

NORDIC REAL ESTATE STRATEGIC OUTLOOK

Mid-Year 2021

IN A NUTSHELL

- _ Long-term economic growth in the Nordics is forecast to comfortably exceed the European average. Stockholm and Copenhagen are expected to outperform, supported by population growth and urbanisation.
- _ Pricing still looks reasonably attractive in comparison to some Core European markets. Higher entry yields and strong growth projections are likely to encourage international investors.
- _ Residential and urban logistics stand out as the top performing sectors. We are more cautious on the office market in general, although we do still see select opportunities for investment.

Like elsewhere in Europe, the Nordic region has now entered a period of economic recovery. Looking forward, long-term economic growth is forecast to exceed the European average, with the region's major cities in particular supported by positive demographic trends. As is the case across most of Europe, the residential and logistics sectors are expected to outperform. We are more cautious regarding the office market, which faces new challenges as a result of increased home working. As such, our office rental growth forecasts are somewhat weaker than prior to the pandemic. Nevertheless, we still see opportunities in 'next generation' office space in the right locations. We expect the retail sector to face continued challenges over the coming years.

Nordic cities well positioned for long-term growth

While no country has been immune to the impact of the Covid-19 pandemic, the Nordic region proved relatively resilient in comparison to its European counterparts. Across the region, GDP fell by around -2.6% in 2020, compared to the E.U. average of -4.6%.¹ While the Nordic economies saw a slight further contraction in the first quarter of this year as increased Covid-19 infections led to the reintroduction of social distancing measures, the region has now entered a phase of economic recovery.

Having not experienced the same extent of economic decline as many other parts of Europe, short-term recovery looks more subdued across the Nordic markets. Over the longer term, however, economic growth is forecast to outperform the E.U. average, with the major cities of Stockholm and Copenhagen looking particularly well placed for employment and income growth, alongside strong population growth.²

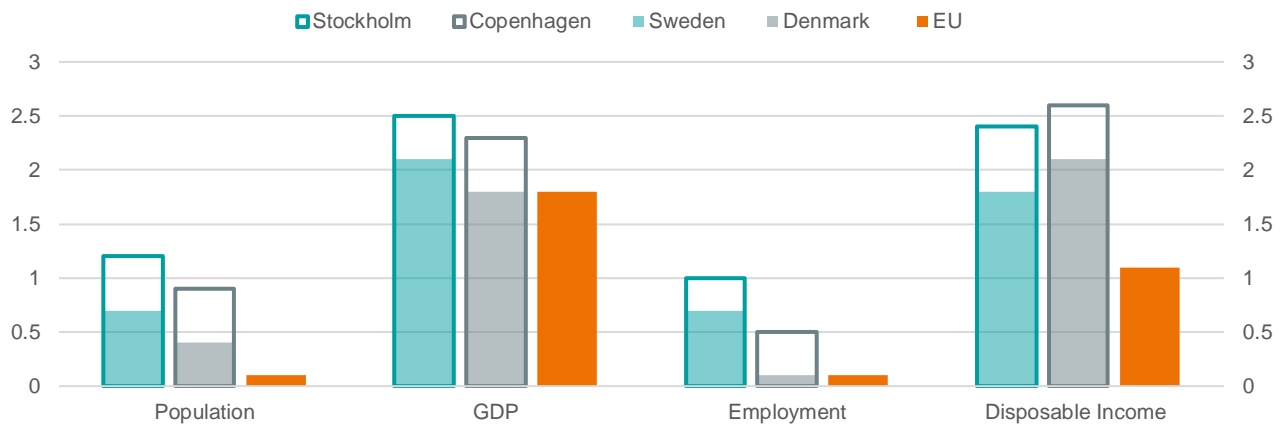
¹ DWS, July 2021

² DWS, Oxford Economics, July 2021

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ECONOMIC DRIVERS (% P.A., 2021-2030F)

Sources: DWS, Oxford Economics July 2021. F = Forecast. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

Attractive pricing spurs investor interest in the Nordics

With investors increasingly searching for higher value and returns, we expect the current yield premium available across the Nordic markets to encourage further international capital into the region, particularly targeting logistics and residential. With pricing in these sectors looking increasingly tight across Europe, we see the potential for good investment opportunities in the Nordic region. Indeed, despite notable yield compression in recent years, at the end of 2020, Nordic residential commanded a premium of around an 80 basis points over Core Europe, although that gap has already narrowed in the early part of 2021.

Despite ongoing challenges as a result of the Covid-19 pandemic, transaction volumes held up remarkably well in 2020, with Norway and Denmark even seeing year-on-year increases. Over the first half of 2021, strong investor interest continued, particularly as market fundamentals began to improve in the second quarter. Sweden remains comfortably ahead in terms of invested capital, but Denmark has seen the most significant increase in activity over the latest six months.³ As investors increasingly target the region, 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.

Nordic cities offer attractive residential opportunities

As in other European markets, we believe residential remains best placed to outperform over the coming years. 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. Stockholm and Copenhagen in particular are projected to benefit from faster household and disposable income growth over the coming decade.⁴ Despite a pickup in development over recent years, supply in these markets remains relatively constrained, providing a catalyst for healthy rent growth. However, it is worth noting that although we are forecasting Stockholm to achieve some of Europe's highest risk-adjusted returns, the residential market is highly regulated in Sweden and realising strong rental growth on existing held assets is unlikely.

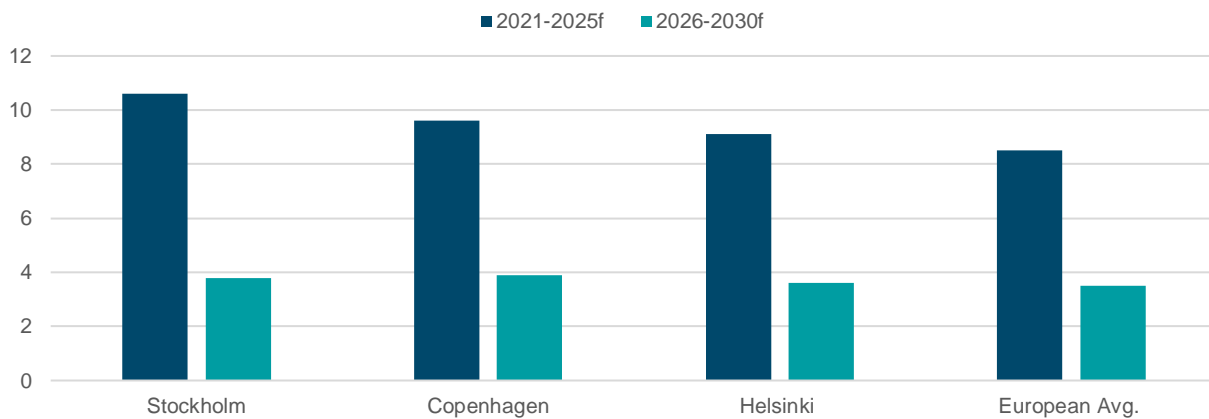
While on balance we maintain a strong call on the Nordic capital cities and their surrounding commuter locations at present, yields have moved in notably over the last 18 months. This means that although prime yields do still offer a premium over some Core European markets, pricing is becoming increasingly tight. As such, we also recommend seeking opportunities

³ RCA, July 2021

⁴ DWS, Oxford Economics, July 2021

in the largest regional cities such as Gothenburg and Malmö in Sweden, or Aarhus in Denmark. We believe these locations, which typically have a large university presence and strong employment prospects, have healthy long-term growth projections, tight supply and are typically more affordable.

PRIME RESIDENTIAL TOTAL RETURN OUTLOOK (% P.A.)



Source: DWS, July 2021. F = Forecast. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

The logistics sector has performed well across the Nordic markets in recent years, with already high levels of e-commerce adoption boosted further by the Covid-19 pandemic. As the online sales ratio climbs further, we anticipate that demand for last mile, urban facilities will continue to grow, and given the often constrained supply in these locations, such assets are expected to outperform in terms of both rental growth and total return. With regard to corridor logistics, although demand drivers certainly remain positive, the abundant supply of development land outside of the major Nordic cities has held back strong rental growth in these locations in recent years. Looking forward, rental growth in corridor locations is anticipated to be broadly in line with other European markets over the next five years.

On the whole, we are now more cautious on the office sector, as we anticipate that the acceleration of remote working could dampen office demand over the longer term. As such, across Europe our prime office rental outlook is now weaker than prior to the pandemic. 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. Nevertheless, we do believe the physical office will continue to play an important role and future office demand in the Nordics will be supported by the fast growing tech and life sciences sectors.

Going forward, we expect an increased divergence between prime and secondary stock as firms demand top quality office space. Strong ESG credentials will be increasingly prioritised by investors and occupiers alike, and 'next generation' buildings with a focus on environmental sustainability and employee wellbeing are expected to outperform.

We still see retail as the most vulnerable part of the market, as it continues to face numerous challenges. With dramatic declines in high street and shopping centre footfall, together with 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.

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