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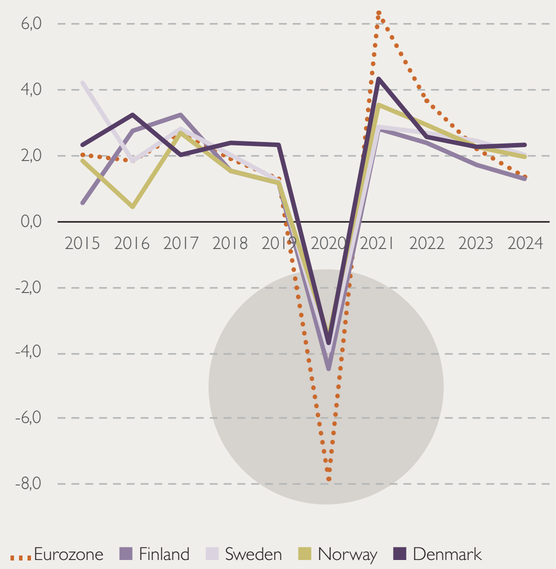
Nordic Market Tracker 2020

I) Economic recovery in the Nordics

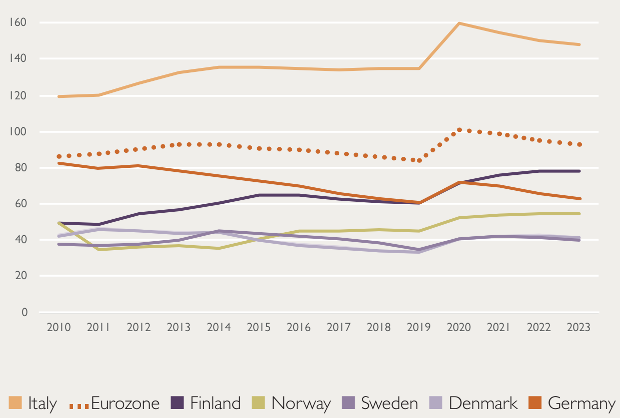
The situation as a result of the COVID-19 pandemic has rapidly impacted the workforce, economies, and financial markets in the Nordic countries, as it has across the rest of Europe and the world. Southern European countries suffer under harsher & longer lockdowns and their structural vulnerability to the pandemic due to a higher share of hospitality and tourism. Nordic financial services have successfully navigated risks during the first phase of COVID-19. Now they have to deal with the COVID-19 recession and the negative side effects of massive fiscal and monetary stimulus (higher inflation expectations due to increasing public debt). Overall, Nordic countries show a high pandemic resilience compared to European counterparts.

Fig. 1: Real GDP (pa in %)



Source: Catella Research, Oxford Economics

Fig. 2: Gross Government Debt (as a % of GDP)



Source: Catella Research, Oxford Economics

- Sweden's economy declined by 8.6% in Q2 but started to grow again in June. The crisis has brought a major fiscal response, with a package of tax deferrals, spending, and credit to over 15% of GDP. The Riksbank launched a new round of QE, purchasing assets equal to 10% of GDP and reduced the overnight lending rate by 55 bp to 0.2%.
- Norway's unemployment rate spiked to 10.7% in March but has since receded, as most of those claiming benefits are temporary lay-offs. Norway's banks have a relatively high reliance on bond markets for funding. Therefore, a property-related shock would not only hit the value of banking assets but could also lead to a surge in funding costs and tighter credit conditions. Norges Bank reduced the policy rate by 1.5 percentage points to zero and provided additional liquidity to banks in form of loans of differing maturities and a swap facility of USD 30bn via the FED.
- Global trade will be a key determinant of Finland's recovery as exports account for almost 40% of the Finnish GDP. Finland's economy contracted by 3.2% in Q2 which was far milder than almost all other European economies (EU average -12.1%). Residential construction spending is likely to continue its recent downward trend. The government budget deficit will rise to 9% of GDP this year.
- Denmark is recovering quickly since May. Industrial production picked up in June and business confidence continues to rise. The fiscal policy supports growth in H2 as policymakers responded quickly and forcefully to the crisis, a debt to GDP ratio of just 33% in 2019 creates further financial scope. Denmark's National bank decreased the policy rate by 15 bps to -0.6% and launched standing swap lines with ECB and FED.

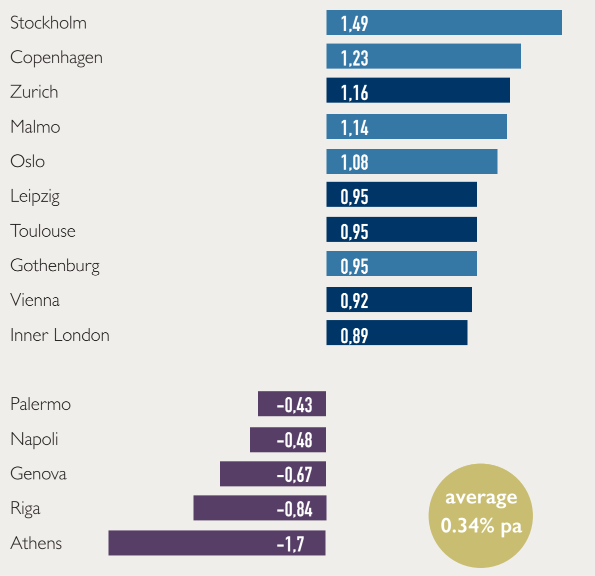
We expect monetary conditions to remain loose for an extended period due to weak growth and inflation outlooks and don't see interest rates to rise until 2023. Monetary and governmental policymakers stopped the COVID-Debt-Wave to spread from the real economy to commercial real estate and the financial system but risks still remain. The Nordic countries, in general, are relatively well equipped to deal with recession risks, as Finland, Sweden, and Norway have some of the healthiest public finances in Europe and ample space to ease fiscal policy. Money supply acceleration drives real asset prices while fiscal stimulus supports economic recovery.

II Residential Property Market

Strong population growth and smaller family sizes are driving demand: The share of Europe's population residing in urban areas rose between 2000 and 2018 from 71% to 75% while in the Nordic countries the rates of urbanisation are much higher than average. Five out of ten cities with the highest predicted population growth are located in the Nordics. The residential market in general is expected to show a high resilience to the COVID-19 crisis.

Fig. 3: Population growth 2020-2025, annual %

Top 10 and last 5 cities



Source: Catella Research, Oxford Economics

Several years of rising house price growth in Sweden came to an end in 2017 due to stricter mortgage amortisation requirements related to household indebtedness and a dramatic increase in housing supply. House prices fell sharply in 2017 but continued to be stable through 2018 and rose again in 2019. Long-term demand should be supported by strong population growth, especially in urban areas, as well as loose monetary policy. We observe increasing residential investment activities in recent years on the Finnish property market. In major Finnish cities, residential rents continued to increase in the second quarter 2020 whereby Helsinki, Tampere and Turku stand out. International investors increase their exposure furthermore.

The Norwegian housing market is highly transparent and liquid. After years of rising house prices, they fell over 2017 in response to rising supply as well as measures imposed by the government. But this decline is a correction rather than an outright reversal. The nationwide house price index started again to rise by a modest 2.3% from Q2'19 to Q2'20, according to Statistics Norway.

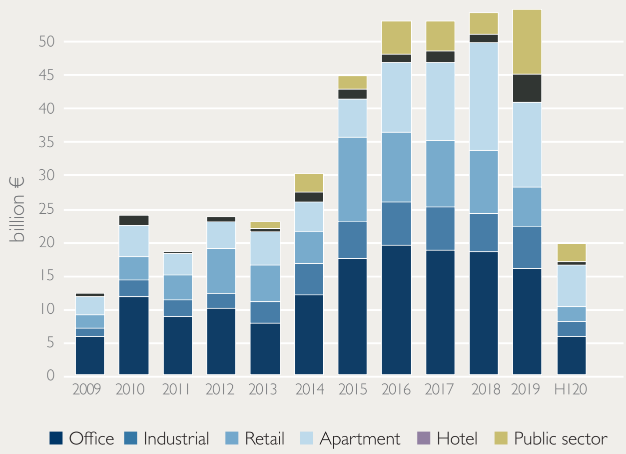
III Investment Market

The Nordic property markets benefit from fiscal and monetary support via low interest rates and decreasing bond yields in the crisis. While investors demand should remain strong due to high market liquidity and a lack of alternative investment opportunities, the letting market is under pressure as falling revenues and increasing risks arise. After years of yield compression and rising capital values, the commercial investment market is facing tighter financial conditions and increasing risks of non-performing loans as revenue prospects for tenants decrease. The transaction activity is still on a high level in view of the pandemic, but the remaining risks are highly dependent on the asset class.

We expect increasing financing costs and credit margins related to high-risk property segments. Major changes in demand and activity between the property segments can be observed. Investors' interest is currently tilted towards well-located properties in the major cities. Investors seek for stable cash flows and low vacancy rates, therefore public properties, residential rental properties and prime logistics segments are focused. The share of residential deals has increased significantly compared to the previous year. Investment managers are the largest type of investors in the Nordics while investment allocation towards real estate is increasing further.

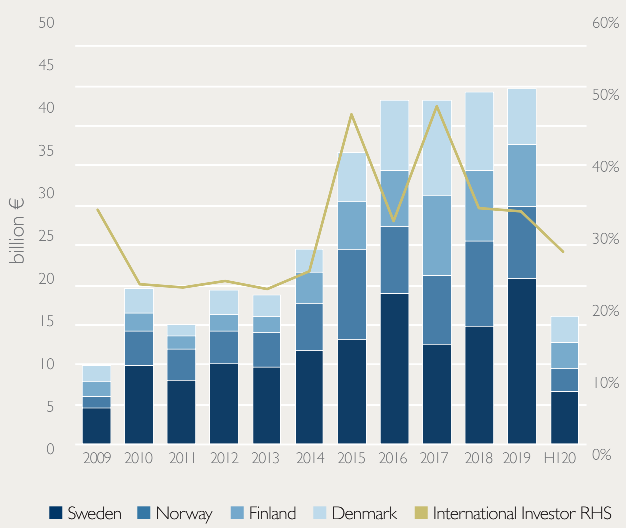
Since the northern European property market has shown structural stability in the long term, we expect an increasing demand of international investors with multi-country and multi-asset strategies in the future.

Fig. 4: Nordics Commercial Transaction Volume by Asset Class (bn €)



Source: Catella Research

Fig. 5: Nordics Commercial Transaction Volume by Country (bn €)



Source: Catella Research

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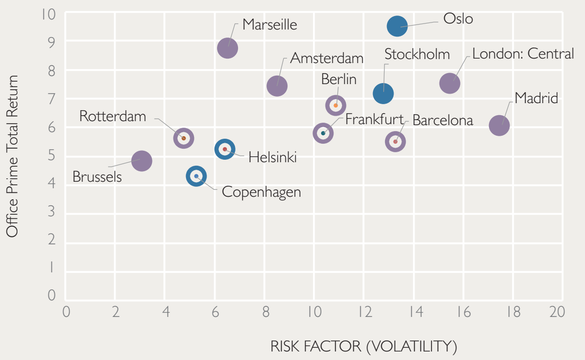
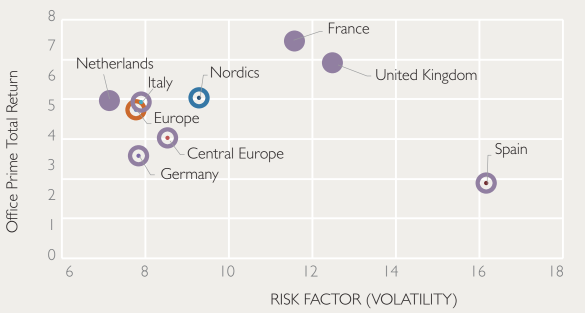
After setting a new record with almost €45 billion in 2019, the commercial transaction volume in the Nordic property market was exceptionally high again in Q1. Due to the pandemic, investment activity dropped more than 40 percent in the second quarter. Standing at €16.1 billion in the first half of 2020, transaction volume is down 14% year on year. Norway recorded the sharpest decline with a fall of 22%, while Sweden's transaction volume decreased by 14% to €6.7 billion. The average deal size rose up to €38 million, while the total number of transactions shrank by 23% year on year. Finland reached an all-time high first-quarter volume with €3.0 billion followed by the lowest quarterly volume (€400 million) since 2013. Foreign investors' share of the total transaction volume amounted to 57%.

Fig. 6: Risk-Return-Profile



Source: Catella Research, PMA

Fig. 7: Risk-Return-Profile

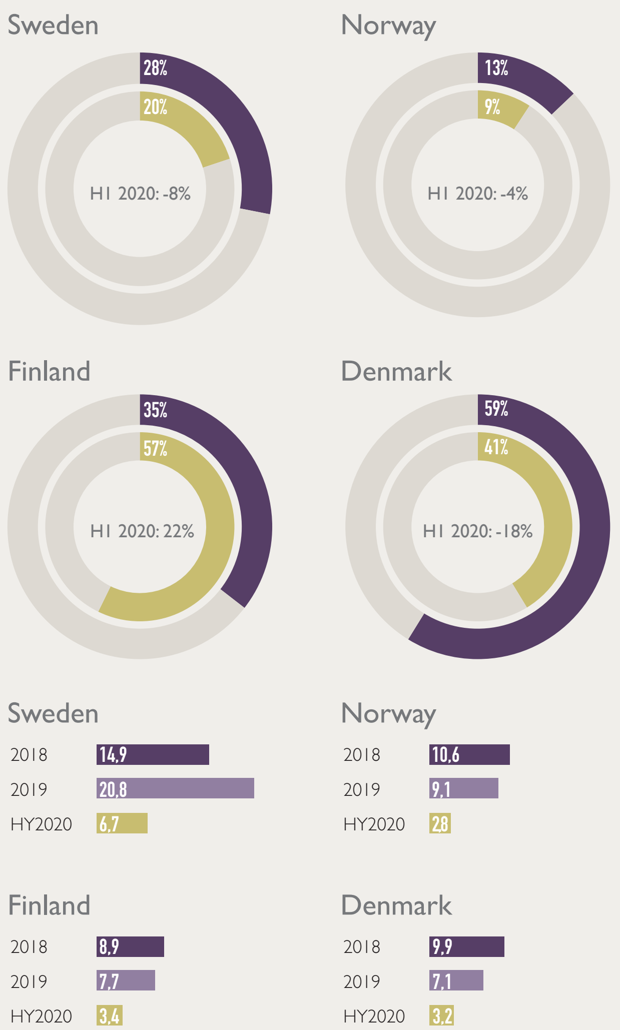


Source: Catella Research, PMA

The office market is driven by macro fundamentals and rising economic risks, but fiscal and monetary stimulus may lead to a higher attractiveness of real estate properties compared to other asset classes. There is a strong demand for core properties and public tenants in prime locations with low rental income risks. As forward guidance and long-term growth prospects are pointing to low interest rates for longer, multi-asset investors may be willing to pay a premium on "safe" office buildings.

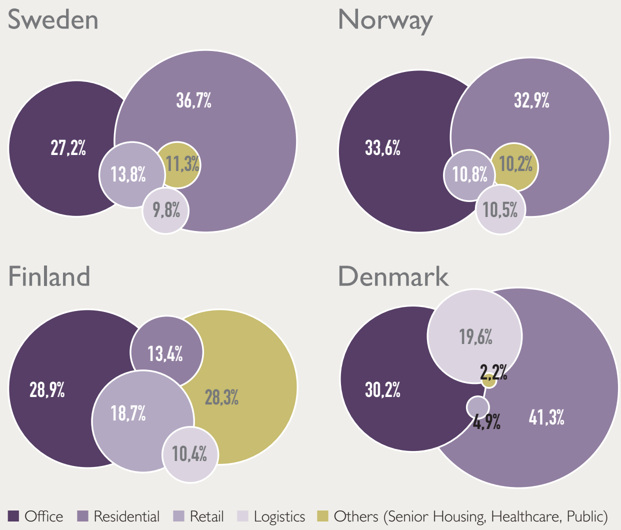
Non-core properties, in contrast, contain increasing credit risks: possible cost savings due to expanding home office and the rising fear of non-performing loans and credit losses may affect the risk evaluation of non-core office buildings in the future. While Helsinki and Copenhagen have relatively low total returns on a moderate risk level (on a 20-year-average), the valuation and market risk level in Oslo and Stockholm are more advanced. In a European country comparison, Nordics' risk-return profile is quite in the mid-range. Prime office yields increased slightly by 0.2% in the Helsinki Metropolitan Area while the office vacancy rate decreased from 12.3% to 11.9% during the first half of 2020.

Fig. 8: Transaction Volume
Share of international investors



Source: Catella Research

Fig. 9: Transaction Volume by Type of Asset



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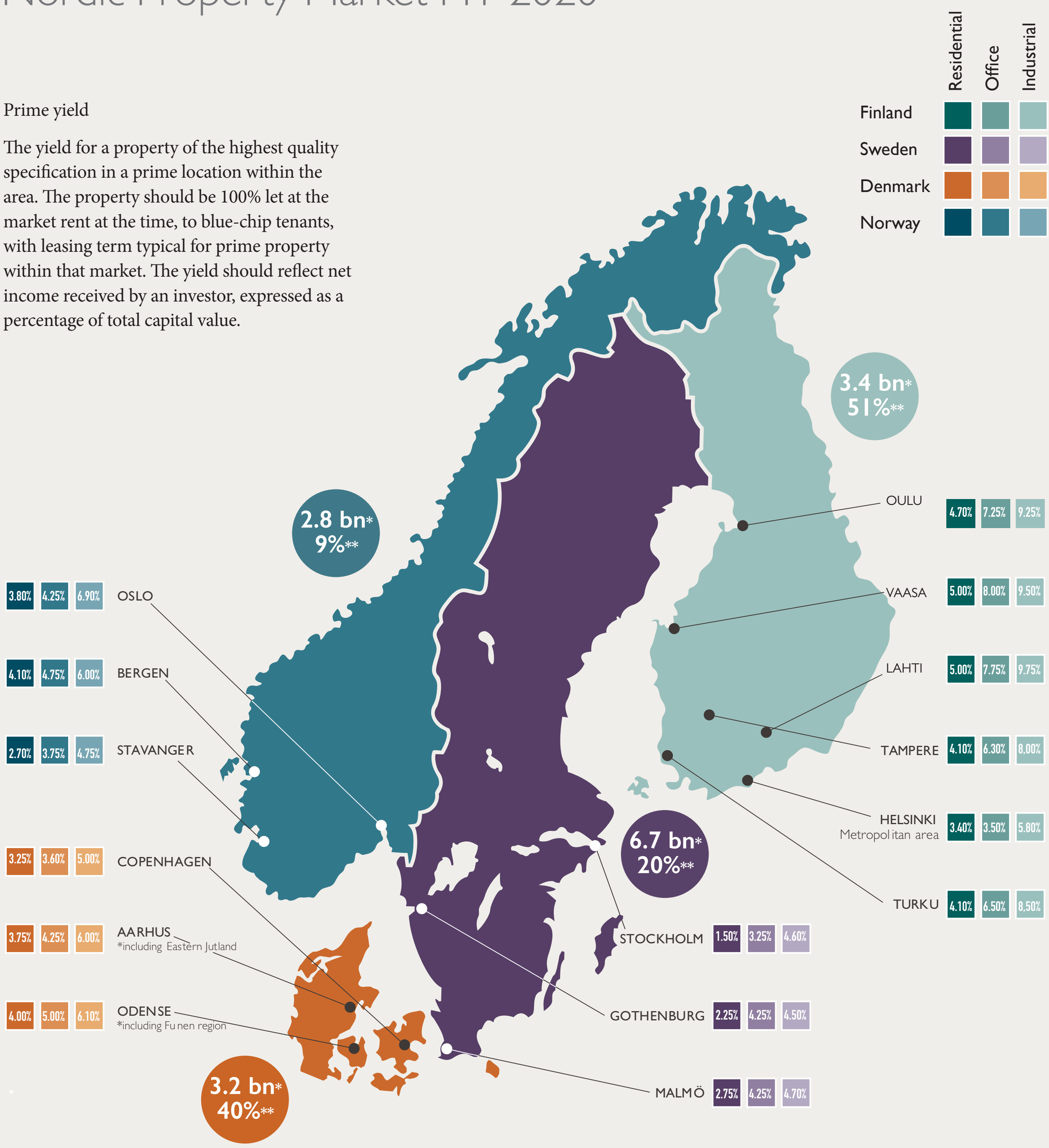
Nordic Property Market HY 2020

Prime yield

The yield for a property of the highest quality specification in a prime location within the area. The property should be 100% let at the market rent at the time, to blue-chip tenants, with leasing term typical for prime property within that market. The yield should reflect net income received by an investor, expressed as a percentage of total capital value.



* Commercial Transaction Volume HY 2020
** Share of International Investors

About Catella
Catella is a leading specialist in property investments and fund management, with operations in 14 countries. The group has assets under management of approximately EUR 14 billion. Catella is listed on Nasdaq Stockholm in the Mid Cap segment

Read more online at catella.com

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