NORDIC INSIGHT

MARCH 2012

MARKET NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

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DO THE NORDICS OFFER A SAFE HAVEN?

The fiscal and debt problems in Europe are worse than is generally believed. We expect that not only Greece but also Italy will default on its debt eventually and that investors will continue to suffer losses on government bonds issued by the weaker eurozone countries.

Our bearish outlook is based on two arguments. Firstly, it is often overlooked that repayment of public debt is more a matter of will than of ability. Countries will default long before their repayment options are truly expended. Given the amount of debt, the political will to undertake austerity measures and pay debt down must be exhausted eventually. Secondly, a favorable outcome of the sovereign debt crisis would mark a complete break with history. The Nordic countries have thus far been able to avoid such troubles and in a turbulent Europe the Nordics offer a safe haven. Is this favorable outlook priced into Nordic real estate?

The sovereign debt and fiscal crises have held the eurozone in their grip for a number of months, even striking a blow to the perceived creditworthiness of the very core, France and Germany. Markets are very concerned that a number of eurozone countries will default, in part or in full. We believe that these concerns are fully justified and that the situation will get worse before it gets better.

Firstly, whereas the sheer mathematics of the situation paints a dire picture, defaulting on debt is not merely a matter of maths or the ability to pay. Unlike a company or private person, a country can choose not to pay. Thus, payment of its bills is a matter of will just as much as of ability. And the political will to repay debt is often exhausted long before that ability to pay.

Secondly, countries with the credit histories of the likes of the GIIPS—Greece, Ireland, Italy, Portugal and Spain—have, in the past, been unable to recover from the debt-to-GDP ratios that they are currently experiencing. Historical evidence points to defaults at debt-to-GDP levels that are considerably lower than those existing in these countries today. Are things different now? To some extent, they are. But mostly things are just the way they have always been and these countries will likely default, just as they have in the past. One of the biggest follies in every crisis is to assume that the current situation is different from the past. History does have a habit of repeating itself.

Thus, we take the bearish view that the sovereign debt and fiscal problems will get worse—potentially much worse—before they get any better. The Nordics, on the other hand, have largely avoided such problems, with all countries having sustainable long-term debt-to-GDP

ratios and small or no deficits. We think that the debt and fiscal problems of Europe will weigh on productivity for a long time to come, and that this points to a comparatively favorable performance for the Nordics.

Does this mean that Nordic real estate is cheap and that high returns can be expected? Not necessarily. The favorable conditions are widely recognized and have already been largely priced in. Due to this, we think high returns in the Nordics are unlikely going forward. However, we also see less risk and a more restricted downside in the Nordics, which sets the stage for decent risk-adjusted returns.

Won't Pay, Don't Need To

For any country, paying its bills is a matter of will. That such a high number of countries have historically decided to default on debt that is low in comparison to GDP illustrates this point. A country may decide to pay its debt for various reasons—for example, for the benefit of retaining access to international capital markets or to avoid a breakdown of international trade or to uphold international relations, to name a few. However, the cost of paying down debt, for many countries, often exceeds these benefits.

Look at Greece with this in mind. Given the current debt-to-GDP ratio, following the partial default, estimated to be considerably over 100%, it would take decades of austerity and running surpluses before the debt is back at what we would consider to be a long-run sustainable level. At some point during the next decade, probably already within a few years, the elected leaders are going to come to the conclusion (correct or not) that the benefits of repaying the debt are smaller than the benefits of defaulting, and will choose to default. Deciding not to default requires an iron will, but iron wills do not go hand in hand with democracies that have new elections every three to five years. In addition, some economists already seem to think that a default is the best option for Greece.

Is It Different This Time?

Most economists would agree that debt-to-GDP ratios of 100% or more are not healthy and could be a precursor to a sovereign debt crisis. Thanks to the wonderful studies of the likes of Reinhart and Rogoff, we know that, historically, sovereign debt crises occur at debt-to-GDP ratios that are much lower than one would expect.

Reinhart and Rogoff have tracked the amount of foreign debt for countries at the time of a crisis (domestic debt is seldom available). Looking at the most recent crises for medium-income countries such as Brazil, Mexico, Russia and Turkey, they find in their sample that only 16% of the crises occurred in countries where foreign debt-to-GDP ratios were in excess of 100%. More than half of the crises occurred at foreign debt-to-GDP ratios of 60% or less, and one-fifth of all crises occurred at a ratio of less than 40%. To provide some concrete examples, Chile's last default in 1972 took place at a foreign debt-to-GDP ratio of 31.1%. The crisis in Iran in 1992 took place at 41.8%. Russia defaulted at 12.5% in 1991, and at 58.5% in 1998.

> "MOST ECONOMISTS WOULD AGREE THAT DEBT-TO-GDP RATIOS OF 100% OR MORE ARE NOT HEALTHY"

Most countries in the sample have defaulted during the past 40 years. We resist the temptation to believe that things are any different now, just as we do not think they will be any different 10 or 20 years from now.

Does Debt Matter for Growth?

Arguably the best analysis of the relationship between real GDP growth and total government debt (both external and domestic debt) is provided by Reinhart and Rogoff. Firstly, it is worth noting, at least for more developed economies, that there is no evident relationship between real GDP growth and total debt levels, when the debt-to-GDP ratio is less than 90%. However, where countries have experienced a debt burden exceeding 90% of GDP, median growth has been 1% lower and average growth has been 4% lower, when compared to peer countries that have debt burdens below 90%.

Assume that southern Europe has total government debt at the 90% plus level for five years. Five years, for example, of 1-2% lower growth per year should have a significant effect on real estate investments.

Things Are Better Up North

For various reasons the Nordics have all but escaped these types of problems.

Chart 1 shows the deficit and debt-to-GDP ratios for 2010 for 11 European countries, plus averages for a larger set of European countries (the then eurozone 16 and the EU-27). From the chart, it is apparent that the Nordic countries are very well placed. They enjoy low deficits and low debt in relation to GDP. Norway, which consistently runs large fiscal surpluses, is in a league of its own. Norway does have debt of up to 45% of GDP, but this debt is small in comparison to the country's massive sovereign wealth fund, valued at approximately EUR 430 billion at the beginning of January.

Chart 2 shows the change in government gross debt from 2009 to 2010 as a percentage of GDP. This illustrates that not only is debt in the Nordic countries low by comparison, but also that debt levels are growing much more slowly. Debt levels are generally growing quite fast in the countries that are already heavily indebted. Sweden was the only country in the sample to see its gross debt fall, from 42.8% in 2009 to 39.8% in 2010.

The fiscal health in the Nordics does show up in financial markets. ***Chart 3*** shows yields on long-term bonds. It is clear that, alongside Germany and the United Kingdom, the Nordics have some of the lowest borrowing costs in Europe.

Chart 4 shows a comparison of credit default swap spreads for Finland, Sweden and selected European countries. Due to low liquidity, quotes for Norway and Denmark have not been included.

History and track record are also on the side of the Nordics. Reinhart and Rogoff have collected data showing that since 1800 the Nordic countries have not suffered a single sovereign debt crisis. The only other countries in western Europe to enjoy a similar track record are Belgium and the United Kingdom. During the same period, Spain has suffered 13, Germany eight, Hungary and Austria seven, Turkey six, Greece five, and Italy and the Netherlands one each.

Spain, one of the countries that are in the worst shape at the moment, is thus a serial offender and this does not count in its favor in the current crisis. Against this background, we think the probability that a restructuring of Spanish debt will take place in the medium term is fairly significant. Medium term for us is within five years.

In short, by almost any measure, the risk of a sovereign debt problem in the Nordics is infinitesimal; the finances of the Nordic countries are quite sound. That said, the Nordics are, of course, not immune to developments elsewhere in Europe. By virtue of being small, open economies, a slowdown abroad quickly translates to a slowdown at home. But, whereas an acute drop in economic activity could result if the rest of Europe again slips into a recession, we believe that the long-term

Chart 1: Debt and Deficit, Selected European Countries, 2010

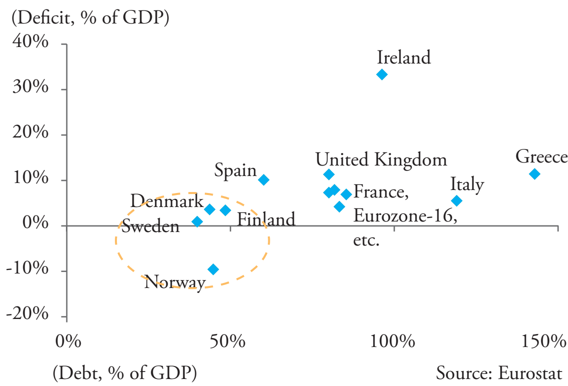


Chart 2: Change in Government Gross Debt for Selected European Countries from 2009 to 2010 (% of GDP)

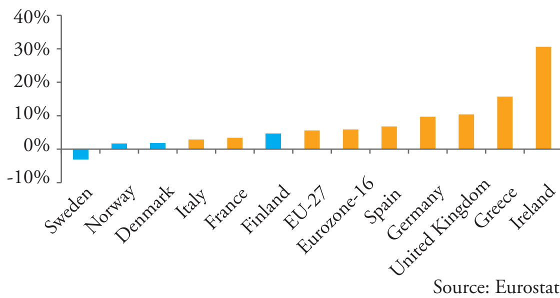


Chart 3: Long-Term Government Bond Yields

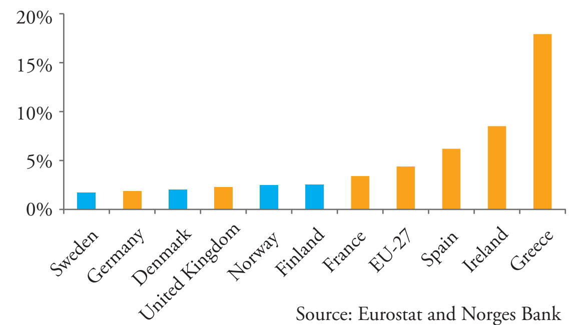


Chart 4: Credit Default Swap Spread Comparison, February 2012

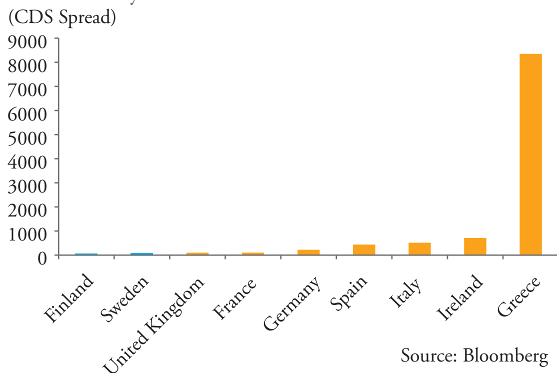


Chart 5: Number of Sovereign Debt Crises/Debt Restructurings since 1800

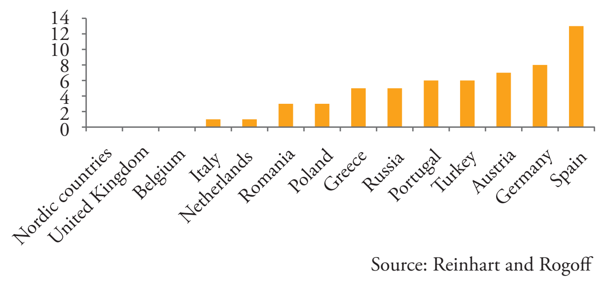


Chart 6a: Forecast GDP Growth for Selected European Countries and the United States, 2011

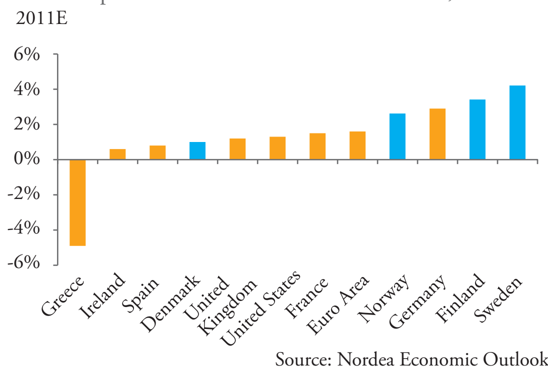
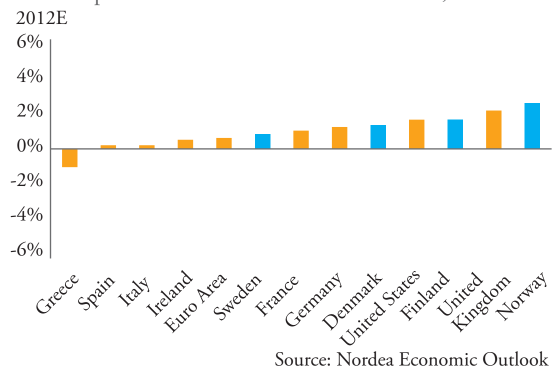


Chart 6b: Forecast GDP Growth for Selected European Countries and the United States, 2012



> "THE STRENGTH OF BANKS IS VERY MUCH A FUNCTION OF THE COUNTRIES WHERE THEY RUN THEIR OPERATIONS"

GDP growth prospects for the Nordics are much better than for Europe as a whole. The short-term prospects are also quite favorable on a comparative basis, as can be seen below in the recent forecast from the Swedish bank Nordea.

Nordic Banks Also In Good Shape

At the time of writing, there is considerable turbulence in the European banking sector. This includes poor performance in share prices, high interbank interest rates and increased reliance on governments, the ECB and short-term debt for financing. Money market funds have staged an exodus out of parts of banking Europe, refusing to roll over debt or rolling over debt with much shorter maturities than before.

If there was any doubt that the major banks in the western world operate with an implicit government guarantee, such doubts were put to rest in the financial crisis of 2008-2010. Given the severe effects of the default of Lehman Brothers, no government can be expected to take similar risks again, even if they were in a position to execute a bailout.

Given the implicit governmental guarantees and the poor health of the banking sector, it is apparent that the strength of banks is very much a function of the countries where they run their operations. We argue that the Nordic banks, backed by their strong countries, are well placed to weather the gathering storm.

In our own experience, the Nordic banks fared well during the financial crisis and were more willing to lend to real estate than banks in most other places in Europe.

Genesta had the privilege of raising debt in the Nordics in the fall of 2009, when we were acquiring a prime office property in central Oslo. Not sure that we would get a single bank to show an interest, we courted eight banks and received a tremendous seven offers. The most competitive bids offered margins in the vicinity of 200 bps at a leverage ratio of 65-70%. This was very good at that time. In many other European markets, it was difficult to raise debt at all, let alone on such good terms. Before the current sovereign debt crisis gathered strength in late July and August last year, it was possible to achieve margins of 125 bps at a gearing level of 70%, for good products in Norway. From a European perspective, this seems rather favorable. We are willing to bet that, if a new serious downturn becomes a reality, the Norwegian banks will be the banks in the Nordics that are best placed to weather the storm.

The Nordic banks, especially the Swedish and Finnish banks, showed a lot of restraint during the strong market of 2006-2007. We believe that, in part, this is the result of the lessons learned from the long and deep recession that took hold in Sweden in 1991-1992, when the banks suffered massive losses on commercial real estate. This means

they have fewer legacy issues to deal with than many of the foreign banks that lent to Sweden and Finland during 2006-2007.

We are also willing to bet that, if the current financial crisis gets any worse, the Nordic banks will be among those best placed to stay out of trouble and will be in a position to lend more to real estate than banks elsewhere.

An exception is Denmark, where the banking sector is anything but healthy. About 10 lenders have fallen since 2008, and in July 2011 Standard & Poor's issued a report saying that up to 15 more lenders could fail during the next three years, mainly due to the exposure of the banks to commercial property and farming. The collapse of the regional lenders Fjordbank Mors and Amagerbanken in 2011 meant haircuts for senior bondholders, and these losses made it more difficult for Danish banks to find international funding. It is going to take time for Danish banks to recover.

What Does it All Mean for Real Estate?

The current European fiscal and debt crisis will weigh on Europe GDP growth prospects for a number of years to come. We believe that the legacy of these troubles will still be felt in five years' time. In addition to low GDP growth, the troubles should lead to a lower supply of capital, especially debt capital, for commercial real estate investments.

We expect the Nordics, which have largely avoided these problems, will enjoy higher GDP growth and will have a higher availability of capital for commercial real estate investments.

"WE EXPECT THE NORDICS ... WILL HAVE A HIGHER AVAILABILITY OF CAPITAL FOR COMMERCIAL REAL ESTATE INVESTMENTS"

The good prospects for the Nordics have not gone unnoticed and, as always, there are few free lunches. As we see the situation, demand for good quality real estate in the Nordics is high, from both foreign and domestic investors. Retail properties, whose market values were probably unjustifiably hit during the most recent crisis, were in heavy demand throughout 2011 and have seen an amazing recovery. Some trades during the spring and summer of 2011 were overpriced, in our opinion. Although we would not say that high-quality retail is overpriced, a lot of the office stock is probably comparatively less expensive.

Due to the strong recovery across all sectors and in most cases conservative gearing from the start, the refinancing and debt overhang problems are fairly minute and concentrated into a small number of deals. There have been few distressed sales compared to many other parts of Europe. Take Sweden as an example. Unless the market falls heavily again, our best estimate is that there is a stock of about EUR 500-700 million left that will be sold under heavy pressure from creditors in Sweden. No more than that.

From an historical and very general perspective, we do not perceive the market to be overpriced, with rents and

> "WE VIEW NORDIC REAL ESTATE TO BE … AN ALTERNATIVE WITH LOWER DOWNSIDE RISK THAN REAL ESTATE ELSEWHERE"

per-square-metre prices in real terms only slightly above their long-term averages and below what we perceive to be the long-term trend. It is more difficult to say that nominal yields look attractive when compared to their historical averages, but this needs to be seen in context. Firstly, real interest rates have been in decline in the western world for a long period and, thus, the running returns on real estate today, in absolute terms, should be lower than during the 1970s, 1980s and 1990s. Secondly, inflation expectations today are much lower than the actual inflation outcome for considerable parts of the historical data, especially for the 1980s. Thus, we would expect yields to be lower now than they have been historically.

Among the Nordic markets, we perceive the Finnish market to be the market that has had the weakest recovery from the fall in 2009. Liquidity continues to be very low. Finland is also the country where we expect the best return performance going forward, but it is also a market with a lot of pitfalls for an investor with limited experience of this particular market.

We view Nordic real estate to be relatively attractive and an alternative with lower downside risk than real estate elsewhere. However, the sovereign debt crises, coupled with stalled GDP growth in many of the major markets, with real estate prices not falling substantially during the past three months, makes it difficult to see real estate being a bargain anywhere in Europe at the moment.

In this turbulent financial world, we strongly believe that, although real estate bargains will be hard to find and returns will be less bountiful, the Nordics offer a safer haven for real estate capital that has Nordic know-how. ■

DEBT OVERHANG AND VALUE DESTRUCTION

WHY FORGIVING DEBT CAN BE A WIN-WIN SITUATION

Debt overhang is still persistent in many European markets, and will be for some time to come. Recent research from DTZ[1] estimates that there is a potential gap of USD 45 billion in the United Kingdom alone between the amount of commercial real estate loans maturing and the amount of debt that can be raised during the next three years. Large gaps can also be found in places like Ireland and Spain. Real estate investments are simply too highly leveraged.

Creditors are pushing a lot of the problem to the future. They are evergreening their loans—effectively extending the maturities of the loans, hoping that things will get better before their position is realized. Low interest rates and massive government support have made such extensions possible. And these extensions have served them well; had they realized their positions during the height of the crisis, they would have sold at the bottom.

Although debt overhang is less of an issue in the Nordic markets than in many other countries in Europe, we have still witnessed the value destruction that excessive debt can create. As will be explained below, debt overhang can give rise to several issues, not least in that it incentivizes equityholders to pass up profitable projects, something that can be very detrimental to creditors. To maximize their own expected pay-off, it may make sense for creditors to write off some debt, changing the incentives of equityholders. We hope that the theoretical examples provided below will spark an interest in the problem of debt overhang; learning more about the debt overhang problem could provide useful arguments in debt negotiations.

Deviating From Par Value

So what is debt overhang? Definitions differ, but for the purposes of this article let us use the definition that it is when the market value of a bank's claim deviates substantially from the claim's

[1]Please see DTZ's report *Global Debt Funding Gap* from 8 November 2011

> “HAD [CREDITORS] REALIZED THEIR POSITIONS DURING THE HEIGHT OF THE CRISIS, THEY WOULD HAVE SOLD AT THE BOTTOM”

par value. A bank may have lent EUR 80 million to a real estate investment and the claim is now, due to a fall in the value of the collateral asset, valued only at EUR 70 million.

Debt overhang results in a number of issues. One issue is a fall in liquidity. When the asset value is at or near the par value of the debt, the pay-off to the owners from a sale is small and thus they have very little incentive to sell; it is better to wait and hope for a recovery on a things-cannot-get-much-worse, only-better basis. What would have been a good sale, had the owners not levered the investment, suddenly seems not so attractive because of the debt. An asset may sit with the wrong owners longer than necessary.

Further, debt overhang can create incentives for equityholders to choose riskier strategies over safer ones, even when the latter have a higher net present value. The investors choose the strategy with a high variation in outcome, as this increases their chances of getting some kind of pay-off from their out-of-the-money position.

Necessary Encouragement

However, the most acute problem with debt overhang, in our opinion, is the fact that it skews the incentives of owners and makes them fail to undertake projects that have a positive net present value. Such projects can be important ones, like necessary repairs or tenant improvements needed to lease space to new tenants. Interestingly, in these cases, it may make sense for the bank to forfeit some of its claim, bringing the leverage down.

Let us take an example to illustrate this point. Assume that a property was acquired for 100 and initially geared to 85% with non-recourse financing. Let us further assume that the value of the property has fallen by 30% since the investment’s inception and is today valued at 70. The investment is thus now geared to 85/70=121%. The equityholders are now fairly far out of the money, ie only a significant recovery will enable them to get any pay-off from a sale. In this situation, they should be hesitant to invest any further money into the property, as it is unlikely that they will reap any benefit from their investment.

Assume that the owners find a new tenant who will lease the building in its entirety for a rent that is higher than the property’s passing rent. The owners do the calculations and find that the costs for tenant improvement for the space for the new tenant is 10, whereas the value increase of the building is 20, bringing the total value of the building up to 90 (70+20). If the owners were to sell the building after the new tenant has moved in, they would now receive 5 (90-85), as opposed to 0 earlier. But they had to invest 10 to get this pay-off of 5, which means that the net benefit of investing in tenant improvements for the new tenant is -5. It is therefore perfectly rational for the owners to decide not to undertake the investment; they

would pass it up. If the investment for the new tenant is passed up, the bank receives 70, that is, the full proceeds, upon sale. If the investment is undertaken, the building is valued at 90 and the bank receives its full 85 back. It would thus very much want the owners to invest in the tenant improvements, as a failure to do so gives it a loss of 15.

In this situation, it would pay for the creditors to forfeit some of their loans. Say they would write off 6, giving a new debt balance of 79. The owners would then undertake the investment for the new tenant as they receive a pay-off of 1 from doing so (90-10-79=1). The creditors receive a full 79 instead of 70. Hence, this is a win-win situation for the owners and the creditors.

Another option would be for the owners to try to find debt financing to finance the tenant improvement investment, but raising new debt at such gearing levels is normally out of the question. It may, however, make sense for creditors who have already lent money to the investor to finance the investment, as they and not the owners would be the primary beneficiaries of the investment. In practice, we rarely have observed this happening.

Familiar Symptoms

We have witnessed several large, heavily geared investments suffer from debt overhang during the past two years. The symptoms are all too familiar: a lack of investment in tenant improvements, resulting in lease termination and increased vacancy; a lack of investment in marketing and in repairs and maintenance. As anyone who has owned buildings knows, deferred maintenance is costly; a dollar of maintenance deferred today can easily translate into three to five dollars of required investment in the future to deal with the damage caused. Owners of nearby properties will start targeting tenants in the property suffering from debt overhang, knowing that few tenants will sign a long lease in a property where there is no money for tenant improvements and where the owner is distressed.

> "VALUE DESTRUCTION IS NOT GOOD FOR THE INDUSTRY, REGARDLESS OF WHO BEARS THE COST IN A SPECIFIC CASE"

One could ask why equity investors should be concerned with a problem that primarily is that of the banks? Well, we would argue, value destruction is not good for the industry, regardless of who bears the cost in a specific case. In the long run, the costs for debt overhang problems will be shared by all participants.

The topics discussed in this article are found in a number of corporate finance books. It is worth being reminded of them at a time like this. And it is easy to forget about them in the day-to-day management of a levered real estate portfolio. Hopefully, this can provide some alternative perspectives on debt management and arguments to use when negotiating with creditors. ■

This article is the author's revised version of the original article that appeared in the March 2011 issue of *The Institutional Real Estate Letter – Europe.*

SWEDEN

NOT IMMUNE TO THE EUROZONE SLUMP

Even Sweden, one of Europe's strongest performers over the past couple of years, is unlikely to avoid recession in 2012. But room for monetary and fiscal loosening means that a repeat of the 2008–2009 slump is unlikely.

Q3 2011's GDP figures suggest that the Swedish economy is weathering the storm created by the eurozone fiscal crisis pretty well. The quarterly rise in GDP of 1.6% left the annual growth rate at a robust 4.6%, far stronger than the annual gain of 1.4% recorded by the eurozone over the same period. ***(See Chart 1.)***

But timelier data paint a more downbeat picture. The EC Economic Sentiment Indicator (ESI), a measure of business and consumer confidence, has recently fallen more sharply than the equivalent eurozone index and suggests that Swedish GDP growth slowed sharply at the turn of the year. ***(See Chart 3.)***

Meanwhile, the severe recession that we expect to see in the eurozone, Sweden's largest export market, will hit exporters hard. With growth elsewhere likely to slow, too, exports may start to contract before long. ***(See Chart 4.)*** The strong krona will not help matters.

The recent slump in consumer confidence does not bode well for household spending, either. Another sign that households are becoming more cautious is the fact that house prices have started to fall on an annual basis. ***(See Chart 5.)***

Given that the house price-to-earnings ratio remains high by historical standards, further falls in house prices appear likely.

Admittedly, the recent interest rate cut by the Riksbank, the current healthy state of the labor market and the fact that CPI inflation is likely to fall over the coming months ***(see Chart 6.)*** will help to support household spending. Nonetheless, spending is likely to expand at a snail's pace, at best.

The upshot is that we expect the economy to expand by just 0.5% this year and next. Against this backdrop, the Riksbank will continue to reduce interest rates, perhaps to about 0.5% by early 2013. While this perhaps suggests that the krona will weaken, we expect the dire situation in the eurozone to prompt the currency to *strengthen* against the euro.

The weak economic outlook suggests that the robust recovery in commercial property rental values seen over the past two years will slow considerably this year. This is especially true for more secondary locations and markets. Retail rental growth may prove more resilient. ***(See Chart 7.)***

Investors may also require higher property yields to compensate for lower expectations for growth in income. Increasing risk aversion will add to this effect. However, recent falls in 10-year sovereign bond yields mean that property/bond yield spreads are at their highest level since at least 1992. ***(See Chart 8.)*** This could limit the upward pressure on property yields. ■

Chart 1: Swedish & Eurozone GDP (% y/y)

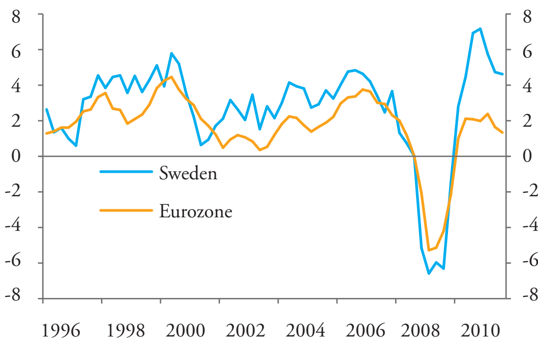


Chart 2: Swedish & Eurozone EC ESIs

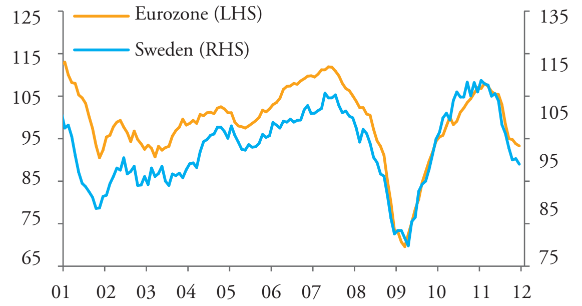


Chart 3: Swedish GDP & EC ESI

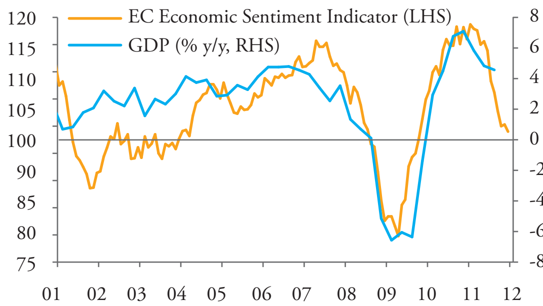


Chart 4: Swedish Exports & GDP in Sweden's Major Trade Partners

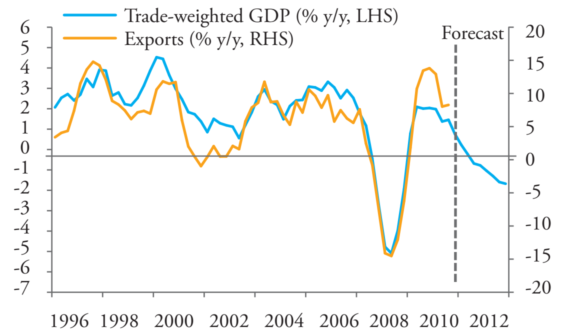


Chart 5: Swedish House Prices & Home Sales (% y/y)

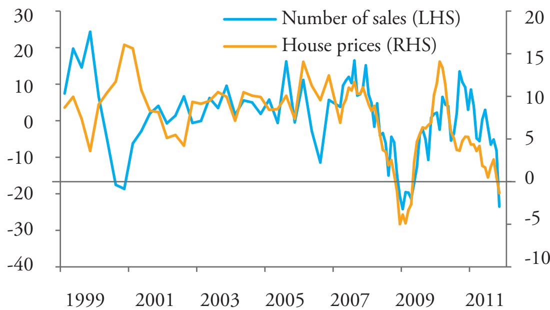


Chart 6: Swedish Headline & Core HICP Inflation

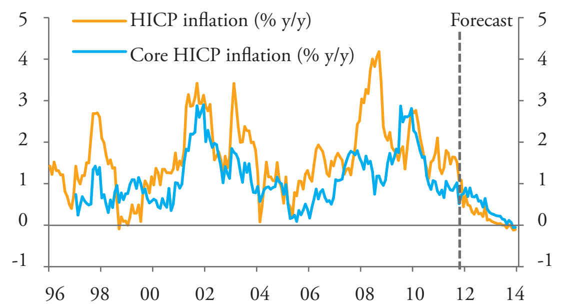


Chart 7: Stockholm Prime Rental Value Growth (% y/y)

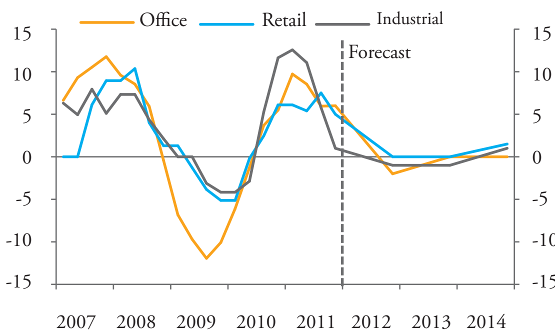
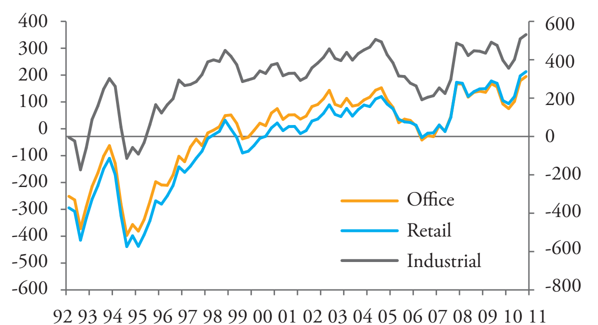


Chart 8: Stockholm Commercial Property/10-year National Government Bond Yield Spreads (Bps)



Sources: Statistics Sweden, European Commission, Capital Economics

FINLAND

EXPORTERS TO BE HIT PARTICULARLY HARD

Finland is better placed than most of the other eurozone economies to withstand the ill effects of the region's debt crisis. Nonetheless, as the external slowdown intensifies, the economy looks set to slip back into recession.

Finland has so far been largely unscathed by the eurozone debt crisis. Indeed, the economy expanded at a healthy rate by eurozone standards last year and government bond yields have plunged. ***(See Chart 1.)***

What's more, the banking sector has benefited from its low exposure to the most troubled eurozone economies. This is supported by the fact that its banks have made little use of the ECB's lending facilities and that lending to households and firms has continued to grow at a solid pace. ***(See Chart 2.)***

Nonetheless, there are clear signs that exporters are suffering. As ***Chart 3*** shows, annual export growth has recently fallen into negative territory and the survey-based measures of firms' employment intentions suggest that this is probably more than a temporary blip. Given that exports fell particularly sharply in Finland during the 2008–2009 recession ***(see Chart 4.)***, there is clearly a risk that much worse is to come.

What's more, the debt crisis and slowing house price inflation appear to have hit consumer sentiment, suggesting that household spending will be far weaker in 2012 than in 2011. ***(See Charts 5 and 6.)*** Note, too, that in comparison to elsewhere the boost to households' real incomes from lower inflation this year will be less, as a result of increases in duties on a range of consumer goods. Admittedly, a modest fiscal squeeze by eurozone standards and reasonably low levels of household debt suggest that the outlook for Finnish household spending is brighter than for the eurozone as a whole. Nonetheless, we expect spending to fall both this year and next.

The upshot is that we think that the Finnish economy will contract by about 1% this year and by 2.5% or so in 2013. This is broadly in line with our forecast for the eurozone as a whole, but much worse than our forecasts for its Swedish and Norwegian neighbours.

Clearly, all this does not bode too well for commercial property occupier demand. We expect rents in the main sectors to remain flat or maybe even decline over the coming years. Having rebounded by nearly 20% last year, office rents look to be pretty exposed to a renewed downturn. But the industrial sector is already cooling, suggesting that the outlook for industrial rents is not much better. ***(See Chart 7.)***

Meanwhile, in absolute terms, at 325 basis points or more, property/bond yield spreads are pretty high. However, relative to "normal" levels seen over the past decade, such spreads do not look so obviously wide. Indeed, among eurozone markets, only property/bond yield spreads in France are closer to normal levels. ***(See Chart 8.)*** Given this, as well as the current uncertainty over the economic outlook and the high probability that rents will fall, we think that property/bond yield spreads in Finland will not compress over the short term. Therefore, we have pencilled in unchanged yields for the coming year for all three of the main commercial sectors. ■

Chart 1: Finnish & Eurozone GDP (% y/y)

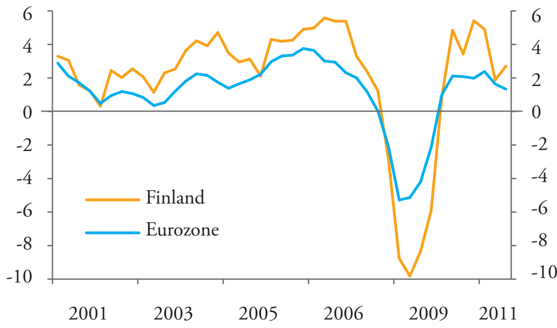


Chart 2: Bank Lending to Households and Non-Financial Firms (% y/y)

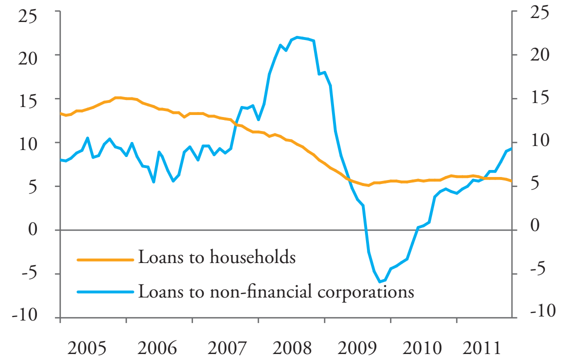


Chart 3: Exports & EC Export Orders

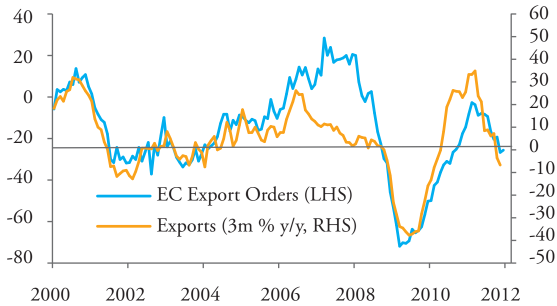


Chart 4: Peak-to-Trough Falls in Exports in 2008 & 2009 (%)

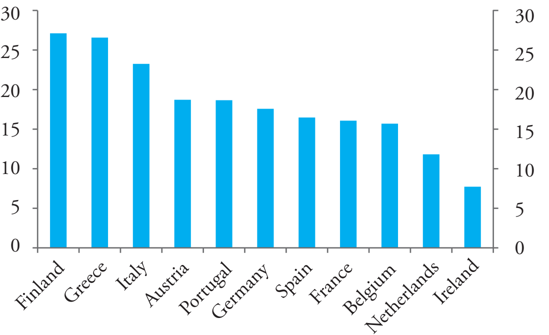


Chart 5: Consumer Confidence & Spending

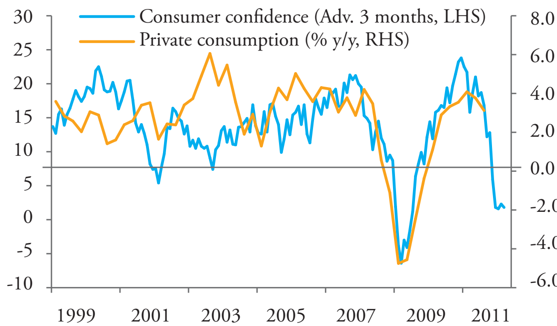


Chart 6: House Prices & Household Spending (% y/y)

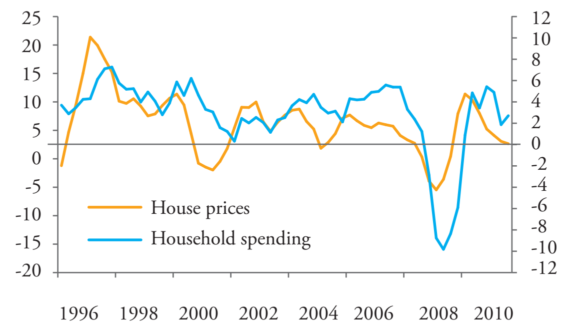


Chart 7: Helsinki Commercial Property Rental Value Growth (% y/y)

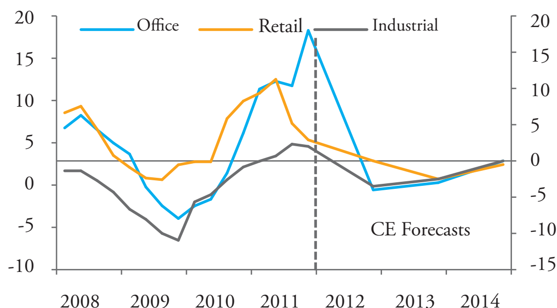


Chart 8: Eurozone All-Property/10-year Bund Yield Spreads (Bps Difference from Long-Run Average)

Sources: Eurostat, European Commission, ECB, Capital Economics

NORWAY

OIL SECTOR COMING TO THE RESCUE

After lagging behind its Swedish neighbor in 2010 and 2011, Norway may be the top-performing Nordic economy this year.

The negative impact on exports from the eurozone recession is likely to be exacerbated by a rise in the krone against the euro. But since Norway is less open than its neighbors, the impact of the downturn on overall GDP growth may not be as significant as in other parts of Scandinavia. ***(See Chart 1.)***

What's more, Norway is set to receive a boost from strong investment growth in the oil sector as a result of the high oil price and the discovery of new reserves. Indeed, a recent survey suggests that investment in the oil and gas sector may rise by over 20% this year.

And while consumer confidence has recently fallen, it still points to reasonable household spending growth. ***(See Chart 2.)*** Meanwhile, the reasonably healthy labor market, slowing consumer price inflation and looser monetary policy all suggest that household spending and house prices will continue to rise, albeit at a slower pace than last year.

In all, we expect the economy to expand by 1.5% or so this year and 0.5% in 2013. ***(See Chart 3.)*** A sharp drop in oil prices could prompt weaker growth. But the fact that there is scope to loosen monetary and fiscal policy suggests that Norway should be able to avoid following the eurozone into a deep recession.

Norway's commercial property market has been one of Europe's star performers over the past two years. But given the current market pricing and the high costs for financing we think further significant yield compression over the short term is unlikely. ■

Chart 1: Exports (2010, % of GDP)

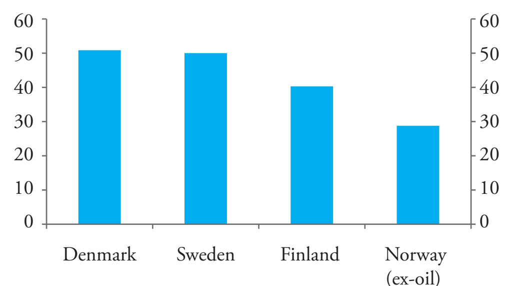


Chart 2: Household Spending & Consumer Confidence

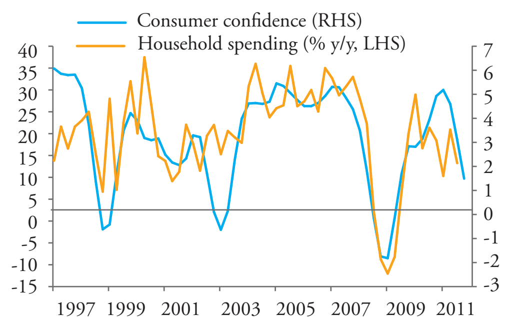
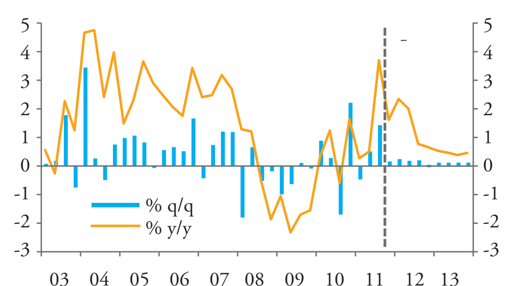


Chart 3: GDP



Sources: Statistics Norway, Bloomberg, Capital Economics

DENMARK

ENTERING ANOTHER DEEP SLUMP

Unlike the other Nordic economies, Denmark looks set to contract more sharply than the eurozone in 2012.

The plunge in Danish business and consumer sentiment that has taken place since the spring has prompted the EC Economic Sentiment Indicator to fall to a record low. On past form, the survey points to a rather sharp decline in GDP. *(See Chart 1.)*

The sharp deterioration in confidence has at least partly reflected the ongoing problems in the banking sector, which have prompted lending to firms, in particular, to fall fairly sharply on an annual basis. *(See Chart 2.)*

Weaker sentiment, tight lending conditions and high levels of debt are likely to prompt further falls in property prices. Note that the fall in house prices in Q3 2011 was broadly on a par with those recorded at the height of the 2008–2009 slump. *(See Chart 3.)* Despite low levels of public debt, a reasonably large budget deficit will prevent a major fiscal loosening.

Admittedly, if we are right and the euro weakens substantially, exporters may perform a bit better than their Scandinavian counterparts. But this will not prevent a pretty nasty recession. We expect GDP to contract by 1.5% or so this year and 2% in 2013.

Copenhagen office and retail property yields are currently among the lowest in Europe. While history suggests that is fairly typical, their spread over government bond yields looks somewhat low. *(See Chart 4.)* Retail yields have risen by 20 basis points over the past year and are likely to rise a little further. Meanwhile, although the industrial property/bond yield spread is lower than the peak seen in 2010, yields in this sector appear most insulated from a renewed downturn. ■

Chart 1: EC Economic Sentiment & GDP

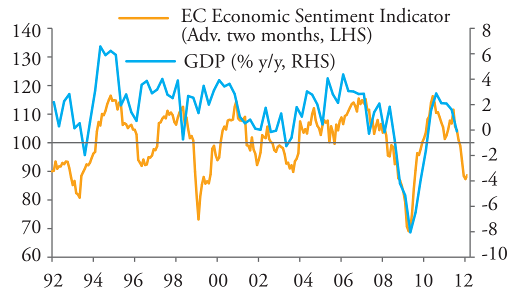


Chart 2: Danish Bank Lending to Households & Firms (% y/y)

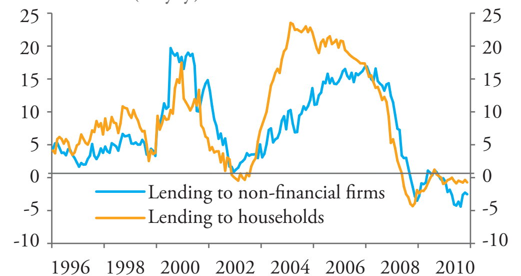


Chart 3: House Prices

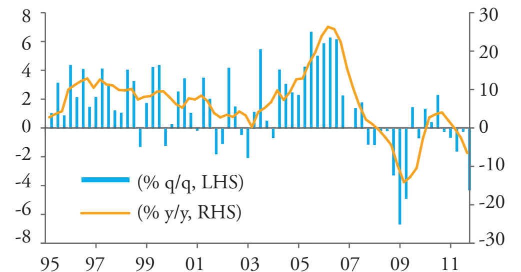
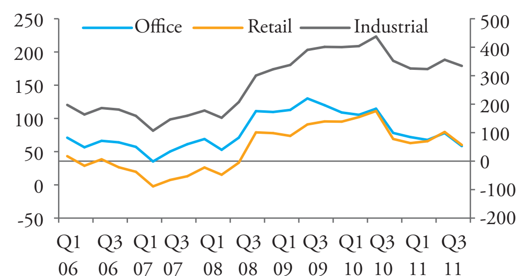


Chart 4: Copenhagen Commercial Property/10-year Danish Government Bond Yield Spreads (Bps)



Sources: Statistics Denmark, European Commission, Danmarks Nationalbank, Association of Danish Mortgage Banks, Capital Economics

DETAILED FORECASTS

TABLE 1. REAL GDP (% CHANGE YEAR-ON-YEAR)

% change year-on-year	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	3.4	-0.8	-5.1	5.4	4.5	0.5	0.5
Finland	3.7	1.0	-8.2	3.6	2.5	-1.0	-2.5
Norway(1)	1.9	0.6	-1.6	0.3	1.5	1.5	0.5
Denmark	2.0	-1.1	-5.2	1.7	1.0	-1.5	-2.0
Eurozone	2.3	0.3	-4.2	1.7	1.5	-1.0	-2.5

(1) Total GDP (not mainland)

TABLE 2. CPI (HICP, % CHANGE YEAR-ON-YEAR)

% change year-on-year	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	1.5	3.3	1.9	1.9	1.4	0.3	0.0
Finland	1.5	3.9	1.6	1.7	3.3	2.5	0.8
Norway	1.8	3.4	2.3	2.3	1.2	0.8	0.8
Denmark	1.9	3.6	1.1	2.2	2.7	1.2	0.5
Eurozone	2.0	3.3	0.3	1.6	2.7	1.5	0.0

TABLE 3. UNEMPLOYMENT RATE (%)

% workforce	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	7.6	6.2	8.3	8.4	7.5	7.7	8.5
Finland	9.0	6.4	8.2	8.4	7.8	8.5	10.5
Norway	3.5	2.5	3.1	3.5	3.3	3.7	4.5
Denmark	4.7	3.3	6.1	7.4	7.5	8.5	10.0
Eurozone	8.9	7.7	9.6	10.1	10.1	11.0	12.5

DETAILED FORECASTS

TABLE 4. GOVERNMENT BUDGET BALANCE (% OF GDP)

% of GDP	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	1.3	2.2	-0.7	0.2	0.0	-0.5	-1.0
Finland	2.9	4.3	-2.5	-2.5	-2.5	-2.0	-2.5
Norway	11.7	19.1	10.7	10.6	12.5	10.0	10.0
Denmark	2.3	3.2	-2.7	-2.6	-4.0	-6.0	-4.5
Eurozone	-1.9	-2.1	-6.4	-6.2	-4.3	-4.0	-4.0

TABLE 5. OFFICIAL INTEREST RATES (%)

% year-end	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	3.14	2.00	0.25	1.25	1.75	1.00	0.50
Finland	3.06	2.50	1.00	1.00	1.00	1.00	1.00
Norway	4.85	3.00	1.75	2.00	1.75	1.00	1.00
Denmark	2.98	3.75	1.20	1.05	0.70	0.70	0.70
Eurozone	3.06	2.50	1.00	1.00	1.00	1.00	1.00

TABLE 6. HOUSE PRICES (% CHANGE YEAR-ON-YEAR)

% change year-on-year	Average 1998–2007	2008	2009	2010	2011f	2012f	2013f
Sweden	9.4	2.1	5.3	6.3	2.0	-0.5	-1.5
Finland	6.2	5.9	4.0	8.7	3.0	-1.0	-2.0
Norway	7.3	8.5	3.2	1.6	5.5	2.5	1.0
Denmark	11.1	24.6	22.5	3.0	-4.3	-6.5	-2.0

SWEDEN

Sweden has a population close to 9.5 million, which has increased by an average of 0.8% per year for the last five years. 22% of the Swedish population lives in the Greater Stockholm area, and this population has grown by an average of 1.7% per year in the last five years. In 2010, Sweden had a GDP of USD 459 billion, about USD 49,200 *per capita*. The unemployment rate fell during 2011 and in December 2011 stood at 7.1%, a reduction of 0.3% from the December 2010 figure.

The Investment Market

Liquidity on the Swedish property market during 2011 was equal to that of 2010. The transaction volume for the first three quarters of 2011 was SEK 59 billion, almost identical to the same period in 2010. However, the volume during the fourth quarter of 2011 declined against the respective quarter of 2010 due to increasing concerns on the eurozone sovereign debt crisis. The harsh credit market will benefit financially strong players. The banks are becoming increasingly selective in their lending, which is having a direct negative impact on small- and medium-sized investors.

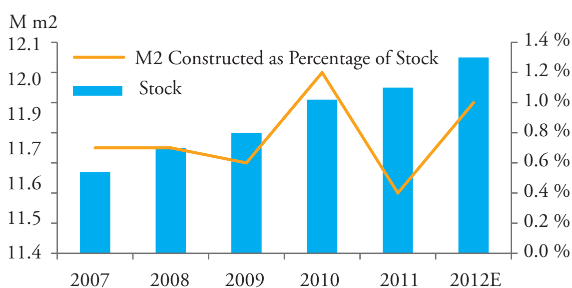
During the fourth quarter of 2011, a difference became apparent between high-quality prime office properties and office properties in secondary locations that had higher risk in the forms of vacancies and only short-term lease commitments. One example of the prime category is AFA Försäkring's acquisition of Gångaren 16 on western Kungsholmen, which was acquired together with Gångaren 20. Gångaren 16 was completed by Skanska during 2011 and more than 95 percent is leased by Visma on a long contract. AFA Försäkring, which already owns several properties close by, acquired the property off-market, which contributed to the direct yield requirement for the transaction coming in just below 5.0%. An example of the secondary category is NCC's acquisition of the properties Startboxen 1 and the nearby car-park building Sadelplatsen 2. NCC has its head office at Startboxen 1 and its lease agreement runs out soon; this gave NCC a good negotiating position with Morgan Stanley, which found itself forced to sell at a substantial loss. Morgan Stanley acquired the properties from DB Real Estate for just over SEK 960 million in the autumn of 2006 and has now sold them five years later for SEK 415 million. Startboxen 1 comprises 23,500 m2 and NCC now plans to develop its headquarters to modern standards, with a focus on energy efficiency.

The Office Market

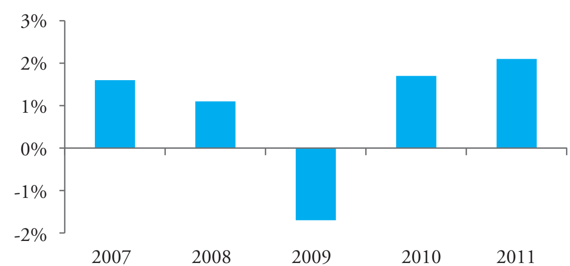
The total office stock in Greater Stockholm amounts to approximately 12.0 million m2. Stockholm CBD is considered to be the most attractive office area and its stock totals about 1.9 million m2. Stockholm Central has an office stock of about 4.3 million m2. The main office areas in Greater Stockholm are found in the municipalities of Stockholm, Solna, Sundbyberg, Nacka, Sollentuna, Järfälla, Danderyd and Upplands Väsby.

List of Transactions - Top 8 - Greater Stockholm Area - Q4 2011

No.	Object	Location	Buyer	Seller	Property Type	Value (SEK million)	Size (m2)	Yield (%)
1.	Three City Gallerias	Stockholm Central	AMF Fastigheter	Centini	Retail	4,000	59,100	4.50-5.00
2.	Skandia's headquarters	Stockholm Central	AMF Fastigheter	Skanska	Office	~1,275	29,700	~ 5.00
3.	Two properties	Stockholm Central	AMF Fastigheter	Skanska	Office and mixed-use	1,010	26,100	N/A
4.	Three properties	Stockholm CBD	Three labor unions	Niam	Office	~ 900	17,000	~ 5.25
5.	Building rights	Stockholm (Arenastaden)	Unibail-Rodamco	Råsta Holding	Building rights	630	100,000	-
6.	Five municipality centers	Greater Stockholm	FastPartner	Centini	Municipality centers	~ 500	70,000	~ 9.00
7.	One property	Stockholm CBD	Hufvudstaden	Fabege	Office	478	6,700	~ 4.75
8.	Two properties	Stockholm (Järva)	NCC	Morgan Stanley	Office and parking garage	415	23,500	N/A



Source: Newsec



Source: Newsec

List of Office Projects - Top 5 - Sweden - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	Lustgården office building	Stockholm (Kungsholmen)	Skanska	55,000	2011	2014
2.	New headquarters for Swedbank	Stockholm (Sundbyberg)	Humlegården	44,000	2011	2013
3.	New headquarters for Vattenfall	Stockholm (Arenastaden)	Fabege	43,000	2009	2012
4.	New headquarters for the Swedish Security Service	Stockholm (Huvudsta)	Specialfastigheter	35,000	2010	2013
5.	Rättscentrum i Malmö	Malmö	Vasakronan	34,000	2010	2013

New Supply

During 2011, projects totaling just over 40,000 m2 were completed; the low amount of new construction was a result of the financial turmoil experienced during 2008–2009. About 80% of the office space completed in 2011 is now let. Construction activity for 2012 is back to a high level of close to 130,000 m2, of which over 90 percent is pre-let. Only a few new-construction projects that were initiated speculatively are currently in progress in Stockholm. These projects are Skanska's Lustgården, NCC's Torsplan and Fabege's Uarda 1. During the fourth quarter of 2011, major lettings occurred in all these projects.

The known possible new-production projects in Greater Stockholm add up to nearly 2.5 million m2 of office space. For a large proportion of these plans, start-up lies several years into the future and the proportion of speculative project starts in the next few years is expected to be limited.

The top four office projects in Sweden are being built in Greater Stockholm. Skanska initiated its Lustgården office project during 2011 and announced that the company intends to locate its head office at Lustgården in fall 2013, and will then occupy about half of the area in the 55,000 m2 office building. Swedbank will relocate all the bank's operations, presently located in Gallerian in Stockholm CBD, to new premises developed by Humlegården in Sundbyberg.

The relocation will take place at the turn of the year 2013–2014.

The third office project from the top five listing is Vattenfall's new headquarters, which is being built in Arenastaden. Vattenfall will move to its new location during the third quarter of 2012.

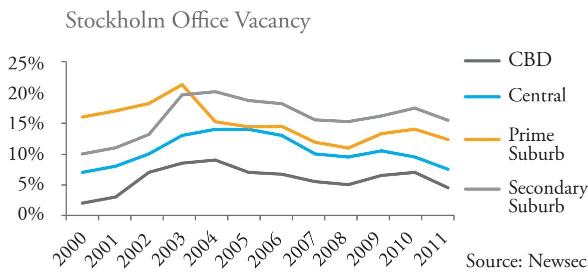
The Occupier Market

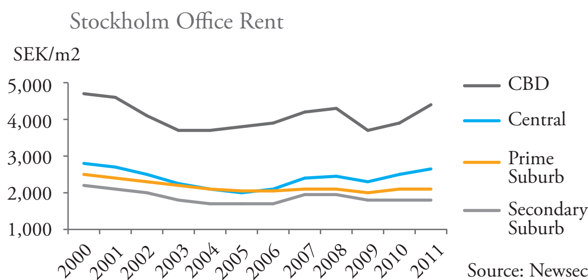
Rental levels in the CBD continue to increase and are now estimated at SEK 4,400 per m2, an increase of close to 13% since 2010. Newsec estimates that the rent at the end of 2012 will be SEK 4,500 per m2. During the fourth quarter of 2011, the rental market activity was at a level where attractive premises disappeared rapidly from the market.

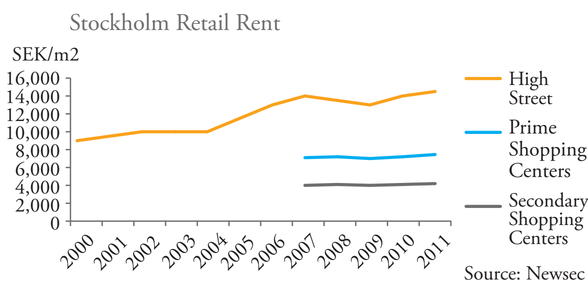
Vacancies continued to fall throughout 2011 and in the CBD the vacancy rate is just under 4.5%. Vacancy in the CBD is expected to continue to fall until around the end of 2013, when Swedbank will be leaving Gallerian, Försäkringskassan will be leaving Uggleborg 12 on Vasagatan, and Diligentia has completed the renovation of Träsket 17 on Sveavägen.

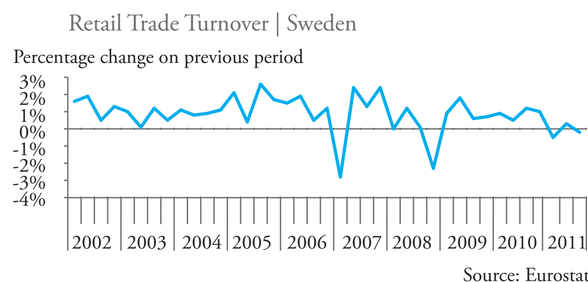
The Retail Market

Consumer confidence fell during the summer and fall of 2011 due to expectations of rising interest rates and general economic uncertainty. Households' caution is clearly reflected in the retail sector, which is going through a difficult period, with low growth a consequence. Conditions exist for retailers to be able to show relatively good growth figures, but the psychological effect on households was clearly reflected in retail sales during the second half of 2011. Households' real disposable incomes increased by 1%–1.5% per year in 2009 and 2010, and are expected to increase at a rather higher rate in 2011–2012 due to a combination of wage rises and low inflation.









New Supply

About 500,000 m2 of new retail space is planned in Stockholm up to 2015. The largest project is Mall of Scandinavia next to the new National Arena for football in Solna, which will have about 100,000 m2 divided among 250 stores. During the fourth quarter of 2011, Unibail-Rodamco acquired building rights for the intended project area. Täby Centrum, also owned by Unibail-Rodamco, is to add about 25,000 m2 of retail space, which is expected to be complete in 2015. The new shopping center Emporia will have about 65,000 m2 and is being developed by Steen & Strøm. Emporia will open in October 2012.

The Occupier Market

High Street retail rents were fairly stable throughout the second half of the 2000s, due to the inherent stability of Swedish private consumption. The High Street retail rent rose by SEK 500 per m2 during 2011 to SEK 14,500 per m2.

List of Retail Projects - Top 5 - Sweden - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	Mall of Scandinavia	Stockholm	Unibail-Rodamco	95,000	2012	2015
2.	Emporia	Malmö	Steen & Strøm	65,000	2006	2012
3.	Torp Retail Area	Uddevalla	Ikano/IKEA/Steen & Strøm	40,000	2010	2013
4.	IKEA/Ikano Shopping Center	Umeå	Ikano/IKEA	35,000	2012	2014
5.	Täby Centrum	Stockholm (Täby)	Unibail-Rodamco	25,000	2011	2015

FINLAND

Finland's population is some 5.4 million, with an average annual growth over the last five years amounting to 0.4%. 24% of all inhabitants live in Helsinki. In Finland, GDP in 2010 was approximately USD 240 billion, around USD 44,000 *per capita*. The labor market showed positive signs during 2011 and it is estimated that the unemployment rate for 2011 will be about 8.0%.

The Investment Market

The transaction volume in the first half of 2011 increased by a third compared to the first half of 2010 – from EUR 750 million to EUR 1 billion. During the first half of 2011, the main focus of international investors was still prime office assets in Helsinki. Throughout the second half of the year, activity fell slightly; looking at the year in total, the transaction mood was quite hesitant. A majority of the investors were equity investors from Sweden and Germany. Domestic investors on the Finnish market mainly bought residential portfolios, offices and industrial premises. Activity in 2012 is estimated to stay quite moderate, as the markets are still waiting. Safiiri Business Park, located in the Matinkylä district in the surrounding areas of Olari in Espoo, will be developed in two stages – the first stage is under construction and will be completed during March 2012. The property is located near the big shopping mall Iso Omena in Vantaa. The purchaser is a German fund and the premises of Safiiri are fully let. The Tapiola Stockmann property was split from the Tapiola Centre and sold. The Tapiola Centre will be redeveloped in the near future, when the Metroline is established in the area. Also more apartments will be built in the area. The buyer is Wereldhave NV, which also owns the biggest shopping mall in Finland, Itäkeskus. The property Kielotie 1-3 has a long tenancy agreement with a sports center operator. The property is located in Vantaa, right next to the railway station in the developing area of Tikkurila.

The Office Market

The size of the total office stock in the Finnish university cities is about 11 million m2, with the largest volumes in Helsinki, Espoo, Tampere, Vantaa and Turku. About 8.5 million m2, or 75% of the total stock, is located in the Helsinki Metropolitan Area (HMA) which is the commercial centre of Finland. Of the HMA office stock, 70% is located in Helsinki itself and the remaining parts are located in Espoo and Vantaa. CBD Helsinki is the most attractive office submarket in the HMA, offering the best accessibility and making up the favored location for many head offices. The prime submarkets are important sections of the HMA office market and consist of Ruoholahti, Center Pasila and Kalasatama in Helsinki, Keilaniemi and Leppävaara in Espoo, and Aviapolis in the Vantaa region.

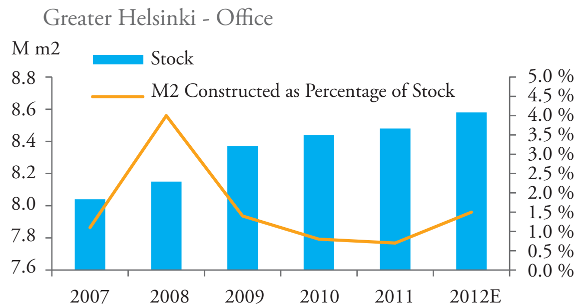
New Supply

There are many projects that can be started in the near future; a lot depends on how the market will develop in the years to come. Examples are to be found along the Töölö Bay area, close

List of Transactions - Top 8 - Greater Helsinki Area - Q4 2011

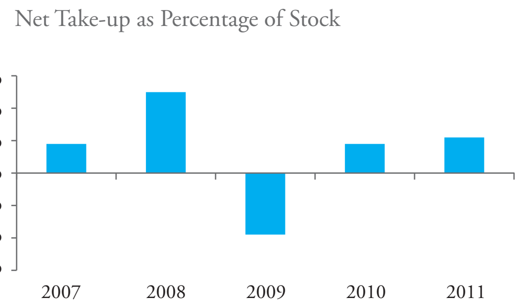
No.	Object	Location	Buyer	Seller	Property Type	Value (EUR million)	Size (m2)	Yield (%)
1.	Office property	Helsinki (Espoo)	N/A	YIT	Office	50	14,000	N/A
2.	Shopping center (Tapiola Stockmann)	Helsinki (Espoo)	Wereldhave NV	Tapiola KR 3	Retail	45	11,500	~ 7.50
3.	Office property	Helsinki (Vantaa)	Union Investment	NCC	Office	20	5,925	7.00
4.	Mixed-use property	Helsinki (Espoo)	Pohjola	SRV	Retail	5	1,550	6.90
5.	Office property	Helsinki Central	Catella	Capman	Office	N/A	4,650	N/A
6.	Retail property	Helsinki (Espoo)	Fennia	K/S	Retail	N/A	9,750	N/A
7.	Two residential properties	Helsinki	Taaleritehtaan As.rahasto	Nordea Henkivakuutus	Residential	N/A	6,420	N/A
8.	Sports center	Helsinki (Vantaa)	J Tallberg-Kiinteistöt Oyj	OAJ	Other	N/A	3,300	N/A

Greater Helsinki - Office



Source: Newsec

Net Take-up as Percentage of Stock



Source: Newsec

List of Office Projects - Top 5 - Finland - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	KOY Metsätapola	Helsinki (Espoo)	Ripatti Oy	27,000	2011	2012
2.	Quartetto Business Campus	Helsinki (Espoo)	Hartela	14,220	2011	2012
3.	Innova 2	Jyväskylä	Technopolis	10,000	2011	2012
4.	Vaihe I (Safiiri Business Park)	Helsinki (Espoo)	YIT	9,000	2011	2012
5.	Vaihe II (Technopolis Ruoholahti)	Helsinki (Vantaa)	Technopolis	9,000	2011	2012

to Helsinki's central railway station, where new office buildings are being planned. Another example is the partly ongoing project south of Ruoholahti where buildings providing an office area for 6,000 jobs will be built between 2009 and 2025.

The new construction projects that completed between 2009 and 2011 added little volume, as a result of the financial turmoil of 2008–2009. Construction for 2012 is back to a higher level of nearly 130,000 m2. There are many possible new office projects, but the majority of these will most likely not be started in the near future, unless a certain occupancy rate is achieved beforehand.

KOY Metsätapiola will be a new office building close to the new metro line in Tapiola. The building will have high energy efficiency and the project will be completed during 2012. Quartetto Business Campus will be offering high-tech office spaces in the Helsinki Metropolitan Area. Quartetto stage one is a combination of four five-story office buildings located in Espoo, 10 minutes from Helsinki city centre. Innova 2 is a new office building in Jyväskylä built by Technopolis. The project started in January and so far 30 percent is occupied. Furthermore, the office operator and developer Technopolis is developing an office building, Technopolis Ruoholahti stage two, close to the city centre and the developing area of Ruoholahti.

The Occupier Market

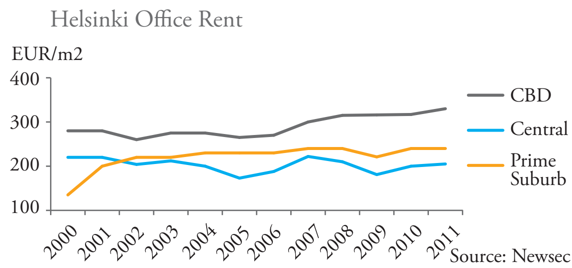
The decrease in office rents during 2009 was temporary and in 2010 rents increased. Rents in Helsinki CBD also showed a slight increase in 2011, and Newsec believes that this trend will continue this year. In Helsinki CBD, prime rental levels are around EUR 330 per m2. Rents in the most popular business parks are relatively stable, whereas in weaker areas new contracts are occasionally signed to declining rental levels.

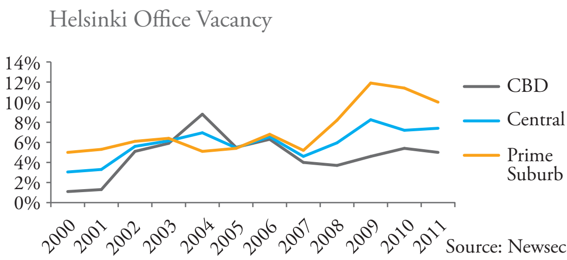
The vacancy rates in the Helsinki Metropolitan Area either decreased in the past year or were at a stable level. In the CBD, the vacancy rate is about 5.0%, indicating that the central area has kept its attractiveness. During 2012, vacancies throughout the HMA are expected to show a minor decrease, whereas 2013 is expected to see some increase due to tenant efforts to enhance the usage efficiency of office space and the constant construction of new office buildings.

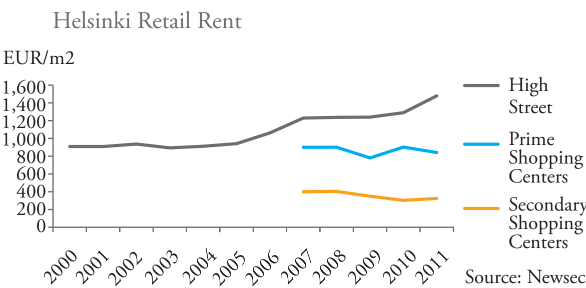
The Retail Market

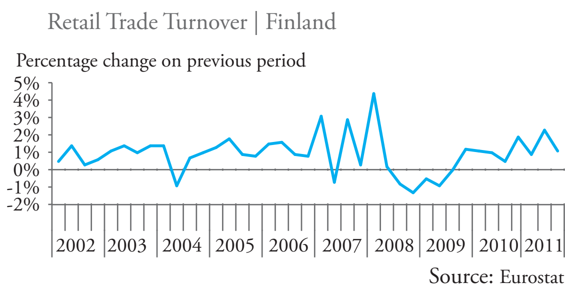
Retail trade turnover in Finland has historically been quite strong. The combination of this with a good consumer confidence level and growth in private consumption has fueled further development.

The total retail stock of the major Finnish cities comprises approximately 6.6 million m2. Around 3.4 million m2 is located in the Helsinki Metropolitan Area. About 50% of the retail stock in the HMA is located in Helsinki and around one-quarter each in Espoo and Vantaa. Large stores have for a long time played a substantial role in the Finnish everyday commodity trade. The market share of stores larger than 1,000 m2 is approximately 65%, where 10% of all the stores are representing half of the value of grocery trade, according to Nielsen.









New Supply

The City Centre Expansion is a project in the CBD area of Helsinki. The old building will be expanded to provide approximately 30,000 m2 of retail space, which is quite a significant expansion given its CBD location. As a response to this, Citycon plans the Oulu Retail project, which is a retail centre in the Oulu CBD. The building is being developed in collaboration with the local retailer Osuuskauppa. The Hämeenlinna shopping center, in the downtown of Hämeenlinna, will be expanded with retail passages and is a massive project for the city. Another large project is in the centre development of Hyvinkää, which consists of 11,800 m2 retail space and is situated 50 km from Helsinki.

The Occupier Market

In Helsinki, High Street retail rents increased throughout the second half of the 2000s. High Street retail rents rose slightly in 2011 to EUR 1,550 per m2. In the coming three years, a stable development or minor increase is expected.

List of Retail Projects - Top 5 - Finland - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	City Centre Expansion	Helsinki	Sponda Oyj	30,000	2011	2012
2.	Oulu Retail	Oulu	Citycon	30,000	2012	2014
3.	Hämeenlinna Shopping Center	Hämeenlinna	NCC/City of Hämeenlinna	30,000	2012	2014
4.	Hyvinkää Keskuskortteli	Hyvinkää	Peab Oy	11,800	2012	2012
5.	Myllypuro Retail Center	Helsinki	Citycon	7,300	2011	2012

NORWAY

Norway has a population close to 5.0 million, which has increased by an annual average of 1.2% in the last five years. The Greater Oslo area accounts for nearly 25% of the Norwegian population and has grown by an average of 1.9% per year for the last five years. In 2010, Norway had a GDP of USD 413 billion, about USD 84,100 *per capita*. The unemployment rate in Norway is exceptionally low and has been so for many years. In October 2011, it stood at 3.3%, a decrease of 0.2% over October 2010.

The Investment Market

Investors in the Norwegian market have shown greatest interest in core office properties and properties with long leases. However, “value-adding” properties, with a potential for higher rents or development possibilities, have increased in popularity among investors. Banks are reluctant to fund investments in the value-add property segment, however, and this has resulted in easier funding for core properties with long leases.

Niam, a Swedish real estate fund, purchased four shopping centers at the end of 2011 from Oslo Areal for about NOK 2 billion. The transaction, for assets in Lillehammer, Drammen and Stavanger with a total size of about 93,000 m2, was the largest in Norway in 2011 in terms of transaction value.

Sjølyst Arken is one of the most modern and central buildings in Skøyen, a prime suburb to Oslo. The offices of 18,000 m2 are occupied by Visma and the first floor is occupied by an ICA food store. The property was bought in 2007 by DnB NOR Eiendomsfond I, which in 2010 changed its name to FORTIN. The most recent buyer was Tvenge, through Fram Management, which already owns several properties in Skøyen. The purchase price was about NOK 1 billion.

The Office Market

The total office stock in Oslo is approximately 9.4 million m2. The Oslo CBD is relatively small compared to the other Nordic countries and the most attractive and highest-priced office locations are in the Vika and Aker Brygge areas. However, Bjørvika and the area around the Central Station will soon form another part of the CBD when they are developed. The other major submarkets are Skøyen, Lysaker, Fornebu, Nydalen, Helsfyr and Bryn, all located outside the city centre.

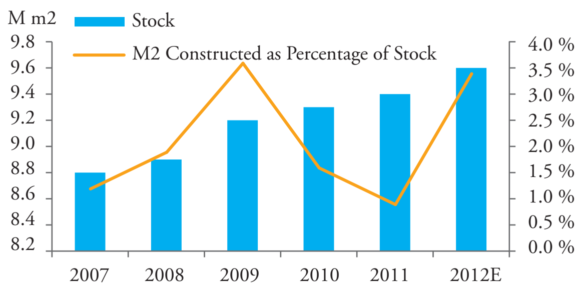
New Supply

The relatively large amount of m2 constructed per year in Oslo is due to the fact that tenants, especially the larger occupiers, demand highly space efficient offices. The amount of new construction in Greater Oslo as a percentage of stock has been about 2.0% per year on average over the last five years.

List of Transactions - Top 5 - Greater Oslo Area - Q4 2011

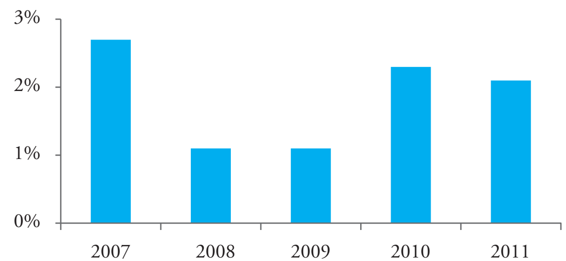
No.	Object	Location	Buyer	Seller	Property Type	Value (NOK million)	Size (m2)	Yield (%)
1.	Shopping center portfolio	Mixed locations	Niam	Oslo Areal	Shopping center	~ 2,000	N/A	N/A
2.	Sjølyst Arken	Oslo (Skøyen)	Tvenge	FORTIN	Office	1,000	23,170	6.00
3.	Akersgata 64-68, 73	Oslo CBD	KLP (unconfirmed)	Höegh	Office	~ 800	N/A	5.55
4.	Tomt Fornebu	Oslo (Fornebu)	Aker Solutions	Fornebu Utvikling	Office and residential lot	780	98,000	N/A
5.	Middelthuns gate 17	Oslo Central (Majorstuen)	Obos/Veidekke	Norwegian Property	Office	700	33,320	6.50

Greater Oslo - Office



Source: Newsec

Net Take-up as Percentage of Stock



Source: Newsec

List of Office Projects - Top 5 - Norway - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	New headquarters for DNB	Oslo (Bjørvika)	OSU	80,000	2010	2012-2014
2.	New office for Statoil	Oslo (Fornebu)	IT Fornebu	65,000	2011	2012
3.	New office for Egmont	Oslo (Nydalen)	Avantor	33,500	2010	2012/2013
4.	New office - Statkraft and PGS	Oslo (Lysaker)	Mustad	31,000	2010	2012/2013
5.	New office for Statnett	Oslo (Nydalen)	Avantor	22,000	2011	2013

The corresponding figure in Stockholm is between 0.5% and 1.0%. Throughout the period of financial turmoil, the net take-up as a percentage of stock in Oslo remained positive, while in both Stockholm and Helsinki it was close to -2.0% in 2009 as a percentage of stock.

Oslo S Utvikling AS (OSU) is the developer behind DNB's new headquarters, which will consist of three office buildings with a lettable area of about 80,000 m2. The buildings will be completed from 2012 to 2014 and house 4,200 DNB employees. The new headquarters will be located in the middle of the new Opera district in Bjørvika, Oslo CBD.

IT Fornebu, developer of the former airport area Fornebu in the western part of Oslo, has commissioned Skanska to build the new headquarters for Statoil. The contract is for an office building with five contiguous buildings of nine floors. The project comprises a total of about 65,000 m2. Construction began in January 2011 and the project is estimated to be completed in September 2012.

The Occupier Market

A relatively low amount of office space was constructed in Oslo in 2011 and a substantial amount of the office projects estimated to be completed in 2012 is pre-let. This led to a decline in vacancies during 2011 and contributed to an upward pressure on rents. IT and oil related companies have accounted for a large share of take-up; so did a number of governmental agencies whose offices were destroyed in the bombing attack in the summer of 2011.

The Retail Market

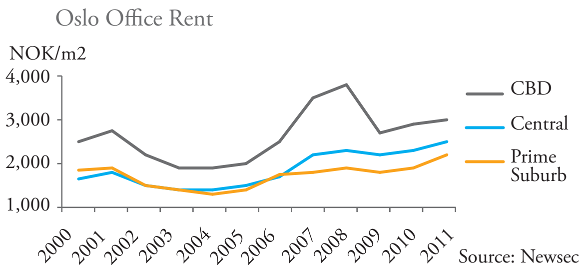
Throughout the first seven years of the 2000s, retail trade turnover and consumer confidence in Norway were at a high level. The financial turmoil in 2008–2009 broke this trend with an increase in unemployment and a weaker growth prognosis. The retail trade turnover has increased since with only a minor slump in 2010.

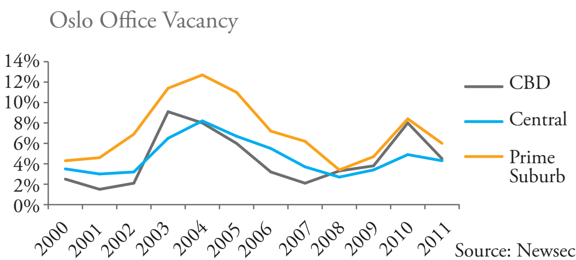
New Supply

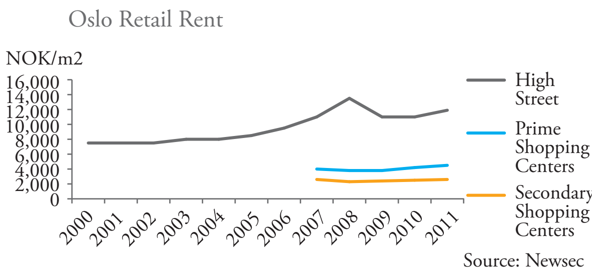
In 20 years, the total floor space in Norwegian shopping centers has quadrupled, and today more than one-third of all Norwegian retail trades take place in shopping centers. Hence Norway has one of the largest *per capita* levels of retail space in the world. The level of new developments has fallen as a consequence of the relatively saturated market.

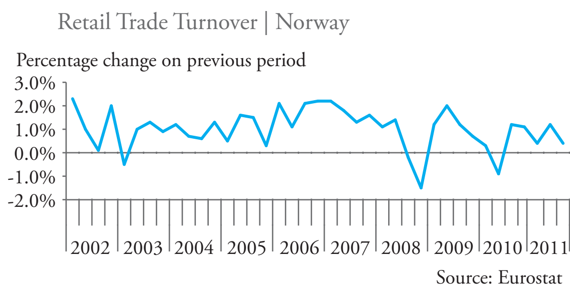
There are, however, some plans for new shopping centers and an expansion of existing centers. Sørlandssenteret, close to Kristiansand in the south of Norway, is undergoing a major expansion. 73,000 m2 of new retail stores will be completed in 2013. Together with the existing 44,500 m2, this will make Sørlandssenteret the largest shopping center in Norway in terms of floor area.

Steen & Strøm is projecting a 60,000 m2 shopping center in Økern, Oslo. The project is one of the most ambitious urban development projects in Oslo and will in total comprise about 250,000 m2. Apart from the shopping center, it will also include a kindergarten, private residences, offices, a water park, a cultural centre, restaurants, a library, a museum and health services.









The Occupier Market

In Oslo, High Street retail rents are found in boutiques on streets like Karl Johans Gate and Bogstadveien. High Street retail rents have been fairly stable since the peak in 2008 but there was a tangible increase in rent during 2011. Vacancies are close to none in good locations on High Streets and prime shopping centers. Due to the inherent stability of the Norwegian economy, fueled by the oil sector, Norway will stand tall against the forecast global recession. This will provide opportunities for continued rent increases during the next few years.

List of Retail Projects - Top 5 - Norway - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	Sørlandssenteret	Kristiansand	Olav Thon	73,000	2010	2013
2.	Steen & Strøm, Åsane senter	Bergen	Steen & Strøm and Nordea Liv	70,000	2010	2017
3.	Økernsenter	Oslo	Steen & Strøm	~ 60,000	2010	2017
4.	Jekta kjøpesenter	Tromsø	Coop Nord	~ 35,000	2010	2013
5.	KBS senteret	Trondheim	Riholding AS	30,000	2010	2012

DENMARK

Denmark has a population of around 5.5 million, which has increased on average by 0.5% per year over the last five years. 22% of the population is resident in Greater Copenhagen. In 2010, GDP was about USD 310 billion, about USD 56,000 *per capita*. The unemployment rate has increased since 2008 and peaked in 2010 at 6.2 percent, which also was the most recent rate.

The Investment Market

Transaction activity continued to be weak in 2011. At the end of 2010 and the beginning of 2011, there were several large transactions that led to expectations that the market had recovered. However, investors became increasingly anxious about the implications of the emerging eurozone sovereign debt crisis, and the number of transactions was therefore very low. Financially strong investors, such as institutional investors and well-consolidated property companies, are still the dominant actors in the market. The debt crisis had negative effects on the banking sector and resulted in further difficulties in obtaining financing. As a result of the economic downturn, property investments are an attractive asset compared to other types of cash flow based investments, because of the extremely low interest rates. In 2012, the total transaction volume is expected to remain at a low level once again.

In Marmormolen, a newly developed harbour area in Copenhagen, a new European headquarters consisting of 45,000 m2 and intended for the United Nations is being built. Tenant is the Danish state with a lease period of 15 years. The developer, CPH City & Port Development, sold a majority of the project to a company jointly owned by ATP and PensionDanmark, for a 45.75% project stake each, and kept an 8.5% stake itself. The project also includes 60,000 m2 of building rights.

Copenhagen is forecast to undergo a strong demographic development during the next 30 years, and the future demand for flats is expected to exceed supply. Niam, the Swedish real estate fund, bought a residential portfolio of 65,000 m2 for DKK 1.3 billion. Balder, the Swedish property company, invested DKK 1.1 billion in a large residential property portfolio in Copenhagen. Balder's acquisition was from one of many property projects that the banks took on their balance sheets during the financial turmoil 2008–2009, which illustrates that the financial institutions now are more willing to sell their properties at a lower price.

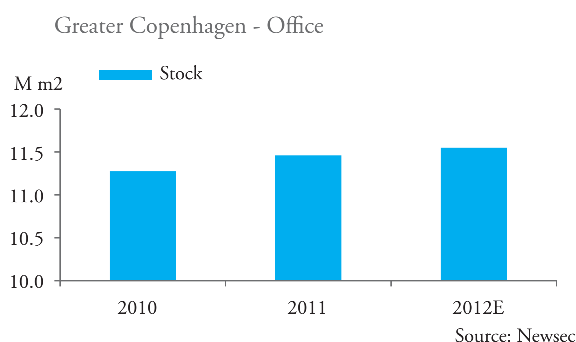
The Office Market

Office properties located in Copenhagen CBD generate the highest rents, with top rental levels at locations by the water. Important sub-areas are the Copenhagen city districts of Østerbro, Nørrebro, Frederiksberg, Sydhavnen and Amager/Ørestad as well as Hellerup in the northern parts of Copenhagen, Herlev/Ballerup in the western parts of Copenhagen and the West Corridor encompassing the towns of Brøndby, Glostrup and Albertslund. The office stock in the CBD consists of

about 5 million m2 and the total office stock in the Copenhagen area amounts to around 11 million m2. Although, as mentioned, there is currently only low activity in the market, there is still a high level of interest for prime properties. Therefore, yields are stable in the prime segment.

New Supply

The uncertainty about the course of the overall economy in the next couple of years will place new construction under pressure. However, the population forecast for Copenhagen is very positive, and it is expected that the city will have long-term growth that will make new construction attractive. The occupier focus is on premises in new



List of Transactions - Top 5 - Greater Copenhagen Area - Q4 2011

No.	Object	Location	Buyer	Seller	Property Type	Value (DKK million)	Size (m2)	Yield (%)
1.	UN-city, Marmormolen	Copenhagen	ATP/PensionDanmark	CPH City & Port Dev.	Office	1,800	45,000	5.00
2.	Residential portfolio	Greater Copenhagen	Niam	Amagerbanken	Residential	1,323	65,000	5.30
3.	Østerfælled Torv	Copenhagen	Balder	Amagerbanken/ Nykredit	Residential	1,100	43,500	3.20
4.	Teglholmsgade	Copenhagen	PKA	NCC	Office	194	9,230	6.00
5.	Ringager 2-4	Copenhagen (Brøndby)	Sparekassen Lolland	Essex	Office	152	18,000	9.50

List of Office Projects - Top 5 - Denmark - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1.	UN-city, Marmormolen	Copenhagen	ATP/PensionDanmark	45,000	2010	2013
2.	Flintholm company house	Frederiksberg	PKA	20,000	2010	2012
3.	ATP pakhus langelinie	Copenhagen	ATP	15,000	2012	2014
4.	New headquarters for Siemens	Ballerup	PenSam	12,000	2011	2012
5.	Teglholm company house	Copenhagen	PKA	9,200	2010	2012

developed buildings and on modern facilities. In Greater Copenhagen, the construction level continues to be very low. Approximately 100,000 m2 of new office buildings in Greater Copenhagen are expected to come on-stream in 2012. In 2013, this number will be slightly higher.

Flintholm Company House consists of 20,000 m2 office space and is being constructed by NCC. This is a multiuser office building where small companies can rent office premises and benefit from shared canteen and meeting facilities. The building will be ready for lettings during the second quarter of 2012. The Danish pension fund ATP is projecting a large office building on Langelinie in the centre of Copenhagen. The building will have water on both sides, and the plan is that the building will be very energy efficient. The construction will begin when the occupancy rate is high enough. Siemens has substantial windmill activities in Denmark and is now building a new domicile. KPC is the developer and in charge of the construction. The project was sold to the Danish pension fund PenSam in mid-2011.

The Occupier Market

In 2011, the occupier market in Copenhagen improved slightly and rental levels in the CBD increased. The office rent in Copenhagen CBD during 2009–2010 was about DKK 1,550 per m2, and during 2011 it rose to DKK 1,600 per m2.

The office vacancy rate in the CBD increased in 2011, ending the year at just above 8%. The rate represents a surge of more than 5 percentage points from the low levels of around 3% recorded in 2007, and is primarily attributable to the economic downturn. The office vacancy rate is expected to fall in the coming years, but only slowly.

The Retail Market

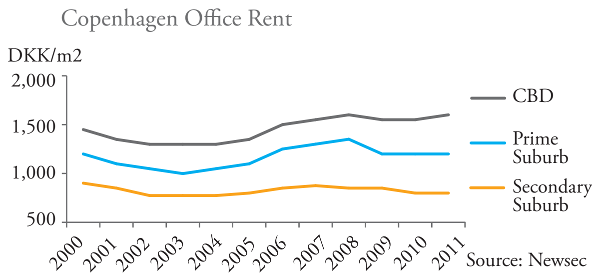
Tight legislation, regulating both the size and location of retail areas, is a characteristic of the Danish retail market. Therefore, Denmark has a large number of High Street or in-town shops and relatively few out-of-town shopping centers and retail parks. The total retail stock in Denmark stands at around 11.5 million m2, of which about 2.2 million m2 is located in the capital. More than half of Denmark's 100 largest shopping centers are also located in Greater Copenhagen.

In Denmark, household finances are still impaired by the property bubble of earlier years. However, Nordic households are fundamentally strong and private consumption is expected to be one of the most important growth engines during coming years.

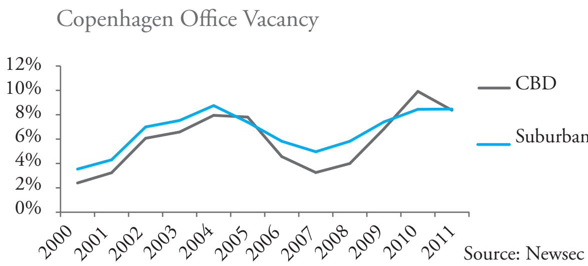
New Supply

In Odense CBD, the Norwegian developer Steen & Strøm is planning to build a shopping center. The centre will comprise about 45,000 m2. The construction is projected to start this year. The shopping center will be a competitor to Rosengårdcentret, a shopping center in the outskirts of Odense. In addition to the large shopping center City 2 in Høje-Taastrup, Danica Pension is planning to develop a new designer outlet center. The new building will comprise 20,000 m2, with around 80 new shops. Frederiksberg Centret is a shopping center located in Frederiksberg, Copenhagen. The center will be extended with about 10,000 m2

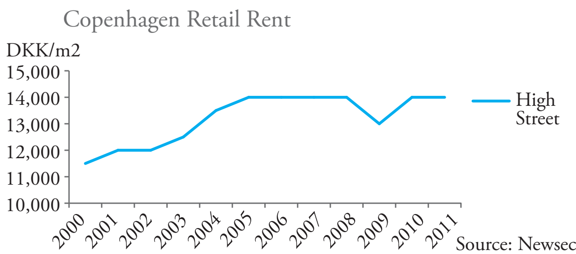
Copenhagen Office Rent



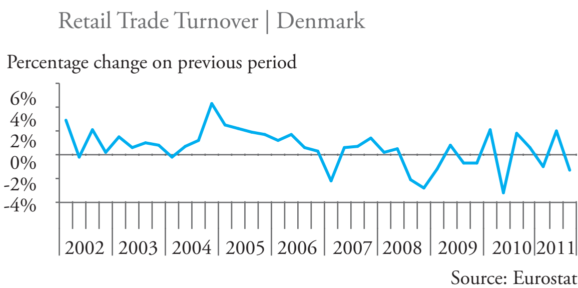
Copenhagen Office Vacancy



Copenhagen Retail Rent



Retail Trade Turnover | Denmark



of retail space and new parking facilities. The extension will begin during 2012 and is expected to be completed in 2014.

The Occupier Market

Renegotiations have become quite common; in 2009, these caused a minor decrease in retail rent levels. However, the modest supply led to an increase in retail rents in 2010. Prime retail rents in Copenhagen are about DKK 14,000 per m2, excluding operating costs and taxes. High Street retail rents are expected to remain relatively stable, with a small upward pressure in the coming three years, due to the lack of new development prospects and an anticipated increase in demand.

List of Retail Projects - Top 5 - Denmark - Q4 2011

No.	Object	Location	Owner/Developer	Size (m2)	Project start	Expected date of completion
1	Slagterigrunden	Odense	Steen & Strøm	45,000	2012	2015
2.	City 2 - Designer outlet	Høje-Taastrup	Danica Pension	20,000	2012	2013
3.	Frederiksberg Centret	Copenhagen	Danica Pension	10,000	2012	2014
4.	Karlslunde Stationscenter	Greve	Sinai Group	6,000	2011	2012
5.	Aalborg Storcenter	Svendborg	ATP	3,000	2012	2013

NORDIC INSIGHT

MARKET NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

GENESTA PROPERTY NORDIC

Genesta Property Nordic is a fund and investment manager that specializes in commercial real estate in the four Nordic countries. We invest in office, retail and logistics assets and have offices in Stockholm, Helsinki, Oslo, Copenhagen and Luxembourg. Genesta's assets under management total more than EUR 800 million and 500,000 m2 of space.

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