | Baltic Region

Per cent Source: Newsec

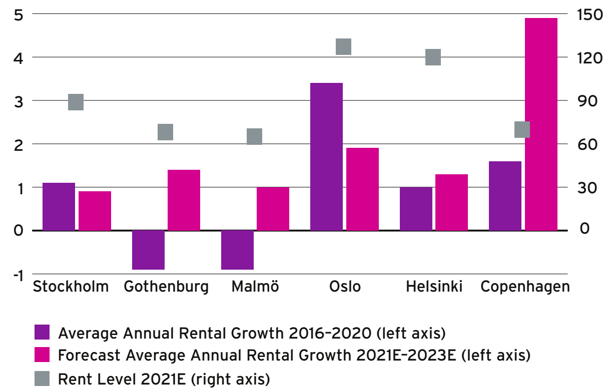


Logistics rents

Prime Logistics Rents | Nordic Region

Source: Newsec

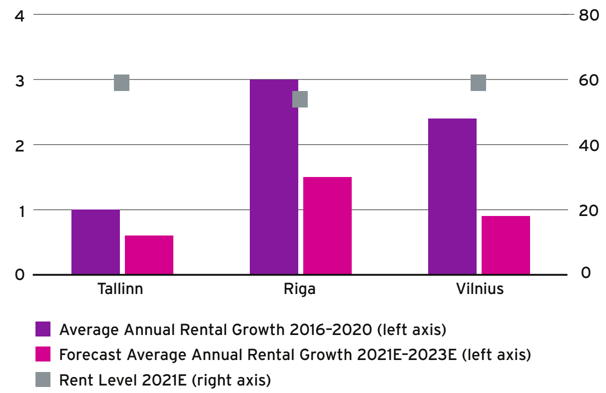
Per cent EUR/m²



Prime Logistics Rents | Baltic Region

Source: Newsec

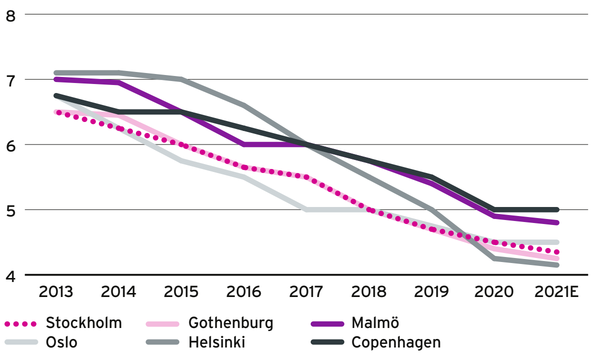
Per cent EUR/m²



Logistics yields

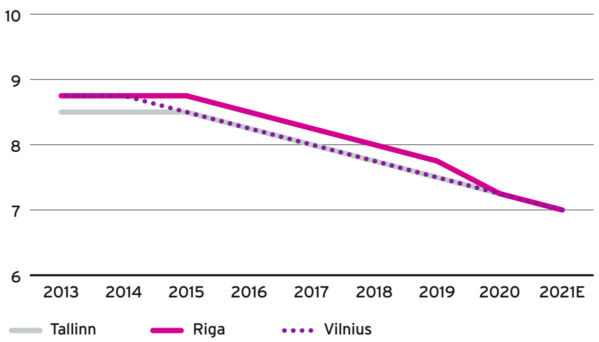
Prime Logistics Yields | Nordic Region

Per cent Source: Newsec



Prime Logistics Yields | Baltic Region

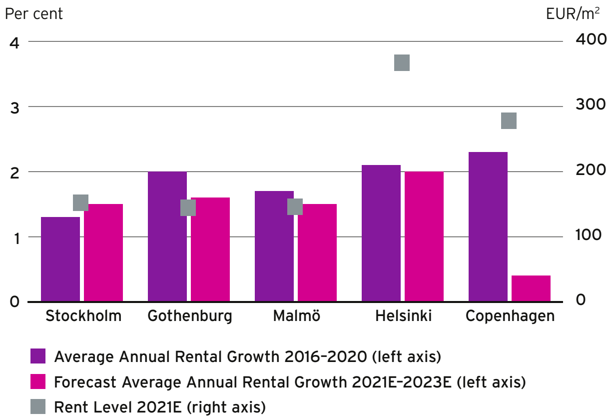
Per cent Source: Newsec



Residential

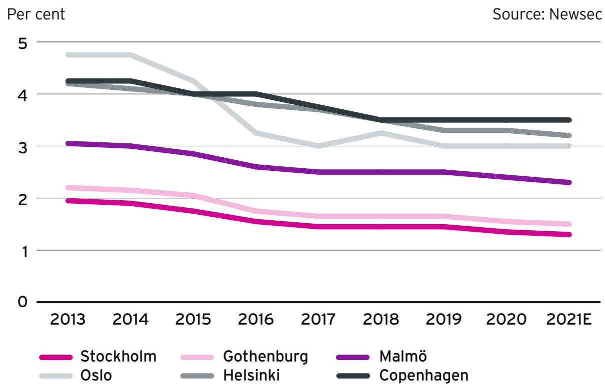
Prime Residential Rents | Nordic Region

Source: Newsec



Prime Residential Yields | Nordic Region

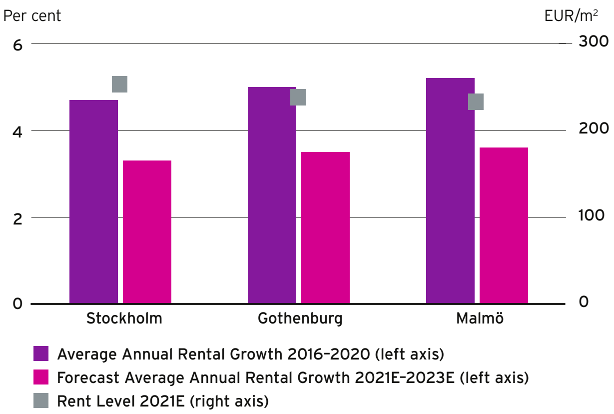
Source: Newsec



Public Properties

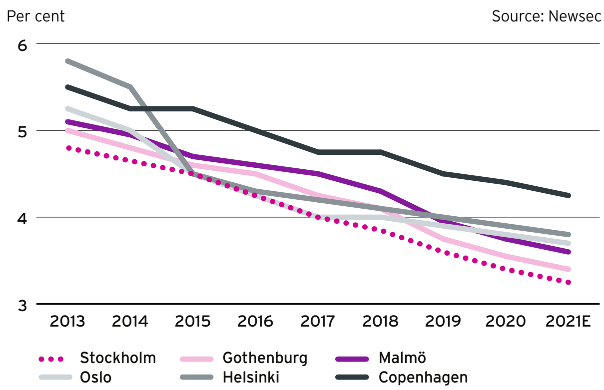
Prime Public Properties Rents | NordicRegion

Source: Newsec



Prime Public Properties Yields | Nordic Region

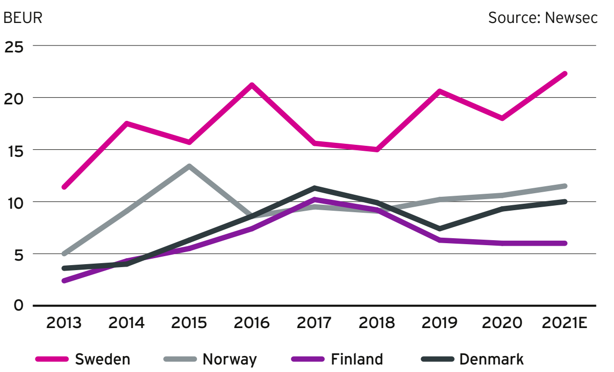
Source: Newsec



Annual transaction volumes

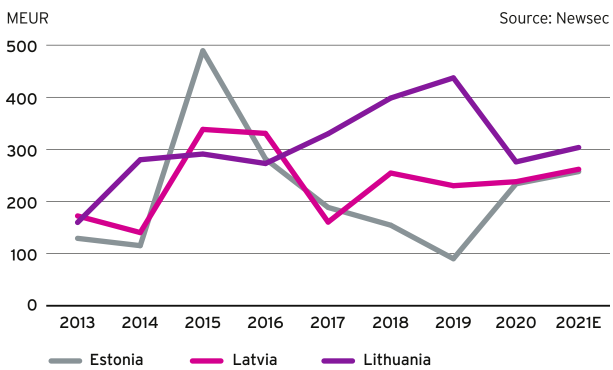
Transaction Volumes – Annual | Nordic Region

Source: Newsec



Transaction Volumes – Annual | Baltic Region

Source: Newsec



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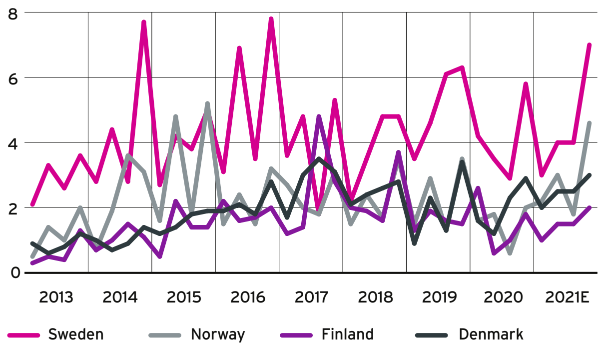
Transaction Volume

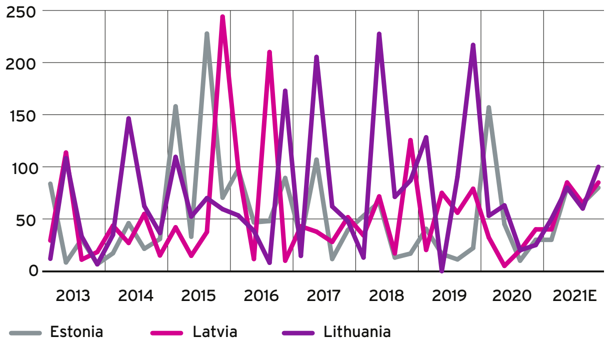
Transaction Volumes – Quarterly | Nordic Region

BEUR Source: Newsec



Transaction Volumes – Quarterly | Baltic Region

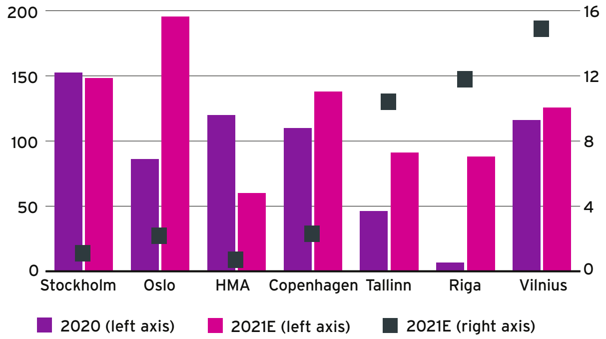
MEUR Source: Newsec



Office new construction

Office New Construction (Capital Office Market) Source: Newsec

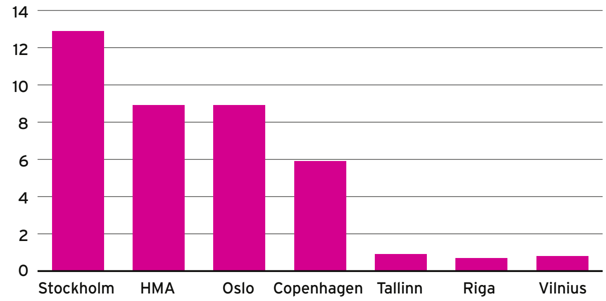
Thousand m² Per cent of stock



Office stock

Office Stock Q4 2021E (Capital Office Market)

Million m² Source: Newsec



DEFINITIONS

General

- All rents, yields and vacancies are end-of-year values.
- All forecasts are referring to nominal values.
- The rental levels are the most probable prime rent when signing a new lease agreement.
- All yield levels are referring to net initial yield.

Offices

- The forecast is referring to new/refurbished modern and flexible office premises with normal area effectiveness.
- The rents are referring to premises of at least 500 sqm.
- The rent is excluding heating and excluding property tax.

Retail

- The rents are referring to modern retail premises of 70–250 sqm.
- The rent is excluding heating and excluding property tax.
- The rents refer to prime areas with definitions by each country.

Logistics

- The forecast is referring to warehouses and logistics premises.
- The rents are referring to premises of 5,000-10,000 sqm with a 10 year lease agreement.
- The rent is excluding heating and property tax.
- The rent refers to modern, newly built premises with a solid lease contract and tenant A properties.

Residential

- The forecast is referring to attractive locations with an area of around 80 sqm.
- Definitions generally, as well as of new and old housing depend on the country.

Public Properties

- A public property is defined as a property used predominantly for tax-financed operations and specifically adapted for community service. In this document, public properties are limited to schools (pre-schools and primary schools), hospitals, and elderly care homes.
- The market data refers to public property premises of normal to modern standard with normal space efficiency.
- The market rent refers to the rent excluding supplements.

Exchange rates

All rents and transaction volumes are calculated using the average exchange rates in 2021.

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THE FULL SERVICE PROPERTY HOUSE IN NORTHERN EUROPE

Newsec – The Full Service Property House in Northern Europe – is by far the largest specialised commercial property firm in Northern Europe.

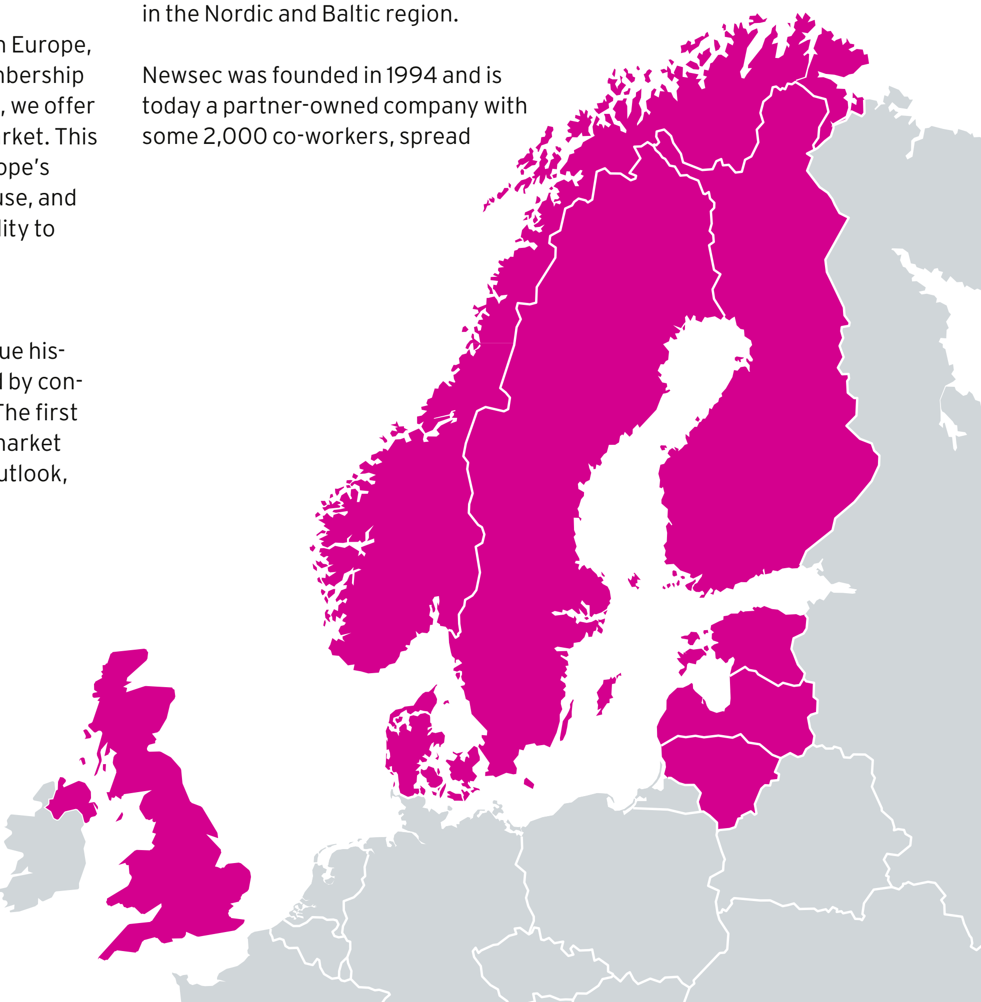
Newsec manages more properties and carries out more transactions, more lettings and more valuations than any other firm in Northern Europe. Through this great volume, and the knowledge and depth of our various operations, we acquire extensive and detailed knowledge of the real estate market. In turn, we can quickly identify business opportunities that create added value.

Our prime market is Northern Europe, but through our alliance membership with BNP Paribas Real Estate, we offer our services on the global market. This makes Newsec Northern Europe's only full service property house, and provides us with a unique ability to forecast the future.

A history of growth
Newsec is the result of a unique history of growth, characterised by constant originality of thinking. The first issue of the comprehensive market analysis, Newsec Property Outlook, was published in 2001.

The Group expanded internationally into Finland in 2001, Norway in 2005, the Baltic countries in 2009 and Denmark in 2016. The Norwegian asset and property management companies First Newsec Asset Management and TM Partner were acquired in 2012. In 2013, Newsec acquired Jones Lang LaSalle's Swedish property management operation. In 2017, Newsec grew with the acquisitions of Norwegian Basale and Danish Datea, further strengthening the position within Property Asset Management. In 2018, Newsec opened a London office to assist international investors interested in the Nordic and Baltic region.

Newsec was founded in 1994 and is today a partner-owned company with some 2,000 co-workers, spread across the seven Nordic and Baltic countries. Newsec has approx. EUR 65 billion under management and annually signs lease agreements of approx. 1.6 million square meters, transactions of some EUR 7.6 billion and does real estate valuations with an underlying property value worth almost EUR 188 billion. Thanks to large volumes and local presence combined with in-depth understanding of a range of businesses, Newsec has a unique expertise of the real estate market in northern Europe.



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