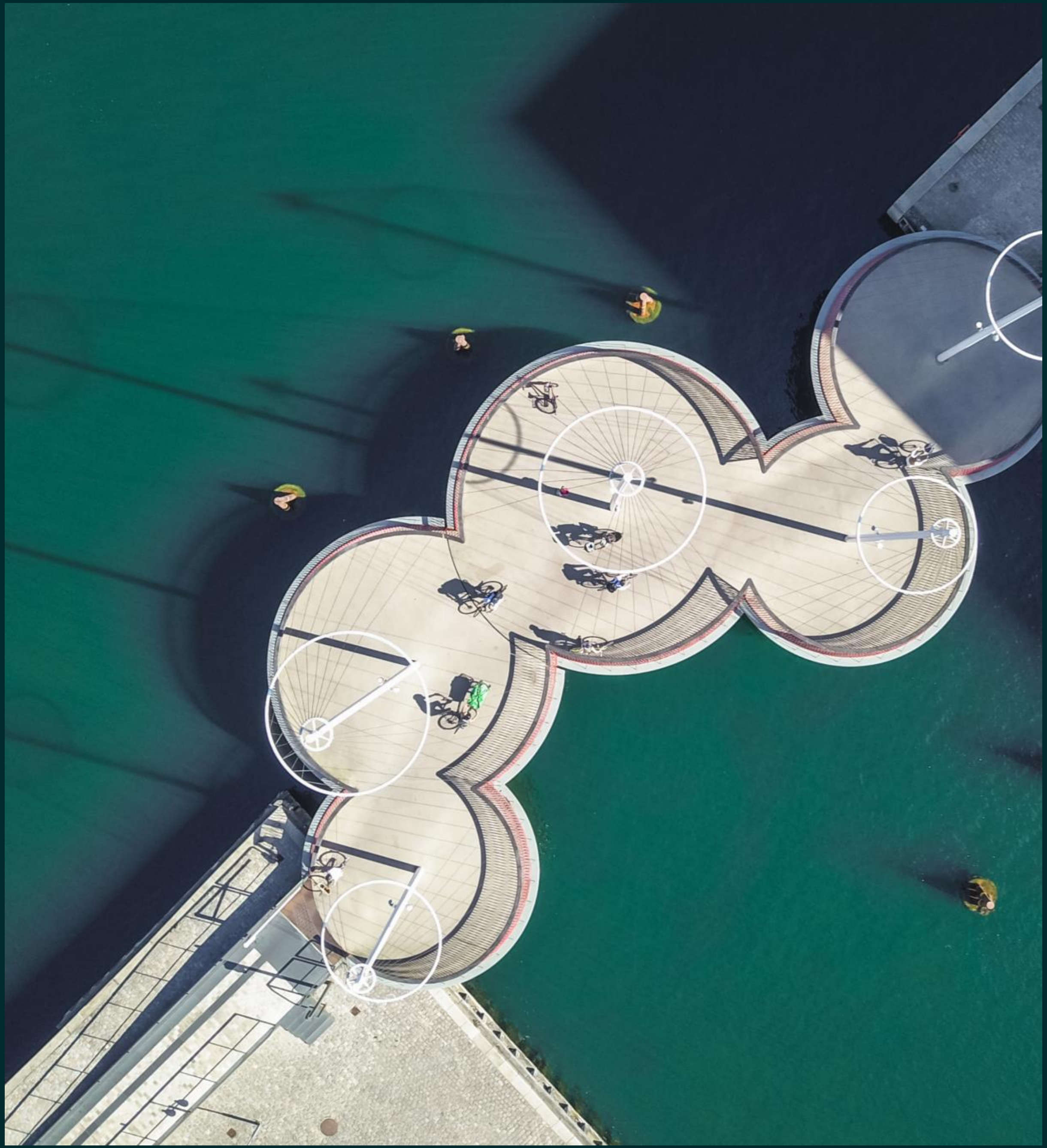
Creating Resilience

Market Outlook 2023

REPORT

DENMARK
REAL ESTATE

CBRE RESEARCH



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Introduction

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Welcome to the 2023 edition of CBRE Denmark's Outlook report, detailing our perspective on likely trends in each sector of the commercial real estate market in 2023 and the opportunities we foresee emerging for our clients in the year ahead.

It is a difficult time to forecast how the property market will develop. We all thought COVID was difficult, but that was just an interlude to what we are experiencing now. The big challenges are high energy prices, particularly European natural gas prices and higher interest rates. On the other hand, the European economies, in particular the Nordic countries, have performed better than anybody thought they would in 2022.

The trend we are going through tends to make the market think quite negatively. Investors are quiet at the moment; many of them are sitting on the fence. But the change in sentiment will happen at one point. The beginning of 2023 will probably be quiet. In Q2, slowly but surely, investors are likely to get ready again for reallocations, starting to build a pipeline. In the second half of the year, we are expecting to see more deal activity.

The impact of the repricing we are currently experiencing will be substantial, but many indicators point towards repricing being short-lived. It is not going to be the same for all locations and all sectors, but it is going to be material. This is not very good news for those who have invested in the past three years. However, if you are looking to invest, the future suddenly got much brighter. The new equilibrium will be settled among commercial real estate buyers and sellers as well as investor return expectations.

We have produced this report to help you navigate the macro environment we expect in 2023, and we look forward to working with you.

01

Economy

Key takeaways

01

A moderate recession is expected to result in a decreased economic activity from an inflated level to a more stable state. This can partly be attributed to the combination of high inflation and a restrictive monetary policy aimed at achieving inflation targets.

02

In 2023, it is projected that unemployment will rise from its present low historical level. Despite this, the economy will continue to exhibit unrelieved demand for labour, resulting in a relatively mild increase in unemployment.

03

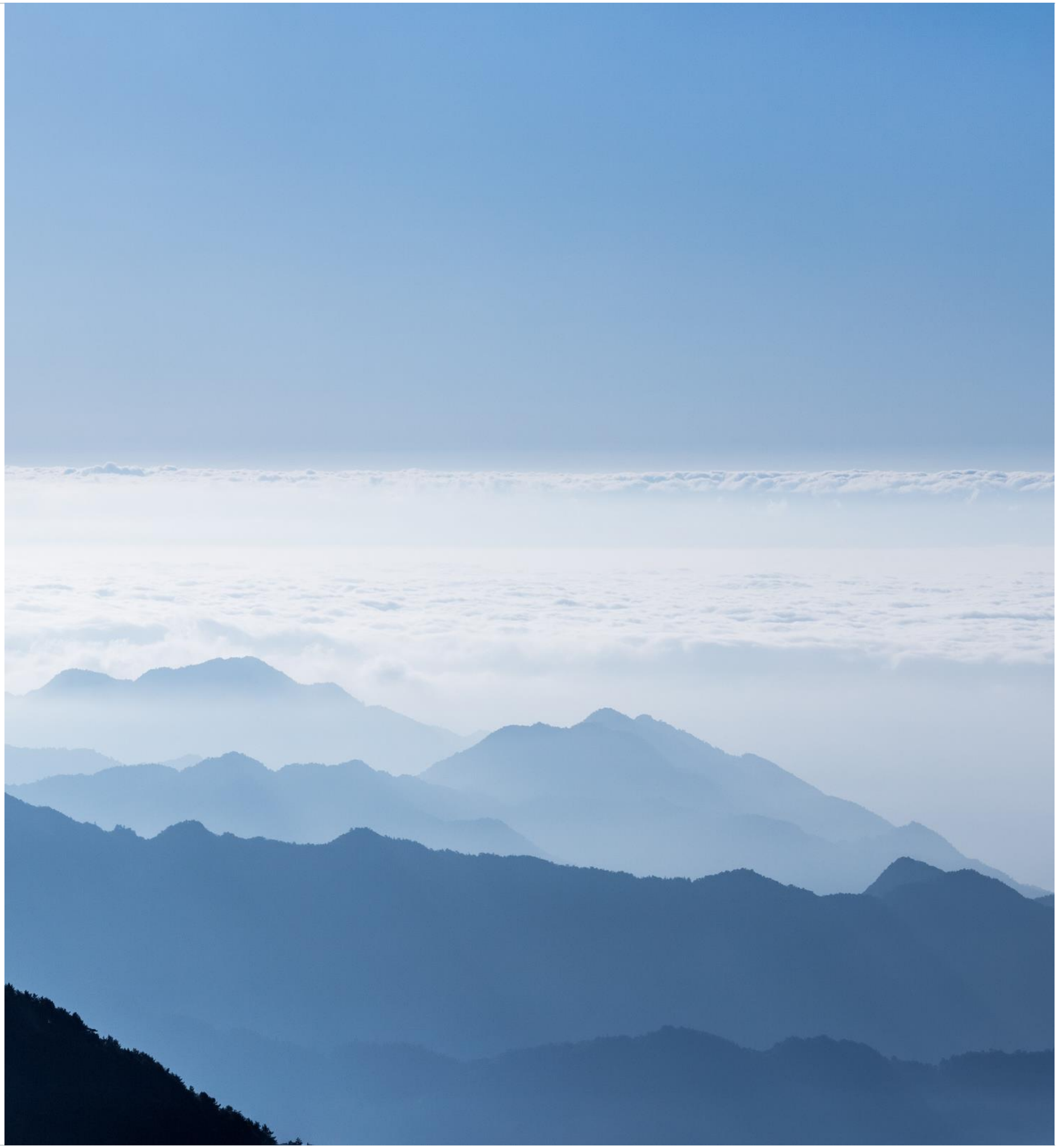
Inflation has likely reached its peak and should normalise due to decreasing demand and stabilising energy prices. However, a delay in costs transmitted to consumers will keep inflation elevated at the beginning of the year.

04

The Danish central bank will keep increasing key interest rates, which are anticipated to reach a peak in the mid-year. The rate of increase is predicted to slow as the neutral rate approaches. The interest rates are likely to decline gradually as inflation decelerates. However, the rate is expected to stabilise at a higher level.

05

Increasing mortgage rates will inhibit housing demand, permeating through the economy. A severe housing-induced recession is, however, unlikely due to stricter mortgage regulations and the well-cushioned finances of the Danish population.



The Danish economy is prepared for a moderate downturn

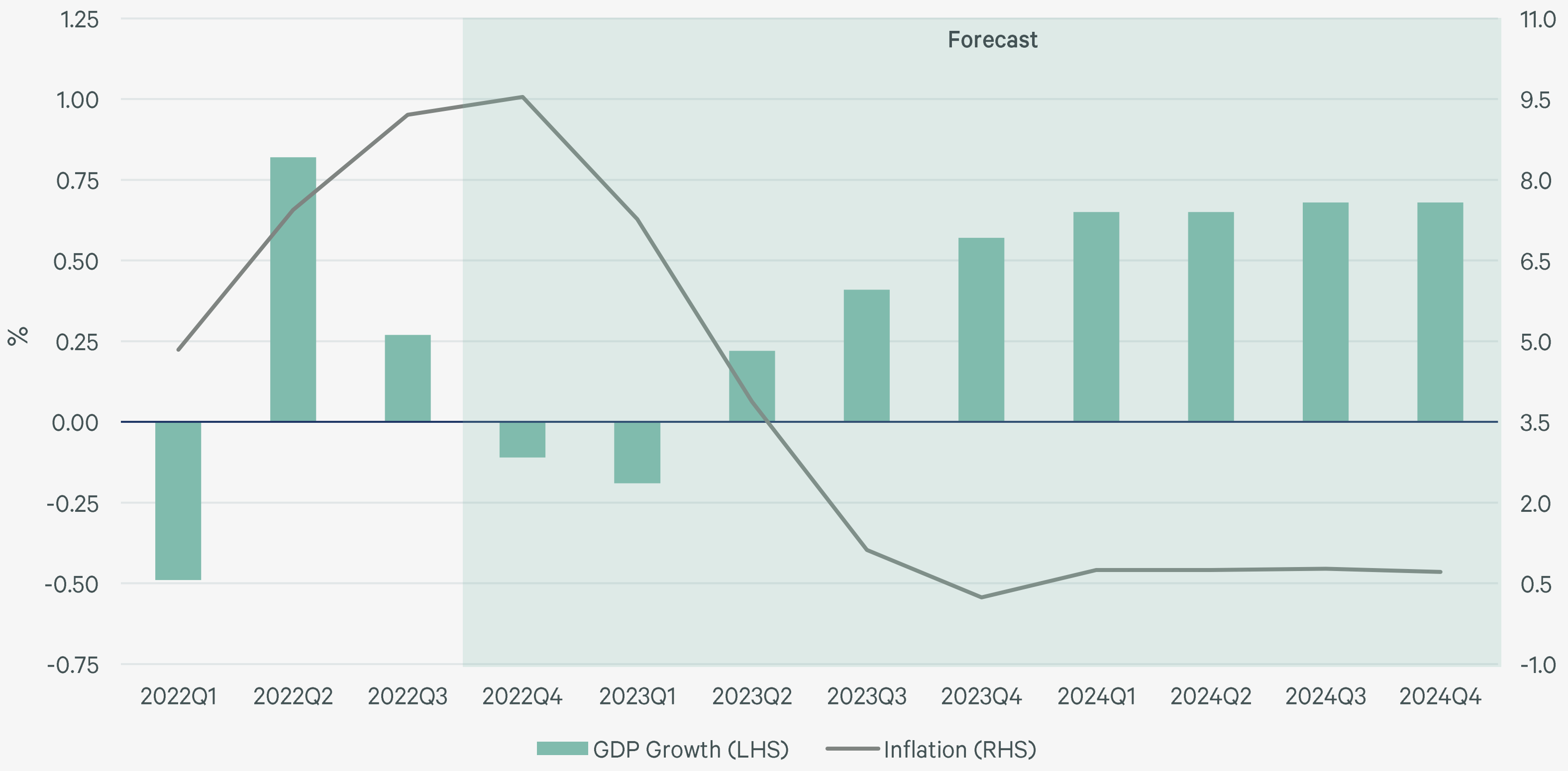
The past year has witnessed significant economic fluctuations, including a 40-year high inflation and a sharp increase in interest rates. Based on current trends, it is projected that the Danish economy will enter a moderate recession in 2023, with a projected GDP growth of just 0.4%. However, it is anticipated that the economy will recover in 2024, with a projected growth of 2.0%.

While traditional indicators such as GDP and government finances have yet to indicate an impending recession, other factors such as inflation and corporate financial performance have begun to deteriorate. Additionally, the expectation of rising interest rates has further clouded the outlook for the year ahead.

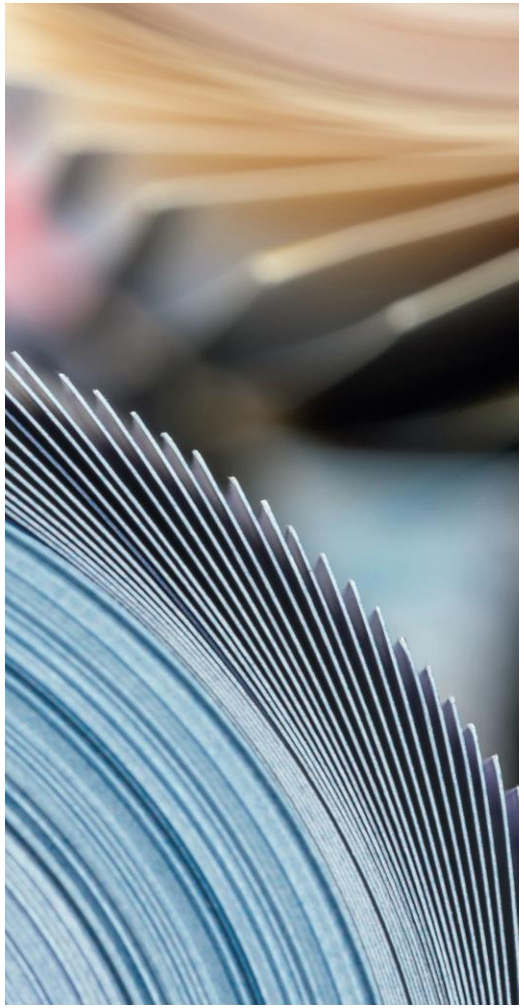
Consumer confidence decreased materially in 2022, which impacted retail sales significantly. This impact is, however, believed to be relatively short-lived. On the other hand, businesses will most likely be forced to implement cost-saving measures to maintain profitability, resulting in job losses and an overall increase in unemployment during 2023. However, it should be noted that unemployment will only rise moderately as there remains a demand for labour in certain sectors.

Despite the indicators pointing towards a recession, there are mitigating factors that suggest it will be a moderate one. One of the main reasons is the strong financial standing of both households and corporations. The tight labour market is further expected to prevent a significant increase in unemployment. Additionally, the Danish economy has a relatively low sensitivity to global industrial cycles, particularly due to the significant presence of the pharmaceutical industry.

Figure 1: GDP Growth and CPI Inflation, Denmark



Source: Oxford Economics, CBRE Research



Highest inflation in four decades

In 2022, inflation rates in Denmark reached extraordinary levels, with Consumer Price Index (CPI) inflation reaching 10.1% in October. It has since retracted to 8.7% in December. Core inflation, which excludes the volatile prices of food and energy, was 6.6%. The spike in core inflation was primarily driven by rising prices of imported goods, indicating that domestic inflationary pressures were not the primary cause.

The persistent increase in inflation in 2022 was primarily driven by a surge in post-COVID demand which was met with bottlenecks in global supply chains. The ongoing conflict in Ukraine further exacerbated supply shortages, leading to an upward pressure on prices for commodities such as energy, food, and raw materials. Additionally, high freight rates amplified these pressures by increasing the cost of imported goods. While most of these underlying factors are external, the tight labour market in Denmark, characterised by a historical low unemployment rate, also contributed to the inflationary pressures in the economy.

The high inflation experienced in Denmark is not an isolated phenomenon. As an example, CPI inflation for December 2022 in the euro area and the United States was 9.2% and 6.5%, respectively. Despite structural differences in these economies, the common underlying source of the high inflation is the high prices of energy and goods, as well as disruptions to global supply chains.

Inflation is expected to normalise in 2023

The underlying price pressures driving inflation in the economy are believed to have reached their peak due to decreasing demand and stabilisation of energy prices. Commodity prices have also started to fall after a year of fluctuations due to geopolitical events. Therefore, the drivers of inflation are expected to be resolved gradually during 2023.

Inflation is expected to decrease, driven by lower energy prices, improving supply bottlenecks, and tighter monetary policy. However, there may be a delay in the pass-through of costs to consumers, particularly in the services, where prices are likely to be under continued pressure. As a result, inflation may remain slightly elevated in the near term.

Our view is that inflation has reached its peak and will moderate in the coming year. We expect the rate of inflation for 2023 to be around 3.4%. However, it is important to note that this projection is subject to geopolitical risks and potential monetary policy errors by central banks.

If the conflict in Ukraine escalates further, energy and food prices could be subject to upward pressure once again as supply chains come under pressure. Additionally, there is a risk of a wage-price spiral as consumers and businesses are affected by rising costs.

80%

Drop in Dutch gas prices. They are now below the August 2022 peak and the level at the end of 2021.[1]

10.1%

Inflation in Denmark expected to peak in Q4 2022.[2]

3.4%

Expected rate of inflation for Denmark in 2023.[3]

Source: [1] Trading Economics, Jan. 2023
[2] Statistics Denmark
[3] CBRE Research

Pace of interest rate hikes expected to moderate

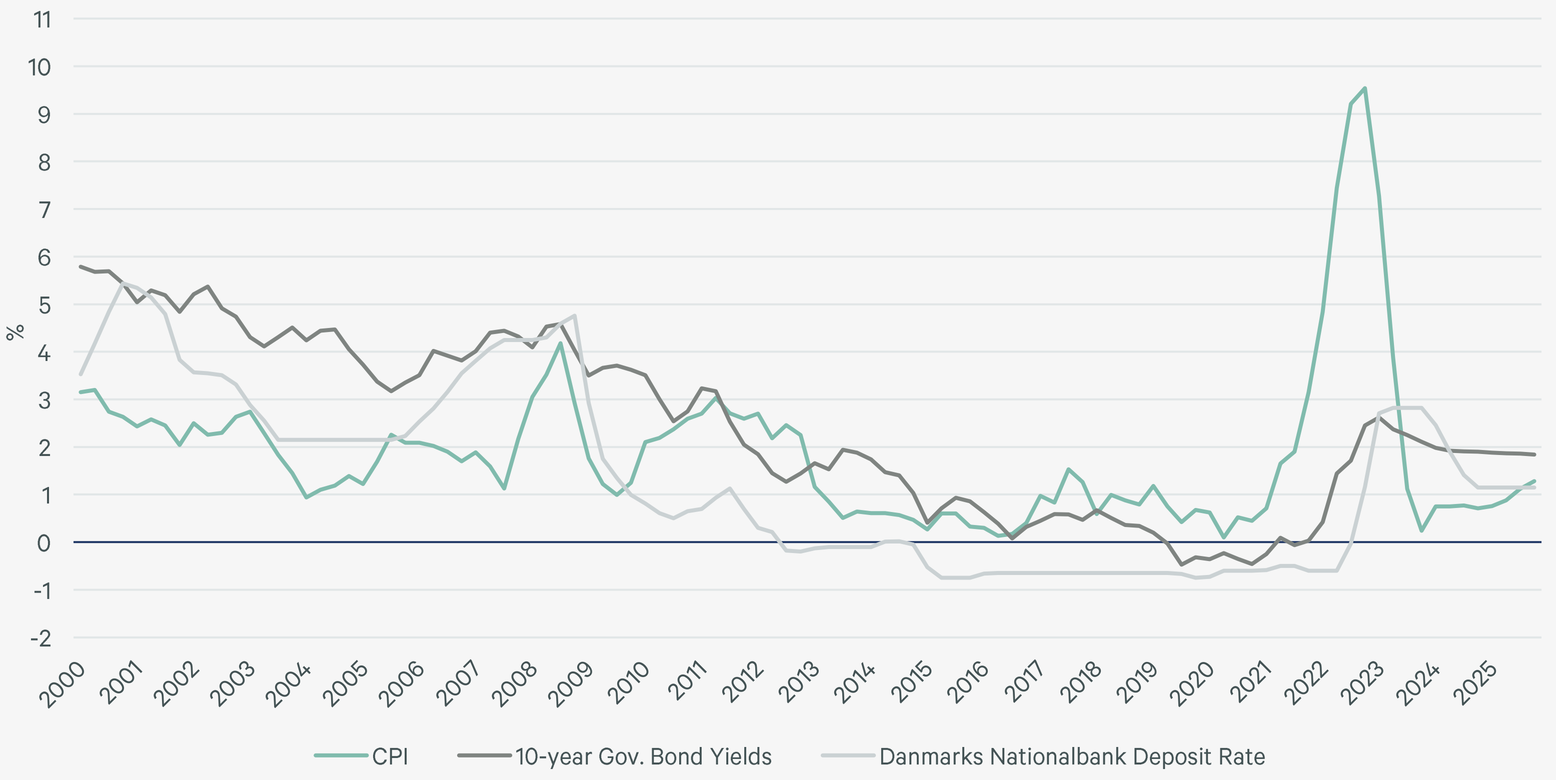
To address the high inflationary pressure, the Danish central bank, Danmarks Nationalbank, increased rates by 235 basis points (bps) through 2022. Danmarks Nationalbank has closely followed the interest rate adjustments of the European Central Bank (ECB) to maintain its fixed exchange rate policy against the euro. However, an appreciation of the Danish krone has necessitated an increase in the rate spread by 15 bps. Given the ongoing pressure on the euro to depreciate, the rate spread is anticipated to continue to widen.

Danmarks Nationalbank will likely undertake further monetary policy tightening measures, with the deposit rate projected to reach a peak of 2.8% in the middle of 2023. This forecast is, however, contingent on the progression of interest rate adjustments made by the ECB.

Long-term interest rates began to rise in anticipation of the first interest rate hike from Danmarks Nationalbank in several years. The Danish 10-year government bond is projected to reach a peak of 2.6% in early 2023, and subsequently, the yield is expected to experience a gradual decrease towards 1.8% in Q4 2025.

It appears that interest rates are approaching their peak and are expected to decline by the end of the year once inflation is under control. While this perspective may hold merit, there are potential risks to consider. The ongoing conflict in Ukraine may impede the gradual decrease in prices for energy, food, and other commodities. Additionally, the Danmarks Nationalbank's monetary policy may be excessively restrictive, resulting in a harsher economic downturn than necessary to curb inflation.

Figure 2: Inflation and interest rates, Denmark



Source: Oxford Economics, CBRE Research

02

Investment

Key takeaways

01 The slowdown in commercial real estate investment activity that began in the second half of 2022 will continue in the first half of 2023. Investment activity will likely decrease in the first quarter and then gradually improve.

02 Financing may be difficult to obtain as the cost of capital increases and lender appetite diminishes amid volatility in financial markets. CBRE expects lenders will become more active as the macroeconomic environment improves and interest rates stabilise.

03 Due to their relatively strong fundamentals and positive long-term demand outlook, multifamily and industrial properties are expected to remain the most favoured by investors.

04 Core and core plus strategies will remain sought-after among investors. However, interest in opportunistic acquisitions could surprise on the upside.

05 Copenhagen scored high in terms of city-level performance expectations in our 2023 European Investor Intention Survey, landing as number eight in the top ten preferred European cities.

2023 will see the new equilibrium being settled on among buyers and sellers

Danish commercial real estate activity witnessed a setback in 2022, in line with the cost of capital increasing and lender appetite diminishing amid volatility in financial markets. Nevertheless, the 2022 full-year investment volume reached DKK 86bn, which is the third-best year on record.

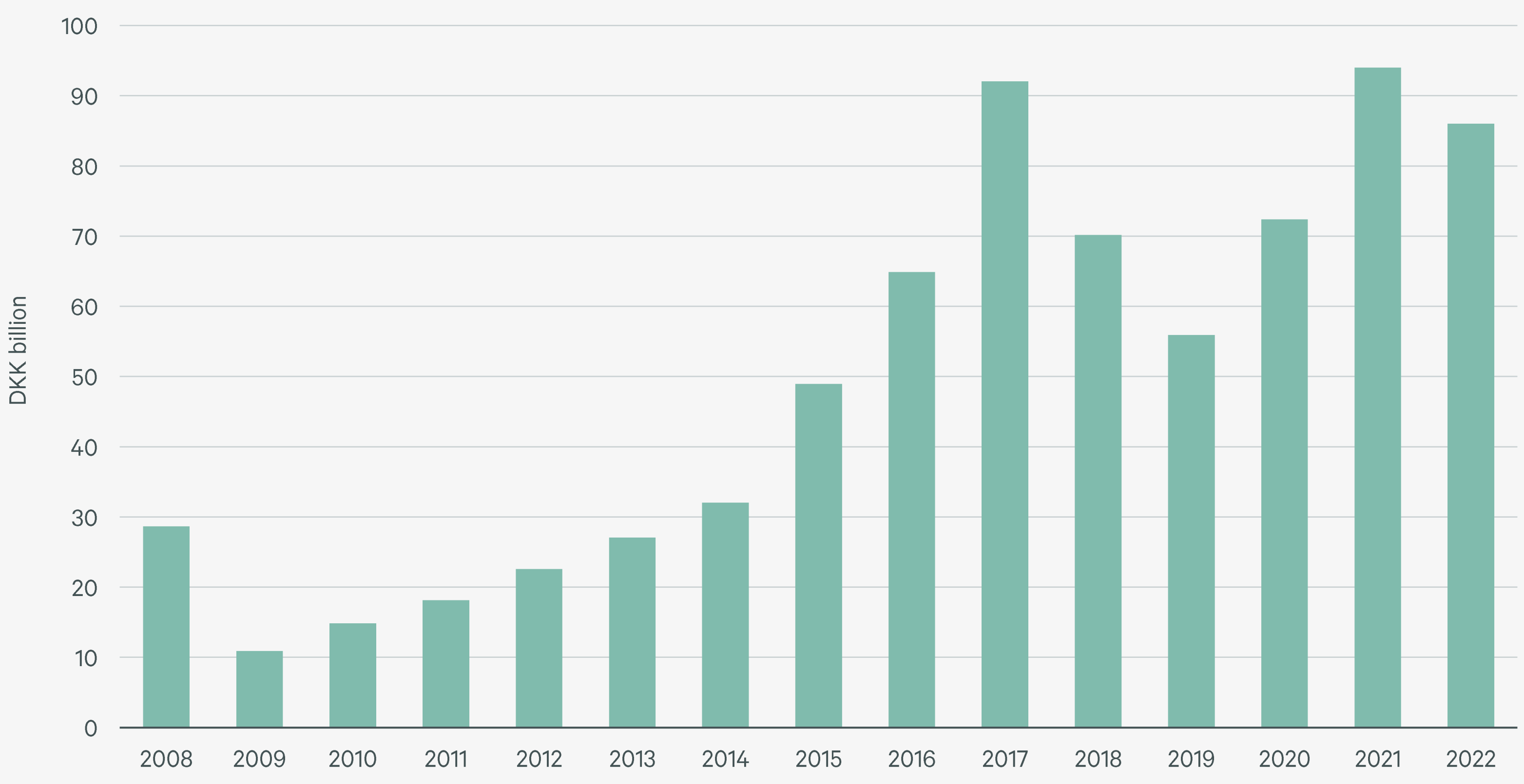
Capital availability will continue to be challenging, with lenders becoming more active as the macroeconomic environment improves and interest rates stabilise. Increasing borrowing costs will be highly relevant for re-financing the existing loans in light of the decline of collateral values and lower LTVs.

As financing costs went up, yield widening started in Q2 2022 across all sectors. Repricing of assets is a key issue in the current investment market, presenting both a challenge and an opportunity for investors. Discounts are expected across sectors, though probably most pronounced in some subsectors of retail and value-add office assets.

Total investment volume in 2023 is projected to be below 2022. However, the second year half could surprise on the upside. Core and core plus strategies will remain popular among investors, supported by strong occupier fundamentals. On the other hand, opportunistic and value-add assets will offer the possibility to capitalise on pricing discounts.

CBRE's European Investor Intentions Survey 2023 has shown that distressed properties remain sought-after across Europe. However, the availability of this type of investment product is expected to be limited in Denmark.

Figure 3: Danish commercial real estate (CRE) investment volume



Source: CBRE Research

Different investment strategies will come to the fore in the Danish market

High interest rates are impacting value

The gap between the prime office yield and the 10-year government bond was closing really quickly in 2022. From an institutional investors' point of view, this meant that the additional return that could be secured if investing in real estate shrank quite rapidly. When the year-end valuations started to come in, the repricing became visible. With this in mind, the pace of change and the level of impact on property owners is very high.

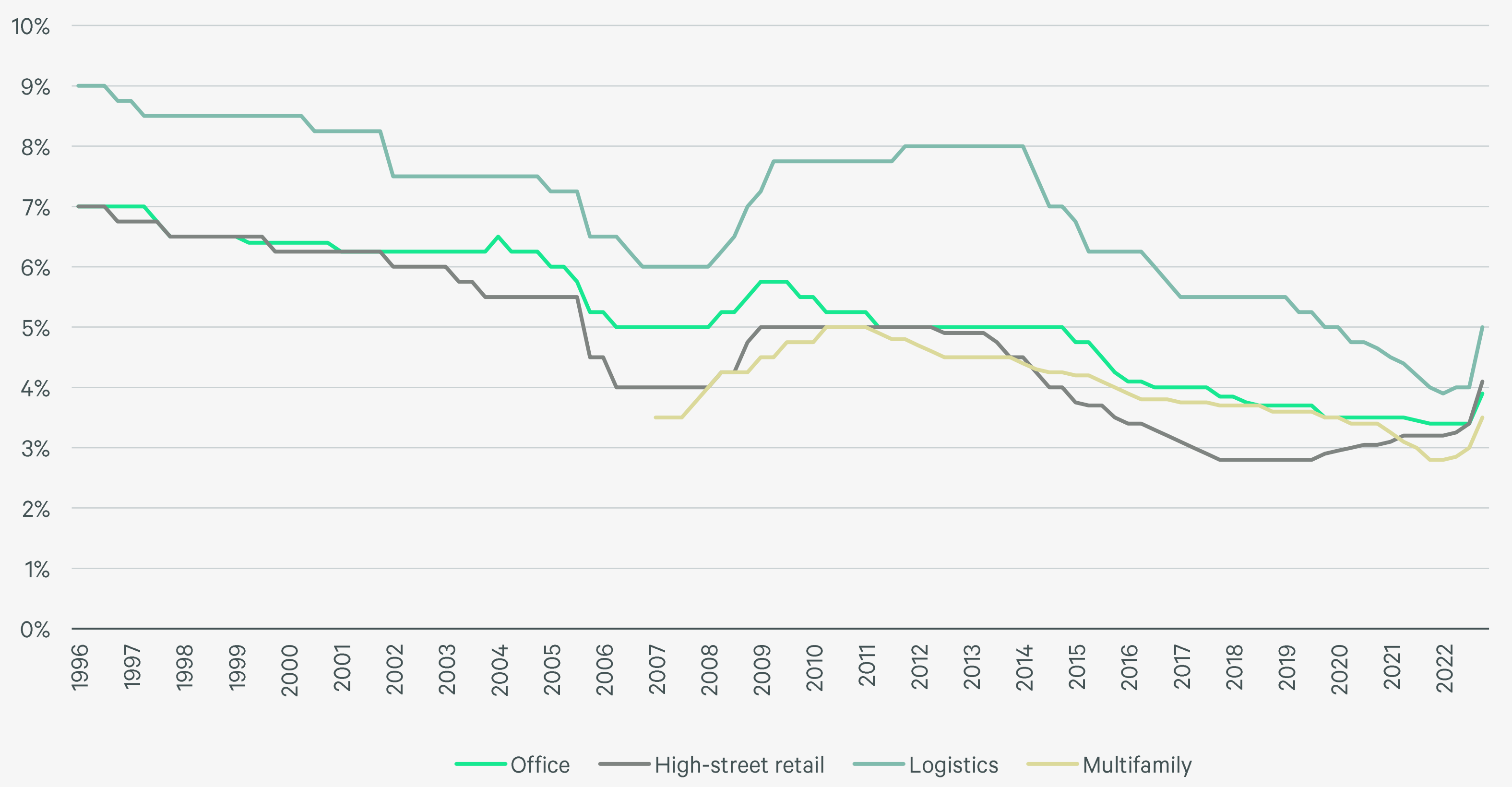
Since bottoming out in late 2021 and early 2022, prime yields are up by 50-100 bps across all property types, translating to a decline in values through 2022. Further expansion of prime yields, though limited, could be expected in 2023.

Opportunities arise from market adjustments

Danish investment assets are still viewed very favourably in a European context, underpinned by a robust economic outlook.

Industrial/logistics and residential assets will likely continue to capture the most investor interest, given the tailwinds of e-commerce and demographic shifts. On the other hand, offices will continue to be sought-after, with investors being more strategic in selecting opportunities. Supermarkets and grocery-lead retail are also expected to stay in demand.

Figure 4: Prime yields



Source: CBRE Research

03

Debt & Financing

Key takeaways

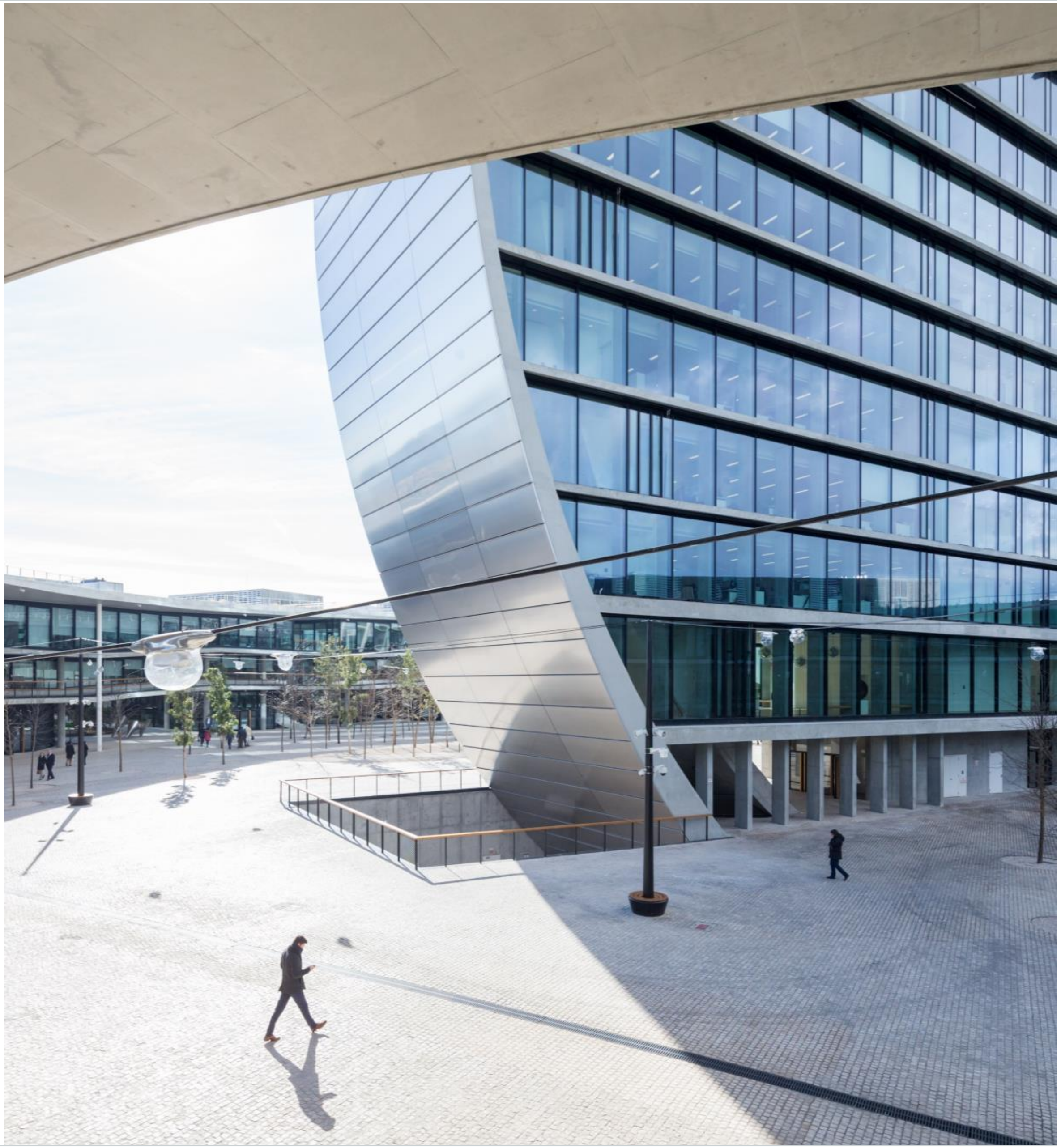
01 Debt markets stabilised in Q4 2022, and senior lending terms for prime properties in Copenhagen were similar to Q3.

02 Copenhagen reports the lowest senior loan margins for prime properties: 90 bps for offices and retail; 125 bps for logistics.

03 Rating agencies expected to continue downgrading the number of bond issues – however, this is already priced in the current credit spreads and will have minimal impact.

04 Nordic banks are extremely well capitalised and have among the lowest credit default swap spreads globally – hence there is no sign of over leverage, and we expect capital markets to continue to function well.

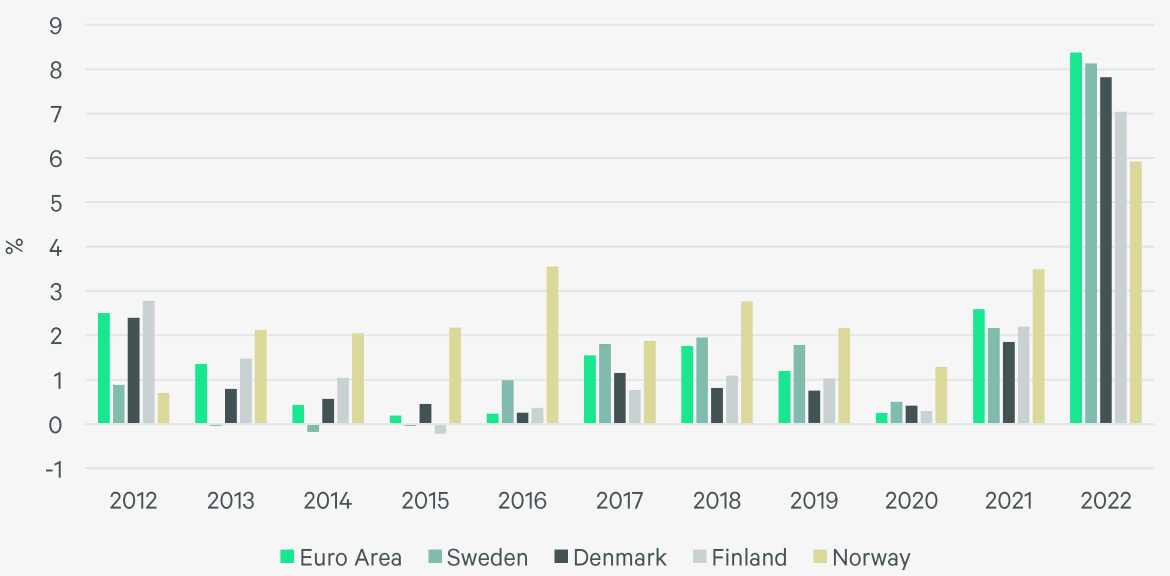
05 Lenders are likely to remain selective in what they finance. Investors may need to inject additional equity or subordinated debt to refinance assets, given changes in values and loan terms.



Inflation in the last decade has been at a very low level in the US and Europe. On the back of the great financial crisis in 2008 (GFC), central banks have been very active in providing amble liquidity in markets. And we have experienced a period of record length of low rates. As observed by Bloomberg's Index of Negative Yield, late 2022 was the first time in more than five years where no fixed income debt classes had observable negative yields. Thus the landscape has changed significantly during 2023.

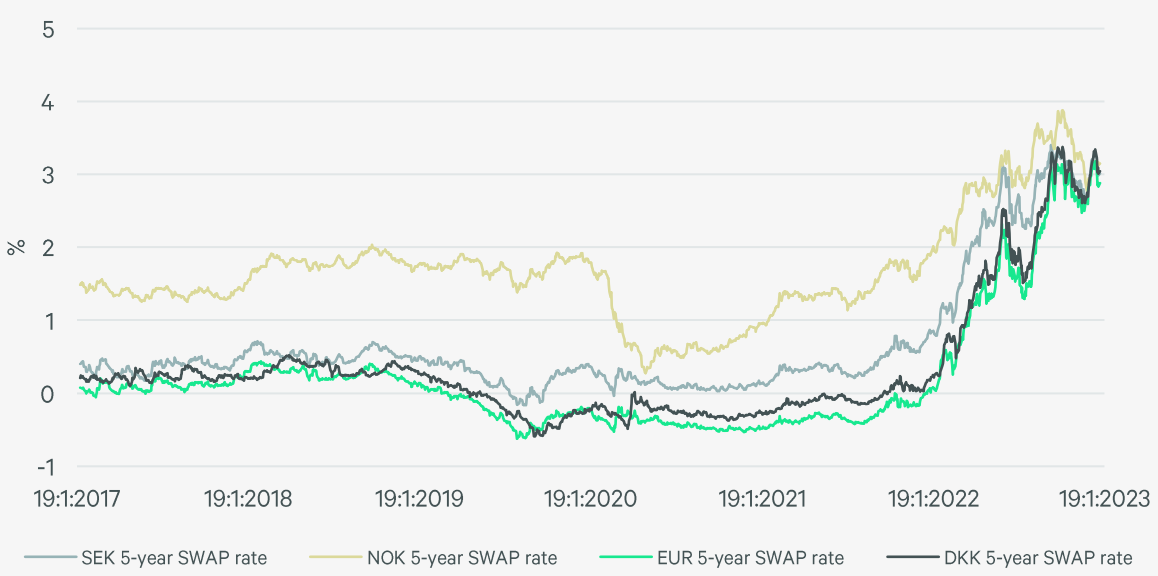
5y swap rates rose more than 300 bps. This had a very direct impact on real estate transactions where all-in debt costs increased significantly, and leverage was reduced further to satisfy ICR hurdles.

Figure 5: Inflation rates in the euro area, Sweden, Denmark, Finland and Norway, 2012-2022



Source: CBRE Research

Figure 6: Swap rates in Sweden, Norway, the euro area and Denmark, 2017-2022

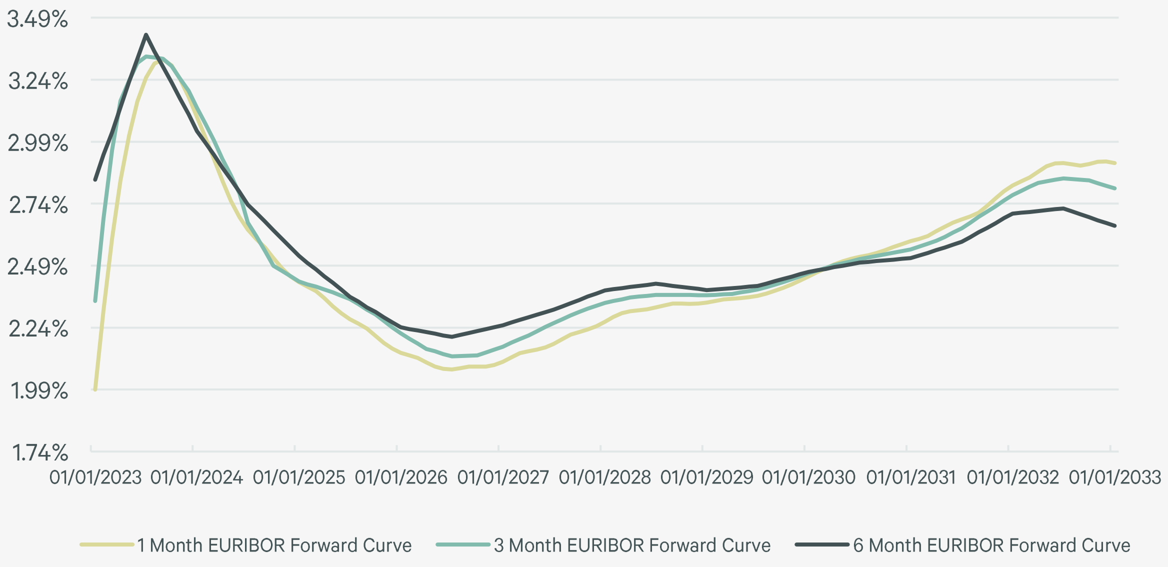


Source: CBRE Research

The current forward rates curve indicates that rates will peak in 2023 in conjunction with an expected recession in the Euro area. We see some tail risks in the current pricing where potential ripple effects on inflation do not seem to be priced adequately in the current curve. Also viewed by several macro hedge funds being actively taking on bets of higher inflation for longer.

However, it will be a positive factor for the real estate markets in the Nordics that rates are expected to tighten, also providing a positive sentiment for further investments. In Q4 2022, lending terms for prime office properties remained in many locations, similar to the previous quarter. Lending terms for retail and logistics indicated contrasting trends in Europe while lending terms for multifamily stabilised in Q4.

Figure 7: Euribor forward curve, 2023-2033



Source: CBRE Research

Figure 8: Senior lending key terms for prime assets, Q4 2022

	Prime Office		Prime Retail		Prime Logistics		Prime Residential	
	LTV	Margin	LTV	Margin	LTV	Margin	LTV	Margin
G7 Group	55.00	1.61	52.50	2.19	55.00	1.59	55.00	1.55
France	55.00	1.40	55.00	1.40	55.00	1.50	55.00	1.60
Germany	55.00	1.40	55.00	1.60	55.00	1.40	60.00	1.40
Italy	55.00	2.00	50.00	3.00	55.00	1.80		
UK	55.00	1.65	50.00	2.75	55.00	1.65	50.00	1.65
Scandinavia Group	51.67	1.42	51.67	1.50	51.67	1.58	55.00	1.75
Denmark	50.00	0.90	50.00	0.90	50.00	1.25	50.00	0.90
Finland	55.00	1.75	55.00	1.80	55.00	1.90	55.00	1.75
Norway	55.00	2.30	55.00	2.30	50.00	2.30	55.00	2.30
Sweden	50.00	1.60	50.00	1.80	50.00	1.60	50.00	1.60

Source: CBRE Research

Real estate companies and funds face a number of challenges in the years to come. The most leveraged entities could face challenges breaching covenants on debt driven by either a lower ICR or higher LTV. However, leverage is much lower than we saw in 2007-08.

Further, Moody's latest Nordic Real Estate report estimates that SEK 300bn of corporate bonds issued by real estate companies need to be refinanced in 2023-24. However, it should be noted that the companies' cash position is relatively strong and almost 50% of the nominal amount that needs to be refinanced is cash equivalents on the companies' balance sheets. Our view is that private debt markets (banks + insurance + debt funds) combined with the public bond markets will function well and absorb the refinancing need.

Lastly, the capital position of Nordic banks is strong. This can be clearly seen by the CDS (credit default swaps) of the Nordic banks, which are lower than European banks in general. This will also put less pressure on banks' appetite for lending to CRE and margins.

Outlook real estate debt markets 2023

CHALLENGES

- Yield gap narrowed
- Financial covenants (LTV, ICR)
- Liquidity in public bond markets challenged
- Cost of debt increased
- Expected downgrades (already priced in)
- Refinancing risk / Maturity wall

MITIGATING FACTORS

- Leverage significantly lower than GFC
- Nordic banks well capitalised and funding spreads lower than rest of Europe
- Hedging has mitigated mark-to-market losses on CRE
- Cash position of public real estate companies

04

Residential

Key takeaways

01 In 2023, higher mortgage rates are likely to subdue activity in the housing market. This presents a significant challenge for first-time home buyers, as obtaining financing is difficult in the current economic climate.

02 The housing market is projected to experience a period of decreasing prices in correlation with a broader economic slowdown. However, stricter mortgage regulations will provide a buffer against distressed sales and mitigate excessive price declines.

03 The rental market is expected to remain robust in 2023 as rising interest rates impede the housing market. Occupancy rates will likely increase as more individuals opt for renting as a result of the flexibility it provides, particularly in an uncertain economic climate.

04 A persistent imbalance between supply and demand is expected to sustain rental growth throughout 2023. However, it is worth noting that this trend does not hold true in cities that have experienced an over-supply in recent years.

05 Last year, the government implemented a temporary cap on residential rent increases for unregulated properties. As a result, rent adjustments for lease agreements following the NPI are capped at 4% in 2023. The impact will be less pronounced in the new year as inflation normalises.

Activity on the housing market to weaken further

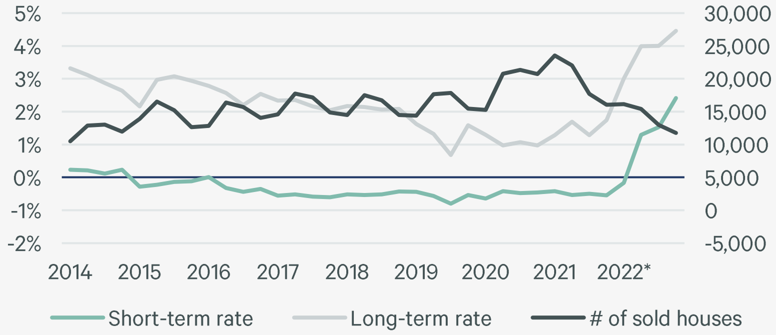
The Danish housing market has undergone a period of volatility in recent years. In 2021, the market witnessed a record number of transactions. However, a rapid increase in financing costs and a heightened level of economic uncertainty resulted in a substantial decline in market activity during 2022. This led to the lowest number of transactions in eight years. Additionally, the market saw an influx of supply and longer sales times, with an increasing number of properties offered at discounted prices. Consequently, house prices declined by 6% throughout the year.

An uncertain economic outlook for 2023 is expected to bring some continued instability to the housing market in the coming year. Persistently high mortgage rates will continue to make it challenging for individuals to obtain financing for housing, and house prices have not yet decreased enough to compensate for the increased interest expenses. This effect is particularly pronounced for first-time buyers, as they tend to have less equity to provide as collateral.

Consequently, it is projected that the housing market will continue to experience a significant decline in activity and, subsequently, house prices. This is particularly the case in high-priced areas, such as owner-occupied apartments in major metropolitan areas where prices have seen the most substantial growth.

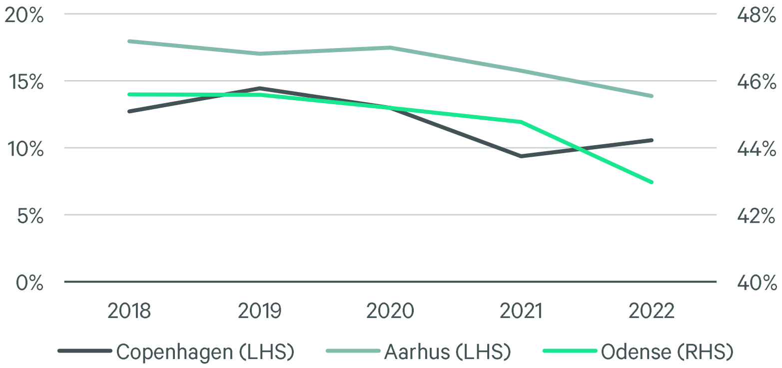
It is not anticipated that the housing market will experience a full-scale collapse due to several mitigating factors. Firstly, nominal income growth and high inflation will provide some support to house prices. Furthermore, Danish households are well-positioned and have utilised the low interest rates to reduce their debt, resulting in the lowest average loan-to-value ratio in recent history.

Figure 9: Mortgage rates and housing market activity



Source: Finans Danmark, *Houses sold in 2022 Q4 is based on an estimate

Figure 10: Nursing affordability index



Source: CBRE Reseacrh, Statistics Denmark, Nationalbanken

High interest rates offset decreasing house prices

Despite a 6% decrease in house prices in 2022, purchasing a new home has not become more accessible for individuals. The sharp increase in interest rates has significantly elevated the costs associated with obtaining a mortgage. Consequently, the current decrease in house prices has not been sufficient to offset the impact of increased financing costs, resulting in an overall increase in the costs associated with buying a new home.

The rising cost of living combined with decreasing affordability of home ownership have made renting a more viable option for many individuals. This trend is particularly pronounced in regions where property prices have increased significantly, such as Copenhagen. Additionally, the flexibility offered by renting, as opposed to the commitment of a long-term mortgage, is particularly desirable in an uncertain economic environment with the potential for declining property values. As a result, we anticipate a positive trend in the demand for rental units throughout 2023, as renting may be viewed as a more favourable option.

The declining affordability is further reflected in the Nursing Affordability Index (see Figure 10), which shows the proportion of houses that a person employed as a nurse in Denmark can obtain financing for. Despite the decreasing house prices in 2022, the index illustrates that higher interest rates have in general made financing more expensive, thereby further diminishing the affordability. In 2022, a person working as a nurse was able to secure financing for approximately 10% of listings in Copenhagen, 14% in Aarhus, and 43% in Odense.

Demand for rental units to remain robust as long as interest rates are elevated

Increased construction costs and financing expenses have created less favourable conditions for new construction projects. As a result, construction activity is expected to decrease, impacting thus the supply of residential units. This is likely to result in a heightened demand for existing properties, particularly in urban areas such as the city of Copenhagen.

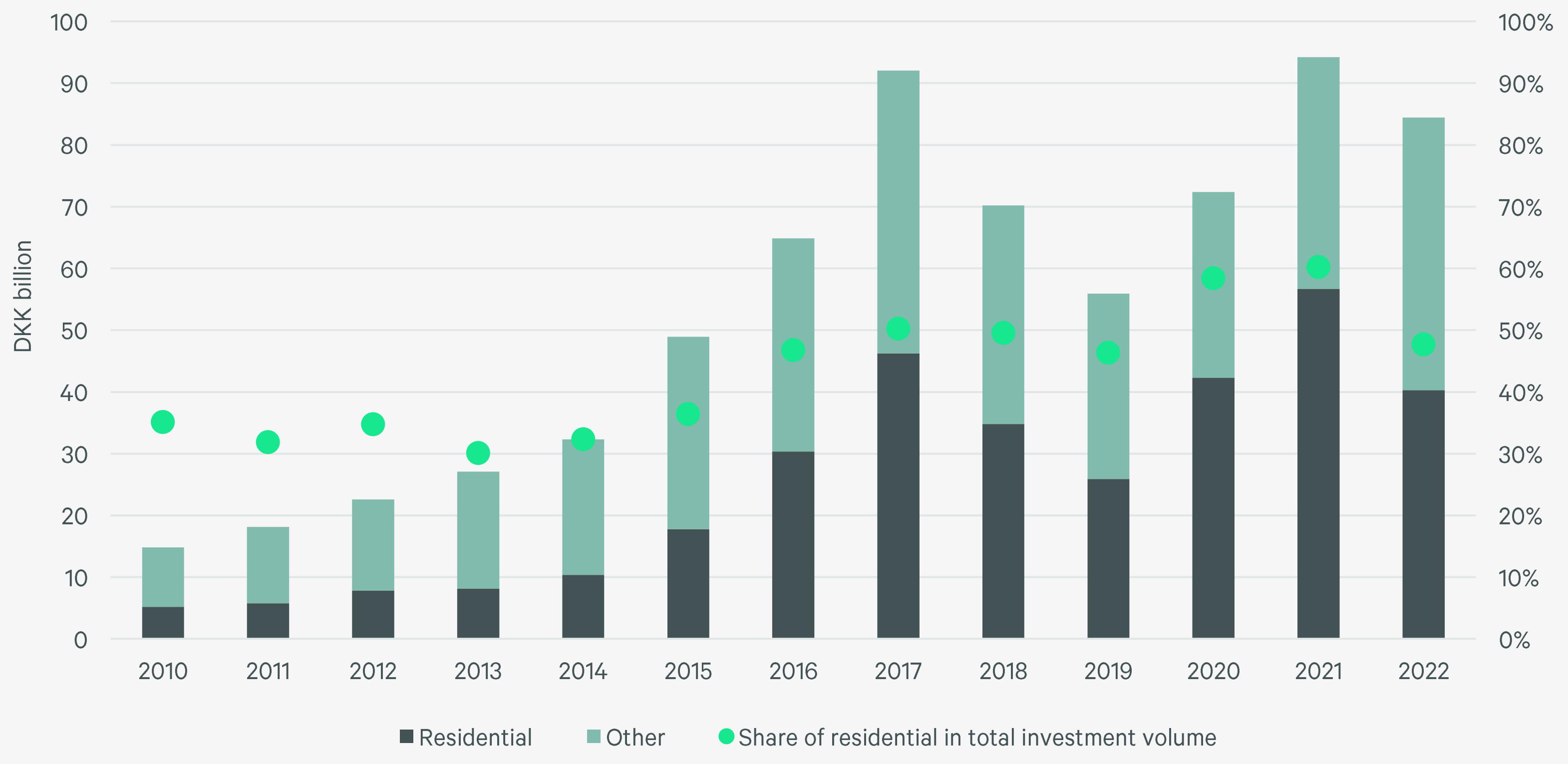
It is important to note that the projected growth in the market may not be distributed evenly across regions in Denmark. Specifically, the market in Aarhus has experienced an oversupply in recent years, leading to an increase in vacancy rates throughout 2022. Furthermore, the pipeline for new developments in Aarhus remains high, indicating a continued elevated supply in the coming years. As a result, the outlook for rental growth in Aarhus has deteriorated.

Pricing expected to adjust further

In 2022, the residential sector remained the largest in terms of transaction volume in Denmark, despite a significant decline in the latter half of the year. This was in line with the rising interest rates, which led to repricing in the market, resulting in a 70bps expansion of the prime residential yield over a six-month period.

The economic conditions may lead to a further expansion of residential yields as the yield spread decreased significantly in 2022. It is anticipated that any further repricing is likely to occur in the first half of the year.

Figure 11: Residential investment volume



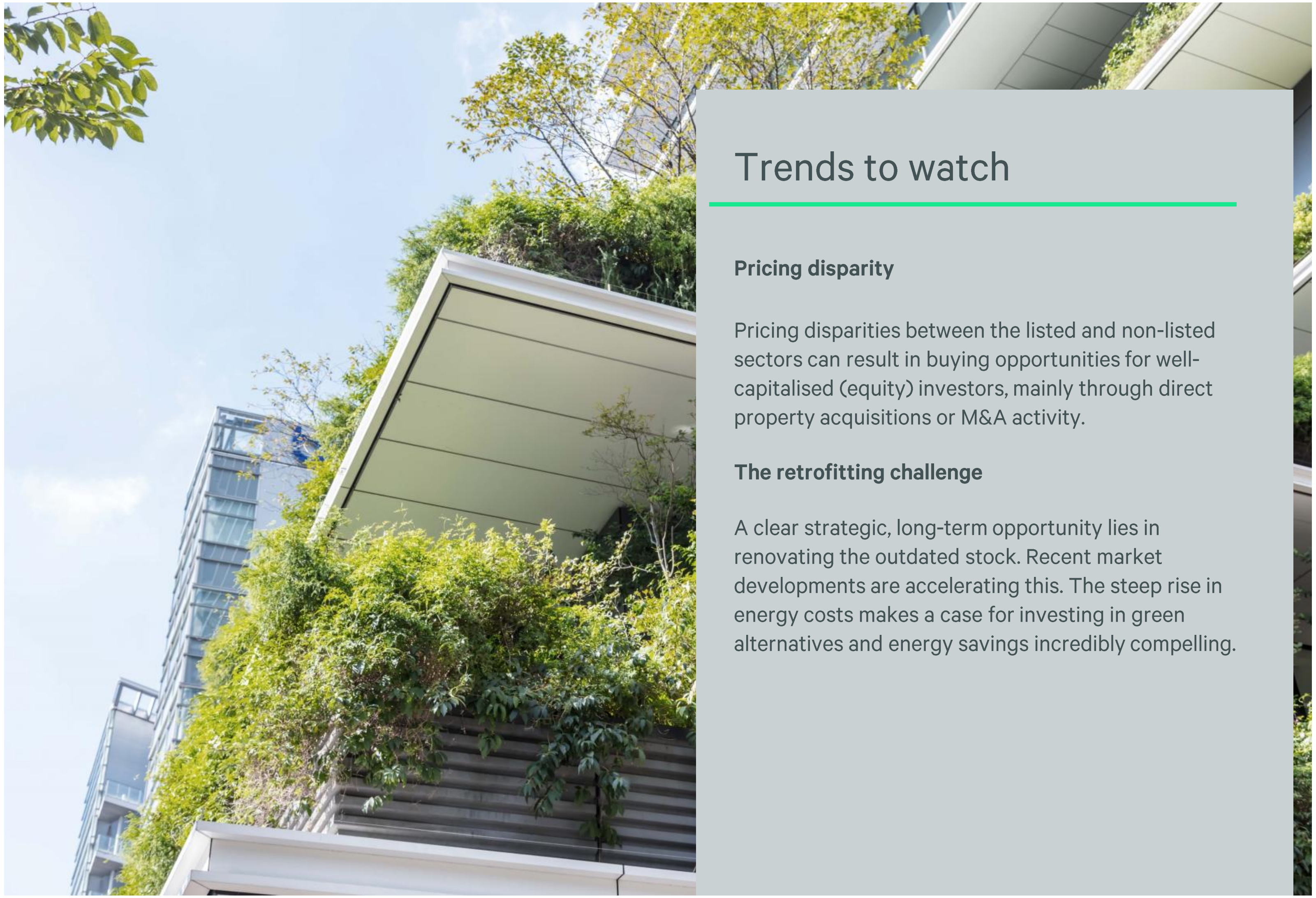
Source: CBRE Research

Less significant impact of temporary rent cap

In 2022, the significant rise in inflation greatly impacted the cost of living and diminished the purchasing power of households. As a result, there was a notable increase in the number of tenants unable to pay rent.

The Danish government, therefore, implemented a temporary 4% cap on residential rent increases for unregulated properties to prevent disproportional rent indexations. This cap will be in effect for 2022 and 2023 and replaces the previous policy, which allowed for annual rent increases based on changes in the net price index.

Commercial real estate has historically been a reliable form of inflation protection as rental income is often tied to a price index. The implementation of the temporary cap did reduce some of this protection. However, with a moderate inflation forecast for 2023, the impact of the temporary cap on rental increases is anticipated to be less significant.



Trends to watch

Pricing disparity

Pricing disparities between the listed and non-listed sectors can result in buying opportunities for well-capitalised (equity) investors, mainly through direct property acquisitions or M&A activity.

The retrofitting challenge

A clear strategic, long-term opportunity lies in renovating the outdated stock. Recent market developments are accelerating this. The steep rise in energy costs makes a case for investing in green alternatives and energy savings incredibly compelling.

05

Offices

Key takeaways

01 Looking into 2023, two factors emerge as particularly important for the occupier market: how occupiers continue to adjust to flexible working arrangements and the forecasted slowdown in office-based employment growth.

02 Increased construction costs, labour shortages and supply chain issues are causing delays in office projects. On the flip side, this can prove to be beneficial for keeping the vacancy rate relatively stable.

03 Hybrid work and office utilisation will remain in focus. Companies will work on finding an optimal balance between office utilisation and the space they need per employee.

04 Poorer quality or poorly located office space is expected to underperform in 2023. Office conversions may therefore arise as a second chance for underutilised space.

05 As the importance of sustainability credentials for occupiers and landlords grows, this will lead to a larger bifurcation in rents and values across different categories of office stock.

Limited growth in office-based employment will constrain growth in the office leasing market

Office-based employment in Copenhagen, having dipped in 2020 and bounced back in 2021 and 2022, is set to rise further in 2023, but only by 1.2%. This, coupled with an uncertain economic environment, is expected to constrain growth in the office leasing market.

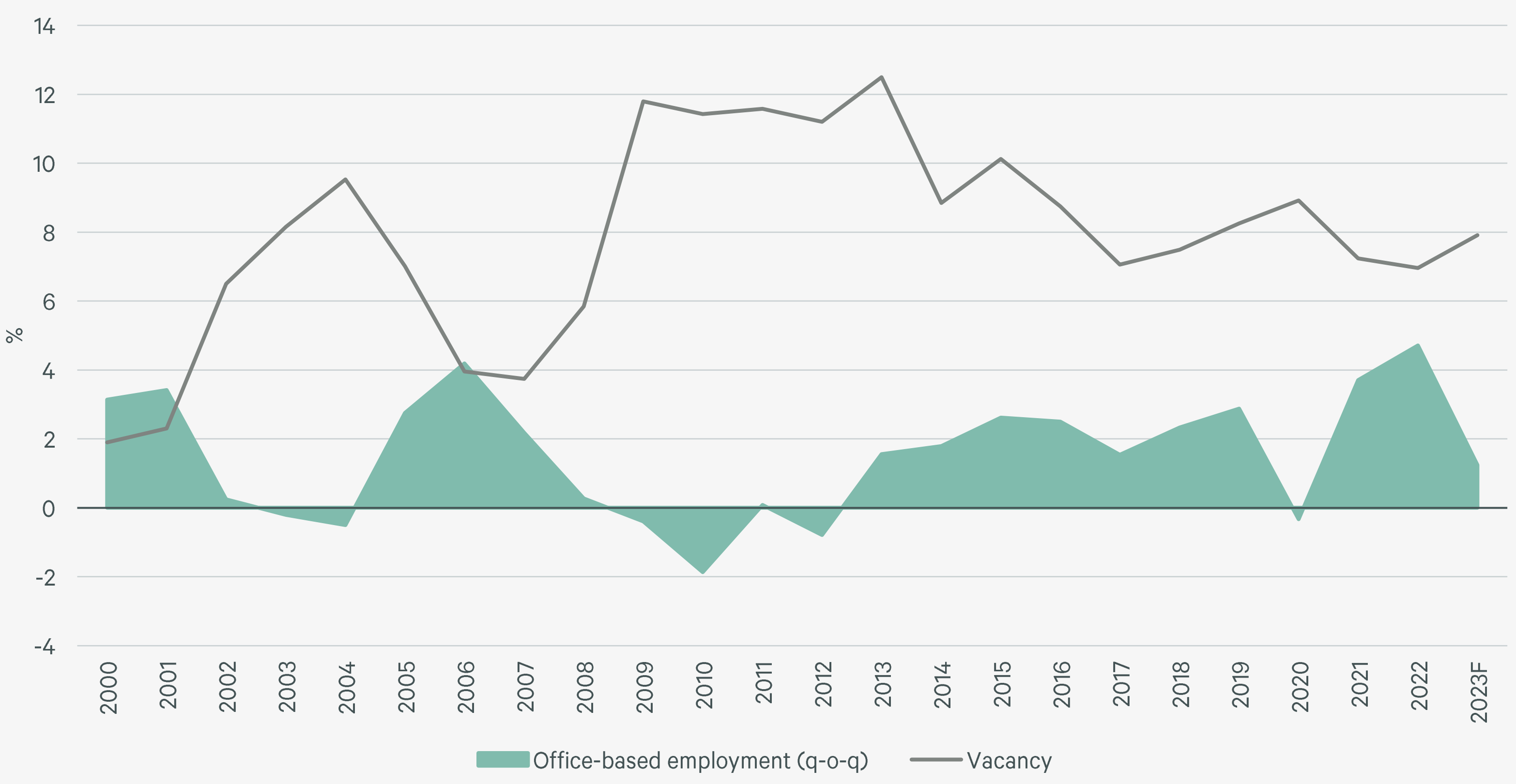
A large portion of the office space under construction, due to completion in 2023, has already been pre-let. On the other hand, increases in construction costs, labour shortages and supply chain issues are causing delays. On the flip side, this can prove to be beneficial for keeping the vacancy rate relatively stable.

Hybrid work and office utilisation in focus

Since the onset of the pandemic, awareness of the benefits of work-life balance and flexibility has grown substantially. Although financial remuneration remains the overriding criterion for most workers, the search for flexibility is increasingly influencing job choices and workplace decisions and is also closely linked to improved sentiment at work.

The commute time is an important factor for employees in job selection. This is reflected in occupiers' decision-making when committing to new office space. The bifurcation between the demand for prime assets as opposed to secondary and suburban offices could become more pronounced. Poorer quality or poorly located office space is therefore expected to underperform in 2023.

Figure 12: Copenhagen office-based employment growth (q-o-q) and vacancy



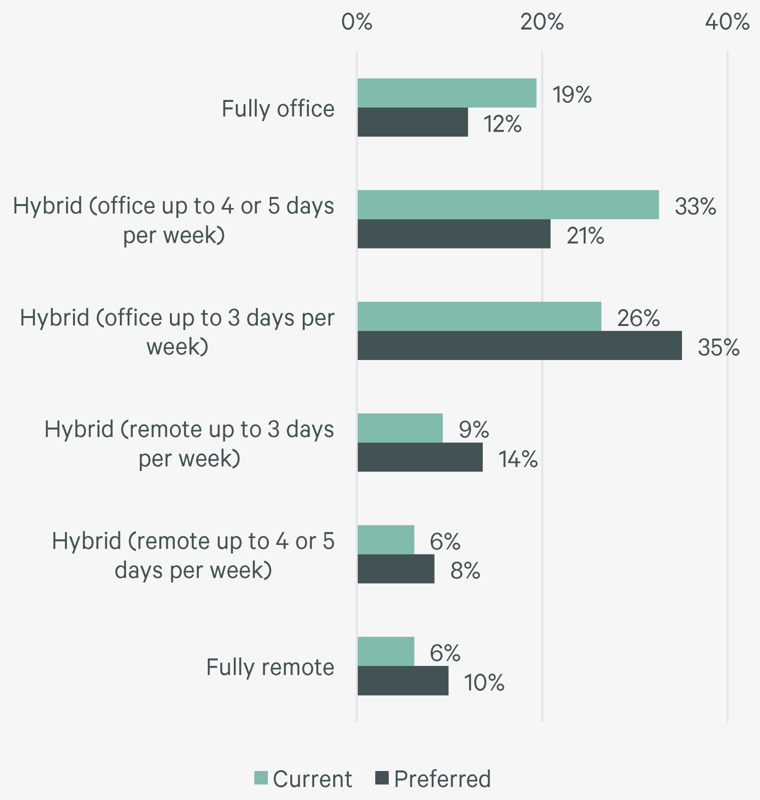
Source: CBRE Research, Ejendomstorvet

With most office-based employees embracing hybrid working, flexibility over when and where to work is becoming much more important when choosing a job. Companies that do not offer such arrangements may find it harder to attract talent. Our 2022 survey (see Figure 13) shows a strong desire among employees to continue the shift towards hybrid working, with nearly 20% of respondents currently being office-based all the time but only 12% wanting this to remain the case in the future. Workers who already have a hybrid pattern want to move further in that direction. At the other extreme, the proportion wanting to be fully home-based in the future remains negligible, meaning that almost all workers want to spend at least some time of their working week in the office.

Office conversions: A second chance for underutilised space

With long-term forecasts calling for structurally higher office vacancies, owners of properties that do not appeal to modern tenants may want to explore office conversions. While this trend has been seen in Copenhagen's central business district (CBD) over the past few years, this option can be attractive in more secondary office locations. A surplus of available office space in these locations will continue to weigh on market fundamentals in the foreseeable future.

Figure 13: Time split between office and home (Denmark)



Source: CBRE Research, The Global Live-Work-Shop report, 2022

The growing role of ESG

Environmentally certified office buildings have become a larger component of the European office market over the past few years. However, both Aarhus and Copenhagen are scraping the bottom compared to other European cities in relation to the proportion of sustainability-certified office buildings.

In Aarhus, the certified share stands at 3% as of mid-2022 compared with 2% in 2019; while in Copenhagen, the share remained unchanged at 7%. This development is worrying – both regarding reaching the national and city climate targets and attracting investors.

Take-up in office buildings with sustainability certifications is expected to intensify in 2023. Many corporate users of office space have stated their commitments to carbon neutrality goals and need their real estate portfolio to reflect this.

However, although sustainability certifications are certainly a good selling point, they are just one of the factors occupiers take into account when committing to a new space/location. Therefore, balancing locational preferences with the ESG agenda will be the key to securing tenants.

06

Logistics

Key takeaways

01 It is projected that occupier demand will remain sturdy, although it will likely be slightly lower than the high levels recorded in recent years.

02 The supply response has so far not been enough to move the vacancy rate needle, as vacancies remain at a historically low level. The rising cost of capital and increasing construction costs will impede the ability to bring new properties to the market.

03 The supply-demand imbalance is expected to sustain rental growth. This trend is likely to persist as the continued expansion of e-commerce drive demand from occupiers. As such, rental growth is expected to remain robust in the coming years.

04 The stabilisation of global supply chains has reduced pressures. As a result, companies may review and adjust their precautionary excess inventory levels. However, it is important to note that supply chain reconfigurations may still occur, presenting potential investment opportunities.

05 After a period of repricing, logistics yields are projected to stabilise in the near term. This stabilisation is likely to occur sooner than in other sectors, as logistics assets are expected to continue to be a desirable asset class for investors.

Rental growth to moderate despite ongoing occupier demand

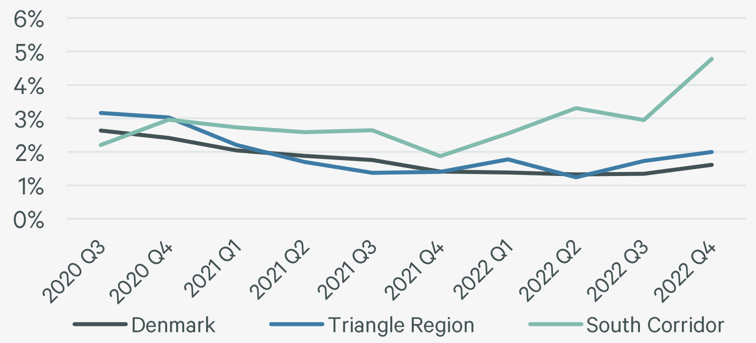
Occupier demand persists, albeit reduced

Following a period of increased activity, take-up levels in 2022 showed signs of slowing down due to concerns about the impact of rising costs and reduced consumer spending. Despite this, take-up levels for the industrial and logistics sector still increased in the third and fourth quarter of 2022. This indicates a continued interest from occupiers in this type of real estate.

Occupier demand is expected to persist in 2023, although take-up levels may slow further as occupiers re-evaluate their expansion plans. The demand for warehouse and logistics space is anticipated to come primarily from large retailers, occupiers, and third-party logistics (3PL) companies, as smaller businesses may not have the financial resources to expand their operations. Additionally, companies may look to increase their use of 3PL services as they seek greater flexibility and outsource more of their supply chain processes. This trend is likely to be further accentuated by the ongoing uncertainties in energy prices, fluctuations in retail demand, and broader economic risks.

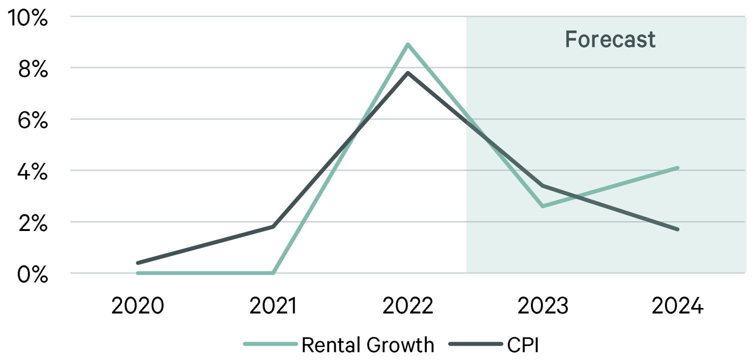
Additionally, the growth of the digital economy will continue to lead to an increased share of the online retail market. E-commerce players are therefore expected to continue to acquire space to meet the growing consumer demand from online channels. In general, younger shoppers contribute significantly to this trend, which is why companies are expected to increase warehouse presence in metropolitan areas to save transportation costs.

Figure 14: Vacancy rates



Source: Ejendomstorvet, CBRE Research

Figure 15: CPI Inflation and rental growth



Source: CBRE Research, Q4 2022

Limited supply will support rental growth

In 2022, significant investments were made in developing new industrial and logistics facilities. However, despite the addition of a large amount of new space, the Danish market for industrial and logistics properties remains constrained. New properties are rapidly absorbed by occupiers, resulting in a low national vacancy rate.

Elevated construction costs and an increased financing cost are expected to impede the supply response in 2023. The current low vacancy rates indicate that any new stock will be attractive to occupiers due to the limited supply. As a result, the supply of logistics space is likely to be insufficient to meet the demand for such properties.

A persistent demand combined with a limited supply has created a supply-demand imbalance, which is expected to sustain rental growth. However, the anticipated rental growth will be somewhat limited compared to last year, though remaining significantly above the growth levels seen prior to the pandemic.

Occupiers will continue prioritising properties in prime locations; however, we anticipate increased interest in buildings in secondary locations. This will be driven by a shortage of properties in prime locations that meet the specific requirements of occupiers, combined with more affordable rents in these areas.

Repricing of the market expected to stabilise

It is anticipated that most of the repricing of prime logistics assets will have occurred in 2022, with a slowdown in the movement of prime yields expected in early 2023. Low vacancy rates across industrial assets are expected to mitigate the effect of potential further repricing as it provides support for capital values and income growth.

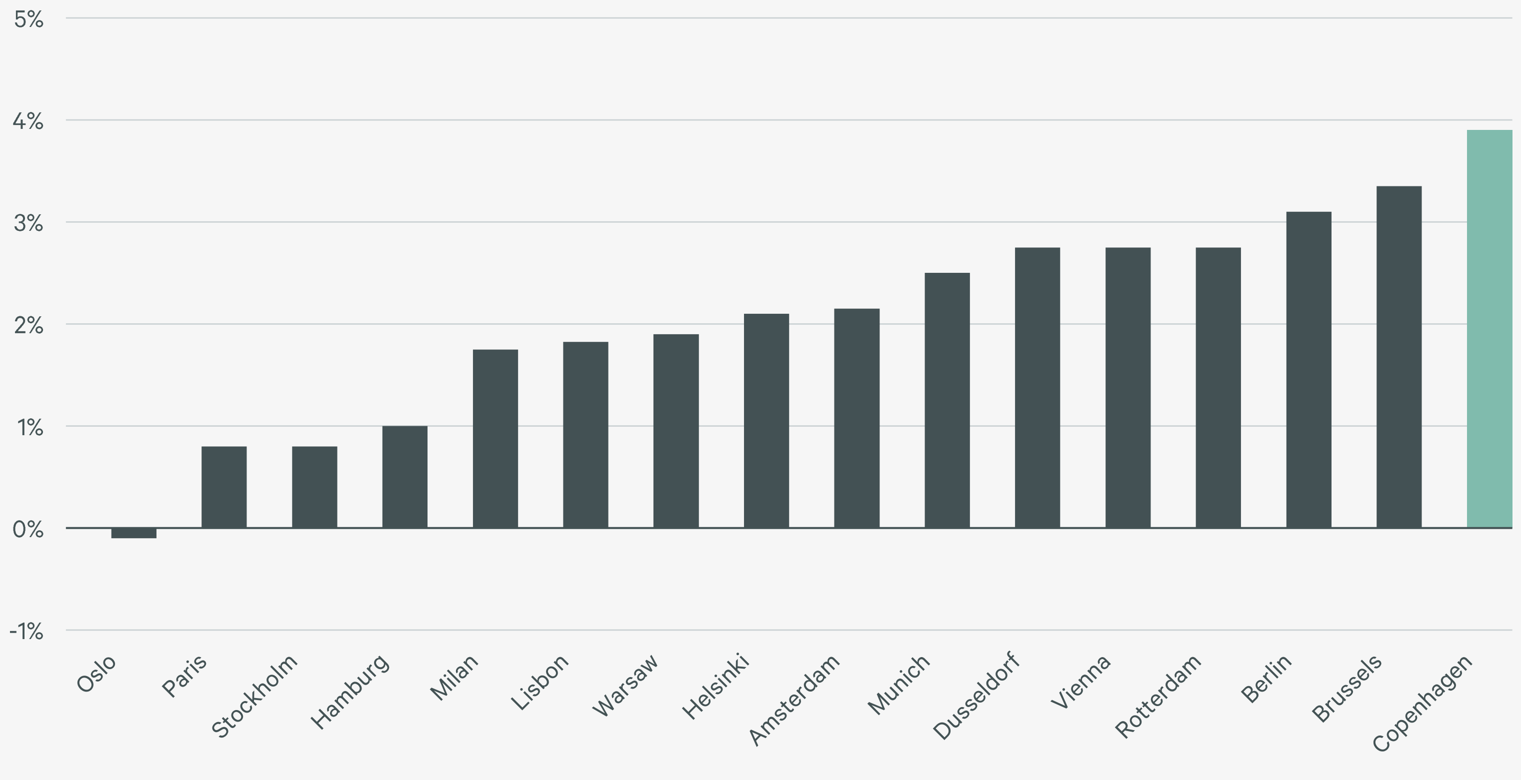
In 2023, the total real estate investment is expected to decrease compared to the level registered last year. Even though logistics is no exemption, it does remain one of the preferred sectors for investors to invest in. On a European level, it is also expected that the industrial and logistics sector will continue to absorb market share.

Long-term expectations remain optimistic

The capital value of prime logistics assets located in Copenhagen is projected to experience substantial growth over the next five years, with an expected annual growth rate of nearly 4%. This growth rate is expected to be higher than growth rates in other sectors and among the highest in Europe.

The projected growth suggests that the repricing experienced in the latter half of 2022 and early 2023 is temporary and will eventually be replaced by increasing capital values. The recent repricing may therefore present opportunities for long-term investors. Furthermore, growth in capital value for prime logistics assets in Copenhagen is expected to outperform growth rates in other sectors, indicating a strong potential for investment in this area.

Figure 16: Prime logistics capital values growth (per annum), 5 years



Source: CBRE Research, Q4 2022

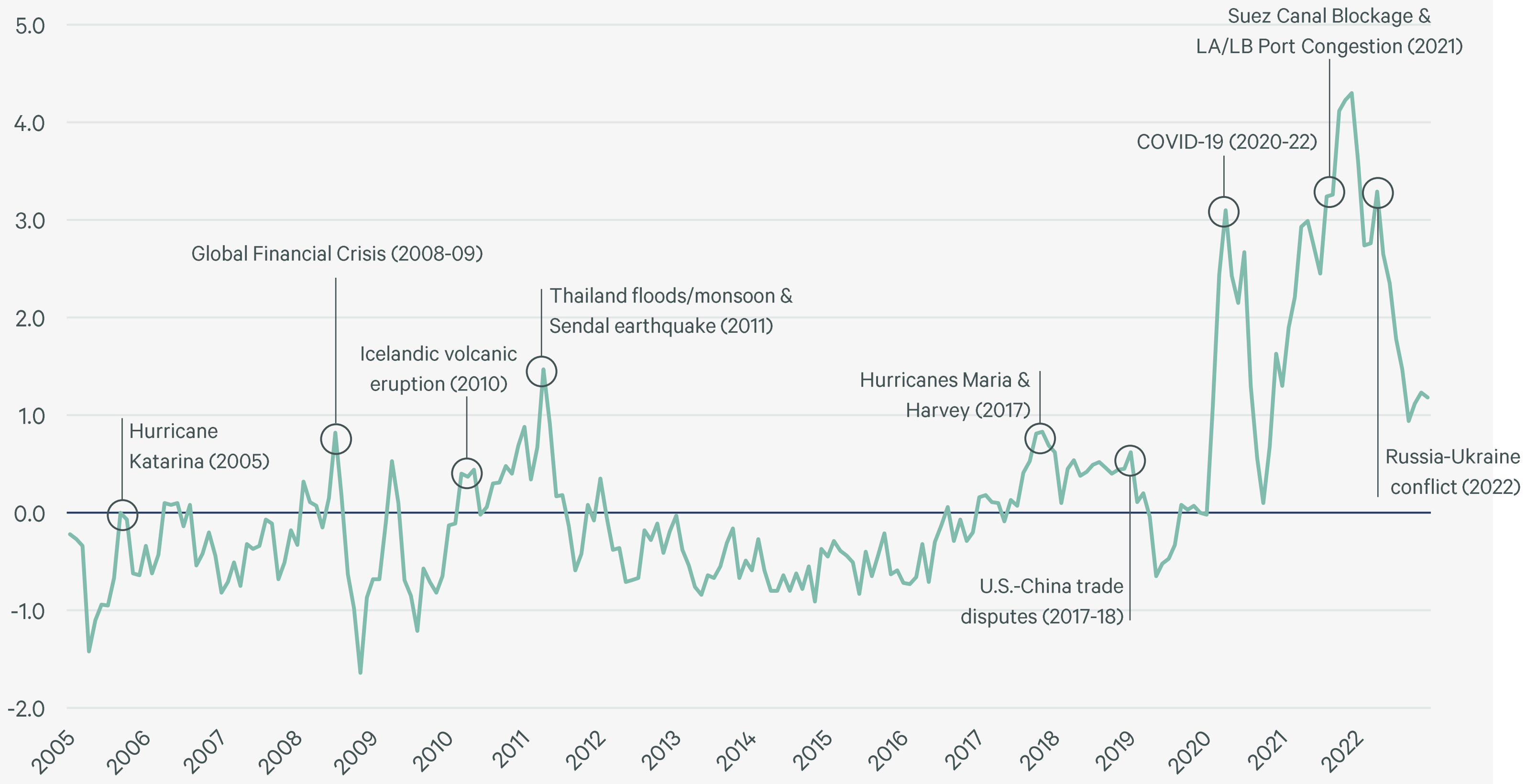
Pressure eases on global supply chains while reconfiguration continues

The global supply chains faced significant strain due to various geopolitical events such as the COVID-19-induced closures, the congestion of the Port of Los Angeles, and the ongoing conflict in Ukraine, which all contributed to increasing international freight rates. These pressures began to wane in late 2022 as bottlenecks and disruptions eased off.

Although the situation has improved, the pressure on supply chains remains high in a historical context. The supply chain disruptions caused a spike in demand for logistics space as companies required larger safety inventories as a precautionary measure. As supply chains normalise, some of the pressure on demand and rent may ease as companies reassess their inventory strategies and no longer need to maintain excess stock.

Despite improvements in seaport congestion and reduced international shipping costs, global supply chains continue to be under transformation. As a result, corporations will continue evaluating their operational strategies and diversifying product sourcing to mitigate potential future disruptions such as labour disputes, port closures, and ongoing conflicts. This trend of nearshoring is expected to persist in the coming year, offering opportunities for both tenants and investors in the logistics market.

Figure 17: Global supply chain pressure index



Source: Federal Reserve Bank of New York

07

Retail

Key takeaways

01

Lagging consumer confidence will weigh on retailers. They will attempt to counter this by enhancing the consumer experience.

02

The surge in e-commerce penetration that the market has seen in the last few years will provide consumers with more choices than ever on how to shop.

03

Stores will be used to increase efficiencies and enhance the omnichannel experience for the customer. Investors should consider how store and shopping centre design can support these non-traditional uses.

04

Given the attractiveness of some of the retail segments, a potentially softer yield expansion can be expected versus what may be anticipated in other commercial property sectors.

05

ESG considerations are rising, with shoppers taking action to consume less, buy locally or use smaller or independent brands.

Retail is not immune to the wider economic headwinds

Consumer confidence is at a historic low – below the levels reported during the global financial crisis and the height of the COVID-19 pandemic. In Q2 2022, the Danish retail sales volume index started dipping though from historically high levels. Given the current economic backdrop, retail sales can continue to decrease in 2023.

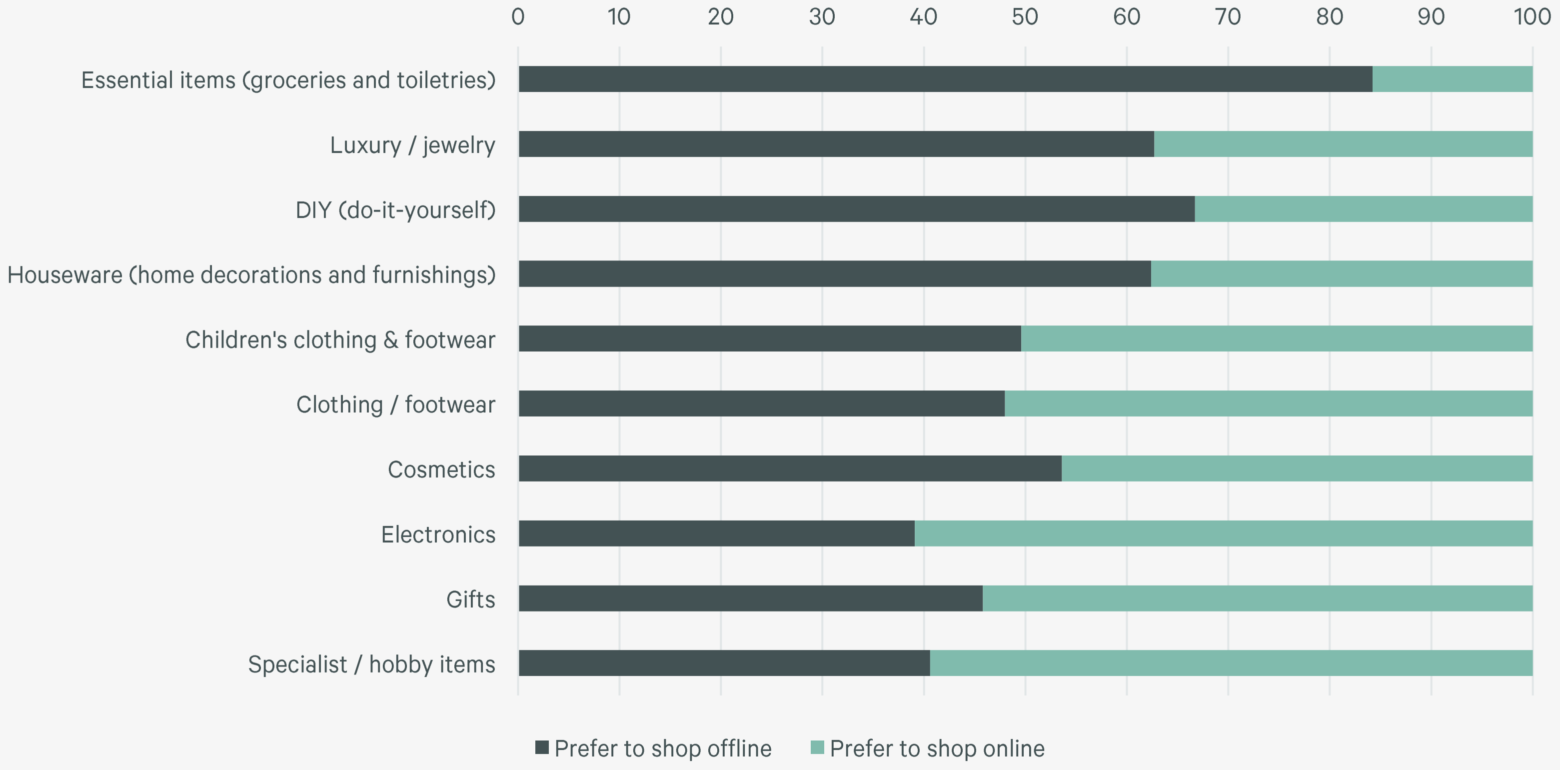
The role of the store will continue to evolve

Looking ahead to 2023, we expect online penetration to remain stable. Clearly demonstrating that physical retail remains a valued amenity, CBRE's Global Live-Work-Shop Survey found that Danish consumers prefer in-store shopping for five out of ten product categories.

The survey also showed that many consumers still like to see a product in-store before ordering online and prefer to return online orders in-store instead of by mail. Postal returns are costly for retailers, and many have now started or are considering charging for this service. Utilising store networks can therefore increase supply chain efficiency for occupiers.

To support these non-traditional uses of the store, where re-configuration is required, landlords will increasingly become mindful of using zoning and how this can be best facilitated in terms of design. Stores will be used to increase efficiencies and enhance the omnichannel experience for the customer. Investors should consider how store and shopping centre design can support these non-traditional uses.

Figure 18: Preferred methods of shopping based on product category (Denmark)



Source: CBRE Research, Global Live-Work-Shop Survey, 2022

Prime high-street still challenged

Retail vacancy in Copenhagen's central business district (CBD) saw an upward pressure in the first half of 2022 and then started declining in Q3, with the current vacancy rate standing at 6.3% (as of Q3 2022; Source: Danish Property Federation).

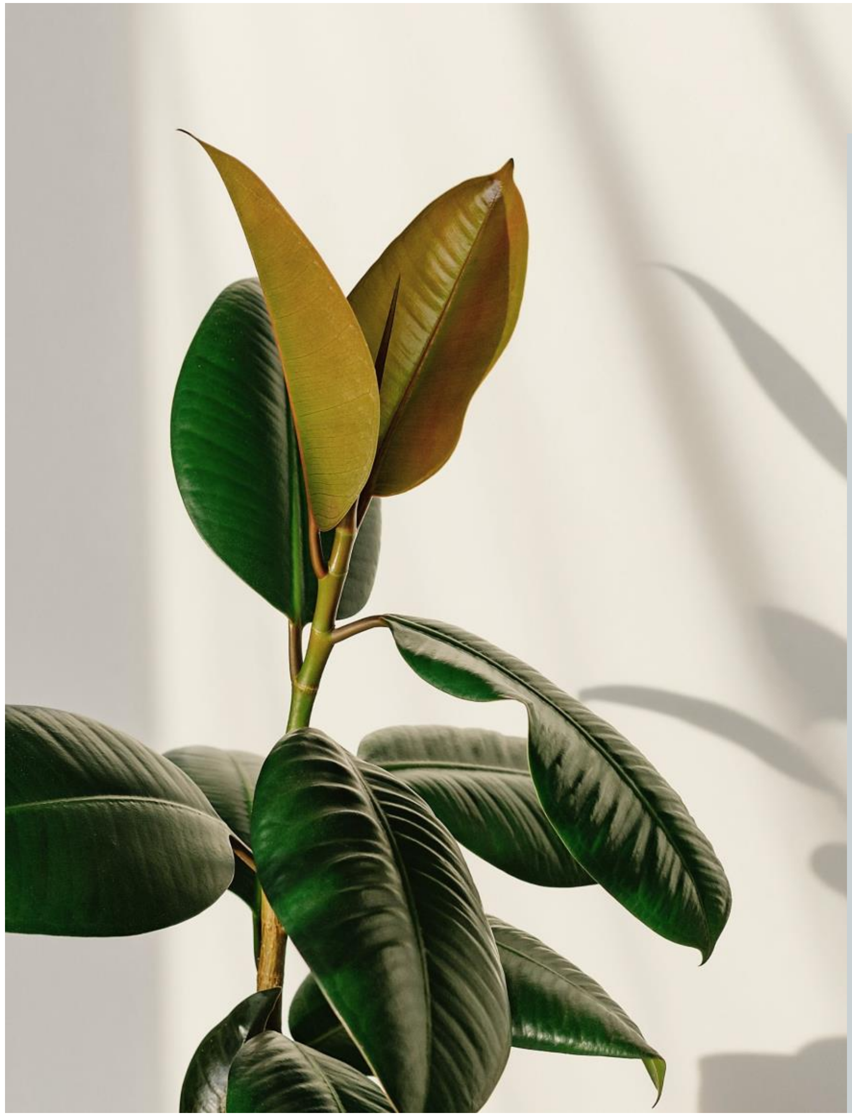
Copenhagen's high-street area is though far from approaching full occupancy, with vacancy levels remaining elevated in the short term.

Investors will continue to favour retail parks and convenience-led assets in the short term

Retail investment surprised on the upside in 2022, recording the second-best yearly result over the last decade. Grocery-anchored retail assets have proven to be particularly resilient, and this trend is expected to persist throughout 2023.

On the other hand, investment activity in the high-street area has been subdued, reflecting challenging occupier fundamentals.

Prime yields moved out during 2022 by 35 bps to 90 bps, standing at (as of Q4 2022) 4.10% for high street retail (from 3.20% in January 2022); 5.75% for shopping centres prime (from 5.10%); 5.25% for supermarkets prime (from 4.75%) and 6.0% for retail warehouse prime (from 5.65%). Given the attractiveness of some of the segments, a potentially softer further yield expansion can be expected versus what may be anticipated in other commercial property sectors.



Trends to watch

Rise of grocery stores

The role of grocery stores will continue to evolve. Although food & beverage digital sales are growing, most of these orders are fulfilled at the store level through curbside pickup or third-party delivery. Grocers will transform their footprints to better suit multi-channel retailing.

ESG consciousness is rising among consumers

As evidence grows of the sustainability challenges facing the planet, environmental and societal issues are increasingly moving up the agenda for both consumers and businesses. This can lead consumers to focus on purchasing less, shopping locally sourced/produced products and smaller/independent brands.

08

Sustainability

Key takeaways

01 Net-zero commitments are likely to accelerate, with market stakeholders taking tangible steps to embrace the need for and benefits of sustainable business practices.

02 Investor focus on sustainability/ESG is to remain strong, despite macroeconomic headwinds and a challenging geopolitical landscape. This is supported by their expectations of occupier preference and rental premiums for ESG-compliant assets.

03 Although the energy transformation of the commercial building stock is seen as a huge investment opportunity, securing CapEx in today's high interest rate environment can prove to be challenging.

04 The market will continue to speculate on the timeline for implementing regulatory frameworks related to minimum energy efficiency standards for real estate.

05 As more regulations are implemented, liability risks associated with statements and claims will increase. Transparency of data structuring and reporting will therefore become front and centre.

The market is still focusing on costs related to the ESG agenda in stead of its benefits

The E in ESG is expected to dominate the narrative also in 2023. Climate change is a systematic financial risk, and as such, it can not be hedged or diversified away. It must be addressed in the real economy. Therefore, the net-zero journey will be driving change in both company fundamentals and asset valuations. However, the main challenge remains the unclarity regarding how the net-zero transition will be financed.

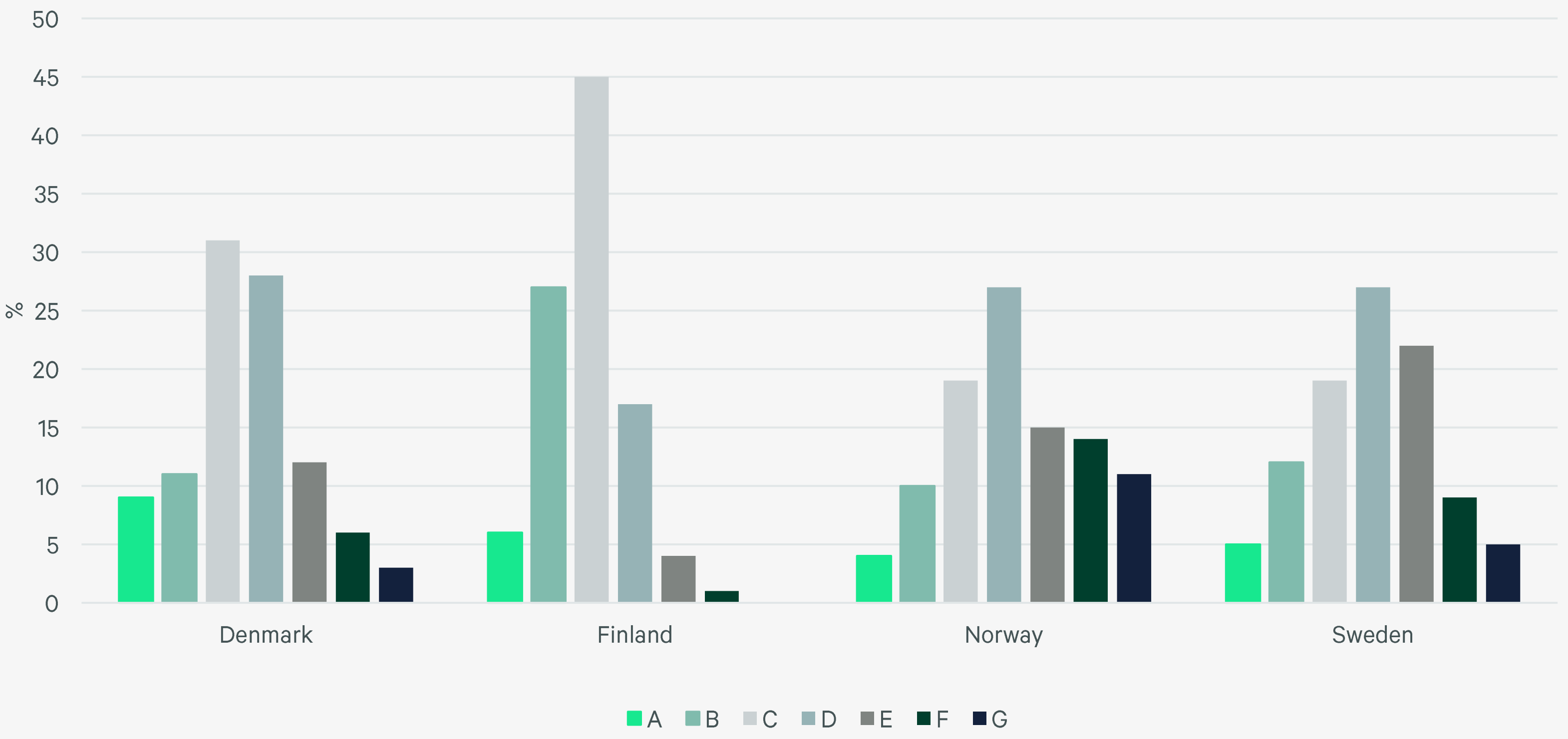
Market focused on creating 'carrots' due to a lack of 'sticks'

Going into 2023, the market is expected to continue to speculate on the timeline for implementing regulatory frameworks related to minimum energy efficiency standards for real estate (EPC ratings). However, this attitude can prove to be dangerous as it focuses solely on regulations implemented by the government while omitting the fact that markets are also being ruled by the users of real estate.

Even if assuming that the legislation regarding minimum EPCs for real estate will first come into force in 2030, this will become irrelevant, provided a majority of occupiers increasingly choose to occupy only the most energy-efficient stock.

As both stakeholder and regulatory pressure will increase, the window of opportunities for investors must be regarded as transitory. Adopting a proactive approach to the ESG agenda and, in particular, the net-zero transition will prove to be a huge advantage for those who do it well.

Figure 19: EPC distribution as a proportion of office stock

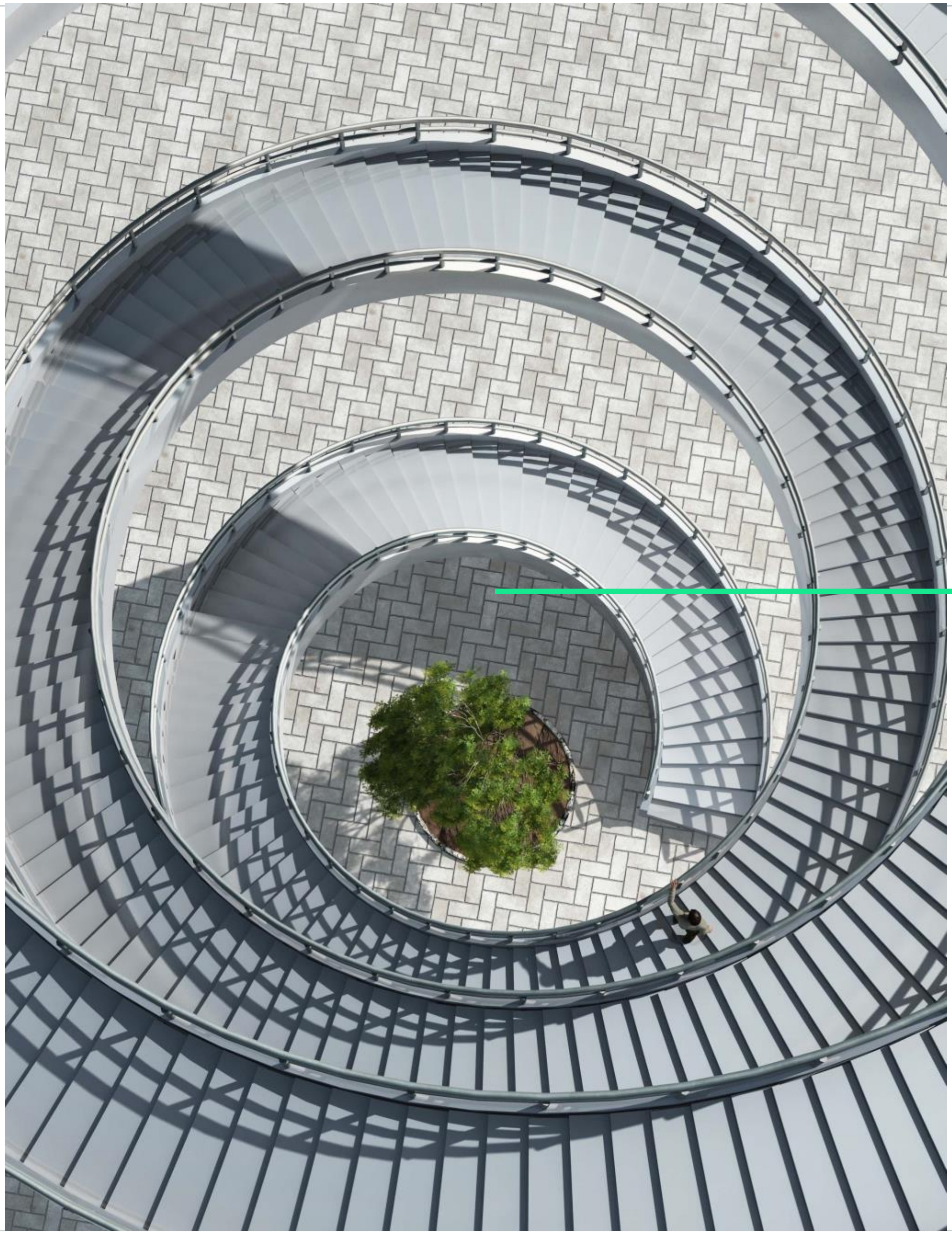


Source: CBRE Research

Valuations will increasingly reflect sustainability features

Correctly pricing the value of building environmental features will remain important both for asset owners and financial institutions, provided the asset is being used as collateral. Although the relationship between energy efficiency improvements, credit risk and asset value is rather complex, evidence suggests energy-efficient buildings are associated with a lower risk of default.

In addressing the need to retrofit existing assets, securing financing will remain a huge part of the challenge. While some investors will be able to finance energy efficiency improvements themselves, others will be either partially or fully dependant on external financing. However, securing CapEX in today's high interest rate environment can prove to be challenging, in particular in relation to the value to be attributed to retrofitting from an LTV perspective. However, the support from the real estate credit markets is of vital importance for ensuring the Danish commercial real estate market has the ability to contribute towards net zero commitments.



SFDR reporting is now mandatory, with real asset managers expected to provide financial disclosures based on 2022 data.

Contacts & Further Reading

This report was written by CBRE's research team. If you have any questions regarding the content of the report, the contacts listed below are ready to assist you.

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