

2012

KTI Market Review *Autumn*



- Transactions market remains quiet
- Demand is targeted at prime properties in both investment and rental markets
- Office vacancy rates will increase due to new development
- Increase in residential rents slowing down

KTI Market Review – Autumn 2012

Economic uncertainty deteriorates the sentiment in the property market

The uncertainty of the overall economy and financial markets impacts all areas of the property markets. The transactions market remains slow, as the supply does not meet the demand. After a few significant transactions completed during the summer, expectations for increasing activity have proved to be unrealistic. In the challenging economic conditions, prime properties would usually attract investors, but the supply of these assets remains scarce.

The unavailability of debt is further slowing the market down. Debt capital is only available for the best assets and long-term clients. The approaching terminations of debt given in highly leveraged transactions in 2006-2007 will probably induce some distressed sales, although the volume of these cases is not expected to become significant.

In the commercial property rental markets, uncertainty is mainly seen as decreasing volumes and the lengthening of decision-making. Reorganisations of corporations, as well as normal renegotiations of rental contracts maintain the activity in the rental markets. However, hurdles for decisions causing increasing space costs remain high.

The vacancy rate of the offices in the Helsinki metropolitan area is expected to increase through the completion of the abundant stock of new developments. The key concern of the owners of vacant office buildings relate to the identification of the buildings for which the improving cycles will cure the problem in the future, and in which cases the vacancy turns out to be more structural and permanent. New starts of building projects have now slowed down due to the current economic uncertainty.

During the past five years, residential rents have increased continuously in all growth cities. However, the economic conditions also impact the housing markets and the paying capacity of the tenants seems to have reached its maximum levels. Increase in rents seems thus to have slowed down significantly or stopped altogether. It is only in the small apartments of the very best areas that rents have continued increasing slightly.

The Finnish economy is affected by international cycles

Finnish GDP growth is slightly in positive territory

Forecasts for the Finnish GDP growth for 2012 and 2013 have been lowered during the autumn. In 2012, the Finnish economy is expected to grow by less than 1 per cent, as the slight growth of the first half will be diluted by the negative development of the latter half. For 2013, a growth of ca. 1 per cent is forecasted. Private consumption is keeping this year's growth in positive territory. However, in 2013, tightening taxation, together with increasing unemployment, will decrease real income and deteriorate the outlook for consumption. Due to decreasing consumer confidence, decisions for larger purchases are being postponed, and this will further slow the economy down. This will also impact the retail property market with a slight lag, where premises for daily goods sales are expected to hold well also in poorer market conditions.

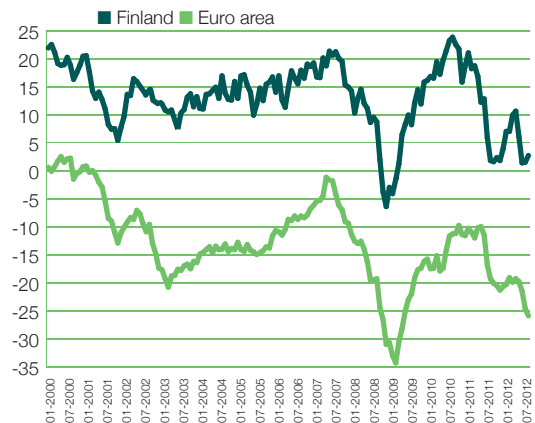
According to the current forecasts, the volume of the Finnish exports is expected to decrease by ca. 2 per cent in 2012. In addition to the economic development of the most important target countries – Germany, Sweden and Russia – the development of exports is dependent on the competitiveness of the Finnish exporting industries.

- Economic forecasts are being lowered
- The Finnish economy remains one of the strongest in the euro area
- Deteriorating employment impacts the rental market
- The volume of Finnish exports decreasing slightly this year

Employment increasing – but how much?

During the autumn, several major layoffs have been published in the news. Unemployment is expected to increase to ca. 7.5-8.0 per cent. Next year, it is expected to increase further, and exceed 8 per cent, but, in 2014, the improving economic outlook will support positive development of employment. The retirement of the baby boom generations will also have a positive impact on the unemployment figures. Abundant redundancies and stringent cost savings programmes also constrain corporations' decision making regarding premises.

Consumer confidence indicator



Source: European Commission

Finland is strongly affected by the euro crisis, but is still a triple A economy

In uncertain conditions, the relative attractiveness of the economies affects the directions of capital flows. The position of the Finnish property market is strengthened by the relative strength and stability of the economy. Having the euro currency used to be a clear strength compared to e.g. Sweden, but this has now changed due to the turbulence in the euro area. In uncertain economic conditions, Finland's position as a small, peripheral and fairly illiquid market area also increases the risks related to the property markets.

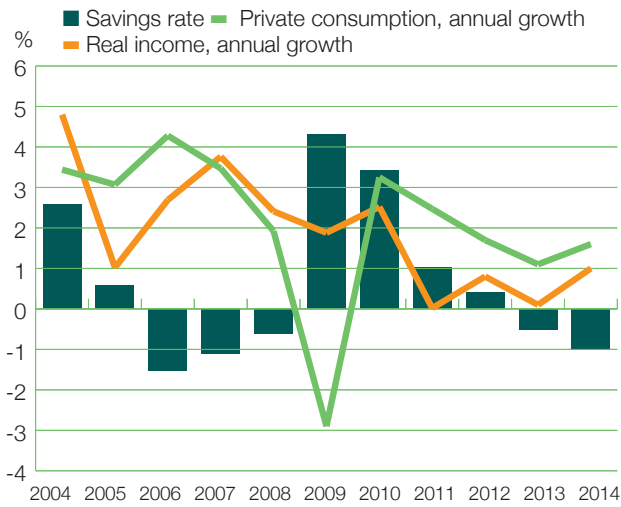
Key economic indicators, %

	2004	2005	2006	2007	2008	2009	2010	2011	2012**	2013**
GDP (change in volume)	4.1	2.9	4.4	5.3	0.3	-8.5	3.3*	2.7*	1.0	1.0
Exports	8.2	7.0	12.2	8.2	5.8	-21.3	7.5*	2.6*	-0.3	2.5
Inflation	0.2	0.9	1.6	2.5	4.1	0.0	1.2	3.4	2.6	2.4
Unemployment rate	8.8	8.4	7.7	6.9	6.4	8.2	8.4	7.8	7.6	8.1
Interest rates 3 months	2.1	2.2	3.1	4.3	4.6	1.2	0.8	1.4	0.6	0.3
Interest rates 10 years	4.1	3.4	3.8	4.3	4.3	3.7	3.0	3.0	1.8	1.6

* = preliminary ** = forecast

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

Households' real income, private consumption and savings rate



Source: Statistics Finland, Ministry of Finance

Supply does not meet the demand in the property investment market

Volume of transactions remains low

The volume of major property transactions amounted to ca. €1.6 billion at the end of the third quarter of 2012. Within the year, the peak of transactions was seen during mid-summer, as several major deals were published. The biggest transaction of 2012 was carried out by the Swedish-originated NIAM, which acquired the so-called Bronda portfolio, which consisted of 17 properties that filed for bankruptcy earlier in the spring. Other major transactions of the summer comprised acquisitions of an office property in Helsinki CBD by Cordea Savills, a business park in Espoo by Union Investment, as well as a department store in Turku by Keva.

During the autumn, the market has remained very quiet. There are, however, some major deals in the process, and these might close before year-end. The realisation of these transactions depends on both the shared views on pricing between the seller and the buyer, as well as on the availability of finance for the buyers.

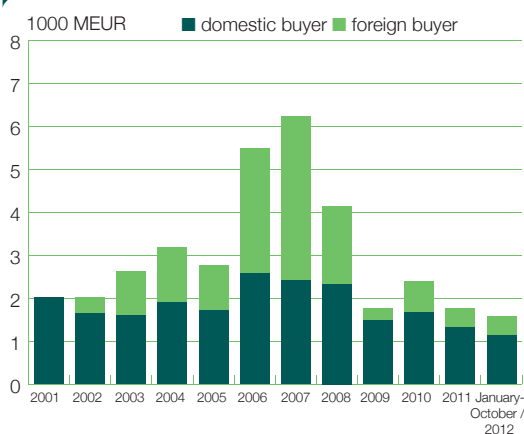
- Prime-yields remain stable
- Investors avoid risks
- Unavailability of debt slows the transactions market down
- The position of Helsinki CBD strengthened further

The position of prime assets remains strong

The continuity of the economic uncertainty increases the attractiveness of low-risk prime assets. Properties with secured cash flows and good locations attract institutional investors in particular, as bond yields remain at a very low level, and turbulence continues in the equities markets. Yields for the very best assets have compressed further, and in the RAKLI-KTI Barometer Survey, which was carried out in October, the quote for a prime office building in Helsinki CBD was 5.4%. This represents a decrease of 0.1 percentages since the spring.

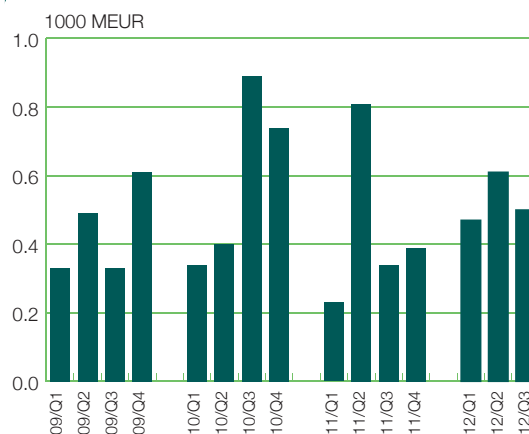
On the other hand, yields for secondary assets are facing upward pressures, and their liquidity remains low. The spread between prime and secondary properties has thus increased further. In this autumn's barometer survey, 88 per cent of the respondents stated that it was difficult or very difficult to sell a secondary asset in current market conditions. On the other hand, selling a prime asset was regarded as easy or very easy by more than 60 per cent of the respondents.

Transactions volume in the Finnish property market



Source: KTI

Quarterly transactions volume



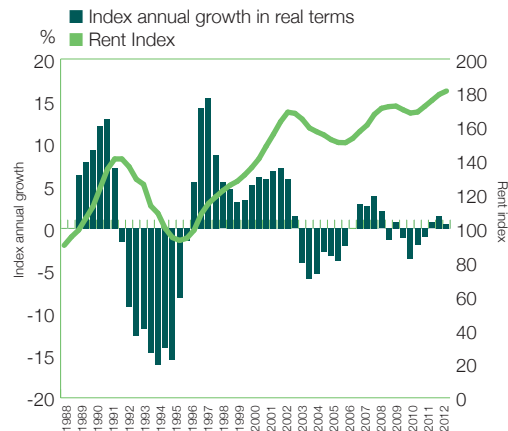
Source: KTI

Volume of distressed sales set to increase?

The liquidity of the market is constrained by the scarce supply of prime assets for sale. Secondary assets, which are offered in the market, on the other hand, do not attract investors. The unavailability of debt for higher risk profile properties also effectively prevents transactions from happening.

In the next couple of years, some €6-7 billion of property debt is estimated to terminate. A significant part of this debt will not be refinanced by banks, which are facing increasing regulatory constraints. A major part of the terminating debt is also related to secondary properties, for which there is not much investment demand. Therefore, the prices of these properties will probably face increasing downward pressures. The magnitude of the needed cuts in prices depends on both the market sentiment at the time of the sale as well as on the specific characteristic of the asset and the number and type of its potential buyers. Some part of the highly leveraged assets will probably be put in the market by the lenders, who want to settle their accounts despite the losses being realised. However, the volume of distressed sales is not expected to be a significant level.

Office rent index
Helsinki CBD offices, index 1993=100



Source: KTI, Statistics Finland, Ministry of Finance

The attractiveness of Helsinki CBD remains strong also in the rental markets

The deteriorating economic cycles seem to not affect the position of Helsinki CBD in the rental markets. At the same time, when many submarkets suffer from increasing vacancies and decreasing rental levels, new peak levels of office rents in Helsinki CBD are being recorded. In the KTI rental database, the upper quartile of office rents in Helsinki CBD exceeded €28 per sq m per month. The KTI office rental index for Helsinki CBD shows an annual increase of 3.1 per cent. The increase has slowed down a bit during the last six months.

In addition, the retail rents are holding well in CBD; although the rental activity has focused recently on larger premises, where rents per square metre are typically lower. Rents in CBD are expected to continue increasing also in the future. In all other areas, however, expectations for rental development are either stable or slightly negative.

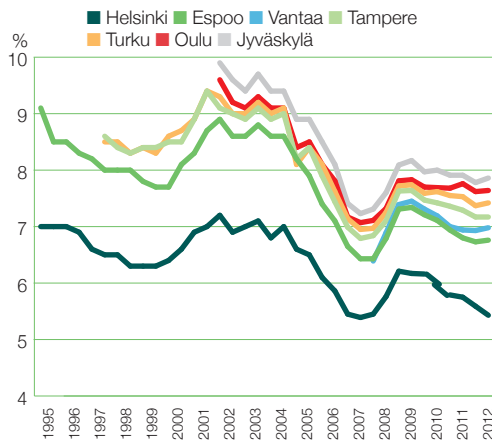
New development increases the office stock

At the end of September, there were ca. 230,000 sq m of office space under construction of major redevelopment in the Helsinki metropolitan area. New offices are being built in e.g. the Töölönlahti area in the Helsinki CBD, by the new western metro line in Espoo, as well as in the airport area in Vantaa. Significant redevelopment projects are being carried out e.g. in the CBD, Ruoholahti and Kamppi areas. Within the past year, some 170,000 sq m of office space has been completed. The demand for new and redeveloped premises in good locations remains strong in the rental market. The completion of newly built offices will thus increase the vacancy rate in the older office stock further.

Operating costs continue increasing

In addition to the high vacancy rates, the increasing operating costs also create downward pressures for property owners' net incomes. The operating costs of office properties increased by 9% in 2011, according to KTI operating cost index. During the last ten years, the average annual growth has been ca. 4%. While the rents are increasing only in the best office locations, it is essential for investors to find ways for decreasing the costs.

Prime office yields in major Finnish cities



Source: RAKLI-KTI Barometer Survey

Commercial properties under construction in Helsinki Metropolitan Area in September 2012

Rentable area, sqm



Source: KTI, RPT Docu Oy

What to do for vacant offices?

Many owners of office properties have to evaluate if it is possible to redevelop the property into some different use, or whether the property should even be demolished. During the last five years, about ten office properties, with a total area of ca. 50,000 sq m, have been redeveloped into hotels in Helsinki. Some offices have also been redeveloped into residential use, and a couple of office properties have been completely demolished.

Outlook for new development is deteriorating

Retail construction in the Helsinki metropolitan area is currently characterised by major redevelopment projects, which are being carried out in e.g. Forum, Itis, and Ruoholahti shopping centres, as well as in the Tapiola area in Espoo. There are no major new development projects going on currently. The uncertain economic outlook decreases the construction activity both in the residential and commercial property markets. With regard to new housing development, construction companies react quickly to changes in demand. Moreover, the interest in the development of subsidised rental housing remains low.

Increase in residential rents stopped?

Residential rents have increased significantly in all major cities during the past few years. Despite the continuous scarcity of rental housing, the increase in rents seems now to have slowed down, or even stopped in some areas. The uncertainty of the economic outlook, together with the increasing unemployment and decreasing consumer confidence seems to have set a limit now for the tenants' ability and willingness to pay. Tenants search for cheaper options, which can be seen in decreasing demand and increasing pressures for lowering rents also in better locations. In the RAKLI Residential rent barometer survey, carried out in August, the respondents were still confident about the continuous increase in rents. These expectations seem to, however, prove to be unrealistic in the current market conditions.

- Residential rents continue increasing in the best areas in Helsinki
- In Vantaa, rents started decreasing during the summer
- Increase in rents slowed down or stopped in all major cities

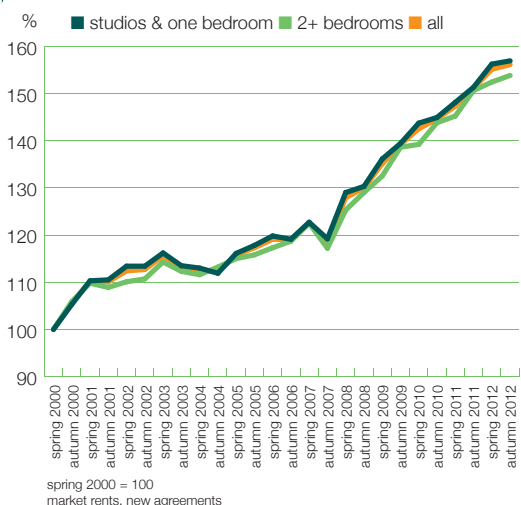
Increase in rents continue in the best areas in Helsinki

The best areas in Helsinki differentiate from the others also in the residential rental markets. Although the increase in rents have slowed down significantly even in these areas, they still continue to increase. The KTI residential rent index shows an annual increase of 4.2 per cent throughout all of Helsinki, whereas the change during the past six months only amounted to 1.8 per cent. In the best areas, rents increased by more than 2 per cent during the past six months, whereas in the other areas, rents have remained stable.

Rents decreased slightly in Vantaa

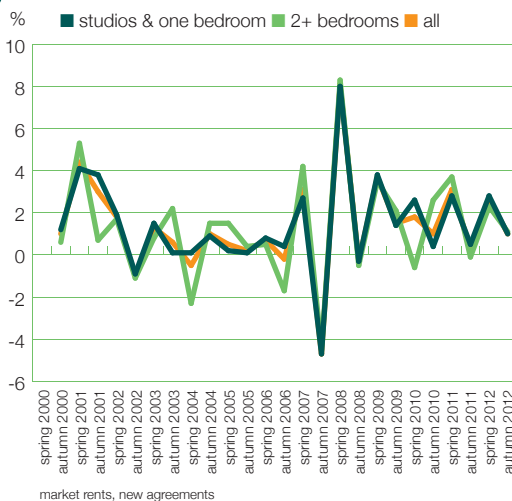
In Vantaa, new rental agreements have recently been made at lower levels compared to the previous six months. Demand for bigger apartments in particular has slowed down and rents have had to be adjusted downwards. For the whole year, the KTI Rental index shows an increase of 0.3 per cent. In Espoo, rents have remained stable during the past six months.

KTI Residential rent index
Helsinki Metropolitan area



Source: KTI

KTI Residential rent index
Semiannual growth, other large cities
(Tampere, Turku, Oulu, Jyväskylä and Lahti)



Source: KTI

Similar development in all major cities

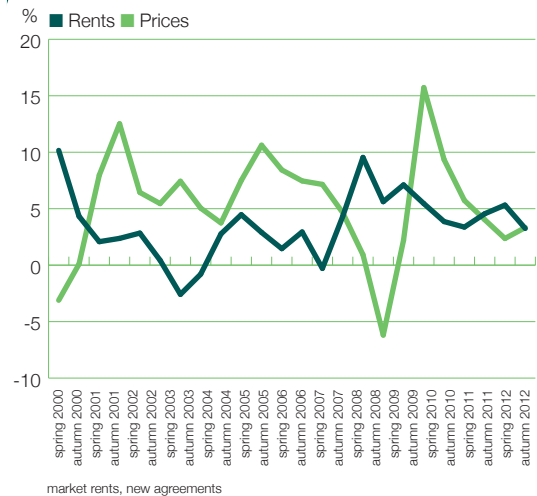
The KTI Rental indexes show a similar picture for all major Finnish cities. During the past six months, rents in new contracts have remained stable or continued increasing slightly in Tampere, Turku, Oulu and Lahti. In Jyväskylä, rents have even decreased slightly. The annual index shows an average increase of 3.7 per cent for all major cities and, during the latter half, the increase was only 1.0 per cent.

Demand for rental housing remains strong

In the first place, the pressures in the rental markets result as an increase in tenant turnover, as tenants are eager to search for cheaper options. As the demand still exceeds supply in rental markets, occupation rates of residential portfolios remain typically high. Supply is not expected to increase significantly, as the outlook for subsidised production in particular remains fairly negative. New development is mainly focused on free market rental housing stock.

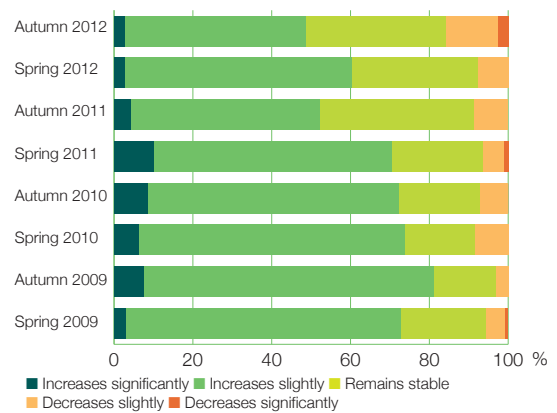
Housing prices have also stabilised due to the deterioration of the economic outlook. Low interest rates support housing prices. The outlook for the development of housing prices and rents have awakened somewhat controversial opinions. The economic uncertainty effectively increases the opaqueness also in the residential sector.

Residential rents and prices in Helsinki Metropolitan Area, Annual change, old apartments



Source: KTI, Statistics Finland

Expected development of rental apartment supply within next 12 months



Source: RAKLI Residential property barometer

Rental market activity remains rather high in the largest cities

Large regional differences in HMA office occupancy rates

The amount of vacant space remains high in Helsinki Metropolitan Area (HMA), due to abundant new supply and low space demand. In September, there were 40,000 sq m more vacant office space in HMA than six months earlier, according to the KTI database. However, the regional differences are significant. In the best office submarkets, the occupancy rates are well above 90%, but in some areas even below 65%. The amount of vacant space has increased for more than 10,000 sq m, for example in Ruoholahti, Keilaniemi, and Tapiola. The most positive development has been witnessed in the Vallila area, where vacant office space had decreased by over 11,000 sq m from the spring. Furthermore, in Helsinki CBD the occupancy rate is above 90%.

- Helsinki CBD remains attractive
- Office gross take-up at low level in Helsinki area
- Office occupancy rates decreasing in Tampere
- New retail space in Turku

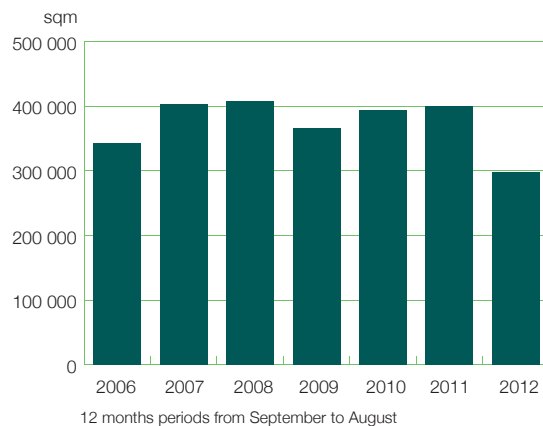
The amount of signed lease agreements has been rather high, but gross take-up has remained low, because a large number of the contracts has been the renegotiations of old lease agreements. The office gross take-up in HMA was ca. 300,000 sq m during the last 12 months, which is over 100,000 sq m less than in the previous year.

Office rents increasing only in CBD

The rental levels of new office lease agreements have continued to increase in the CBD area. Also in the best office submarkets in Espoo the development of rents has been positive. In many areas, however, the office rents are stable or decreasing. Ruoholahti is an example of an office area, where the rents of new agreements have decreased slightly.

The respondents of RAKLI-KTI Barometer Survey expect that office rents in Helsinki CBD will increase by approximately two per cent within next 12 months. In other office submarkets in HMA the rents are expected to decrease slightly. More than half of the respondents expect that the amount of vacant office space will increase during next winter.

Office gross take-up
Helsinki Metropolitan Area



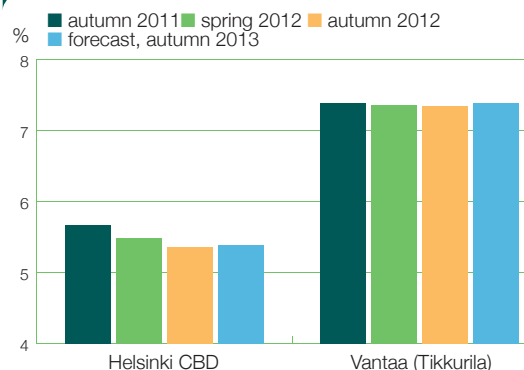
Source: KTI

Occupancy rates of retail properties remain high

The amount of vacant retail space in HMA has increased by ca. 1,000 sq m during the last six months. The occupancy rates are still close to 97% in all cities in the area: Helsinki, Espoo and Vantaa. In the CBD area, the amount of empty retail space has slightly increased, but the occupancy rate is also there above 96%. The respondents of the barometer expect that the amount of vacant space is about to remain stable.

According to barometer, the prime retail yield in Helsinki CBD has decreased from spring almost 0.15 percentage points, to less than 5.4 per cent. The difference for other submarkets is significant. For example, in the regional centre of Tikkurila, the retail yield is assessed to be almost 7.4 per cent.

Retail property yields



Source: RAKLI-KTI Barometer Survey

Plenty of new office lease agreements in Tampere

In the Tampere city centre area, the leasing activity of office premises has been higher than in the previous periods. The demand has mostly targeted larger office spaces. The rental levels have remained stable. The median rent of new office agreements in the city centre area is ca. 14 euro per sq m per month.

The respondents of RAKLI-KTI Barometer Survey are expecting the rental levels to remain stable or slightly decrease during the winter. The occupancy rates have also started to decrease. The amount of vacant office space has increased for example in the Hervanta area where Nokia has moved away. In retail premises, however, the development has been positive, and the occupancy rate has increased to 97.6%. KTI has also conducted a regional barometer survey in Tampere, in co-operation with Catella and, according to that survey, the regional property market professionals expect that empty space will increase in all property types within the next year.

The prime office yields have remained stable, slightly above 7%. Investment market has been rather vivid. During this year, more than ten commercial property transactions have been completed in Tampere and its neighbouring cities.

Activity in Turku retail property markets

In Turku, the supply of retail space is increasing. Especially large, "big box" type of retail properties are being built outside the city centre. In the city centre area, a couple of retail properties have been redeveloped, and the amount of new lease agreements has increased, due to the completion of these projects. In the summer, CapMan's fund sold the property of Stockmann department store to Keva.

In offices, the number of new agreements has been low in the city centre area. The amount of vacant space has increased in office and industrial premises. The respondents of the RAKLI-KTI Barometer Survey expect that rents will slightly decrease in all property types.

Oulu, Jyväskylä, Kuopio and Lahti

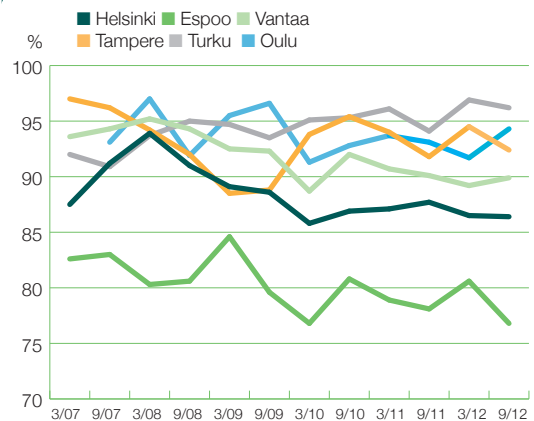
The rents of new office lease agreements have slightly increased in the central area of Oulu. However, more than 40% of the barometer's respondents predict office rents to decrease during the next six months. The occupancy rates have improved in all property types. For example, in the Limingantulli area, many new contracts have been signed from both office and retail premises.

In Jyväskylä, only few property transactions have been completed during this year. Office prime yields have increased close to 8%. The amount of new lease agreements has been low in offices, but above average in retail premises. Both in offices and retail premises there is now more vacant space compared to spring.

Also in the city centre of Kuopio a lot of new retail lease agreements have been made. The rents of new agreements have decreased slightly. The supply of retail space has increased in Kuopio in recent years, and there is still new Ikano shopping centre under construction. The occupancy rates of both office and retail premises are lower than in other large cities.

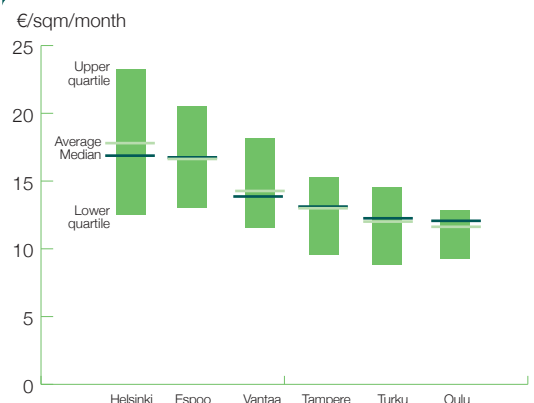
In Lahti, the amount of vacant space has slightly decreased both in retail and office properties. The number of new lease agreements has been lower than in the previous years. The new headquarters of L-Fashion Group is about to be completed in the Renkomäki area.

Office occupancy rates



Source: KTI

Office rents in largest cities New agreements



Source: 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, the Finnish Association of Building Owners and Construction clients.

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