Commercial Real Estate
Different aspects of rent setting

Bachelor Thesis within Business Administration

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Jönköping December 2007
Kommersiella fastigheter

Olika aspekter av hyressättning
Kandidatuppsats inom Företagsekonomi

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Jönköping December 2007
Acknowledgements

The authors would like to convey our deepest gratitude to all representatives and organisations participating in our interviews, for their support, provision of assistance and contribution of valuable information.

Furthermore the authors would like to acknowledge Gunnar Wramsby and the opponents in the seminar group for their guidance in the process of writing this thesis.

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Abstract

Background
The Swedish economy is currently in a boom and due to the fact that the commercial rental market is closely correlated with the development in the Swedish economy and its economic indicators, commercial real estate companies are successful. Commercial real estate companies generate their main revenue out of rents from their tenants, therefore the setting of rent and the factors affecting the procedure are of great importance. The report will not only examine the commercial rental market but also the composition of the lease contracts, factors affecting the rent setting and risks associated with commercial leases.

Purpose
To analyse the commercial rental market comprising of several different lease contracts. The focus will be to analyse the setting of rents and the factors affecting the procedure.

Method
A deductive approach and a qualitative research method is used in order to get reliable and valid data to be able to fulfil our purpose. The data is collected from interviews done with three different real estate companies, situated in Stockholm and Gothenburg. The sample include Håkan Hellström representing Castellum, Lovisa Lindberg representing Landic Property and Roddy Carlsson representing Vasakronan.

Conclusion
As could be expected, the commercial rental market is closely correlated with supply and demand in the Swedish economy. Currently, demand is increasing due to a growing employment rate and a strong GDP growth. Market rents are increasing, since the demand is continuing to accelerate and vacancy rates are falling. The vacancy rates are currently below the natural level since rents are increasing in both Stockholm and Gothenburg. It is shown that the vacancy level is lower in Gothenburg compared to Stockholm.

Location is the most important factor affecting the setting of rents apart from supply and demand. Rent for office space is highest in the cities’ CBD. Additional factors are attributes that make the premises more attractive and client care that enables for satisfied tenants and long lasting tenant relationships.
Sammanfattning

Bakgrund

Den svenska ekonomin är idag i en högkonjunktur och på grund av att den kommersiella hyresmarkanden är starkt korrelerad med utvecklingen i den svenska ekonomin och dess ekonomiska indikatorer, är kommersiella fastighetsbolag framgångsrika. Kommersiella fastighetsbolags intäkter består till största del av hyror från deras hyresgäster. Därför är hyressättningen och dess påverkande faktorer av stor vikt. Rapporten kommer inte enbart undersöka den kommersiella hyresmarkanden, utan även komponenter i kommersiella hyreskontrakt, faktores som påverkar hyressättning och risker associerade med kommersiella hyreskontrakt.

Syfte

Att analysera den kommersiella hyresmarknaden bestående av flera hyreskontrakt, med fokusering på hyressättning och dess påverkande faktorer.

Metod


Slutsats


Hyressättningens viktigaste faktor som påverkar hyresnivån förutom urbud och efterfrågan, är läge. Hyran för kontorslokaler är som högst i städernas CBD. Hyressättningen påverkas av ytterligare faktorer som gör kontorslokalen mer attraktiv och kundvård som möjliggör långa kund relationer med nöjda kunder.
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1 Introduction

The Code of Land Laws (Jordabalken) defines a property “Real estate is land, which is divided into properties. A property is bounded either horizontally or both horizontally and vertically”. (Lindholm & Nordback, 2007) On the property there may be one or more buildings. A building can either be fully owned by the landowner or it can be leased. A commercial real estate is composed of several tenancy agreements or lease contracts that yields revenue. A lease contract gives the right to use the property given by a lessor and in return paying the lessor a fixed or determinable payment in a fixed or indefinite period of time. (Pyhrr & Cooper, 1982)

The turnover on the Swedish real estate market is continuing to set new records. During 2006, the turnover for real estate was SEK 140 billion. Commercial real estate stands for 45 percent of the total turnover of the whole real estate market. (AP fastigheter, 2006)

Commercial real estate is real estate zoned for business or industrial use. The land or real property use and improvements are intended for use in a business area and the goal is to generate money. Commercial real estate includes a wide variety of property types such as office buildings, apartment properties, malls, shopping centers, warehouses, distribution facilities and research-laboratory properties. (Investopedia, 2007)

Commercial real estate is divided into the real estate market and the rental market (Geltner & Miller, 2001). In this thesis, focus will be on the rental market, especially office space. The commercial rental market will in this thesis be referred to as the commercial rental market for office space. The rental market, i.e. the market for leasing premises, is closely related to the development in the Swedish economy. The Swedish economy is currently in a boom and has a satisfactory growth in the gross domestic product (GDP) (Konjunkturinstitutet, 2007). This is primarily due to rising private consumption, higher exports and increased investment in the Swedish market. The employment rate is another aspect that reflects the demand in the rental market. A positive employment rate has a decisive impact on demand for premises and rental levels, particularly in major urban areas with economic growth. (Vasakronan, 2006)

The rent for a specific premises is based on a market rent determined by the supply and demand in the Swedish economy. Other criteria’s that are followed when setting rents are the length of the lease contract, location and special features. (Castellum & Vasakronan, 2006)

The motive behind this subject is due to the fact that rents are the main revenue for commercial real estate companies and it is interesting to see how the reasoning behind setting rents is done. This thesis will be based upon interviews with commercial real estate companies, theory concerning commercial real estate and factors contributing to the setting of rents. There will be a discussion of how the rents are set and what aspects to take into account in order to get satisfied customers and gain as much revenue as possible.
1.1 Background

The commercial rental market has improved in the larger cities of Sweden (Vasakronan, 2006). Currently, there is much to suggest that revenues from commercial real estate will increase and employment is expected to increase as well (mainly in the service sector). This can lower the degree of real estate vacancies and make it possible to increase the rents; and further on even revenues. On the other hand a possible recession in the future might limit the chance of raising the rents further and give an opposite effect. (Riksbanken, 2007)

Commercial real estate on the rental market generate their main revenue out of rents from their tenants. Even if this subject is in a boost, few studies have been made about how lease contracts in commercial real estate are conducted. It is in our interest to see how lease contracts are composed and what risks that are associated with setting appropriate rents. Risk is estimated differently for commercial real estate compared to private real estate since the risk is diversified in commercial real estate (Phyrr & Cooper, 1982). Market analysis, tenant structure and vacancy are important aspects to take into consideration when dealing with risk in the procedure of setting rents in the commercial rental market (Vasakronan, 2006).

The supply of capital is high due to the fact that both domestic and international companies are willing to develop and expand their businesses in Sweden. One limitation is however that the demand is rising but the supply is currently rather limited in the Swedish rental market. (Riksbanken, 2007)

According to Riksbanken (2007), the development and change on the commercial real estate market are factors that are crucial for a stable Swedish economy from a financial point of view. This is due to that banks have a central role in the financing of commercial real estate, and the majority of companies with real estate listed on the stock market consist of commercial real estate. The real estate companies constitute as the banks’ main exposure since real estate is often used as bank loan collateral. The Swedish banks’ main borrower are real estate companies, approximately twenty percent of the four major banks’ total lending goes to companies that manage commercial real estate.

1.2 Problem and Research Questions

Primarily, rents are based on supply and demand in the Swedish economy, but there are additional aspects to take into consideration that are less obvious. Real estate companies use series of actions in order to set a beneficial rent for themselves and their tenants. It is important for all real estate companies to gain as high operating surplus as possible (rent revenues subtracted by operating and maintenance costs).

Our thesis will try to answer the following questions:

- What is the current state of the economic indicators in Sweden and how are they influencing the commercial rental market?
- What is the current state of the commercial rental market in Stockholm and Gothenburg?
- How are commercial lease contracts composed?
- What factors are affecting the setting of rents apart from supply and demand?
• Which risks are associated with commercial leases and how does real estate companies cope with those risks?

1.3 Purpose

The purpose with this thesis is to analyse the commercial rental market comprising of several different lease contracts. The focus will be to analyse the setting of rents and the factors affecting the procedure.
2 Method

In this thesis a qualitative research method is chosen. The main tool for data collection is open interviews. In the chapter the authors will present why such a method is chosen and used and how the interviews were conducted.

2.1 Deductive vs. Inductive Research Approach

There are two alternative research approaches to choose from. The first approach is called the deductive approach, in which you develop a theory and hypothesis and then design a strategy to test the hypothesis based on an already existing theory (Saunders et al., 2003). The deductive approach is a logical process of deriving a conclusion from something known to be true (Zikmund, 2000). The second approach is the inductive approach, which involve collecting data and develop a theory as result of your data analysis (Saunders et al., 2003).

A deductive approach is chosen since it is the best alternative in order to fulfil our purpose. Our purpose is to analyse existing data, not to build our own theories from the data collected.

2.2 Qualitative vs. Quantitative Research Methods

In order to achieve a satisfying result the research method must be suited and beneficial for the specific study. As a researcher you can use either a quantitative or a qualitative research method. To be able to understand the difference between the two methods one has to take into account how the data is collected and how the data is analysed. They both have advantages and disadvantages, but by weighing these one will be able to choose the most suitable method. By choosing the wrong method one might receive biased results. (Saunders et al., 2003)

The focus of qualitative research is not on number, instead based on words and observations. The quantitative research on the other hand, is based on numbers and the purpose is to determine the quantity of some observable fact in the form of numbers. (Zikmund, 2000) Qualitative data are not immediately quantifiable unless they are coded and categorized (Sekaran, 2003).

There are many situations where it can be favourable to use a qualitative research interview. The interviews will contribute the authors to gather valid and reliable data, relevant to the research questions and objectives. When using interviews there are some advantages and disadvantages, but the most important aspect is to choose whichever method that contributes to high validity and reliability of the research. Having all the following points in mind the authors could only find advantages with using in-depth interviews. (Saunders et al., 2003)

The first point is the nature of the approach for the research which deals with the aspect of using interviews. Here the interviewers have the chance to elaborate further on the questions and can by doing that eliminate any misunderstandings or misinterpretations of the interview questions. (Saunders et al., 2003)

The second point is the significance of establishing personal contact. This is connected with the first point in the way that it gives an extension to the questions. The most important difference for other type of qualitative methods is that when meeting someone face to
face the interviewer has the possibility to ask awkward questions and by that forcing the interviewee to answer questions that he/she would have left out using for example a questionnaire. (Saunders et al., 2003)

The third point is the nature of the questions. When doing an in-depth interview the questions can be both longer and more complex, for that reason more complicated questions can be asked.

The last point, which is to a large extent connected to the third, is the length of time required for completeness of the process. It is difficult to develop a questionnaire that will cover just as much as an in-depth interview. The reason behind this is that the number of interviewees is limited to just a few and the subject has not been investigated at this point. Using other types of qualitative methods might lead to missing out important data and the authors collecting insufficient data. (Saunders et al., 2003)

A quantitative method on the other hand can be applied when a standardized approach of analyzing the results are used (Saunders et al., 2003). This method is not used in this thesis because a qualitative method is used instead due to the fact that no standardised approaches are available. It is of great importance that the authors can structure the result and make sure that the same analyse is performed according to the same standard for all the respondents input. In this thesis this is done by using interview guides for every interview.

2.3 Approach and Method Chosen

After deciding to use a deductive research approach and a qualitative research approach the authors chose how to conduct the research further. The empirical findings for this thesis should most favourable be conducted by performing open interviews to get the best results.

To fulfil the purpose of this thesis the authors felt that the method best suited would be open in-depth interviews. The authors felt based on the type of data to be collected that interviews would be the best choice. In addition to the interviews market analyses from CB Richard Ellis and Jones Lang Lasalle will be used. The reasoning behind this is that it will give the authors the most accurate answers considering the subject under study.

In-depth interviews are used when the researcher wants to increase the knowledge in a subject and the researcher need to consider that one does not interpret the data in the wrong manner to get the most valid results. If the data are to be seen as valuable it has to be analysed in a critical way making sure that the proper questions have been asked and the fair view of the interviewee has been reflected. On the other hand, a structured interview gives several answer alternatives to choose between, which all are determined in advance. (Lantz, 2007)

2.3.1 Sample Selection – the Interviewees

As the first step of the thesis the authors contacted several real estate companies by e-mail. The authors wanted to interview organisations dealing with commercial real estate, which are well-established and well-known. All the interviewed organisations have an interest in real estate and the rental market. The best suitable interviewees within each organisation were selected; they are presented below:
Castellum is one of the major listed real estate companies in Sweden. The fair value of the real estate portfolio amounts to over SEK 24 billion and comprises of commercial properties. Castellum’s real estate portfolio is concentrated to Greater Gothenburg, the Öresund Region, Greater Stockholm, Mälardalen and Eastern Götaland. (Castellum, 2006) At Castellum the authors interviewed the Chief Executive Officer, Håkan Hellström at Castellum’s office in central Gothenburg. The reason for interviewing Håkan Hellström was that his knowledge concerning our questions is very broad.

Landic Property is one of the largest real estate companies in the Nordic countries. They have substantial market shares in Sweden and Denmark and are market leader in Iceland. The property portfolio totals 2.8 million square metres of rental space, more than 3,800 tenants and total assets of SEK 41.4 billion. (Landic Property, 2007) The authors interviewed Lovisa Linberg, who is representing Landic Property in this thesis. She is Investment Manager at the Stockholm office. The reason for choosing Landic Property was their experience and size. Due to lack of time and money to do a face-to-face interview, Lovisa Linberg was interviewed over the phone.

Vasakronan is one of the leading commercial property companies in Sweden. Vasakronan has operations in Stockholm (with suburbs), Gothenburg, Malmö, Lund and Uppsala. The property portfolio comprises 160 properties with a total floor space of 1.8 million square metres. Vasakronan saw its best results ever in 2006 when income after tax amounted SEK 3.4 billion. (Vasakronan, 2006) Roddy Carlsson, one out of three managers at Vasakronan in Gothenburg was interviewed because the authors thought that his expertise would help to get the most relevant answers to the questions.

Both Håkan Hellström and Roddy Carlsson were interviewed face-to-face at their offices in Gothenburg. All three authors were present and during the interview notes were taken. The authors are satisfied with both the interviews and the data collected.

2.4 Validity and Reliability

Validity concerns the issue of the authenticity of the cause-and-effect relationships and their generalizability to the external environment. Reliability refers to the degree to which the instrument measures is without bias (error free) and is an indication of the consistency and stability of the study. (Sekaran, 2003)

The goal with the interviews was to get as valid and reliable data as possible, but there are many aspects that affect these matters. Always when doing a face-to-face interview there is a risk of unwillingness from the interviewee to answer the interviewer’s question. This might be for a lot of reasons. Discussions on what type of interviews and questions that will be performed are important when trying to find a valid and reliable result. (Saunders et al., 2003)

If the authors are careful when doing the interviews and make sure that the interviewees fully understand the questions from the angle that the interviewers have intended them to be, the validity will increase (Saunders et al., 2003). The authors will try to achieve the best results from the interviews by e-mailing the questions and a draft of the thesis in advance to all the interviewees of choice to get them familiar with the study and what the authors want to investigate.
The authors are of the opinion that using open in-depth interviews will give the most valid result for this study and by interviewing more than two people will give answers seen from different angels. The authors believe that the chosen interviewees are suitable as they possess broad knowledge about the topic which will help generate a valid result for the thesis.

Sticking to the same questions for all the interviews is also important, otherwise the data can not be seen as reliable if different questions would be used for the different interviewees (Saunders et al., 2003). The authors’ goal is to raise the same questions to different people in hope to receive answers that agrees and disagrees with each other.

After producing a result that the authors believe to be valuable, the question of the reliability have to be considered. An important factor to consider is whether the interviewee is trustworthy or not. The interviewee might on purpose leave out certain information or he/she might lack the knowledge or misinterprets the questions. This can later on lead to biased results. This is always a risk when using interviews as a research method. The authors carefully choose the interviewees and by doing so hoping to limit the risk of missed out information and biased results.
3 Frame of Reference

The frame of reference starts with a presentation of the real estate system and the markets associated with it. The chapter also presents factors taken into consideration in commercial leases and rent setting such as risk, cash flow projections and the economic indicators in the Swedish economy.

3.1 The Real Estate System

The commercial real estate market is according to Geltner & Miller (2001) divided into the space market and the asset market. An additional component in the real estate market is the commercial property development industry. The space market and the asset market are linked together by the development industry. Together they form the real estate system.

3.1.1 The Space Market

The space market is according to Geltner & Miller (2001) the market for the usage of real property. It is often also referred to as the rental market. The demand side of the space market are individuals and firms that want to use space for either consumption or production purposes. The supply side consist of owners who rent space to tenants.

The real estate space market is hugely segmented because both supply and demand are location and type specific. In turn, the rental prices for physically similar spaces can differ widely from one location to another or from one type of building to another.

![Demand function](image)

Source: Geltner & Miller (2001)

Figure 3-1 Demand function

The typical demand function looks essentially like the classical demand functions of economic theory. As demand grows, the downward-sloping line moves out and to the right. The increase of the demand is usually due to both national and local factors.
The supply side, on the other hand, looks completely different from the classical supply function. Instead, the supply function is illustrated as being “kinked”, meaning that it is not continuous, but has a corner or break in it. Due to the extremely long lifetime of built space the supply of a space is almost completely inelastic, which means that if demand falls, the space can not be reduced (at least not in the long run). So for several years the market will essentially maintain the same quantity of supply. (Geltner & Miller, 2001)

The “kink” in the supply function occurs at the quantity of built space at a rent level that relates to the long-run marginal cost of supplying additional space to the market. The marginal cost, in the case of the space market, is the cost of developing new buildings. When the development cost of new buildings is greater than the last one built, then the supply line is rising above the “kink” point. If it would cost less, the supply function is falling. The shape of the supply function fundamentally determines the level of rents as demand changes over time. In general, the “kink” means that if the space market is currently in equilibrium, future increase in demand will result in a small or zero increase in rent levels in the long run. Due to that, the “kink” in the supply curve in the real estate space markets have often tended to be cyclical, with periods of excess supply followed by tight markets. This happened in many real estate markets in the late 1980s and early 1990s. The demand could not match the supply which in turn resulted in falling rent levels. (Geltner & Miller, 2001)

### 3.1.2 The Asset Market

Real estate assets consist of real property, that is, an estate or property consisting of lands and of all appurtenances to lands, as for example buildings. These assets are according to Geltner & Miller (2001) in an economic perspective, consisting of claims to future cash flow, e.g. the rents that the building can generate. The asset market is also often referred to as the real estate/property market or the investment market.

According to Geltner & Miller (2001), the demand side of the asset market is composed by investors wanting to buy property. The supply side is made up of other investors who want to sell the total or reduce a part of their holdings of real estate assets. The balance between supply and demand determines the overall level of real estate asset values. Specific property values is determined by the perception of potential investors, what the investors are willing...
to pay, regarding the level of and risk of the cash flow that the property can generate in the future. The most widely, especially in commercial property markets, used measure is the capitalization rate (cap rate). Cap rates provide a tool for investors to use for roughly valuing a property based on its income (e.g. rental income generated from lease contracts). It is the ratio between the cash flow produced by an asset (the real estate) and its capital cost (the original price paid to own the asset). The rate is calculated in a simple fashion as follows:

- annual cash flow / cost (or value) = Capitalization Rate

The property value can thus be represented as:

- Earnings (essentially net rents) / cap rate

The cap rate is according to Geltner & Miller (2001), determined by capital investment supply and demand in the asset market and is based on three major factors:

1. Opportunity cost of capital – real estate assets are competing with all components of the capital market, i.e. bonds, stocks and money market instruments. These components’ interest rates and opportunities for earning returns are thus important. If the interest rate is low on the stockmarket, investors tend to be more eager to invest in the real estate market. This will raise the price they are willing to pay for the property and reduce the cap rate.

2. Growth expectations – investors will try to forecast the likelihood of the growth in the rent they can expect to generate from the property in the future. This forecast is done in the space market in which the property is situated. The greater the expected growth in the future net rent, the more investors will be willing to pay and hence, the smaller the cap rate. Growth depends on the current state of the market (equilibrium) and the shape of the supply function. In addition there are specific attributes for specific properties, such as existing leases and need for capital improvements.

3. Risk – when investors foresee a property certain and less risky they will be willing to pay more and thus the cap rate reduces. When a property is seen as less risky the space market is relatively stable, in balance and easy to forecast.

3.1.3 The Development Industry

As stated before, buildings are “long-lived” assets. It is therefore only the demand for new built space that supports the development industry. Because the demand is sensitive to general economic changes, the development industry is subject to “boom and bust” cycles. (Geltner & Miller, 2001)

The development industry is according to Geltner & Miller (2001), the converter of financial capital into physical capital. In addition, the development industry serves as a feedback loop from the asset market to the space market, adding to the supply side of the space market. The development industry is governing the amount of physical space on the supply side of the space market.
According to Geltner & Miller (2001), investors’ perceptions of the risk and returns of the real estate assets and forecast about the future of the space market determine the current cap rate. These interactions between the asset market and the space market produce the current real estate asset values. These values represent the output from the asset market and the input in the development industry.

When forecasting the investors’ must take both the economic base underlying the demand side of the space market and the activity in the development industry on the supply side of the space market into consideration. In addition, they must consider forecasts of the capital market and macroeconomic factors such as interest rates and inflation. (Geltner & Miller, 2001)

3.2 Return and Risk Management

In the commercial real estate market risk is defined as the possibility that future investment performance will vary over time in a manner that is not entirely predictable at the time when the investment is made. Risk is a crucial factor to consider when investing in real estate. Understanding how risk is related to returns is a basic part of understanding the real estate investment. Other things being equal, real estate investors will prefer less risky investments. There is an underlying risk for the investors to lose all of the capital they invested or to lose any of the capital invested. An investor’s primary financial goal is to maximize wealth by accept capital investments that offers some optimal combination of return and risk that fulfil the investor’s preferences. For the most of the time investors want their rate of return to be very high since they prefer more return than loss. Also, other things being equal, the rate of return should be dependable and stable, which means that they prefer less risk to more risk. (Geltner & Miller, 2001)

Risk is related to the possible future returns that the investment might earn and the degree of deviation or dispersion of those expected returns. Standard deviation is the most common measure of statistical dispersion. The greater the standard deviation in the possible return, the greater is the risk. A diversified portfolio of real estate assets has a smaller standard deviation. Risk is represented by the range of deviation of the possible future return outcomes. If an investor has to choose from two assets with the same expected return, the investor should choose the more risky asset since it will typically have a greater chance of returning a larger profit. It is a fundamental fact that expected returns are greater for more risky assets. Risky assets must offer a higher expected return in order to compensate investors for taking on risk when they buy these assets. Even though standard deviation is one of the most widely used measurement of risk it is worth mentioning that measuring the exact risk of an investment is highly difficult. (Geltner & Miller, 2001)

In the commercial rental market, risk is viewed from a different angle. Risk is instead associated with creating long lasting stable relationships between real estate companies and their tenants. Risk is also connected to the diversification and spread of the expiring of a contract portfolio. A diversified contract portfolio consists of a mix of tenants with diversified tenant structure and lease maturity structures. Real estate companies have different risk perceptions and preferences. For example, small real estate companies may not be able to diversify their portfolios and therefore they are exposed to more risk.
Real estate companies also need to make sure that their tenants are capable of paying the rent now, as well as in the future. This fact is also associated with some risk since it is impossible to guarantee a positive future for all tenants within the contract portfolio. (Geltner & Miller, 2001)

3.3 Cash Flow Projections

When rents are set the real estate company first need to do a forecast of the property’s future cash flow by trying to estimate as unbiased as possible. The forecast can be done by going through the proforma which is a document laying out all the cash flow projections. A forecast of this type is usually done over a long period of time. Ten years is the most common time period used. Commercial real estates are long-lived and most real estate companies usually hold the properties for long periods and the transaction costs on returns are also minimized. (Geltner & Miller, 2001)

It is fundamental for a real estate company to consider the ability for a property to generate operating income over the long term, so even if the investment is short term, a long horizon time perspective is needed to set the most accurate resale value (i.e., the price any potential buyer would be willing to pay for it) of the property. The prediction of where the future rental market is heading, concerns the most difficult part in the forecast. Here one has to consider both supply and demand but also the particular premises circumstances. This is crucial to property valuation. It is also important to recognize that the future is inherently uncertain because we can not predict the future without a perfect accuracy. For an analysis, the only thing needed is a forecast that is realistic and unbiased. (Geltner & Miller, 2001)

Predictions can also be done about the current market by examining the recent leases signed for the premises and then compare them with recent leases signed in similar premises. This procedure is called the rent comps analysis (comps is short for comparable) and is used as a standard procedure of commercial appraisals. Projections about the future of markets rents involves analysis of supply and demand in the relevant market and is often projected to grow with the general inflation rate as a constant percentage growth per year. This might not apply when the local rental market is “out of equilibrium” and the method tends to ignore the effect of functional and economical depreciation of the building. (Geltner & Miller, 2001)

Two categories of cash flow should be represented in the proforma to be able to do the value analysis: operating cash flows and reversion cash flows. Operating cash flows refers to cash flows that result from normal operation of the property and will accrue to the property owner as long as the property is held as an investment. The reversion cash flows on the other hand only occur at the time and due to the sale of or a portion of the property asset. (Geltner & Miller, 2001)

3.3.1 Revenue

The potential gross income (PGI) represent the property’s primary resource of revenue, meaning the cash it could earn if fully rented. In properties with long-term leases the term is often also called rent roll. The PGI is calculated by multiplying the amount of rentable space in square meters and the rent per unit. If the leases cover a long period of time the PGI calculation can be rather difficult and made in different ways. The first alternative applies as long as the lease will be in effect. This means that the revenue is a function of the contractual rent in that case. The other alternative applies once the existing lease expires
and for any space not covered by an existing lease. Now the revenue will be calculated as a function of future leases that are likely to be signed. (Geltner & Miller, 2001)

It is unrealistic to predict that a property will be fully leased at all times and generating its entire PGI every year. It is therefore crucial to include the vacancy allowance in the analysis. The vacancy allowance stands for the expected effect of vacancy in the net cash flow of the property. The vacancy allowance for commercial properties is usually first to forecast the likely vacancy period that will be associated with each rental unit or space in the premises, considering the expiration of each lease currently in the premises. If the vacancy differs to a substantial extent to the typical vacancy in its market, this difference can often either be explained or corrected. Vacancy allowance tends to increase over time as the premises ages. The effective gross income (EGI) is the projected PGI subtracted by the allowance rate. The property is most likely to have other sources of earning income besides the rental income. Examples of such sources can be revenue from vending machines or parking operations plus billboard and antenna rental. (Geltner & Miller, 2001)

3.3.2 Expenses

A property does not only have cash in-flow but also cash out-flow and the major part of the cash out-flow is consisting of operating expenses. Typical sources of operating expenses are property management and administration, utilities, insurance, regular maintenance, repairs and property taxes. (Geltner & Miller, 2001)

It is useful to divide the operating expenses into fixed and variables costs. Fixed expenses are costs that are unaffected by the level of occupancy of the building, which means that they will stay the same no matter if the vacancy rate is zero. Typical costs of this type are tax and insurance. The variable expenses on the other hand occur in a direct proportion to the level of occupancy. Premises often have what is called a net lease, where the tenants pay all or most of the operating expenses. Other premises may have reimbursement of some or all operating expenses or so-called expense stops in which the tenants pay all operating expenses over a certain agreed-on level. This is often a reflection on the operating expense per square meter when the contract was signed. (Geltner & Miller, 2001)

By subtracting the operating expenses from all the sources of the revenue premises has to calculate the net operating income, abbreviated NOI. This term is the most commonly used indicator of the net cash flow or operating profit generation ability the property has. A property also has capital improvement expenditure which in general refers to the major expenditure done for example to improve the long-term physical quality of the property required to remain. In addition to the improvements done to the specific premises there is also expenditure associated with for example specific long-term leases such as tenant’s improvement expenditure and leasing commissions to brokers. This type of expenditure include customized physical improvements provided at the time of lease signing before occupying the space, often called concessions that the landlord offers the tenants to make them sign long-term leases. All of these expenditures mentioned above is mainly considered to add value to the property in one way or another. (Geltner & Miller, 2001)
Reversion cash flow also needs to be included in any year where all or just a part of the property is expected to be sold. Otherwise a large part of the value under analysis will be left out. To be remembered is that a projection of future selling price is to not expect it to be without errors, just unbiased. If the future selling price will differ from prior projections, it is merely a reflection of the fact that real estate investing is very risky. (Geltner & Miller, 2001)

3.4 Economic Indicators

To be able to compose a commercial lease contract it is necessary to consider the macroeconomic factors. Conducting a market analysis is a part of the macroeconomic analysis. A market analysis should be based on realistic data and at the same time simple enough so it can be applied quickly and inexpensively. A market analysis should also be arranged so it is easily communicated and understood in the real life. The purpose of a market analysis is different depending on which purpose and market level each analysis is focusing upon. The most common market analysis will focus upon just a few indicators that characterize both the supply and demand side of the real estate space market as well as stability between the both sides, the market equilibrium. (Pyhrr & Cooper, 1982) The economic indicators which influence the supply and demand and hence are important for the commercial rental market will be explained below.

3.4.1 Inflation

Inflation is an essential reason for both financial successes and failures of commercial real estate companies. An increase in the inflation will cause interest rates, operating expenses and premises costs to increase more rapidly than rents. In turn, undercapitalizing lenders have taken a more protective role when lending money to commercial real estate companies in the Swedish real estate market. Lenders are demanding more structure of the capital at the same time as borrowers must invest greater amounts of capital. Institutions are accepting larger operating risks in return for larger yield expectations and protection against inflation. Inflation cycles have a crucial impact on real estate returns, values and risks and should therefore not be ignored. (Pyhrr & Cooper, 1982)

The key to understanding how inflation affects the investment returns and risks is to have knowledge about the different macroeconomic variables e.g. property values, operating expenses, rental income and debt alternatives. If the investor has the knowledge to project these variables over time by means of discounted cash flow, sensitivity analysis and risk analysis techniques, investment decisions can maximize wealth over time. The more knowledge the commercial real estate company possess, a better strategy can be developed for taking advantage of cyclical developments. Inflation does not inevitably limit the opportunities on the Swedish real estate market. If real estate companies can adapt to inflation and stimulate investment and productivity the investment outlook can be favourable. (Pyhrr & Cooper, 1982)
3.4.2 Gross Domestic Product (GDP)

One central way to measure the Swedish economy is by the indicator gross domestic product (GDP). The GDP of a country defines the total market value of all final goods and services produced within a country in a given period of time. It also includes the sum of value added at every stage of the production of all final goods and services produced within the country during this time. GDP measures the output in a country equal to the income. For the most of the time GDP is seen in the relation to the total population of a country to attain the most relevant measure of the standard of living between countries. The GDP for a country is composed by different measurements of the Swedish economy such as; consumption, investment, government spending, exports and imports of a country. (Konjunkturinstitutet, 2007)

Strong growth in the domestic economy results in a robust increase in investment and strongly rising consumption. When the public finances are very solid, the growth in general government consumption will be relatively forceful. (Konjunkturinstitutet, 2007)

![Figure 3-3 GDP, forecast and outcome in the Swedish economy](image)

Source: Konjunkturinstitutet (2007)

The GDP reflects the whole Swedish economy and how people and companies act. When the GDP increases, the Swedish economy is in a boom which results in companies wanting to invest and expand. In contrary, when the GDP decreases, the economy is in a recession and companies want to keep their money and be safe. Using analyses and predictions for the development of business cycles it is natural to indicate the GDP growth i.e. the change in the volume of output. (Konjunkturinstitutet, 2007)

3.4.3 Employment

Regular employment is the number of persons employed on the regular labour market. The employment ratio is the number of persons employed as a percentage of the population. Unemployment is the state in which a worker wants, but is unable, to work. The unemployment rate is calculated by the number of unemployed workers divided by the total civilian labor force. The employment rate in Sweden is reflecting the population that are employed in the ages between 15-64 years old. In the category of employed people a
person needs to work at least one paid hour each week or as an unpaid assistant in a family business. (Statistiska Centralbyrån, 2007)

The labour effort in a country exists of the total sum of worked hours. If the total number of hours worked increase, the more a country can produce and the GDP level increase. When the GDP is increasing and the Swedish economy is in a boom, people tend to spend more money and companies invest. This cycle results in a higher employment rate and unemployment will drop. A rise in the output due to higher productivity is also a result of a recovery in the labour market. Investment from companies desire more people to achieve their goals, i.e. more people are employed. (Konjunkturinstitutet, 2007)

![Figure 3-4 Unemployment, recruitment and vacancy rates in Sweden](image)

Source:Statistiska Centralbyrån (2007)

The figure shows the relation between the unemployed part of the population and recruitment rate. The recruitment rate is defined as the share available jobs in each sector. A higher recruitment rate tends to increase the recruitment activity. The vacancy rate is a normalised variable that shows the relative lack of labour. (Statistiska Centralbyrån, 2007)

### 3.5 Vacancy Rate

The vacancy rate refers to the percentage of the stock of built space in the market that is not currently occupied. To compute an accurate vacancy rate all space should be included that is currently unoccupied and available for occupancy, including space that may be under lease but available for subleasing. The vacancy rate is an indicator between supply and demand in the market. (Pyhrr & Cooper, 1982)

In a typical rental market it is normal that some vacancy exist. This is due to the fact that it makes no economic sense for landlords to rent space to the first possible tenant, no matter what the tenant is offering to pay. In the same way, it does not make sense for tenants to rent the first premises they find. Therefore both the supply and the demand sides of the market will be maximized if tenants and landlords take some time to search for better deals. To come up with the optimal decision, perfect information must be available on the market. Consequently, zero vacancy will be a result of suboptimal behavior on the part of decision makers. (Pyhrr & Cooper, 1982)
A natural vacancy rate is the vacancy rate that tends to prevail on average over the long run in the market and designate when the market is in balance between supply and demand. When vacancy is below the natural vacancy rate the market is a sellers’ or landlords’ market or that the rental market is tight, with demand exceeding supply. When the vacancy rate is above the natural level the market is said to a buyers’ or tenants’ market with the supply of available space exceeding the current level of demand. A vacancy rate below the natural rate results in that rents will tend to be driven up and new development will occur. When vacancy is above the natural rate, rents will tend to be driven down. Vacancy rate information is more generally available and more dependable than the other equilibrium indicator, rents. (Pyhrr & Cooper, 1982)

### 3.6 Market Rents

Market rent is described in the Residential Tenancies Act as what “a willing landlord might reasonably expect to receive, and a willing tenant might reasonably expect to pay for the tenancy”, in comparison with rent levels for similar properties in similar areas. Market rent is a useful guide when you are deciding what the rent will be. It needs to be comparable to the rent charged for other properties of a similar type, size and location. The rental price is also a determination from the supply and demand in the rental market that gives a signal about the current value of built space and the current balance of supply and demand for that space. If usage demand grows and space supply remains constant. Rents will tend to rise and vice versa. (Geltner & Miller, 2001)

Market rent refers to the level of rents being charged on typical new leases currently being signed on the market. The level of rents will be different depending on the specific nature of the site and space size being rented and to the terms of the lease. It is for that reason important to control these variations when trying to measure trends in rents across time. This makes reliable criterion of market rents rather difficult. It is also important to control the effect of inflation to observe the trend in real rents. (Pyhrr & Cooper, 1982)

One important characteristic of the long-term commercial lease contract is that the rent changes over time during the contract. Rent changes serve several purposes. One of the most basic purpose is to reflect changes in the relevant rental market that cause the equilibrium to change for new leases being signed in that market. Another purpose is to protect the landlord from changes due to the inflation in the Swedish economy since operating expenses are affected. (Geltner & Miller, 2001)

### 3.7 Summary

The commercial real estate system is divided into three parts; the space (rental) market, the asset (investment) market and the development industry. The supply and the demand on the commercial rental market is determined by the economic indicators in the Swedish economy. The economic indicators that are of great importance are inflation, GDP and employment. Furthermore, supply and demand influence the vacancy rate and the market rent on the commercial rental market and the overall level of real estate asset values on the investment market. Both market rent levels and vacancy on the commercial rental market is primarily dependent on growth in the Swedish economy and the level of new development. (Geltner & Miller, 2001)
Cash flow projections involve a forecast of the real estate’s ability to generate long run operating income. The forecast also include the current state of the market by examining supply and demand, the recent leases signed and predictions about where the future rental market is heading. It is of great significance to weigh risk and return to maximize wealth. Risk is seen from a different perspective in the commercial rental market, focusing on diversification and long lasting tenant relationships. (Geltner & Miller, 2001)

By earning as much potential gross income (PGI) as possible, which primary consist of income from rents, and keeping their expenses low, real estate companies can generate a high net operating income (NOI). (Geltner & Miller, 2001)
4 Empirical Findings

In this chapter, the empirical findings collected from the interviews with Håkan Hellström at Castellum, Roddy Carlsson at Vasakronan and Lovisa Lindberg at Landic Property are presented. The chapter is based on the most valid and interesting information gathered from the interviews, annual reports received during the interviews with the real estate companies and market analyses conducted by Jones Lang Lasalle and CB Richard Ellis.

4.1 The Economic Indicators in Sweden

The Swedish economy is currently in a boom which has reflected the economic growth and the employment rate. Sweden is therefore experiencing a positive macroeconomic performance with high rates of economic growth and low rates of unemployment.

The commercial real estate business is long term, and the demand is primarily determined by economic growth and employment trends related to the gross domestic product (GDP) growth. According to Statistiska Centralbyrån (2007), the GDP growth is approximately 4% in 2007. The GDP growth is expecting to continue, but at a slightly lower level in 2008. As a result of the favourable economic condition in Sweden, the employment rate is rising.

In the commercial rental market, the employment and economic growth has been concentrated to major urban areas and larger growth regions in Sweden. More jobs are being created and the demand for manpower is high. The growth in employment has a decisive significance for the commercial rental market. With growth in the economy and employment, the demand in the commercial rental market increases. (Vasakronan, 2006)

Inflation remains low in Sweden, but in order to secure the rental income from increasing inflation, real estate companies use a so-called index clause. This is done by including index clauses in their commercial leases, which provides for an upward adjustment of the rent corresponding to a certain percentage of inflation. (Castellum, 2006)

Source: CB Richard Ellis (2007)

Figure 4-1 Nordic office market view Autumn 2007
4.2 The Commercial Rental Market in Gothenburg

According to Roddy Carlsson (personal communication, 2007-11-09), Gothenburg has experienced an increase in knowledge-intensive and high-technology companies in recent years. A trend is also that Gothenburg is becoming a more important region for the financial and business sectors, adding to the city’s long term industrial tradition and the fact that the city’s harbour is Scandinavia’s largest. According to CB Richard Ellis (2007), the number of foreign-owned companies has grown from 300 in 1990 to nearly 2,000 in 2006.

This information implies that Gothenburg is one of the strongest regions in Sweden in terms of both population growth and economic performance. The improved market situation in Gothenburg shows, according to Vasakronan (2006), that office employment will increase by approximately 10,000 office jobs through the year of 2009. This will have a positive impact on the demand for offices, and thus the commercial rental market in Gothenburg.

The Gothenburg region has experienced good economic growth, which has made vacancy rates decrease. Due to the increasing demand and the fall in the vacancy level, the market rent in Gothenburg is increasing. (Castellum, 2006) Vacancies in Gothenburg fell by more than 2 percentage points to approximately 10 percent. Rent levels in prime (A-level) locations are nearly SEK 2,800/m². (Vasakronan, 2006) Both Håkan Hellström (personal communication, 2007-11-09) and Roddy Carlsson (personal communication, 2007-11-08) consider their lease portfolios to be in line with market rents.

Rental levels as well as vacancies for commercial contracts are mainly depending on the growth in Swedish economy, but are also affected by the level of new development. According to both Roddy Carlsson (personal communication, 2007-11-09) and Håkan Hellström (personal communication, 2007-11-08), the level of new development is limited and thus the supply in the rental market is limited. According to Vasakronan (2006), one of few new developments in Gothenburg is Vasakronan’s conversion and extension of the police headquarters to create a new law enforcement center (Rättscentrum). Vasakronan is investing SEK 720 M in the project for which long leases have been signed. The project is scheduled to be completed in 2009 and NCC is conducting the development.
4.3 The Commercial Rental Market in Stockholm

According to Castellum (2006), the strong economic trend also corresponds to Stockholm, where the employment is expected to increase in all sectors. The growth in the employment rate has been strong during the last ten year period with a 50 percent faster growth than the average growth in Sweden. According to Lovisa Lindberg (personal communication, 2007-11-07), the high employment rates and the current state of the Swedish economy are reflecting the rental market with an increase in demand. The central business district (CBD) is greater in Stockholm than in Gothenburg. CBD is according to CB Richard Ellis (2007), a functional center around which the rest of the city is structured and characterized by the presence of comparison shopping, office accommodation, leisure facilities, government functions and so forth.

The demand for modern premises is increasing, especially in the CBD. According to Lovisa Lindberg (personal communication, 2007-11-07), the commercial rental market is striving to meet the demand of modern premises due to that they generally have lower vacancy rates and results in lower overall costs. Property owners therefore have great incentives to upgrade vacant premises. The trend is likely to continue in years to come, thereby leading supply to better match the increased demand for modern premises. Due to the tight supply, market rents are increasing in the CBD and in other submarkets such as in the rest of the inner city and Solna. Stockholm’s prime (A-level) locations rent are SEK 3,800-4,000/m² (Vasakronan, 2006). According to Castellum (2006), the vacancy rates has been reduced due to the improved demand. The general vacancy rates for office space in Stockholm are estimated to 15-20 percent.

4.4 The Property Clock

All interviewees mentioned the property clock which is an additional aspect apart from the frame of reference in chapter three. According to Lovisa Lindberg (personal communication, 2007-11-07), the property clock is a cyclical way of describing the commercial rental market in a foreseeable manner.

The property clock is a convenient tool for understanding and comparing the relative position of markets in their rental cycle. Markets can move around the clock at different speeds and directions. Both Gothenburg and Stockholm are situated in the “rental growth accelerating” zone of the clock. (Jones Lang Lasalle, 2007)

![STOCKHOLM CBD RENTAL MARKET](source: CB Richard Ellis (2007))

Figure 4-3 Nordic office market view Autumn 2007
Interest in the commercial rental market continues to be on a high level in both Stockholm and Gothenburg. Interest in the Swedish real estate market on the part of both domestic and international investors are very strong and is in turn, boosting the rental market as well. (Vasakronan, 2006)

According to Håkan Hellström (personal communication, 2007-11-08), the current economic growth in Sweden is considered to lead to an increased demand and consequently to decreasing vacancies with the possibility to result in increasing market rents. This makes new development possible and consequently an increased supply in the rental market.

![Diagram showing rental growth and falling rents in Stockholm and Gothenburg](source: Jones Lang Lasalle (2007))

Figure 4-4 Nordic City Report; Property clock Q2, 2007

### 4.5 Risks

Risk in real estate is broad. Risk differs to a large extent whether one is dealing with the commercial real estate market (investment market) or the commercial rental market. After having done all the interviews the authors have limited the risk part and decided to focus only on the commercial rental market and the risks associated with that specific market. Since all interviewees make the distinction between the different risk expositions the limitation and focus seems appropriate.

#### 4.5.1 Market Analysis

According to Lovisa Lindberg (personal communication, 2007-11-07), one tool to reduce the risk in many aspects is to conduct a market analysis. To be able to analyse the market in a proper way all interviewed real estate companies outsource the market analysis to companies such as New Sec, CB Richard Ellis and Jones Lang Lasalle. These companies offer real estate services that help the clients to make informed real estate decisions. The analysis of the market is though and time consuming and these services are therefore bought to get accurate results. In the different analyses the real estate companies can learn about where the market is expected to go, how the market has developed in recent time, current state in the business cycle, current interest rates, current market rents and a lot more worth to know to make as safe decisions as possible. The market analysis firms also take all real es-
tate firms in one area into consideration when doing the analysis, which increase the validation and reliability of the results. All interviewed real estate companies also compare their leases in a specific premise with leases in similar premises, i.e. rent comps analysis.

4.5.2 Tenant Structure and Rental Income

One strategy to cope with risk is to rely on many smaller tenants, than depending on one or a few larger ones. According to Håkan Hellström (personal communication, 2007-11-08), the risk of large changes in the vacancy rates increases with the amount of large tenants. In Castellum, the single largest contract as well as the single largest tenant accounts for approximately one percent of the group’s total rental income. Håkan Hellström (personal communication, 2007-11-08) goes on further claiming that a flexibility to sign both short and long leases improve Castellum’s competitiveness. Castellum’s current lease maturity structure together with the lease portfolio divided into both size and sectors, spreads the risk. All interviewed real estate companies concentrate on holding properties in geographic markets in Sweden where the economic growth is high. Several cities in Sweden are satisfying the requirement of being an economic growth area.

![Lease Maturity Structure](image)

Source: Castellum (2007)

Figure 4-5 Lease maturity structure

Vasakronan’s largest tenant is the Police Authority in Gothenburg, which accounts for 7% of total rental revenues. Roddy Carlsson (personal communication, 2007-11-09) says, that other large tenants are for example SEB and Åhléns, also situated in Gothenburg. According to Vasakronan (2006), the ten largest tenants represent 27% of total rental revenues. The renegotiation risk associated with large tenants is reduced due to that the terms of Vasakronan’s leases with major tenants vary.

According to Roddy Carlsson (personal communication, 2007-11-09), rental income from state-owned tenants have essential lower level of risk than other tenants due to the fact that their leases often last for long periods of time. This entails a lower risk in credit losses. As mentioned before one of Vasakronan’s largest tenant is the Police authority, which are state-owned and have a long lease contract.
Roddy Carlsson (personal communication, 2007-11-09) claims that Vasakronan’s strategy is to have an evenly distributed maturity structure for its leasing portfolio and to have a good mix of different tenants within the same premises to create a good atmosphere. This strategy entails, according to Vasakronan (2006), that approximately 10–20% of leases to be renegotiated each year. Such a maturity structure provides not only stability but also entails a lag in profit/loss with respect to changes in market rents.

Roddy Karlsson (personal communication, 2007-11-09) also claims that it is important to take the potential tenant’s history and future into consideration, to be sure to get future rental payment assurance. He says that companies with a stable growth is an aspect to be specifically valid to have as a tenant. A mix of tenants might help to improve the success of the whole real estate.

### 4.5.3 Satisfied Customers

All interviewees have mentioned that a close and long-term relation to their customers is the key to growth and success. If the customers are satisfied there is a better chance of long-term profitability.

Vasakronan’s strategy is to view their properties as long-term investments and not primarily as transaction assets. They view their tenants as customers with whom they build long-term relationships. To keep the tenants satisfied at all time lowers the risk of them to move. By offering creative workplace solutions and additional services, they aim to make their customers more successful in their own operations. (Vasakronan, 2006)

According to both Håkan Hellström (personal communication, 2007-11-08) and Roddy Carlsson (personal communication, 2007-11-09) a trend in recent years has been to add value to the property by offering all sorts of services that the tenants might be interested in. This include everything from a car-wash in the basement to a dry-clean service in the reception. These facility management services are used as a tool to make the property more attractive on the market and for competitive advantage in leasing. Services similar to the ones mentioned above have existed for a long time in for example the USA, and recently, also Swedish real estate companies have seen its importance. Riksbanken (2007) claims that the service sector is the most growing sector in Sweden.
As a basis for continued improvement work, customer attitudes towards the companies are measured by means of various internal and external surveys. All the interviewed real estate companies have for several years participated in the Property Barometer Satisfied Customer Index (SCI). The SCI measures the customers’ views on areas such as the premises, location, rent, service and faults. The survey shows for example how high/low the customers’ faith in the companies is. (Castellum, 2006)

<table>
<thead>
<tr>
<th>Landlord</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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</thead>
<tbody>
<tr>
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<td>77</td>
<td>81</td>
<td>82</td>
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<tr>
<td>Hufvudstaden</td>
<td>76</td>
<td>73</td>
<td>80</td>
</tr>
<tr>
<td>Vasakronan</td>
<td>78</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td>Industry index</td>
<td>69</td>
<td>71</td>
<td>72</td>
</tr>
</tbody>
</table>

Vasakronan has been ranked first according to the NKI Property Barometer five out of the eleven times that the survey has been conducted. Only the top three in the survey are now reported, as well as an Industry index.

The following companies participated in the survey in 2006: Abromeri Property Investors, Akatellis Huset, Alfrasuggeter, Castellum, Dilligentia, Hufvudstaden, Jernhusen, Kungs, Nemea, Vasakronan and Vasakronan.

Source: Vasakronan (2006)

Figure 4-7 Satisfied Customer Index 1

Source: Castellum (2006)

Figure 4-8 Satisfied Customer Index 2

### 4.5.4 Vacancy Rate

According to Vasakronan (2006), a change in the vacancy rate has a relatively rapid impact on revenues. The vacancy rate represented 7% of rental revenues at December 31, which corresponds to a rental loss of SEK 192 M. The risk, and hence the cost, of vacancies is reduced if Vasakronan keeps customers satisfied by offering attractive premises and services. A one percent change in the financial vacancy rate at January 1st, 2007 would have an impact of SEK 28 M on income for the year.
According to Lovisa Lindberg (personal communication, 2007-11-07), one way to reduce the risk when a lease expires is to do as accurate assumptions as possible. She also claims that an analysis needs to take different scenarios into consideration to get a more reliable analysis. The main goal in the commercial rental market is to rent out as much space as possible. When a lease expires, renegotiation or finding a new tenant should be done immediately.

All interviewees agree upon that the lease portfolio should have good diversification considering lease durations as well as a large number of tenants in many fields of business. Tenants that rent a large part of the total property collection increase the risk of larger differences in vacancy rates. The properties should be general and adjustable to suit different types of operations. Roddy Carlsson (personal communication, 2007-11-09) refers to it as “clever premises”. By focusing on general premises the real estate companies reduce the risk of vacancy and makes it easier to switch from one tenant in one sector to another doing something completely different.

4.5.5 Political Risks and Other Risks

Political risks include for example decisions on political levels affecting the property tax and tax on energy. Other regulations might also affect the companies in a way beyond their control. For example if there are price changes in energy, the expenses for operation and maintenance increase. Such expenses are independent of the vacancy rates and therefore a change in price can have major effects on the net operational income (NOI). (Vasakronan, 2006)

4.6 Factors Affecting the Setting of Rents

When setting the rent for a commercial real estate, the real estate company have different factors to take into consideration. The obvious and initial factor is the current state of supply and demand on the Swedish market. There are however, factors that are not obvious and not correlated with the Swedish economy, but yet an essential part for the commercial real estate companies to take into consideration when setting rents.

The supply and demand reflect and influence the market rent which is the second obvious factor affecting the lease contract. The market rent works as an indication for how reasonably priced the rent for a premises ought to be. The rent needs to be closely linked to the other market rents in the same area and in the same commercial real estate, meaning that a real estate company can not choose any rent, but have to adjust to the rent set by the market. Therefore real estate companies need to add value in different ways to be able to affect the rent level. (Lovisa Lindberg, personal communication, 2007-11-07)

4.6.1 Location of the Premises

One factor that all three interviewees considered as a significant indicator that affects the rent level is the location of the commercial real estate. If the premises have a high accessibility the rent will be higher than if the premises are located far away from the central parts of the city according to Roddy Carlsson (personal communication, 2007-11-09). He also underlines that this is a central aspect for the rent setting for Vasakronan since the most of the commercial real estate owned by them are located in attractive and central parts of Gothenburg. Håkan Hellström (personal communication, 2007-11-08) clarifies that a commercial real estate can be positioned in an A, B, or C-level where A is more attractive
and central than the C level i.e. A level will have a higher rent than the B level and the C level. Premises in a CBD area is considered to be positioned in an A-level and thus have higher rental levels than premises far away from central districts. Lovisa Lindberg (personal communication, 2007-11-07) clarifies that in small cities the rents are for the most of time very equal compared to larger cities where the rents differs more due to the location of the premises.

4.6.2 Lease Contract Composition

All the interviewed commercial real estate companies agree upon two basic assumptions when composing a lease contract and setting the rent. Firstly, the lease contracts contain a base-rent, i.e. the rental level at the time of signing, and an index clause which provides for a yearly upward adjustment by a certain percentage. Håkan Hellström (personal communication, 2007-11-08) also explains that Castellum along with the index clause includes the real estate tax in the rent and the lease contract. Secondly, the rent is based on cold rent, i.e. no heat are included in the rent, instead it will be added on to the basic price. This is very common for all the commercial real estate companies since they want to exclude unexpected high heat expenses.

According to Håkan Hellström (personal communication, 2007-11-08), in order to compose a new lease with new conditions, the lease needs to be renegotiated prior to the lease termination. The period of notice is usually nine months. If neither the real estate company or the tenant want to terminate the contract or renegotiate, the lease contract is extended with unchanged conditions. He also mentions the tenants’ indirect right of tenancy, which means that the real estate company can not terminate the contract prior to the period of notice.

If a tenant is dissatisfied and has complaints regarding the rent level or the two parties can not agree upon a termination or conditions in the lease contract, the question of what the current market conditions are, is submitted to the Swedish Tenancy Tribunal, an independent rent tribunal. The Swedish Tenancy Tribunal is working as a mediate in disputes concerning premises. The Tenancy Tribunal will come up with decisions in those cases where the two parties are not able to agree. In cases where the Swedish Tenancy Tribunal is not able to come to a solution, the matter will be decided in the Swedish court. (Hyresnämnden, 2007)

According to Lovisa Lindberg (personal communication, 2007-11-07), the length of the contract is a factor that affects the rent level. If a tenant is preferable and a long lease contract exist, the rent will be lower. If the contract will be valid for a shorter time the rent for the premises will be higher during that period. She also points out that Landic Property increase the rent for tenants that are operating a non value-added tax activity in the premises since Landic Property have to pay the cost for the premises. This results in a higher rent to cover potential expenses.

4.6.3 Attributes Included in the Setting of Rents

One factor when setting rents is the amount of investment that needs to be done before a new tenant will access the premises. Lovisa Lindberg (personal communication, 2007-11-07) points out that this is an important factor that Landic Property takes into consideration. To attract a specific tenant, Landic Property rebuilds the premises in accordance to the tenants needs, in return for a higher rent. According to Håkan Hellström (personal
communication, 2007-11-08), this investment strategy is also used by Castellum to attract a specific tenant. When a lease contract expires the real estate needs to be flexible and useful for the next potential tenant. This is also a crucial aspect for Vasakronan (Roddy Carlsson, personal communication, 2007-11-09). Vasakronan has the theory to build as smart as possible to be able to do as small and easy changes as possible when a new tenant will enter the premises. To build a commercial real estate and its premises as smart as possible is due to the fact that the commercial real estate company want to do as small efforts as possible with the premises for the new potential tenant.

Roddy Carlsson (personal communication, 2007-11-09) describes a new kind of service sector that are getting more common in the larger cities in Sweden nowadays. In some commercial real estate Vasakronan offers tenants care which increases both the value of the commercial real estate and the rent. The tenant care includes all everyday life obligations that need to be done except things that needs physical presence. All tenants and businesses located in a commercial real estate that offers tenant care can hire someone else to do their everyday life obligations such as clean the car, shop groceries, take the clothes to the dry cleaning and so on. This concept of service is the next step of attracting tenants and increases the proportion of satisfied tenants. Vasakronan, Castellum and Landic Property all agree upon that the primarily focus is to satisfy the tenants.

Additional factors that are affecting the rent are those attributes that makes the premises more fancy and special. According to Lovisa Lindberg (personal communication, 2007-11-07), tenants in Stockholm desire modern and new premises. Håkan Hellström (personal communication, 2007-11-08) points out that Castellum wants commercial real estate with quality. If the quality of the commercial real estate is exceptional and the real estate have some special interiors, the value of the commercial real estate will increase and thus the rent. Roddy Carlsson (personal communication, 2007-11-09) agree on this assumption that some special features affect the setting of rents. He puts a lot of emphasize on the premises that have a welcoming and spacious entrance, interior of hardwood or open plan solutions. The rent can be higher due to the fact that the premises offers special features. He points out that if the commercial real estate owns a parking space that the tenants can use, the rent will increase since this is seen as a special feature that is adding value for the tenant. This specific attribute exist especially in the larger cities where there is a lack of parking spaces. The tenants will value the opportunity to have a specific parking space included in the real estate.
In this chapter, the analysis for this bachelor thesis is presented and the question whether the purpose is fulfilled or not is answered. It is divided into headlines corresponding to the most interesting and outstanding topics analysed and correlated to the headlines in the previous chapters.

5.1 Analysis Structure

The analysis will have a structure reflecting the previous chapters to make a satisfactory flow and understanding in the text. The major topics discussed will be found under different headlines below. Since both the frame of reference and the empirical findings were constructed in a resembling way, this structure seems applicable. There will be no in-depth analysis of the specific respondents and their real estate companies due to the fact that the answers received during the interviews turned out rather similar.

5.2 Factors Affecting the Setting of Rents

5.2.1 Economic Indicators

The commercial rental market is strongly correlated with the GDP and the employment rate which in turn reflect the Swedish economy. An increasing GDP has a positive influence on the Swedish economy and thus the commercial rental market in Sweden. The employment rate is probably the most significant economic indicator, since employment has a substantial impact on the demand for premises on the commercial rental market. These economic indicators are crucial since they initially determine demand and supply on the commercial rental market. When setting the rent in commercial premises, supply and demand are fundamental factors to take into consideration. Supply and demand thus initially determine the rent level.

Inflation is an economic indicator that correlates with the Swedish economy, but it is not considered in the rent setting procedure since an index clause is included in the lease contract. Inflation is thus a basic component in the lease contract and it can only affect the rent if inflation changes in some future time, during the lease period.

Market rent is the second factor that affects the setting of rent. Market rent is an additional factor which correlates with the Swedish economy since it is reflected by demand and supply on the commercial rental market. Real estate companies continually keep themselves updated regarding the market rent in their different areas through market analyses. Market analysis is an external analysis that is of great importance since real estate companies gain most of their valid information about where the market is expected to go, what the current and future market rents tend to be and what differences that exist when comparing the major cities in Sweden. Based on the information in the market analysis the real estate companies can reduce risk by making more accurate and safe decisions, which is the core to be successful in business.

The economic cycle reflects changes in the Swedish economy and shifts over time between growth and recession. The economic cycle and its indicators are factors that the real estate companies are not able to influence and consequently, supply and demand can not be influenced either. When rents are set, real estate companies must adapt their rental level to the current state of supply and demand in the Swedish economy and the market rent. With this in mind, these are factors that the real estate companies can not leave out in the rent
setting procedure. If the rental level is not accurately set and not adjusted according to demand and supply and the market rent, the question is submitted to the Swedish Tenancy Tribunal. This legal authority is of great importance since it prevents real estate companies to not consider these two factors discussed and set an unreasonable rent.

5.2.2 Additional Rent Setting Factors

Today, it is more common with attributes that increase the value of the premises and affect the rent setting procedure. It is of great importance that the premises have an attractive design that corresponds to the tenants operations. Lawyer firms are for example dependent on attractive premises for a serious appearance towards their clients. Moreover, the tenants are willing to pay a higher rent if the commercial real estate has some specific attributes that make their daily operations easier. One of these specific attributes can be parking space for the employees. Since it is difficult to find parking spaces in cities such as Stockholm and Gothenburg, the tenants will be keener to pay a higher rent for these attributes. In the future these attributes will probably be more essential and important for the commercial real estate companies to attract potential favourable tenants, who also are willing to pay for these desired needs. Even if the demand for premises is in a boom, features such as parking space and attractive design will probably need to be available in the premises to affect the rent in a positive way for commercial real estate companies.

The length of the lease contracts influence the rent for tenants. If a tenant is satisfied with the premises, it is a better option for the tenant to have a lease contract that covers a long period of time to receive a lower rent. For some tenants a shorter lease contract may be preferable due to an unstable economic cycle or insecurity of the business future. If the tenants have the alternative to rebuild the premises from their wishes and needs, the tenant will probably choose the long term lease contract if the premises match the tenants’ operations.

From the commercial real estate companies’ point of view, they need to be flexible and accept different lengths of the lease contracts to reduce the risk. If all the lease contracts expire at the same time, the commercial real estate company will be required to renegotiate all the leases simultaneously. Therefore commercial real estate companies aim to have a diversified maturity lease structure. The risk concerning the length of the lease contracts will probably be even more important in the future depending on how the Swedish economy is fluctuating. Currently, if a lease contract expires when the economy is in a boom, the demand for premises are high and new tenants are relatively easy to attract. Facing a future recession, the risk is greater and therefore real estate companies need to put a lot of emphasis on as a diversified maturity lease structure as possible. In a recession the demand is flattened and there might be some predicament for the commercial real estate company to attract new tenants.

5.2.3 Location

Location is the the most essential factor for commercial premises. To denote an attractive location for office spaces especially, the premises have to be positioned in an A-level within the CBD. This might not be true for other commercial real estate, such as industrial premises. Since the office spaces have no industry section to adapt to, their desire for location is in the central parts of the city. One reason for the increased desire of being located in the CBD might be that Stockholm and Gothenburg is changing behaviour towards a European style. The European approach is focusing on social activities that can be achieved more
easily when the office spaces are located in the CBD. Today, the employees are valuating relationships with co-workers and want to be able to take lunches with business clients and meetings outside the office.

Easy access to social activities, such as after work, might be an important aspect in the future for the employees which require a location in the CBD. Although, another reason why office spaces want to be in a central location, might be due to the fact that the employees want to be within walking distance to their social activities. The employees might in the future be able to walk to most of their destinations and become more environmental friendly. Moreover, to have premises inside the CBD can also be a strategy to expose the business name. A large sign in a central area where many businesses are situated and where a lot of people are passing by, is a strategy to increase the public awareness. Even if the location is the most essential factor today, the attitudes towards having office spaces in the CBD might become even more necessary in the future. Real estate companies might have less pressure to improve their business compared to other businesses, since there will constantly be tenants wanting to lease in attractive areas, such as in the CBD. Therefore, location will always be the most essential factor affecting the setting of rents.

All of our three interviewees agreed upon that the rent increased if the location was in a central and attractive part of the city. Since the CBD is the most vital part where the office spaces want to be located, the tenants might be willing to pay a high rent to access this essential part of the city. All the different advantages that the central position offers are often worth the high rent for the tenant. If the commercial real estate company can provide some of the advantages in a good manner, the higher the rent will be.

An interesting point of view in this discussion is that in small cities such as Stockholm and Gothenburg, there is only one CBD in each city. This can result in a higher market rent since the demand is high and a lot of tenants compete to have an office space in this district. There might be more than one CBD in large cities such as Paris and New York. In these cases, it might not be unproblematic to obtain of premises in a CBD for the reason that it exist more than one. Even though there exist more central office spaces in the market, the supply might still be limited and thus result in limited lease contracts.

5.2.4 Client Care

Client care is relatively new on the Swedish market and is a good idea for creating long term relationships with the tenants. This factor might affect the setting of rents. According to Roddy Carlsson (personal communication, 2007-11-09), the additional services included in client care might increase in Sweden in the future and all real estate companies are presumed to become more service oriented. According to Riksbanken (2007), the service sector is the most growing sector in Sweden for the moment. Therefore, the key to success might be to put more emphasise on services. A suggestion is to become flexible, meaning that all premises might not need the services, but implementation of those services where there exist a demand, should be done.
The idea of client care is based on additional services which are included in the commercial real estate that all the employed people in the real estate can use. The services are all kinds of daily activities except from errands that requires personally attendance. The employed people in the real estate can request the services, which might include shopping groceries, washing cars or filling cars with petrol. Due to these additional services, the tenant might save money, since its employed workers will work effective the whole day and still get their private errands done.

With client care included in the commercial real estate, the business might generate more productive and efficient work from each employee. Since the business might pay the employee when taking time off from work to do private errands, they will instead get work done when paying out the salary. Commercial real estate companies might take higher rents for these exclusive services. At the same time, the tenants are probably willing to pay for these services since their employees get more work done. Currently, client care is an evidently small part of the commercial real estate, but will probably be more attractive and developed in Swedish major urban areas in the future. However, client care might not be very successful in Sweden, since the demand for these additional services might not be high enough to have a substantial impact on the setting of rents.

5.3 The Commercial Rental Market in Stockholm and Gothenburg

The vacancy rate is an indicator between supply and demand on the commercial rental market. Real estate companies are able to set a higher rent if demand exceeds supply which in turn lowers the vacancy rate. The rental level increases due to an increase in demand and a fall in the vacancy level. Currently, the vacancy rate is below the natural level since rents are increasing in both Stockholm and Gothenburg. Real estate companies can keep the vacancy level low by keeping their tenants satisfied and thus decrease the risk of tenants moving out. Tenants might stay for a longer period of time if the real estate company offers to renovate their facilities to make them stay and not move to more modern premises elsewhere. A redecorated premises might also lead to that the tenants will be more satisfied and more successful in their own operations, which is a crucial part since they then are more likely of paying the rent and thus that risk is reduced. This is also a way of potentially raise the rent seen from a longer perspective. One solution to the problem of vacancy might be to build the premises as general as possible to attract a wider range of potential tenants and adopt the premises for the next potential tenant. The more general the premises are, the smaller might the risk be that they become vacant.

There is however, normal that some vacancy exist in the commercial rental market. This vacancy is currently found in older un refurbished premises. This trend is likely to continue due to the increased demand for modern premises. Especially Stockholm is experiencing a strong demand for renovated open plan offices. The availability of such premises is more limited than for older, less flexible premises. Flexibility will probably be an even more indispensable determinant when trying to attract preferable tenants in the future.
The vacancy rate is higher in Stockholm than in Gothenburg. This might be due to a higher quantity of older premises and a higher demand for modern premises.

New development is limited in both Stockholm and Gothenburg. The trend might instead be to concentrate on upgrading existing premises to modern premises to suit the needs of more demanding tenants. The potential is best for modern, high quality premises with high technical standards.

Due to the fact that the commercial rental market is segmented, location and type specific, both supply and demand differ between locations. Demand is highest for high-quality premises located in the CBD, where new construction is problematic due to the limited space. It is therefore of great importance for the real estate companies to make use of all currently located premises in the CBD. The space limitation in the CBD results in smaller office units for the tenants. A future trend might therefore be that companies/tenants want to relocate from many small office units to one large headquarter, not located in the CBD. In the future, tenants might focus more on cost per workplace rather than on the traditional cost per square meter. This might result in an increase in rental level as well as cost savings for the tenant.

The supply side of the commercial rental market is tight due to limited new development and the demand side is high due to a stable labour market and a strong economy, which result in increasing rental levels. The labour market is stable since the number of lay-offs is declining and instead companies increase their hiring, which results in increased competition and therefore increased rents. Exports, employment and consumption are all showing an upward trend which result in a robust commercial rental market in both Stockholm and Gothenburg. These factors boost the Swedish economy and hence the commercial rental market. Another factor that is of importance is the number of new companies entering the Swedish market. The number of companies reflect the level of demand in the commercial rental market. Both international and domestic companies appear to be increasingly interested to invest in the Stockholm and Gothenburg market. Currently, Sweden is experiencing economic growth through a strong GDP and employment rate, resulting in companies wanting to invest and expand. Due to these conditions and the fact that investors primary goal is to maximize wealth, investors see the Swedish commercial rental market as a satisfactory combination of risk and return.

Gothenburg might have smaller share of international investors. This is probably mainly due to the city’s long term industrial tradition. Recent years have though shown a trend of an expansion in the financial and business service sector which in turn attract and increase the demand of international investors.

The property clock is a useful tool when attempting to see where the commercial rental market is situated. In the second quarter of 2007, both the commercial rental market in Stockholm and Gothenburg were situated in the “rental growth accelerating” zone of the property clock. Currently, in the fourth quarter of 2007, Stockholm has probably not moved much and is still on the border to the “rental growth slowing” zone. Stockholm’s commercial rental market is Sweden’s largest and it is robust. Given the high demand on premises in Stockholm’s CBD, which is the largest in Sweden, and the tight supply, the rental level will grow further. As stated before, the demand is increasing for modern premises which means that modern B-level premises are experiencing an increasing demand too. As long as the Swedish economy is in a boom and the supply is tight, rents will not decrease. Although, Stockholm will probably be the first commercial rental market that suf-
fers from a stagnating Swedish economy, which might result in Stockholm moving into the “rental growth slowing” zone.

Gothenburg is still situated in the “rental growth accelerating” zone. This is probably primarily due to that Gothenburg is experiencing good economic growth and the financial and business sector is growing, which in turn increases the demand with the possibility of increasing rental levels.

![Figure 5-1 Property clock Q4 2007](image)

**5.4 Revenue**

The potential gross income (PGI) represent the property’s primary resource of revenue, meaning the cash it could earn if fully rented. However, in a normal market it is unrealistic to predict that a property will be fully leased at all times and generate its entire PGI every year. The vacancy allowance is therefore a major part in calculating the current and future potential PGI. The vacancy allowance might differ to large extent from what is common in the present market, but this can often be explained or corrected.

The major part of the PGI is the revenue generated out of rents. To solely depend on the revenue from rent can be very vulnerable if the vacancy rate should increase, so other sources of revenue are to recommend. Additional services and client care can be a solution to either raise the rent or choose to charge the tenants extra in addition to the rent.

Another way for real estate companies to improve their net operating income (NOI) would be to decrease their fixed costs. Since costs for property management and administration, utilities, insurance, regular maintenance, repairs and property taxes are fixed and does not change whether their vacancy is high or low, it is important to keep them as low as possible. It is impossible for real estate companies to avoid these costs, but they use different actions to protect themselves against changes in for example energy costs. In general, all real estate companies have very high utility costs and controlling these costs can have a major impact on the NOI. More in-depth investigation about energy and energy consumption should be done to really see where energy consumption is especially high and if some actions to reduce it could be done. Today, it is also possible to fix the price of, for example...
energy, since the competition among energy companies might increase. In the future this trend will probably continue to be of great importance given the increased awareness of the environment that might increase energy prices.

It is of great importance that an as accurate as possible investigation concerning the potential of a real estate to generate operating income is done. The projections are mainly done over the long term and contain several steps. If a real estate is projected to generate high potential future income the investment in the real estate might be worth doing. If these projections about future income are poorly done, the losses in the future can have devastating consequences for the real estate company. The operating income today is mainly the revenue from rents paid by the tenants, but nowadays additional services and client care of different kinds generate more income apart from the rent. In the future, client care might be more significant aspect to take into consideration.

The rent cannot be set to any level the real estate companies desire, but have to follow the market rent represented in the specific area. Therefore it seems relevant to add extra services to have an opportunity to increase the revenue from their tenants that are not solely rent, but still paid by the tenants. All interviewees mentioned that they use a base rent and then add the costs for energy, internet and other types of extra services. To include utilities in the rent can result in over consumption and negligence, since the tenants know that it is included in the rent no matter how much they consume. On the other hand, some tenants might use less than what is paid for, but the safest choice ought still to be utilities paid in addition to the rent.

5.5 Shortcomings

All of the interviewees represent commercial real estate companies and the aim was to analyse their rent setting and factors affecting the procedure. The outcoming result from the interviews showed a similar view of rent setting and the affecting factors, which the authors did not expect. In addition, the interviewed real estate companies might not always see their own market in a sufficient subjective way. Therefore, it might have been interesting to increase the interviews to not only real estate companies, but external companies such as NewSec and Jones Lang Lasalle as well, to be able to obtain as impartial results as possible.

Due to the fact that previous research studies and literature concerning commercial real estate and lease contracts are limited, valid information was hard to find. The literature used, was recommended and is therefore to be seen as sufficient, valid and reliable.
6 Conclusion

In this chapter the research questions will be answered and conclusions will be drawn in the order they are stated in chapter one and suggestions for further studies will be presented.

What is the current state of the economic indicators in Sweden and how are they influencing the commercial rental market?

Currently, the Swedish economy is in a boom and it is experiencing a strong GDP growth and employment rate. The supply and demand on the commercial rental market is primarily determined by the level of employment related to the GDP growth. The employment rate is probably the most decisive factor affecting the demand on the commercial rental market, since a high employment rate increases the demand of manpower and more jobs are created and hence increases the demand for commercial premises. Inflation is the third economic indicator that correlates with the Swedish economy, but it is not considered in the setting of rent since it is included in the lease contract in the form of an index clause.

An increasing demand has a positive influence on vacancy rates and market rents. Due to the increasing demand and falling vacancy levels, the market rent increases. The current state of supply and demand and the market rent are initial factors which real estate companies must adapt and adjust their rental levels to.

What is the current state of the commercial rental market in Stockholm and Gothenburg?

The commercial rental market in Stockholm and Gothenburg are robust since domestic and international companies interest in investing, exports and employment are all showing an upward trend. These factors boost the commercial rental market and thus increase the demand on premises in Stockholm and Gothenburg. Rental levels are increasing in both cities due to the increasing demand.

The demand is high for modern premises, especially in the CBD, and due to the fact that new development is limited, the trend is instead to upgrade existing premises to modern premises. Especially Stockholm is experiencing a strong demand for high quality and open plan premises with high technical standards. The vacancy rate is higher in Stockholm than in Gothenburg. This might be due to a higher quantity of older premises and a higher demand for modern premises. The vacancy rate is currently below the natural level since rents are increasing in both Stockholm and Gothenburg.

How are commercial lease contracts composed?

It is standard on the commercial rental market, that the lease contracts are based upon two assumptions when setting the rent for a commercial real estate. The first assumption is, that the lease contracts contain a base-rent, which is the rental level on the market at the time of the contract composition. The lease contracts also include an index clause which adjusts the contracts with a yearly upward percentage. The second assumption is that no heat is included in the rent. Instead, the rent will be based on a cold-rent and the heat costs will be added on to the base-rent, due to the fact that all the commercial real estate companies want to eliminate unexpected expenses.
The length of the contract is the most essential factor in a contract composition, which affects the rent level. If a commercial lease contract is composed over a long period of time, the lease contract will influence the rent to be lower for the tenant. If the tenant or the commercial real estate company is dissatisfied with the present lease contract, it is possible to renegotiate and compose a new contract prior to the lease termination.

Which factors are affecting the setting of rents apart from supply and demand?

Location is the most significant factor affecting the rent level. The rent will be higher if the premises have a high accessibility and are located in an A-level in the CBD. When the premises is rebuilt to match a specific tenant’s operations, the setting of rents will be higher for the tenant. When weighing the evidence, it appears that flexibility will be even more important when trying to attract preferable tenants in the future.

Another factor that affects the rent in a positive way for the commercial real estate companies, is client care. This concept is a strategy to attract tenants and a method to increase the rent for the commercial real estate companies. Some additional attributes that makes the premises more attractive is also a strategy to affect the rent, since the tenants desire new and modern premises today. If tenants achieve premises with some special features, such as parking spaces, they will be willing to pay a higher rent.

Which risks are associated with commercial lease contracts and how does real estate companies cope with those risks?

Risk can be seen from different angels considering the commercial rental market, but probably the most important fact is to first identify what risk is in the specific areas and how should the risk be dealt with. It is proven that all risks cannot be eliminated totally, but reduced to a large extent if the real estate companies handle it in a proper manner. Satisfied tenants and a diversified tenant structure will reduce the risk of having vacant premises. The risk concerning the length of the lease contracts can be reduced by having a diversified lease maturity structure, hence mixing long and short lease contracts.

6.1 Suggestions for Further Studies

The real estate system is vast and consists of different parts, all contributing to the whole system in its own specific way. It is impossible to include all parts in one bachelor thesis and therefore a limitation to particularly concentrate on the commercial rental market was done. It would be interesting to continue investigating the asset market and the development industry to get a better understanding of the entire real estate system and how the different parts are correlated.

A suggestion for further studies could be to further analyse the asset market with focus on the cap rate’s importance when selling a real estate, how the cap rate change over time and what factors that contribute to the value of the real estate. Studies concerning the bank’s perspective regarding real estate valuation including the relation between real estate values and new development activity might be aspects to examine. It might also be interesting to see whether the asset market is as segmented as the space market.
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8 Appendix

8.1 Intervju underlag

1. Hur ser marknaden ut för kommersiella fastigheter i Stockholm och Göteborg idag?
   - Hur är balansen mellan utbud och efterfrågan?
   - Hur ofta ändras utbudet? Har de ändrats mycket de senaste åren? Hur ser framtiden ut?

2. Vilka risk faktorer finns på hyresmarknaden?
   - Vad gör Ni för att minska dessa risk faktorer?

3. Använder Ni någon form av standard vid hyressättning?
   - Finns det några begränsningar och regler att ta hänsyn till?

4. Vilka faktorer tar Ni främst hänsyn till vid hyressättning?
   - Kommer några av dessa faktorer att få större/mindre betydelse i framtiden?

5. Vilka är de viktigaste komponenterna i ett hyreskontrakt?

6. Hur går Ni till väga för att ”spå” framtiden för att få en så relevant analys som möjligt?
   - Använder Ni er av rent comps analysis?

7. Vilka makroekonomiska faktorer påverkar hyressättning?
   - Använder Ni er av marknadsanalyser?
   - Hur stor påverkan har inflation?
   - Vilka strategier använder Ni för att anpassa Er till inflation?
   - Hur håller Ni vakansgraden på en låg nivå?
   - Har vakansgraden stor påverkan vid hyressättning?
   - Hur stor hänsyn måste tas till marknadshyror?
   - Vilken makroekonomisk faktor har störst inverkan vid hyressättning?