Optimism returning but challenges still remaining

At the end of February, Tell Media Group, in cooperation with **JPMorgan Asset Management** and **Principal Asset Management**, sat down with Finnish institutional investors to discuss opportunities and challenges in real estate.

By: Niklas Tell Photo: Christer Salling

With the real estate market having gone through some difficult times, the discussion kicked off with the investors sharing their general sentiment towards the asset class.

EVA LEMPINEN: "I think it's best described as cautiously optimistic. But it of course depends on which country and which sector you're talking about. The market is very polarised, but the general sentiment is that things are getting better. There's light at the end of the tunnel."

MARKUS NORDBERG: "I would agree with that – especially regarding the polarisation and I think as real estate investors, we need to identify and understand that polarisation. The European and US markets currently differ sector-by-sector and we've also seen a different pace with regard to rate cuts. So different markets and different sectors are not moving in sync. We must also remember that real estate is a cyclical asset class and we've been through a significant change in the interest rate environment. With rate cuts now being made, I think this is a very interesting point in time. The challenge is that if you wait for too long, then it's too late and the best opportunities are gone."

NIKLAS TELL: ARE WE SEEING LIQUIDITY COMING BACK TO THE REAL ESTATE MARKET AND IS THAT THANKS TO THE INTEREST RATE CUTS?

PETER REILLY: "Absolutely. Liquidity is a function of investors' comfort with pricing and when they're not comfortable with pricing, they're not going to make investment decisions. While interest rates were going up in response to inflation and a number of other geopolitical events, investors were nervous about where it would end and I think more recently, they have gotten a sense that perhaps the low point in the valuation cycle is behind us. That means investors are going to get more comfortable transacting and when that starts to happen, I think we'll see a more normalised market."

SEBASTIAN DOOLEY: "I think cautiously optimistic definitely is how we're viewing things. Last year, there was a lot of excitement around interest rates coming down, which probably slightly overestimated what was going to happen in reality. From our perspective, that made it very difficult to transact as sellers were expecting to get ridiculous pricing. Now we're seeing pricing that actually makes sense and we're able to move forward so hopefully liquidity starts to come back."

NIKLAS TELL: WHERE ARE YOU CURRENTLY THE MOST ACTIVE AND WHAT ARE YOU LOOKING AT RIGHT NOW IN TERMS OF GEOGRAPHIES AND SECTORS?

EVA LEMPINEN: "In Finland, we do direct investments and we're active both as buyers and sellers but very selectively. In Finland, our investments are more on the core side. When we go outside Finland, we look more for value-add type of investments and we do think it's a really good time to invest. One reason is that there's a lack of capex capital available for some owners and they need to sell, which means they accept the pricing that's offered to them. You still need to be selective and you also need to decide which sectors you would like to focus on."

MARKUS NORDBERG: "First of all, Mandatum is not really a core type of investor. We're looking for active value creation, which could be value-add or core-plus type strategies. Some we will manage in-house and for investments outside our home market, we will use external managers but always with that active focus. Geographically, we're mainly investing in Europe and we're currently seeing interesting pockets of supply and demand imbalances, which are situations that we typically like to explore."

PETER REILLY: "If you look at property market dynamics, the sectors that have been disrupted the most and where there's the most uncertainty is probably where you get the best pricing. If you go back 20 years, that was the retail space where the whole sector was disrupted by technology. Today, it's the office sector that's also being disrupted by technology but for different reasons. On the one hand, our view would be that as a whole, the office markets are going to struggle and continue to struggle until all this restructuring gets sorted out and that could take anywhere from 10 to 20 years. However, in the meantime, there are lots of opportunity in the office sector and the magic or the art in our job as asset managers is to differentiate between that office that is going to do really well and those that it would be unwise to spend money on. That skill is going to be very valuable for the next 10 years and will create a lot of opportunities."

SEBASTIAN DOOLEY: "I think a lot of the returns over the next few years is going to come out of rental growth, so it's key to figure out ways to drive that rental growth. That means active management will be important and that brings you to the value-add or core-plus strategies. It's also about matching the right asset class in the right location. Two of our big focus areas at the moment are hotels and data centres. If you look at Germany, from a data centre perspective, we see some incredibly compelling opportunities to invest there. However, from a hotel perspective, we see almost no opportunities there. It's the same economy, the same people, the same markets, but very different asset classes and very different demand drivers. It really is about selecting the right asset classes, selecting the right markets and really understanding the dynamics of what's driving each asset class in each market."

NIKLAS TELL: WHEN YOU SIT DOWN IN MEETINGS WITH INVESTORS, ALSO OUTSIDE THE NORDICS, WHAT ARE SOME OF THEIR TYPICAL QUESTIONS AND CONCERNS?

PETER REILLY: "I think it starts from the top level. When are the value drops going to stop and when are we going to see positive returns from real estate? There are also discussions around valuations, which of course is important if you're investing through funds because valuations tend to lag both on the upside and the downside. Investors like to understand when the valuers have caught up with the market and when it's right to jump back in again. The other thing investors are really focused on is the office market because it's such a significant part of the real estate market."

SEBASTIAN DOOLEY: "I think it slightly depends on who you're talking to. We're seeing European investors still being slightly more cautious on real estate as a whole whereas our Asian investor base came back to the market a couple of years ago or a year ago. The fact that interest rates in the eurozone are relatively lower than other locations does help and that seems to be driving some of the capital flows thanks to the distribution pickup that happens when you hedge currency risk. Interest among US investors have definitely picked up and they are willing to invest, so the discussions there are more about understanding the nuances of different markets and how to be positioned. In general, I would say that the conversations we're having with investors outside of Europe is more about how we can execute and how we can drive value rather than convincing them to invest in Europe."

CAROLINE LIINANKI: EVA, WHAT ARE YOU LOOKING FOR IN A REAL ESTATE MANAGER?

PARTICIPANTS

- **EVA LEMPINEN**
  Portfolio manager at OP Real Estate Asset Management
- **MARKUS NORDBERG**
  Head of private real estate at Mandatum Asset Management
- **PETER REILLY**
  Portfolio manager and senior advisor for the real estate Europe group at JPMorgan Asset Management
- **SEBASTIAN DOOLEY**
  Senior fund manager at Principal Asset Management

EVA LEMPINEN
Portfolio manager at OP Real Estate Asset Management since 2014. In her current role, she is responsible for international real estate fund and real estate debt investments. Since the beginning of 2025, she is also part of the alternative investment team and focuses on private equity and private credit fund investments. Before joining OP as an analyst in 2012, she worked at Nordea and Sampo in Helsinki.

MARKUS NORDBERG
Head of private real estate at Mandatum Asset Management since November last year. He is responsible for externally managed private real estate investments outside of Finland. He has worked at the Mandatum Group since 2010, holding previous roles in real estate and alternatives portfolio management and business development.

EVA LEMPINEN: "Some obvious things are track-record and experience. For value creation strategies, they would also need to have local teams and they need to have relationships with local players because that means they will be able to buy well. They also need to understand the market of course and I need to be comfortable and believe that the team knows how to create value in the asset. What kind of actions needs to be taken and how much money will they need to spend? What kind of return are they targeting? In the end, it's very hands on and it's always helpful visiting some assets to understand how they do things."

MARKUS NORDBERG: "I agree – clearly important factors. In our process, given the importance of the active value creation, we try to dig very deep into the deals that the manager has done previously. We always like to understand each and every investment and when you're going through those opportunities and the business plans, we get a better feeling for the real skillset of the manager. We also put a lot of effort in understanding the ESG know-how of the manager. While most managers seem to be doing a good job, you do find differences if you dig deeper and talk about individual real estate investments and ask what they have done to improve energy efficiency or how they cater for their tenants."

NIKLAS TELL: WOULD YOU SAY THAT THE ROLE OF REAL ESTATE IN A WELL-DIVERSIFIED PORTFOLIO HAS CHANGED?

EVA LEMPINEN: "It's obviously been quite a ride over the past two years with negative returns, but I think the fundamentals for why you should have real estate as part of your portfolio is still there. Also, while we didn't see full inflation protection during the rapid inflation peak, I would say that the inflation protection works over the longer term. We haven't seen any significant changes to the overall allocations but that could change in Finland as we have a pension reform coming. This will allow pension funds to take more risk in their investment strategy, which could mean allocating assets away from real estate towards equities."

MARKUS NORDBERG: "Real estate offers inflation protected cash flows and we've seen that the rents have picked up significantly where you have the right asset in the right location catering for today's requirements. And that rent cash flow is typically stable. Then it's more a question of whether that meets the return targets of your portfolio. Over the longer term, we don't think real estate has lost its place as a stabilising and diversifying asset in a portfolio."

PETER REILLY: "We obviously have clients globally and we talk to them all the time and I haven't observed any trend of investors dramatically thinking about shifting their allocations. From time to time, investors will notch up their allocation or notch down their allocation but it seems to be more around the edge. We haven't really seen any trend of major changes in allocation from our clients."

NIKLAS TELL: EVEN IF YOU ARE NOT SEEING ANY MAJOR ALLOCATION CHANGES, I GUESS THE CONTENT OF THAT ALLOCATION HAS CHANGED SIGNIFICANTLY BECAUSE WHAT WAS CORE 20 YEARS AGO IS NOT THE SAME AS TODAY.

EVA LEMPINEN: "That's absolutely correct. 10 years ago, a real estate portfolio consisted of offices and retail and nothing much else. That's changed."

SEBASTIAN DOOLEY: "I think we're definitely seeing a big sway towards either operational real estate or alternative real estate. Even office investments are not the same as it was. Today it's about finding specific offices that can be developed. Overall, we're seeing a move away from the traditional to the more specialised asset classes."

MARKUS NORDBERG: "I think what investors are concerned about is that old core and what to do with that. After a long period of low transaction volume, I assume many investors have assets in their core portfolios which are not fully meeting today's requirements. The need to recycle that part of the portfolio is what drives the need for active management."

NIKLAS TELL: WHAT DOES THAT MEAN FOR RISKS AND RETURN OF A REAL ESTATE ALLOCATION?

MARKUS NORDBERG: "I think we might see a two-level pricing for some time. You will have 'reference' pricing that reflects today's modern core assets and then you have another price for those assets that investors want to get rid of. Those who are willing to pick up the tools and do the hard work should be rewarded for that. Today, we see an increased value-add spread – the spread between the targeted yield on cost and the target exit yield and you should therefore be able to create higher returns for example by taking on the risks to buy secondary offices and create a modern core product."

PETER REILLY: "I think the other main difference might be just the way that real estate is held, so direct versus indirect real estate is being re-evaluated. We see a lot of investors that own a lot of direct real estate all throughout Europe and they are facing challenges in today's more volatile and capital intensive market. Assets need to be fixed periodically and that requires an active skillset and people on the ground, as was suggested before. So I think we will see a trend away from direct ownership back into indirect ownership. A decade ago, we saw it go the other way – away from funds and towards direct ownership. At that time, a lot of investors said that they didn't want to be in funds and that they would rather control and manage their own real estate. Now they're discovering that it's actually not that easy."

CAROLINE LIINANKI: WHAT ABOUT FEES FOR REAL ESTATE FUNDS? HAVE THESE BEEN COMING DOWN OR ARE THEY REMAINING HIGH CONSIDERING WHAT YOU HAVE ALL BEEN SAYING ABOUT SUCCESSFUL INVESTMENTS TODAY REQUIRING A LOT MORE WORK?

PETER REILLY: "If you're going to put your faith in a team that you think can really add value, then you're probably going to structure the fee in some combination of a fixed fee and a performance fee. I think in most of the structures where there's really active value creation and where the team is super important, you're going to find that combination. Where I do think there's pressure on fees is on the core side. That said, in all the years I've been in the industry, I don't think there's been a single year where investors are not putting pressure on fees."

MARKUS NORDBERG: "I need to agree with Peter that if the manager is doing a good job, they should of course be compensated for that. However, we do see that the financial industry in general is moving into more cost-effective ways. One good example is co-investments where the tradition has been that if you invest alongside your fund commitments, you pay half the fee and half the carry. Now, especially when it comes to private equity managers, which are eager to raise capital for larger deals, you're seeing offers of no-fee/no-carry on co-investments. We're also seeing this in infrastructure and maybe we will start to see more flexibility from real estate managers as well."

NIKLAS TELL: WHAT ARE SOME OF THE KEY SUSTAINABILITY CHALLENGES WHEN IT COMES TO REAL ESTATE?

MARKUS NORDBERG: "Firstly, it needs to be recognised that things are moving in the right direction if you for example look at the development of energy efficient buildings. Before the pandemic, we set a target for our fund investments that at least half of the buildings should meet green building standards, such as having a certification and that was kind of bold at the time. Today, we see that managers are not only

PETER REILLY
Portfolio manager and senior advisor for the real estate Europe group at JPMorgan Asset Management's private markets business, based in London. Prior to joining the asset manager in 1998, he spent 13 years at The O'Connor Group, where he was head of acquisitions for O'Connor Realty Advisors.

SEBASTIAN DOOLEY
Senior fund manager at Principal Asset Management covering the European data centre sector and is based in London. He has previously been responsible for managing a pan-European logistics separate account and was the assistant fund manager for the Principal European Core Strategy. Prior to joining the asset manager, he worked in the corporate finance department of Telereal Trillium.

willing to certify but they are certifying at very good levels. We're of course seeing a push back after the US election, but I'm happy to see that the EU is still committed to the climate goals. When it comes to physical risks, we've seen droughts and flooding increasing, which in our opinion are probably the biggest risks in Europe and you need to be mindful of where you invest considering these risks."

NIKLAS TELL: HOW ARE YOU WORKING WITH THESE CLIMATE RISKS?

SEBASTIAN DOOLEY: "With my focus on data centres, this is obviously a key question because the number one rule is that you cannot turn off your data centre, so there's a huge amount of focus on site selection and on designing infrastructure to be clever around the potential risks over the next 20 to 30 years. I recently visited an asset that's being developed at a site that is comfortably above sea level, but yet they decided to build it roughly six meter above ground just to be safe. Then you of course need to consider the impact these assets have on the environment, which is a big topic. On the one hand, digitalisation is very important as we move to a net neutral world but you're of course owning an asset that uses a huge amount of electricity and in some cases a huge amount of water. In Germany, we're seeing regulation coming in with regards to energy efficiency of data centres where PUE is a very important metric – basically how much power the building is using as a whole versus how much power the computer servers are using. This creates good opportunities to buy assets that are currently not meeting these targets and upgrade them."

NIKLAS TELL: HOW IMPORTANT IS THE MAPPING AND UNDERSTANDING OF CLIMATE RISKS FOR REAL ESTATE IN GENERAL?

PETER REILLY: "It's of course a very important aspect of our business and the pressure is especially visible in Europe across tenants, lenders and investors. I do think it's important to understand that as an investor, you need to bring a balanced approach, especially if you're dealing with existing buildings that need to be repositioned. You really have to make some judgments about what's the right thing to do. Then there are certain buildings that might never be good enough from a climate-risk perspective and today, we just won't buy that building."

EVA LEMPINEN: "It's also interesting to see how ESG will be included into the evaluation process. If you have two similar types of buildings where one has an EPC (energy performance certificate) rating of A and the other one has a rating of C – is the value of the buildings the same?

CAROLINE LIINANKI: WHAT DOES THE REGULATORY FRAMEWORK AROUND SUSTAINABILITY LOOK LIKE FOR REAL ESTATE IN EUROPE?

SEBASTIAN DOOLEY: "It's definitely increasing. Most countries across Europe have EPC rules for offices for example and you need to hit certain EPC levels by certain dates and that's leading to a huge amount of capex requirements – and potentially stranded assets."

PETER REILLY: "Regarding the valuation of assets, I do think it's fair to say that the vast majority of assets are mark to market without fully reflecting the costs to get them to where they need to be, especially if we're talking about office buildings. That's a challenge for the industry. As a buyer of an asset, we can only buy the asset if the seller is going to sell to us at the price that reflects all that. However, if properties are not trading and they're just being valued, I suspect that the industry is not 100 per cent reflecting all those future costs."

NIKLAS TELL: IF DEALS ARE NOT DONE, DOES THAT MEAN THAT THE VALUE WILL STAY TOO HIGH FOR THESE BUILDINGS OR WILL WE SEE A GENERAL RESET?

ROUNDTABLE - HELSINKI REAL ESTATE

PETER REILLY: "Over time, I think more and more of these metrics will be incorporated in the valuation – I just don't think it's instantaneous. One reason is of course that it's also somewhat judgmental – there's no right answer to how much money you could spend on a building. So it's going to take some time for this all to factor through the system and for the valuers to ultimately incorporate more and more of this into their annual valuations."

SEBASTIAN DOOLEY: "One of the climate change risks that also doesn't seem to be fully baked into valuations across Europe is insurance. We're seeing more of this in the US where it's starting to be challenging to get insurance in locations such as California and Florida and you can't really acquire an asset without insurance because you're not going to be able to get financing. If we look at areas in southern Europe with forest fires becoming a more frequent issue, we might see assets also in Europe becoming uninsurable over the next 10 to 15 years."

EVA LEMPINEN: "It's also about insurance pricing. Here, you can still get insurance but eventually the price of insurance might get too high, at least for certain assets so that's something you need to consider as well."

PETER REILLY: "I think it's important to also mention this is not just a challenge for the real estate industry. These are issues that affect the global economy generally and lots of other industries."

CAROLINE LIINANKI: LOOKING AHEAD, DO YOU EXPECT 2025 TO BE A BETTER YEAR FOR REAL ESTATE INVESTMENTS COMPARED TO THE LAST COUPLE OF YEARS AND WHAT ARE SOME OF YOUR BIGGEST WORRIES?

EVA LEMPINEN: "I think the yields have bottomed out and we are in the beginning of a new cycle, so I think we have the negative years behind us. I don't, however, think the recovery will be quick and easy but rather very volatile. It comes to down to asset selection as some assets will perform quite well while others will struggle. With regards to worries, the first thing that comes to mind is obviously the geopolitical situation and in turn what that will mean for economic growth and inflation going forward."

MARKUS NORDBERG: "Inflation is of course a worry regarding whether it is under control and how much room central banks have in the face of potential global shocks maintaining uncertainty. Another worry is the office sector given the pure size of it, but as we have mentioned several times already, it's all about owning the right assets. For 2025, given the clear supply/demand imbalances in many European real estate sectors, we expect the environment to remain attractive in terms of investment opportunities."

PETER REILLY: "I think the property fundamentals look really good and there's no reason to think that's going to change anytime soon. If you have the right office in the right location, you can potentially achieve record-high rents and it's similar across most real estate sectors. The supply side is muted because it's increasingly difficult and expensive to build, so adding new stock is getting more difficult. The demand/supply equation is really good. It's really just the capital markets that have taken its toll upon the real estate industry in the last couple of years. Hopefully, we will see capital markets stabilise a bit and with property dynamics in good shape, we should see attractive returns for the industry going forward."