

NEWSLETTER

Commercial property in Denmark and abroad

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Office property in Greater Copenhagen

Demand for office space remaining strong

Demand for office space in Greater Copenhagen has been relatively stable in 2000 to date.

The situation is mainly due to the buoyant Danish economy, which is supported by a stable domestic market and growth in key export markets. Other drivers include the strong activity in the high-tech industries; IT, telecommunications and pharmaceuticals.

Finally, the regional coherence emerging on both sides of the Øresund as the fixed link between Copenhagen and Malmoe nears completion has convinced quite a number of influential international companies of the benefits of using Copenhagen as the centre for their Scandinavian operations.

Moderate rent increases

For years, rents have been much lower for Copenhagen office space than for office space in comparable European capitals. This has led to recurrent speculation of a surge in market prices to gradually bring rents in Copenhagen on a par with the levels of other major European cities.

Over the past 12 months or so, the prime rent has stabilised at approximately DKK 1,700 per sq m per year and there are no indications of an increase in the immediate future. With the boom in construction activity on the Copenhagen waterfront, from Kalkbrænderihavnen and Søndre Frihavn in the north to Ny Tøjhusgrunden and Kalvebod Brygge in the south, existing construction opportunities for new office projects in that area will be exploited within the next 12-24 months.

New office opportunities coming onto the market

On the other hand, Fisketorvet, the new retail development, offers the potential for 100,000 sq m of new office space and the imminent closure of the DanLink ferry operations will free substantial space for construction opportunities at Søndre Frihavn.

Other areas offering attractive locations are Havnestaden, the former Soyakage industrial area next to Islands Brygge, the large remaining areas in Sydhavnen, Ørestad (potential for 600,000 sq m in Central Ørestad alone), the Scanport area near Kastrup marina and the Tuborg Syd area north of the city centre.

The areas north-west of the city offer the fewest opportunities for new office construction. Lyngby and Birkerød and parts of Ballerup all offer limited opportunities.

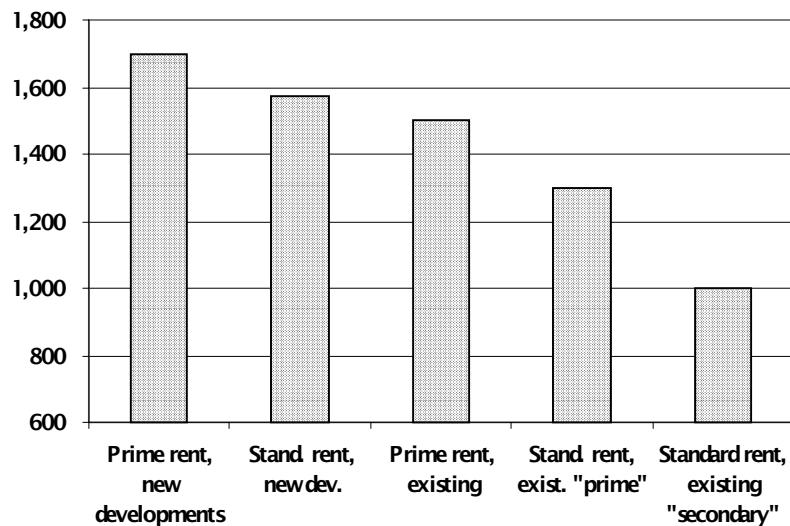
On the other hand, the decision to relocate the Danish Broadcasting Corporation to the Ørestad will free the existing broad-

casting centre complex for office purposes. This is an area with a good infrastructure and companies that have traditionally looked for office space in the Lyngby to Ballerup corridor, including those that have elected not to move to the Ørestad in order to accommodate their existing staff, could well see it as an attractive alternative.

New developments and existing property rents in balance

The figure below shows current rent levels net of operating costs (direct and indirect taxes, insurance, cleaning, etc.) in the Copenhagen CBD (Central Business District).

CBD prime office rents (annually in DKK per sq m)



Source: Sadolin & Albæk • ONCOR International

As the figure indicates, rents for new developments are about 15% higher than rents for comparable existing property.

On the other hand, the greater space utilisation that is typical of new developments is usually enough to eliminate the price spread.

Typically, companies require 15%-20% less space in new developments than they would in existing buildings as factors such as permanent partition walls, impractical building depth, small coherent areas on each floor reduce space utilisation.

High rents and

Over the past five years, low city rents and the substantial wa-

poor parking facilities in the CBD causing relocation out of the city

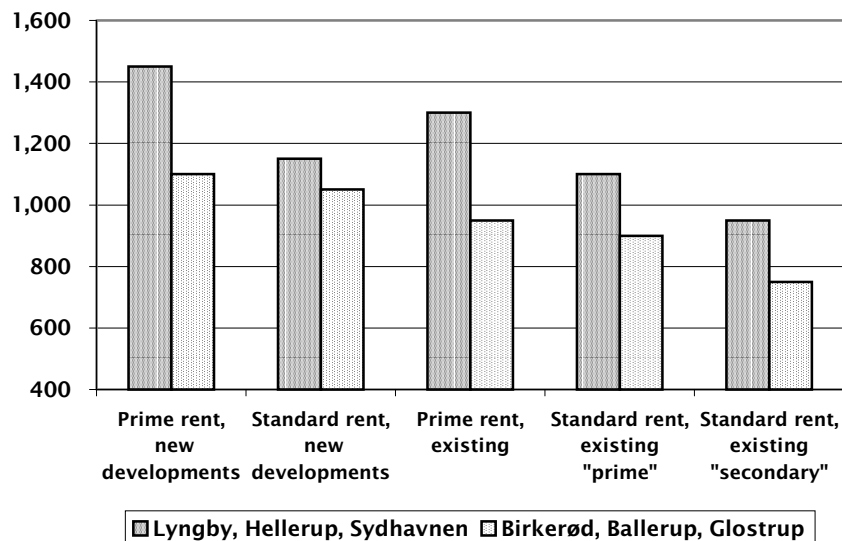
terfront area building opportunities have triggered a net relocation of businesses into the CBD.

Recent developments indicate a reversal of that trend, however. In the last few months, large companies, such as *Statoil* and *Shell*, have relocated from their traditional headquarters in the CBD to Sydhavnen and Nærums, respectively. Both of these areas offer leases at around DKK 1,000 or even less per sq m per year. In addition, the new headquarters offer greater space utilisation as well as better and cheaper parking facilities than does the CBD.

Rents in areas outside the CBD

Rents are also in balance in areas outside the CBD, with new developments commanding a 15% premium over existing property.

Office rents in selected non-CBD areas (annually in DKK per sq m)



Source: Sadolin & Albæk•ONCOR International

The figure above shows office rents in selected decentralised areas, i.e. the very popular areas in Lyngby, Hellerup and Sydhavnen and the attractive, but less prestigious, areas in Birkerød, Ballerup and in the vicinity of Glostrup Station.

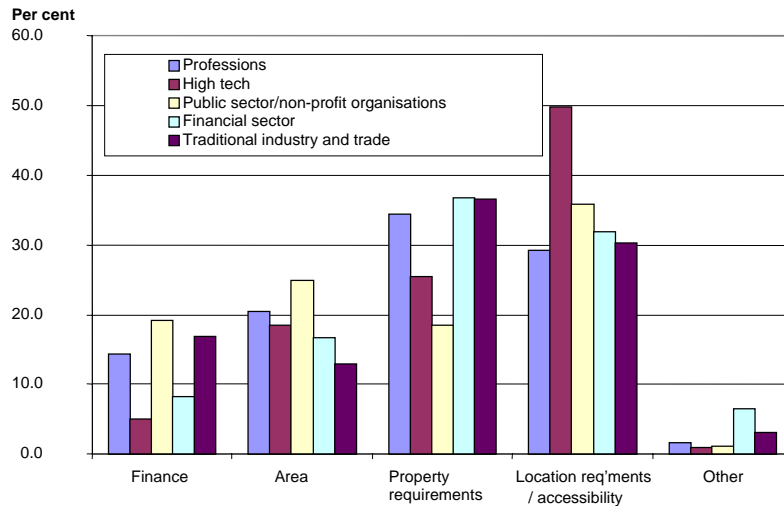
Corporate location requirements

Sadolin & Albæk was recently appointed by the Industrial and Urban Policy Committee (established by Jytte Andersen, the Minister of Housing) to analyse businesses' location preferences.

Our analysis shows that corporations give very high priority to location settings and flexible property applications. It would appear that other than among public sector organisations, the

price is not considered to be a principal factor.

Location priorities of office businesses



Source: Sadolin & Albæk • ONCOR International

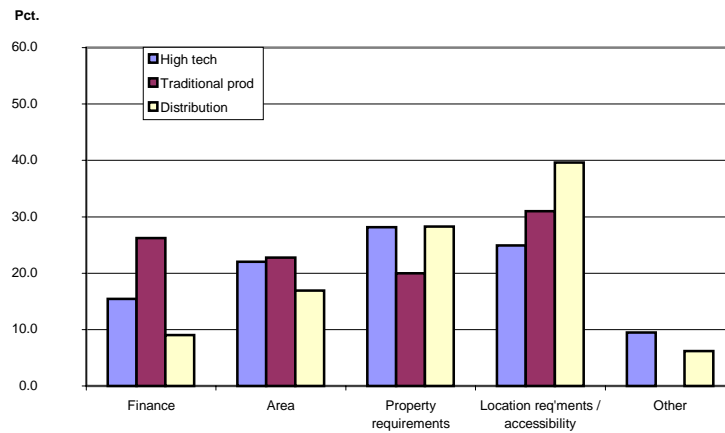
Some of the important location requirements are proximity to current and future employees, to the city centre, easy access with motor vehicles (private transport) and proximity to the motorway network.

The priorities given to property requirements vary somewhat, but there is a tendency to prefer parking facilities, flexibility, modern installations and efficient parking space utilisation at the expense of a prestigious location.

On the face of it, it seems somewhat surprising that proximity to educational or research institutions and to public transport is not given greater priority than is the case.

In all likelihood, the relatively low weighting accorded to proximity to educational or research institutions can be explained by businesses considering any location in Greater Copenhagen as being close to educational or research institutions.

Location priorities of industrial businesses



Source: Sadolin & Albæk • ONCOR International

Insufficient supply of locations with train station proximity

The relatively low priority given to public transport is not an indication that businesses do not prefer locations near train stations.

The problem is that there are no such locations that also meet the requirement of proximity to the companies' employees. The question is whether the train-station proximity principle serves its purpose, when it forces businesses to locate away from the areas their employees live in.

Instead, this results in longer transportation time and potentially greater traffic and environmental loads. Even though businesses locate near train stations, there will always be some employees who prefer to drive their own car, not to mention those for whom driving to customer sites is a part of their job.

Furthermore, the existing public transport system is considered to be lacking in efficiency and flexibility. This is particularly the case for locations outside the Copenhagen CBD, especially the ring road connections.

The poor weighting of public transport and the high weighting of private transport is a natural response to the growing difficulty that businesses requiring very large amounts of space are having in finding appropriate CBD locations.

Access to a qualified work force will be a key requirement

The ability to accommodate employee requirements will gradually become more and more important in the years ahead, as businesses will find it increasingly difficult to attract enough qualified employees, considering the small contingents of young newcomers to the labour market.

The businesses that, due to their locations, are able to offer employees flexible transportation between their home and work hold a competitive edge on the businesses that are unable to do so.

Is public transport efficient and flexible enough?

This is where access to transportation, both public and private, becomes key. Employees of the new generation will not want to spend a lot of their "leisure time" commuting. In addition, the borderline between working time and leisure time is becoming increasingly blurred. Not only will this require increased efforts from businesses when planning their operations, it will also result in demands for future urban functions.

The question is whether the public transport system can match the combination of efficiency and flexibility that private transport offers.

Transition from industrial society to knowledge/service society creating labour-intensive businesses

The changed requirements businesses have regarding space are driven by the shift from an industrial society to a knowledge/service society. In turn, this will trigger a shift towards more labour-intensive businesses and traditional industrial businesses would be expected to relocate to countries offering substantially cheaper unskilled labour resources.

The principal requirements for space are expected to derive from the following business sectors in the years ahead:

- Communications;
- IT;
- Software and related industries;
- Services – lawyers and accountants;
- The financial sector;
- Educational and research institutions.

Finding locations for these types of businesses will centre on regions with the largest supply of qualified labour resources, ie near large cities with educational and research institutions. There is little doubt that the Øresund region will be strongly positioned as such developments progress over the next few years, and the business types listed above are already focusing strongly on factors such as these.

The relocation of traditional manufacturing businesses to countries with cheap unskilled labour triggers a growing demand for transport and storage of goods and products. This is expected to lead to strong growth for distribution businesses located in urban areas but near the international motorway arteries.

Distinction between industrial and office companies becoming blurred

The distinction between industrial and office businesses has become blurred in that, more and more, industrial businesses are becoming research and administrative operations, ie taking on an office function, while actual production is being relocated to other countries. As a result, many traditional industrial districts are now coming popular with users of office space.

Areas such as Amager and Allerød/Birkerød/Hillerød would benefit if their local plans offered greater flexibility with respect to meeting the needs of both management-intensive businesses and of businesses in areas such as high-tech or software development.

The service industry's spatial requirements will be largely identical to that being seen among ordinary office businesses today.

Obviously, there will always be a demand for traditional industrial space, particularly for distribution purposes, but as the traditional industrial businesses gradually become less and less production orientated their future spatial requirements will be more and more like that of office businesses.

Industry in the classical sense of the word will soon be a thing of the past in the Greater Copenhagen area and the number of traditional production businesses is expected to decline in the years ahead.

Planning Regulations Act imposing new spatial regulations on retailing

Minister of the Environment taking control of retail sector planning

For more than a year, the market has anxiously awaited the implementation of the spatial restrictions in the Planning Regulations Act, according to which the establishment of food retail outlets of more than 3,000 sq m or of non-food outlets of more than 1,000 sq m must be motivated by special planning conditions.

In the metropolitan area, both local and regional authorities have worked very intensively to implement the provisions of the Act. We have monitored the progress of these efforts which we believe represent a serious attempt to clarify the scope of such special conditions in adherence to the spirit of the Planning Regulations Act.

Therefore, we cannot help but wonder why the Minister of the Environment has felt himself called upon to interfere with the outcome of the decentralised planning efforts.

Intervention on the part of the government could mean that it

will no longer be possible to establish new non-food outlets of more than 1,000 sq m on Copenhagen's main pedestrian street, Strøget, even though one of the principal reasons for changing planning procedures governing new retail outlets has been to strengthen the retail trade in urban centres.

Six months ago, there was political opposition to reclassifying Daells Varehus, the former department store, for retail and hotel purposes. Local politicians wanted to keep the 20,000 sq m building as a retail outlet even though both Danish and international retailers agreed that they could not run a profitable department store on that site. Now, just six months later, the narrow interpretation of the Planning Regulations Act's spatial restrictions for new outlets is making it difficult to establish a retail outlet of a mere 2,000 sq m – and at even more centralised locations, at that.

The Ørestad shopping centre

Eight years ago, progressive politicians decided to build a Copenhagen metro that would make an essential contribution to improving the quality of public transport in the city's key central areas.

Project finance was to be raised through a sale of lots for the then future Ørestad that was being planned on Amager Fælled, an area that would have a unique infrastructure consisting of the metro, the motorway and the railway line connecting central Copenhagen to the airport and the new link to Sweden. As early as 1992, the legislation approving the Ørestad development predicted that the new urban district would have substantial retail facilities.

However, this has done nothing to simplify the planning procedures for a shopping centre in Ørestad. The prolonged uncertainty surrounding the shopping centre has meant that businesses and investors with seriously considering relocating to Ørestad have not dared make a final decision to this effect.

Uncertainty about the shopping centre has delayed the Ørestad development

For private companies and property market investors to invest hundreds of millions of Danish kroner in commercial property in Ørestad as was originally envisioned, it would require a guarantee that the new district will offer a number of basic urban facilities. This would include substantial, modern retail outlets, restaurants and other similar facilities. The prolonged uncertainty about the establishment of the Ørestad shopping centre has undoubtedly caused a major delay in the development of the Ørestad.

We would have expected, as a matter of course, that the planning for a new international shopping centre in Ørestad would draw on the latest international retailing trends. Therefore, it

seems rather inappropriate to operate with rules limiting the size of retail outlets in a centre of that kind, as this would most certainly prevent successful international concepts from being launched in Denmark.

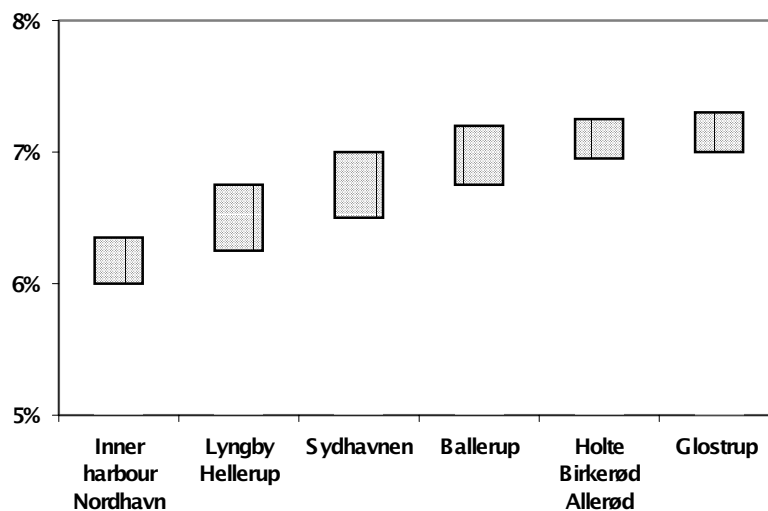
The investment property market

Stable net initial yield on commercial property

The net initial yield target on prime Copenhagen investment property seems to have stabilised following several years of a slightly declining trend. Although we have seen a few investment transactions involving high street property with a net initial yield of about 5.5%, it would appear that generally the market requires a yield of at least 6% on office and retail property.

A typical institutional investment property, ie a new office building leased to a single tenant on a fully-indexed 10-year interminable lease, currently provides a net initial yield of between 6.0% and 7.3%, depending on location.

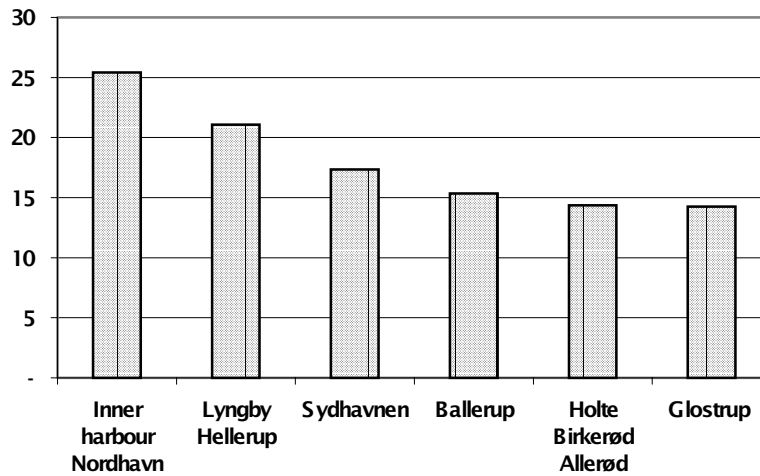
Net initial yields, new office property on a 10-year lease



Source: Sadolin & Albæk • ONCOR International

By dividing current net rents with these yield targets for prime office space, we derive the theoretical capital value per sq m of fully let investment property.

New office property, capital values per sq m, DKK '000



Source: Sadolin & Albæk•ONCOR International

As can be seen from the figure above, a prime waterfront location lifts the value of new, fully let office property by about 40%, or DKK 10,000 per sq m, relative to an average peripheral location. It should be noted, however, that the centrally located property would typically feature a slightly higher quality in terms of architecture, materials used and technical features.

Vast amounts of foreign capital allocated to the property market

During the last 12 months, we have recorded stable foreign investor interest in the Greater Copenhagen property market. To date, only a limited number of transactions have been completed, however, not least because contractors and developers pre-place many of the most attractive fully let office development projects with their regular institutional business partners. The international investment activity and thereby the long-term market liquidity would undoubtedly benefit if such projects were offered to a wider market.

The new Act on Business Leases has attracted greater foreign investor interest

The added interest from foreign investors is motivated by several factors. Due to the substantial supply of capital in the international property markets, investors have set their sights on new markets and many of them have recognised the financial and business potential that the creation of an integrated Øresund region would entail.

Furthermore, the new Act on Business Leases provides for free assessment of evidence in rent disputes heard by a rent tribunal. Previously, the market rent was defined as the rent paid for a comparable lease, but in a number of cases, this led to rent decisions that were unreasonable from a market point of view.

In some instances, for example, it was impossible to identify relevant comparable leases with a rent in line with what the market was generally willing to pay. As a result, rent tribunals were forced to fix rents that could potentially deviate considerably from the levels generally accepted in the market.

In addition, the new Act on Business Leases allows contracting parties to agree on terms that are more like the standards applied internationally. Obviously, it would be easier for a German or UK investor to approve a lease with great similarities to a German or a British lease.

It would seem to us that quite a few landlords are not fully aware of the opportunities available under the new Act. On the other hand, we believe that there is a very good chance that a standard institutional lease could develop over the next few years, similar to the situation in the UK.

This could result in property leased in accordance with the institutional standard attracting investors at a lower net initial yield than would property leased on non-institutional terms.

New investors offering smart money

For several years, many investors in the unlisted market have offered smart money rather than mere passive investments. Smart money denotes investors offering highly innovative finance and in-depth market knowledge, who are capable of contributing venture capital on terms designed specifically for new business start-ups or development companies and who can provide management resources and contribute to developing company competencies.

Major international investment funds are also channelling smart money to the property market. These investors can team up with local players and help to renew the dynamics of the Danish property market by financing new business concepts for property development and management.

As a result, the challenge facing the market will not be to raise capital for potential projects, but rather to provide a sufficient number of attractive projects to this new group of investors.

The Danish property market and the euro

So far, the uncertainty surrounding Danish membership of the EMU has had only a limited impact on the capital markets. Short-term interest rates are up, but they are only marginally higher than euro zone rates.

The important players in the property market are still unaffected by the uncertainty. The relative stability of long-term interest rates is one of the reasons that growing short-term interest rates have not influenced investors' net initial yields.

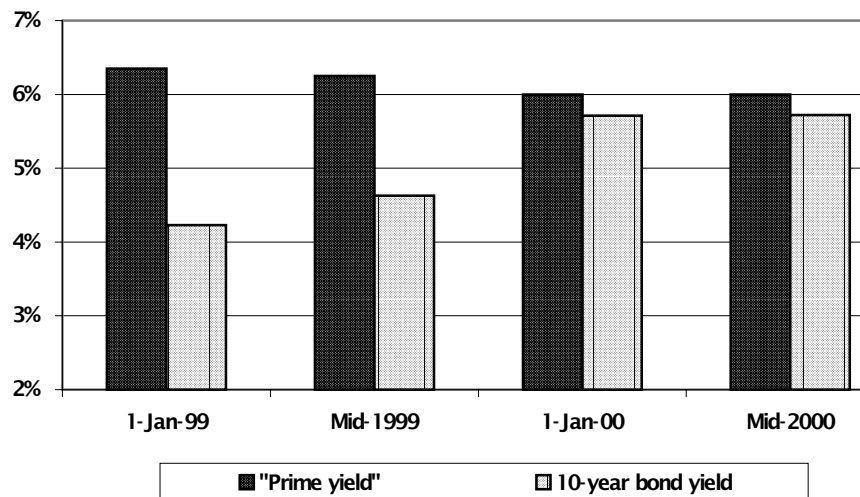
It should be mentioned, however, that a few of the foreign investors currently taking an interest in the Danish property market are fully aware of the potential consequences if Den-

mark rejects the euro in September. Moreover, we would not rule out that investment transactions concluded in the run up to the referendum contain an escape clause should Denmark reject the single currency.

In our view, the greatest risk of a property market setback following a rejection of the euro would not be directly brought about by the potential increase in interest rates that a No-vote could cause.

For example, it has never been possible to prove a unique relationship between the prime yield and 10-year bond yields.

Prime yield and the benchmark 10-year bond yield



Source: Sadolin & Albæk • ONCOR International

Rather, investors' target returns on property investments depend on the general business cycle, consumer confidence in economic developments and the employment situation, as a combination of these factors provides an indication of the future demand for new leases.

In the short term, a No-vote at the September referendum would have the same effect on the property market as the Maastricht referendum had in 1992, when the market temporarily went into a coma causing the turnover in the investment property market to plummet.

The international property markets

London almost back up to the prime yield level of 1989-1990

Just over a decade ago, prime office rents in London peaked at GBP 70 per sq ft.

Three or four years later, the prime rent had dropped to half that amount, with the result that a very large proportion of London investment property was over-rented.

The prime rent is now at GBP 65 per sq ft, which in metric figures is the equivalent of no less than EUR 1,130 per sq m.

Prime rent in GBP per sq ft – London City and West End



Source: Sadolin & Albæk / Nelson Bakewell•ONCOR International

The rental market is still buoyant with a healthy and constant demand which in the current year has been driven by the numerous and highly expansive Internet-related businesses. The vacancy rate has dropped slightly to 4.7% of the total market.

New development activity is expanding with almost 1 million sq m under construction, but this is still far below the level seen in 1989-1991. Some 80% of current project start-ups are speculative developments without pre-lets.

So far, the market has been able to absorb the new developments, which for the most part have been fully pre-let.

Initial net yield targets stable

Apart from the crisis from 1991 to 1993, investors have kept their initial yield targets fairly stable at about 5.5%, even with the considerable fluctuations in interest levels during that period.

Net initial yield (Prime) – London City and West End

Source: Sadolin & Albæk / Nelson Bakewell•ONCOR International

Time to take profits

For the fairly large number of foreign investors, especially those from Germany and to some extent those from Denmark, who have been active on the market in the last five to seven years, now may be a good time to take profits. The rental market is beginning to feel the same over-renting effect that a few years ago meant that prime office property was available at initial yields of 7.5%-8.5%. As a result, yield targets for this property have dropped considerably.

Keep an eye on lease interminability period

Many investors are attracted by the very long terms of leases being used in the UK, many of which run for 25 years. On the other hand, this means that when leases still have 12-15 years to run they are not considered to be particularly long term anymore.

This means that for investors who five to seven years ago acquired property with 21 to 23 years remaining on the leases, it will soon be time to consider a sale. Waiting for another couple of years will most likely result in higher yield targets from potential buyers.

A final argument for considering a sale is the strong appreciation of sterling against the euro zone seen in recent years. Many investors already hedged their currency position at the time of purchase, but that would normally not include the gain available now.

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