KTI Market review *autumn* 2014

- Transactions activity increasing in the Finnish property market
- Finland attracts foreign investors
- Increasing challenges in commercial property rental markets
- Residential rents continue increasing

KTI - High quality property information

KTI Market Review – autumn 2014

The current development of the property investment market differs significantly from that of rental markets. Weak economic conditions are reflected in the commercial property rental markets in particular. Property investment markets have, however, shown increased activity during the summer and autumn. The Finnish market has attracted foreign investors and domestic players are restructuring their property portfolios. Low interest rates and improving availability of debt financing support the inflow of capital in the property markets.

Transactions activity is at its highest level since 2008. Volumes have increased mostly due to a few individual large transactions, the biggest of which is the foundation of a new property company Certeum in September. New domestic funds are also increasing their portfolios. During the year, a few new significant foreign investors have entered the market. The Finnish market attracts Swedish and German investors in particular. Strong investment demand has created downward pressure on prime property yields.

In the office markets, weak economic conditions, together with increased space efficiency, continue decreasing rental demand. In the retail markets, weakening consumer confidence and consumption start pushing rents down and the amount of empty space has started to increase. The negative development is expected to continue, and rents are expected to decrease and vacancy rates increase in both office and retail markets.

Due to negative economic development, construction activity is decreasing in 2014 and 2015. Residential construction has slowed down due to weak consumer demand. Residential property funds are lowering the hurdle for new construction starts through co-operation with construction companies. Commercial property development has slowed down by corporations' low investment volumes, as well as by unused space capacity in vacant or underutilised space. Ongoing commercial property development projects are strongly driven by tailored tenant solutions and / or new traffic connections.

In the residential property markets, rents continue increasing, although at a slower pace than in previous years. Increases are most significant in Helsinki metropolitan area; in other major cities, increases continue but have slowed down. The development of new rental dwellings is concentrated on non-subsidised stock. Low availability of plots, as well as slow planning processes and tight construction regulations remain the biggest obstacles for rental residential development.

Economic conditions remain challenging

The Finnish GDP development is expected to remain in negative territory for the third consecutive year. Any significant signs for improvement are yet to be seen. Due to the weak outlook, Standard & Poor's decision to lower the Finnish rating to AA+ was not a big surprise. The immediate impact of this decision seems, however, to be insignificant.

In the current situation, economic uncertainty has been fueled by the crisis in Ukraine and the economic constraints executed on Russia due to the crisis. Because of active economic relations, Russian economic development and EU actions have a significant impact on the Finnish economy.

- Economic outlook has weakened since last spring
- Investment volumes are decreasing in all fronts
- Low interest rates and abundant availability of finance support property investments

Finnish economic development is dependent on exports, which have still not started to increase. The demand for the Finnish exports has decreased due to the slow economic development in Europe, as well as the tight conditions in Russia. The outlook remains generally uncertain. If exports start to increase next year as expected, by 2-3 percent, it will push the Finnish GDP growth slightly positive in 2015.

Investment volumes are decreasing

In addition to exports, other components of economic growth also continue to develop sluggishly. The volume of investments is expected to decrease for the third consecutive year. Both investments in production as well as in construction are expected to fall compared to 2013. Investments are not expected to pick up next year either, as the potentially increasing demand can probably be satisfied with existing production capacity. This is most likely true also for space demand, where there is a lot of underutilized capacity due to decreasing employment and increased space efficiency. Investment in residential development is slowed down by minimal growth of households' purchasing power. Alongside this, public investments are being cut down due to the state's and municipalities' tight economic situation.

Key figures – Finnish economy, %

	2006	2007	2008	2009	2010	2011	2012	2013	2014**	2015**
GDP (change in vol)	4.1	5.2	0.7	-8.3	3.0	2.6	-1.5*	-1.2*	-0.5	0.3
Change in exports	10.1	9.1	6.6	-20.1	6.2	2.0	1.2*	-1.7*	-0.2	2.1
Inflation	1.6	2.5	4.1	0.0	1.2	3.4	2.8	1.5	1.0	0.4
Unemployment rate	7.7	6.9	6.4	8.2	8.4	7.8	7.7	8.2	8.7	9.0
Interest rates										
3 months	3.1	4.3	4.6	1.2	0.8	1.4	0.6	0.2	0.2	0.1
10 years	3.8	4.3	4.3	3.7	3.0	3.0	1.9	1.9	1.4	1.0

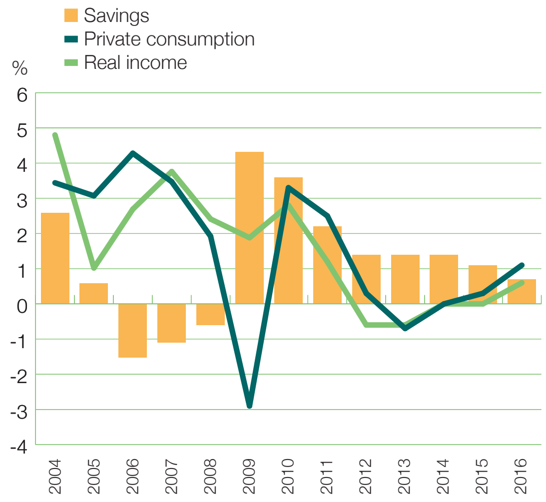
* estimate
** forecast

Source: Bank of Finland, Statistics Finland, PT, Nordea

Retail sector facing challenges

The outlook is sluggish also for private consumption. Worsening unemployment has decreased households' purchasing power and overall consumer confidence. The official unemployment rate has now exceeded 8 percent, and hidden unemployment, which is not captured by the statistics, has also increased sharply. Retail sales are expected to decrease this year, which increases the challenges in the retail space markets. If consumer confidence starts to strengthen, private consumption can be expected to increase slightly in 2015.

Private consumption, real income and savings, *annual change, %*



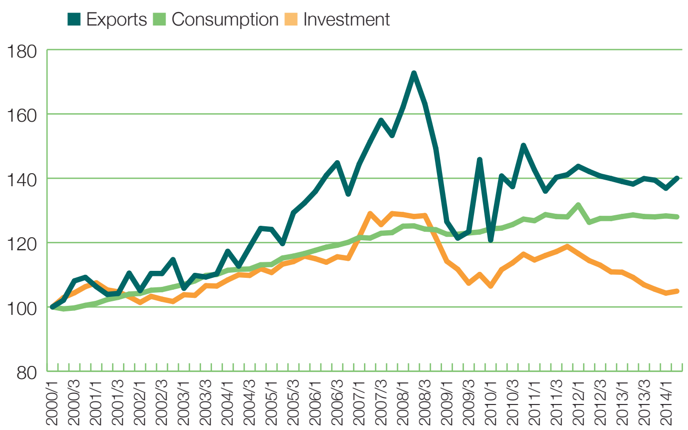
Source: Statistics Finland, Ministry of Finance

Low interest rates support property investment markets

Due to the expansionary actions taken by the European Central Bank, the availability of finance for property investments has improved markedly during the past year. Low interest rates also increase the relative competitiveness of property investments compared to, for example, bond and money market investments.

Due to the challenging economic conditions, inflation is expected to remain slow, at some 1 percent in 2014 and 2015. This inflation is mostly a consequence of tightening taxation. In 2016, inflation is expected to accelerate slightly due to an improving economic outlook.

Development of exports, consumption and investment
volume index 2000 = 100, seasonally adjusted



Source: Statistics Finland

Property transaction volumes are increasing

The total volume of property transactions amounted to some EUR 2.9 billion at the end of the third quarter of 2014. This is more than double compared to the volumes in 2013. In October, the total volume exceeded EUR 3 billion. This is – by far – the highest volume since 2008.

The largest individual transaction of 2014 is the foundation of a new logistics and industrial property investment company Certeum Ltd. Upon its foundation, the company purchased 124 properties from Sponda, Varma and three property funds managed by Sponda. The total value of the portfolio amounts to EUR 917 million. Even without the Certeum transaction, this year's total volume would have been more than 60 percent higher than that of the first three quarters of 2013.

- Competitive yields attract foreign investors
- New property funds increase their portfolios
- Availability of debt has improved
- Negative outlook for retail rental markets
- Construction volumes decreasing

Foreign investors increase their activity

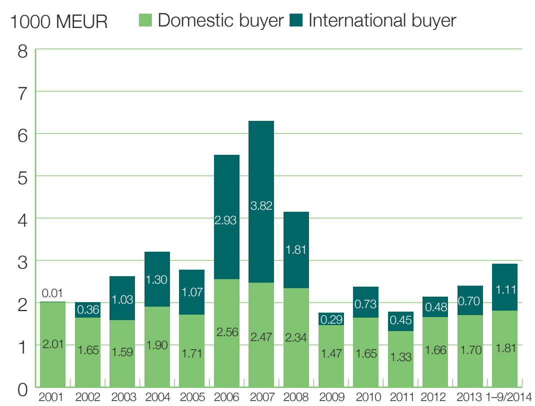
The share of foreign investors amount to 38 percent of all transactions. Measured in euros, the volume of foreign investors' transactions is – already at the end of September – higher than any annual volume since 2008.

The biggest newcomer in the Finnish market is the Swiss Partners Group, which purchased all remaining retail and office properties of the Niam III fund for EUR 240 million. Niam has, on the other hand, continued to increase its other funds with two large office property acquisitions. Redito is another active Swedish investor, which has continued to increase its Finnish portfolio with acquisitions from HOK-Elanto and Sveafastigheter.

Euro currency and competitive yields attract foreign investors

Net yield for a prime office in Helsinki is some 100 basis points higher than in Stockholm, which is a strong sales argument in current market conditions, where investors appreciate annual cash flows. In the world of turbulent currencies, the euro also strengthens the competitiveness of Finland compared to the other Nordic markets. The strong interest of foreign investors is expected to continue also in the future. Of the respondents of RAKLI-KTI Property Barometer, some 60 percent believe that foreign investment demand will increase in the coming 12 months. This supports the total transactions volumes, which are also expected to increase, especially in the office and retail property sectors.

Transactions volume in the Finnish property market



Source: KTI

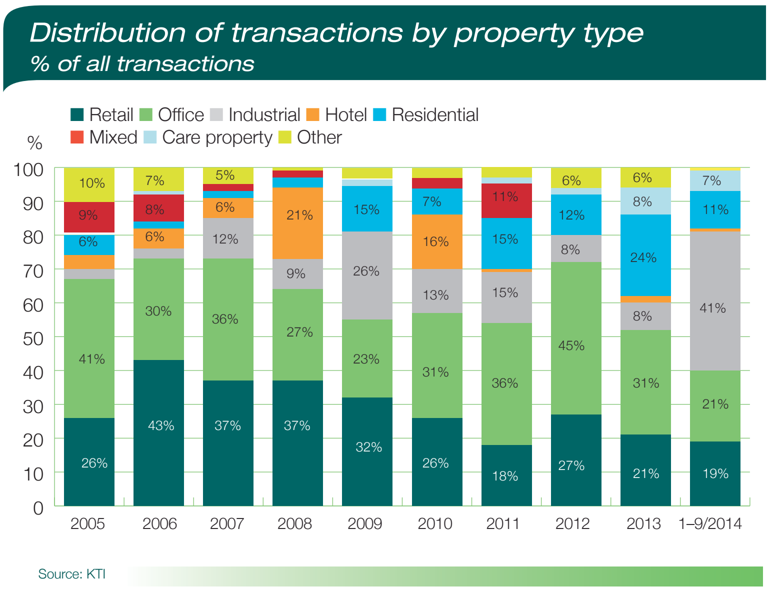
The diversity of property sectors has increased in the transaction market. The Certeum transaction, together with a couple of other major deals, increased the share of logistics and industrial properties to more than 40 percent of all transactions. The traditional office and retail sectors' shares stand at some 20 percent for both sectors. Residential properties have maintained their attractiveness in the investment market, although their share is significantly lower than last year, at some 11 percent. Many investors continue increasing their residential property allocations through new developments, which are not recorded in the transaction statistics.

Domestic property funds continue to increase their portfolios

New property funds are increasing the number of players in the investment markets. New mutual special funds investing in property, which are also marketed to private investors, have increased their popularity during the past year. The biggest funds in this sector include eQ Care property fund, Ålandsbanken's residential fund, as well as OP-Rental Yield, which invests in both residential and commercial properties.

New funds – typically limited partnerships – have also been established in the institutional investment markets. For instance, Pohjola Property Management founded a new fund – Suomi Toimitilakiinteistöt Ky – which acquired a EUR 100 million portfolio of logistics and industrial properties in the summer. Also Kesko, one of the big retail chains in Finland, has announced that it plans to establish a EUR 750-950 million property fund, for which it would sell shopping centers and other retail properties in Finland and Sweden.

Altogether, domestic property funds have purchased some EUR 500 million worth of properties in 2014. Domestic institutions' share is, on the other hand, exceptionally low – some 1 percent of all transactions, which reflects the change in their strategies towards indirect and non-domestic investments.



Strong investment demand creates downward pressure for prime yields

In the RAKLI-KTI Property Barometer survey, carried out in October, the yield for prime office property in Helsinki CBD was recorded at 5.3 percent, which is slightly lower than in last spring's survey. For the very best properties, the yields are even lower, with the lower quartile of responses standing at 5.0 percent.

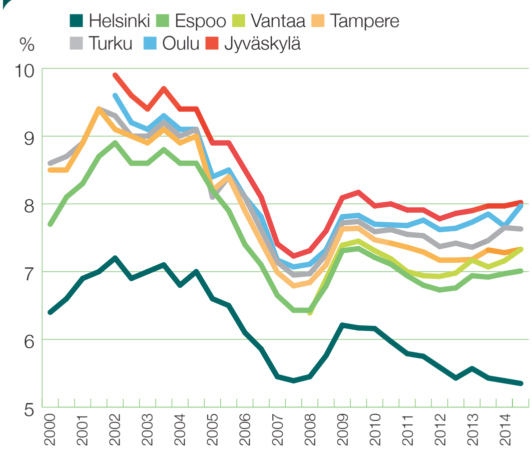
However, the increased investment demand has not – at least so far – pushed down secondary property yields. The premium between Helsinki CBD and other cities has continued to increase, with net yields for offices in Espoo, Vantaa and Tampere standing between 7.0 and 7.3 percent. In Oulu and Jyväskylä, the yields have increased to some 8 percent.

Low interest rates support property investments

The increased availability of debt finance is one of the drivers for increased transaction volumes. In the RAKLI-KTI Property Barometer, more than 60 percent of respondents assess that the availability of finance has improved and interest margins have lowered in the past 12 months. Loan-to-value ratios remain, however, significantly lower than before the financial crisis. Banks are also very selective with regard to financed assets and clients, and for risky assets, it still remains difficult to get bank finance.

The biggest investors acquire financing increasingly through bond issues. The listed companies Sponda, Citycon and Technopolis, as well as big residential companies SATO and VVO have utilized bonds, and they currently have some EUR 2 billion worth of bonds issued altogether.

Prime office yields in major Finnish cities



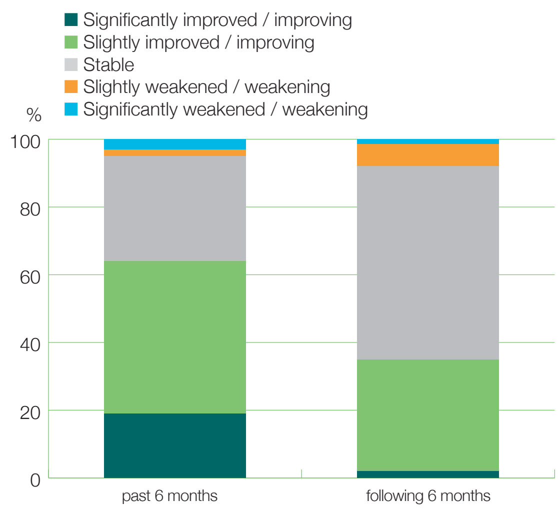
Source: RAKLI-KTI Property Barometer

Weak space demand challenges office rents

The weak economic conditions are clearly reflected in the commercial property rental markets. In the RAKLI-KTI Property Barometer, more than half of the respondents say that the vacancy rate in the Helsinki metropolitan area offices has increased during the past six months. In the rest of Finland, the figure is even higher – around 60 percent. The outlook is also negative. In the KTI Rental database, the occupancy rate of offices currently stands at some 85 percent for the whole country.

The weak demand is also seen in the rental levels, where the negative outlook has now also spread to the Helsinki CBD. Some 25 percent of the respondents assess that CBD office rents have decreased during the past six months. In the survey, the market rent of a prime office is now recorded at EUR 28 per sqm, which is about one euro lower than in the spring this year. In Espoo and Vantaa, some two thirds of the respondents say that rents have decreased. The outlook remains negative for all regions.

The development of the availability of bank financing in the past 6 months / following 6 months?
Distribution of responses, %



Source: RAKLI-KTI Property Barometer

Decrease in consumer spending and e-commerce increase challenges in retail markets

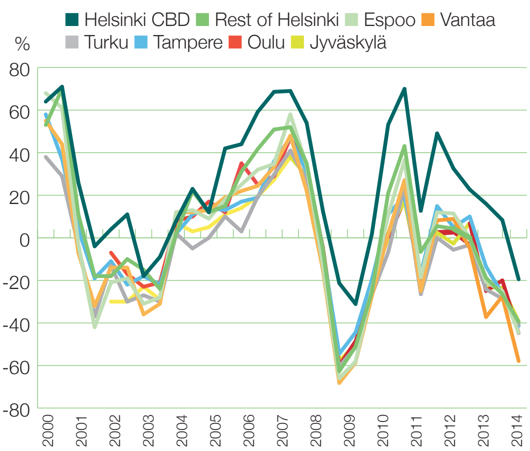
The change in market conditions and sentiment is even more dramatic in the retail space markets. Up until this barometer survey, the conditions in the retail market have remained much more positive than those of the office markets. However, the outlook has now turned negative in all areas – including the Helsinki CBD. More than 30 percent of the respondents assess that the rents will decrease in the coming six months, while some 50 percent think they will remain stable. In Espoo and Vantaa, the outlook is more negative than in Helsinki, and the majority expects rents to fall. The majority of respondents expect retail vacancy rates to decrease within the next six months.

The best shopping centres seem to suffer less from market conditions than other types of retail space – at least so far. According to the market data of the Finnish Council of Shopping Centers and KTI, the amount of visitors and sales has remained quite stable. There are, however, significant differences in the development of sales between different types of retailers.

Construction volumes decreasing

Despite oversupply, there are some significant office development projects going on in the Helsinki metropolitan area. In total, ongoing projects will increase the office supply by some 120,000 sqm. Despite this, the outlook for new construction is quite negative. The Confederation of Finnish Construction Industries RT estimates that construction volumes will decrease by some two percent this year compared to 2013. The outlook is becoming even more negative, and volumes are expected to decrease also in 2015. Office construction is pressured by oversupply and retail construction by weakening consumer demand. Residential construction activity is pressured by increasing unemployment and decreasing consumer confidence.

Outlook for retail rents
Balance figures



Source: RAKLI-KTI Property Barometer

Residential rents continue to increase

Demand for residential rentals remains strong in all major cities. In the RAKLI Rental residential barometer survey carried out in August, the outlook for rental development was significantly more positive than last spring. The demand is still the strongest for small apartments. In the Helsinki metropolitan area, also rents for larger apartments are expected to increase slightly. In other major cities, however, expectations for rental development of large apartments are mostly negative.

- Supply for private rental housing is increasing
- Rents for small apartments continue to increase in the Helsinki metropolitan area
- Residential property investment attracts property funds and institutional investors

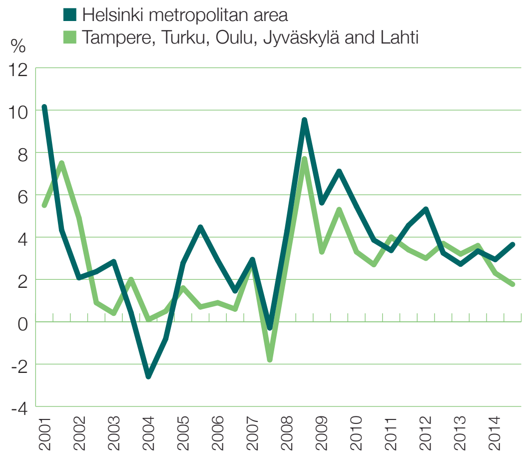
Rents increasing in Helsinki metropolitan area

According to the KTI residential rent indices, the annual increase for rents in new agreements amounted to some 3.6 percent in Helsinki metropolitan area. The increase has been most prominent in Vantaa, where new stock has driven the rents up by some 6 percent, as well as in Espoo, with an increase of almost 5 percent. In all of Helsinki, the annual increase was 2.3 percent.

Outside the Helsinki area, rents have increased most in Tampere, by some 5 percent during the past year. In Turku and Lahti, the increase amounted to some 2 percent, whereas in Jyväskylä and Oulu the increase was only 0.7 percent and 0.3 percent, respectively.

KTI Residential rent index

Annual change, HMA and other large cities



Index, spring 2000 = 100
Market rents, new agreements

Source: KTI

Examples of residential rents in Helsinki metropolitan area, September 2014

Median rent and quartile range for new agreements

	Helsinginniemi & Töölö	Leppävaara	Tikkurila & Viertola
Studio, 30 sqm	783 727 – 873	692 657 – 725	583 564 – 701
One bedroom, 50 sqm	1,114 994 – 1,253	933 836 – 1,004	878 820 – 955
Two bedrooms, 70 sqm	1,425 1,349 – 1,556	1,136 1,040 – 1,210	1,075 985 – 1,141

median
lower quartile – upper quartile

Source: KTI

New construction is limited to private rental apartments

The Confederation of Finnish Construction Industries RT estimates that new housing construction starts will be limited to some 25,000 dwellings this year, which is some 3,000 less than in 2013. In 2015, new starts are expected to decrease even more. In 2014, some 6,500 state-subsidized dwellings will be started. According to RT, the number of unsold completed apartments has increased markedly, which increases the hurdle to start new developments.

Property funds investing in rental residential have increased their portfolios actively both through own development and investment in existing properties. New construction is currently concentrated on private rental dwellings, as the terms for state-subsidised housing remain too restrictive. The Finnish government is about to introduce a new framework for a 20-year subsidized loan term, but even this model is not expected to increase state-subsidised housing development, as it is considered to be too restrictive and does not include any true incentives for suppliers. Another reform is that pension funds will be allowed to use debt finance in residential property investment. These rules have received more positive feedback from market participants, even though the three-year expiration period for this liberalization is considered to be too short.

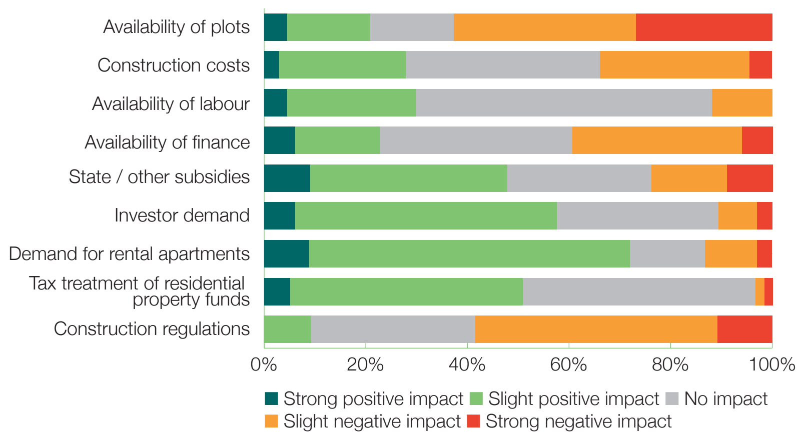
Availability of plots remain a serious bottleneck for housing construction

In the RAKLI Rental residential barometer, the limited availability of plots was still considered as the biggest hurdle for new rental housing construction. Market participants plead for more flexibility in planning and implementation of building regulations, which is also considered to be the biggest driver for the increase in construction and housing cost. In planning procedures, more flexibility is also needed for cases where the use of a building needs to be changed, for instance in order to enhance the possibilities to redevelop vacant office buildings for residential use.

Strong rental demand, improved availability of finance and low interest rates were seen as the most important factors supporting new residential development. Therefore, the market participants would be willing to start new projects to ease the lack of rental apartments in the Helsinki metropolitan area. However, significant increase in new production would require increased flexibility for planning processes and construction regulations.

Drivers affecting rental residential construction

How will the following drivers impact the construction of rental residential properties within the next year?



Source: RAKLI Rental residential barometer, autumn 2014

Regional commercial property markets

Helsinki metropolitan area offices

- The rents of top premises still increasing in Helsinki CBD
- Some significant commercial property development projects under construction in all largest cities
- Expectations of space demand development mostly negative

Investor interest towards the Helsinki metropolitan area (HMA) offices has remained high. This year almost 20 office transactions have been concluded in the HMA. The largest deal has been Deka's EUR 176 million acquisition of Sanoma House in Helsinki CBD in early spring.

Office occupancy rates have remained low, at 82.6 percent in the whole HMA in September. The amount of empty office space has increased for example in the Sörnäinen, Niittykumpu and Aviapolis areas but on the other hand decreased in e.g. Keilaniemi and Pasila submarkets. In addition to offices, the occupancy rates have decreased close to 80 percent also in HMA industrial premises.

However, there is still demand for modern office space. Currently, there are a half dozen new office projects under construction in the HMA. For example OP-Pohjola Group, Sponda, Technopolis and Peab Invest are developing new offices. In the Tikkurila area, Etera and Nordic Real Estate Partners have invested in the Dixi commercial centre, comprising both office and retail space.

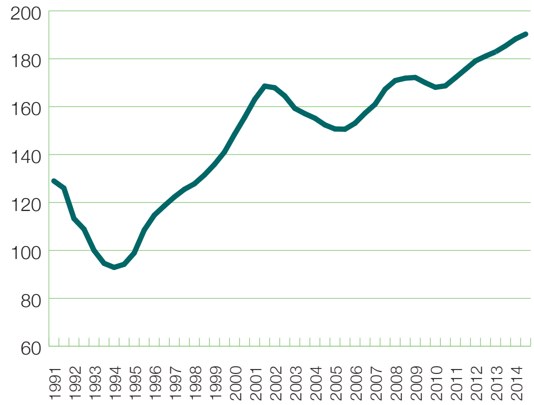
The respondents of RAKLI-KTI Property Barometer survey expect negative development for office rents, but according to the KTI Office Rental Index, the rents of new office agreements in the Helsinki CBD have still increased by 2.6 percent during last 12 months, and by 1.1 percent during last six months. The upper quartile of new office rents has increased to 30 euro/sqm/month. In addition to the CBD area, several new office lease agreements have been signed for example in the areas of Leppävaara, Pasila, Pitäjänmäki and Lauttasaari. In Leppävaara and Pasila the median rents for new lease agreements have been approx. 18 euro/sqm/month, but in Pitäjänmäki and Lauttasaari regions they have been only approx. 12-13 euro/sqm/month.

Helsinki metropolitan area retail

The amount of empty retail space has increased by 9,000 sqm during March-August in the Helsinki central area, but some large premises will be occupied during this autumn. The retail occupancy rate has remained above 95 percent in the HMA. The number of new retail lease agreements has been low, and median rents for new lease agreements have decreased in many submarkets. In the Helsinki CBD, however, a few agreements have been signed on prime retail spaces in the best locations, and therefore the rents for new lease agreements have increased.

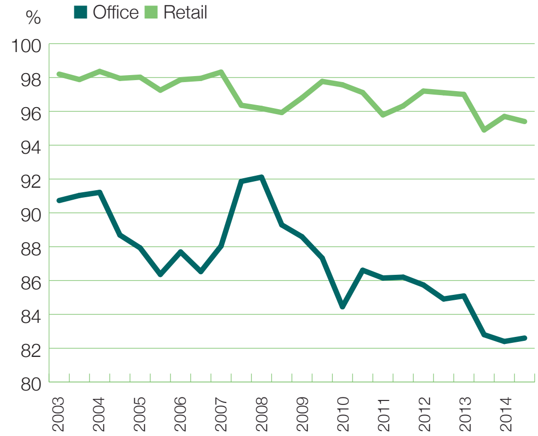
Retail property development is active especially in the areas next to the new western metro line. In Lauttasaari and Tapiola, some old retail properties have been demolished, and new shopping centres are currently under construction. In Matinkylä, the extension project of Iso Omena shopping centre is underway. Citycon currently owns the whole shopping centre, since it acquired the 40 percent share of GIC this October. This has been the largest retail property transaction in the HMA this year.

KTI office rent index, Helsinki CBD
1993=100



Source: KTI

Occupancy rates in Helsinki metropolitan area



Source: KTI

Tampere

In Tampere, there are a couple of large ongoing development projects close to the city centre. Technopolis is developing 11,900 sqm of new office space, and a 4,000 sqm extension of the Stockmann department store will be completed soon. In October, the almost 90-meter high hotel Torni Tampere was completed. The largest transaction of the year was signed in July, when Sponda acquired four office buildings in the Tulli Business Park from UBS. Retail occupancy rate has remained high, at 97 percent, but in offices the occupancy rate is only approx. 88 percent. The respondents of KTI Regional Barometer survey expect that occupancy rates will decrease in both offices and retail. Office and retail rents are expected to remain stable in city centre area.

Turku

In Turku, the outlook for office and industrial properties is rather stable, but the retail property market is more challenging. The strongest office submarket is the Kupittaa-Itäharju area, where 25 percent of the respondents of KTI Regional Barometer survey expect office rents to increase. The office occupancy rate is higher than in many other large Finnish cities, at 93 percent. In industrial premises, the respondents of the barometer survey expect slightly positive development for both space demand and rents. In retail premises, however, the space demand is expected to weaken and rents to decrease. Carlyle Group has sold two office properties this year in Turku: one to Turku Technology Properties and another to the group of local private investors. The most significant development project in the Turku region is the extension of shopping centre Mylly in Raisio.

Oulu

In Oulu, plenty of modern retail and office space is currently being developed in the city centre. Retail occupancy rate has remained at almost 97 percent, and the outlook for retail market is slightly positive. In office markets, occupancy rates have slightly decreased during summer, and the median rent for new office lease agreements is approx. 13 euro/sqm/month. The outlook for industrial property space demand and rents is negative. A couple of office and industrial property transactions have been completed this year.

Jyväskylä

The respondents of the KTI Regional Barometer survey expect the rents of both office and retail premises to decrease slightly in the Jyväskylä city centre. Only a couple of small property transactions have been made in the region this year. A new Prisma hypermarket will be developed in the Seppälä area, while Itella and Lidl will expand their logistics centres in the Jyväskylä region. The development of Kangas area, comprising a large amount of new apartments and working places, is expected to begin next spring.

Other cities

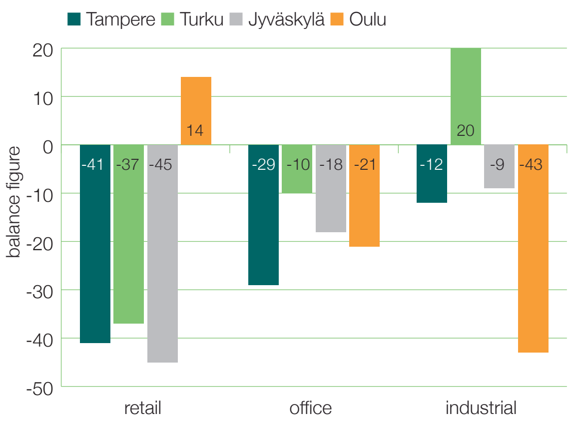
In Lahti, a 7,500 sqm office property BW Tower will be completed next autumn, and in the city centre there are also a couple of large office redevelopment projects underway. Nordic and Baltic Property Group acquired a 7,000 sqm office property in the summer, and Renor has bought a couple of industrial properties in Lahti.

The rental market has been rather active in the Kuopio central area. The median rent for new office lease agreements has been approx. 12 euro/sqm/month. Keva acquired IsoCee retail property in the city centre.

In the end of October, both the Puuvilla shopping centre in Pori and the Goodman shopping centre in Hämeenlinna opened up. In Lappeenranta and Vaasa, there are significant plans for development of the city centre.

Space demand growth expectations

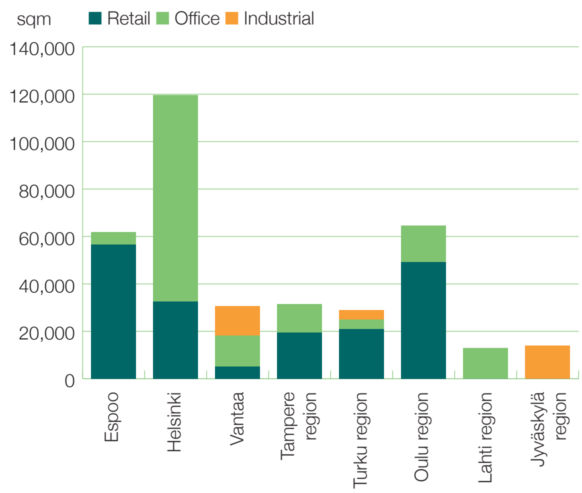
Tampere, Turku, Jyväskylä and Oulu regions, balance figures



Source: KTI Regional Barometer survey, autumn 2014

Commercial properties under construction

rentable area, sqm



Source: KTI, RPT Docu Oy

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 - High quality property information

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