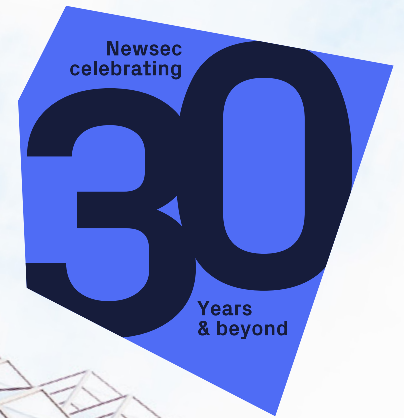
Newsec property outlook

Spring 2024



newsec

Shaping another 30 years with Newsec, focused on excellence, integrity and innovation

As we reflect on the remarkable journey of Newsec over the past 30 years, I would like to take this opportunity to share some insights and reflections on the role of artificial intelligence (AI) in our ever-evolving landscape. Our spring edition of Newsec Property Outlook is not just a testament to our three decades in the real estate business, but also exploration of the transformative power of AI as a vital tool and partner in our professional lives.

The rapid advancement of AI, especially in the last few months, has been nothing short of astonishing. AI has become an indispensable force, reaching every aspect of our lives, personal as well as professional – a natural evolution that enables almost everyone to harness the capabilities of AI.

Yet, amidst this transformative wave, acknowledging that while AI is a powerful tool, it is not a substitute for the fundamental importance of human relationships. It's not for nothing that we have the guiding principle 'Passion for colleagues and clients' as our direction at Newsec.

Personal interactions, built on trust and understanding, remain irreplaceable in our professional landscape. As we embrace AI, we must recognize that its true potential lies not in replacing human capabilities but in strengthening our efficiency and productivity.

AI's exponential growth and its potential to reshape our world as we know it can be intimidating, but let us not underestimate our ability to adapt. The World Economic Forum in Davos this winter has provided valuable insights, addressed fears, and highlighted the exciting possibilities that AI holds. It is essential to view AI not as a threat but as a source of enthusiasm and innovation.

Incorporating AI into our business strategies should be a measured process. Rather than using one tool to address every challenge, let us take small steps and engage AI in focused applications. When we witness its success in these smaller actions, we can confidently expand its role, ensuring a more seamless integration into our operations.

Regulation is undoubtedly necessary against potential obstacles, but we must step carefully not to rule out innovation. Striking a balance between oversight and fostering an environment of creativity is crucial. Personal leadership combined with digital evolution is key, highlighting our leader's role in fostering commitment and responsibility, ultimately building lasting relationships with colleagues and clients. Thirty years of accomplishment driven by human connections, emphasizing pride, modesty, and the responsibility that accompanies being market leader in the Nordics and Baltics.

In conclusion, the Newsec Property Outlook not only celebrates our 30 years in the industry but also serves as a reminder that AI is not merely a technological leap but a collaborative journey. Embrace the changes, utilize the potential, and let us together shape a future where AI contributes to the best interests of business and let us put greater effort and time into the foundation of our common success, our personal networks and relationships.

AI did not build 30 years of Newsec – our coworkers, clients and partners did.

Max Barclay
Head of Advisory and Deputy CEO, Newsec

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Newsec, Box 7795, SE-103 96 Stockholm, Sweden.
Phone + 46 8 454 40 00, www.newsec.se.

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A risky landing

The Nordic and Baltic economies are gradually healing after the shocks of pandemic and war. Bond yields and stock markets have gone through sharp swings. For the remainder of this year, markets should see a normalisation with less turbulence, as inflation comes down and interest rates follow. Such a soft landing would be a relief for battered property markets. However, increasing political risks – escalation of war, protectionism and populism – could still spoil those hopes.

Klas Eklund, Chief Strategist på Dahlgren Capital

Towards normalisation?

During 2023, lingering inflation and shifts in monetary policy roiled markets. The year started with bond markets pricing in lower key rates and stock markets picking up speed. But during summer, central banks warned markets that inflation was still too high, promising key rates would stay "higher for longer". The result was a rout, with all asset classes taking severe hits.

In late November the sentiment shifted, as the Federal Reserve signalled that inflation was coming down enough for the bank to claim the key rate peak had been reached – whereupon markets became euphoric; stock markets reached new heights and bond yields fell. Around year-end, however, central banks again issued a warning that markets were running too fast – and a new market backlash took place.

Thus, the tug-of-war between central banks and markets continued all through 2023 and the beginning of this year. In the recent episode of this war, markets have largely given in to central banks. The rest of 2024 should be calmer. The inflationary shocks from Covid and war have subsided. Both in the US and the Euro Zone, inflation is approaching targets, irrespective of metric.

Financial markets get support

This means a calmer environment for central banks. As inflation comes down, they will cut key rates – albeit later than markets hoped for – both to avoid rising real rates and to support sluggish economies. This will give fundamental support to both bonds and stocks.

Stocks have already rallied sharply, with sentiment and valuations reaching record-high levels. The boom has largely been concentrated to a few large American tech companies, which – in my opinion – are approaching bubble territory, with ensuing risks of disappointments. Smaller companies, in general, are priced lower and should be able to show a relatively strong performance. But in a situation with falling inflation, pricing power will probably weaken somewhat, making it harder to further increase profits. Equity markets will therefore meet some headwinds, despite falling rates.

As regards bonds, short-term market yields will come down in line with key rates. Long bond yields have already fallen and will be more stable. Gradually, yield curves will shift from negative to positive. Real rates will take longer to fall.

The main risk to this scenario is that inflation refuses to fall "the last mile". This could be because of new supply disruptions, caused by geopolitical shocks. But inflation could also refuse to fall because of stronger than expected growth and higher-than-projected wage increases.

A further risk is that lingering effects of high interest rates will cause another round of runs on American regional banks with exposure to commercial real estate. In the US, the office market still suffers from the pandemic, and losses in that sector feeds into local banks. However, this should not amount to a systemic threat to the banking system.

Slow but positive growth

- The American economy has shown surprising resilience. Forecasters say **the US** will slow down, as previous Fed hikes take their toll. Still, the expected soft landing

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"Recent forecasts by the IMF indicate slow growth at the same level as in 2023"

is an outcome far better than almost all economists expected. The American strength may cause the Fed to be careful. The base case is that short-term rates will come down 75–100 basis points.

- **China** is in dire straits, because of cyclical as well as and structural factors. Poor demographics, a crash for property markets and widespread pessimism are taking their toll. Stock markets have collapsed, urging authorities to prop them up with administrative support. Deflationary forces are strong, meaning that China will be a drag on the global economy.
- In **Europe**, both the Euro-zone and the UK are experiencing troubles. Germany, in particular, is suffering from recession in its auto and energy-intensive sectors. The GDP of the Euro Zone as a whole has been flat since Russia's invasion of Ukraine two years ago, to a large extent because the subsequent gas price hikes and attempts to reduce the dependence on Russian gas exports. The recovery will be weak and slow,

With several important engines like Germany and China growing clearly below potential, the global economy as a whole will show continued bleak performance in 2024. Recent forecasts by the IMF indicate slow growth at the same level as in 2023. A clear uptick should come in 2025. After four years of severe shocks, inflation and rate hikes, gradual healing will have worked its way through the economy.

Political risks

This base case presupposes no new severe shocks. But geopolitical risks abound. The war in Ukraine could mean new disturbances of energy and food supplies. The turbulence in the Mid-East is escalating and causes higher freight and energy prices. If the US and Iran were to enter a direct military confrontation, all bets are off when it comes to energy prices and market reactions – and more or less everything else.

Increasing tensions between China and Taiwan is a longer-term threat. A full-blown invasion is not likely, but increasing economic pressure and partial blockades may cause disruptions in trade, most importantly for semiconductors.

Donald Trump may win the American presidential election this fall, which could usher in a new, more severe wave of protectionism with higher tariffs and trade restrictions. Should a Trump White House block further aid to Ukraine, Vladimir Putin may be emboldened to ramp up aggression. NATO may be weakened. American-Iran tensions would probably get more dangerous.

So far, markets have taken these threats calmly; the oil price is up, but not dangerously so. The same goes for freight prices. Still, there is a non-significant risk that all these tensions may cause several interacting supply problems that could increase costs, raise prices, and halt the downward trend of inflation and bond yields. These risks, however, are all but impossible to quantify.

The longer term

So, if we put the political risks aside (admittedly leaving out some extremely important factors), 2024 will be a year of economic normalisation, with inflation coming down and interest rates following suit. Growth will be slow during the first half of the year, because of lingering effects of tight monetary policy (real interest rates are still high). Growth will gradually pick up during the second half of the year.

But then what? Personally, I believe supply problems may gradually push up

inflation again, once the base effects have worked their way through the system during the coming year. Protectionism, fracturing of supply chains, the green transition – all will mean higher long-term costs, which one way or the other will be pushed on to consumers. Thus, it is not likely that we will return to the deflationary threats that dominated before the pandemic.

Consequently, central banks will not go back to the extreme stimulus we saw in the 2010s. There will be no more quantitative easing, nominal rates will be higher because of inflation – and then, central banks probably also prefer positive real rates after the experiments with ultra-low rates. All this means that nominal key rates will hover around three per cent in the "new normal", from 2025 and onwards. Bond yields will be accordingly higher. Money will not be free in the new normal. Investors will have to be more selective.

Property markets

The property market follows the lead from bond yields to a large extent, but real estate has also been directly affected by the pandemic; not least by how it changed our habits of work and travel. As a result, both the market as a whole and different sectors have gone through violent swings in recent years.

The pandemic and technical change have promoted work from home and e-shopping. Although some of these changes were transient, some will remain. Offices have struggled, especially in the US, as more people prefer to work from home. The sector is now coming back, albeit slowly. Retail and logistics have been hit in different ways – the first negatively, the latter positively – from digitalisation. These effects will remain.

And, of course, the huge swings in inflation and interest rates (both real and nominal) have affected house prices and yields as well as affordability. In the commercial real estate market, transactions in most countries were hit hard by tightening of monetary policy. If the general macro picture painted above holds, 2024 and 2025 should be years of normalisation. There is a lot of "dry powder" out there. However, positive real bond yields will slow down the increase of property prices once key rates have reached the new normal and housing markets have rebounded up from the abyss.

Even so, highly indebted developers and builders will still suffer. Further consolidation will take place. There is a clear risk that problems in this sector will cause strains in regional banks with a large exposure to property, especially in the US.

The Nordics

The Nordic region has suffered through the same storms as the rest of Europe. But the effects on the individual countries have differed, mainly depending on geography and economic structure. Norway and Denmark have withstood the stress better. Sweden and Finland are the laggards, for different reasons, but in both cases a recovery will start during the latter part of 2024.

Denmark

The Danish economy dipped during the autumn of 2023, but has in general shown strong resilience. It will experience slow but positive GDP growth in 2024 and chances are good that the economy will improve further in 2025. Shipping and pharma have driven strong net exports of both goods and services, building huge surpluses in the balance of trade. After a weak year, private consumption is now picking up speed as real wages increase after the fall of inflation. The labour market is strong, and real wages are set to rise further.

> **"Money will not be free in the new normal. Investors will have to be more selective"**

Photo: iStock

As in most countries, construction has declined. However, the service sector is holding up well. All in all, the Danish economy has been less hurt by external shocks than most countries. Part of this resilience, however, is due to the phenomenal performance of one company – Novo Nordisk, which now is the highest valued pharmaceutical company in Europe, courtesy of its diabetes and anti-obesity medicine. Danish shipping is also vulnerable if global transports are hit by geopolitical troubles.

Inflation is falling, opening up for lower interest rates. Since Denmark's krone is fixed to the euro, the key rate will follow the ECB's refi rate, with small variations. Courtesy of the large current account surplus, Denmark's Nationalbank will be able to hold its key rate just below the ECB's. Bond yields will be stable.

The Danish property market was hurt by rising interest rates in 2022–23, but has nonetheless been resilient, with only a small fall in house prices during 2023. Lower interest rates and increasing real income should give support to market during 2024 – albeit with a lag. Higher property taxes may hurt expensive apartments.

Norway

Volatile oil and gas prices have battered the Norwegian economy in recent years. But strong growth in business investment, particularly in oil services, gives a positive contribution to GDP. If the oil sector is included, Norway's GDP growth has been the strongest in the Nordic region. Outside the commodities sector, however, growth has been weak. Forecasters believe mainland growth will be sluggish in 2024.

The labour market is strong, with low unemployment compared to neighbouring Sweden, causing wages to grow more rapidly. Inflation has been high, causing Norges Bank to hike rates more rapidly than the other Nordic countries. Also, the peak is higher. One reason has been imported inflation caused by the weakening of the krone; a result of risk aversion in global markets.

But, as in other countries, inflation is now coming down. In order to prevent real rates from rising, the central bank will cut rates, but starting the easing process later than its neighbours. The relatively strict monetary policy will probably give some strength to the krone during H2 2024.

The property market has held up better than in other Nordic countries. House prices fell only marginally in 2023. This year, rising real income and low supply will lead to slowly rising house prices, followed by an acceleration in 2025. The commercial real estate market has been hurt by rising key rates; transactions fell markedly. With lower interest rates, the outlook will improve.

Finland

The Finnish economy was in recession in 2023. The problems were broad-based; both structural and cyclical. Russia's invasion of Ukraine affected the Finnish economy more than most European countries, given the long border to Russia and Finland's previously large trade with its big neighbour. Manufacturing has suffered from weak international demand, and as a result, investments have been postponed. Unemployment is rising, and private consumption has been falling. This year, consumption should gradually recover, as inflation falls, but unemployment will continue to rise. The labour market is presently in a turbulent phase as large-scale union strikes are directed towards new labour legislation. This will weigh down economic performance for some time.

Inflation was comparatively low already in 2023, and will continue down, below the inflation target this year, partly driven by the weak economy. Since Finland is a member of the Euro zone, key rates are set by the ECB. Consequently, interest rates will come down, starting this spring or summer.

Construction has fallen sharply in recent years. The sector will be helped somewhat by falling interest rates, but since inflation also is falling – more than in most countries – real rates will still be relatively high. Construction will recover only slowly. As for the property market it took a hard hit in 2023, with a sharp drop in transactions. House prices fell. As interest rates come down later this year, a cautious improvement is to be expected.

Sweden

The Swedish economy is in a mild recession. Net exports have been strong, but the economy has been dragged down by a crash in the construction sector and by contracting private consumption. The factors behind the weakening of consumption are the sharp fall in real income during 2022–23 and the likewise sharp increase in mortgage costs. Swedish households are highly in debt and their mortgages are mainly floating rate, meaning that the tightening of monetary policy has hit purchasing power harder than in fellow Nordic countries, where fixed rates are more common.

These negative forces will dominate also the first half of 2024. Thus, growth will hover around zero. During the second half of the year, however, we should be able to see an upturn again. Inflation has fallen close to the Riksbank's target, and the key rate will probably be cut by 75–100 bps in total during 2024. This will gradually ease the pressure on debt-ridden households – but with a lag. As inflation falls, real income will start rising again and private consumption will recover.

In 2023, the combination of rising rates and falling household income hit housing with a double whammy. As a result, construction has fallen along with house prices. Transaction volume fell to its weakest level in almost 15 years. Several developers in commercial real estate have encountered severe financial difficulties. A restructuring of the sector is under way and will continue. As we are approaching the Riksbank cuts, optimism is starting to recover. Transactions are bound to increase, and house prices will gradually start to recover.

> **"Swedish households are highly in debt and their mortgages are mainly floating rate"**

"Most real factors point in the right direction. The big question mark emanates from external threats"

The Baltics

After a period of strong growth, the Baltic countries were hard hit by first the pandemic, thereafter by the Russian invasion of Ukraine. All the Baltic countries border Russia and have a long – and bloody – history of war and occupation from their aggressive neighbour. The new war has heightened security risks, necessitated increased defence spending and disrupted trade as well as production. As a result, all Baltic states experienced negative GDP growth in 2023. This year will bring economic improvement and falling inflation. All the Baltic countries are euro members, and the expected ECB key rate cuts will support the recovery.

Estonia

The downturn in Estonia during 2022–23 was the most severe in the region. One reason is that Estonia is more export-dependent and thus was hit harder by the general economic stagnation in the region. Manufacturing contracted sharply. Since manufacturing is an important employer, industrial recession has also caused a deterioration of the labour market, resulting in household pessimism and falling real income. Construction has fallen but is to some extent supported by public investment in infrastructure.

As inflation and interest rates fall, consumption will recover and the general situation gradually improve, but also 2024 will be a bleak year. Any noticeable upturn will wait until 2025. In this environment, real estate has suffered. Prices have fallen as well as transactions. Expected rate cuts by the ECB are, however, gradually injecting new optimism in the market.

Latvia

After a period of stagnation, the economy bottomed out in late 2023 and is expected to start growing again this year. Latvia may show the strongest GDP growth of all the Nordic and Baltic countries in 2024–25. Growth is pulled by strong real wage growth; nominal Latvian wages have grown rapidly, and as inflation comes down this translates into increasing purchasing power. Exports, however, is facing headwinds as construction has fallen in neighbouring countries (Latvia is an important exporter of wood products for construction). EU funds are expected to contribute to strong investments in infrastructure.

Inflation is now falling rapidly, while unemployment has peaked and begun to decline. Demand for houses is thus recovering. Many construction projects were put on hold during the recession; as the situation improves, construction will pick up again.

Lithuania

Last year, GDP avoided a bigger contraction and remained just about flat – a better performance than expected. Manufacturing and exports both fell at the end of 2023, but a gradual recovery will take place this year. The country is in a good position to pick up speed. Investments are moving up. Nominal wages are increasing strongly, and since inflation has come down, this will cause real wages to strengthen. Consumption is expected to increase as purchasing power and confidence are rebounding.

Housing prices have held up surprisingly well, but activity has been weak. Housing construction has fallen, but infrastructure investments are doing well, partly because of funds from the EU. As in neighbouring countries, commercial real estate has been hit by geopolitical worries and a weakening economy. But optimism started recovering at the end of 2023, and investments in the sector is rising again. As the ECB starts cutting rates, real estate will experience a clearer improvement.

The big question

After several difficult years, the Nordic and Baltic countries – and their property markets – should gradually recover in 2024. Most real factors point in the right direction. The big question mark emanates from external threats.

- Inflation may be more stubborn in the US, preventing the Fed from cutting rates as expected. This would give global cascade effects, once again hurting financial markets and disturb the recovery of real estate.
- Geopolitical disturbances may push up energy and freight costs, speeding up the ongoing process of fragmentation and de-globalisation. Such supply shocks would not only push up inflation but also have negative effects on growth.

The base case is that the Nordic and Baltic property markets should demonstrate a clear improvement in 2024 – but risks refuse to go away ...

NewsecGPT

The Future of Property

Photo: iStock

As we enter 2024, the real estate industry faces a transformative era driven by rapid advancements in AI and digitalization. Navigating a complex landscape of new technologies, unexpected world events and an uncertain macroeconomic landscape, the sector is increasingly acknowledging the critical role of AI and digitalization. It's not just a strategic choice anymore; it's a fundamental necessity for staying ahead of competition.

However, these fast-paced technologies do not come without its challenges, and Newsec is here to guide through the potential pitfalls. After a year of considerable turbulence both globally and within the property market, Newsec predicts that we might have reached the bottom. Now, the only way is up – with a little help from both AI and Newsec.

"At the heart of this revolution is the utilization of big data and predictive analytics."

Playing catch up with AI and digitalization – real estate could potentially lead the race

In an era where technological innovation continuously redefines the global context, AI and digitalization emerge as fundamental in shaping our future. 2024 continues to witness the transformative impact of these technologies across various sectors, indicating an age where digital expertise is not just an asset but a necessity. This is particularly evident when setting eyes on the property industry, a sector traditionally grounded in brick and mortar, now increasingly navigating the digital space.

AI and digitalization are revolutionizing industries like healthcare, finance, and real estate, improving efficiency and global market accessibility. At the heart of this revolution is the utilization of big data and predictive analytics. AI algorithms, capable of processing vast amounts of data, are providing unprecedented insights into market trends, customer preferences, and investment opportunities. This global perspective is crucial, as the real estate market is no longer just local but interconnected, with international investors and stakeholders shaping its dynamics.

5G's integration in the property sector is also transforming the industry. 5G enables sophisticated smart city solutions, increasing property values and investment appeal. This technology supports dense connected devices, enhancing urban functionality and sustainability. Concurrently, AI and digitalization in the real estate industry are redefining user experiences with smarter buildings. Enhanced by 5G, these buildings offer improved efficiency, safety, and comfort, while AI-driven property management optimizes energy use, predicts maintenance, and elevates tenant services, promoting cost savings and sustainability.

Connectivity – a key driver in future property selection

The gap between the potential and actual implementation of AI and digitalization in the property industry is clear, with many commercial properties struggling to provide robust indoor connectivity. The technology exists, the benefits are clear, and yet, the widespread implementation within the property sector lags behind. A recent market report made by Newsec, which incorporated a comprehensive survey, has revealed a critical issue: the widespread dissatisfaction from tenants and project managers with the current state of indoor mobile networks and WiFi in their work environments, a majority being offices and retail premises. This is not just seen as an inconvenience or a safety problem, but as a loss of functionality and appeal of the workspace overall.

According to the survey, a significant majority of respondents (68%) consider a good indoor mobile network to be very important or even a requirement when selecting future premises (see Exhibit 1 on the following side). This highlights a growing trend: connectivity is no longer a mere convenience but a critical factor in the evaluation and selection process. As remote working and digital reliance increases, the expectation for seamless indoor mobile and WiFi networks has intensified, putting pressure on property developers to prioritize these aspects in their offerings.

This is further illustrated by the discovery that 34% of office workers consider poor mobile reception to be an obstacle to their willingness to come into the office. However, there's a silver lining—75% of this group would be more inclined to spend additional time

in the office if the indoor mobile network were improved, see Exhibit 2. This data clearly highlights the direct impact of indoor connectivity, as well as other digitalization initiative, on workplace attractiveness and tenant satisfaction – a potential 25% increase in office occupancy.

Navigating the limitations of AI in the Real Estate Market

AI and digitalization in the real estate industry is clearly compelling at first glance and can provide endless possibilities. Investors frequently use AI models to analyze market trends, digest complex financial reports, and simulate investment scenarios, which has saved huge amounts of time. However, during these economically challenging times, with the projection of macroeconomic trends nearly impossible for individuals, reliance on AI-driven solutions for informing and enhancing investment strategies is increasing. As making predictions becomes more difficult, investors are increasingly trusting the insights and forecasts provided by these sophisticated technologies. Therefore, it is essential to step back and recognize the limitations and risks

EXHIBIT 1:
How important will indoor mobile network be when selecting premises in the future?
(1=not important, 5=very important)

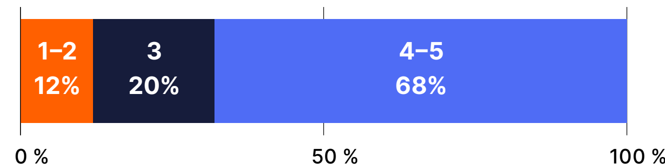
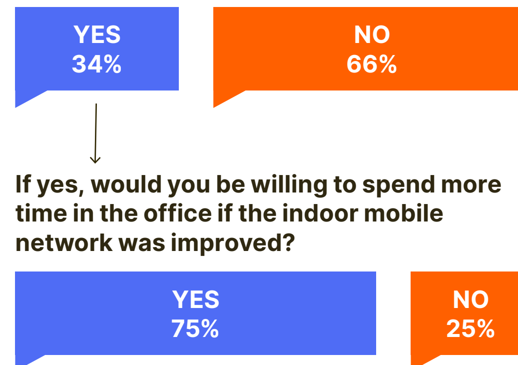


EXHIBIT 2:
Does poor mobile reception affect your willingness to come into the office?



“While AI can analyze historical data, it often fails to account for black swan events that will not follow historical patterns.”

associated with these technologies. Despite their transformative impact on numerous industries, including real estate, it is vital to understand that they come with their own set of flaws and challenges.

One of the fundamental limitations of AI, including popular models like ChatGPT, is their reliance on historical data when it comes to making projections. AI algorithms thrive on patterns and trends from the past. While this approach can provide valuable insights into market behavior, it can be greatly inadequate when it comes to predicting unprecedented events or disruptions that can significantly impact the property market.

Consider the COVID-19 pandemic for example. No AI model could have accurately predicted the extent to which remote work trends would reshape the property landscape, causing urban migration patterns to shift dramatically. The Russian invasion of Ukraine is another example that could not have been predicted, causing a large macroeconomic shift in the world with higher interest rates and higher inflation. The whole real estate industry has been affected, with much more challenging financing conditions. This demonstrates that while AI can analyze historical data, it often fails to account

Photo: iStock

for black swan events that will not follow historical patterns.

Furthermore, AI models in real estate may not fully capture market nuances, like neighborhood feel and cultural dynamics, which significantly influence property values. They often provide a global view but lack the detailed understanding necessary for local market complexities. Additionally, AI struggles to adapt to regulatory changes like zoning laws and tax policies, which greatly affect the market. Moreover, AI predictions depend on the quality of their training data; biases or gaps in this data can lead to skewed or inaccurate analyses, potentially resulting in flawed investment decisions.

Testing AI Predictions Against Market Realities

To illustrate some of the limitations of AI, Newsec asked ChatGPT to predict the Nordic and Baltic property transaction volume combined, as illustrated in Exhibit 3. Based on six macroeconomic inputs for each country (such as GDP growth, interest rate etc.) from 2005-2023 and historical transaction volumes from 2005-2014, as well as other significant inputs that it had to find on its own, ChatGPT has attempted to project the transaction volumes from 2015 to 2023. As seen in the diagram below, the actual transaction volumes during this period have deviated significantly from these projections, despite ChatGPT using four different methodologies to conduct its forecast.

To further explore the limitations of AI forecasting, Newsec engaged ChatGPT to project the Swedish policy rate from 2015 to 2023, a highly relevant and discussed subject in these times. This task was carried out using a variety of macroeconomic factors from the years 2005–2023, including historical policy rates spanning 2005–2014. ChatGPT was also required to independently identify and utilize other relevant data inputs. Exhibit 4 displays the actual Swedish policy rate alongside the various predicted rates from different forecasting methods. It becomes clear that, after 2021, the actual policy rate significantly strayed from what the AI models had predicted. Despite the advanced algorithms and the extensive data these models analyzed, they were not successful in predicting the steep increase in the actual policy rate that occurred in the following years.

This disparity between AI-generated projections and real-world outcomes under-

EXHIBIT 3:

Actual vs. ChatGPT predicted transaction volume

Nordic and Baltic transaction volume (sqm)

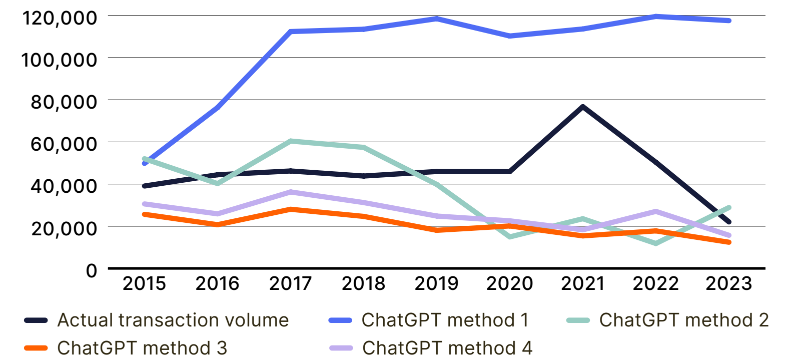
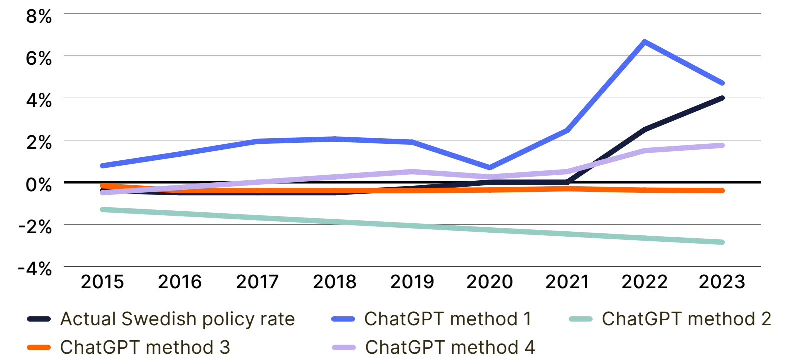


EXHIBIT 4:

Actual vs. ChatGPT predicted policy rate in Sweden



"It is essential to complement AI-driven insights with human expertise"

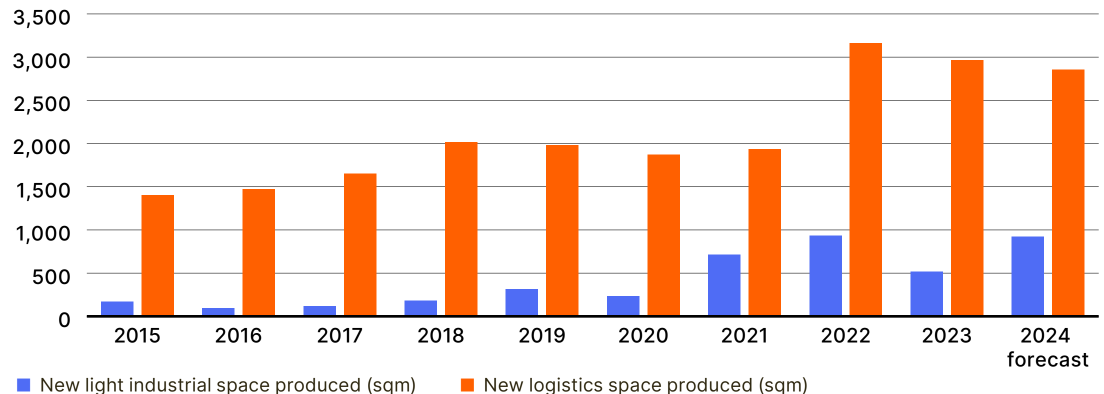
scores a critical point: AI models, while powerful tools, are not reliable when it comes to investment decisions. They primarily rely on historical data and established patterns, often failing to consider external events and factors that can disrupt the market.

As seen, it is essential to complement AI-driven insights with human expertise and a critical understanding of the nuances of the real estate market. In fact, Newsec sought ChatGPT's advice on the best segment to invest in, based on historical segment distribution of total transaction volume in the Nordics and the Baltics. ChatGPT initially did not want to provide an answer at all, but eventually suggested the industrial segment, only considering its increasing share of total transaction volume over the years.

When asked to specify whether logistics or light industrial would be the better investment, ChatGPT recommended logistics, citing the significant growth of e-commerce in these countries in recent years. Yet, it failed to consider that e-commerce growth, while surging during the pandemic, has started to stagnate in the Nordics and Baltics regions, which would be crucial information for an investor considering the logistics segment. This is not to say that logistics is not still a worthwhile investment – but perhaps the light industrial segment has been in its shadow for too long and deserves some more attention.

To make this same practice, without the help from AI, Newsec conducted an analysis of new logistics and light industrial spaced produced in the Nordic and Baltic countries. The results are shown in Exhibit 5, revealing that significantly fewer square meters of light industrial have been built compared to logistics space. In fact, light industrial has, on average, represented less than 20% of the total new production in the industrial sector from 2015 to 2024E. Moreover, considering the fast-paced development towards green industrialization in Sweden, Finland and Norway, and the escalating demand for sustainable energy solutions, Newsec sees the great potential that light industrial properties have to offer in these regions. This example

EXHIBIT 5:
New light industrial vs. logistics space produced
(thousand sqm)



illustrates the need for nuanced, context-aware analysis that AI, in its current state, may not always provide.

To navigate the complexities and uncertainties of the property and investment industry effectively, it is essential to complement AI-driven insights with the expertise of real estate professionals and advisors such as Newsec. Property experts contribute with experience, local knowledge, and an understanding of the subtle factors that AI may overlook. They can provide invaluable guidance and help investors make informed decisions that encompass both data-driven insights and the ever-changing realities of the property market.

Seizing the opportunities of 2024: combining AI insights with industry expertise

As we head into 2024, Newsec stands ready to navigate through the complex property market, emphasizing the critical balance between AI's technological capabilities and the essential insights of human expertise. The importance of integrating AI's analytical power with the understanding and strategic foresight that only experienced professionals can offer, is evident for making successful decisions.

Looking ahead, 2024 is anticipated to be a year of significant growth and transformation within the real estate sector. As the clouds of high inflation, high interest rates and low transaction activity are now starting to clear, Newsec expects the real estate industry to make a comeback. In these more promising times, the early bird, armed with AI's data insights and Newsec's expertise, will indeed catch the worm.

Contact:
Adam Tyrcha, PhD
adam.tyrcha@newsec.se
Josefin Jangälv
josefin.jangalv@newsec.se

Photo: iStock

Property markets

Photo: iStock

The Swedish property market

A year filled with potential

Sweden had a tough year in 2023, coming out as one of the worst performers in the OECD from a macroeconomic perspective. The key interest rate reached 4.00% and preliminary figures indicate that GDP contracted by 0.6%. Unemployment increased slightly throughout the year and real wages fell. In 2024, however, things are expected to begin to turn. GDP is expected to recover by at least 0.5% – though it is likely that this recovery will be stronger, given recent optimism about the interest rate outlook. Indeed, much like across most of the rest of the world, the interest rate is expected to be cut a number of times throughout the year – likely bottoming out somewhere between 2,5-3,25% at year-end. This should serve to stimulate the economy, and lead to falling unemployment and a stronger GDP growth than current forecasts.

The Swedish real estate market did not have its strongest year in 2023. The full-year transaction volume ended up at SEK 103.9 bn, which is the weakest transaction volume since 2013 – inflation-adjusted, the weakest since 2009. The high interest rate environment and tough financing conditions impacted investor appetite, and the usually strong Q4 proved to be a disappointment, coming in at just SEK 24.2 bn. Yields increased significantly throughout 2023, and towards the end of the year, the previously strong occupier market began to falter, with market rents beginning to move down slightly, while vacancy also increased across many markets. 2024, however, has begun with a lot more optimism. Though transaction volumes have been low so far this year, the anticipated interest rate cuts have led to widespread market optimism, with likely yield compression kicking in towards the end of the year. Newsec forecasts that savvy, well-informed investors will invest in H1, while investors late to the party will join in H2 – leading to a relatively strong transaction volume and an active year.

Contact:
Adam Tyrcha, adam.tyrcha@newsec.se

Interesting trends on the Swedish property market

Lack of light industrial space

This edition of the theme text touches on the lack of light industrial and warehousing space in the Nordics. The situation is especially pressing in Sweden. Between 2018 and 2024 (including forecast production for 2024), 7 million sqm of logistics space will have been produced – while just 1.7 million sqm of light industrial space will have been produced in the same time period. Though there is still very strong take-up and demand for logistics, light industrial vacancy is also very low. Conversion away from light industrial to other uses, as well as inshoring of production activities following supply chain and global turbulence, has led to a lack of space – which is not being produced to a sufficient degree.

International capital flocks to Sweden

Foreign investors accounted for 29% of the total transaction volume in Sweden in 2023 – a post-GFC high. The Swedish market remains very attractive to international investors, who are now also facing less competition from domestic capital and are thus able to make attractive acquisitions. Cadillac Fairview's acquisition of a logistics portfolio for over SEK 1.5 billion from Mileway towards the end of the year is one prime example. Despite turbulence among some Swedish listed players, international investors understand that the underlying fundamentals on the Swedish market remain strong – leading to a number of new market entrants throughout the year.

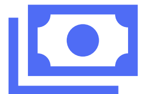
Bankruptcies, consolidations and market potential

Though fundamentals on the Swedish market remain strong, there has been substantial turbulence primarily among listed players in the last few months. Though most of the major listed companies have been able to weather the storm relatively well, many smaller listed and non-listed players have been struggling. Companies like Oscar Properties and Kvalitena have sold and likely will continue to sell portions of their portfolio at substantially discounted levels, as a result of their poor financial solidity. Some real estate funds and other types of players, who expanded aggressively in years prior and are now facing high interest costs, have also been struggling.

Indexation stronger than market rental growth?

The occupier market generally weakened throughout 2023 and 2024 thus far, with the autumn and winter seeing rising vacancy rates and plateauing rental levels. Though CPI-indexation came in at 6.5%, market rental growth over the past year has been more limited than that. This has resulted in negotiations on contract expiry between property owners and tenants increasingly being quite tough, since tenants on indexed contracts are in some cases paying rents which Newsec assesses are above market. Rather than lower rents, many property owners have been seen to increasingly be offering expansive tenant incentive packages, often in the form of long rent-free periods or other forms of discounts.

SEK 104 billion
Total investment volume in 2023



SEK 125 billion
Total investment volume expected in 2024

0.9%
GDP growth expected in 2024

Photo: Shutterstock

The Norwegian property market

Brighter days ahead

Throughout 2023, the Norwegian economy showed resilience in the face of high inflation and rising interest rates. Despite the continuous policy rate hikes, unemployment remained low, and Mainland GDP grew by 1% in 2023. However, in 2024, these figures are expected to worsen somewhat. The Central Bank of Norway predicts negative employment growth and only a 0.1% increase in Mainland GDP. Economic demand is expected to decline, particularly corporate and housing investments are facing a tough year.

Rising interest rates have begun to have a tightening effect onthe economy, but there are signs that the major cost shocks are over, and that inflation haspeaked. Consumer price growth among key trading partners fell, and Norwegian inflation is gradually trending downwards. Overall, the Norwegian economy appears to be heading for a soft landing. The policy rate was raised in December to 4.50%, likely for the last time. It's expected to remain at this level throughout 2024.

Given the economic backdrop, 2023 was a challenging year for commercial real estate in Norway. In the autumn, both the NOK 5-year and 10-year SWAP rates reached highs of about 4.60% and 4.40%, respectively. Sharply rising interest rates, higher risk premiums, limited liquidity in the bond market, and cautious banks contributed to a sluggish transaction market with a volume of NOK 57 billion – the lowest since 2013. The prime yield increased from 3.75% to 4.50% over the year.

Entering 2024, the outlook improves. The key policy rate has peaked, most of the value loss in commercial real estate is likely realized and uncertainties are diminishing. The market reflects the expectation of falling interest rates. Both the NOK 5-year and 10-year SWAP rates have significantly dropped. Risk premiums in the bond market are starting to decline, and there is hope that banks will ease lending. These factors set the stage for increased transaction activity, with Newsec estimating a volume of NOK 80 billion for 2024. The market is expected to gradually recover, with activity returning to normal by summer.

Contact:
Karen Cecilie Thunes, karen.cecilie.thunes@newsec.no

Interesting trends on the Norwegian property market

Office and retail segment with record-low liquidity

Office and retail are normally the largest segments in Norway, but this changed throughout 2023. The office segment performed strongly operationally throughout last year with low vacancy and solid growth in market rents.However, investor interest remained slow and long,secure cash flows proved difficult to calculate net positive. At year-end, the office segment accounted for 28% of the total transaction volume, down from the historical average of approximately 45%. It was no better for retail, which only accounted for 9% of the 2023 volume, down from a historical average of around 20%. Weaker consumer purchasing power has facilitated a decline in turnover rents and dampened investor appetite, which is likely to continue into 2024.

Sustainable logistics the new standard

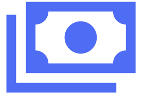
Appetite for logistics properties has been euphoric in recent years, and almost all types of standard buildings have achieved fantastic pricing. This is now beginning to change. Investors are significantly more selective, and the logistics segment may now be the segment where we see the greatest willingness to pay for sustainable buildings. In a challenging market with increased yield requirements, only logistics buildings with a clear green profile achieves the sharpest pricing. The building must have a high energy rating. Internally, it should be set up for automation, and externally, it is crucial to have solar panels on the roof and charging stations for electric vehicles. Will logistics become the green winner?

Lack of buying interest from syndicates

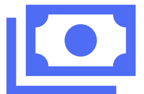
Syndicates have historically been important players for liquidity in the market. From 2015 to 2023, activity from syndicates has been on an upward trend, with an average of 88 transactions annually, representing about 30% of the purchase volume. Most purchases have been focused on the office segment, but car dealerships and big boxes have also been of great interest. However, in 2023, activity has been at a record low, with only 38 completed transactions. Syndicates, as a financially focused investor, have faced a tough market with rising interest rates and higher risk premiums on debtcapital, resulting in difficulties in realizing attractive dividend potentials. With an expectation of cheaper debt capital in 2024, Newsec expects higher activity from this investor class once again.

International players with a changed segment focus

International investors have been active in the Norwegian market since 2014 with significant volumes. Until 2020, their interest was clearly focused on office properties in the largest Norwegian cities, and this segment accounted for 50% of their purchase volume. In recent years, the office internationally has faced challenges with increased remote work. Despite this not appearing to be a threat to the Norwegian office market, the decline of office use in the USA and parts of Europe has influenced the segment preferences of international players. This is also visible in Norway. In 2023, logistics accounted for 40% of international players' purchase volume in Norway, strongly supported by increased online shopping and heightened awareness of supply chain pressures and bottlenecks.



NOK 57 billion
Total investment volume in 2023



NOK 80 billion
Total investment volume expected in 2024

0.8%
GDP growth expected in 2024

Photo: Shutterstock

The Danish property market

The CRE investment market faces a more normal and predictable 2024

The macroeconomic development in Denmark is relatively positive. GDP grew by 1.8% in 2023 after a surprisingly strong increase in Q4. Economic growth was boosted by the pharmaceutical industry to such an extent that GDP would have fallen by 0.1% if this industry is excluded.

In 2023, there was a significant drop in inflation, particularly in Q4 when it fell below 1%, primarily due to lower energy prices. Core inflation exhibited a more gradual decline, reaching 2.6% by the end of the year, signaling reduced inflationary pressures. Projections indicate that annual headline inflation will decrease from 3.3% in 2023 to 2.0% in 2024. A return to "normal" inflation is not anticipated until at least 2025.

The Danish Central Bank acted by raising its interest rate six times in 2023, increasing it from 1.75% to 3.60%. In the upcoming year, it is expected to maintain its policy spread relative to the European Central Bank, with rate cuts anticipated to commence in mid-2024, totaling a reduction of 0.75% for the year. Bond yields in 2024 remain uncertain, but they are likely to exhibit relative stability.

Since 2022, rising interest rates have impacted property investments, resulting in yields falling below the long-term average. There is a possibility of property value adjustments in 2024, but the stabilization of interest rates should alleviate some of the yield pressure. Transaction activity in 2023 saw a significant decrease, totaling DKK 37 billion, which is only half of the activity observed in 2022. Foreign investors contributed a mere 35% to this reduced activity.

In contrast, the rental markets performed well in 2023 due to factors such as employment growth, increased industrial production, and favorable demographic trends. Vacancy rates remained low, and rents saw upward trends, especially in major cities. Looking ahead to 2024, the economic slowdown could potentially impact commercial property demand, influencing vacancy rates and rental growth. These effects will be contingent on local factors, including new developments and business relocations.

Contact:
Robin Rich, robin.rich@newsec.dk

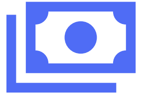
Interesting trends on the Danish property market

Will there be more distressed sales in 2024?
The stalled situation in the real estate market in 2023 can largely be attributed to the gap between buyers' and sellers' expectations, with sellers not having to act while property prices being low. Stable mortgage financing, often long-term and at a fixed rate, means that many borrowers have not been financially squeezed. The question is whether the pressure on property owners will increase in 2024. The Danish Central Bank disclosed that the share of outstanding mortgage loans for commercial real estate (including residential rentals) with expiration, refinancing, or interest rate fixing within the next year was 51% at the end of 2023. For variable-rate loans, the share was 71%. An increase from the beginning of 2022 when the share was 44% and 67%, respectively. All things equal, this means that more current borrowers will experience increased financing costs in a "higher-for-longer" interest rate scenario. However, the level is not alarmingly high in a historical perspective. The number of bankruptcies in the real estate and rental industry has slightly increased in 2023, but the level is still low. All in all, this suggests a possible slight increase in the number of property owners looking to sell in 2024, but probably not to an extent where distressed properties will dominate the market in general.

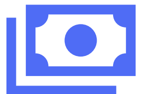
Industrial & logistics stand out positively
The market for industrial & logistics properties also saw transaction activity fall, but not as much as other property types. In 2023, investments in this segment ended up on par with the 5-year average from 2018-2022. The increasing popularity of the segment is visible, representing almost 20% of the total transaction market in 2023, compared to only 5% in 2018. The relatively positive development was due to the segment maintaining a good amount of interest from abroad. International investors were behind almost all large transactions with properties valued over DKK 100 million in 2023.

Are foreign investors coming back?
Foreign investors accounted for 35% of all transactions in 2023. In comparison, their share was 53% in 2022 and 63% in 2021. The question now is whether the dip in foreign investment is a one-off or the beginning of a new normal. Part of the explanation is the difference in property yields between Denmark and the rest of Europe. Although yields have risen in Denmark, the gap vs. an average of yields in Europe has developed differently for different segments. For prime office space, the spread has widened, making Denmark relatively more expensive. In comparison, yields for prime logistics in Denmark have moved at roughly the same pace as for similar types of properties in Europe. During the same period, foreign acquisitions of office properties have largely disappeared, while the interest remained in industrial and logistics properties.

Will mega-corporations affect the real estate market?
Denmark has traditionally seen itself as a country with an economy dominated by small and medium-sized businesses. That picture has changed in recent years, with companies such as Novo Nordisk, Maersk, Carlsberg, and Lego taking up an increasing share. From January-September 2023, the top ten companies accounted for 32% of Denmark's total exports, and the pharmaceutical industry alone contributed 1.9% points to the country's overall GDP growth in 2023.This development may well have an impact on the rental and occupier market, with increased demand for large properties in administration, production, research, and distribution.



DKK 37 billion
Total investment volume in 2023



DKK 60 billion
Total investment volume expected in 2024

1.0%
GDP growth expected in 2024

Photo: Shutterstock

The Finnish property market

Careful optimism on the rise as financial markets ease

The series of economic and financial shocks in recent years have affected Finland more than other Euro Area countries or the Nordics for several reasons. Russia's invasion of Ukraine, for example, had a significant impact on Finland, given its status as a neighbor and major trade partner. Before the war, Russia accounted for about 5.5% of Finland's exports, or 1.5% of GDP, a figure now nearly zero. Finland's export-driven economy has struggled as demand in key markets weakened, leading to a recession in 2023. In the third quarter, the economy contracted the most since early 2020, with declining export industries and high borrowing costs impacting consumers. However, Finlan's largely domestic energy production shielded it from the energy price hikes that affected much of Europe. In 2024, Finland is expected to see economic growth, driven by global demand and domestic consumption as interest rates decrease.

The pandemic led to overheated economies and high inflation, prompting the European Central Bank (ECB) to raise its benchmark interest rate by 450 basis points to 4.00%. This helped slow inflation and economic growth. With demand declining, the ECB has reached the peak of its rate hiking cycle. Rate cuts are expected to start in June, with forecasts suggesting a decrease to 3.00% by year-end.

The monetary policy response to inflation affected money supply, credit flows, and investor sentiment, significantly impacting the 2023 real estate market. Global real estate investment fell by 50%, with Finland seeing a more pronounced 62% drop in transaction volume to 2.6 billion euros. Logistics fared relatively better with a 39% decrease.

In 2024, Finland's transaction market is expected to be more active. Interest rate declines are likely to increase liquidity and investor interest. However, returning to the pre-crisis 5-year average investment level of 7.1 billion euros is not imminent due to ongoing challenges in debt markets and selective investor behavior. Despite this, cautious optimism is growing, with the potential for transaction volume to gradually increase in 2024.

Contact:
Valtteri Vuorio, valtteri.vuorio@newsec.fi

Interesting trends on the Finnish property market

Office fundamentals: a different story

Prior to the pandemic, Finland was already a leader in hybrid work. In 2018, 28% of Finnish workers were remote, rising to about 40% by 2022, with 11% working entirely from home. While office occupancy in other Nordic areas rebounded, Helsinki saw only 6 of 27 office submarkets with lower occupancy than pre-pandemic. By 2023, 7 submarkets had reduced occupancy, indicating a permanent shift to hybrid work.

During the pandemic's peak, office contracts were extended, anticipating a post-pandemic return to traditional office work. However, a "new normal" of established hybrid work models emerged, changing office space requirements, often leading to downsizing.

Global economic uncertainty prompted companies to seek cost-effective office spaces, aligning with hybrid work models. This significantly impacts vacancy levels in Helsinki's office market, with a general trend of businesses downsizing and reducing premises size. The full impact will be evident as contracts expire.

Helsinki's office market faces chronic high vacancy rates due to historical surplus. There's a dichotomy of lower availability in prime submarkets and higher vacancy in secondary areas. The downsizing trend promotes densification, with businesses favoring prime locations and buildings that adhere to higher standards. This shift increases the rent premium between the Central Business District (CBD) and prime submarkets.

Industrial & logistics: sound performance amongst the backdrop of declining volumes

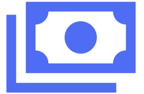
Investment volumes in the industrial and logistics sector in 2023 were below the previous year but above pre-pandemic levels. Despite financial challenges, investment activity remains resilient, particularly in the Helsinki Metropolitan Area (HMA). The demand for modern logistics centers in well-situated areas continues, underpinning competitive local supply chains.

Space availability challenges persist in the HMA, with a limited construction pipeline, leading to speculative construction and expansion into the Greater Helsinki Area, attracting core investors.

Macroeconomic factors are bringing the supply down, but no apartment shortage in sight

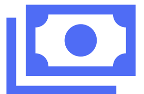
The residential sector in Europe, including Finland, continues to draw investor interest, focusing on residential properties. Residential markets reprice rapidly, and demographic fundamentals support optimism for the sector's trajectory.

Demand issues are impacting the construction of new residential units, as companies adjust to increasing costs. In Finland, notably in the HMA, there's a housing surplus, in contrast to many European countries. Weakened demand has slowed residential construction, with few new starts in 2023. However, about 18,000 units are projected by 2025. Newsec Finland's model anticipates a balanced supply in the HMA by 2027. The surplus in the past 5 years led to high vacancy rates in certain areas, but it's uneven across submarkets. Investors are targeting locations with potential for long-term growth or resilience to inflation.



EUR 2.5 billion

Total investment volume in 2023



EUR 4 billion

Total investment volume expected in 2024

0.9%

GDP growth expected in 2024

The Estonian property market

Low expectations make results look better than they are

The Estonian economy has been shrinking since 2022, with no soft landing in 2023 as GDP fell by an estimated 3.5% in real prices. The forecast for 2024 is a modest drop of just 0.4%, indicating a mild improvement.

Photo: Shutterstock

Despite slow reactions in the unemployment rate, certain sectors, like manufacturing, have suffered the most, while the export sector, dominated by Nordic customers, has faced severe challenges.

Unemployment in 2023 is estimated at around 6.8%, 1.2% higher than in 2022. This likely results from a delayed impact of the economic decline, with expectations of further rising unemployment, reaching 9% in 2024. This will hinder salary growth and internal consumption. However, there is a silver lining as inflation is anticipated to decrease to about 3.4% in 2024.

The government sector has offered limited assistance. Expansive fiscal policy would typically help in such situations, especially with Estonia's low debt-to-GDP ratio. However, the country struggles to reduce its budget deficit to meet EU requirements, making additional debt unwise. The government seeks ways to cut current costs and increase taxes, despite the potential negative impact on GDP.

Speculation about a possible reduction in eurozone base interest rates has greatly affected the Estonian real estate market. High rates have impacted every real estate owner. Following a recent 0.25% increase, rates for deposits, main refinancing operations, and marginal lending facilities are at 4%, 4.5%, and 4.75%, respectively. Eurozone inflation is projected at about 2.7% in 2024, nearing the 2% target. Simultaneously, Eurozone GDP is expected to grow by 0.8% this year, offering optimism for a slight reduction in base interest rates.

At the outset of 2023, the Estonian investment market seemed frozen, with low expectations. Throughout the year, there were six transactions exceeding EUR 5 million, with some making headlines. The total volume in 2023 amounted to EUR 187 million, down from EUR 225 million the previous year. A Viru Centre transaction dominated the 2023 volume, highlighting the overall decrease in market activity, as the six transactions in 2023 paled in comparison to the 23 in 2022. Anticipating a continued lack of alignment in buyers' and sellers' expectations, 2024 is likely to witness a limited number of deals. A shift may occur once interest rates gradually decline.

Contact:
Mihkel Männik, m.mannik@newsec.ee

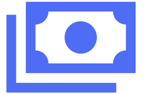
Interesting trends on the Estonian property market

Elevated office vacancies
Office vacancies began to increase more rapidly in the second half of 2023, reaching an average level of 7.7% in Tallinn, home to the largest and most modern office market. Companies remained cautious about relocating, making it more challenging for developers to find tenants. This has lengthened the sales process and elevated vacancy levels. In the coming year, vacancy rates are likely to remain high, even for Class A buildings. Rising unemployment is expected to drive vacancies higher as companies reduce staff and require less space, or at least limit their expansion.

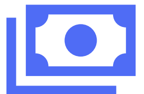
New office supply remains high
Despite the economic downturn, the planned supply of office space in 2024 remains relatively high. Approximately 60,000 sqm of new office space is expected to be delivered to the market this year, significantly above the yearly average of about 40,000 sqm. However, nearly half of this new space is in the 29,000 sqm Arter Quarter project, which is almost fully leased out. Other developments range in size from 2,500 to 9,000 sqm.

First new residential development since regained independence
Since Estonia regained its independence, the city of Narva has not seen the development of any new apartment buildings. The primary concern has been uncertainty over whether people in Narva can afford new, relatively expensive apartments. Now, the construction of an entire residential quarter is planned in the coming years. A total of five buildings are planned, with the first expected to be completed in 2025. This project is a breath of fresh air for nearby manufacturers, who need highly skilled engineers and other specialists. These professionals have often been reluctant to move to Narva due to the lack of modern housing.

Residential market remains inactive
In 2023, the number of apartment transactions fell to about half of its peak level in 2021. Problems began with rising interest rates in the second half of 2022 and have continued through 2023. Despite the lower activity, the average price of apartments, especially new ones, has continued to climb slowly. However, there is a statistical issue: agreements to buy apartments are often made months before the actual transaction. For older apartments, the market reacts more quickly. Their price growth halted at the beginning of 2023 and has since decreased by about 10%. Eventually, the average price of new apartments is expected to stop growing and may even fall slightly. The situation is likely to improve when interest rates decrease.



EUR 187 million
Total investment volume in 2023



EUR 225 million
Total investment volume expected in 2024

-0.4%
GDP growth projected in 2024

The Lithuanian property market

After a strong year-end run, 2024 is welcomed with more positivity

Eika Development, UAB photo by Leonas Garbačauskas

Lithuania's open economy has demonstrated resilience in the face of challenges. GDP performed better than expected in 2023, contracting by only a modest 0.3% for the year. While negative, this number has paved the way for positive expectations for 2024, with forecasts suggesting a rebound to 1.7% growth.

The labour market was strong, where an increasing population kept the unemployment rate stable at 6.9%. Inflation, while present, is under control. It has declined to under 9% on an average annual basis, and the year-on-year rate fell below 2% by year-end. There also a possible interest rate cut in the spring of 2024.

More broadly, Lithuania appears well-positioned to start a recovery. Encouraging economic indicators and optimistic forecasts suggest that the most challenging phase may now be behind us. The economic and geopolitical challenges of the past two years had consequences for the market, creating substantial hurdles for investments in commercial real estate in the Baltic region. However, towards the end of 2023, things turned around quite unexpectedly in Lithuania, and total real estate investment for the year was almost at 2022 levels. Real estate transactions in the Baltics totalled EUR 785 million, with Lithuania contributing 55% of that figure, which is just over 80% of the long-term average for the region.

Local investors have dominated the market for three years, and their influence is still perceptibly on the rise. Meanwhile, some long-standing Nordic investors have maintained their interest and involvement in the market. The market size is expected to remain at current levels, with foreign investor interest likely to grow only in the long term. Thus, the activity of local investors is crucial. The transaction volume indicates a narrowed gap between current interest rates and the targeted returns on commercial projects, highlighting potential alignment in the market.

In the Baltic region, especially Lithuania, the decline in market activity has been more moderate than in the broader European context. Such resilience reflects opportunities, capacities, and the keen interest of local investors, who continue to underpin overall market vitality. While there's a shortage of assets that are easy to sell, there are still appealing opportunities that catch the eye of local investors. Considering how well 2023 ended, Newsec predicts a positive 2024.

Contact:
Kristina Živatkauskaitė, k.zivatkauskaite@newsec.lt

Interesting trends on the Lithuanian property market

The office segment and its lead in the investment market

Each Baltic country had its real estate investment segment leader in 2023. The highlight of the year was Lords LB Asset Management's agreement at year-end to acquire the Ozas Campus from Technopolis. This major transaction underscores the continued prominence of the office segment. It includes 106,000 sqm of gross leasable area spread across six buildings, accounting for almost 10% of the modern office stock on the Vilnius market. It sets a precedent for strategic investments, shaping the future trajectory of the city's office sector.

Resilience in the office market

The Vilnius office market has proven resilient, maintaining a relatively stable vacancy rate thanks to take-up aligning with new supply. Looking ahead to 2024, a reduction in new supply is anticipated. Given the economic uncertainties, developers are adapting their strategies.

Tenant profiles are unique in the Baltic region, particularly in Lithuania. Global Business Services (GBS) companies with large numbers of employees, the thriving startup scene, and the robust Fintech ecosystem collectively account for a significant portion of the office market. This diverse mix, along with IT companies and various other local tenants, ensures steady demand and helps keep office occupancy high. New demand from international companies, which is eagerly anticipated, should further strengthen the market in Vilnius. As the office market navigates anticipated changes, the overarching theme is adaptability.

Adaptability and innovation

In an era of rapid change, adaptability and innovation have become the cornerstones of success. Innovative financing models, collaborative partnerships, and flexible development strategies can help stakeholders navigate uncertainties effectively. Vilnius's active office market may also witness the emergence of new development models.

Growth in sustainability and proactive strategies in the industrial segment

The industrial segment is experiencing heightened activity, particularly in warehouse development, with a focus on built-to-suit projects for large end users. Notably, there is a growing trend towards the creation of attractive portfolios, particularly in Lithuania. For warehouse properties, sustainability has become a highly relevant topic. The logistics and industrial segment is at a juncture, having drawn significant attention following recent major projects in Lithuania. Grocery and DIY retailers are primarily adopting a built-to-own or built-to-suit approach. As these new projects near completion, vacancies and availability are shifting towards older stock, leading most speculative market developers to put further new developments on hold. Nonetheless, a few proactive logistics and warehouse developers are taking the risk and planning new deliveries.

EUR 430 million
Total investment volume in 2023

EUR 350 million
Total investment volume expected in 2024

1.7%
GDP growth projected in 2024

The Latvian property market

Investment market picked up in 2023

In 2023, GDP shrank by 0.4% last year and is set to grow by 2.0% in 2024 and 3.6% in 2025. Meanwhile, private consumption fell by about 1.8% in 2023 and is forecast to grow by 2.8% this year and 4.3% next year. Although inflation was high in 2023, at 9.1% it was still nearly 2 percentage points lower than forecast a year ago, and is expected to normalize to 2.0% in 2024 and 2.3% in 2025.

Unemployment remained low in 2023, at 6.5%, and is set to decrease further to 6.3% in 2024 and 6.2% in 2025. Notably, wage growth in 2023, estimated at 12.0%, outpaced the rapid inflation. Wages are projected to grow by 8.0% in 2024 and 7.9% in 2025.

The value of Latvian exports fell by 19% in H2 2023. The value of imports, however, also decreased by nearly 20%, thus the foreign trade balance did not worsen. Exports to all the top 20 destinations decreased except those to France and the Czech Republic. This export decline is much worse than it was in 2020. Still, the drops can be seen as a push for exporters to change and diversify their markets, which is a key step to recovery and future growth. In fact, many businesses have approached new markets and further developed existing ones to weather the economic changes. It is worth mentioning that in 2023, exports to some more distant countries in Africa and Asia, increased by several hundred percent. While these countries' combined share of Latvia's total exports is only about 1%, this shows the growth potential. Indeed, as a small country, Latvia has unlimited export growth potential.

The urge to invest and divest in real estate outweighed the long-standing uncertainty in the market, and thus nearly EUR 170 million were invested in 2023. The last quarter of the year was the most dynamic, partly as long negotiations on earlier initiated transactions came to fruition. A noteworthy transaction was the sale of Rimi's central logistics and office facilities in Riga, which Rimi will continue to occupy under a 15-year lease agreement.

Investment will most likely pick up further in 2024, with more deals than last year. No segment stands out in the overall weak real estate market, but there are weaker properties in each of the segments, usually with high or increasing vacancy and often poor management. While demand will remain strong for good quality properties with high occupancy and solid strategies, the supply of such properties is limited.

Contact:
Inita Nitiša, i.nitisa@newsec.lv

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Interesting trends on the Latvian property market

New offices remain in strong demand

In terms of new office development and supply, recent years have been very dynamic. In 2023, seven new high-quality offices were delivered, totalling over 64,000 sqm of space. Two offices, accounting for more than 50% of that space, were delivered in the popular Skanste area, strengthening its position among office locations.

Some earlier concerns about potential vacancies in new offices have not materialized – the demand for offices, including space still under construction, is very strong. The key advantages of new offices are the latest well-being and energy efficiency standards, up-to-date design, and robust marketing support. Office take-up rose to a record of over 77,000 sqm in 2023, with 70% of that in prelease transactions. Meanwhile, the occupancy level of offices delivered in recent years exceeds 80%. One can certainly say that the strong supply is fueling demand.

So far in 2024, six properties are scheduled for delivery. The predicted rise in office vacancies will not be substantial and probably mainly affect older offices in both Class A and B.

Unemployment back to 2019 levels as jobs are actively created

The unemployment rate for 2023 stood at 6.5%, which is just 0.2 percentage point higher than 2019's record low. Meanwhile, unemployment is forecast to decrease further. Positive figures for the economy, though a challenge for employers.

Local and international firms are showing strong demand for employees at all levels. Under programmes supported by Latvia's Investment and Development Agency (LIAA), for instance, 46 projects were launched in 2023 with total investments of nearly EUR 620 million, creating more than 2,500 new jobs.

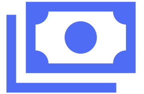
Low unemployment favours jobseekers, with more work opportunities offered. It also makes companies focus not only on growing sales, but also on being competitive as employers. Besides remuneration, engaging management and a great team, the physical working environment is also important – whether that be a modern office with a great view or a well-organized warehouse with comfortable break rooms. Thus, demand is rapidly increasing for high-quality, well-designed, green properties built according to international wellbeing and energy efficiency standards. This is also creating pressure for the transformation of older properties into better, greener facilities.

Development continues though timelines are longer

The real estate development agenda remains busy, with a new project supply market that seems steady and growing. However, many projects are taking substantially longer to deliver than in pre-Covid times. Delays are usually due to cash flow disruptions, volatile construction costs, and sometimes a lack of materials amid shortages or delivery delays.

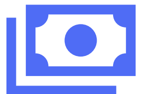
In 2023, average construction costs increased only slightly, though labor expenses in the industry grew by more than 6%. In addition, Rail Baltica, as a major project, continues to intensify competition, especially in the labor market. On the one hand, the increase in construction costs is not significant, but on the other hand, the market was hoping for a reduction after substantial growth in construction materials costs in previous periods, so any increase at all is a burden.

Meanwhile, some projects are on pause, to be reconsidered when there is less uncertainty. Overall, strategic decisions take longer to make than before as they involve more money and more risk.



EUR 170 million

Total investment volume in 2023



EUR 200 million

Total investment volume expected in 2024

2.0%

GDP growth projected in 2024

European Markets in H1 2024

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A New Cycle

The real estate cycle that began with the GFC in 2008 explicitly came to an end in 2023. What is particularly notable about this cycle end is its elongated nature: drawing the cycle to a close took an entire year. That reflects the protracted nature of monetary policy where it has taken central banks an entire year to get on top of persistent inflation. However, they remain cautious about current trends in inflation. This means they may be slow to normalised interest rates. The consequence of this is that the recovery in real estate activities may be equally slower at the start of this new cycle.

Real Estate Investment Volumes bottom out in 2023

European investment volumes for 2023 were sobering, staying at a decade low of €133bn, down 51% on 2022. In the big 5 markets, the UK leads at €43.5 bn (-43% y-o-y), Germany €23.3 bn (-57%), France €14.3 bn (-51%), Spain €7.1 bn (-45%) and Italy €6.4 bn (-49%).

The ever-shifting ground of financing costs that characterised much of 2023 took a toll on European investment activity. The elongated nature of the monetary policy cycle has created difficulties in establishing suitable pricing against bond yields and acceptable lending costs. At the heart of this is the continuing price discovery rather than lack of liquidity.

Going forward it is likely that investment volumes will pick up though this may be more apparent towards the back end of 2024. The great unknown of the investment market is the extent to which the market may be driven by distressed sales because of the funding gap. Like residential mortgages, many commercial loans are on fixed rates and due for refinance in the coming years. They are mostly likely to be done at a higher interest rate.

It is unlikely that the high volume of transactions seen in the past five years will reappear any time soon, reflecting two aspects of the cycle. The first being the scale of repricing, which means more assets will have to transact to attain similar volumes. That seems very unlikely in the short term. Secondly, the cost of finance is likely to stay expensive for the short term, which may inhibit some transactions going forward.

Yield decompression almost at the close

Instead of ending the interest rate tightening cycle in early 2023 as had been hoped, central banks maintained the tightening bias into the third quarter. Given the nature of valuation systems in different European countries, it has meant an almost constant process of catch-up all year: 2023 will be regarded as the year of yield decompression. European markets are now characterized by protracted price discovery processes across all asset

types, albeit at different speeds. The European composite yield for retail stood at 4.0% (3.6% in 2022) and logistics 4.6% (4.2% in 2022). The composite office yield stood at 4.6% (3.8% in 2022) for the 16 top markets. While we see, albeit marginal, further decompression in yields in 2024, we accept we are at the tail end of this process.

Although yields have repriced broadly, investors' appetite varies among the various asset classes. No asset commanded a substantial risk premium (over bonds) at the end of 2023. That alone suggests for some assets classes, offices especially, there may be some more expansion to come. The attractiveness to investors therefore depends greatly on the asset's geography and occupational dynamics, tenant demand and rental growth potential most of all.

This leads us to think that the market will reactivate selectively by asset type first, followed by geography, with strong tenant demand and rental growth as the main

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adrivers of performance. This points to investor demand for the alternative sectors such as residential with strong demand, ultra-low vacancy, and robust rental growth prospects.

As the new cycle develops, owners of real estate must look more to rental growth to generate returns than yield compression. We continue to anticipate divergence in rental performance between sectors with those that have historically performed well like offices and logistics having to work much harder to generate meaningful rental uplift. That inevitably means greater focus on tenant retention with increased incentives and the cost that implies. Retail, though not generating the magnitude of rents seen historically (luxury is an exception here), is likely to expand after years of decline.

Cooler logistics rental growth

Demand for logistics space cooled in 2023, on the back of the economic slowdown. Take-up decreased by 35% in the leading European markets, though the decline comes after an exceptional volume seen in 2021 and 2022. Take-up mirrored levels seen in 2016 so is still strong but considerably more selective. Some of that reflects weaker tenant demand and the cost of constructing new units. This is still likely to be more expensive than in the past even with more accommodative monetary policy. That will help to stabilise the cost of financing construction, though the design and build side of supply will still be affected by high construction prices. Material prices have been on a roller coaster in the last two years and though key commodity prices may fall over the forecast period, the absolute price levels are still likely to remain above that seen between 2015 to 2019.

The outcome is that scarcity is unlikely to disappear soon even with more selective demand. Rental levels, already high, increased by an average of 6.3% over 2023 against a backdrop of weaker take-up; it highlights the supply distortion. We continue to think that further rental growth may challenge some occupiers to find more cost-effective units. Added into the mix is the need for more energy compliant buildings.

The combination of more selective demand and a reactivated pipeline means we think the pace of rental growth may slow over the next few years. ***By contrast, retail rental growth is set to turn positive.***

Though the European economy did not enter recession and inflation moderated over 2023, consumers remained cautious about spending. Price levels remain high, especially for food, which discourages the sort of discretionary spending on which retail thrives. The cost-of-living crisis produced a classic consumer substitution response; reduce, replace, and remove with emphasis on necessities. That benefitted discounters mostly at the expense of the midmarket segment. Immune to this is the luxury segment that continues to chart its own path of relentless growth.

The prospects for retail recovery are good. The structural challenges that retailing has gone through over the last twenty years means many companies have learnt to cope. What made for a successful retailer over the slowdown was the ability to adapt pricing, leverage brand and adopt an optimum omnichannel delivery strategy. The latter is important because many companies that did not do well either overinvested in e-commerce at the expense of stores or underinvested. Getting the balance right may end up being a unique feature of this cycle.

Though an abundance of retail units remains, these are increasingly ones that do not fit into the innovation strategies of mass market or are not located in the right places for luxury. We think that select retail locations are set to recover with brand expansion. ***Consequently, we anticipate that high street rents could begin to grow again, backed by increasing demand for the best assets in terms of location.*** Shopping centres and retail parks are of key interest to retailers seeking omnichannel options, especially "click and collect".

Construction may see office rental growth taper over the forecast

The new cycle underway for the office market may embed the quality factor as key to commanding the best rents. Scarcity of modern and abundance of secondary assets characterises supply. Yet this binary dynamic is now in flux as owners decide what to do with buildings. It is a slow process to alter the built environment, yet the two drivers of tenant demand and energy regulation mean more development is rolling forward, even if at a high construction cost.

Take-up of large-scale floorplate units was particularly weak in 2023. With greater economic strength over 2024 and especially from 2025, larger scale requirements are likely to reactivate. We continue to think that this will focus on the most modern units. However, we see future demand for large units being lower than in previous recoveries because of the impact of hybrid working. Yet it is important to note that many companies are still exploring how this style of working operates. It is not as simple as applying the same density ratios used pre-pandemic in a smaller space as the hybrid working concept is a rethink of how space is used.

The office sector therefore continues to face a confluence of structural changes that favours prime and modern units and less space. The combination may mean prime assets experience strong rental growth in the near term which slows over the next few years. There is sufficient momentum behind development of prime units in CBDs to take the edge off rental growth even if requirements stay unaltered.

For secondary assets, especially those located outside the CBD, prospects are murky. There is considerably less demand which could result in excess supply as vacancy increases. These types of assets may record an even slower rate of rental growth. The ever-increasing performance gap in rents between old and new offices is likely to dominate the new cycle.

> **"Take-up of large-scale floorplate units was particularly weak in 2023"**
>
> Samuel Duah, BNP Paribas Real Estate UK

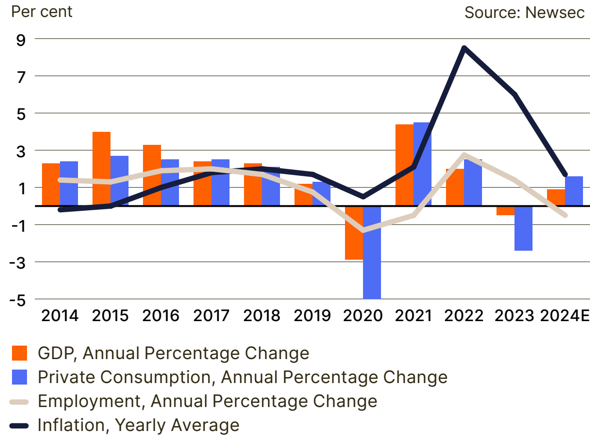
Photo: iStock

Macroeconomic and Property data

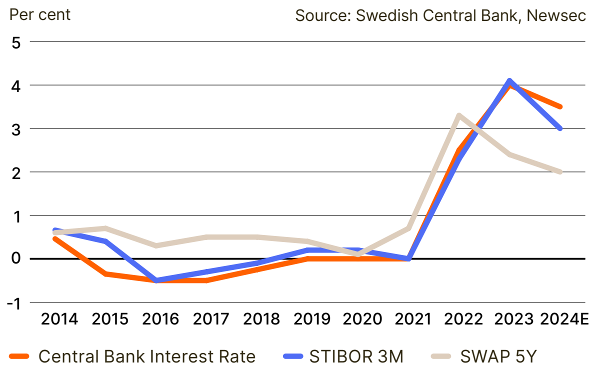
Macroeconomic Data

Sweden

Economic Indicators

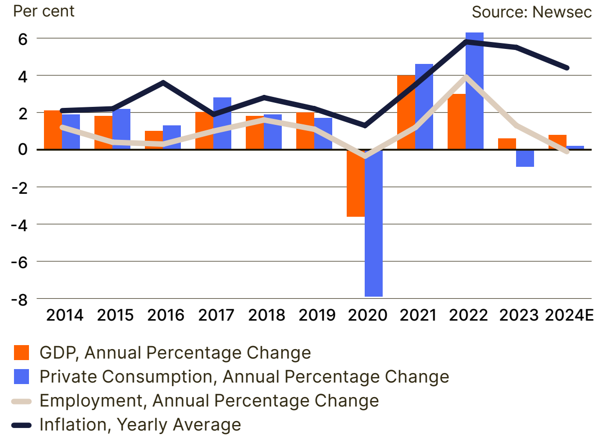


Interest Rates



Norway

Economic Indicators



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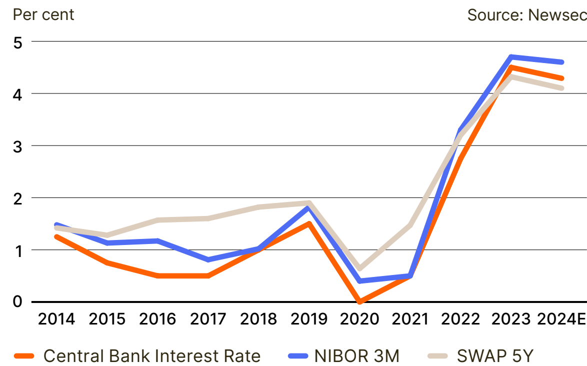
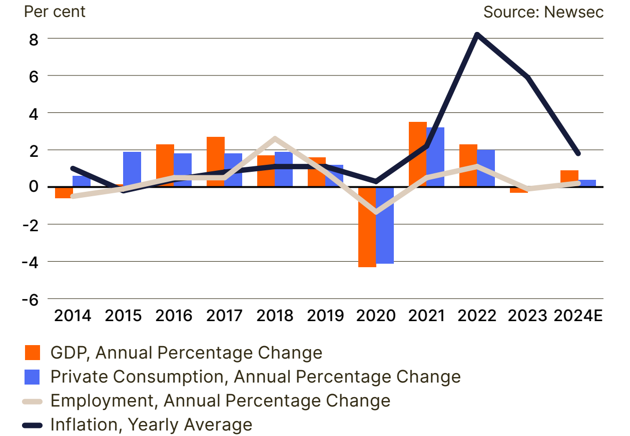


Finland

Economic Indicators



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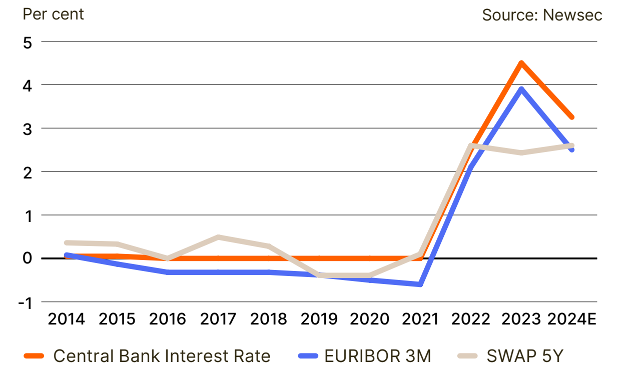

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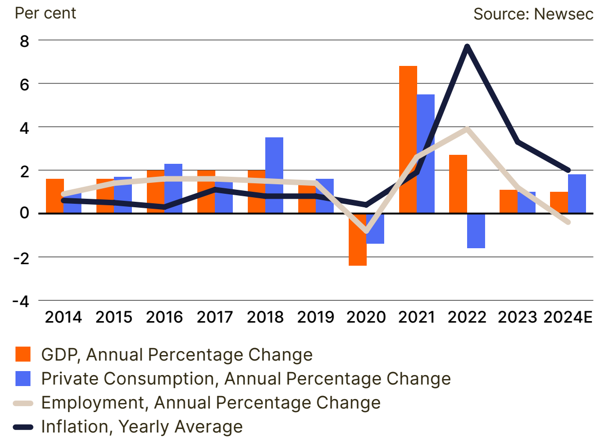
Denmark

Economic Indicators



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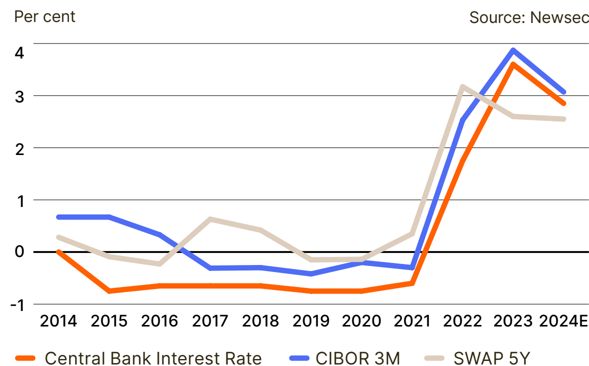
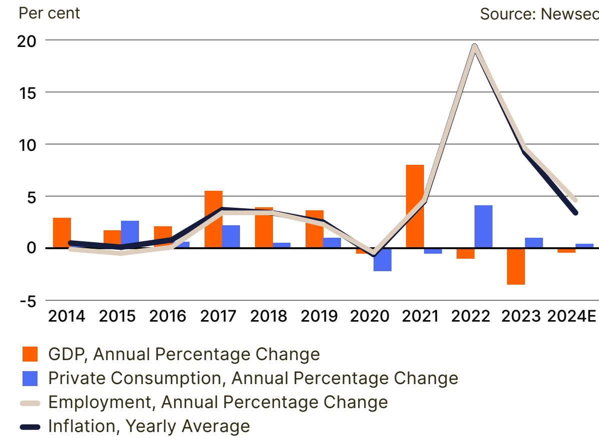


Estonia

Economic Indicators



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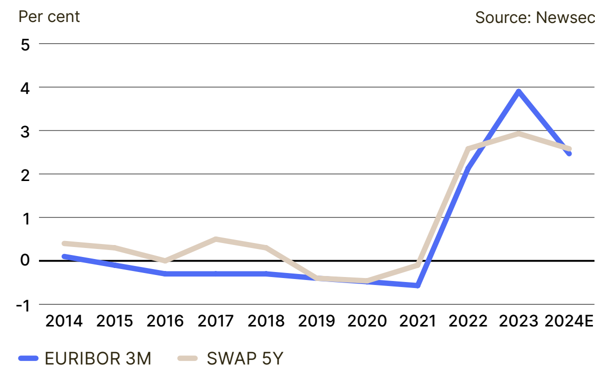
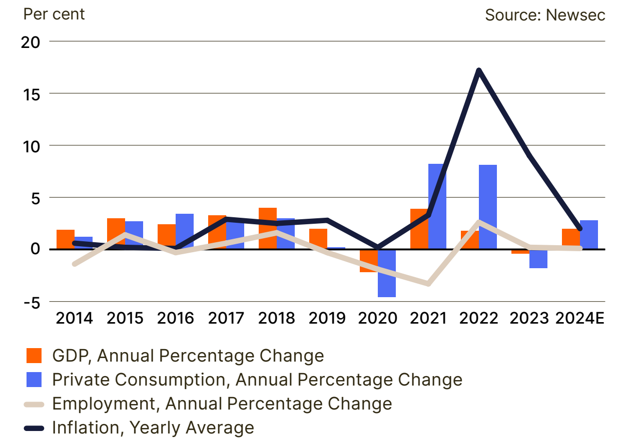
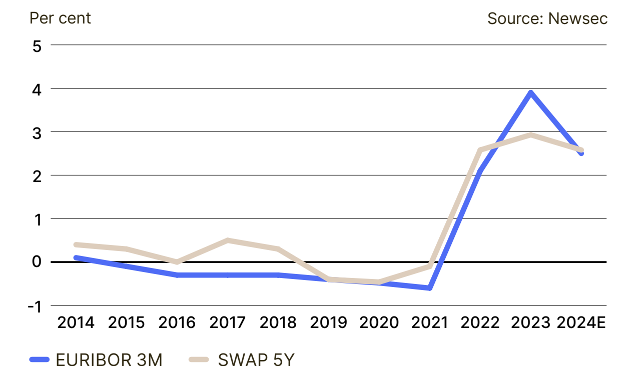


Latvia

Economic Indicators



Interest Rates



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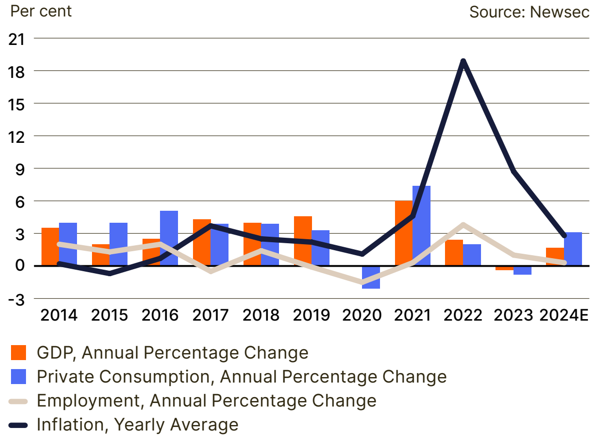
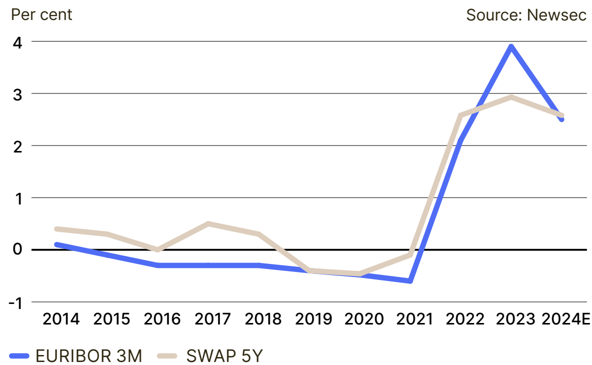
Macroeconomic Data

Lithuania

Economic Indicators

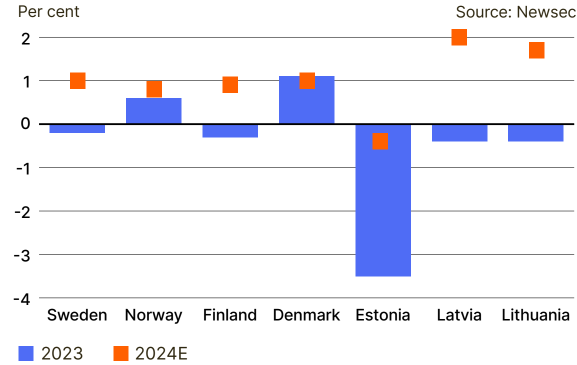


Interest Rates



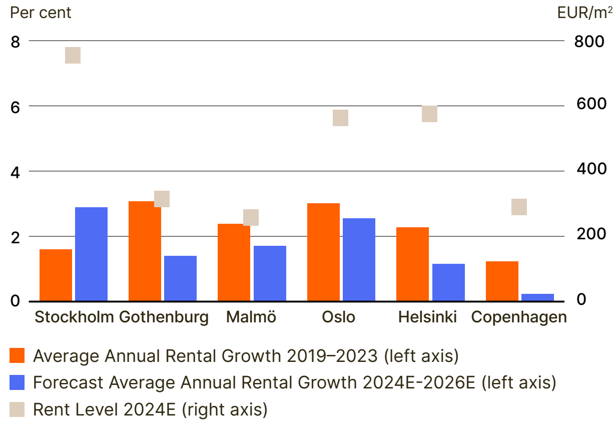
GDP Growth

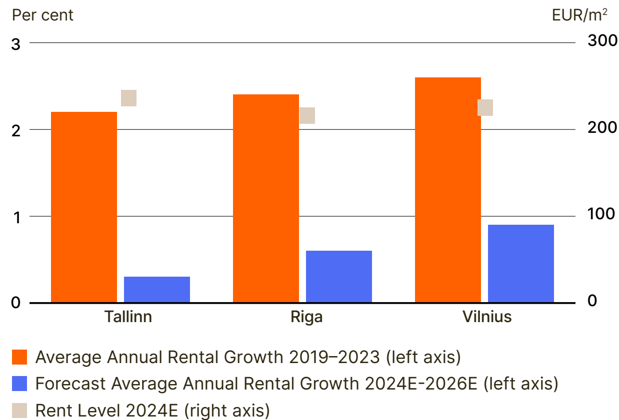
GDP Growth 2023–2024E



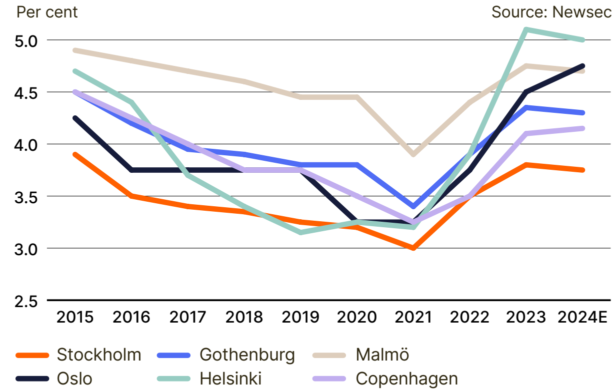
Property Data

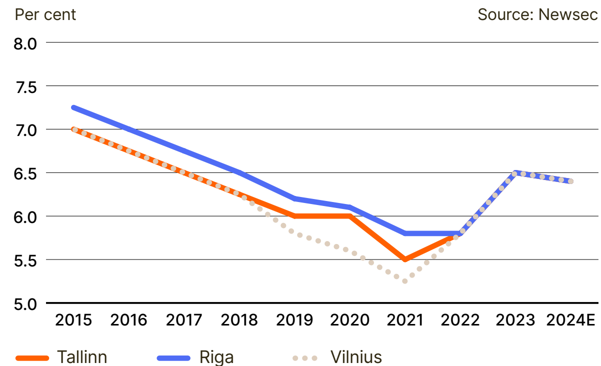
Office rents



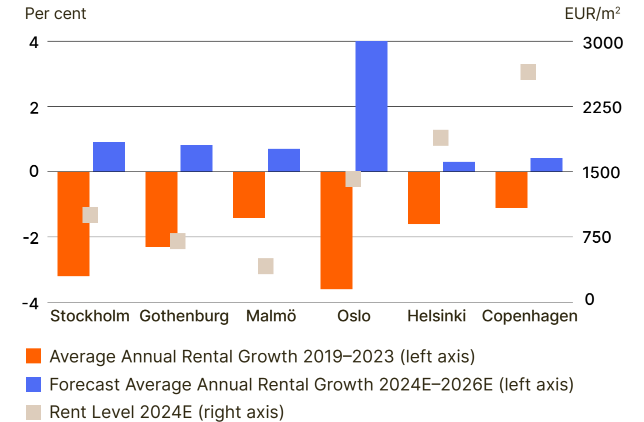


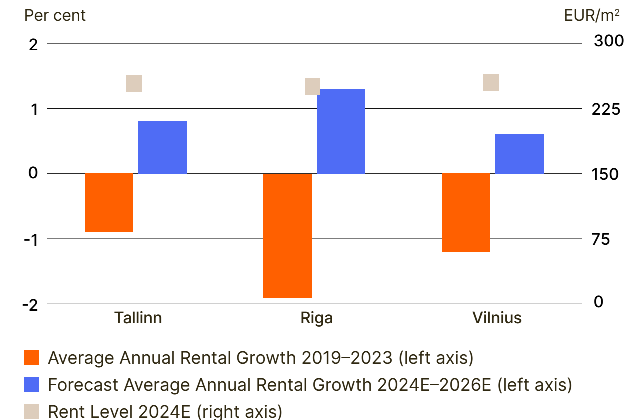
Office yields





Retail rents

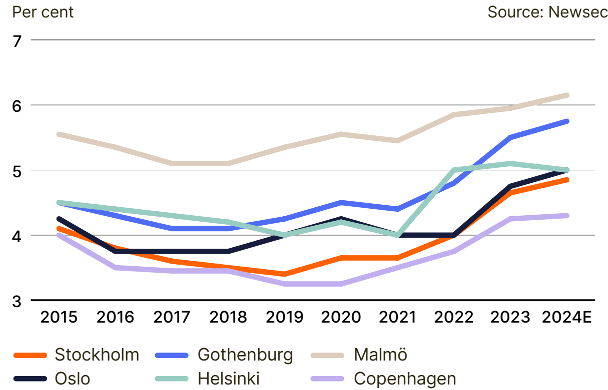




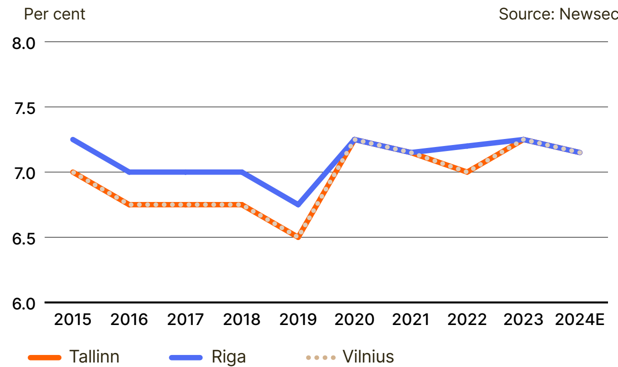
Property Data

Retail yields

Prime Retail Yields | Nordic Region

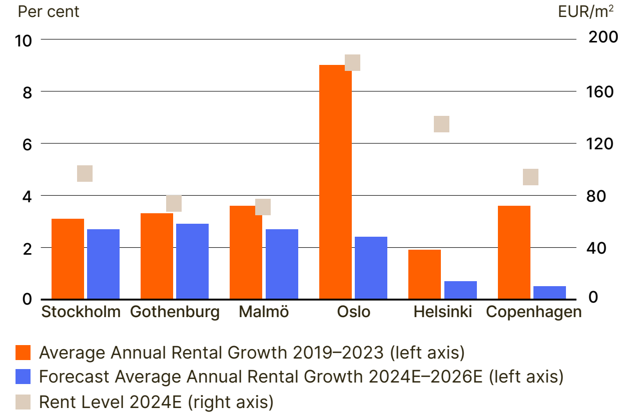


Prime Retail Yields | Baltic Region

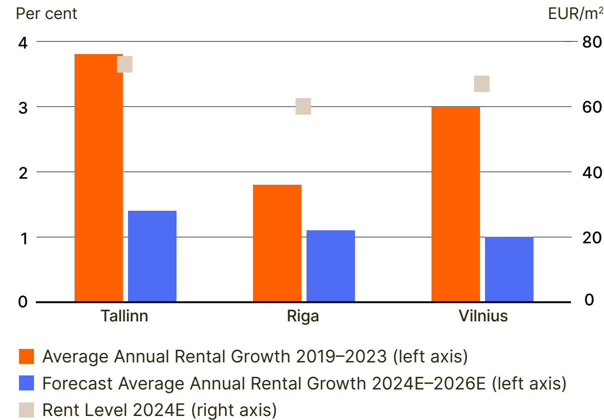


Logistics rents

Prime Logistics Rents | Nordic Region

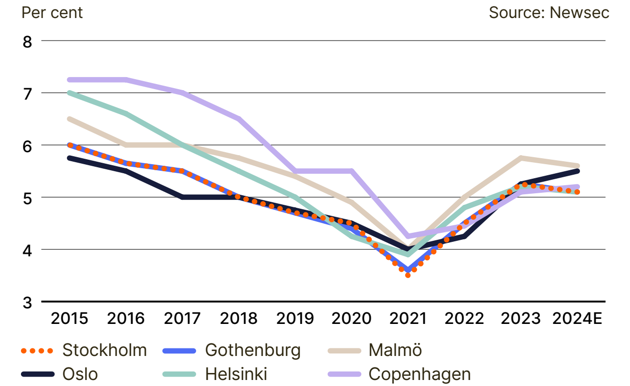


Prime Logistics Rents | Baltic Region

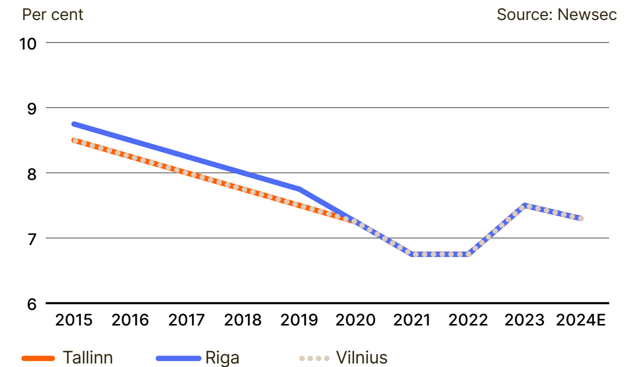


Logistics yields

Prime Logistics Yields | Nordic Region



Prime Logistics Yields | Baltic Region



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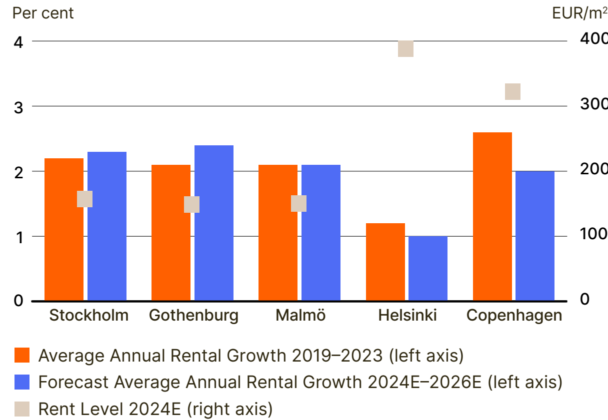
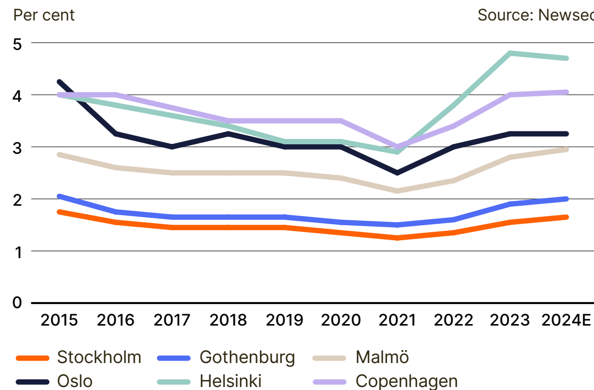
Residential

Prime Residential Rents | Nordic Region

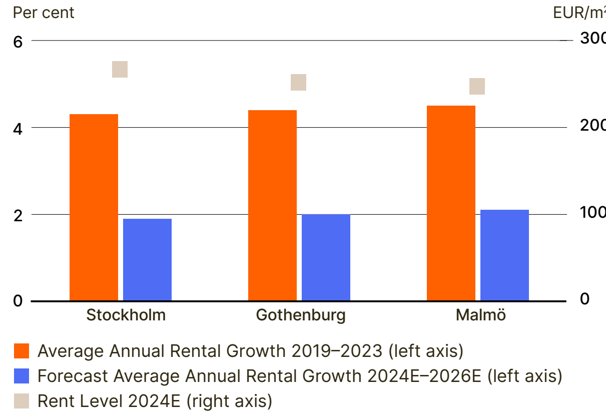


Prime Residential Yields | Nordic Region

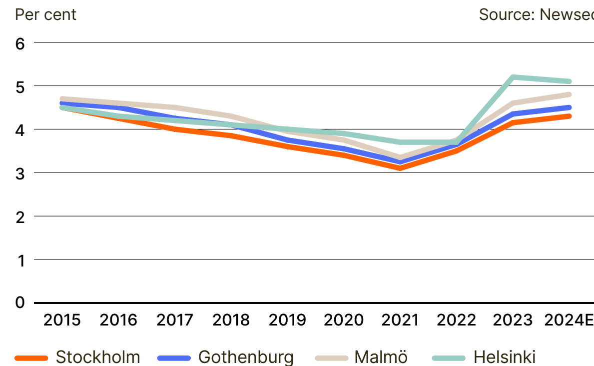


Public properties

Prime Public Properties Rents | Nordic Region

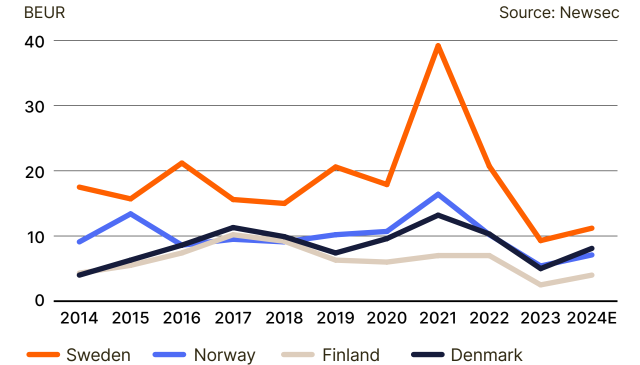


Prime Public Properties Yields | Nordic Region

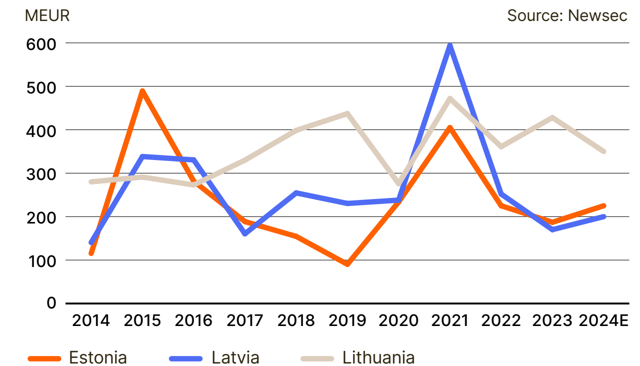


Annual transaction volumes

Transaction Volumes — Annual | Nordic Region



Transaction Volumes — Annual | Baltic Region



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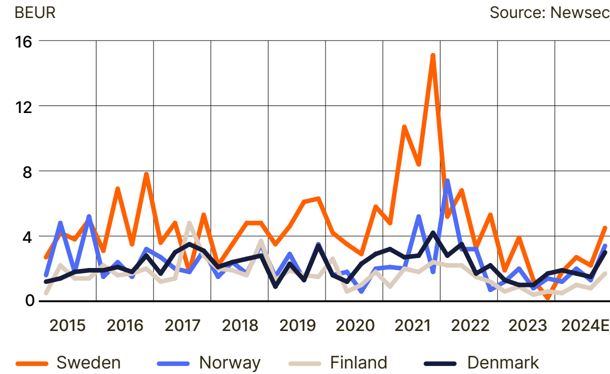
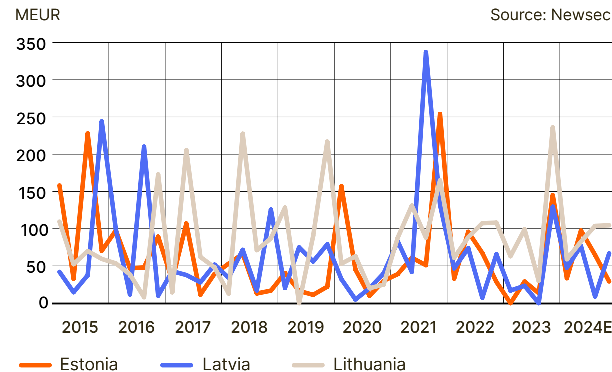
Property Data

Transaction volume

Transaction Volumes — Quarterly | Nordic Region

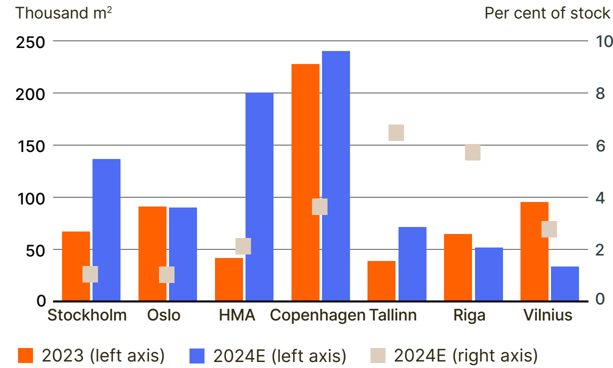


Transaction Volumes — Quarterly | Baltic Region



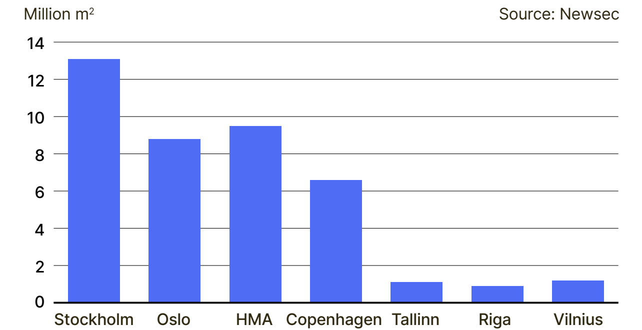
Office new construction

Office New Construction (Capital Office Market)



Office stock

Office Stock Q4 2024E (Capital Office Market)



Definitions

General

- All rents, yields and vacancies are end-of-year values.
- All forecasts are referring to nominal values.
- The rental levels are the most probable prime rent when signing a new lease agreement.
- All yield levels are referring to net initial yield.

Offices

- The forecast is referring to new/refurbished modern and flexible office premises with normal area effectiveness.
- The rents are referring to premises of at least 500 sqm.
- The rent is excluding heating and excluding property tax.

Retail

- The rents are referring to modern retail premises of 70–250 sqm.
- The rent is excluding heating and excluding property tax.
- The rents refer to prime areas with definitions by each country.

Residential

- The forecast is referring to attractive locations with an area of around 80 sqm.
- Definitions generally, as well as of new and old housing depend on the country.

Logistics

- The forecast is referring to warehouses and logistics premises.
- The rents are referring to premises of 5,000–10,000 sqm with a 10 year lease agreement.
- The rent is excluding heating and property tax.
- The rent refers to modern, newly built premises with a solid lease contract and tenant A properties.

Public Properties

- A public property is defined as a property used predominantly for tax-financed operations and specifically adapted for community service. In this document, public properties are limited to schools (pre-schools and primary schools), hospitals, and elderly care homes.
- The market data refers to public property premises of normal to modern standard with normal space efficiency.
- The market rent refers to the rent excluding supplements.

Exchange rates

All rents and transaction volumes are calculated using the average exchange rates in 2022.

The Newsec Property Outlook Team

Max Barclay
Head of Advisory and
Deputy CEO of Newsec

Sweden

Ulrika Lindmark
Head of Valuation, Research
& Strategic Analysis
ulrika.lindmark@newsec.se

Adam Tyrcha, PhD
Head of Research &
Strategic Analysis
adam.tyrcha@newsec.se

Josefin Jangälv
Associate
josefin.jangalv@newsec.se

Norway

Øyvind Johan Dahl
Head of Research
ojd@newsec.no

Karen Cecilie Thunes
Senior Analyst
karen.cecilie.thunes@newsec.no

Christian Hagen
Senior Analyst
christian.hagen@newsec.no

Mari-Ann Høgheim Torgersen
Analyst
mariann.torgersen@newsec.no

Denmark

Morten Jensen
Head of Newsec Advisory Denmark
morten.jensen@newsec.dk

Robin Rich
Head of Research
robin.rich @newsec.dk

Finland

Valtteri Vuorio
Head of Research
valtteri.vuorio@newsec.fi

Baltics

Mindaugas Kulbokas
Head of Research & Analysis
m.kulbokas@newsec.lt

Kristina Živatkauskaitė
Senior Analyst
k.zivatkauskaite@newsec.lt

Inita Nitiša
Real Estate Economist
i.nitisa@newsec.lv

Mihkel Männik
Analyst
m.mannik@newsec.ee

Newsec – a leading property data & insight provider in the Nordics

Thanks to Newsec having one of the most comprehensive data bases for real estate related data in the Nordics & Baltics we are able to offer tailormade data deliveries and analyses. We also offer analyses and segment market reports which provide you with a valuable summary of the property market.

Market Report Logistics

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Market Report Residential

Market Report Construction Rights

Market Report Future Growth Markets

Market Report Office

Market Report Retail

Market Report Public Properties

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Newsec's Transaction List

Valueguard

Market Report Nordic Market

Access Newsec's market report portal: marknadsrapporter.se/store. For more information about data deliveries and analyses customized to your needs contact: adam.tyrcha@newsec.se

Contact and addresses

Sweden

info@newsec.se

Stockholm
Stureplan 3
P.O. Box 7795
SE-103 96 Stockholm,
Sweden
Tel: +46 8 454 40 00

Stockholm
Humlegårdsgatan 14
P.O. Box 5365
SE-102 49 Stockholm,
Sweden
Tel: +46 8 55 80 50 00

Gothenburg
Sankt Eriksgatan 5
P.O. Box 11405
SE-404 29 Göteborg,
Sweden
Tel: +46 31 721 30 00

Gothenburg
Kungsportsavenyn 33, 5 tr
SE-411 36 Göteborg,
Sweden
Tel: +46 31 733 86 00

Öresund Office
Davidshallsgatan 16
SE-211 45 Malmö,
Sweden
Tel: +46 40 631 13 00

Norway

info@newsec.no

Oslo
Haakon VIIs gate 2, Oslo
Oslo, Norway

Trondheim
Beddingen 10
NO-7042 Trondheim
Norway

Denmark

Newsec Advisory in Denmark
info@newsec.dk

Copenhagen
Vester Farimagsgade 19, 3.2
1606 København V
Tel: +45 33 14 50 70

Aarhus
Skanderborgvej 277D,
1. sal
8260 Viby J
Tel: +45 87 31 50 70

Newsec Property Asset Management in Denmark
pam@newsec.dk
+45 26 01 02

Lyngby
Lyngby Hovedgade 4
2800 Kgs. Lyngby

Aarhus
Skanderborgvej 277D,
1. Sal
8260 Viby J

Næstved
Ringstedgade 24, 1.tv
4700 Næstved

Finland

info@newsec.fi

Helsinki
Mikonkatu 7 A 3
00100 Helsinki
Finland

Porkkalankatu 3
00180 Helsinki
Finland

Tampere
Aleksanterinkatu 32 B
FI-331 00 Tampere
Finland

Turku
Yliopistonkatu 16 C
FI-20100 Turku
Finland

Estonia

info@newsec.ee

Tallinn
Viru väljak 2
Metro Plaza, 4th floor
EE-10111 Tallinn
Estonia
Tel: +372 5330 5313

Latvia

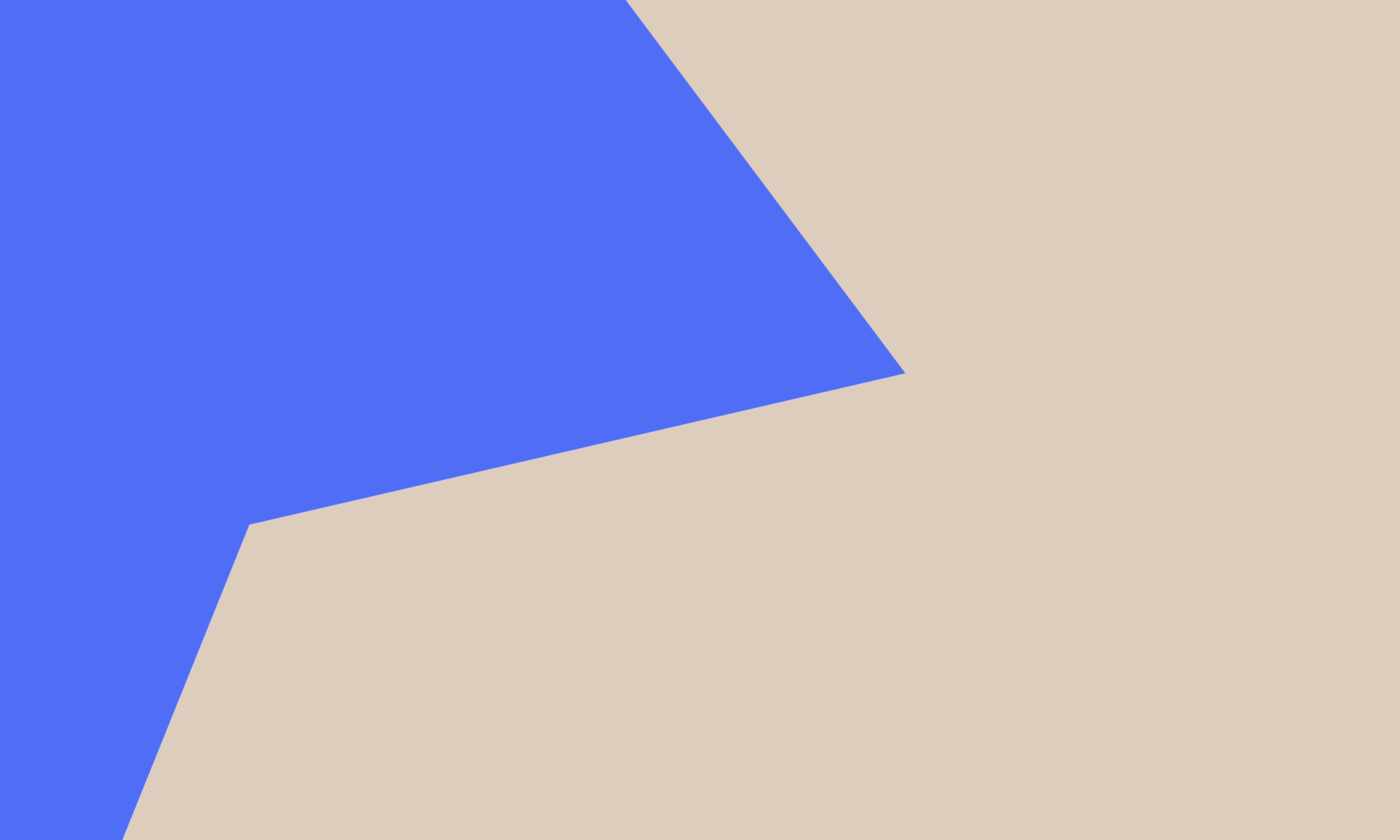
info@newsec.lv

Riga
Vesetas iela 7
LV -1013 Riga
Latvia
Tel: +371 6750 84 00

Lithuania

info@newsec.lt

Vilnius
Konstitucijos ave. 21C,
Quadrum North, 8th floor
LT-08130 Vilnius,
Lithuania
Tel: +370 5 252 6444



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