Same same but different
The Nordic property markets in a European perspective

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For quite some time, Sweden, Finland, Denmark and Norway have attracted substantial interest from international property investors. For some investors, these four markets are profoundly different, whereas other investors might treat them as one due to their similarities with regard to institutions, language and social models.

How similar are they, what differs between them and how do they compare with other European property investment markets?

This report aims to answer the above questions by taking a closer look at a number of key investment market metrics such as liquidity, rents and yields and how these have evolved over time.

The Nordic property markets attract substantial interest from international investors.
Same same but different – The Nordic property markets in a European perspective
Large property investment markets in absolute terms...

If aggregated, the four Nordic countries comprise the third largest property investment market in Europe, after the United Kingdom and Germany but ahead of France.

This becomes more pronounced if related to population. The total population in the Nordic countries amounts to almost 26 million people, which can be compared with the United Kingdom’s 65 million, Germany’s 81 million and France’s 66 million people.

Sweden, which is the largest property investment market in the Nordics, is by itself the fourth largest market in Europe. Sweden is, however, only the eighteenth largest country in Europe in terms of population and the tenth largest in terms of GDP.
...providing investors with high liquidity

The absolute figures by themselves indicate that the Nordic countries offer investors very liquid property markets. However, for the purpose of providing a more formal measure of liquidity, property transaction volumes over the ten-year period 2005–2014 have been related to the estimated size of each country’s total commercial property stock \(^{(1)}\) to arrive at a turnover ratio for each country.

Over the last decade, Sweden has actually been Europe’s most liquid property market, with Denmark, Finland and Norway on fourth, fifth and sixth place, respectively.\(^{(2)}\) How can this high liquidity be explained?

First, the Nordic countries are all characterized by transparency (to a varying degree), stable and high-quality institutional environments and top scores with regard to ease of doing business which reduce uncertainty, indirect transaction costs and barriers to enter the markets.

Second, liquidity breeds liquidity, i.e. high transaction volumes, especially if sustained over consecutive years, instill confidence in investors that an investment can be exited at a time deemed favorable. This is particularly important for international investors entering macroeconomic bets on regions or individual countries.

Third, direct transaction costs are lower in the Nordics compared to many other jurisdictions making it less costly to allocate capital both to and from property as well as to change the composition of a property portfolio. For example, both stamp duty and capital gains tax can under certain circumstances be avoided or at least postponed by making share deals instead of asset deals.

Property investment market turnover ratio for the ten most liquid countries in Europe, average 2005–2014

<table>
<thead>
<tr>
<th>Country</th>
<th>Turnover Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>6.3%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>5.8%</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>4.7%</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.6%</td>
</tr>
<tr>
<td>Finland</td>
<td>3.6%</td>
</tr>
<tr>
<td>Norway</td>
<td>3.4%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.3%</td>
</tr>
<tr>
<td>Germany</td>
<td>2.1%</td>
</tr>
<tr>
<td>France</td>
<td>1.9%</td>
</tr>
<tr>
<td>Poland</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

1. The size of the total commercial property stock is estimated as 45% of nominal GDP for developed countries and 45% \(\frac{GDP \text{ per capita}}{GDP \text{ per capita threshold}}\) of GDP for developing countries where the GDP per capita threshold is defined as €15,000, the result of which becomes consistent with the World Bank’s classification of countries in ‘developed’ and ‘developing’. This method for estimating the size of the total commercial property stock is usually referred to as the ‘Prudential formula’ as it was devised by employees at Prudential Real Estate Investors.

2. When applying the Prudential formula, the United Kingdom’s commercial property stock is sometimes increased by 25% due to the heavy concentration of property value to London not being captured by the standardised formula. This has, however, not been done here. Should that adjustment be made, the United Kingdom’s turnover ratio would decrease from 5.8% to 4.7%.
Financial crisis impact on the Nordic property investment markets

In line with the rest of Europe, the financial crisis of 2008–2009 led to a sharp decline in transaction activity in all four Nordic countries. Having said this, some differences between the markets can be noticed, explaining the countries’ differing recovery patterns.

First, capital for property investment derived to more than 90% from leveraged buyers during the years leading up to the financial crisis in all four Nordic countries. In Sweden, Finland and Denmark, this share dropped to roughly 70% during 2010–2012 whereas it stayed more or less the same in Norway over the entire time period. In addition, investors generally deleveraged during the financial crisis, further contributing to the aggregated capital structure containing more equity now than it did before 2008.

Second, foreign investors accounted for 40–50% of transaction volume in Sweden and Finland during 2005–2007, compared to 10–20% in Denmark and Norway, making Sweden and Finland more exposed to the withdrawal of non-Nordic capital which occurred as a result of the crisis.

Third, in the financial environment which followed the financial crisis, characterized by low interest rates and high risk aversion, domestic institutional investors in Sweden began to perceive the risk-return profile of property as attractive relative other asset classes, thus investing rather heavily in real estate. In Finland and Denmark, however, domestic investors were much more restrictive with regard to allocating additional capital to property.

In summary, the transaction market recovered faster in Sweden, as insurance companies and pension funds replaced foreign and/or leveraged investors as large buyers of property, and Norway, which was less dependent on foreign capital and where leveraged investors to larger extent remained in the market, than it did in Finland and Denmark.

On a final note, despite the slowdown in transaction activity, Nordic property market liquidity remained among the highest in Europe, and higher than in Germany, France and the Netherlands, through the entire financial crisis, of 2008–2009.
Property transaction volume per Nordic country, 2005–2014
EUR billion
Yields have compressed across the Nordics

Over the past 25 years, basically all prime office property markets in Europe have experienced yield compression against the backdrop of falling interest rates and increasing degree of market sophistication. The Nordic capital cities are no exception from this trend. Yield compression has been greatest in Oslo, where yields initially were much higher than in the other Nordic capitals, partly because Norway’s banking crisis started several years earlier than Sweden and Finland’s.

With regard to yields, the Nordic countries appear to have coped better in the financial crisis than the substantially larger investment markets London and Paris, since prime office yields in the Nordic capitals expanded by 50–125 basis points during the financial crisis whereas corresponding yields in London West End, London City and Paris rose by 200, 275 and 175 basis points, respectively. Among the Nordic cities, Copenhagen experienced the smallest yield expansion.

1. By yield compression here means a general fall in yield levels, i.e. a downward trend. In the case of Stockholm, even though the first observation is lower than the last observation the trend is nonetheless downward-sloping. Although the first observation is the lowest, 80% of the observations are higher than the last one – therefore the trend in yields is decreasing.

2. Denmark did not experience a systemic banking crisis in the beginning of the 1990’s.
Prime office property yields in selected European cities, 1990–2015 H1

Stockholm
Helsinki
Copenhagen
Oslo
London West End
London City
Paris
Rental volatility varies within the Nordics

Over the past 25 years, rental volatility\(^1\) has been twice as high in Stockholm and Oslo compared to Helsinki and Copenhagen, deriving in the case of Stockholm to large part from the dotcom boom-and-bust around the turn of the millennium and in the case of Oslo from very strong rental growth underpinned by a booming economy in the mid-2000’s which was later ended abruptly by the financial crisis.

In a European perspective the rental volatility in Stockholm and Oslo places after London’s but is higher than in other European cities, whereas rental volatility in Helsinki and Copenhagen are among the lowest in Europe.

At the same time as being among the most volatile rental markets. Stockholm and Oslo have due to their positive rent level trends provided ample opportunities for an investor to benefit from rental growth, at least as long as an acquisition was not made at the cities’ respective rental peaks. The rent level trend in low-volatility Copenhagen, on the other side of the spectrum, has been negative, which can be explained by infrastructure investments having made possible construction of new office areas, putting downward pressure on CBD rents.

Investors are not, however, necessarily compensated for taking on higher volatility through better prospects for rental growth and vice versa, illustrated by the case of Helsinki, where volatility has been low and rents flat, and London City, which has experienced high volatility as well as a negative trend in rents over the past 25 years.

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### Prime office rent volatility and rent level trend for selected European cities, average 1990–2014

<table>
<thead>
<tr>
<th>Prime office rent volatility</th>
<th>Prime office rent level trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>London City</td>
<td>27%</td>
</tr>
<tr>
<td>London West End</td>
<td>25%</td>
</tr>
<tr>
<td>Stockholm</td>
<td>20%</td>
</tr>
<tr>
<td>Oslo</td>
<td>20%</td>
</tr>
<tr>
<td>Amsterdam</td>
<td>15%</td>
</tr>
<tr>
<td>Munich</td>
<td>14%</td>
</tr>
<tr>
<td>Paris</td>
<td>13%</td>
</tr>
<tr>
<td>Hamburg</td>
<td>12%</td>
</tr>
<tr>
<td>Copenhagen</td>
<td>12%</td>
</tr>
<tr>
<td>Helsinki</td>
<td>10%</td>
</tr>
</tbody>
</table>

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1. Actually ‘coefficient of variation’, i.e. the standard deviation divided by the mean to make rents in different countries, which might be at very different absolute levels, comparable with one another.
2. It is important to bear in mind that definitions vary between countries which may distort the comparison of absolute rent levels. For example, Danish lease agreements tend to put relatively more responsibility for operating and maintenance costs on the tenants who also lease common areas to a larger extent than is the case for example in Sweden. All-in-all, this would increase the Copenhagen rent level by 50 EUR/m².

3. Rents are stated in today’s price level, i.e. adjusted backwards in time to remove the effect of general price level changes and make rent levels comparable over time.
Property investment market liquidity is very high in the Nordics.
Implications for investors

The Nordic countries offer investors very liquid property markets, facilitating for an investor to both enter and exit the markets. Although liquidity remained relatively high throughout the financial crisis, sound respect for the impact a sudden withdrawal of capital might have on transaction volume on these markets is advised.

Over the past 25 years, Stockholm and Oslo have shown positive rental trends, albeit at the price of relatively high volatility. Rents have been much more stable in Helsinki and Copenhagen, but on the other hand having shown a flat or – in the case of Copenhagen – even negative trend.

Similar to other European property markets, the Nordic capital cities have experienced a prime yield compression over the past 25 years. Despite their smaller absolute size, the Nordic capitals withstood the financial crisis better than London and Paris. Among the Nordic cities, Copenhagen was the most resilient city with regard to prices.