

NORDIC REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

- _ Long-term economic growth in the Nordics is forecast to comfortably exceed the European average. The region's major cities are expected outperform, supported by population growth and urbanisation.
- _ Like other parts of Europe, residential and logistics stand out as the top performing sectors.
- _ We are more cautious on the office market, which faces new challenges as a result of increased remote working, although we still see select opportunities for investment.

The Nordic region proved relatively resilient in 2020; both the economic and social impacts of the Covid-19 pandemic were less severe than elsewhere in Europe. Looking forward, while there will still be short-term challenges, longer-term economic growth in the Nordics is forecast to comfortably exceed the European average. In particular, the cities of Stockholm, Copenhagen and Helsinki are expected outperform, supported by increased urbanisation and strong population growth. Like other parts of Europe, residential and logistics stand out as the top performing sectors across the region. We are more cautious regarding the office market, which faces new challenges as a result of increased home working. Nevertheless, we still see opportunities in 'Next Generation' office space in the right locations. We expect the retail sector to continue to face notable challenges over the coming years.

The Nordic region well positioned for recovery

In the short term, as Covid-19 remains an immediate threat, there are still headwinds for much of the European real estate market, with the Nordic region no exception. As many areas face further lockdowns and social distancing restrictions, suppressed occupier and investment activity is likely to continue over the first half of 2021, particularly impacting the office and retail sectors.

However, with a vaccination programme now underway across Europe, as the year progresses we expect a rebound in economic activity and the Nordic markets look well placed for recovery. Indeed, while no country has been immune to the impact of the current global crisis, the Nordic region has so far proved relatively resilient in comparison to its European counterparts. Across the region, GDP is estimated to have fallen by an average of 4% in 2020, significantly less severe than the predicted E.U. average of -6.4%.¹

¹ DWS, Oxford Economics, January 2021

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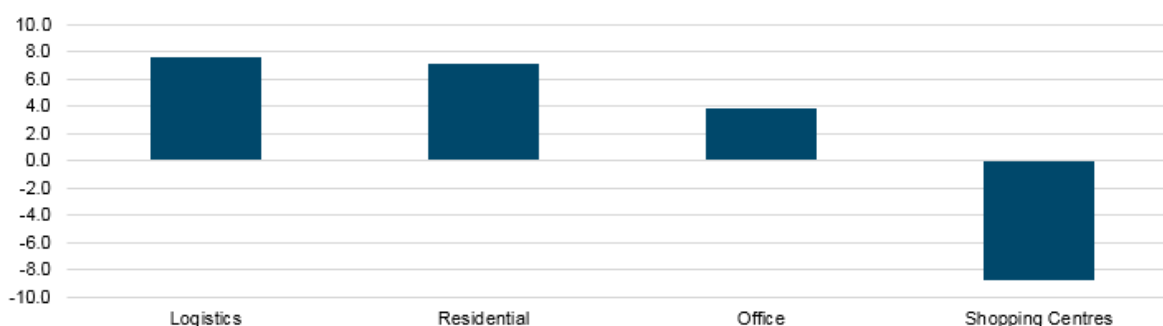
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Over the long term, economic growth across the Nordics is forecast to continue outperforming the E.U. average,² with the major cities of Stockholm and Copenhagen looking particularly well placed.

Residential and logistics lead the way

The residential and logistics sectors are expected to have recorded further capital value growth across all of the major Nordic markets in 2020. By comparison, we expect the office and retail sectors to have seen value declines of -4% and -18%, respectively.³ Looking forward, as in other European markets, we feel residential and logistics remain best placed to outperform over the coming years.

Prime Nordic Capital Value Growth (% P.A., 2021-22F)



Source: DWS, December 2020. F = Forecast. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

The Nordic logistics markets already benefit from high levels of e-commerce adoption. As the online sales ratio climbs further, we anticipate rising demand for logistics stock located ever closer to the end consumer. As such, demand for last mile, urban facilities should continue to grow rapidly and with relatively tight supply across all markets we are forecasting healthy rental growth over the medium term.

Within the residential sector, the significant urbanisation of Nordic populations continues to drive demand for mass market private rental schemes, both within the city centre and increasingly towards the more affordable suburbs. Of all the European cities we track, Stockholm and Copenhagen are projected to see some of the strongest population, employment and disposable income growth over the coming decade.⁴ Despite some pickup in development over recent years, supply in these markets remains relatively constrained, providing a catalyst for healthy rent growth.

On the whole, we are now more cautious on the office sector, as we anticipate that the acceleration of remote working could dampen European office demand over the longer term. In the Nordic region, the adoption of remote working was significant last year and the increase in employees working from home comfortably exceeded the European average.

However, we do believe the physical office will continue to play an important role. Going forward, we expect an increased divergence between prime and secondary stock as firms demand high quality, flexible office space. In addition, ESG will play an increasingly important role in both occupier and investment decisions. 'Next Generation' buildings, with a focus on environmental sustainability and employee wellbeing, are therefore expected to outperform.

It is important to note, however, that we are more negative on the Stockholm office market. We are still concerned about rental affordability for the most prime space, particularly as vacancy rates continued to increase over 2020. As such, we expect further notable rental decline in 2021. More affordable, emerging submarkets, including Hagastaden, Solna and Sundbyberg, are better placed for recovery.

² DWS, January 2021

³ DWS, PMA, December 2020

⁴ DWS, Oxford Economics, January 2021

We continue to see retail as the most vulnerable part of the market. With dramatic declines in high street and shopping centre footfall and increasing vacancy across all markets, rents fell significantly last year. Structural changes – most notably the shift to online spending – are firmly expected to continue impacting the retail sector going forward and we anticipate further rental decline over the coming years.

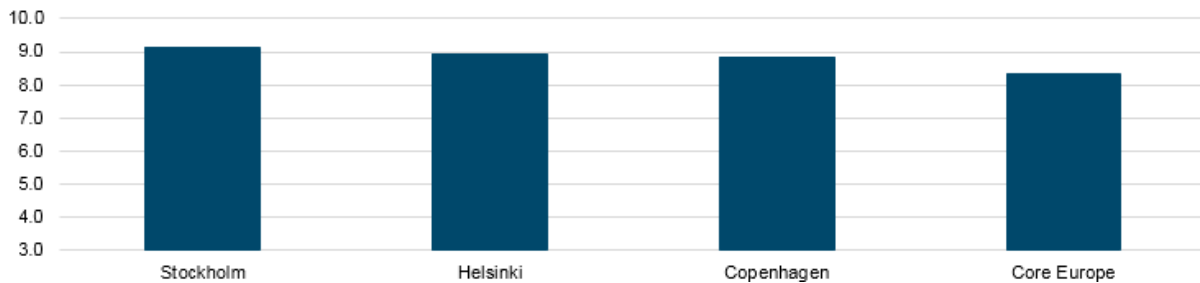
Attractive pricing should encourage international investors

A key factor in our outlook for Nordic real estate is the attractive pricing in comparison to Core European markets. With investors increasingly searching for higher value and returns, we expect the yield premium available across the Nordic markets to encourage further international capital into the logistics and residential sectors.

In the logistics market, for example, despite notable yield compression in recent years, the Nordic markets still command around a 70 basis point premium over Core Europe. With pricing in the sector looking increasingly tight across Europe, we see the potential for good investment opportunities in the Nordic region.

Furthermore, the Nordics was identified as one of the relatively few European regions to see an increase in investor sentiment over 2020, second only to Germany in this respect.⁵ As investors increasingly target the Nordic markets, this weight of capital will likely drive yields down further over the short-to-medium term. With this in mind, we are forecasting the combination of yield compression and healthy rental growth to support higher-than-average total returns.

Prime Logistics Total Return (% P.A., 2021-25F)



Source: DWS, December 2020. F = Forecast Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

⁵ PMA Survey of Investor Preferences, September 2020

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