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Nordic property: investment and funding

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On firm foundations

WITH A TRACK RECORD OF REGULAR GROWTH, THE NORDIC PROPERTY SECTOR PRESENTS AN ATTRACTIVE DESTINATION FOR INVESTORS. HIGH QUALITY ASSETS AND POLITICAL STABILITY SUGGEST THAT THE ENVIRONMENT WILL REMAIN A GOOD RISK FOR THE FORESEEABLE FUTURE. **SVERRIR THÓR**, EDITOR, ECONOMICS AND FINANCE, *FASTIGHETSNYTT*, REPORTS

When it comes to investment in property, the Nordics are an attractive option – regardless of whether this is direct or indirect exposure to the asset class and the region. Over the decade ending on March 30, 2018, the Nasdaq index for the Nordic property sector had increased with an average annual rate of 13.6% (total return). In the single largest of the Nordic markets, Sweden, the index has risen by an additional 0.3 percentage points.

And while what goes up must eventually come down, there are few signs that this will happen any time soon. The market is made of professional players with good knowhow in both property management and in finance.

Similarly, asset quality is generally high and there seems to be an insatiable demand for new space to let, in both the office and residential rental segments. Finally, the price of money – which is perhaps the most important of all inputs in the modern property industry – is expected to remain low for a long time to come.

Good fundamentals

To add to that there is a strong underlying economy, political stability and a level of corruption lower than in most countries – indeed, the Nordic economies frequently top the lists of low-corruption countries. Thus, fundamentals indicate that the region's property industry will remain prosperous for the coming years – but of course there are challenges.

Economic fundamentals can change fast, resulting in falling demand, and interest rates could start rising more rapidly than planned. These are perhaps not improbable events but are manageable as they have a cyclical element. A riskier – and in the short term, harder to manage – event might be a sudden capital drought. The property industry by its nature is highly capital intensive and while cash-flow generation is the main objective of operation, it is important to have working channels to secure capital, both for the development of new projects but also to maintain existing property.

When Lehman Brothers collapsed and the credit crunch went from being a local to a global phenomenon, Nordic banks tightened the

Sverrir Thór, editor, economics and finance, *Fastighetsnytt*

screws. The Nordic banking sector was highly exposed to property and from a risk management perspective it was important to reduce that exposure. As a result, the sector started steering its funding away from being almost solely provided by banks to the money market – and, more specifically, the corporate bond market.

Bond presence

Today, most larger Nordic property companies have a healthy presence in the bond market – some might argue that it is becoming a bit too healthy. In the Swedish money market, for example, almost half of the outstanding volume of bonds has been issued by property companies.

While most issuers are robust companies with stable cash flows and are nowhere near at risk of becoming insolvent, this has created the need for larger issuers to enter foreign markets. So far, most of the bonds denominated in foreign currencies have been issued in euros (although some companies have also entered the sterling market) and there is more supply to come.

Based on historic performance, the case for indirect exposure to Nordic properties is strong – through equities as well as funds and fixed income – and as the number of companies entering the international markets increases, the number of opportunities to invest in Nordic property markets will only grow further. ■

Sverrir Thór is economics and finance editor of Fastighetsnytt.

Greater numbers: Stockholm's population is expected to grow by about 850,000 by 2030, putting further pressure on the property market

Stockholm's party goes on

HOUSE PRICES HAVE TUMBLED IN SWEDEN'S RED-HOT REAL ESTATE MARKET, AND A SHORTAGE OF AFFORDABLE HOUSING AND OFFICES MEANS FOREIGN INVESTMENT OPPORTUNITIES ABOUND. **SEBASTIAN SHEHADI** REPORTS

While most of Europe was left shell-shocked by the 2008 financial crisis, Sweden quickly rebounded, reporting 5.7% GDP growth in 2010. Performance has been strong ever since: in the past four years the country has averaged 3% GDP growth.

At the same time, Swedish house prices had been growing at breakneck speed since 2012, thanks to a growing population, high levels of immigration and urbanisation, low inflation, strong income growth and a conducive monetary policy.

Foreign investment in Swedish real estate is greater than in the other Nordic countries, pre-dating the 2008 financial crisis, and the country is widely considered to be a safe haven on this score. Total real estate transactions amounted to SKr147.5bn ($16.7bn) in 2017, 23% of which came from foreign investors, according to commercial property firm Newsec.

A housing bubble?

What goes up, must come down, however. From late 2017 onwards, house prices in Sweden saw their steepest drop since the end of 2008. In January 2018, the Swedish housing price index HOX fell 2.2% year on year, with flats in Stockholm hit the hardest with a fall of 8.6%: not surprising, given that the capital accounts for 45% of Sweden's total real estate market.

The impact on the construction sector has been clear, with highly leveraged small to medium-sized developers' stock falling by as much as 60%. Newsec predicts that, as a result, there will be bankruptcies, further project delays and buyer hesitancy in 2018 and 2019, while GDP growth is expected to slow but remain strong.

Although some have described this as a market crash, the consensus among Sweden's banks and real estate CEOs is that it is more a case of market slowdown and correction, and that prices could continue to drop for a matter of months or years.

"When people talk about the housing bubble, they often forget it's a specific part of the market relating to highly priced apartments in Stockholm," says Ilija Batljan, CEO of Swedish property company SBB. Indeed, the ongoing housing slump is only affecting direct sales, not the letting market.

Understanding the market

One of the main causes of the so-called bubble is a mismatch over the past few years between supply and demand, according to Claes Magnus Akesson, chief financial officer at Sweden's largest housing developer, JM. "Currently, the demand is predominantly from first-time buyers, young people or buyers with less ▶

MOST OF THE RESIDENTIAL DEVELOPERS HAVE SEEN THEIR SHARE PRICE FALL BY 50% ON AVERAGE. SO THIS IS A BIG OPPORTUNITY

purchasing power," he says. "However, Stockholm has an oversupply of luxury apartments, and not enough lower to medium-income flats."

One intentional cause of the price slump is the fiscal policy of Sweden's Financial Supervisory Authority (FSA), especially since 2016. On two occasions, the FSA set tougher amortisation rules to allay fears surrounding what was perceived as too-easy access to mortgages – potentially leading to excess demand – and the rapid rise of house prices and debt.

Mr Batljan contends that the government mistimed its latest mortgage measure, announced in May 2017, just when prices were peaking and naturally beginning to descend. Similarly, Sweden's minister of housing, Peter Eriksson, says he believes the government's response was too drastic and too late. However, the FSA denies responsibility and blames the oversupply of luxury housing.

"When prices are going up, somebody says: 'This can't go on, I'll get out before it ends.' So it's self-fulfilling," says Tomas Hermansson, CEO of real estate company Bonnier Fastigheter. "The newspapers start to write about it and that drives uncertainty." So too does geopolitics, especially rising interest rates in the US.

Window of opportunity

But does the bubble present an opportunity for investors interested in Stockholm? "There's been a shortage of options because everyone has been wanting to buy, and suddenly this window is opening up," says Mr Hermansson. "Prices are going down now by as much as 20% to 30%, but there'll be a big uptake in the longer term."

Most foreign investment in Swedish property is through the stock market, where there are 28 listed real estate companies. "Most of the residential developers have seen their share price fall by 50% on average. So this is definitely a big opportunity," says Mr Akesson.

Opportunities abound in light of the huge demand for more affordable apartments in Stockholm, caused partially by the aforementioned oversupply of luxury housing. However, Mr Akesson says he has not seen many foreign investors developing or buying lower to average-priced apartments to sell. "Developments are always a bigger risk, and foreigners don't understand the planning process as well, the local context and language. But it's just a matter of time before opportunistic investors come," he says.

Despite most Swedes speaking English, the rules around building in Sweden have been hard to access in other languages. "We are now starting translation, beginning with English," says Mr Eriksson. Similarly, local investment promotion agency Invest Stockholm is hosting courses for foreign investors to guide them through the market and the planning process. The agency advises that first-time foreign investors should work with local companies.

Housing shortage

As one the fastest growing cities in Europe, economically and demographically, Stockholm's need for more housing is widely acknowledged. For decades, the capital had a population growth of 20,000 per year, while new production averaged 6000 units. However, over the past four years population growth has risen to 40,000 per year, while new production has risen to 15,000 units a year, according to Mr Akesson. "Considering an average of two people per home, there's been a widening gap [for decades]," he adds.

The demand for affordable housing has risen due to Sweden's increasingly young population and large inflow of immigrants. The shortage is exacerbated by tax legislation that is preventing older people from selling off their houses and bigger apartments because their profits are taxed.

In response to the shortage, Sweden's government has committed to building 340,000 dwellings in the Stockholm region by 2030, worth a total of $63bn. This is Sweden's largest housing push since the so-called Million Programme of the 1960s, which was twice the size. However, with Stockholm's population expected to grow by about 850,000 by 2030, will the housing programme be enough, especially in light of the existing deficit?

"We don't have enough companies here to reach our [340,000] target," says Soren Pettersson, who works with Invest Stockholm. "We've got the four big real estate companies who are up to their necks with work. If we're going to succeed, we need foreign companies to help double the pace".

Of note is the fact that Sweden is building a new high-speed train line, called East Link, which will better connect the capital to its surroundings and significantly cut the journey time to and from Stockholm's satellite towns. Thus, East Link will increase the size of Stockholm as a living area.

Betting on letting

Another consequence of the shortage in affordable housing is increased demand for rentals. To get a rental, "you have to wait between five and 20 years. The average age of [adults] still living at home is 27," says Biljana Pehrsson, CEO of real estate company Kungsleden. There are just over 6000 vacant rental apartments in all of Sweden, which amounts to a little over 0.2% of total housing stock.

In light of the huge demand, Mr Batljan believes that "rental residentials are the best opportunity for foreign investors in Sweden, [especially in Stockholm]". This is why Blackstone bought a large share of listed rental residential company D Carnegie in late 2016.

Mr Akesson agrees: "Rental residentials have been good assets over the years. They are very liquid, although there's municipality regulation on how much rent could be charged."

Mr Batljan's top tip is to "rent after refurbishing efficiently", which he says can offer a yield on cost of 7% or 8%. He also recommends investing in the new market for community service properties – schools, homes for the elderly, hospitals – which is open for private investors and is considered low risk with good returns.

It should be noted that many, if not most, people in Sweden buy apartments in a co-op, an economic association where the buyers form a board. It is very unusual for such boards to approve subletting, which explains why Sweden does not have much of a buy-to-let market.

The commercial story

Sweden's commercial property segment is far removed from the drama surrounding the bubble. As a very stable market, Stockholm is one of the leading European and global locations for multinational corporations locating their headquarters. Home to Swedish companies such as Spotify, the capital has a thriving tech scene and start-up economy, which is why Stockholm's most common occupation is a programmer.

Over the past decade, the country's robust economic growth has attracted ever more companies, and therefore led to growing demand for commercial space. However, supply of office space has been limited. This is partly the result of strict regulations regarding obtaining building permits. Mr Eriksson, the minister of housing, agrees that the planning process takes too long, but says: "We have addressed this, not least by digitising the process a lot."

The office segment's market share fell from 30% to 18% of total volume in 2017, leaving residential as the largest segment with 26%, according to Newsec. Nevertheless, demand for office space is still very high, rents are rising, and in Stockholm's central business district the vacancy rate is 2%, and below 5% in the inner city according to Newsec.

Retail properties made up 18% of the transaction volume in 2017, similar to previous years. However, as in many countries, e-commerce is a problem for the retail market. Nevertheless, large retail players are expected to keep expanding their stores, albeit to increase visibility rather than sales.

Government moves

The government has recently proposed raising taxation on commercial property transactions, something which Mr Hermansson says "may have scared investors off – but it shouldn't be too bad". Under the proposal, a new general limitation on the right of interest expense deduction may be introduced for negative net interest.

Other potential disruptors are the 2018 general elections and the gradual increase in Swedish interest rates – following the global trend – expected to begin in mid-2018. Moreover, Newsec warns that the cost of building has risen at a unprecedented rate since 2013, but that this trend is showing signs of correcting itself since the housing bubble.

Most importantly, Swedish fundamentals are very firm. Sweden remains a safe haven from political uncertainty in Europe and elsewhere. Moreover, Sweden boasts market transparency, very low interest rates, a strong, highly digitised economy and ranks highly in ease of doing business rankings. "The Swedish krona is at one of its lowest levels – hence our very high exports – so for foreign investment this lowers prices by 30% or more," says Mr Eriksson. ■

Peter Eriksson, Sweden's minister of housing

Border crossing: the Oresund Bridge links Malmo with Copenhagen, boosting the city's investment potential

Malmo reborn

FOREIGN INVESTORS OFTEN FOCUS ON CAPITAL CITIES, MISSING OUT ON SMALLER, UP-AND-COMING LOCATIONS SUCH AS MALMO. **SEBASTIAN SHEHADI** EXAMINES THE REBORN CITY'S UNIQUE SELLING POINTS AND OPPORTUNITIES

The Swedish city of Malmo has undergone something of a transformation in recent years. Its once-thriving shipping industry fell into ruin following the oil crisis of the 1970s, which led to population flight and mass unemployment.

However, since 2000, Malmo has reinvented itself as a city of knowledge, start-ups, services and sustainabile technology. Kockums shipyard, which formerly employed 6000 people, has been replaced by 250 companies employing 8000.

Now Sweden's fastest changing and third largest city, Malmo also claims the third largest share of the country's real estate market, with roughly 10% of Sweden's transaction volume based on the past three years.

I THINK IT'S DIFFICULT TO DEVELOP AS A FOREIGNER, WITHOUT LOCAL EXPERTISE, AND BUY YOURSELF A POSITION IN THE MARKET

Unique fundamentals

Malmo's transition began in 2000 with the founding of Malmo University – located, unusually, within the city's central business district – and the construction of the Oresund Bridge, which connects the city to the Danish capital of Copenhagen, 29 kilometres to the west.

Bringing Malmo within a 20-minute drive of Copenhagen's 4 million inhabitants and international airport, the largest in the Nordic region, the bridge turned Malmo into Sweden's gateway to Europe, thereby attracting companies such as Ikea and IBM and the Nordic regional head offices of other multinationals. Unsurprisingly, the city's unemployment and vacancy rates have plummeted in line with its ongoing economic boom.

Malmo now has Sweden's highest rate of inbound immigration and ethnic diversity, proportionate to its small population of 341,000, with a total 181 different nationalities represented. Its inhabitants often commute to Copenhagen for work, and vice versa. Malmo is also the youngest city in Sweden, with more than half its population under the age of 35, not least because the cost of living is much lower than Stockholm's.

The youthfulness of Malmo is also boosted by five major universities located close by. The city's main clusters are in greentech, gaming, media and medicine. Director of city planning Christer Larsson says Malmo has the most vibrant and dense start-up and tech scene in Sweden proportionate to its size.

Real estate opportunities

As with every big city in Sweden, Malmo has a shortage of rental homes and a huge demand for them, partly due to a nationwide shortage of affordable houses on sale. Consequently, international investors such as Starwood Capital and Vonovia have recently made bids on Malmo-based real estate company Victoria Park or on ready-developed rental properties.

Mr Larsson says he has seen international investors taking advantage of Malmo's run-down areas, which can be refurbished into high-value rentals. Another opportunity is to buy co-ops – economic associations – which is generally how Swedes buy an apartment. In Malmo, many co-ops are going into debt and then being sold and transformed in the rental market.

Similarly, a growing number of 'public houses' (apartments let by the government) are on sale because municipalities are not able to maintain and manage them, which has attracted several international pension funds.

Exciting initiatives

With such a fast-growing economy, there is great demand in Malmo for office space. Unlike Stockholm, the city has plenty of centrally located land available for development, according to Anders Jarl, president of Wihlborgs, the real estate company that has overseen most of Malmo's redevelopment. For example, a large mixed-use office district is being built close to the central station.

Other initiatives include the Malmoring, which is reviving the old railway that encircles Malmo. "The railway was a social barrier. We are creating new stations which will be nodes for integration. Around them, we'll establish new enterprises, housing and cultural spaces," says Mr Larsson.

Malmo aims to power itself entirely through renewable energy by 2030. "We've put a lot of effort into creating a sustainable city and we work closely with the private sector when developing new areas," says mayor Katrin Jammeh. "We recently released SKr1.3bn [$147m] of green bonds available for private investors to buy."

The city's Western Harbour district, entirely powered by renewable energy, has received international attention and is now being used as a model for the rest of Malmo. This is why one of Sweden's largest developers, Skanska, "is really focusing on sustainable properties in Malmo", according to the company's regional director Camilla Wieslander.

However, Wihlborgs' Mr Jarl maintains that the best option for foreign investors is the stock market. "I think it's difficult to develop as a foreigner, without local expertise, and buy yourself a position in the market," he says. Potential developers might seek the help of footballer Zlatan Ibrahimovic, who recently lent his support to a project in his home district of Rustenburg. ■

Katrin Jammeh, mayor of Malmo

WE'VE PUT A LOT OF EFFORT INTO CREATING A SUSTAINABLE CITY AND WE WORK CLOSELY WITH THE PRIVATE SECTOR DEVELOPING NEW AREAS

Gothenburg's growing pains

GOTHENBURG IS BLOSSOMING AFTER ITS INDUSTRIAL TRANSFORMATION, AND THE RACE FOR SPACE IS ON. REAL ESTATE OPPORTUNITIES EXIST DESPITE SOME RESISTANCE TO OVERSEAS INVESTORS, AS **SEBASTIAN SHEHADI** REPORTS

Gothenburg's story is one of industrial transformation. The city is Sweden's second largest in terms of population and real estate market share. In 2017 it accounted for 12% of the country's property transaction volume, growing from SKr3bn to Skr16bn ($345m to $1.84bn) over the past eight years.

Gothenburg's shipbuilding industry went into decline in the 1970s. Following years of soaring unemployment, Gothenburg began its transformation into a knowledge-based city with the creation of a science park in 1999. With 24,000 workers and more than 400 companies, the park employs more people than the shipyards ever did.

Recent years have seen a growing focus on Gothenburg's automotive industry, which seemed doomed only 10 years ago. The city is now a leader in specialised digital systems. Volvo Group, the biggest company in Sweden and now owned by China's Geely, is headquartered in Gothenburg. Geely's innovation centre employs 2000 staff.

Gothenburg also boasts big names such as SKF, the world's largest bearing manufacturer, and pharmaceutical giant AstraZeneca, whose research centre employs 2700 researchers.

Millennial surge: Gothenburg has grown by 170,000 people and created 134,000 jobs since 2000

Hungry for real estate

With such strong economic growth in Gothenburg, demand for office space is huge: indeed, some companies are moving away because they cannot expand, says Andreas Gothberg of Business Region Göteborg. As is the case in Stockholm, there is an undersupply of affordable housing and a large number of luxury homes. As many as 200,000 Gothenburgers are in the queue for affordable homes.

Gothenburg has grown by 170,000 people and created 134,000 jobs since 2000, impressive numbers even by European standards. Contributing to this is the city's excellent land and sea connectivity. Gothenburg was named the best logistics location in Sweden for 16 consecutive years by trade journal *Intelligent Logistik*.

The city municipality is investing €100bn in housing, offices and infrastructure. Some €30bn is going towards the River City project, one of the biggest city centre development projects in Europe. Due to be completed by 2035, River City will double the size of central Gothenburg by creating 25,000 apartments, 50,000 new workplaces and Scandinavia's tallest building.

River City's central location currently has a vacancy rate of 0.8%, while Gothenburg central business district has only 2.1%. On Gothenburg's outskirts there are several other major commercial and residential projects, such as the expansion of Kallered Shopping Park. For foreign investors, opportunities are plentiful.

Investor advice

Mr Gothberg says that property developers from Stockholm, let alone from abroad, find it difficult to build in Gothenburg. Most foreigners buy ready-built commercial projects, but even then, local companies often outbid outsiders. Tough competition is not unusual within real estate, especially for foreign investors, but Gothenburg's business environment seems more closed compared with Malmo and Stockholm. The local press has been damning of 'outsiders' who have let property standards slip.

This can largely be explained by the decades-long rule of mayor Goran Johansson, who oversaw what many in the city consider to be an anti-business regime. "It became a rather [protectionist] climate," says Han Wallenstam, CEO of Gothenburg-based property company Wallenstam. "The mayor left in 2009 so that [legacy] is dying. [For example] Volvo is Chinese now."

However, an easier way in for foreign investors is to buy stocks and shares. Direct investments are simpler in Stockholm and Malmo's more open markets, suggests Per Gunnar Persson, CEO of local property company Platzer. ■

The direct approach

PRIVATE EQUITY FUNDS ARE EXPRESSING EVER-GREATER INTEREST IN THE NORDIC PROPERTY MARKET, AND LISTED COMPANIES ARE NEXT ON THEIR SHOPPING LIST, WRITES **STEFANIE LINHARDT**

Interest in direct investments in Nordic real estate is growing, especially from international investors. Large institutional investors looking for geographical diversification often choose local property funds to manage their money, and competition from pension money is strong.

"In the Nordics, and in particular in Sweden, a lot of pension money owns many of the core properties in the major cities," says Helena Olin, head of real asset investments at the Second Swedish Pension Fund AP2. "That can make it hard to compete for some newcomers. For some international investors, it still is a small market, but looking at return figures, they should have already been here a few years ago."

In specialised areas in particular, it can be more difficult for new investors to enter the market, for example in retail parks, where real estate company Svenska Handelsfastigheter operates.

"We have seen competition going down, as widespread uncertainty around retail properties makes it more difficult to get financing for new investors, [though] this is not a problem for us," says the company's chief executive Lennart Sten.

On the list

Nevertheless, international private equity funds are increasingly pushing into the Nordic property market.

> UNCERTAINTY AROUND RETAIL PROPERTIES MAKES IT MORE DIFFICULT TO GET FINANCING FOR NEW INVESTORS, WHILE THIS IS NOT A PROBLEM FOR US

"There is a lot of interest from international investors in Nordic real estate, especially in direct investments," says Max Barclay, head of full-service Swedish property firm Newsec Advisory. "But the individual deal sizes are still too small, so investors are turning to buying listed companies."

The approach by US investment house Starwood Capital is a prime example. In early April, the investor in global real estate made a bid to take private Victoria Park, the sixth largest Nordic property company by market capitalisation, as of trading data on March 29.

The private equity fund has locked in 31.5% of the shares and communicated that it needs at least 35% approval of its offer to go through with the purchase, according to Mikael Söderlundh, head of research and partner at Pangea Property Partners, which advises Starwood. However, Victoria Park's board have recommended shareholders not to accept the deal. The acceptance period ends at the end of May.

"If you would like to invest €2bn or €3bn, you can do this slowly by adding assets or quickly," says Mr Barclay. "But as the stock market is trading at a discount, we will probably see more mergers, larger deals and take privates in the near term."

Another big firm with big plans in the Nordics is US private equity fund Blackstone. One of the buyers behind the largest takeover in the sector in 2017, Blackstone, together with local fund Areim, acquired all shares in Finnish retail and office owner, leaser and developer Sponda for an estimated €3.8bn, before delisting the company.

Among other transactions, Blackstone also sought to buy out the shareholders of residential property owner and developer D Carnegie in 2016, and as of the end of 2017 held 64% of the voting rights in the business.

"The region is one of the wealthiest in Europe, with growing populations, strong urbanisation trends and a liquid and transparent real estate market supported by significant domestic and international capital," says James Seppala, head of European real estate at Blackstone. "Our €7bn office, retail, residential and logistics portfolio continues to perform strongly and we look forward to investing further in the region."


Svenska Handelsfastigheter chief executive Lennart Sten

Advisories are reacting to the international push. To serve this growing market and potential new client base, Newsec is looking to set up an office in London, which is expected to open at the back end of 2018.

A currency play

According to Pangea Property Partners research, the most active investors looking to add Nordic real estate exposure in 2018 are institutional investors, property funds and international investors. According to Pangea's Mr Söderlundh, crossborder transactions in particular have been picking up.

"Net we have seen almost €10bn of crossborder investments in 2017 and expect this trend to continue this year," he says. "We have never seen such a high number before."

Some of this money is related to pan-Nordic cashflow, but about 60% comes from outside the region, notably Germany, the UK and US. "For a lot of Anglo-Saxon investors, the local currencies in the Nordics are quite attractively valued," says Mr Söderlundh. ■

Route to growth: Oslo has seen a 10% drop in housing prices since their peak late in 2017, but the market is now stabilising

Oslo reaching maturity

LONG A FORBIDDING LOCATION FOR OVERSEAS INVESTORS, OSLO'S REAL ESTATE MARKET HAS WITNESSED A FLOOD OF FOREIGN INTEREST – BUT CAN IT LAST? **SEBASTIAN SHEHADI** REPORTS

A long-time magnet for foreign capital, Sweden has dominated Nordic real estate for decades and still represents 45% of the regional market transaction volume. However, in 2015, heads turned after Oslo received NKr15bn ($1.87bn) of real estate foreign investment, a whopping 40% of Norway's market share and equal to the past 10 years of foreign capital into the country's real estate market. Since then, overseas investment has contributed to about 25% of Norway's total transaction volume, which in turn represents 25% of the Nordic volume.

The starting gun was fired when Starwood Capital and Blackstone took a big bite of Norwegian real estate in late 2014 and early 2015, buying multi-billion-krone portfolios. A deluge of foreign interest followed.

An oil slump bonus?

This dramatic entry can be attributed, in part, to Norway's oil downturn in 2014, which saw the krone depreciate by 39% against the euro, thereby making the country significantly cheaper for foreigners.

However, international investors began looking to Norway before the oil price decline, according to Jo Gullhaugen from real estate company Union. "Investors were more attracted by yields, population growth, ease of doing business, and other fundamentals such as the strong fiscal position of the Norwegian state," he says.

The hunt for yields has pushed investors beyond London, Paris and central Europe's crowded real estate markets, blighted by political uncertainty. Norway's fresh and safe market started to look like an attractive proposition.

Sheltered Oslo

Norway's onshore economy is robust. Indeed, only 1% of GDP relates to oil, meaning the country is well protected from volatility and cushioned by a vast sovereign wealth fund that is used to stimulate the economy yearly, and more so during crises.

Thus, although the downturn hit Norway's oil-rich west coast hard, Oslo was largely spared. Indeed, unemployment actually decreased and, when interest rates were cut to mitigate the slump, Oslo's housing prices increased.

Concerned about a growing housing bubble, the government introduced restrictions on mortgages and loans in 2017. Subsequently, Oslo saw a sharp 10% drop in housing prices since their peak in September 2017. The past two months have seen prices stabilise and increase slightly as the market has corrected.

With the boom over and house prices expected to rise by 2% annually, the dying bubble is not a foreign investment opportunity, according to Erik Bruce of Nordea Bank. Besides, foreign investment in Norway's residential market is very rare, he adds. Unlike in Sweden, residentials are not a large asset class because 90% of Norwegians own their own home, meaning the letting market is small.

Thus, for large international investors, the opportunities are not big enough. However, smaller companies willing to take time building critical mass could benefit, especially since the krone is still weak.

I DON'T THINK WE'LL SEE A FURTHER DECLINE OF YIELDS IN OSLO – I BELIEVE THEY'VE FLATTENED OUT ALREADY AND ARE AT THEIR BOTTOM LEVEL

Indeed, John Solberg, head of property company CBRE Norway, believes Oslo's residential opportunities have been neglected by investors, and that foreigners should select local partners and enter the lucrative developers' market, which is likely to offer strong returns for several years.

Moreover, with the oil downturn and housing bubble in the past, the macroeconomic picture for Norway is looking good. GDP growth is forecast at 2% for 2018 according to the IMF. Unemployment is below 4% in Oslo. The greater Oslo metropolitan area, with 1.3 million inhabitants, is expected to grow by 1.3% in 2018.

Commercial hot spot

Commercial turnover hit €8bn in 2017, according to data from Pangea Research. Foreign investment in Norway has almost exclusively focused on commercial real estate, mostly through direct single-asset transactions. Madison International and the Carlyle Group were the frontrunners for single-asset transactions, and others followed suit because returns are good, according to Christian Müller of law firm Thommessen.

There are only three Norwegian listed companies in real estate because most are financially independent and privately held due to incentives that reduce Norwegian's taxable fortune. As a result, the stock market is less attractive for foreign investors.

However, unlike in Sweden, a big chunk of Norway's market use syndicates funds such as Pareto Securities: single-purpose vehicles – essentially, private equity – that buy individual ready-built assets by facilitating and raising capital from private investors. Foreign investors are welcome to enter these structures, becoming indirect players, like everyone else, but beneficiaries of local expertise. Foreign investors such as HIG Capital have used syndicates to buy an industrial park, among other assets.

Although Oslo has an unusually high amount of city-centre development, many commercial opportunities exists just outside the centre in areas such as Okern. However, Mr Solberg says French real estate giant Klépierre is struggling in Okern because demand for shopping malls has fallen in Oslo.

Commercial trajectory

Since 2015 it has been relatively easy to make money in Oslo's commercial property market due to yield compression and high demand. Prime yields today stand at 3.75% and vacancy rates in greater Oslo are at 6%, and lower in the central business district.

With an interest rate hike expected in mid-2018, some fear that yields will soften and rise, pushing real estate values down. While yields may initially follow interest rates upwards, Mr Müller expects these to be balanced by rent increases, CPI inflation adjustment and continued strong demand and availability of capital.

Mr Gullhaugen says: "I don't think we'll see a further decline of yields in Oslo – I believe they've flattened out already and are at their bottom level. Prime yield may increase to 4% within the next 12 to 18 months, primarily driven by higher interest rates. Overall, we think the market is sound."

Local firm Pangea Property Partners takes a more negative view of Oslo which, in terms of return on investment for prime offices, is the most expensive of the Nordic capitals. "Investors looking at Oslo's offices need to have a case based on rental growth or higher inflation CPI," says CEO Bard Bjolgerud.

Rental upside for prime offices in Oslo is between 10% and 15%, as in Stockholm's central business district. However, the cost of renting an office in the latter is roughly double that of Oslo. But while Norway is an interesting and low-risk market, it remains outside the EU and has a local currency that makes it more expensive to hedge.

Moreover, Oslo is a maturing market and some people lag. "Being so rich and therefore picky, Oslo was quite a closed market, historically," says Mr Solberg. "Local favouritism was very evident, but now you only see traces of it." ■

Runner up: In 2017, Copenhagen was second only to Berlin in PwC and the Urban Land Institute's Emerging Trends in Real Estate in Europe scorecard

The great Dane real estate boom

LED BY BOOMING CAPITAL CITY COPENHAGEN, DENMARK'S REAL ESTATE IS CONTINUING TO THRIVE, THANKS TO STRONG ECONOMIC FUNDAMENTALS AND A CURRENCY PEGGED TO THE EURO. **JASON MITCHELL** REPORTS

Property transactions in Denmark's capital, Copenhagen, jumped by 30% in 2017, underlining international investors' strong perception of the country as a safe haven.

Total real estate transactions in Denmark last year reached DKr92bn ($14.8bn) according to Cushman and Wakefield Red. About two-thirds of the transactions were concentrated in the greater Copenhagen area. International investors accounted for 53% of all transactions, compared with 41% in 2016. Residential real estate deals made up 40% of the total, while office space accounted for 21%, retail for 18% and industrial 11%. Land and hotels made up the remainder.

In 2017, eight of the top 10 investors in Danish property were foreign. Heimstaden, the Norwegian real estate company, made 18 transactions in the Danish market, worth a total of DKr10.19bn. It was followed by ATP Ejendomme, the Danish property investor, which was part of 16 deals valued at DKr6.9bn, and Swedish real estate private equity company Niam, with 20 transactions valued at DKr5.1bn.

A new metropolis

"Copenhagen's real estate market has been doing very well since 2009," says Claus Lønborg, chief executive officer at Copenhagen Capacity, the Danish investment promotion agency for the greater Copenhagen area. "Following the international financial crisis, many foreign investors saw Denmark as a safe haven. It has a stable economy and a low level of bureaucracy, and Copenhagen is seen as one of the cities with the highest standard of living in the world. The city has grown tremendously. It used to be seen as a large village in the Nordic region but is now regarded as an international metropolis."

In 2017, Copenhagen was in joint second position with Frankfurt in PwC and the Urban Land Institute's Emerging Trends in Real Estate in Europe scorecard. Berlin took the top spot.

"All of the main real estate sectors in Denmark were depressed following the international financial crisis," says Peter Winther, chief executive officer at Danish commercial real estate company Sadolin & Albaek. "But, thankfully, the economy is now growing well again and we see a record level of employment. Prime office rents are increasing by 5% a year.

"The real estate investment market in Denmark is now very bullish, helped by very low interest rates," Mr Winther adds. "In particular, German pension funds are quite active in the Danish market, as German cities are now seen as expen-

THE INTEREST RATES FOR COMMERCIAL AND RESIDENTIAL MORTGAGES ARE LOW. THIS HAS BEEN AN IMPORTANT DRIVER IN BOTH MARKETS

sive and the Nordic countries are viewed as safe."

The strength of the real estate sector is highlighted by the country's low vacancy rates: below 2.5% in the warehousing sector, under 6% in the retail sector and slightly higher than 7% in office space, according to Ejendomstorvet, Denmark's main commercial real estate portal.

"The interest rates for commercial and residential mortgages are very low," says Simon Birch Skou, a director at Ejendomstorvet. "This has been an important driver in both these markets."

Sound basis

Experts say that the fact that the Danish krone has been pegged to the euro since 1999 has created much optimism for eurozone investors in the country. Among the Nordic countries, Sweden and Norway do not enjoy this advantage, and Finland is a eurozone member.

Denmark, with its 5.75 million inhabitants, enjoys sound economic fundamentals. GDP grew by 2.1% in 2917 and is forecast to increase by 2% this year, according to the IMF. The inflation rate is estimated at 1.4% this year and the unemployment rate is expected to drop to 5.7%. Denmark is one of the few countries in the world with a negative interest rate, at -0.65%. GDP per head is $50,564 and increasing at 2% annually. In January, a record 2.72 million people were employed in the country, surpassing the previous record set in April 2008.

Denmark is also one of only a handful of countries in the world to continue to have an AAA credit rating from the three main ratings agencies, Standard & Poor's, Moody's and Fitch.

"During the first quarter this year, transactions were 13% higher than the same period last year," says Jacob Riiser de Lichtenberg, an associate at Cushman and Wakefield Red. "All the indicators in the real estate market are strong at the moment but there is a degree of uncertainty surrounding interest rate dynamics. We are being a bit cautious. Perhaps the market will become a bit flatter because sellers expect prices that purchasers are not prepared to pay."

He adds that prime office space offers the highest annual yield at about 3.75%, while retail offers 3% and newly built residential 3.5%.

Peter Lassen, chief operating officer at Colliers International in Denmark, says: "Danish pension funds have also been strong investors in the residential space in Copenhagen and in the country's second biggest city, Aarhus. There is not enough residential space available to investors, so they have started to turn to offices."

Here to stay

Hotels are one of the fastest growing real estate markets in Copenhagen. In 2017, the total number of bed nights amounted to 7.2 million compared with 6.93 million in 2016, according to Sadolin & Albaek. This number is expected to rise to 7.7 million by 2019. In terms of bed nights, the market expanded by 66% between 2009 and 2016.

The city has 15,700 hotel rooms in total today. It is estimated that the total demand for rooms will grow by 84% during the period from 2009 to 2019, almost matched by an 80% increase in supply during the same period.

Transactions in the hotel sector in Copenhagen reached a record DKr4.85bn for the year until December 2017, according to Sadolin & Albaek. The annual occupancy rate was 82.3% in regular hotels last year but is forecast to decline to 80.2% in 2019 as more hotels come on stream. Major hotel developments expected to go live this year include Scandic Kødbyen (370 rooms), Citizen M (230 rooms) and Cabinn (1200 rooms).

Foreign investors are attracted to Denmark's real estate market because of the country's political and economic stability. Copenhagen looks set to continue growing strongly, as more and more people want to visit the city – and to live there. ■

Helsinki makes its mark on real estate radars

HELSINKI'S TECH-SAVVY WORKERS ARE LEADING A REVOLUTION IN THE CITY'S OFFICE SPACE MARKET, AS **JASON MITCHELL** REPORTS

Finland's capital city, Helsinki, has seen a significant jump in demand for co-working office space with time-based rents – and this could set a trend for other global cities to follow.

The country and its 5.5 million inhabitants are at the forefront of digital industries including gaming, cloud services, e-commerce and digital consulting, and many self-employed people in these sectors require highly flexible office space. They prefer to rent somewhere by the week, or even by the day.

"This shift to more adjustable offices may create problems for investors with old-fashioned offices," says Sirpa Ojala, CEO at Colliers International Finland. "The demand for old-fashioned offices will decline in the market, which in turn may increase vacancy rates and decrease the estimated rental value of old office investments. However, modern and well-managed offices with a distinctive brand image have an excellent opportunity to succeed in the market, as demand remains high for those kind of premises."

A new record

In 2017, yields on prime office space in Helsinki amounted to 4.2% annually, down from 4.7% in 2016. Total property transactions in Finland hit a new record of €10.2bn last year, however, 38% higher than the previous record year of 2016, according to a report by Finnish real estate research company KTI. In 2017, offices were the largest segment of the transactions marketing in the country, with total volume exceeding €4bn.

In June, Polar Bidco, a fund managed by Blackstone, acquired Sponda, a listed Finnish real estate company, for €1.8bn in cash. Sponda has €3.8bn in assets under management, mostly in the office and residential space. Stockholm-based real estate manager Areim was a co-investor.

Another major deal that boosted the total volume in Finland was Blackstone's sale of Logicor, a large European warehouse company, to China Investment Corporation, the Chinese sovereign wealth fund, in June. Out of Logicor's €12bn total property portfolio, 8% is located in Finland.

International interest

In 2017, foreign investors made up 68% of all property transactions in the Finnish market. Analysts say that German investors, in particular, were active, attracted by the fact that Finland has the euro and hence no currency exchange risk exists. The size of Finland's professional property investment market amounted to €63.7bn in 2017, up 9% on 2016.

"Transactions in the Finnish market have really started to take off," says Janne Eriksson, managing director of Cushman & Wakefield in Finland. "The country's economy is one of the fastest growing in Europe and the population of Helsinki is expected to increase by 15% by 2030. That will lead to a lot more demand for all kinds of real estate."

Sami Kiehelä, a senior director in the capital markets team at CBRE in Finland, adds: "International investor interest in Finland has picked up because of our stronger economic growth and Helsinki's favourable position compared with other European cities. The population is growing strongly because of a higher birth rate and a high rate of domestic and international migration to the city. The growing population is driving the residential market."

Making a home

Central Helsinki has a population of about 645,000 but the greater metropolitan area has 1.4 million inhabitants. It is estimated that the urban area's population is rising by

"FOR A SHOPPING CENTRE TO WORK TODAY IT MUST BE LIFESTYLE ORIENTATED, WITH A STRONG EMPHASIS ON ENTERTAINMENT AND EATING OUT"

Still growing: it is estimated that the population of Helsinki's urban area is increasing by about 20,000 per year

about 20,000 people per year. According to Statistics Finland, construction started on 45,000 new homes throughout the country in 2017, a 12% rise on 2016. Some 6900 new homes were under construction in Helsinki.

"We are seeing a number of lifestyle changes that affect where people want to live in Helsinki," says Anni Sinnemäki, the city's deputy mayor for the urban environment. "The number of new apartments with their own saunas is dropping dramatically, for example.

"There has been a big increase in the quantity of public or communal saunas and people are happy to use them rather than have one in their own home. We are seeing a strong demand by people for an urban lifestyle, with all the amenities and cultural facilities that that has to offer. Many families would now prefer to live in the city centre."

Ms Sinnemäki adds that the city's traditional port areas are now being turned over to residential use (the main cargo port is now at Vuosaari in eastern Helsinki). In the traditional city centre only apartment buildings of up to six storeys are permitted, but in the West Harbour, modern apartment buildings have been constructed of up to nine storeys, and in the Fish Harbour they rise as high as 32 storeys.

"These harbour areas are in very good locations, close to the city centre. They are ideal for residential development as they have good public transport links," says Ms Sinnemäki.

Retail boom

Two large mixed-use developments are taking place at Redi in Kalasatama, in the eastern part of Helsinki, and at Tripla in the Pasila district in the central-northern part of the city. Redi includes a 60,000-square-metre shopping centre that will open in September. It will host 38 restaurants and coffee shops. Two residential towers of up to 30 storeys are also being built.

Tripla is a three-block urban centre with 115,000 square metres of retail space, 50,000 square metres of office space, a 430-room hotel and more than 400 apartments for 1000 residents. It involves a €1bn investment, making it the biggest current construction project in Finland. The European Investment Bank has provided €130m of financing.

"It will take up to five years for the market to absorb all the new retail units coming on stream," says Tapani Piri, managing director at JLL in Finland. "E-commerce has also started to affect the traditional retail offering. For a shopping centre to work today it must be lifestyle orientated, with a strong emphasis on entertainment and eating out. E-commerce is also leading to a very big rise in demand for small warehousing units in city centres. These are necessary so that goods purchased online can be distributed within the city."

Finnish real estate, it seems, is becoming more and more popular with international investors because of the country's strong economic growth and stable political climate. ■

Bricks and mortar: Finland's Citycon invests in urban shopping centres like Buskerud Storsenter in Norway

Will the equity markets maintain their hot streak?

PROPERTY COMPANIES IN THE NORDIC REGION HAVE FAVOURED THE EQUITY MARKET RECENTLY AS INVESTORS RESPONDED TO LOW INTEREST RATES. CAN THE OUTLOOK REMAIN POSITIVE DESPITE SWEDEN'S DECLINING HOUSE PRICES? **STEFANIE LINHARDT** REPORTS

Nordic real estate companies have been blessed with strong growth and returns since the financial crisis. Indices such as the Carnegie Real Estate index have doubled in value in the past five years. But can this performance last? House prices, which have been rising over the past six years, especially in Sweden, fell by about 10% between September 2017 and February 2018. Is this having an impact on the commercial real estate sector? What are the key drivers of real estate performance?

"Normally, I expect 10% total performance per year on my portfolio, but the average in the past five years has been 20% per year," says Jonas Andersson, lead portfolio manager of Alfred Berg's Fastighetsfond Norden, a fund investing in Nordic property stocks. "I target more than 10% going forward for 2018 and 2019."

Mr Andersson calculates the "more than 10%" on a company's net asset value level as a cashflow yield of 6% plus a 2% value growth at an average leverage level of 55%, which doubles the impact of the property value increase. "But that is based on a 2% value growth – I assume values to grow even more," he says.

Knock-on effects

But how do these expectations square with the fall in house prices, especially in Sweden?

"There are quite important differences between the drivers of the housing market and the commercial real estate side," says Anna Breman, chief economist at Swedbank. "The correction in the housing market on the non-commercial side has really been a side-effect of regulatory changes, higher levels of construction and hence more supply in the market, and it is mainly driven by the largest cities."

Ms Breman adds that in the commercial real estate market, low interest rates, global growth in general and domestic economic expansion, as well as a growing business sector, play more of a role when analysing the performance of the real estate segment. Additionally, there have been no significant regulatory pushes or increased supply that could affect the market negatively.

Not just real estate

Yet, despite the historically strong performance of real estate equities in the Nordic region, many listed companies are currently trading below net asset value, according to Max Barclay, head of Sweden-based full-service property house Newsec Advisory.

As Pangea Property Partners' real estate-specific indices show, the Nordic retail sector has been hit particularly hard in 2018. In the first 16 weeks of the year, the company's PREX Retail index is 8.2% lower, while construction (-0.9%) and mixed real estate (-0.1%) have also underperformed, pushing the overall PREX Property index down 0.5% in 2018 to date.

Company and sector selection is,

NORMALLY, I EXPECT 10% TOTAL PERFORMANCE PER YEAR ON MY PORTFOLIO, BUT THE AVERAGE IN THE PAST FIVE YEARS HAS BEEN 20% PER YEAR

therefore, crucial for investors. Alfred Berg's Mr Andersson, for example, is underweight on retail-exposed real estate companies and favours those renting out offices, a sector in which the Pangea index has increased by 1.2% in 2018 to date.

"Stockholm is super hot. Here we have seen the highest percentage increase for office rents," he says. "There has been a shortage in new office space, while demand is increasing, so rent levels are booming."

Vacancy rates in the Stockholm office sector are very low at 2.5%, compared with 5.4% in Oslo, 6.8% in Copenhagen and 6.9% in Helsinki, according to Swedbank research. The bank predicts that office rental growth in Stockholm will slow down.

Sweden's surge

From a macro-economic perspective, the recent rapid increase in the Swedish population from 9 million to 10 million in 2017 and expectations of 11 million inhabitants by 2025, will also have an impact on the real estate industry, according to Ms Breman.

"Given that you have this high population growth in Sweden, there is a lot of need for investment into real estate that is focusing on the public sector: schools, daycares and elderly care," she says. "These demographic factors are supporting the commercial property market."

According to research from Pangea, the outlook is positive for both offices and logistics, slightly positive for the public sector and neutral for the residential and hotel real estate sectors, while the retail outlook is slightly negative, although there is a "large difference" between prime and secondary retail.

"The retail real estate market has been punished far too much by stories of mall closures in the US, which are not comparable with Europe," says Marcel Kokkeel, chief executive at Finland-headquartered retail real estate development company Citycon. "In the US, you can copy any store and you can build it anywhere. At Citycon, we are investing in urban shopping centres, which are uniquely integrated with public transport and offer community services such as libraries or walk-in medical services."

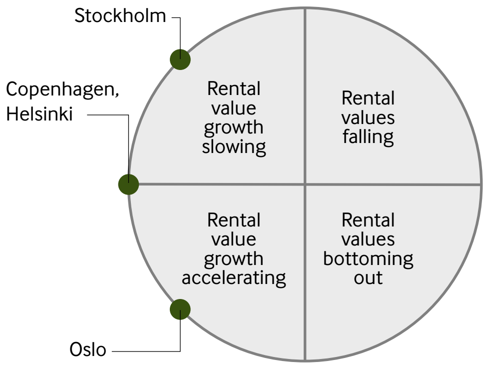
Focus on the core

Citycon, which started out as a Finland-focused business, has over the past five years trebled its equity and broadened its exposure geographically to become a pan-Nordic company. It now looks to divest its assets in smaller cities to focus on the Nordic capitals.

"We now have relevant size, which allows us to focus on investing in the assets we have, to make them better and have them work better for the community," says Mr Kokkeel.

Companies such as mixed real estate businesses Kungsleden and Castellum are following similar strategies, which see them sell assets outside their key focus areas while further consolidating their portfolios.

NORDIC OFFICE PROPERTY CLOCK, Q1 2018



Source: JLL

The fourth largest Nordic property company, Hemfosa Fastigheter, meanwhile, is in the process of splitting its operations into two: Hemfosa, which will remain listed and retain the company's public sector real estate portfolio, and Nyfosa, which will act as an "agile and transaction-intensive property company", according to current Hemfosa chief executive Jens Engwall, who will take over the helm at Nyfosa once the split has taken place.

The plan is for Nyfosa to also be listed by the end of the year, which is expected to happen through a stock split, giving current Hemfosa shareholders shares in both companies.

More supply?

Property companies flocked to the equity market between 2014 and

2016 because more investors were seeking to invest in property stocks, given the low interest rates and low returns that were available in the bond market.

"Everyone from the bus driver to smaller and larger institutions all showed a lot of interest in investing in real estate stocks," says Newsec's Mr Barclay. "This is still the case, but the interest in direct investments is also increasing."

He notes that the businesses now looking to enter the equity market are largely single-asset companies, which have been set up as special-purpose vehicles.

In 2018, the only ordinary share issues recorded by Pangea Property Partners were a SKr1.01bn ($118m) rights issue by D Carnegie to finance acquisitions in Stockholm and Västerås, and a listing by Cibus, a portfolio of assets divested by Finnish investor Sirius on Stockholm's First North exchange for smaller businesses. In the past 18 months, there has only been one initial public offering on the main exchange, for mid-sized Swedish developer SSM in April 2017.

The weaker pipeline for equity capital market deals goes hand in hand with a growing focus on direct investments by Nordic and international institutional money and private equity funds.

Fighting off private equity

The recent takeover offer by US private equity investor Starwood Capital for Victoria Park, the sixth largest stock exchange listed property company in the Nordics, is a case in point – and it underlines a trend of international private equity money targeting listed businesses.

In the case of Victoria Park, the board has recommended to decline the offer. So, especially at a time of lower valuations, are hostile takeovers something other businesses need to be wary of?

> THERE ARE IMPORTANT DIFFERENCES BETWEEN THE DRIVERS OF THE HOUSING MARKET AND THE COMMERCIAL REAL ESTATE SIDE

Ilija Batljan, chief executive at SBB Norden, a Stockholm-based business with a focus on public sector rentals, believes so. "I think all of us need to look at and analyse what kind of consolidation opportunities there may be," he says. "Otherwise you might just wake up one day and someone is buying you out of the market."

A typical way to lower the share price discount to net asset value would be to buy back some of the outstanding shares, according to Mr Andersson at Alfred Berg. He points to residential and office real estate business Wallenstam, which has a buyback programme but is using it mainly as a complement to paying a dividend.

Other options include mergers and acquisitions (M&A) among the existing players.

"Valuations and share prices might provoke M&A," says Citycon's Mr Kokkeel. "We are keeping our eyes open. If there was an opportunity that was good for shareholders, we would explore it."

Five to 12?

At times of increased investor demand and after several years of record returns, the question arises: how much longer can such a market environment last? And where is the property clock, or cycle?

"If you had asked me this time last year, I would have said the same thing as today," says Mikael Söderlundh, head of research and partner at Pangea Property Partners. "We are high in the cycle. Not at the peak yet, but quite close to it in Sweden, with the other Nordic countries perhaps a year behind."

Pangea expects international investors, institutions and property funds in particular to further increase their exposure to Nordic real estate in 2018.

But as with differences in performance between the different real estate segments, distinctions might be necessary when analysing the cycle for property as a whole.

"There is a difference between real estate companies focusing more on the needs of the public sector, which is more structural, as the need for daycare, elderly care and schools is not going to slow down in the near future," says Swedbank's Ms Breman. "But other sectors like office space are more mature and will heavily depend on global growth developments."


Anna Breman, chief economist at Swedbank

According to the JLL Property Clock for the office sector, as of the first quarter in 2018, Oslo is at about 7.30, still with scope for accelerating rental growth, Helsinki and Copenhagen are at 9, while Stockholm is at about 10.30 (see graph, page 19).

"One thing that could cool the market down in Sweden is the new amortisation rules, which were introduced on March 1 this year," says Mr Söderlundh. However, those have a greater impact on owner-occupied properties. Mr Söderlundh adds that the general elections in September as well as the introduction of interest rate deduction rules later in 2018 could have an impact on the real estate market, too.

Yet the most important factor will remain interest rates, and with them companies' costs to finance themselves (see articles about bank lending and fixed income on pages 21 and 22, respectively). And while expectations are for an increase in rates at the back end of 2018, the step change is likely going to be slow in coming. Ms Breman expects hikes to be very gradual and only of 10 basis points as a first step, which should mean interest rates, at least in Sweden, remain at zero for the course of 2019.

So the cycle will turn at some point, but likely not in the next couple of years. ■

Why loans retain a real lustre

WHILE NORDIC FIRMS ARE USING MORE BONDS, AND ARE KEEN TO DIVERSIFY THEIR FUNDING BASE, THEIR PREFERENCE FOR BANK LOANS IN THE REAL ESTATE SECTOR SHOWS LITTLE SIGN OF WANING, AS **DANIELLE MYLES** DISCOVERS

The Nordic property market is among Europe's biggest, but when it comes to funding it is also one of the most traditional. While the UK sector, for instance, relies primarily on unsecured bonds, bank loans are still the mainstay of Nordic debt stacks.

As listed property companies – particularly those in Sweden – become more financially sophisticated, they are turning to bonds. But their finance chiefs do not see the capital markets displacing loans as their main funding source any time soon. "The bond market is strong now but if that changes, and you need to refinance, it's more difficult to do that with a bond than a bank with which you have a long-term relationship," says Susann Linde, chief financial officer at Gothenburg-based property company Wallenstam.

They also value the loan market's stability. Arvid Liepe, chief financial officer at Swedish property firm Wihlborgs Fastigheter, says: "To my mind, bonds are probably more volatile and higher risk. If the market moves into a crisis-like situation, the bond market is more likely to be closed than the bank market."

Motivating by pricing

A key reason that larger operators have issued bonds is pricing. With regional interest rates at record lows, it is cheaper for them to sell an unsecured bond than borrow from the banks, which invariably require collateral. Yet banks can be the most cost-effective option for smaller and lower rated firms, for whom bond prices can fluctuate dramatically.

A typical loan to the sector has a tenor up to five years, is at a floating rate and, as of recent years, has an interest rate floor of zero. The floor has proved problematic in countries with negative rates, such as Sweden, because hedging contracts are not floored. This has led to a perverse outcome whereby firms today have higher interest costs than if the Stockholm Interbank Offered Rate (Stibor) were zero.

"I understand the banks don't want to end up in a situation where they pay the borrower, but a Stibor floor is illogical in that they don't exist in the interest rate swap market," says Mr Liepe. "Between the floor and Stibor being negative, we end up paying in both legs of the swaps."

There are recent examples of banks agreeing to remove Stibor floors, but lenders' ability to compete on price is restricted by other obligations. "In part, it's because of the equity ratios and return requirements the banks have to their stakeholders," says Dag Fjeldstad, client manager of real estate and construction in DNB's large corporates segment. "There is a limit as to how low banks are willing to go with margin, even for the best of credits."

> THE BOND MARKET IS STRONG NOW BUT IF THAT CHANGES, IT'S MORE DIFFICULT TO DO THAT WITH A BOND THAN A BANK WITH WHICH YOU HAVE A RELATIONSHIP

Creating headroom

Bank appetite for Nordic property exposure has varied over time, but both borrowers and banks see no shortage at present. "We don't see access to credit as an obstacle," says Mr Liepe.

Volumes have been muted, but the borrower mix has changed thanks to the capital markets rush. "Lately, it seems that some of the larger companies issuing bonds rather than loans has increased the availability of bank financing for smaller companies," says Swedbank credit analyst Michael Johansson.

Susann Linde, chief financial officer at Wallenstam

Mr Fjeldstad concurs, adding: "We see this as a desirable development. It's part of our policy to assist the smaller, non-investment grade companies that may not be able to tap into the capital markets."

Lending has traditionally been on a bilateral basis, but bankers say this is evolving. "Lately, there has been an increasing tendency towards club deals or syndicated deals, particularly for the larger facilities. Those deals tend to be with other Nordic banks," says Olav Løvstad, head of real estate and construction in DNB's large corporates segment.

Firms with properties in Denmark benefit greatly from the Danish mortgage system, which recognises commercial property as eligible collateral for covered bonds. They can borrow from the country's mortgage institutions at bond market rates for tenors of up to 30 years. ■

Fixed income: the next generation of funding

NORDIC PROPERTY FIRMS' AFFINITY FOR THE BOND MARKET HAS ACCELERATED IN RECENT YEARS. **DANIELLE MYLES** INVESTIGATES WHY

Over the past five years, property companies across Europe have increasingly turned to the debt capital markets, but nowhere is this trend more pronounced than in the Nordics. The numbers say it all. Real estate firms were behind some 43% of the region's Swedish krona-denominated corporate bond sales in 2017, according to Swedbank, and now account for more than 40% of outstanding Swedish corporate paper.

Issuance from Swedish firms alone soared from some SKr10bn ($1.17bn) in 2010 to nearly SKr70bn in 2017, while their Norwegian peers nearly doubled their bond sales between 2015 and 2017. "Real estate companies are starting to issue to a larger degree in the bond market, rather than only relying on loans as their primary source of financing," says Tomas Lundquist, Citi's head of European corporate debt capital markets. "It's a trend that has taken off and I have a feeling is likely to be the case for years to come."

As issuance is dominated by the large, listed Swedish property managers, most real estate bonds are investment grade. Indeed, it is these players that have driven the historically small Swedish krona bond market's transformation into a self-sustaining market. Only about 20% of the sector's outstanding bonds are high yield, having been sold by property developers and sub-investment-grade managers.

Perfect business sense

The primary reason why Nordic property managers are tapping the capital markets is to diversify funding, reduce their historical reliance on secured loans, and spread counterparty exposure. Bonds and commercial paper now account for about 40% of some of the bigger firms' debt stack. According to the Riksbank, the Swedish central bank, as of May 2017, Swedish commercial real estate companies had SKr456bn in bank debt and SKr344bn in bonds and certificates.

It is undeniable, however, that robust market conditions are a major drawcard. Since regional interest rates hit record lows and the European Central Bank started its corporate bond-buying programme, firms have been able to sell bonds with extremely low coupons. Furthermore, while Nordic banks now require interest rate floors in their loans, investors are happy to live without them.

"Currently it is cheaper for us to borrow via an unsecured bond than a bilateral loan for which we must put up collateral," says Arvid Liepe, chief financial officer at Swedish property company Wihlborgs Fastigheter. "Also, an unsecured medium-term note [MTN] programme is a practical instrument to work with – the flexibility is reasonably high and the administrative cost relatively low."

While most European investment-grade notes are fixed rate, Swedish property managers issue a large portion of their bonds as float-

WE ARE ACTUALLY PAYING MORE ON OUR SWAP AGREEMENTS THAN IF STIBOR WAS ZERO

ing rate. Tenors are about five-years – which is similar to what the banks offer – and in Sweden the vast majority of bonds are unsecured. Compared with secured bank loans, this makes it easier for firms to sell properties to improve rental yields. It is notable that in Norway, however, most of the sector's investment-grade issuance is secured.

Buy-side universe

Unconventional monetary policy, having sparked the buy-side to seek out new investment opportunities, such as Nordic real estate, is one reason why the sector's bonds are regularly oversubscribed. But it is the not the only reason. There are fundamental shifts happening within the investor base that indicate the buoyant market will continue after rates rise and central bank bond-buying comes to an end.

First, the buy-side is moving some resources away from industries that dominated bond volumes in the early 2000s – such as utilities and telecoms – and into those driving today's market. "We sometimes meet investors who used to cover utilities, or other sectors, but now cover real estate," says Mr Lundquist. "It seems the investor base is repositioning some of its team to reflect market volumes and opportunities."

As a result, the buy-side is expected to develop a more nuanced appreciation of the characteristics of each sub-sector, be it retail, commercial, residential or logistics. "Today, many investors talk about real-estate as if it is one sector. But they will, and it's important that they do, start to get a more granular understanding of which segment the company operates in," says Mr Lundquist.

Second, debut deals have been snapped up, with the number of property issuers in the Swedish krona market increasing by more than 30% over the past two years. "Investors' willingness to accept new names has also contributed to the very strong market," says Mathias Leijon, Nordea's head of corporate and investment banking. It shows investors will support a growing issuer base.

Finally, Sweden's strong economic growth and financial stability has prompted investors to up their exposure to the country. "Liquidity in the Swedish market has been incredible," says Michael Johansson, a credit analyst at Swedbank. "It has seen very positive fund flows since a few months into 2016, and the larger buyer base has obviously helped them to issue at tight levels."

Sector risks

Furthermore, while Swedish investors do venture beyond the Nordics, they tend to gravitate to familiar names from their home market. "You have a Swedish investor base, particularly the Swedish krona portfolios, that really take a lot of comfort in primarily Swedish names, and also Nordic names more broadly," says Derry Hubbard, Danske Bank's global co-head of debt capital markets.

Biljana Pehrsson, CEO of Ba1

Investors are, however, being advised to watch some sector-specific risks. After a decade-long surge in Sweden's and Norway's house prices – which had sparked warnings from multilaterals, rating agencies and analysts as potential bubbles – both markets experienced corrections in late 2017 and early this year. This has hit the price of tenant-owned apartments and some of the smaller developers building them, but market participants agree there has been no direct and immediate impact on residential property managers.

"Sweden's rental market is regulated, the vacancy risk is close to zero and it takes some time for any price development to fully flow through the cashflow-based valuation models," says Mr Johansson. "So for the managers, certainly at the outset, the direct effect should be quite limited."

Another issue is the sector's relatively short debt maturity profiles. Many firms are regularly refinanc- ▶

ing, which creates liquidity risks plus other potential problems. "Many property companies are rolling over secured bank debt annually or with two- to three-year maturities, while they reduce their reliance on loans by looking more to the bond market," says Fredric Liljestrand, a director in Fitch's industrials and real-estate team. "If the bank debt matures before the bonds, the bonds become temporally subordinated."

According to the principle of temporal subordination, any debt that is payable before the bonds – irrespective of their respective rankings – becomes more senior.

Eurobonds: broadening horizons

Naturally, real estate issuers have initially focused on the local Nordic markets, but there is a nascent trend of firms looking to foreign currencies. A handful of Swedish names, including Akelius, have issued Eurobonds and bankers expect the trend to continue. To date, firms with purely domestic portfolios have steered clear of international issuance as it would create foreign exchange (FX) risk. But for those managing assets in other countries, international bonds are a way to currency match; by borrowing in the same currency in which they hold assets, they reduce their FX risk.

Another advantage of Eurobonds is the ability to raise larger tickets than in the Nordic markets, and for tenors of up to 12 years. It is a way to significantly lengthen debt maturity profiles – particularly useful for real estate companies as it allows them to match their long-term portfolios with long-term financing.

Due to managers' historical reliance on secured bank loans, local markets have become a vital stepping stone to issuing a Eurobond, not only as a form of financial education, but also as a way to unencumber portfolios. This is important for two reasons.

> LIQUIDITY IN THE SWEDISH MARKET HAS BEEN INCREDIBLE. IT HAS SEEN VERY POSITIVE FUND FLOWS SINCE A FEW MONTHS INTO 2016

First, international investors generally are not willing to hold the only unsecured slice of an issuer's debt stack, as it means they rank subordinate to every other creditor. Local investors are less concerned about this, which makes selling domestic unsecured bonds – and using the proceeds to repay secured bank loans – an ideal way to get balance sheets in shape for a Eurobond.

Second, reducing the proportion of secured financing is necessary to convince rating agencies that they are investment grade. "Once they have a more balanced portfolio of secured and unsecured debt, it has become possible for them to get a rating that doesn't penalise them for the secured debt," says Mr Lundquist. "This makes it easier for them to issue bonds internationally."

Ratings enter a new era

Kungsleden is a case in point. Last September, Moody's rated the Swedish company Ba1, and affirmed that at least 30% of its properties must be unencumbered for it to be lifted one notch to investment grade. It has since worked towards that goal by reducing its portion of bank loans, and launching and issuing from a SKr5bn MTN programme. As at the end of March, 26% of its portfolio was not pledged as collateral. Its CEO, Biljana Pehrsson, says the company will consider issuing a Eurobond after it receives an investment-grade rating.

The Moody's assessment was Kungsleden's first official credit rating, and it has already paid off. "The rating has enabled us to reduce the cost of our bond financing by roughly 30 basis points [bps] to 40bps," says Ms Pehrsson. She expects to see a similar reduction again after it has reached investment grade.

The reason why Kungsleden and many other large Nordic corporates have only just received their first official rating is because they have historically relied on so-called shadow ratings. These are free assessments made by Nordic banks using the rating agencies' criteria, which was accepted market practice until late 2016 when the European Securities and Markets Authority warned it would clamp down on the process. Today, the only major Nordic bank to still offer shadow ratings is SEB.

Managers hedge their interest rate risk via local swaps, however Mr

Michael Johansson, a credit analyst at Swedbank

Johansson's research shows that the sector's average maturity for these hedges has not been extended in recent years. "This is understandable given they've paid to fix their interest rates, but haven't got a lot out of it as rates haven't risen as some experts forecast," he says. "If rates look like they will go higher, they might start thinking about pushing out their maturities again."

Another reason Swedish firms have stepped back from interest rate swaps is because negative interest rates have created a mismatch with the loan market. "Bank loans are floored at zero – so we don't benefit from the negative Stockholm Interbank Offered Rate [Stibor] – while swap agreements aren't. It means we are actually paying more on our swap agreements than if Stibor was zero," says Ms Pehrsson.

In a separate development, Nordic real estate firms have implemented world-class sustainability frameworks and have been very active in the green bond market. "Sweden is still the region's biggest market but interest is increasing rapidly in Finland and Norway, and Denmark is starting to pick up, too," says Einar Erici, a director in Nordea's debt advisory division. "It means tapping into another pool of capital, and the price they pay is 2bps to 4bps lower than a conventional bond." Indeed, the sector is a leading example of how issuers can lower their borrowing costs by selling green bonds. ■

A question of value

WHEN COMPARED WITH THE REST OF EUROPE, NORDIC PROPERTY COMPANIES TEND TO OPERATE WITH HIGHER LOAN-TO-VALUE RATIOS. **STEFANIE LINHARDT** LOOKS AT WHY THIS APPROACH WORKS IN THE REGION

Before the global financial crisis, Nordic property businesses used to operate with high loan-to-value (LTV) ratios. While leverage has decreased from what was then often normal levels of some 70%, Nordic real estate businesses still operate with comparably high LTVs on the international stage. But how and why does it work?

"As an investor in the stock market, you get higher returns on leverage, so I like it, because it means that I can get a better performance," says Jonas Andersson, lead portfolio manager of Alfred Berg's Fastighetsfond Norden – a fund investing in Nordic property stocks. "If it's a stable company I can live with high leverage but I want loan-to-value levels to be well in line with what the banks are comfortable with."

In Sweden, banks are broadly looking for about 55% – any higher and it costs more, adds Mr Andersson. In the Norwegian market, average LTV levels for commercial real estate companies are about 60%, but can rise to about 65% depending on special factors, according to Dag Fjeldstad, client manager of real estate and construction in Norwegian financial services group DNB's large corporates segment.

How much is too much?

SBB Norden, a Swedish business with a focus on lower risk rental properties, had a slightly higher than average LTV of 60% at the end of 2017, according to chief executive Ilja Batljan. However, this figure has come down from more than 70% at the end of 2016.

"Ninety percent of our income comes either from government or from regulated residential real estate, which means that our exposure actually is to the Swedish and other Nordic states," says Mr Batljan. "From that point of view we should be able to have an even higher LTV ratio."

From a bank perspective, this would not be a problem, Mr Batljan notes, as "they are often open to have LTVs for regulated residentials of 70%".

"Banks are much more aware when it comes to segmenting the sector, to look at you differently depending on if your properties are retail, office, prime office or regulated public properties," he says. "Our LTV at 60% really is comparable with an LTV at 50% for commercial real estate."

LEVERAGE LEVELS ARE GETTING A BIT MORE PRUDENT AND ARE GOING DOWN TO BELOW 50% AMONG CORE COMPANIES

A risk for bond investors?

As Nordic property companies are increasingly turning to the local and international bond market, could these LTVs turn into a problem for bond investors?

"We believe that a rise in interest rates, even if gradual, could put pressure on the financial risk profile of these companies given their capital-intensive nature," says Marie-Aude Vialle, director at S&P Global Ratings. "Higher interest rates could not only lead to weaker interest coverage ratios, which could be an issue particularly in low-yielding markets such as residential in Sweden, but also negatively affect asset valuations, pushing leverage ratios up, and closer to covenant levels for some issuers."

Yet recently, the trend has been more towards a contraction in LTVs. According to Swedbank's Nordic Real Estate Sector 2017 recap and 2018 outlook published in March, only seven out of 35 businesses increased leverage in 2017, while Humlegården's LTV was the lowest at below 40%.

Helena Olin, head of real asset investments at AP2

SBB Norden is also looking to further lower its LTV ratio, as Mr Batljan aims to improve the company's BB rating to investment grade. He intends to achieve this, like many of his peers, through an increase in valuations. Some companies also raise equity to grow and lower their leverage, such as Citycon, which gradually brought its LTV down from 58% to 46% over a seven-year horizon, according to chief executive Marcel Kokkeel, giving it a BBB rating.

"Leverage levels are getting a bit more prudent and are going down to below 50% among core companies," says Helena Olin, head of real asset investments at the Second Swedish Pension Fund AP2. "This might still be a bit higher compared with some of Europe, where levels are below 40%, but values in Paris or London are more volatile historically, so you might say it is fair to have slightly higher leverage levels [in Sweden]." ■

Nordic FX: volatility ahead?

THE NORDIC COUNTRIES' CURRENCIES ARE RENOWNED FOR STABILITY AND LOW RISK, BUT CONCERNS ARE SURFACING AROUND THE CURRENCIES OF NORWAY AND SWEDEN, NICKNAMED THE 'NOKKIE' AND THE 'STOCKY'. **JOY MACKNIGHT** REPORTS

Managing different currencies adds some complexity to operations spanning the four largest Nordic economies, which are similar in business, legal and sociopolitical aspects. However, foreign exchange (FX) risk is lessened due to Finland's use of the euro and the Danish krone's close peg to the common currency.

The Danish currency keeps within an exchange rate band agreed by the country's central bank, Danmarks Nationalbank, and the European Central Bank (ECB), and is the cornerstone of the country's economic policy. "The central bank keeps a tight rein on the krone and will intervene if it gets too strong or weak," says Jørn Sodborg, director, head of e-business and distribution at Jyske Bank.

He adds: "After the Swiss National Bank unpegged the franc in January 2015, speculators thought the Danish krone would follow. But the Nationalbank acted aggressively in the market to defend the currency, which won it well-deserved credibility." Thus, speculators are not active in the Danish currency market; instead, activity is mainly linked to mergers and acquisitions and hedging by pension funds, asset managers and corporates.

Nokkie and stocky

The Norwegian krone, or 'nokkie', and the Swedish krona, or 'stocky', are the liveliest of the Nordic currencies. Today, they are both on the weak side compared with the euro, according to Richard Falkenhäll, senior FX strategist at SEB. Sveriges Riksbank moved to weaken the stocky to support Sweden's export-driven economy, whereas the nokkie weakened due to plunging oil prices in 2014. Notwithstanding some volatility, Mr Falkenhäll reports that 'real money' investors – such as pension funds and asset managers – commonly do not hedge, and operate with an open FX exposure.

A COMMONLY HELD VIEW IS THAT, AT CURRENT LEVELS, AN INVESTOR ISN'T DOING THAT MUCH WRONG IF THEY DECIDE NOT TO HEDGE

Before the global financial crisis, it was usual to see long hedges in stocky, he says, as exporters hedged future revenues. "But during the crisis their order books disappeared and they ended up being overhedged, which was costly. Since then, domestic companies now hedge less and for shorter time periods than historically," says Mr Falkenhäll.

Magne Østnor, FX strategist at Norwegian investment bank DNB Markets, says real money investors, with a three- to five-year horizon, may use FX forwards and options, but concurs that many long-term investors do not typically hedge FX risk. "A commonly held view is that, at current levels, an investor isn't doing that much wrong if they decide not to hedge," he says.

Real estate company Samhällsbyggnadsbolaget (SBB) de-risks its business by holding assets in the four countries of operation. "While these countries have many things in common, they are four different FX exposures, with economies in different cycles," says SBB chief executive Ilija Batljan.

Potential risks

SBB does not use hedging instruments but matches assets with financing in the same currency, termed natural hedging. "When we buy assets in Norwegian krone, then we do our debt financing in Norwegian krone; when we buy assets in euro, we do the same," says Mr Batljan.

Magne Østnor, FX strategist at DNB Markets

While the euro has normalised, with a relatively long-term neutral position against the US dollar, more broadly there are signs of deceleration in the EU, says John Hardy, head of FX strategy at Copenhagen-based Saxo Bank. "And if a global trade confrontation erupts, the eurozone is poorly positioned as a large exporting bloc. Suddenly, some of the shine has come off of the euro," he adds.

Similarly, the stocky is vulnerable to global trade swings due to Sweden's export-based economy. "If global growth gets back on track then it may recover – but we aren't expecting inflation to come back in any notable way," says Mr Hardy.

The nokkie is better placed, with Norway's oil fund helping to power through the credit cycle. "But the economy has similar structural vulnerabilities as Sweden, such as a housing bubble of almost equal size relative to the economy," says Mr Hardy. Notably, Norges Bank, the Norwegian central bank, has signalled an interest rate rise in September, ahead of the Riksbank and the ECB, which may help strengthen the currency. ■

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