

Uncertainty continues in the commercial property market – residential and health care properties attract investors

Continuing economic uncertainty is impacting all areas of the Finnish property markets. Transaction volumes remain low, leasing markets are becoming increasingly challenging and construction volumes are decreasing. In these quiet markets, most positive news have been related to new property funds. New players have entered the property fund management market, and funds are also being offered to private investors. Market professionals are, however, becoming more optimistic about the outlook for the transactions market. Significant transactions are being prepared, and, if finalised before the year-end, these would increase the annual total volume significantly. Increase in rental demand would, however, require more optimism on the economic outlook.

The total transactions volume of the first three quarters of 2013 amounted to some €1.2 billion, which is about the same level as in 2009, when the lowest annual volume of the whole 2000s was recorded at €1.8 billion. At the end of October, there is still a margin of almost €400 million to be filled to reach even this level. It remains to be seen whether the last weeks' efforts will be enough to increase the annual 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.

New property funds being 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 new funds are also offered to private investors. These funds have also been active in the transactions market.

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 a major share of the annual transaction volume. This year, however, residential properties represent about one third, and health care properties some 13 percent of the total volume.

Prime yields stable in Helsinki CBD, slight increase in other areas

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 for prime properties are, however, still very rare. In other major cities, yields are now slightly higher than last spring. In all non-prime properties, risk pricing is still emphasized. Since 2007, the risk premium between Helsinki CBD and other major cities has increased by some 0.5 percentages. This opens attractive opportunities for investors who are willing to accept higher risks, and who appreciate the higher return potential of secondary properties.

Occupancy rates decreasing in all commercial sectors

The overall uncertainty in the economy is impacting rental markets in all commercial sectors, and the amount of vacant space in the Helsinki metropolitan area has continued to increase. In the office markets, the lowest occupancy levels are recorded in Espoo, where only some 75% of the stock held by major investors was rented at the beginning of September. However, rental levels of new agreements have continued to increase slightly, and the KTI office rent index for Helsinki CBD increased by 1.4 per cent during the past six months. Even though the amount of vacant space has increased slightly even in CBD, these best locations continue attracting tenants also for larger premises. 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.

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. 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.

Office construction activity slowing down

The decrease in investor and rental demand has put an end to construction activity. During 2013, only two major office development projects have been started in the Helsinki metropolitan area: OP-Pohjola's and Amer Sports' headquarters in Vallila. In addition to these, the biggest ongoing projects include the new buildings at Töölönlahti area in the CBD, one next to Iso Omena shopping center in Matinkylä as well as one in the Aviapolis area. Due to the softening rental demand, new projects are unlikely to be started in the near future.

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.

Graphs:

- *Transaction volume in the Finnish property market, quarterly*
- *Prime office yields in major cities*
- *Outlook for office rents, balance figures*
- *Office rent index, Helsinki CBD*
- *Occupancy rates in Helsinki metropolitan area*

The release is based on the KTI Market review, published on November 7th, as well as on RAKLI-KTI Property Barometer survey, carried out in October. Altogether 68 property market professionals responded to the survey, which is carried out twice a year.



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