KTI Market Review

Autumn 2020

Transaction volumes picking up after the summer
Prime yields recovered to pre-crisis levels
Uncertainty increasing in commercial property rental markets
COVID-19 strengthens existing trends in space usage
and creates new ones

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Property market recovered from the worst shock in the spring, but uncertainty blurs future prospects

COVID-19 pandemic will remain in history as the breaking news of 2020 from the perspective of both people's daily lives and health, the overall economy as well as property markets. The sharp restrictive measures taken in the spring and the sudden halt caused by them were followed by a calmer summer, and most areas of the real estate market recovered from the worst shock fairly quickly. However, the worsening pandemic statistics started to increase the uncertainty again in October.

Property transaction volumes froze almost to zero in the spring as a result of restrictive measures and increased uncertainty. During the summer and early autumn many processes interrupted in the spring have been restarted, and market activity has gradually picked up. Current exceptional market circumstances turn investors' interest mainly towards low-risk properties with secure cash-flows. This phenomenon was clearly visible after the global financial crisis, and is now picking up again. The large amount of capital seeking for returns strengthens the demand for property investment, and the yields for prime properties have already decreased to pre-crisis levels or even slightly below it. The liquidity of higher-risk properties is significantly weaker in current circumstances.

In the spring and early summer, landlords in retail and hotel sectors were busy negotiating and seeking solutions with tenants in order to overcome the worst of the crisis. As the situation has not eased as expected during the autumn, many discussions may now have to be reopened. In the commercial property markets, rental activity has not completely stopped, but with the crisis, the search for smaller premises in particular seems to be increasing, which is likely to increase the vacancy rate in the office and, above all, retail rental market, at least in the short term. The longer-term effects on space demand and lease terms will only be revealed in the rental market over time.

In the rental residential market, at least for the time being, the effects of the corona are hardly visible. The relative position of residential property investment is even strengthening, and the overall slowdown in construction activity is supporting the opportunities for new development of rental housing. The gloomy economic situation and growing supply will slow down the development of rents, but the continued population growth of the largest cities will strengthen the demand and maintain investors' interest in rental residential investment.

The uncertainty of the situation is reflected in economic forecasts

Finland still performing relatively well from both the pandemic and the economic situation viewpoint

Economic forecasts are now being made in conditions of great uncertainty. The forecasts for Finland's GDP growth for 2020 year published during the autumn range from -4 to -5 per cent, which is a relatively good figure in international comparison. Next year's forecasts are subject to great uncertainty, as both the development of the pandemic and its effects on various parts of the economy are still unknown. Next year's GDP forecasts released in September – during the short easening phase of the pandemic – predict a reasonably rapid recovery and, at the highest, a growth of some 3 per cent for 2021.

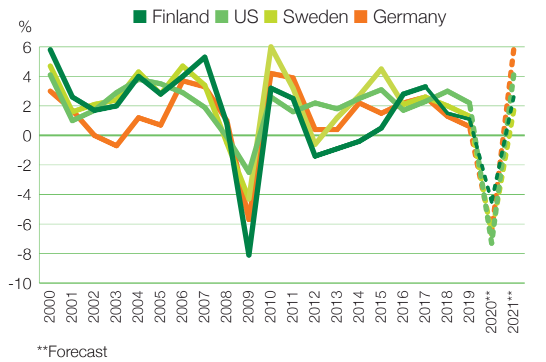
Of the various sectors of the economy, the fastest recovery is expected for private consumption, although the recovery in demand for private services in particular will largely depend on the duration and depth of the pandemic. Both the global demand and the domestic-oriented development of construction will contribute to the recovery in investments. Construction activity in particular is expected to be subdued in the near future. Exports and industrial production – and thus employment – will suffer from the persistence of the pandemic in the target countries of the Finnish exports and are likely to recover more slowly. Their economic effects will, in many respects, only be seen with a delay.

Real estate remains attractive in the investment market

As a result of central banks' stimulus measures, the amount of capital in the investment markets remains exceptionally high. In this sense, the current situation differs significantly from the financial crisis of the late 2000s. The current amount of debt in the real estate market is also significantly lower, which reduces the pressure on banks and is likely to maintain their ability to finance real estate investments also going forward. Therefore, the current crisis is not expected to lead to a similar, several years of extremely low transactions activity, which were seen as a result of the financial crisis. The attractiveness of real estate in the investment market is likely to remain high as interest rates remain low and stock prices high and turbulent. At least for the time being, Finland's position in international comparison has also remained quite strong, so international investor interest can be expected to continue at least at a reasonable level also in the future.

- Forecasting more challenging than ever
- The large amount of money in the market maintains investment demand and asset values
- Real estate financing recovering

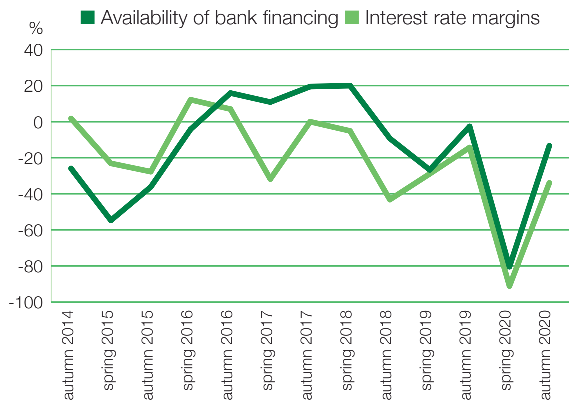
GDP, change in volume, Finland and the main target countries for the Finnish exports



Source: Eurostat, countryeconomy.com, OECD, IMF, Ministry of Finance

Outlook for the availability of bank financing and interest rate margins

Balance figures



If the balance figures are positive, greater amount of the respondents expects the availability of bank financing to improve and interest rate marginals to decrease.

Source: RAKLI-KTI Property Barometer

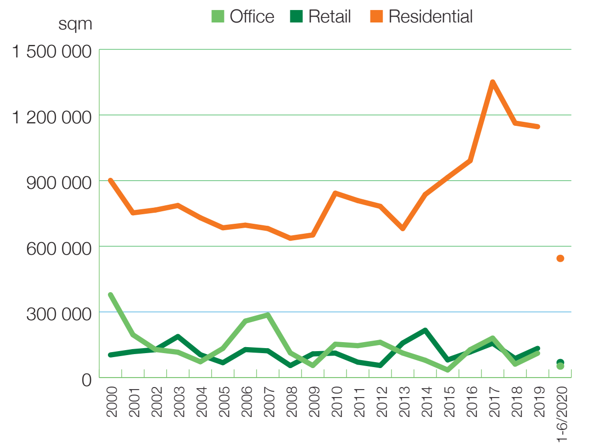
Real estate financing recovered from the worst shock

In the RAKLI-KTI Property Barometer carried out in April, the expectations of real estate professionals about the development of the availability of real estate financing and loan margins collapsed to record negative levels. In the spring, banks were busy with the terms and covenants of existing loans and taking care of their own risk position, and there were no opportunities to process new financing projects. In the recent survey carried out in October, views are much more positive: more than 25 per cent of the respondents expect the availability of real estate financing to ease during the next six months, and the share of respondents expecting tightening dropped from 87 per cent in April to 42 per cent now. However, as always in crisis situations, the selectivity and cautiousness of banks are expected to increase.

Consctruction volumes decreasing

After the high volumes of recent years, construction was expected to start declining even before the outbreak of COVID-19. The pandemic is accelerating the downturn and construction is expected to decline significantly in all areas. The number of housing construction permits and starts fell in the Helsinki metropolitan area already in 2019, and the number of starts this year is expected to be clearly lower than last year, as the conditions for housing development for construction companies are weakened. Ongoing projects in commercial construction will maintain volumes this year, but a clear decline is expected in the starts of new projects. The deteriorating public finances are also not believed to allow large-scale infrastructure or other public construction investments. In the spring, the construction industry RT estimated that construction volumes will fall by about five percent for both the current and next year. In EK's Business Tendency Survey, carried out in October, the outlook for the construction sector deteriorated after having picked up slightly in the summer, and the situation is expected to weaken during the next six months. The order backlog in the industry has fallen clearly below the normal level.

Building permits issued in the Helsinki metropolitan area



Source: Statistics Finland

The active first quarter boosts transaction volume of 2020

The crisis froze trading in the summer, a slight pick-up in the autumg

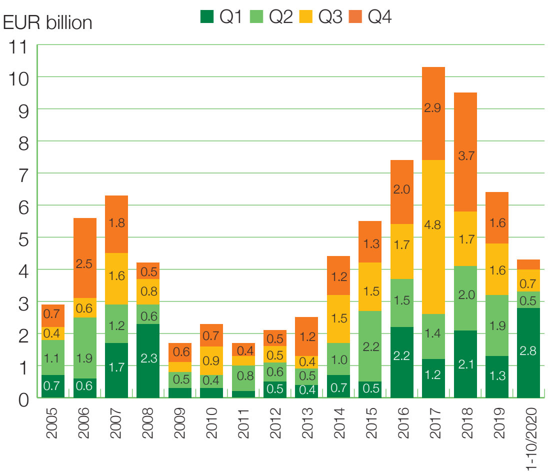
By the end of the third quarter, the transaction volume of the Finnish real estate investment market rose to approximately EUR 4 billion. This is a rather high total volume for January-September in a longer-term comparison, but more than a third of the volume was practically generated during the first two months of the year. For April-June, one of the lowest quarterly volumes ever was recorded, and in July-September, the total volume also remained low at EUR 700 million. By the end of October, KTI has recorded a total transactions volume of approximately EUR 4.3 billion. Despite exceptional circumstances, the share of foreign investors of real estate transactions amount to 53 per cent between January and October.

- Prime yields fell to record levels again
- Residential, public use and prime office properties popular in the investment market
- Property values under pressure from the rental market

Foreign investors also active in the summer and autumn

Although travel and other restrictions caused by the pandemic significantly hamper the operations of international investors in particular, real estate transactions

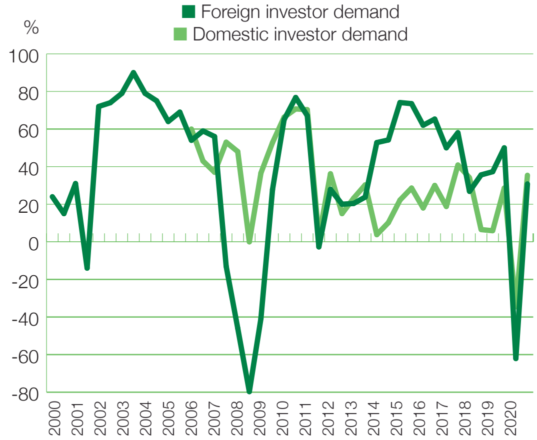
Transaction volume by quarter



Source: KTI

Outlook for investor demand

Balance figures



If the balance figure is positive, greater amount of the respondents expects investor demand to increase.

Source: RAKLI-KTI Property Barometer

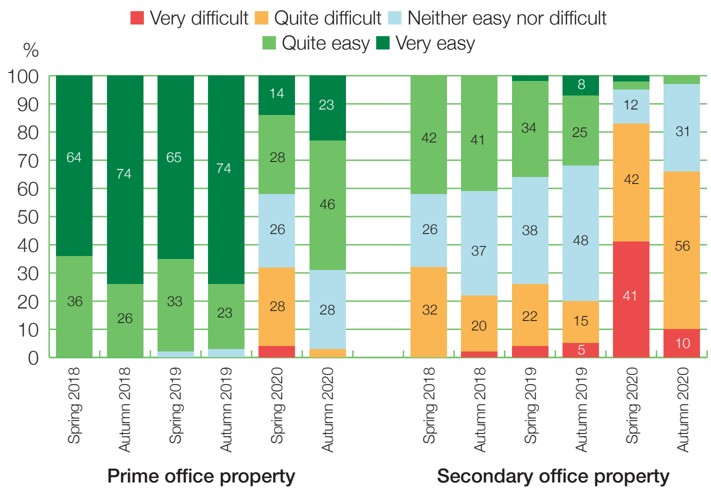
by foreign investors have also been seen during the summer and autumn. The EUR 222 million care property transaction announced in October, in which the Swedish Samhällsbyggnadsbolaget i Norden AB (SBB) bought 55 elderly care and children's day care properties from the eQ Hoivakiinteistöt fund, rises to the top of the COVID-19-era transactions statistics. In the third quarter of the year, a completely new real estate investor entered the Finnish market, as a fund managed by LaSalle bought an office property from OP Life Assurance Company in Arkadiankatu, Helsinki. After a long break, also a fund managed by the German Warburg HIH-Invest made a new investment in Finland by acquiring the newly developed Keilaniemi Next office property from NCC Property Development. Housing investors Catella Wohnen and a consortium formed by Morgan Stanley, RIM and Premico also increased their investments in Finland, and the fund of the German Quadoro Investment GmbH invested in two office properties in Tampere.

Expectations for the investor demand strengthened from the spring

The pandemic collapsed real estate investment activity in the spring, and investor demand expectations in the RAKLI-KTI Property Barometer saw a largest ever one-off collapse in April. In the survey carried out in October, expectations returned to almost last autumn's level, with nearly half of respondents expecting domestic investor

The saleability of prime and secondary properties

Distribution of responses, %



Source: RAKLI-KTI Property Barometer

demand to strengthen over the coming year. Even more, almost 60 percent of respondents, believe that foreign investor demand will grow. In the commercial property market, demand for industrial and logistics properties in particular is expected to strengthen. In the retail property market, on the other hand, more than half of respondents believe that transactions volume will slow further.

The popularity of residential properties continues to grow

In the current market situation, rental housing is perceived as a particularly interesting real estate sector, as the demand for rental housing is perceived to be much more stable and risk-free than the space requirements of most commercial property sectors. The total volume of residential property portfolio transactions in the first three quarters of this year amounted to EUR 700 million, and the share of residential transactions in the second and third quarters exceeded 40 per cent of all transactions. Investments in new development also remain brisk in the rental residential sector, and these investments are mostly not captured in the transaction statistics. In the RAKLI rental residential barometer survey conducted in September, all investor groups were expected to increase their investments in rental residential properties during the next year. The largest rental housing portfolio transaction so far is a EUR 130 million portfolio of more than 600 apartments acquired by a joint venture of YIT and OP-Rental Yield Fund.

Public use, logistics and prime office properties attract investors

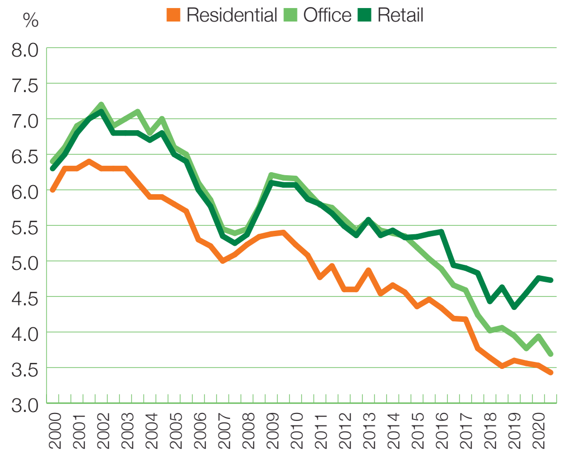
In addition to rental residential, investors are interested in public use properties needed to provide public services. Long-term leases and secure tenants are particularly popular in uncertain market conditions like the present. Several transactions worth hundreds of millions have been carried out in 2020, and in October, total volume of the public use property sector already exceeded one billion euros, which is a new all-time annual volume record for the sector. The first quarter acquisitions of Hoivatilat and Hemfosa saw a significant continuation in the care property transaction between SBB and eQ in October.

In terms of transaction volume, offices remain the most popular property sector, with a total volume of EUR 1.4 billion in the first three quarters of this year. However, almost 80 per cent of this volume was already achieved in the first quarter of the year. After the spring, office transactions have mainly been single-asset deals.

The crisis increases differences between prime and non-prime properties

The total stop in the spring caused a – albeit rather small – correction to the prime property yields, which had been declining for several years. In the October RAKLI-KTI Property Barometer, however, yields fell again, and the lowest-ever figures were quoted for well-located residential and office properties in Helsinki: 3.4 per cent

Prime property yields in the Helsinki CBD



Source: RAKLI-KTI Property Barometer

for residential and 3.7 per cent for offices. Reflecting the uncertainty in the retail property market, the yield for the Helsinki prime retail property remained at the same level as in the spring, at 4.7 per cent.

Although investor demand for the best properties remains stable, the uncertain situation creates challenges for riskier properties. In the RAKLI-KTI Property Barometer, two out of three respondents estimate that the sale of a so-called secondary office property is challenging in the current market situation, whereas almost 70 per cent of respondents finds selling a prime property an easy task. The lack of investment demand is putting pressure and uncertainty – and thus an increase in yields – on more risky properties. Through this the differences between properties in different risk categories, which have been growing for years, are further emphasized.

Rental market uncertainty creates pressures for property values

The large amount of money in the investment market is likely to keep the yields low in the coming years. However, the other driver of property values, rental cash flow, will be under pressure in most sectors in the coming years. In the two largest commercial property sectors in particular, office and retail, short-term outlook for rental development and occupancy rates is declining, and even in the longer term, occupiers' space needs are likely to rather decline than increase. The uncertainty of the rental cash flow will also increase with the increasing flexibility needs caused by the pandemic, as lease terms are expected to shorten and various flexibility elements will be added to the contracts.

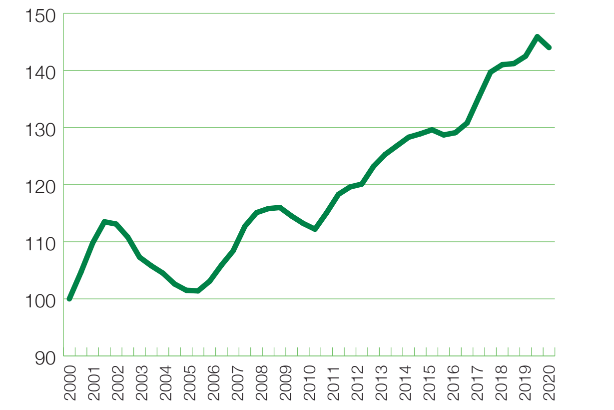
Differences between office properties steepening

Office properties maintain their position as the largest commercial property sector in the investment market. However, the polarisation that has characterized the office market for many years already is further highlighted by the pandemic, which is widening the gap between prime – modern, well-located and flexible – and less attractive properties. Therefore, the office market is expected to be even more diversified in terms of liquidity, yields, rental levels and occupancy rates.

Rents declining even in the Helsinki CBD in the quiet market

In the short term, the economic impact of the pandemic will put pressure on demand of all offices. The rental development of Helsinki CBD, which has shown strong growth figures for several years, has now turned negative, and the KTI rental index for new office leases fell by 1.3 per cent for leases started in March-September. On an annual level, the index continues to show a fair increase of one per cent. The upper quartile of rents, which describes the most expensive contracts, fell sharply, by about three euros to 33.50 euros, while the median and average rents remained unchanged at around 30 euros. However, the price level is obscured by the clear slowdown in the market activity as a result of the COVID-19: the office rental market in recent months is characterized by a significantly lower number and square meters of new contracts than in previous periods, as well as by a decrease in average space size.

KTI Office Rent Index
Helsinki CBD offices, new agreements, index 2000=100



Source: KTI

- Office rents decreased as rental market activity fell
- Vacancy rate expected to remain high
- New office space being constructed, change of use activity remains high

However, in the RAKLI-KTI Property Barometer, the respondents' perception of the current rent for a prime office space in the center of Helsinki continued to rise slightly and was approximately EUR 37 per square meter. However, expectations of office rents in Helsinki CBD were declining. In their comments, respondents emphasise the uncertainty of the situation, the slowness and delays in tenants' decision-making, and the likely decrease in future office space needs.

Net take-up turned negative

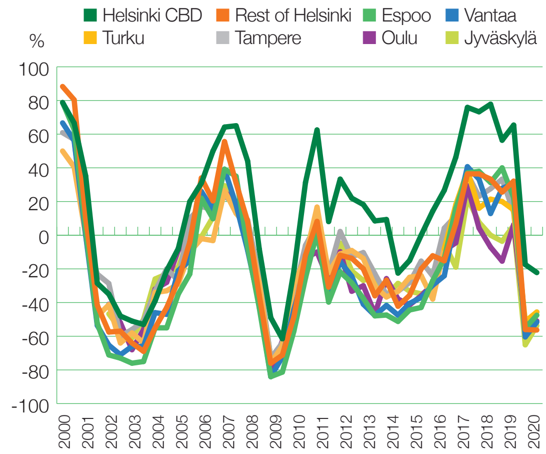
After a couple of years of stable growth, net take-up, which describes the change in the total amount of occupied office space, turned clearly negative in the review period between September 2019 and August 2020. The total amount of space in use in the Helsinki metropolitan area decreased by as much as 100,000 square meters. In the KTI rental database, the occupancy rate of office space owned by large professional landlords fell from just under 85 per cent to less than 83 per cent during the same period. The amount of space in use is weighed down by the increasing space efficiency in modern offices, the deteriorating economic situation and the declining need for workstations and premises through increasing remote working. However, brisk construction and the moving activity of companies kept gross take-up, which reflects the total activity of the rental market, high at almost 380,000 square meters. Also gross take-up slowed down in a period between March and August compared with the previous half-year.

Negative outlook for rents and vacancy rates

In the RAKLI-KTI Property Barometer, expectations of the development of office rents remained negative in all cities, although the balance figures showed a slight upward trend compared to the previous survey in April.

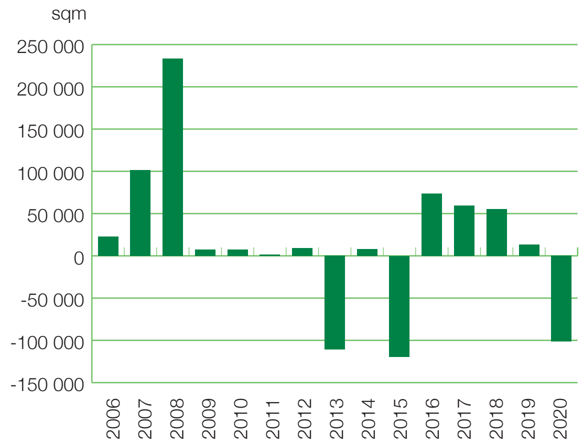
Outlook for office rents

Balance figures



Source: RAKLI-KTI Property Barometer

Net take-up of offices in the Helsinki metropolitan area



Annual figures are calculated from each 12-month period between September and August.

Source: KTI

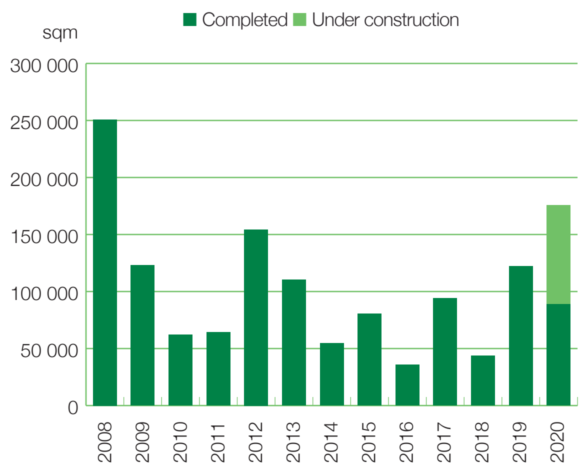
In the city centers of Helsinki, Tampere and Turku, most respondents expect rents to remain unchanged, while in Espoo, Vantaa, Oulu and Jyväskylä, more than half of respondents expect rents to fall. Almost 60 per cent of the respondents expect growth in vacancy rate both in the Helsinki metropolitan area and elsewhere in Finland. At the moment, expectations are weighed down by the immediate economic downturn caused by the pandemic, but expectations of the development of total space needs are also negative in the longer term, as the pandemic has made remote working a viable way of working for most organizations.

New office space is being developed

The polarisation of demand for office space is well reflected in the fact that new space is constantly rising despite the weakening demand outlook. By the end of September this year, almost 90,000 square meters of new office space had been completed in the Helsinki metropolitan area, and almost the same amount was under construction. A few new projects are also likely to be started later this year. However, the total stock is not increasing, as the volume of changes of use was almost the same as in the completed new projects in January-September this year. Outside the Helsinki metropolitan area, significant office projects are underway or about to be started in Turku, Tampere, Kuopio and Jyväskylä.

Completed office space in the Helsinki metropolitan area

Rentable area



Source: KTI, RPT Docu Oy

Gloomy outlook for retail properties

In recent years, retail properties have become unpopular among investors both in Finland and internationally, as changes in consumer behavior and the growth of e-commerce are challenging the business of many tenant sectors. The COVID-19 crisis has further darkened the outlook as shopping centres and city centres emptied of customers in the spring, and as the business of cafes, restaurants and entertainment, experience and wellness services, which have grown strongly in recent years, was virtually halted because of restrictions.

Rental outlook remains clearly negative

In the October RAKLI-KTI Property Barometer, yield for a retail property in the Helsinki CBD was quoted now 0.4 percentages higher than at its lowest level in spring 2019, and rental outlook is clearly negative. Respondents are reasonably unanimous about the declining outlook for retail space rents: there are no believers in increasing rents, and only in the Helsinki CBD the share of respondents expecting stable development rise close to 40 per cent. In all other areas, 70–80 per cent of respondents expect retail rents to decrease during the next year.

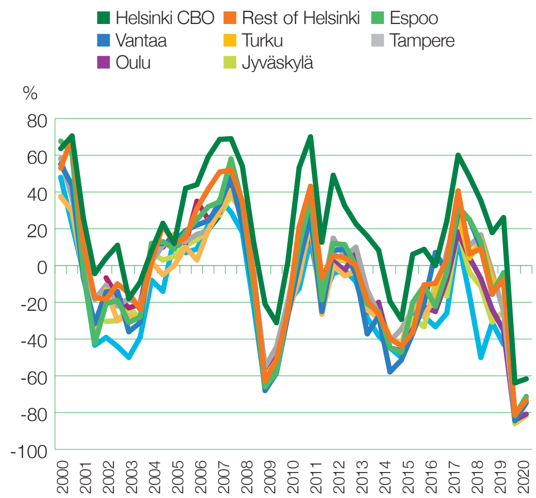
Strong areas in the retail market as well

However, the perception of the difficult situation in shopping centres and city centres is somewhat one-sided. There are also areas in the retail property sector where conditions have even strengthened as a result of the pandemic. The sales of grocery stores are breaking records, and even e-commerce, which has multiplied in this sector, is supporting, at least for the time being, the sales of physical stores. The pandemic has also strengthened the sales of interior design, home appliances and electronics, which supports the demand for big box-type retail space, and this area also sees successful integrations of physical stores and e-commerce. The transactions volume of retail properties amounted to some EUR 700 million in the first three quarters of the year, and the majority of transactions focused on grocery stores and big box properties. In grocery properties, for example, the Swedish Cibus Real Estate Nordic has continued to grow its portfolio in several transactions.

- Sales in shopping centers picked up in the summer but declined again in the autumn
- The outlook for different tenant categories and retail properties is very different
- Groceries and big boxes attract investors

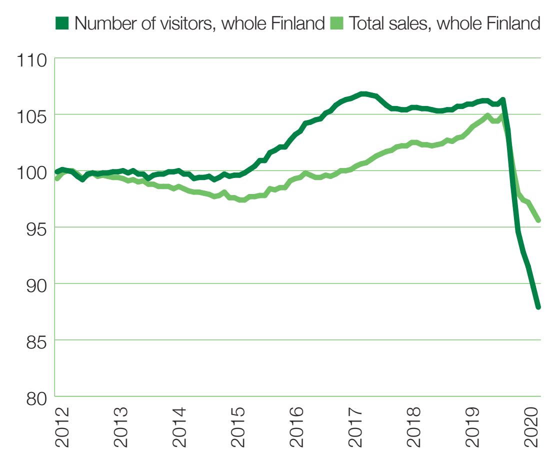
Outlook for retail rents

Balance figures



Source: RAKLI-KTI Property Barometer

Shopping centre sales and visitor indices, Q3/2020



Source: KTI, Finnish Council of Shopping Centers

In shopping centres, the collapse of spring was followed by a pick-up in summer and a declining autumn

The sales and visitor indices of KTI and the Finnish Council of Shopping Centers continue to decline. The pandemic collapsed the expectations of the well-started year, and in the second quarter, a decrease of more than 20 percent in sales and almost 40 percent in visitor numbers was recorded compared to the corresponding period in 2019. In the third quarter, sales were reasonably brisk in July, but the worsening disease situation in the autumn and people's return from summer holidays to remote working pressured the third quarter's total figures. Number of visitors decreased by nearly 18 per cent and total sales by nearly seven per cent compared to the previous year. In January-September sales, groceries and department store sales are close to the previous year's level, while sales of fashion and accessories, cafes and restaurants, and entertainment and leisure services fell by 30-45 per cent. However, the effects of the pandemic are hardly visible in shopping center occupancy rates, at least for the time being.

The position of residential properties is strengthening further

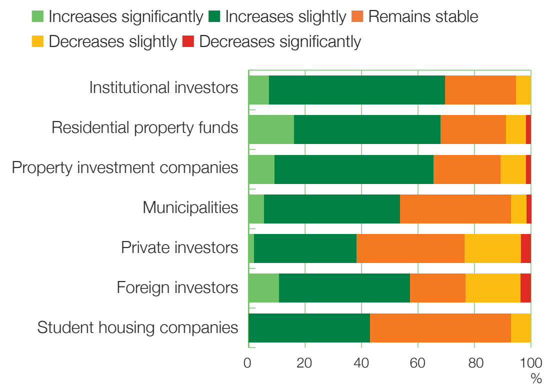
The popularity of rental residential property investment continues to grow both in Finland and internationally, and the COVID-10 pandemic, which mistreats most other real estate sectors, will further strengthen the relative position of residential property investment. Foreign investors who have landed in the Finnish residential property market in recent years have continued to grow their investment portfolios this year as well. Domestic housing funds have continued to be active, especially in the acquisition of new properties from construction companies, while institutional investors and large housing investment companies focus mainly on in-house development. The RAKLI rental housing barometer conducted in September predicted that all investor groups will continue to increase their rental residential investments. The conditions for new construction of rental housing are considered to be even relatively strengthened with the pandemic, as construction cost pressures are eased with the slowing volumes and the interest of construction companies in rental housing project contracts increases.

- Demand for rental housing remains strong in the largest cities
- Slight relief for cost pressures in rental housing construction due to slowing volumes
- The Helsinki metropolitan area, Tampere and Turku stand out from other large cities

The supply of rental housing continues to grow

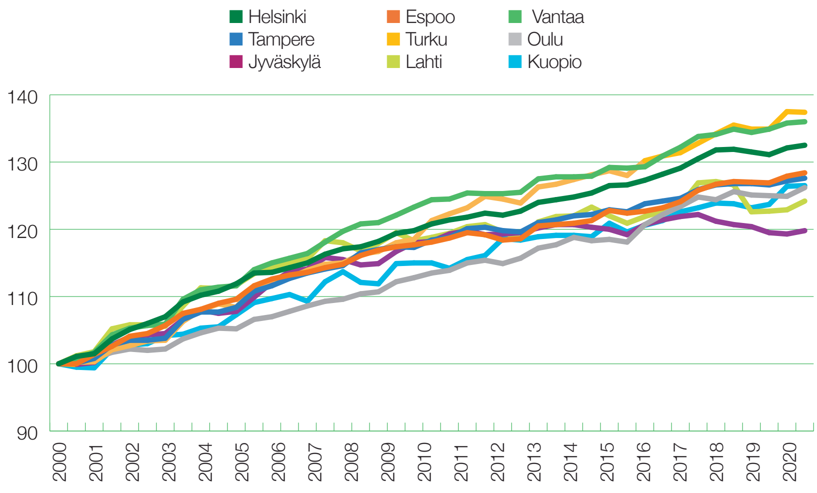
The rental housing market in large cities in recent years has been characterized by a rapid increase in supply. The growth is mainly due to brisk new construction, but in recent months, apartments previously on the Airbnb market have also begun to be offered for longer-term rental use, which has brought a significant increase in supply in some cities. In the Helsinki metropolitan area, Tampere and Turku, the development of demand still seems to support the growth of supply, while the growth of supply in cities in the next size category has led to at least temporary decreases in occupancy, increased turnover and slightly declining rents. New construction of rental housing is currently focused on the largest

Development of rental apartment supply
How do you expect the rental residential portfolios of the following investor groups to develop?



Source: RAKLI-KTI Property Barometer

KTI Housing rental indices
New contracts, large cities



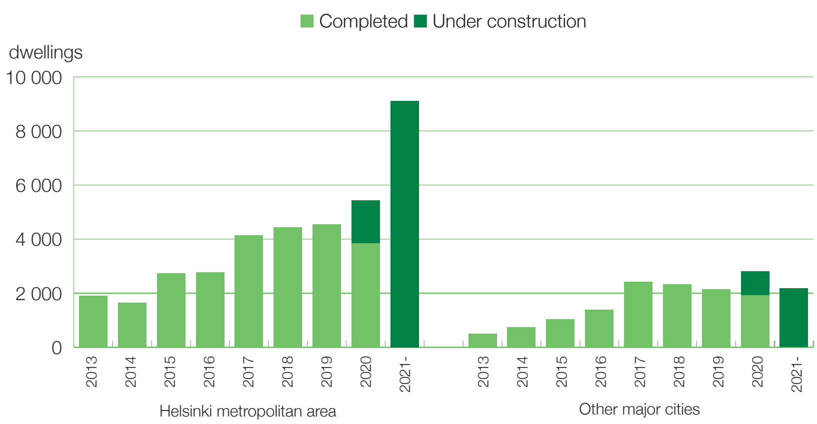
Source: KTI

urban areas: in the Helsinki metropolitan area, some 10,700 rental apartments were under construction at the end of September. In large cities outside the Helsinki metropolitan area, a total of just over 3,000 new rental apartments were under construction, of which more than 2,000 are located in Tampere or Turku.

Rents continue to increase but at a slower pace

KTI Rental residential indices for new agreements showed an average annual increase of 0.7 per cent in the Helsinki metropolitan area in the third quarter of this year. The increase in rents has been slightly stronger in Espoo and Vantaa than in Helsinki. In large cities outside the Helsinki metropolitan area, rents rose by an average of 0.5 percent, but there were significant differences between cities. Over the past year, rents have risen the most in Kuopio, where the development of the previous couple of years has been more volatile. In Tampere and Turku, rents continued to grow steadily, with rental indices rising by 0.7 and 1.4 per cent, respectively. Throughout the 2010s, the rise in rents has been strongest in Turku, followed by the cities of the Helsinki metropolitan area and Tampere. These largest urban areas also stood out in the RAKLI rental housing barometer conducted in September with their more positive outlook for rental development.

Completed / to be completed rental housing projects



Other major cities: Tampere, Turku, Oulu, Jyväskylä, Lahti and Kuopio regions

Source: KTI, RPT Docu Oy

The attractiveness of public use and logistics properties is rising, hotels expected to recover

- Public use properties rising in transaction statistics
- The recovery of hotel properties is believed as the crisis eases
- The downturn in retail properties strengthens demand for logistics

The popularity of properties needed to provide public services will be further strengthened by the pandemic, as the appreciation of stable cash flow is increasing in the investment market. This year's public use property market news has been characterised, above all by large corporate and portfolio transactions, which are already known to break the annual record transaction volume in the sector, and also their share of the total volume is likely to reach a new record. Of the total volume in the first ten months of 2020, public real estate accounted for 23 per cent, having previously reached its highest level of 12 per cent in 2019. Transactions have taken place, for example, in elderly housing, healthcare and educational properties. The most active players in the public use real estate market are investment funds and companies specializing in this sector.

Demand for logistics properties is strengthening with the growth of e-commerce

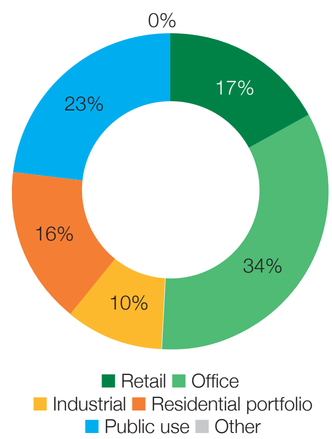
As the retail property market suffers from changes in consumer demand caused by the pandemic, an increasing proportion of goods pass directly to consumers through various logistics facilities. Logistics properties are currently in demand in the investment market, although their supply is relatively limited. In the RAKLI-KTI Property Barometer, the outlook for industrial properties was upward in terms of transaction volumes, yields and rents. During the first three quarters of the year, the industrial property sector has witnessed mostly smaller single-asset transactions, where the buyers have been mainly domestic funds and investment companies. The total transaction volume in the sector this year remains below half a billion euros so far, and it is held back by a shortage of supply rather than a lack of demand.

Faith in the future in the hotel sector

Hotels, along with shopping centres and other retail properties, have taken the heaviest hits caused by the pandemic in recent months. Despite this, hotel construction continues to be brisk: a dozen major hotel projects are currently underway in the Helsinki metropolitan area, and several major projects are about to be started. There are also significant hotel projects in Turku and Tampere. Due to the COVID-19, the start of some projects has been at least postponed, but no significant cancellations have been announced, at least so far. Belief in the recovery of traveling is still reasonably strong, starting first with tourism, and in some time also with business travel, which is why hotel demand is expected to recover over time. On the hotel front, the most positive news of the COVID-19 era so far has been the landing of a new operator in Finland: in October, Ylva announced that the Norwegian Citybox chain will become the operator of its new Lyyra hotel in Hakaniemi. Construction work on the hotel began in the summer and is scheduled to open in 2023.

Volume of real estate transactions by sector in 1-10/2020

Total volume €4.3 billion



Source: KTI

Completed and ongoing hotel construction projects in the Helsinki metropolitan area

Hotel	Number of rooms	Investor(s)	Completion
Original Sokos Hotel Tripla	430	Exilion Pasilan Asemahotelli Ky	2020/Q1
Hotel U14	117	Barings Real Estate Advisers	2020/Q1
Valo Hotel/Work	422	SSA Kodit Oy	2020/Q3
The Folks Hotel	150	OP-Palvelukiinteistöt	2020/Q3
Scandic Helsinki Railway Station	500	Exilion Asemahotellit Ky	2021/Q1
Art Hotel	173	Terrieri Kiinteistöt Ky (managed by Fennia)	2021/Q2
Maestro hotel	232	Rakennusmestarien Säätiö	2021/Q4
Music Tower	100	Aberdeen Standard Investments, Ailon Group	2022/Q2
Scandic Avenue	350	Varma Mutual Pension Insurance Company	2022/Q3
Grand Hansa Hotel	224	Ylva	2022
Citybox Hotel	178	Ylva	2023

Source: KTI

The pandemic also has permanent impacts on space demand and market practices

- The corona affects the use of space in all sectors
- The boundaries between different types of space are blurring

Landlords are currently struggling with the immediate impacts caused by the pandemic and are working with tenants to find solutions to overcome the worst of the crisis. At the same time, however, focus is also shifting to the likely longer-term changes in space use caused by the crisis. The ongoing crisis reinforces and accelerates many trends already visible in space demand. The pandemic also brought to the surface some new forces impacting space demand, the permanence and intensity of which will only become apparent over time.

This year, the pandemic is hitting the worst notch in rental income from retail and hotel properties. In these sectors, too, expectations have improved slightly since the spring, but still nearly 60 per cent of respondents in the RAKLI-KTI Property Barometer anticipate the cash-flow from hotels, and about a third of respondents expect the cash-flow from retail properties to fall more than 15 percent from last year. Even in offices, about half of the respondents estimate that rental income will decrease, but much more moderately. The impact on rental income from industrial, residential and public use properties is expected to be insignificant.

In rental apartments, the appreciation of the space is rising while the importance of location is fading a bit

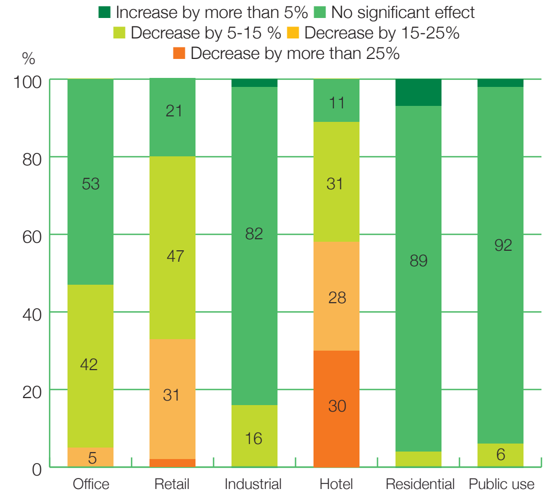
The pandemic has shifted the focus of rental housing demand to slightly larger apartments and moderately priced locations. In both aspects, increase in remote working drives the shift: more space is needed when home also serves as workspace, and the appreciation of key locations falls when there is no need to commute between home and work every day. COVID-19-era remote working has also accelerated new innovations in the provision of flexible workspaces near residential areas, and co-working facilities can now be found in the ground floors of residential buildings, shopping centres and hotels. Hotels also offer reasonably priced options for longer stays for temporary living or working. In the big picture, the pandemic is not expected to have much of an impact on the strong trends in the share of urbanisation or rental housing.

People will return to the offices, but for different reasons than before

Although the pandemic has now emptied a large amount of office premises, the need for office space will by no means disappear. There is a strong belief in the permanent growth of remote working, and therefore, the total need for office space will certainly decrease rather than increase. Even if offices will not be needed to perform routine tasks in the future, space is still needed for meetings and social interaction with colleagues, customers and other stakeholders, for innovations and creative work. These tasks raise the quality requirements of the premises: when people don't have to go to the office, it should be attractive enough to make people really want to go there. The pandemic has also raised safety and security issues – spaciousness, ventilation and hygiene – to a new level, and the time for tightly packed open-plan offices

The impact of the COVID-19 crisis on rental income in 2020

Distribution of responses, %



Source: RAKLI-KTI Property Barometer

would seem to be over at least for the time being. More demanding video conferencing and virtual events are also creating new demands for both premises and technical equipment in offices.

The biggest change in the use of retail space; logistics partly shifting towards store space

The need for retail space, at least in most of the traditional high-end retail sectors, appears to be declining permanently. The advantage of Helsinki CBD, in this respect, is that the area of the most expensive high-street premises is so small that there will probably be enough visitors and space demand there in the future as well. In the next price category locations, at least some of the tenants are likely to be replaced by operators with lower rent-paying ability – public and private services, groceries and traditional big box industries. The growth of e-commerce is partly blurring the tight line between retail and distribution premises when online shopping is increasingly delivered through physical stores or, for example, the restaurant's customer space shrinks to a pick-up location for pre-orders, and portions are made in so-called cloud kitchens solely made for this purpose.

All in all, many of the changes caused by the pandemic are likely to further dispel the boundaries between the different types of space. Work and virtual shopping are done at home, short-term accommodation or hotel services offer new options for living, offices become environments for spending time instead of only working, and retail space can be a store, a distribution warehouse and a workspace at the same time.

COVID-19 strengthens existing trends in space usage and creates new ones

RESIDENTIAL
- Demand remains strong in largest cities, supply is increasing
- Demand shifts slightly towards moderately priced locations
- Remote working strengthens demand for larger apartments

OFFICES
- Flexible and remote working increasing
- Offices needed for innovation and interaction, not for routines
- New demands for space quality, safety, security and technical equipment
- Need for flexibility increases

REDEFINITION OF BOUNDARIES BETWEEN DIFFERENT TYPES OF SPACE

RETAIL
- Increasing differences between tenant groups
- Space demand and ability to pay decreasing
- E-commerce vs physical stores
- City centres vs other locations
- Retail/service/working/other space?

LOGISTICS
- E-commerce strengthens demand
- Increasing technical requirements: automatization and robotisation
- Location: central vs last mile logistics
- Integration of e-commerce and physical stores / distribution facilities

During autumn 2020, KTI has carried out a study commissioned by Senate Properties on the potential impacts of the COVID-19 pandemic on the Finnish real estate and construction industries. The study is based on expert interviews and market statistics produced by KTI and others. The full report will be published during November.

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 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 Property Owners and Construction clients.

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