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‘If you believe in urbanisation and demographics, the smaller Nordic cities could be worthwhile’

Marcus Cieleback, Patrizia Immobilien

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1. MARCUS CIELEBACK, HEAD OF RESEARCH AT PATRIZIA **2.** ALLAN LAVÉN, FIRST VICE PRESIDENT FOR THE NORDICS AT PROLOGIS AND RIKKI LYKKE, HEAD OF PATRIZIA NORDICS **3.** NETWORKING BREAK **4.** NEIL BLAKE, HEAD OF EMEA RESEARCH AT CBRE **5.** DANIEL ANDERSSON, SENIOR DIRECTOR CAPITAL MARKETS AT CBRE SWEDEN **6.** THOMAS PERSSON, MANAGING DIRECTOR OF CATELLA CORPORATE FINANCE SWEDEN

PHOTOS: KARLA GOWLETT

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NORDICS: TALE OF FOUR COUNTRIES

The optimal portfolio allocation in the Nordics can differ depending on whether an investor comes from the dollar, sterling or euro zones

BY **CORMAC MAC RUAIRI**

Some cross-border real estate investors opt to invest in the Nordics as a hedge against developments in other, less stable markets. But these investors often don't fully grasp the fact that the Nordics consists of four countries and four currencies, according to Marcus Cieleback, head of research at European property group Patrizia. The right investment opportunity for a euro investor may not be the best fit for a dollar or sterling investor, Cieleback pointed out in a presentation to PropertyEU's Nordic Investment Briefing, which was hosted by CBRE in London in March.

Investment returns in Norway and Sweden tend to be more volatile for cross-border investors due to currency fluctuations. The Norwegian Krone and Swedish Krona currencies tend to move in the same way in terms of exchange rate fluctuations, because the policies of the central banks of both countries are aligned. The central banks follow their own path in terms of raising and lowering interest rates which can deviate from the policies of the European Central Bank and the Bank of England. Eurozone investors have de facto no currency risk in Denmark as the Danish Krone is tied to the euro via Exchange Rate Mechanism II, Cieleback noted. Similarly, Finland is in the eurozone.

Cieleback argued that returns – and more crucially, volatility – exhibit different patterns when considering currency risks. 'Many investors say they are only interested in direct property and don't care about the currency element, either going in unhedged or they may have hedging overlaying all their investments in property, stocks and other asset classes,' he said. Cieleback said it was not enough for investors in unhedged investments to look only at the respective markets when deciding on their optimal strategy. He said an analysis of historic mean total returns would suggest currency has in the first instance a shift effect. 'But if you look at volatility the picture gets a lot messier,' he said. 'Using the Sharpe Ratio – how much return you get for a unit of risk – it is a very different picture depending on the currencies you are coming into the market with.' (see graph on page 50).

Investors looking for diversification across their Nordic allocation should also be aware between the differences and similarities in performance of the various sectors across the four countries. A cluster analysis presented by Cieleback showed, for instance, that both office and

TOP INVESTMENT PICKS

Asked to specify how they would spend a hypothetical €500 mln, the panellists opted for the following:

ALLAN LAVÉN of Prologis: core logistics with short-term leases; assets that can be configured for smaller tenants

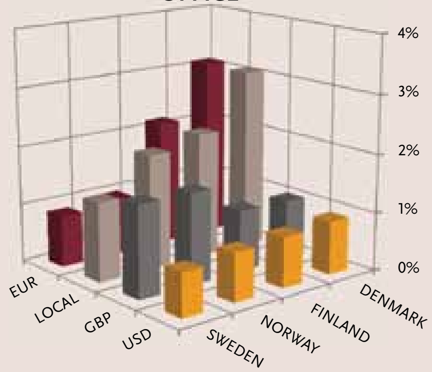
DANIEL ANDERSSON of CBRE: also logistics on short leases and offices in Gothenburg

RIKKE LYKKE of Patrizia Immobilien: residential development in Copenhagen, Aarhus and to a lesser extent Odense (all Denmark); high street retail in Oslo; renovating malls in top 5-15 Swedish cities and residential development in Finland.

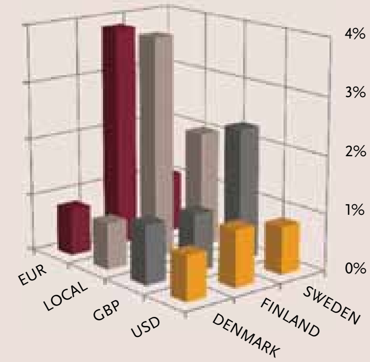
THOMAS PERSSON of Catella: €250 mln on value-add offices in A-minus and B locations in Stockholm, and offices in Copenhagen. Split the remaining €250 mln between core office space in Hamburg and Frankfurt, and put the rest in residential space in Hamburg.

REWARD-TO-VARIABILITY RATIO (SHARPE RATIO)

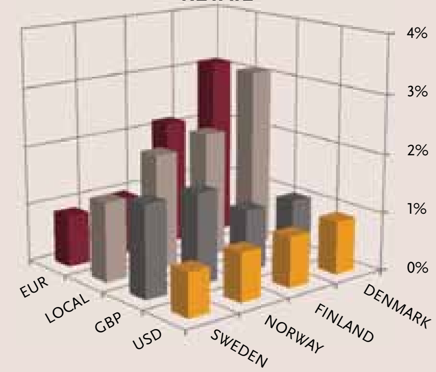
OFFICE



RESIDENTIAL



RETAIL



SHARPE RATIO

	DENMARK	FINLAND	NORWAY	SWEDEN
EUR	0,021	0,0242	0,0074	0,0063
Local	0,0207	0,0242	0,0127	0,0086
GBP	0,0106	0,0082	0,0129	0,011
USD	0,009	0,0077	0,0072	0,0066

	DENMARK	FINLAND	SWEDEN
EUR	0,0082	0,0386	0,0105
Local	0,0082	0,0386	0,0203
GBP	0,0103	0,0101	0,0231
USD	0,0078	0,01	0,0083

	DENMARK	FINLAND	NORWAY	SWEDEN
EUR	0,0309	0,0215	0,0098	0,0088
Local	0,0309	0,0215	0,0197	0,0136
GBP	0,0102	0,0106	0,0155	0,0157
USD	0,0091	0,0086	0,0083	0,0075

SOURCE: PATRIZIA

Copenhagen's office market is set to become a star performer in terms of risk-adjusted total returns over the next five years, according to Neil Blake, head of UK & EMEA research at CBRE. The Danish city's office market has been hit by the sluggish growth of the eurozone in recent years, Blake said. Still, Copenhagen and Oslo, according to CBRE figures, were ranked eighth and ninth in terms of the top 10 European cities for property investment in 2012. Both cities captured 2% of total investment. Stockholm was in fourth place at 3.5%, trailing London (21%), Paris (10%) and Berlin (4%). Forecast gross total returns in euros and risk-adjusted returns for the next five years point to a strong bounce-back for Copenhagen, an increase for Helsinki, and declines for Stockholm and Oslo.

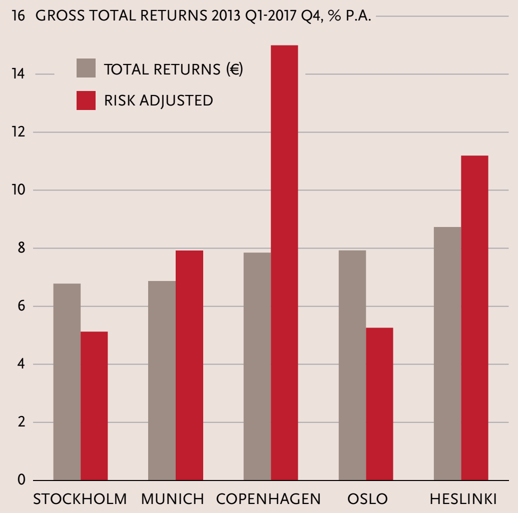
retail have similar characteristics in Denmark and Finland. The same is true for Swedish and Norwegian offices, so investing in the office sector in both countries would not be a diversifier.

DOMESTIC DOMINANCE

In practice, cross-border investment in the Nordics has traditionally been limited in overall terms. Neil Blake, head of EMEA research at CBRE, told the investment briefing that of the €36 bn invested in Nordic commercial real estate in 2011-12, only about 9% came from outside the region. The biggest contributor was the rest of Europe, which invested €2.3 bn or almost 7% of the total. The next largest contributor was North America with just over €700 mln, or 1.9% of the total investment. No money came from Asia. By contrast, domestic pension funds played a leading role with Sweden chalking up a transaction volume of around €8 bn last year. '2012 was very much dominated by the core markets and core investors,' Thomas Persson, managing director of Catella Corporate Finance Sweden said. The main driver of volumes, he said, was a number of large office transactions by domestic pension funds trading office assets in Stockholm's central business district. 'Two pension funds in particular had to sell for various reasons. There is also investment between the four Nordic markets.'

That said, Persson and his fellow speakers said foreign investment is growing and they challenged the widely held assumption that cross-border investors don't influence pricing levels. 'You have to look at what's going on in the different sectors,' said Daniel Andersson, senior director capital markets at CBRE Sweden. '2012 was dominated by a lot of large deals in Stockholm CBD offices and that was pretty much the only sector where international investors are not driving prices. If you look at it, paying a 4% to 4.5% yield in Stockholm doesn't make sense compared to fairly much all other markets in Europe. But if you look at logistics and retail, these segments are definitely driven by international investors but the transaction volumes are smaller.'

TOTAL RETURNS – NEXT 5 YEARS



SOURCE: CBRE; RISK ADJUSTMENT USES THE SD OF TOTAL RETURNS NORMALISED ACROSS THE FIVE CITIES

Based on a Sharpe Ratio analysis, eurozone and local investors can get the best return for the lowest risk from Finnish residential property (61%). Danish and Finnish retail could also be good options for eurozone investors. Sterling investors looking to build a risk-averse portfolio would, according to the Sharpe analysis, go for Swedish residential (55%) and Norwegian offices (21%). Dollar investors would be best advised to put 100% in Finnish residential.

Rikki Lykke of Patrizia Nordics pointed to the dominance of cross-border European players in the shopping centre sectors in both Sweden and across the Nordic region. A few months ago Canada's massive pension fund investor CPPIB partnered with Citycon of Finland to acquire Kista mall in the Stockholm region for €500 mln and Unibail-Rodamco is developing the 101,000 m² Mall of Scandinavia in the Swedish capital. Similarly, German retail specialist ECE recently entered Denmark with the €400 mln acquisition of the Rosengårdcentret in Odense on behalf of a fund. Foreign investors have also had a visible effect on pricing in the logistics sector in Sweden. Allan Lavén, first vice president for the Nordics at Prologis said two transactions in 2012 involved international buyers. 'They have driven the prices up quite amazingly. We would not touch some deals on that sort of cap rate.'

A common refrain during PropertyEU's Investment Briefing was that there is more to the Nordics than simply the four capital cities – Stockholm, Oslo, Copenhagen and Helsinki. Patrizia's Cieleback said investors needed to be educated about the relative importance of the smaller cities rather than just focus on the absolute size of the city. 'Look at Munich in Germany. It is one of the most desirable real estate markets in Europe but it is only 1-2% of the total German population. If you look at Jönköping (89,000 population, ed.) it contains more than 3% of the Swedish population.' More and more investors are beginning to realise, he said, that if you go for the Nordics and believe in urbanisation and positive demographics, the smaller cities could be worthwhile. Given the limited lot size, these markets may be best suited to comingled funds and smaller investors seeking to place €5-15 mln. This limit does not apply to prime retail as evidenced by ECE's €400 mln investment in Odense.

Catella's Persson added: 'In terms of retail there is quite a lot of interest for relatively large cities of 75,000 inhabitants or more. These markets have proved to be very stable in the financial crisis, and probably performed much better than Stockholm and other big cities.' CBRE's Andersson agreed, saying shopping centres in the top 20 cities in Sweden probably had much the same tenants as malls in Stockholm. For offices, Perrson and Andersson suggested Gothenburg. 'It was one of the cities that was hit really badly by the financial crisis but is now bouncing back. Like Copenhagen, Gothenburg is seeing stronger rental growth than Stockholm,' Perrson said.

Logistics investors are not tied to the big cities, Prologis' Lavén noted. 'The business has different drivers and is dependent on the location within the supply chain rather than population density.' In Sweden, key locations include near Gothenburg harbour and at Jönköping in the middle of the country. 'We focus on relettability of a building. You can have the most beautiful logistics building in a B location but you need to think what you are going to do in 10 years when the current lease expires.' Lavén said he would look for prime assets in the Helsinki Greater Area to the Ring Road 3 in Finland; south and north of Oslo towards the airport in Norway, and Copenhagen and around Aarhus in Denmark.

Patrizia's Lykke, charged with setting up and managing the Nordic business, said the focus would be on the top 10 cities in each market. 'The populations of these cities are increasing – something that can't be said for all northern European countries.'

Both Oslo and Copenhagen have embarked on major harbour regeneration schemes to help cater to their growing populations. 'Copenhagen city centre is also forecast to increase by 17% over the next 10 years, and Arhus by 9-10%. Once you have residential then comes offices and retail.' ■