KTI Market review *autumn*

2013

KTI | PROPERTY INFORMATION SINCE 1993

- Transaction volumes remain low
- Several new property funds launched
- Challenges increase in commercial rental markets
- Construction volumes decrease

KTI Market review – autumn 2013

Economic uncertainty increases challenges in the property market

Continuing economic uncertainty is impacting all areas of property markets. Transaction volumes remain low, leasing markets are becoming increasingly challenging and construction volumes are decreasing. Activity needs to increase significantly during the last weeks of the year for even the lowest volumes of 2009 to be reached. Market professionals are, however, slightly more optimistic about the future outlook than six months ago.

Investment demand is still mainly targeted at prime properties, but tight supply as well as low yields of the least risky assets is gradually starting to shift investor interest towards secondary properties. Prime yields remain stable, whereas secondary properties are being traded at whatever levels the seller and potential buyer are able to reach agreement.

In oversupplied markets, leasing of offices is requiring extra work and activity from landlords. Vacancy rates continue to increase and rental market volumes are being maintained by tenant turnover in mostly small premises. In the Helsinki CBD, office rents continue to increase slightly, whereas in other areas rental levels are dispersed and depend on the characteristics of the space as well as other terms of agreement. Challenges are also increasing in the retail rental markets. Occupancy rates have decreased in all commercial property sectors during the past six months.

In these quiet markets, most positive news has related to new property funds. New players have entered the property fund management market, and funds are also being offered to private investors. The majority of new funds target residential or care properties.

In past years, tight availability of debt financing has been offered as the main explanation for low transaction volumes. During 2013, however, the availability of debt has improved slightly, and, at the same time, the margins have decreased. Nevertheless, volumes have not increased, which indicates the sluggishness of demand. In the property finance markets, new instruments are arising alongside traditional bank financing, increasing the variety of options for property finance and investment.

Demand for rental residential apartments remains strong in all major cities. Increase in rents has slowed down in the most expensive areas, but generally speaking, rents continue to increase.

Economic environment of property markets is challenging

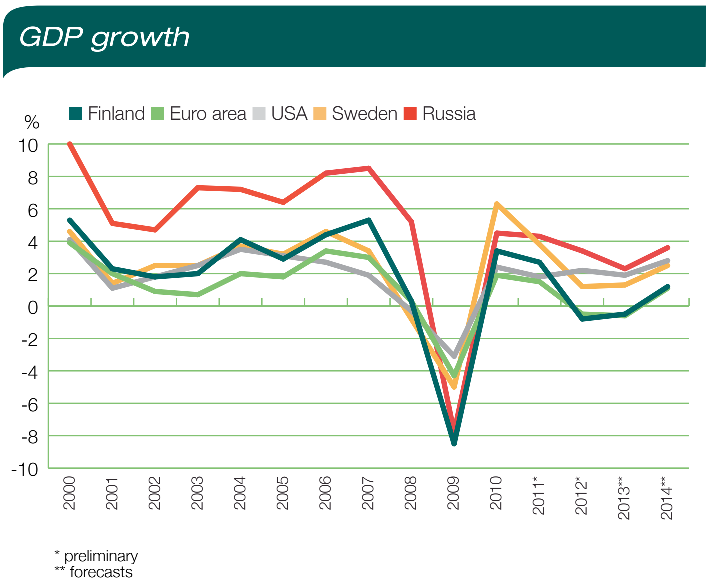
GDP expected to increase slightly in 2013?

GDP growth has remained in negative territory in 2013, although the improving outlook for the global economy enhances expectations for a slightly better future. GDP growth is expected to amount to 1-2 percent in 2014, and improve slightly towards 2015. However, even these figures would not increase total production back to 2007 levels.

- Global economy creates constraints for Finland
- Zero growth in private consumption
- Competitiveness of exports crucial
- Property markets affected in all fronts

Competitiveness of the exporting industries essential

The Finnish economy is dependent on foreign trade, and therefore, much of our future development is largely beyond our own control. Growth expectations are still vulnerable both globally and in the euro area. Potential escalation of the financial crisis, as well as financial and political challenges in the US might have a negative impact on the future development of the Finnish economy. The expected global growth would gradually improve the demand for Finnish exports, whose competitiveness is supported by moderate wage increases and easing of corporate taxation. However, due to presently unused capacity, it will take some time before the expected growth would translate over into any new investments in construction and machinery.

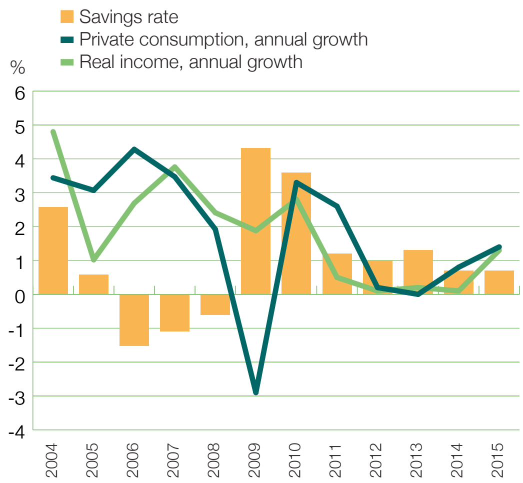


Source: Statistics Finland, OECD, Ministry of Finance

Private consumption will not increase

Low wage increases, tightening taxation as well as increasing unemployment have restrained the growth potential in private consumption. Economic uncertainty and zero growth in purchasing power have decreased consumer confidence, which has decreased the demand for more expensive goods in particular. This has created constraints in the retail markets. In addition to cyclical issues, retail markets are also being increasingly challenged by changes in consumer behavior and an increase in e-commerce. Low consumer confidence has also impacted the housing markets, where transaction volumes are decreasing significantly. Housing prices have, however, remained rather stable. Strongest demand is focused on small apartments in major cities.

Households' real income, private consumption and savings rate



Source: Statistics Finland, Ministry of Finance

Structural changes still not specified

In addition to an enhanced global economy, profound structural changes are needed in order to support the sustainability of the Finnish public finances. The government published its broad plans for the needed changes in the summer, but the details of these changes have not yet been specified. The needed adjustments will create a tight framework for both public investments and taxation.

The tight economic environment has made for increased challenges in the property markets. The challenges are, however, different in various areas. The demand for office space will only start to increase when the economic outlook is clearly improved and corporations are confident enough to increase their workforce. Even then, the growth will, to some extent, be satisfied by the existing buffer in the occupied space. The nature of the challenges in the retail market is becoming more structural. Effects of the shift in consumer behavior are also being seen in the logistics markets. The continuous imbalance between supply and demand in the rental residential market continues to support rental growth, even though the economic uncertainty is also creating constraints on the increase in rents for most expensive submarkets.

Key economic indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013**	2014**
GDP (change in volume)	2.9	4.4	5.3	0.3	-8.5	3.4	2.7*	-0.8*	-0.5	1.2
Exports	7.0	12.2	8.2	5.8	-21.3	7.9	2.7*	-0.2*	-0.5	3.7
Inflation	0.9	1.6	2.5	4.1	0.0	1.2	3.4	2.8	1.6	2.1
Unemployment rate	8.4	7.7	6.9	6.4	8.2	8.4	7.8	7.7	8.3	8.2
Interest rates										
3 months euribor	2.2	3.1	4.3	4.6	1.2	0.8	1.4	0.6	0.2	0.3
10 years	3.4	3.8	4.3	4.3	3.7	3.0	3.0	1.9	1.6	1.9

* preliminary
** forecast

Source: Statistics Finland, Bank of Finland, Ministry of Finance

Transaction volumes at record low level

Property transaction volumes remain at a low level for the fifth consecutive year. The total volume of the first three quarters of 2013 amounted to the same level as in 2009, when the €600 million activity of the last quarter was able to raise the annual volume to €1.8 billion. At the end of October, there is still a margin of almost €500 million to be filled to reach even this level.

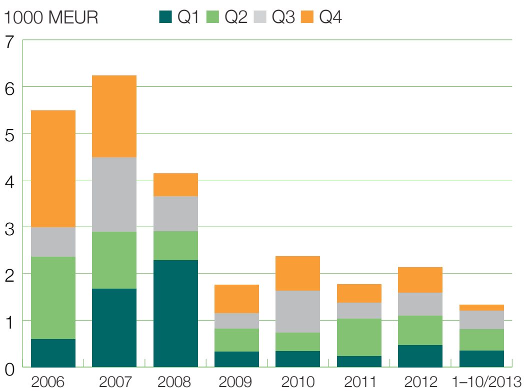
- All time low transaction volume in 2013?
- Low yields of prime properties drive investors to look at secondary assets
- The supply of property finance and investment vehicles is increasing

Lots of transactions being prepared

It remains to be seen whether the last weeks' efforts will be enough to increase the volume to the previous years' levels. According to market professionals, there are quite significant transactions being prepared, but processes tend to be long and their completion remains unsure up until the actual closing. According to the RAKLI-KTI Property Barometer, the outlook for transaction volumes is slightly more positive than six months ago. The interest of foreign investors is, however, expected to remain at its current low level.

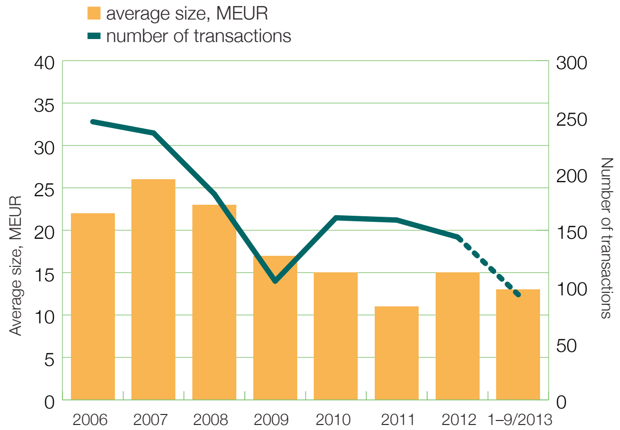
The average size of transactions is still rather small. In 2013, KTI has identified more than 90 transactions of more than €1 million, and the average size of these transactions has been some €13 million. This is about €2 million smaller than in 2012, and only some 50 per cent of the size in the peak year 2007. The biggest transaction of 2013 was made by Trevian Asset Management's new fund, Trevian Care, which bought a portfolio of health care properties worth some €100 million from Varma and Etera. In the list of top 10 transactions in 2013, transactions as small as €20 million are included.

Transaction volume in the Finnish property market, quarterly



Source: KTI

Number and average size of property transactions



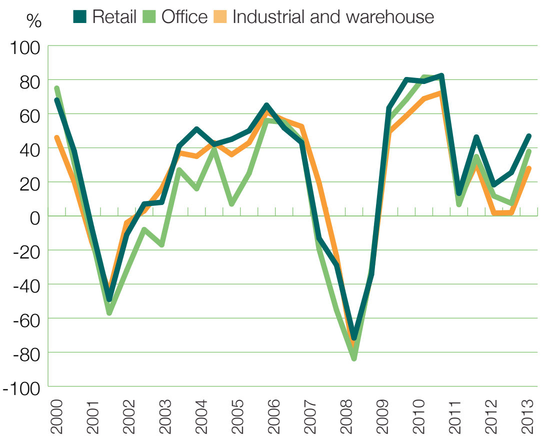
Source: KTI

Investors are sensitive in pricing of risk

Investor interest is still primarily targeted at prime properties. In the recent RAKLI-KTI Property Barometer survey, the yield for prime offices in the Helsinki CBD was recorded at 5.4%, which is a slightly lower level than six months ago. Actual quotations are, however, still very rare – the only office transaction in the city center this year was the sale of two properties by Sanoma in July, and, even in this transaction, the yield was not disclosed. In other major cities, yields are now slightly higher than last spring.

In all non-prime properties, risk pricing is still emphasized. This opens attractive opportunities for investors who are willing to accept higher risks, and who appreciate the higher return potential of secondary properties. Sellers of secondary properties need to be motivated enough to reach agreement on the price with potential buyers. In recent months, secondary properties have been acquired by eg SaKa Hallikiinteistöt, Niam and Fennia.

Investment demand by property sector Balance figures



Source: RAKLI-KTI Property Barometer

The future of distressed properties?

The future of highly leveraged properties and portfolios acquired during the peak years is being actively explored. So far, investors and lenders have been patient and only very few transactions fall in the “distressed sale” category. However, problems have to be dealt with at some stage, and in some cases, either banks or the investors seem to be prepared to face the reality of terminating funds– despite the potential losses. Sometimes these decisions might also be driven by changes in investor strategies. The most striking example on this front was the acquisition of Moveres Business Park, where SaKa Hallikiinteistöt bought this modern, Leed certified property for a fraction of the price that had been paid in 2007, before its completion. These kinds of arrangements are expected to become more common, even though their share of total transactions volume is not expected to become significant.

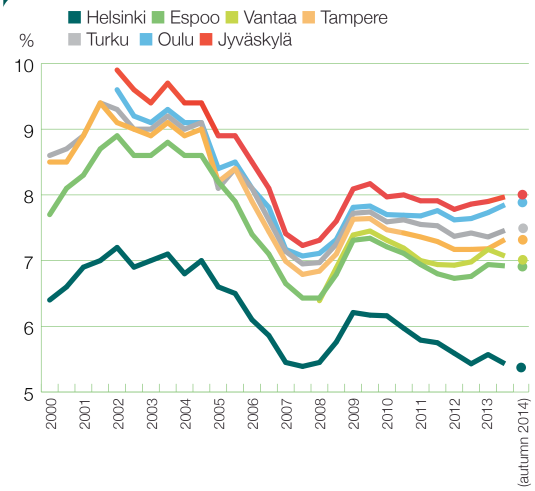
Supply of finance and investment vehicles is increasing

The availability of debt financing has eased slightly during the past months, and the margins have decreased. Despite this, the competitiveness and attractiveness of other sources of financing has strengthened, which increases the amount of options available for property investors.

Institutional investors are showing increasing interest in providing debt for property investments. They have also entered in joint venture arrangements in larger assets with other investors. The latest example on this front is Ilmarinen’s co-investment in the IsoKristiina shopping center in Lappeenranta together with Citycon.

Sponda, Citycon, VVO and SATO have all issued bonds successfully. A new opening in the property finance markets was the shares issue of Orava Asuntorahasto, which was oversubscribed in October. The company was also listed in the stock exchange as the first tax transparent property investment company under the Finnish property fund legislation. Also, Technopolis is currently preparing a rights issue.

Prime office yields in major Finnish cities



Source: RAKLI-KTI Property Barometer

Several new funds launched

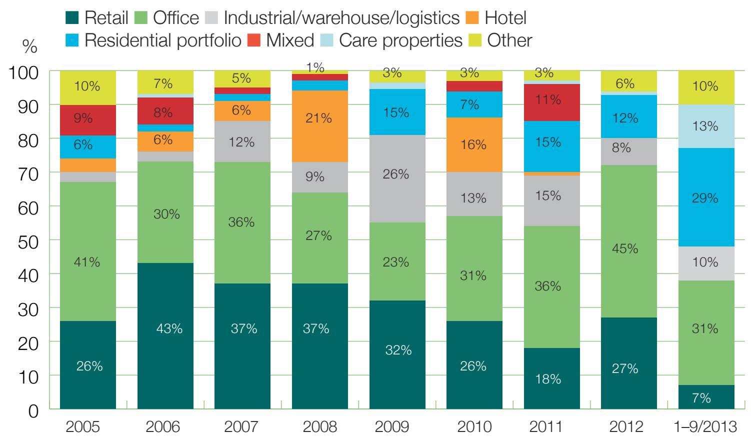
During 2013, almost ten new property funds have been established, and some of these have been launched by management companies just starting their property business. Many of the funds are also offered to private investors. For instance, Ålandsbanken and OP-Pohjola have both successfully launched funds targeted at private investors, and they are able to exploit their wide networks of bank branches in marketing. FIM, Titanium and Elite are examples of asset managers and investment banks that have expanded their business in the property market during 2013.

- Residential and health care properties attract investors
- Vacancy rate of offices continues to increase
- Challenges in retail rental markets
- Construction activity targeted at redevelopments and extensions

Residential and health care properties attract investors

As the uncertainty in the commercial property markets continues, the perceived stability of housing and care property markets is attracting capital. These sectors are also favored by most of the newly launched funds. This has caused a significant shift in the sector distribution of the transactions carried out this year. Traditionally, office and retail properties have typically represented some 50-75 percent of the annual transaction volume. This year, however, their combined share only account for about one third of all transactions of the first three quarters. Residential properties represented about one third, and health care properties some 13 percent of the total volume. Newly established property funds have acquired more than €300 million worth of residential and health care properties this year.

Distribution of transactions by property sector



Source: KTI

Uncertainty in the office rental markets continues

The overall uncertainty in the economy is impacting rental markets in all commercial sectors. The amount of vacant space in the Helsinki metropolitan area has continued to increase. According to the KTI rental database, the amount of vacant space has increased by some 35,000 sqm during the past six months. The activity in the rental markets is primarily maintained by the turnover of tenants in smaller premises that are not as severely affected by the sluggish economic outlook. Gross take-up has, therefore, even increased slightly compared with the respective period in 2012. However, new agreements are not able to increase the total amount of space in use, and completions of new buildings thus increase the amount of vacant space.

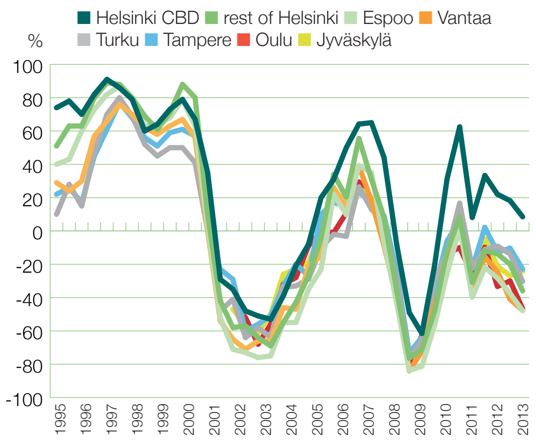
The Helsinki CBD is still behaving somewhat differently compared with most other areas in the Helsinki metropolitan area. In the city center, bigger premises are also attracting tenants, and rents continue increasing. However, the amount of vacant space has increased slightly also in the city center during the past six months. The KTI rental index increased by 1.4 percent, and the average rents in new agreements increased to some €26 per sqm. In the best micro locations, rents are well above €30 euros per sqm per month. However, according to the RAKLI-KTI Property Barometer, the outlook for office rents in the CBD is not quite as positive. The majority of the respondents expect the rents to remain stable in the near future. There is still, however, a clear margin to all other areas, where the outlook remains clearly negative.

Challenges also increasing in the retail markets

The economic uncertainty is now also affecting consumer confidence and earnings, which is having an impact on retail property markets. The amount of vacant space is still very low in most major cities, although it has increased in the past six months. Especially leasing of larger, out-of-town retail premises has become more challenging. The best performance is still being shown by high-street shops and high-quality shopping centers on the one hand and retailing of consumer goods on the other. In the longer term, challenges are also expected from changes in consumer behavior and increase in e-commerce, which will probably change the structure of retail markets and demand for space quite profoundly in the coming years.

In the Helsinki center, rental activity has also been high in larger retail premises. The relatively large average size of the rented premises can also be seen in the rental level, which is now 80 euros per sqm on average. In the RAKLI-KTI Property barometer, the prime retail rent in Helsinki center was now quoted at 120 euros per sqm, which is a slightly higher level than last spring.

Outlook for office rents
Balance figures



Source: RAKLI-KTI Property Barometer

Office gross take-up
Helsinki metropolitan area

Source: KTI

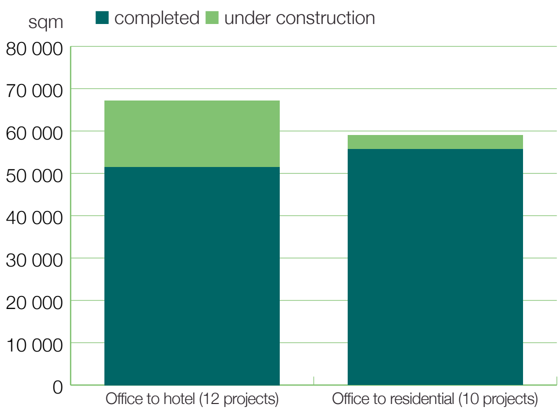
Office construction activity slowing down

Some 750,000 sqm of new office space has been completed in Helsinki metropolitan area since 2007. The highest peaks were seen in 2008 and 2012. At the end of this September, some 100,000 sqm was still under construction. The biggest ongoing projects include the new buildings at Töölönlahti area in the CBD, as well as OP-Pohjola's major project in Vallila. These two areas account for some 55% of the total volume of ongoing construction projects – including all redevelopment projects. During 2013, only one office project has been started in Helsinki metropolitan area in addition to OP-Pohjola's Vallila project. Outside Helsinki region, there are two ongoing office development projects in Turku, and one in both Tampere and Jyväskylä. Due to the softening rental demand, new projects are unlikely to be started in the near future.

In the retail markets, a high level of redevelopment activity continues in the Helsinki metropolitan area. Otherwise, development activity is slowing down in all areas and all commercial property sectors. In the whole country, the biggest development projects include the Hämeenlinnakeskus shopping center project, as well as the S-Group's major logistics project in Sipoo. The biggest redevelopment projects outside Helsinki metropolitan area include Porin Puuvilla and Lappeenranta IsoKristiina shopping centers.

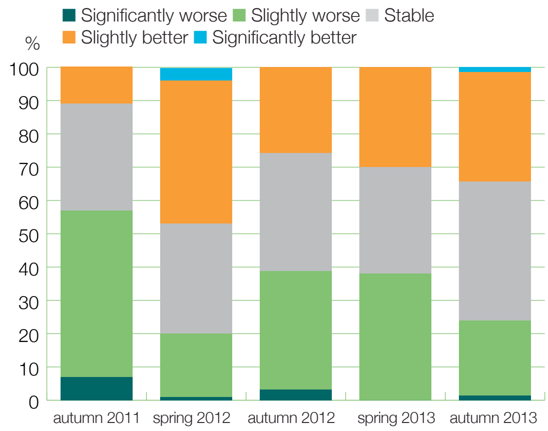
Investors are seeking to tackle the office vacancy challenge both by activating their leasing operations and by developing the properties. In the most positive cases, vacant office buildings can be redeveloped to some other use, eg to residential, hotel or healthcare facilities. Measured by the volume, however, this is still not significant: between 2007 and 2013 some 20 office redevelopment projects have been carried out in the Helsinki area, amounting to some 130,000 sqm of office space having found a new life in either residential or hotel use.

Office redevelopment in other use in 2007-2013 in Helsinki metropolitan area
rentable area, sqm



Source: KTI, RPT Docu Oy

Compared to current situation, how would you assess the conditions in the commercial property rental markets in autumn 2014? Distribution of responses, %



Source: RAKLI-KTI Property Barometer

Commercial property occupancy rates decreased in all largest cities

Helsinki metropolitan area

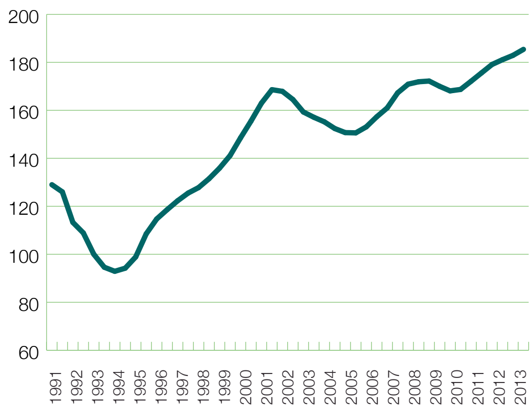
The amount of vacant office space remains large in many submarkets in Helsinki metropolitan area (HMA). The most challenging submarkets are still Pitäjänmäki in Helsinki and Kilo-Mankkaa area in Espoo. Occupancy rates have also decreased in Ruoholahti, Vallila and Leppävaara areas during the last six months. Despite the oversupply of office space, nominal rental levels of new office agreements have remained surprisingly stable, indicating that property owners are not very willing to compromise the current rental levels. However, a slight decrease for new office rents has been witnessed in areas suffering from lowest occupancy rates, and also in buildings completed during the 2000's. In these new buildings the rental agreements are now being renegotiated for the first time.

- Median rents for new contracts decreasing in the areas suffering from lowest occupancy rates
- Several shopping centre redevelopment projects under construction in HMA
- Only a few commercial property transactions outside HMA and Tampere

The outlook for HMA office markets is not very positive. The respondents of the RAKLI-KTI Property Barometer survey expect that both office occupancy rates and office rents will decrease during the winter, with the only exception once again being the Helsinki CBD. Office transaction volumes in the area have been lower than in previous years, but still higher than in the rest of Finland altogether.

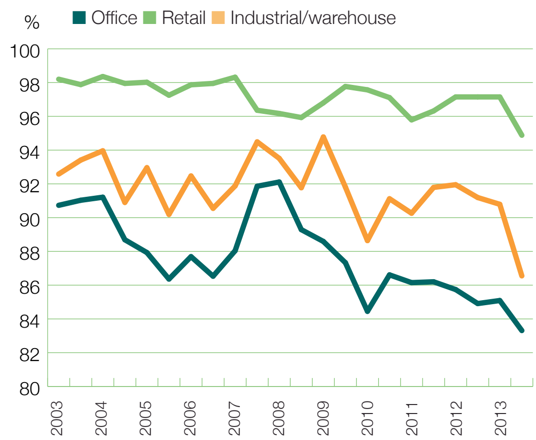
The retail occupancy rates have also decreased in HMA. The amount of vacant retail space has increased over 15,000 sqm during the last six months. Only a couple of retail property transactions have been recorded this year, but there have been investments in the retail property markets through several shopping centre redevelopment projects. The modernization projects of shopping centres CityCenter in CBD and Ainoa in Tapiola have been completed this year, as well as the extension of shopping centre Kaari in Kannelmäki. There are still four other shopping centre redevelopment projects in Helsinki Metropolitan Area under construction.

Office rent index in Helsinki CBD
index 1993=100



Source: KTI

Occupancy rates in Helsinki Metropolitan Area



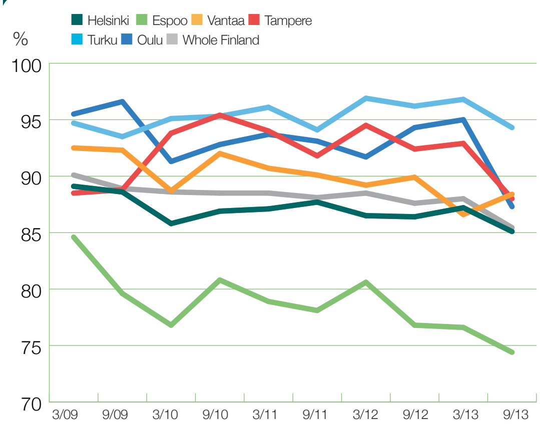
Source: KTI

Tampere

In Tampere, a few large property transactions have been witnessed during this year. In June, W. P. Carey acquired the modern technology centre of Cargotec for approx. 38.5 million euros. This was by far the largest transaction of a foreign investor outside HMA this year.

The median rent of new office rent agreements has remained at approx. 14 eur/sqm/month. The respondents of Tampere regional barometer survey, conducted by KTI in October, expect that office rents will remain stable but that retail rents will slightly increase, especially in the CBD area. Expectations for space demand are negative in all property types. The amount of vacant office space has increased and the occupancy rate of offices has thus decreased to 88 per cent.

Office occupancy rates



Source: KTI

Turku

Also in Turku, the amount of vacant space has increased in commercial properties, but occupancy rates of both retail and office premises are still rather high, at 94-95 per cent. In office markets, the strongest submarket is Kupittaa, where median rent for new office agreements is about 15 euro, which is 1.5 euro higher than in the Turku CBD area. One third of the respondents of the regional barometer survey expect that office rents will continue to increase in Kupittaa.

The largest property transaction in Turku this year occurred in October, when Turku Technology Properties acquired 7,000 sqm of office, laboratory and warehouse space in Kupittaa.

Oulu

In Oulu, retail occupancy rates have remained high, at approx. 97%, and retail rents have been increasing, especially in the city centre area. The respondents of the regional barometer surveys expect that space demand in Oulu retail sector will develop more positively than in Tampere, Turku or Jyväskylä. In office and industrial sectors, however, occupancy rates are below 90 per cent and the outlook for space demand is negative.

Jyväskylä

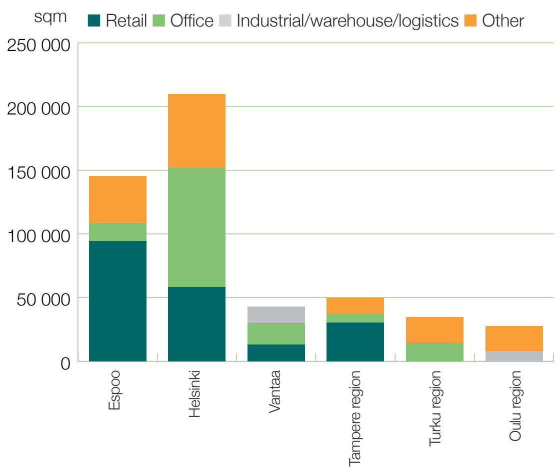
The property investment market has remained quiet in Jyväskylä as well. This year the city of Jyväskylä has sold a couple of small properties and Ålandsbanken's residential property fund has acquired some apartments. According to the RAKLI-KTI Property Barometer, prime office yields are close to 8 per cent, a bit higher than in Tampere, Turku or Oulu. Rental market development has been rather stable, and median office rent in the city centre area is close to 15 eur/sqm/month. Occupancy rates have decreased in all property types.

Other large cities

Overall, the negative development of occupancy rates has been recorded broadly across Finland. According to the KTI database, the amount of vacant space has been increasing in all commercial property types for example in Lahti, Kuopio, Kouvola, Pori, Hämeenlinna and Seinäjoki.

Commercial properties under construction in September 2013

rentable area, sqm



Source: KTI, RPT Docu Oy

KTI

KTI Finland is an independent research organisation and service company providing information and research services for the Finnish real estate industry. KTI maintains extensive databases on returns, rents, transactions, operating costs and customer satisfaction measures in the Finnish property market. Based on these databases, various kinds of benchmarking and analysis services can be provided. KTI's clients comprise all major property investors, managers, occupiers as well as service providers in the Finnish market. KTI is owned by the Finnish Real Estate Federation and RAKLI.

KTI Kiinteistötieto Oy – KTI Finland
Eerikinkatu 28, 7th floor
00180 Helsinki FINLAND

tel.+358 (0)20 7430 130
fax +358 (0)20 7430 131
www.kti.fi

KTI - High quality property information