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THIS TIME IS DIFFERENT?

A comparison of crises in the Nordics

Including the Nordanö Company Overview

Nordanö

Editorial cartoonist: Anders Westerberg/Stockholm Illustration.

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A comparison of crises in the Nordics

The property sector in the Nordics has been hit by many crises; some of them originated 'in-house' within the sector, some of them were triggered from outside of the sector, some were homecooked, nationally, and others were global. What has the impact of these crises been on the property sector and, more importantly, what conclusions can we draw with regards to the current COVID-19 pandemic? What can we learn from history?

In this article we discuss and compare the following crises, in their order of appearance:

- **Great property and banking crisis**
  1990-1994
- **Dotcom bubble burst**
  2000-2002
- **Global financial crisis**
  2007-2009
- **COVID-19 pandemic**
  2020-

Great property and banking crisis
1990–1994

Property companies went bankrupt left and right, triggering a banking crisis that eventually led to the creation of new property companies, when assets were offloaded from the 'bad banks'.

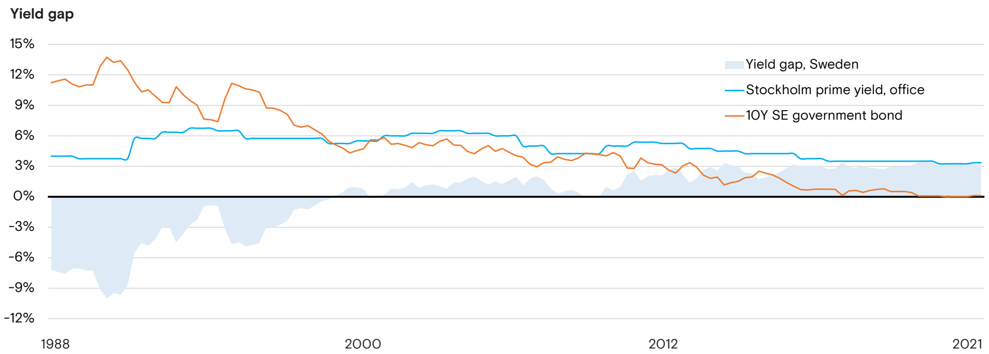
The great property crisis in the early nineties was unprecedented and, so far, nothing has come close in terms of consequences in our sector, in our part of the world.

In Sweden, almost every major property company and developer filed for bankruptcy. The origin of the crisis was in the office sector. Commercial property prices fell about 50%.

So, what exactly happened? Firstly, we were in a completely different macro environment compared to today; in the eighties we had double digit inflation, and nominal interest rates were even higher. Not only nominal interest rates, but even real interest rates were much higher than today.

In such a scenario, with high inflation and high interest rates, it is possible and even reasonable, to have a negative yield gap. But, as shown in the graph, the yield gap in Sweden was exceptionally negative in the late eighties. A central problem with negative yield gaps is debt service. In essence, a property company must continuously increase its nominal debt (but not necessarily loan-to-value, if property values follow inflation) to be able to serve its debt. Property companies needed to refinance themselves repeatedly, just to be able to maintain debt levels, in real terms.

When the crisis unfolded in Sweden, most property companies and developers went bust. Property companies were unable to serve their debt and the banks were unable to rollover their debt. The financial crisis led to a banking crisis that left almost all Swedish banks on the verge of bankruptcy and in need of government bailout.



'Bad banks' were created for the property portfolios of the banks. Eventually, many of those companies were listed, creating large, listed property companies like Diligentia, Kungsleden, Tornet and Castellum, some of which still exist today. One turning point for the office sector was when AP Fastigheter (now known as Vasakronan) started to acquire office properties.

In Finland, a bad bank was created as well, with the bad real estate arm spun off in 1999 as Kapiteeli Oyj, which was subsequently acquired by Sponda in 2006. Sponda was also founded as a result of the crisis and the collapse of SKOP Bank. In general, the recovery in Finland was somewhat more prolonged, because foreign investors entered the property market later than in Sweden.

In Norway, the crisis started a few years earlier, in 1988, with the demise of the property imperium created by Harald O. Osvold. As in Sweden, a quick credit expansion, primarily in the property sector, came to an abrupt ending. The different banks handled the situation differently. In the end, some new property companies were created, for instance Linstow, which is still active today, but a big bulk of the assets were sold to new, private, property investors, many of whom are the property tycoons of Norway today.

Most people in the property sector thought that it would takes 5-10 years to recover from the property crisis. But everything panned out much better than anticipated.

What can we learn?

The crisis in 1990-1994 was very much a product of a macro environment with very high inflation and high interest rates, combined with a bubble in the office sector, were rents and values were expected to outgrow inflation indefinitely. The bubble was fuelled by a credit expansion in the sector, that created highly leveraged and vulnerable property companies.

In the current market, investors are prudent regarding growth projections and in addition inflation and interest rates are low.

Is it possible that we will come back to a macro environment with high inflation and high nominal interest rates? It is highly unlikely, however, there is a medium-term risk of increasing inflation. The impact of inflation is outside the scope of this article, but it is a topic we will come back to in due time.

Dotcom bubble burst

2000–2002

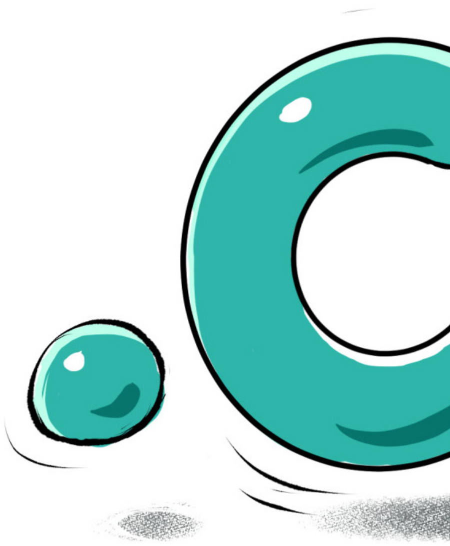
The spectacular burst of the dotcom bubble left behind large office vacancies in a couple of submarkets. In Sweden, foreign investors were crucial in the rebound of the office sector.

This crisis is completely different to the previous one. Sweden, and to a lesser degree Finland, experienced a tremendous growth in the IT-sector. With IT-shares skyrocketing on the stock exchange, a bubble was inflating. A large part of the market value of the Stockholm Stock Exchange was IT-related, and in Finland as well, mainly Nokia. This bubble, as opposed to the other ones, was first and foremost a stock market bubble. When such a bubble bursts, value is not destroyed per se, it is mainly a transfer of wealth from those who acquired at the top to those who sold in time. To illustrate this, the fall from top to bottom on the Stockholm Stock Exchange was 73%, while the economy in general enjoyed a small GDP growth.

However, it was not ***entirely*** a stock market crisis. In Sweden, tens of thousands of jobs were lost in the IT-sector, but they were concentrated to one sector, office, and to two submarkets; Central Stockholm and Kista, leading to a quick and sharp increase in office vacancies in those two areas. The rest of the property market muddled through, without much ado.

The recovery of the Swedish property market was quick. Foreign investors were the driving force, with German investors picking up prime properties in Stockholm and opportunistic investors picking up properties elsewhere. As an anecdote, domestic investors in Sweden were shocked when Deka acquired an office building in Stockholm CBD (Citykronan) from Skanska at a 6.25% yield; 'these Germans are clueless; how can they pay so much?'. A couple of years later Deka sold a at 5% yield, with higher rents, making a hefty profit.

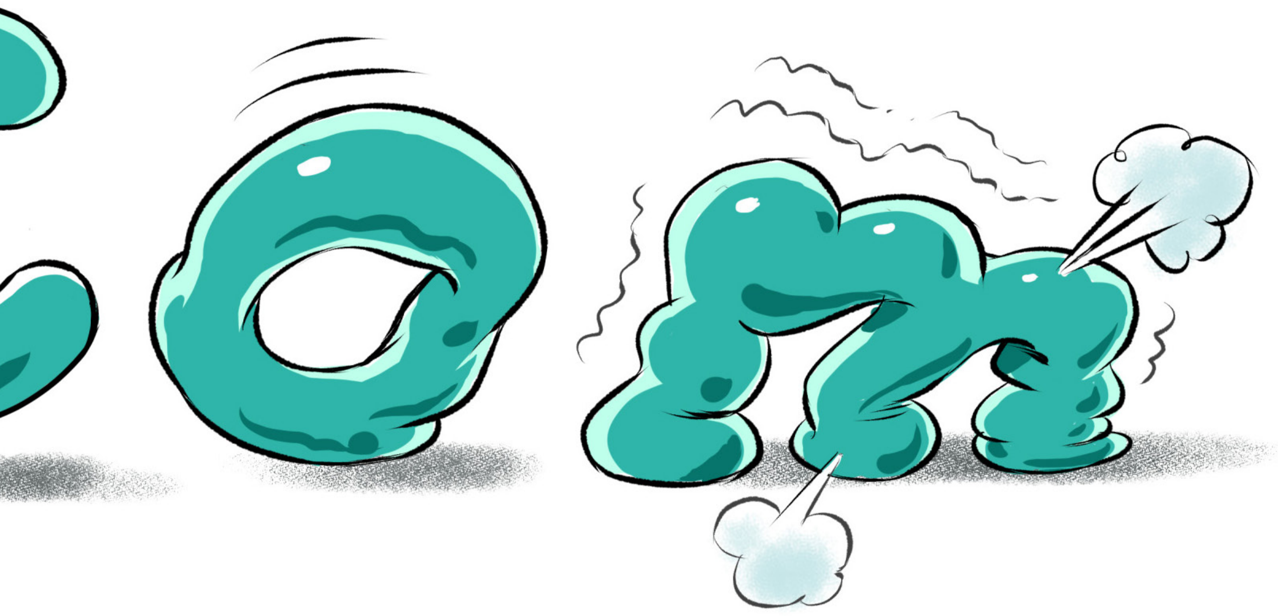
During this time, listed property companies, most of them based in Sweden, were trading at a large discount, and many were taken private, not the least some of those that had been listed less than a decade earlier as a result of the banking crisis.



There was an impact from the burst of the dotcom bubble in Finland as well. In the property sector, two particular office submarkets, Ruoholahti and Keilaniemi were hit by increased vacancies during this crisis. However, at that point of time the office market in Finland was very domestic; most buildings were owned by local institutional investors, which chose to keep this crisis 'under the lid'.

In Norway and Denmark, the consequences of this particular crisis were less severe.

What can we learn?
This crisis in 2000-2002 was limited to the office sector and a few geographical areas. The main lesson was, once again, that the market recovered much faster than expected. Curiously, foreign investors were more successful in identifying and capitalising on the recovery, compared to local investors.



Global financial crisis
2007-2009

The global financial crisis was one of the largest financial crises in the last century. Given the difficult circumstances, the property sector in the Nordics coped well mainly because the economies of the Nordic countries were less affected by the crisis compared to elsewhere.

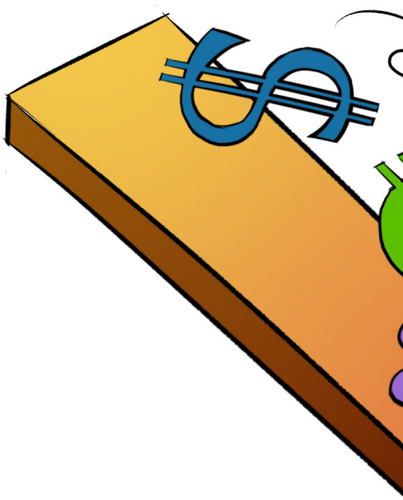
The Global financial crisis is different compared to the two previous crises in several ways; firstly, it was a truly global crisis; secondly, it was not a crisis that was centered around the property sector, although the demise of American sub-prime loans had some impact in the beginning of the crisis and Spain suffered a property crash in the residential sector due to massive speculative residential development prior to the crisis.

The crisis was triggered by multiple factors, but to a great extent it was a crisis caused by leverage. Many European governments had increased their indebtment, in good times, and were not prepared for a recession. In tandem, many European banks were too thinly capitalised. This triggered a credit crunch that accelerated the crisis.

In the Nordics, with the exception of Finland, the contraction of GDP was smaller than in most other countries, since among other things, government debt was low.

However, the property market was paralysed; transaction volume fell by as much as 75% in Sweden. The consensus in the market was that it would take 3-5 years for liquidity to return; but it took only 18 months.

In Denmark, the crisis was more severe than in Sweden; there were lots of bankruptcies that had an impact on the banking sector as well. Whereas many Swedish banks went along the 'extend and pretend' route, to keep property companies floating, in Denmark the banks tightened up financing and highly leveraged investors were hard hit. All sectors were affected by the crisis, but the focal point was in the residential sector, where prices for owner occupied apartments, as well as rental apartments, plummeted up to 30%, and the market took many years to recover.



In Finland, the Global financial crisis was particularly bad, since it was simultaneous with the demise of Nokia, that hit the Finnish economy and stock market particularly hard. In the property sector, liquidity in the transaction market imploded completely; from 2007 to 2009 transaction volume fell by over 80%! In addition, the demise of Nokia created large vacancies that took a couple of years to recover from.

In Norway, the economic impact of the crisis was less severe due to relatively high oil prices. Low levels of government indebtedness allowed the government to provide liquidity to the banking sector. However, in the property sector liquidity fell sharply with a decrease of 2/3 of the transaction volume between 2007 and 2009.

What can we learn?
The Global financial crisis in 2007-2009 has been debated exhaustively. The Nordics were less hit by this crisis, to some extent due to prudent fiscal policy, which bodes well for the current and upcoming crises.

The property sector was hit in varying degree by this crisis, but the worst scenarios didn't materialise, and the property markets recovered surprisingly quickly.

COVID-19 pandemic

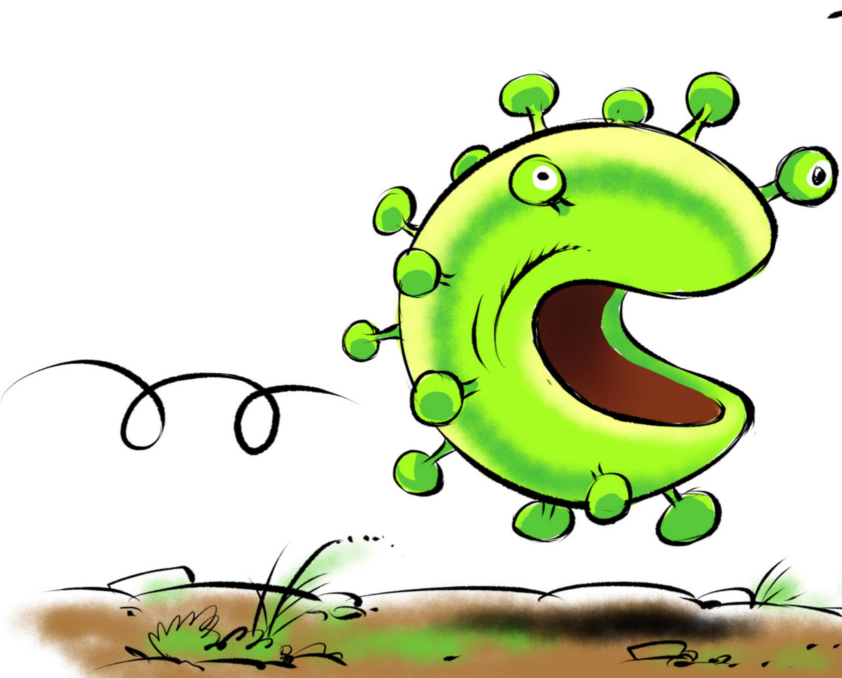
2020-

The COVID-19 pandemic and its ensuing crisis is like no other crisis that we have experienced in our lifetime, and unlike any of the previously mentioned crises in this article.

Although some had warned for the risk of a global pandemic, and many more warned in hindsight after the crisis broke out, it is safe to say that for a majority of the world population the disruption caused by the pandemic was seen as highly unlikely. In this sense, one could argue that the COVID-19 pandemic is a black swan.

Comparing the ongoing pandemic to other crises, it is mostly similar to the Global financial crisis, for several reasons: mainly, the global nature, and the global response. The pandemic has, so far, had a limited impact on the Nordic property sector. It has deeply impacted some sectors of the economy; travel, tourism, hotels, restaurants, etc., but those sectors constitute a small part of the economy and a small percentage of commercial property leases. Furthermore, the structural changes in the retail sector, triggered by e-commerce, had been ongoing for a long time before COVID-19, the pandemic has merely accelerated the process.

Outside of the retail sector, there is a discussion regarding the post-pandemic demand for office properties, since office workers are likely to spend less time working at the office, but it is too early to call, and a topic that we may cover in the future.



In the property transactions market, this crisis is very different to the previous ones. Throughout the crisis, except for Q2 2020, liquidity has been good in many markets; residential, logistics and social infrastructure, while liquidity has dried up in other markets, mainly some retail property submarkets.

What can we learn?

So far, the ongoing pandemic is arguably not a property crisis. That said, it has had an impact on parts of the economy which transposes into parts of the property market.

A particular characteristic of the pandemic is that it has accelerated processes that were already underway prior to the crisis, in particular the following three:

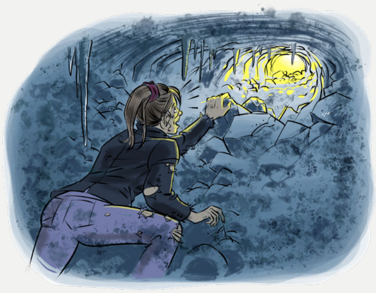
1. The transformation of retail: under pressure from e-commerce, many retail sectors need to restructure or re-invent themselves

2. The flexible office: the office space is changing, with different, parallel trends; coworking, activity-based offices, work from home, work anywhere, etc.

3. ESG: investors, as well as tenants, are increasingly factoring in ESG-aspects when looking at properties, particularly environmental impact and sustainability

One conclusion from the previous crises, outlined in this article, is that in all previous crises, the recovery was much quicker than the market expected, at least in the Nordics. This bodes well for the current crisis.

Four crises – four countries – different outcomes

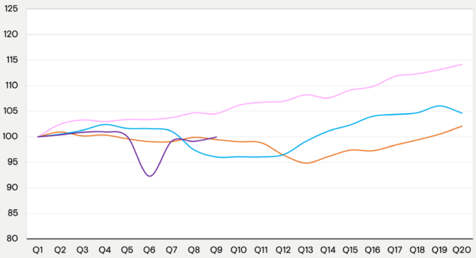


The graphs and tables below illustrate some key findings.

- **The Great property and banking crisis** was a Swedish and Finnish affair, with Finland being hit the hardest and taking long to recover.
- **The dotcom bubble burst** did not result in GDP contraction in any of the Nordic countries.
- Norway was somewhat spared from the **Global financial crisis**, thanks to relatively high oil prices.
- The top-to-bottom GDP contraction due to the **COVID-19 pandemic** has been drastic, but the recovery has been very quick as well!

Sweden – GDP

Index



Denmark – GDP

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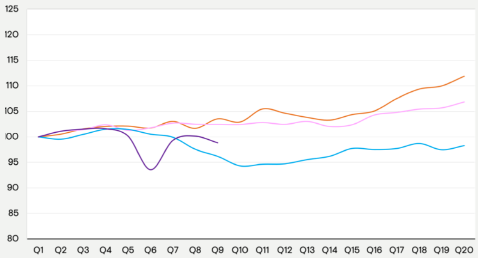

Finland – GDP

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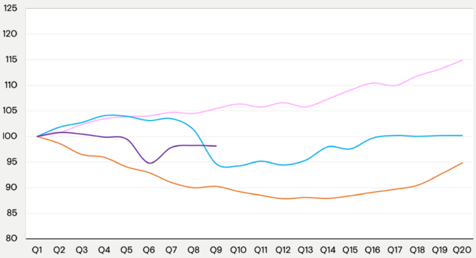

Norway – GDP

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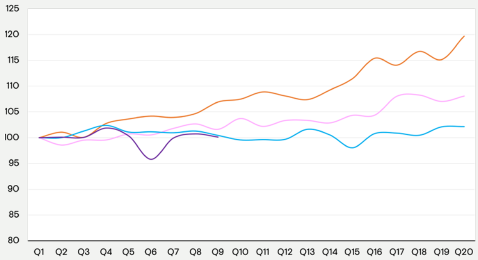

Great property & banking crisis (index Q1 1990 = 100)
Dotcom bubble burst (index Q1 2000 = 100)
Global financial crisis (index Q1 2007 = 100)
COVID-19 pandemic (index Q1 2019 = 100)

GDP contraction (top-to-bottom)	*Sweden*	*Finland*	*Denmark*	*Norway*
Great property & banking crisis (1990-1994)	-6.0%	-12.1%	No decrease	No decrease
Dotcom bubble burst (2000-2002)	No decrease	No decrease	No decrease	No decrease
Global financial crisis (2007-2009)	-5.8%	-9.3%	-7.1%	-2.8%
COVID-19 pandemic (2020-)	-8.6%	-5.9%	-7.9%	-6.0%

Crisis comparison	*Local / Global*	*Black swan?*	*Properties at the center?*	*Impacted property sectors*
Great property & banking crisis (1990-1994)	Local	No	Yes	All
Dotcom bubble burst (2000-2002)	Mostly local	No	No	Some office submarkets
Global financial crisis (2007-2009)	Global	No	Somewhat	All
COVID-19 pandemic (2020-)	Global	Yes	No	Retail, hotels (and office?)

Where are we heading?

Right now, in June 2021, we are at an inflection point in the COVID-19 pandemic. In the US and Europe, we are seeing improvements in the economies and the outlooks are positive, thanks to infection levels decreasing, vaccination accelerating, and restrictions slowly being relaxed.

With fiscal policy being extremely expansive in Europe, and even more so in the US, in combination with monetary policy being expansive everywhere, there is a risk of overshooting, i.e. too much stimulus when the underlying economy is already improving. In such a scenario, a major risk is increased inflation in the mid-term.

The Nordic countries are in an enviable position with economies that are resilient to the current crisis for various reasons; strong public sector finances and low dependence on sectors that have been severely hit by the pandemic, including tourism.

Regarding the property sector, institutional investors continue to pour funds into property, which they see as a safe haven with attractive cash flows and risk-adjusted returns. Less cyclical sectors, such as logistics and residential, as well as social infrastructure, are particularly sought-after by investors. In Sweden there is also a large universe of listed property companies that are currently trading at a premium of 26% to NAV (see next section; the Nordanö Company Overview). The premium enables the listed property companies to further expand their portfolios with acquisitions.

Finally, to answer the question in the title of this article, 'This time is different?', the answer is ‘yes’, of course, because it always is; every crisis is unique, particularly black swans like this one.

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