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Communication is key as Nordic investors face up to pandemic

Nordic managers discuss crucial early correspondences in PERE's first virtual roundtable as the regional market begins to evaluate the impact of coronavirus. Stuart Watson reports

Covid-19 has forced businesses around the world to find new ways of operating, and *PERE*'s Nordic roundtable marked a first for the publication by being conducted as a video conference. As the participants met in March, the gravity of the situation was beginning to become clear as countries across Europe announced lockdowns. At the time of going to press, Norway, Denmark and Finland had imposed tight restrictions, closing their schools and borders, while the Swedish government continued to pursue an alternative strategy, with non-essential businesses remaining open.

In the virtual meeting room are senior figures from three Nordic managers. Two are speaking from Sweden: Leif Andersson, founder of AREIM, and Niam chief executive Fredrik Jonsson; while Kristian Krogh, chief executive of Thylander Gruppen, joins the conference from Copenhagen. Inevitably, there is one topic on the agenda: coronavirus. What are the first steps that Nordic real estate managers are taking? How can they continue to do business as the pandemic takes hold?

Short-term decisions

Communication is swiftly established as the dominant theme. Amid the rapidly unfolding crisis, who should managers call first and what should they say? Who is calling them and what do they want to know? The participants agree the most urgent communication is with their own staff.

"First, we address the situation locally within the family, looking at how best to protect the health of employees. Those were the immediate calls," says Jonsson.

Andersson agrees: "Clearly the first priority is the employees and the people around you. Seeing that people are safe and that we are managing the situation correctly from a health perspective."

"The first things in mind are following the instructions from the authorities and the health and safety of employees," adds Krogh. "Then, all long-term issues, considerations and strategic discussions are suddenly put aside and everything is about very short-term decisions and management. This is a black swan event if there ever was one, so we have to go day-by-day, hour-by-hour, and handle the situation as it unfolds. No one trained for this."

While business as usual has effectively halted, says Jonsson, that does not mean pausing all projects on which Niam has already pushed the button. "We do residential development, for example, and we have not pulled back on that yet. If you have entered into a commitment, then you fulfill it. What we did immediately when states began to issue instructions on social distancing was to halt entering into all new commitments where we could, so we can at least reconsider them."

Where it is possible under the rules of the fund, Niam has also frozen distributions to investors. "We have said we will hold onto them to make a war chest of capital if needed, for instance, to cover interest payments should the

Leif Andersson

Founder, AREIM

Andersson founded Nordic manager AREIM in 2003. The firm is headquartered in Stockholm and also maintains offices in Norway and Finland, employing around 50 people. It closed its AREIM Fund IV in late 2019 with €685 million of commitments, including €150 million of co-investment capital, and manages up to €3 billion of assets in the region in total.

Fredrik Jonsson

Chief executive and managing partner, Niam

Jonsson has been chief executive officer at Stockholm-headquartered fund manager Niam for two years, before which he was the company's chief investment officer. Niam employs 68 people in four offices across the Nordic region, with a portfolio of assets under management of around €4 billion. It is currently investing for its €1.1 billion Niam Nordic VII opportunistic strategy and raising capital for the €500 million Niam Nordic Core-Plus III.

Kristian Krogh

Chief executive and managing partner, Thylander Gruppen

Krogh is chief executive officer at Copenhagen-headquartered Thylander, a manager focused on the Danish market, which employs 30 people and manages a €1 billion portfolio. The firm oversees nine real estate funds, as well as joint ventures and club deals, including both commercial and residential properties, as well as development projects. Krogh joined the company in February 2019 after leaving Niam, where he was country manager for Denmark.

income from some properties in a fund be interrupted."

Screening tenants

The managers' next step is to gauge the impact on tenants and rental income. "We have been doing investigations into our portfolios to try to understand where there could be challenges and issues with payments from tenants. We have had a lot of questions from retailers, especially restaurants," says Andersson.

The impact on some sectors has been immediate and severe, observes Krogh. "Right now, we are spending a lot of time talking to tenants who are having to close down restaurants or cafes, or tenants in the travel and entertainment industries who suddenly have zero turnover. They have just closed down. One of the first places they turn is to ask their landlord not to pay the rent, or get it postponed."

"As a property manager it is very hard for us to initiate any action apart from giving away money, which of course we do not want to do," reflects Jonsson. Unlike AREIM and Thylander, Niam's asset management function is carried out by third parties. "The calls go out to our asset managers and then from them to their property managers or to tenants, so that we can get a grip over the consequences and carry out a sensitivity analysis on our running income. That will help us understand the effect on our financial covenants."

Niam manages five funds. They are exposed to the worst-affected retail and hotels sectors in varying degrees. Jonsson says one of the immediate priorities is to identify which retail tenants will be most impacted: "We are trying to separate necessity retail income from non-necessity. Food, groceries, pharmacies and so on are continuing to sell, and sell better. At the other end of the spectrum are hair salons and other non-necessity retailers where turnover is right down. We are trying to get a grasp of how much income is at risk from hotels and non-necessity retail in each fund."

> *"There will be some super-interesting buying opportunities. The question is, where do you find the quality cashflows when things have changed?"*
>
> **LEIF ANDERSSON**
> **AREIM**

Krogh's team at Thylander is screening tenants to identify those most at risk. He says some sectors like rented residential have suffered little so far. "We do not expect it to be impacted unless people lose their jobs and have to look for a smaller apartment. But that is not where we are yet."

Meanwhile, office occupiers are putting new leases on hold. "Tenants are not making decisions to move to a new office. It is a contraction of activity where people go back to their home base and at a later stage they will maybe re-evaluate and re-price decisions."

Investor communication

One of the most pressing considerations for the participants is communication with investors: what they want and need to know, what relatively concrete information can be gleaned to inform them and how often that communication should take place. All three managers say they issued an immediate report setting out some of the considerations and first steps. But beyond that they each take a slightly differing approach.

Andersson emphasizes the need to control the flow of information. "We had some investors who reached out very quickly, asked a myriad of questions and wanted to have a very detailed update on more or less everything. I understand why they ask those questions. But some of them want weekly updates, and that is not something anyone would benefit from," he says. "All investors have different questions and you have to provide them with information that is relevant to them. But you can't cater for everyone individually. You have to treat them equally and get back to everyone on a regular basis and in an orderly manner with the same information."

Jonsson says Niam will continue to send quarterly reports to investors as usual, together with some additional analysis of the risks posed by the pandemic. "We already have briefly covered what changes in income or risks we see short term. Between those quarterly reports, as soon as we can actually find useful non-speculative information that is based on something substantial and not just what could happen, we will distribute that as soon as it is doable," he adds. "Not on a daily basis, because it is not to be found on a daily basis."

More urgent dissemination of information is sometimes necessary where the virus could have a severe impact on

Market trends pre-Covid-19

Nordics saw increased demand from global capital in 2019

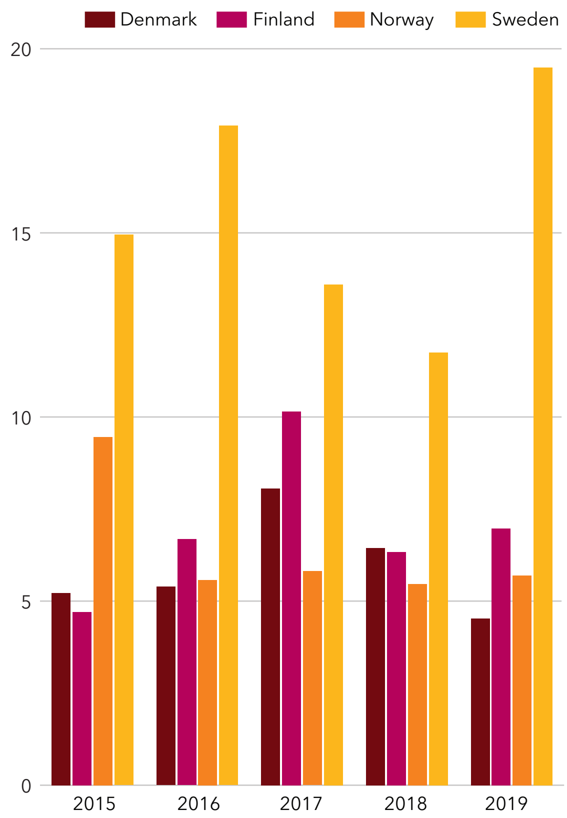
Before the current crisis struck, real estate investment in the Nordics had enjoyed a strong 2019 with a similar robust performance anticipated this year. Some €36.7 billion of real estate was transacted in 2019, according to Real Capital Analytics, a 22 percent increase on the preceding 12 months. Sweden in particular enjoyed a bumper 2019 with €19.5 billion of deals recorded.

RCA research shows capital flows into the Swedish market from non-European international investors reached record levels last year, driven in particular by US opportunistic investors making their debuts in the region's logistics market. Blackstone spent SKr4.5 billion ($450 million; €410 million) to acquire two portfolios, while CBRE Global Investors combined with German insurance company Allianz to buy SKr4 billion of logistics property in Sweden and Denmark.

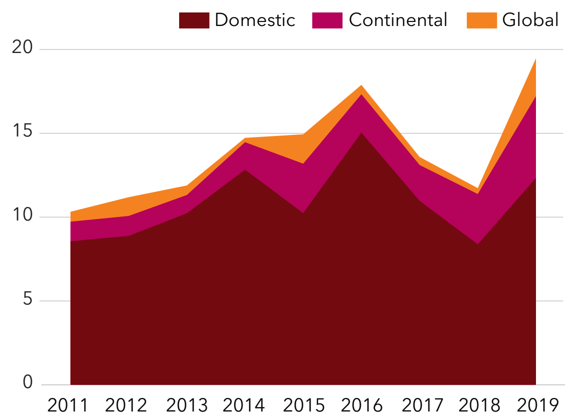
Broker Savills calculates that Nordic industrial prime yields hardened by an average of 29 basis points over the third quarter of 2019 to 5.15 percent, but still offered good value compared with 4.05 percent on average in other core European markets. The same held true for office yields at 3.6 percent in the Nordics compared with 3.22 percent average core prime yields.

While all pre-coronavirus forecasts for GDP growth and unemployment must now be regarded as out of date, demographic trends will continue to provide comfort for regional investors. Savills reports that while Europe's population is ageing overall, with young and working age demographics expected to decline by 1.8 percent over the next five years, Sweden (+4.5 percent), Norway (+3.1 percent) and Denmark (+1 percent) are expected to buck the trend.

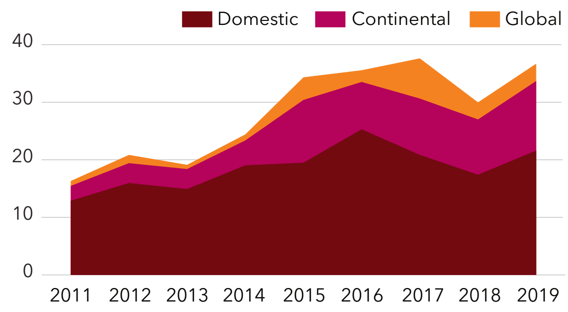
Nordics deal volumes: 2019 was a bumper year for transacations in Sweden (€bn)



Swedish investment: The largest Nordic market saw record levels of investment from global investors last year (€bn)



Nordic investment: Domestic capital still dominates in the Nordic markets (€bn)



Source: Real Capital Analytics

investment performance, argues Krogh. "We manage a big property near the airport, which has a close correlation to the shutdown of the airline industry. And another major tenant in the conference and meeting business has had to close down. The effect on those businesses is pretty dramatic, so our investors are not going to wait around on a quarterly report. Right now, you would rather over-communicate than under-communicate because the communication in itself signals that you are dealing with the situation."

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>
> **FREDRIK JONSSON**
> **Niam**

Denominator effect

Concerns have been expressed in private equity markets that the denominator effect, generated when public equities lose value and investors consequently find themselves proportionally over-allocated to illiquid asset classes, could prompt capital providers to retreat from their commitments to real estate. Both AREIM and Niam have substantial dry powder on hand following recent fundraises. Niam has almost €1 billion of capital available in its latest opportunistic vehicle, while much of the €685 million in AREIM Fund IV has not yet been deployed. Could investors be tempted to renege on their commitments?

"We have that on our radar," admits Jonsson. "We experienced it during the global financial crisis when one of our investors failed to send through money."

He argues it is possible to put measures in place to offset the impact of such an event, however. "If we usually have 10 days between a call and when we should get the money, we will probably at least double that period, so that we allow for the possibility that an investor might drop out and we can still go ahead with the remaining investors having reset the distribution among them. I don't see dry powder becoming wet to the extent that we wouldn't be able to enter into an acquisition because of not knowing whether the investors will contribute their capital, though."

Extending the use of a subscription credit line could be another option for managers in the event of an investor default.

"We haven't made any changes in that regard," says Andersson. "But we have heard that some managers have tried to fully utilize the equity bridge, or the subscription line, to have the capital on the sideline and be certain that they have liquidity if something happens."

Jonsson says he has also heard of managers considering such initiatives.

However, he cautions: "Besides investors not wanting to send money, banks could back out. You could also see a subscription line being pulled."

Nine of the top 10 Nordics-focused funds were raised by three managers

Fund	Firm	Target size ($m)	Final closing ($m)	% difference	Date
Niam Nordic VII	Niam	895.68	1,231.56	37.50	2019
NREP Nordic Strategies Fund III	NREP	1,007.64	1,012.12	0.40	2018
Niam Nordic VI	Niam	551.26	882.02	60.00	2016
AREIM Fund IV	AREIM	578.67	593.67	2.60	2020
NREP Nordic Strategies Fund II	NREP	606.39	657.10	8.36	2016
NREP Nordic Strategies Fund FCP-FIS	NREP	427.46	526.11	23.00	2014
NREP Nordic Strategies Fund I	NREP	526.11	526.11	0	2014
AREIM Fund III	AREIM	465.09	488.34	4.90	2016
CapMan Nordic Real Estate II	CapMan	N/A	482.07	N/A	2017

Source: PERE

"This is a black swan event if there ever was one, so we have to go day-by-day and handle the situation as it unfolds"

KRISTIAN KROGH
Thylander Gruppen

Strong public finances

As the discussion draws to a close, the participants move beyond the discussion of the immediate risks to consider how disruption could create opportunities in the medium term.

"Once we are past the damage control phase, liquidity will be absolutely critical," predicts Andersson. "The consequence of a crisis like this when liquidity dries up is that everyone looks at what assets are safe and what will be the long-term implications for cashflows. There will be some super-interesting buying opportunities. The question is, where do you find the quality cashflows when things have changed? Crises never completely repeat themselves. There are always new elements, so it is difficult to draw conclusions."

"These events will for some time ahead fundamentally change the perception and pricing of risk," agrees Krogh. "Having a new fund with a lot of dry powder could offer a lot of opportunity. Three months down the road, you could potentially be making the deals of a lifetime in a market like this."

The Nordic countries may be comparatively well-placed to weather the current storm, argues Andersson. In 2018 gross government debt across the euro area stood at 85.1 percent, while Sweden, Norway and Denmark all recorded figures below 40 percent, according to Eurostat. "When we are marketing the Nordics to foreign investors, we talk about how the region has strong public finances, so governments here have a lot of dry powder to manage this very difficult situation," he says.

Krogh believes that while real estate may be hit by the rebalancing of allocations in the short term, the Nordics will continue to play an important role in institutional portfolios.

"It seems strange to be talking about a collapsing market when just a few weeks ago we had very competitive processes for every investment that came out. It is not like the Nordics are on the fringe of portfolios and investors will not do any deals here anymore," he says.

"In this situation, we will really see which countries have a well-functioning public infrastructure, responsible politicians and monetary and fiscal headroom. In six to 12 months, international investors may say the Nordics had the capacity to meet the crisis while other countries were hit harder. This could be a situation that further enhances the appeal of Nordic markets." ■

Not enough to go around?

Equity providers face limited options with top Nordics vehicles oversubscribed

PERE research shows that before the covid-19 epidemic, the 10 largest regional investment vehicles in the Nordics were oversubscribed by 38 percent, raising $6.83 billion against $4.94 billion initially targeted. Investor demand has been strong, but equally their options are limited. Of the top 10 funds, nine were raised by just three managers: roundtable participants Niam and AREIM, and Copenhagen-headquartered NREP. "There is still room for more players in the market and investors probably need more," concedes Andersson. "But regulation is pushing in the other direction. It is hard to start a new fund. There are entry barriers that did not exist a few years ago. There is also a very big listed sector in the region, so there are other ways to access real estate in the Nordics other than through funds."

Jonsson believes a culture among regional managers of setting conservative fundraising targets may also be contributing to the level of oversubscription. However, the Nordics have also seen demand pressure: "There is far more appetite for investment-grade real estate than there is supply for almost every asset class, because real estate has moved right into the heart of investment portfolios as much as bonds have moved out."

While demand has remained strong, many investors are now looking for a different risk profile from that which they may have favored 10 years ago, he adds. "They are less keen on extremely high IRRs and keener on longer-standing lower IRRs. They don't necessarily want their capital back fast. We opened our first core-plus fund in 2012 because we saw deals were more plentiful than in the opportunistic space. But from the demand side, it fit well with what investors wanted. That also contributes to the easiness of oversubscribing when raising funds."