Foreign direct investment into Swedish real estate

How has it changed during the 2000 - 2010 period?

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**Abstract**

The purpose of this research is to generalise the results of the 2000-2010 period development of the Swedish real estate market for FDI and provide a better understanding of it from the point of view of foreign investors. The approach used in the thesis was based on deductive method assuming previous theory and research. Quantitative data relies on both scientific and media sources, qualitative empirical data – on questionnaires filled in by companies involved in real estate FDI process. The study addresses the changes of macro and micro economical issues, cultural, political, geographical patterns, changes of market characteristics, investor preferences and provides an overview of both classical investment theories and FDI theories.

The results of current research show that within the indicated 10-year period the major changes in the Swedish property market where: increased difficulties with obtaining finance, higher selectiveness when choosing investment objects, increased use of structured deals, greater importance of diversification, decreased risk and yield levels.

The thesis originates from the prior research in the field by KTH scholars - Axelsson, Victrorin (1999), O'Connor (2003) and Falk, Olsén (2009). The main contribution of the current research is adding to the knowledge about real estate FDI and quantifying the changes during the long time-horizon – 2000-2010 period considering both “economical rationale” and “behaviour rationale”. Present research may be useful for further investigations in the property FDI area, can provide information for foreign investors about the historical development of the Swedish market and be helpful for analyzing or choosing FDI market strategy.
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1. INTRODUCTION

1.1 Background

During the period 2000-2010 Sweden has experienced a substantial growth in foreign real estate investment and its property market has undergone many changes. This was caused to a large extent by internationalization and globalization processes and world financial markets integration. Together with changes in national economy it led to an increase in cross border transactions. Swedish government has contributed to the process by improving investment climate for foreign participants through deregulation and structural changes (Anop, Kharlamova, 2007). During financial crisis, Sweden, like other countries, has experienced a certain downturn in investment activities but being an export driven economy has performed surprisingly well. During 2010 a positive outlook of the Swedish economy and low interest rates have led to a new upturn in market activity, domestic and foreign investors have ‘restarted’ the property transaction market (Prytz, Johansson, 2010). Swedish real estate market provides interesting opportunities for foreign investors, as it is characterized by rather high degree of transparency and liquidity (O’Connor, 2003). In addition, Swedish business climate with high integrity, cultural awareness, relatively easy communication between different real estate professionals (brokers, lawyers, consultants, attorneys etc.) in comparison to other markets, has created a favorable business environment (Arntel, Olofsson, 2004).

The capital comes from different categories of foreign investors, such as real estate funds or private equity investors and from various countries. Similarities and differences in investor and seller types, kinds of transactions, acquired properties can be observed (Blomquist, 2005). This thesis examines the current conditions and main factors influencing real estate investment decisions and how they have changed during 2000-2010, focusing on foreign direct investments (FDI) as an alternative to different financial market investments.

1.2 Problem Statement and Justification for the study

Swedish real estate market has been attractive for foreign property investors and growing during the last fifteen years. The foreign presence began to increase after the Swedish banking crisis of 1990-1994 when large property portfolios were placed on the market. During all these years Swedish market was considered transparent and liquid, with a low degree of exit risk. Though as a result of world economic crisis real estate
market of Sweden fell by 47%, it has quickly restarted and again presents interesting opportunities for foreign investors. Axelsson and Victorin (1999) concluded that an attractive feature of Sweden is that non-residents entering Swedish property market can achieve such as high expected return as possible. Brian O’Connor (2003) also studied secondary motives which bring investors to the country. The major goal of my thesis is to provide an insight about current investment conditions, as well as their past dynamics and changes during the last decade. Some researchers argue that now Swedish real estate market is less transparent due to the use of structured deals and probably less attractive due to taxation changes (Johansson, Prytz, 2010). Therefore, this thesis will address specific issues for Sweden, reasons for choosing it as an investment destination, opportunities which attract participants and analyze changes in preferences during the 2000-2010 period.

1.3 Aim

The major goal of the thesis is to provide an insight about current investment conditions, as well as their past dynamics and changes during the 2000-2010, for foreign participants within the Swedish real estate market. Data for the selected on direct property transactions involving foreign investors was analyzed to identify the main driving motives for investors, what influenced them and how they have changed. Another goal is to identify specific issues for Sweden, reasons for choosing it as an investment destination, peculiarities in transactions, various strategies followed by the different types of foreign investors, opportunities which attract participants, issues crucial for their decision-making process. The paper aims to provide a deeper understanding of investing into Swedish property, difficulties and challenges foreign actors face, and enhance market knowledge with regards to international participants.

1.4 Research question

The main research question is: What has changed in the Swedish real estate market during the period 2000-2010? To answer this question the study investigates investment opportunities on the Swedish market, conditions for cross-border investments, factors motivating foreign actors to invest directly into Swedish real estate market and latest trends and tendencies.
1.5 Limitations

For this study only direct investments into real estate were considered as an alternative to investments into financial instruments as bonds or stocks or investments into equity. The paper focuses on commercial properties, but also considers residential ones as well as investments into real estate for other purposes (for example to supply business facilities). The companies considered for this research could be conditionally divided into two types - those acting at the market for the whole analyzed 10-year period and those who became active on the Swedish market later or quite recently. Since the companies that made real estate investments into Sweden during the 2000-2010 were rather geographically dispersed, empirical study was based on e-mail questionnaires sent out to respondents in different locations.

1.6 Definitions of key terms

Foreign direct investment (FDI) – according to OECD/IMF definition is a type of international investment which is undertaken by a resident entity of one economy with the objective of establishing a lasting interest in an enterprise resident in another economy. “Lasting interest” implies a long-term relationship and a significant influence on the management of an asset/enterprise. This kind of investment gives the investor a direct control over assets and implies the purchase of 10 or more percent of voting stock of a bank, a factory, a port, or some other asset in a foreign country (O’Connor, 2003).

1.7 Disposition

The paper starts with the study background information, research question definition, justification of the study and limitations presented in the first chapter. Theoretical base of the study, methodological approach, information about collecting and analyzing the data are presented in the second chapter. This is followed by the overview of classic investment, diversification theories, various FDI theories, effects of FDI and problems for investors in chapters three and four. The fifth part focuses on identifying the real estate market in Sweden during the 2000-2010 period, including general economic overview, conditions for FDI into real estate, legal features for investors. In the sixth chapter empirical data collected for the current research is presented and the analysis is carried out. The paper ends with conclusions and discussion in chapter seven.
2. METHOD

2.1 Theoretical basis

One of the means to reduce the risk exposure of investments is diversification which means spreading the risk between different investments. Therefore the overall risk of portfolio is reduced when investments are made into different asset classes, sectors and markets. Axelsson and Victorin (1999) demonstrated that foreign investors in the 90s didn't take into account diversification without the possibility of an excess return. They considered that there were plenty of undervalued properties with regard to their analysis. What is interesting to examine is whether the foreign players' views in the investment market have changed since the 2000s. According to the latest reports (ISA 2010) and previous research in the area (Brattström, Heidkamp, 2008) Sweden and especially, Stockholm is the fourth most liquid property market in Europe and has a very high transparency. Therefore one can suggest that some over-priced properties could be found in Sweden during the period 2000-2010 because it's an efficient market (Fama 1970). Previous studies presented the empirical evidence that the share of foreign ownership on the Swedish property market has risen sharply since 2000. In line with this classical theory is an explanation presented by Lindt (2009), who stated that the difference in price could be explained by efficiency gains caused by the ownership structure and suggested that acquisition of new property by a foreign investor was one of the ideal transaction types leading to such gains in the period 2000-2009. O'Connor (2003) in his research mostly analyzes the influence of globalization on FDI, and studies also advantage and behavioral theories. Current thesis will examine the underlying factors which contributed to Sweden's becoming such an attractive investment destination trying to take into consideration all the theories described above.

2.2 About carrying out a Qualitative/Quantitative study

Quantitative research is the systematic empirical investigation of quantitative properties and their relationships which employs models, theories and hypotheses. The process of measurement is central for this kind of research as it provides the connection between the observation and quantitative relationship.

Qualitative methods concentrate on understanding the process and reasons, on why and how the decision is made. Qualitative research allows exploring attitudes, provides
understanding of given context and underlying motivations, values. Qualitative methods are useful for multi-cultural and multi-context study, when it’s important to pay attention to the difference between the countries.

2.3 Choice of method to use

The approach in thesis this is similar to the one used by Brian O’Connor (2003) and is based on deductive method which means assuming previous theory and research. O’Connor based his study on both scientific and media sources, and also on primary data obtained during the interview process. Information about past, present, and future trends and transactions was mainly obtained from newspapers, trade magazines and association newsletters. This method was considered acceptable, though these sources do not provide an overview of all transactions conducted.

The theoretical part of the current thesis is based on scientific articles analytical review, related academic studies already conducted in this area, textbooks. Empirical part presents the information gained from recent and historical market reviews, newspapers and from market participants.

Relevant quantitative data for this thesis was obtained from OECD, the Invest in Sweden Agency, yearly real estate market reviews, trade journals and directly from the companies. For obtaining qualitative empirical data questionnaires were sent to real estate companies involved in foreign direct investment process were carried out. Data on recent trends and developments was obtained from articles in non-scientific journals, publications on official web-pages of governmental organizations, research institutions. The aim of using various sources is to increase the representativeness of available data and insure the most reliable up-to-date information.

2.4 Choice of data source

For this research two groups of respondents were chosen - foreign investors from different countries and companies in Sweden involved in real estate transactions and investment advisory services during the period 2000-2010. As stated in the limitations they were different in terms of time line of their activities. Since the relevant companies that made FDI investments into Sweden were dispersed over Europe and the United States, and the amount of them was rather large no interviews were conducted. Given these conditions the research for this thesis was based on e-mail questionnaires.
2.5 About analysing of data collected

Using the questionnaires to obtain data has made the results of this research comparable and measurable. In order to get the structured view of the data survey questions were divided into several sections – those connected to background information of respondents, general investment conditions, sectorial investment conditions, company specific issues and the respondents’ opinion on the perspective of FDI into Swedish real estate. All the questions were multiple-choice, some of them allowing several answers and an optional different response. The questions which aimed to find out the opinion and agreement with the statement suggested a scale with a range “I fully agree” - “I fully disagree”. Responses of the investors answering “No opinion” were interpreted as neutral with regards to their view of the changes in the Swedish property FDI market.
3. THE INVESTMENT THEORIES

Managers of direct real estate investments have traditionally focused on a particular geographical region. Diversification was mostly achieved through investing across various property types, into assets with diverse characteristics, or by picking assets in targeted locations within one region. Being rather usual in other asset classes, diversifying through international investment has not always been seen as an attractive opportunity for FDI property investments due to lower transparency of real estate market and higher associated risks and costs (Wit, 2009). The reasons for investments to be made are difficult to define and undoubtedly many factors influence the decision-making process. The first steps towards cross-border investments are explained by the globalization of economic activity through such processes as liberalization, deregulation, and development of information and communications technologies. Foreign direct investment theories suggest that in order to compete successfully in a foreign market a firm must possess some ownership-specific assets in knowledge, technology, organization, management, or marketing skills.

3.1 Diversification

One of the basic rules of asset investment is risk distribution. Diversification involves spreading risks over different kinds of assets to avoid excessive exposure to a single source of risk. Proper diversification must take into account at least three factors. The first one is timing issue as the choice of investment type largely depends on the investment time-horizon. Other factors rely on the investor’s decision about how high the return they want and the extent of risk tolerance towards the investment (Axelsson, Victorin, 1999).

Using portfolio theory for investment decisions is one of the ways to determine the areas in which to diversify and how much to invest. A lot of research is devoted to the benefits of international diversification through real estate equities (Wit, 2009). Diversification by investing into various regions versus diversification by property sector is examined by Eichholtz (1996). International diversification benefits for direct real estate or non-listed property is also examined in prior research. The majority of the studies investigates the inclusion of overseas real estate into portfolio from the point of view of mean-variance analysis whereas applying classical portfolio theory to direct real estate has considerable disadvantages. Portfolio theory doesn’t explain which kind of investment strategy - regional or property type diversification one - is more effective and helpful for reducing the volatility of return on property (Wit, 2009).
3.2 Portfolio theory

Markowitz's (1952) mean-variance portfolio theory is based on mathematical calculations, where great emphasis is placed on averages of historical data. It addresses the problem of investors' behaviour under uncertainty. According to Markowitz investors seek to achieve as high expected return as possible given a certain maximum covariance. This is a so-called optimal portfolio (Efficient Frontier). Covariance in this context is the same weighted volatility of any investment asset class expected returns. The higher the risk the higher expected return is required. Higher yield can therefore only be achieved by allowing a greater degree of covariance, however, a lower covariance achieved by accepting a lower expected return.

The individual asset class expected returns and variance are not of equal importance measured in its own dimensions; more emphasis is put on the overall portfolio's weighted yield and covariance, changes after adding a single asset class (Markowitz, 1952). In other words, investors do not strive to achieve maximum expected yield.

Firstly, investor should consider all potential outcomes following a certain action. Secondly, the desire to maximize expected return does not explain why investors choose to diversify their portfolios, as this prevents the possibility of reaching maximum expected yield (Roy, 1952). Results of Roy's research show that investors should seek to minimize their potential risks rather than try to maximize the expected return. The more diversified portfolio is the less is the chance that the consequences of an eventual disaster will have a substantial impact on the entire equity portfolio.

3.3 Efficient market hypothesis

However in a market where the transaction costs of buying or selling a product are non-existent, all information is free and available to all market players and it reflects the current price, absolute efficiency is supposed to exist (Fama, 1970). But even if all these three conditions are not met, the market cannot be called absolutely ineffective. A practical example of this is that the market can be considered effective if the transaction costs of acquisition/sale of goods are high, but the price still reflects all available information. If the market is efficient then one can expect obtained information to be reasonably compensated, but the return one gets to act on this information never exceeds the cost of acquiring it. Practically, the informational efficiency of the market means that one cannot consistently achieve returns in excess of average market returns on a risk-adjusted basis, given that the information is publicly available at the time investment is made.
4. FOREIGN DIRECT INVESTMENT

Foreign direct investment (FDI) is defined as the foreign of purchase of 10 or more percent of voting stock of a bank, a factory, a port, or some other asset in a foreign country (O’Connor, 2003). This type of investment provides the investor with a direct control over assets. The term FDI is also applied with regards to establishing a partnership with a foreign firm or a joint venture. There are three major kinds of undertaking FDI – mergers and acquisitions, expansion investments and green-field investments (Axelsson, Vitorin, 1999). When the physical assets already exist cross-border acquisitions may be a preferable kind, especially when there’s is a limited time frame and financial risks (O’Connor, 2003). The main feature which tells FDI apart from other kinds of investments is the management aspect. FDI according to WTO (1996b) “occurs when an investor based in one country (home country) acquires an asset in another country (host country) with the intention to manage this asset”.

4.1 Different FDI theories

Many FDI theories are developed on a partial-equilibrium basis and therefore it’s not always reasonable to base the empirical analysis on them. There are many determinants of FDI decisions and their significance depends on the context (countries, firms etc. – Blonigen, 2005). A number of theories explain motives which make foreign firms undertake FDIs. The most well known are the theory of competitive advantage, OLI Paradigm and Internationalism theory, Hecksher-Ohlin model, market imperfections theory, the product cycle mode. Behavioural approach to FDI suggests that the investment decision is influenced by behavioural factors. Firms often tend to invest into countries, which are geographically close or similar in other terms (cultural, legal, and institutional environments similar to their own). In the next sections the overview of these theories will be presented.

4.1.1 The theory of competitive advantage (monopolistic advantage)

This theory explains and justifies international trade in a model assuming free trade, no uncertainty, perfect competition, accessible information and no governmental interference. It is assumed that the factors of production are not transportable; therefore advantages of specialization are received through international trade. A firm in one country has a competitive advantage when producing goods compared to that in another country. To be able to undertake a cross-border investment a firm must constantly maintain a relative advantage in its home market which is transferable and sufficient to overcome the costs and difficulties of
operating abroad. Such competitive advantages can appear from the economies of scale and scope, differentiated products, better managerial or marketing expertise, competitiveness of the home market (O'Connor, 2003). When implied in terms of real estate FDI, the comparative advantage can mean that owing a property asset in another country can be profitable if a firm coming to a foreign market possesses some advantage compared to the local investors, for instance in terms of managing the property, abilities of getting access returns from operations.

4.1.2 The Product cycle model

The product life cycle theory established by Vernon (1966) suggests that the FDI decisions of the firm are strongly affected by the life cycle patterns of its main products. The MNC's choice about where to locate production is defined by the character of the firms products and their stage within the life cycle. Product life cycle consists of three stages - new product stage, maturing product stage and standardized product stage. It is assumed that the firm is an innovative oligopolist from a developed country and the location of its production varies internationally depending on the product cycle stage. At the early stage firm sells a small part of the products overseas. When the product reaches the maturity and competition intensifies, the business will search for a new cost effective way to retain competitive edge. One solution is to make an FDI into countries with higher demand for a certain product. Markets with similar characteristics to domestic are considered as target. However, as the product cycle comes to a declining stage more firms would try to invest into developing countries to reach cheap labour force and new markets (O'Connor, 2003).

The product life cycle theory is criticized for being partial and addressing only FDI of the market seeking type. Other kinds of FDI, for instance resource-oriented and efficiency seeking modifications are not considered in it (Dunning, 1993). Though some similarities to real estate circle purchase-operation-disposal can be found and the investors are likely to undertake new FDI also on the second stage of the product cycle when existing property investments are stable and the firm looks for new effective ones, real estate is more related to efficiency-seeking modalities and the product-cycle model cannot explain the property FDI investors behaviour.

4.1.3 Market imperfections

The market imperfections theory assumes that firms continually look for market opportunities and their intention to invest abroad can be seen as an aim to capitalize on
particular capabilities not owned by competitors in foreign countries (Morgan, R., Katsikeas, 1997). However if markets were perfect as this theory suggests, there could exist perfect knowledge, similar input costs and other conditions. Therefore, profitability would also be similar in each country or industry - no benefit from undertaking FDI. MNEs try to take advantage of domestic market imperfections and translate them into opportunities like getting economies of scale, managerial expertise, financial strength etc. Imperfections found on domestic market for both products, factors of production, financing turn into market opportunities for companies (O'Connor, 2003). When related to real estate the market imperfections can mean higher yields for lower risk level, the ability to capitalise on currency fluctuations, difference in access to information, financing etc.

The theory of perfect competition states that firms produce homogeneous products and have the same level of access to production factors. In reality the competition is imperfect, which is reflected in industrial organization theory (Porter, 1985). Firms have different kinds of competitive advantages and its degree varies. It is especially true for real estate as it is not an industry, but a whole sector of the economy. It is composed of many distinct businesses, each them is an industry which will determine the kind and the scope of advantage. Nonetheless, market imperfections theory does not explain why foreign investment is considered the most desirable means of harnessing the firm’s advantage.

4.1.4 Internalization theory

Internalization theory is an extension of market imperfection theory. It relies on the idea that firms aim to develop their own internal markets where transactions can be made at lower cost within the firm. According to this theory market failures (such as information costs, opportunism and asset specificity) are the main reasons for MNE to use FDI instead of licensing. MNE may have a technological or marketing know-how which becomes a firm-specific advantage and it is protected in its internal market. Therefore MNE only expands by FDI when it has competitive advantages over other market participants and these specific advantages should be protected by organizational structure – a firm internalizes its overseas market activity. Internalization states that FDI take place when the benefits of internalization outweigh costs. Internalization implies a form of vertical integration developing new operations and activities, carried out on intermediate markets but under the governance of the main firm (Morgan, R., Katsikeas, 1997). The theory is not directly relevant in terms of real estate investments as they are not usually connected to production and licensing, but might be seen as an explanation for investors' choice between direct and indirect investments if they
assume to gain some advantage from getting managerial functions and internal control.

### 4.1.5 Production theory

Dunning (1980) and Fayerweather (1982) have investigated this issue and created an international production theory. The theory suggests that the inclination of a firm to develop foreign production depends on the particular attractions of its home country compared with resource and location benefits of in another country. This theory clarifies however, that it is not only resource/advantages factors that determine the decision, but also foreign government actions, which can significantly influence the attractiveness and entry conditions for MNEs. Issues such as political stability and regime, taxation, would have a great influence on the decision to invest overseas (Morgan, R., Katsikeas, 1997). For real estate investments it’s an especially important question as direct property investments are often associated with lower transparency, higher risks and costs.

### 4.1.6 The OLI Paradigm & Internationalization

The OLI paradigm tries to form a general framework to explain MNE’s choice of FDI versus entering foreign markets using alternative modes such as licensing, management contracts, joint ventures, exporting and strategic alliances (O’Connor, 2003). Firm's having some kind of competitive advantage in its home market is the assumption of the paradigm. “O” or owner-specific advantage is the one which is transferrable abroad. The firm is considered to be interested in specific characteristics of the foreign market – location specific. “L” allows the firm to utilize its competitive advantage in foreign market. Ownership advantage for FDI into property are mostly connected with managerial aspects, theses advantages can be transferable, location specific – with the local market conditions as informational, financial, taxation etc. The last condition is that the firm can support its competitive position by controlling the complete value-chain in its industry - internalization - "I", or the whole life cycle and operations with the property into which it invested. This leads to FDI rather than licensing or outsourcing (Dunning, 1993).

### 4.1.7 The eclectic theory of FDI

The eclectic paradigm was proposed by Dunning (1993). It acknowledges the inability of a single theory to provide a complete explanation of FDI by MNEs. Therefore it tries to bring
together all the elements (with strong explanatory power) from all of the three aspects mentioned previously (i.e. - ownership, location, and internalization) to suggest a dynamic and comprehensive explanation of FDI (Morgan, Katsikeas, 1997).

Firms’ internationalization advantage depends to a certain extent on the existence of the ownership advantages. The essential condition in the eclectic theory is that all three advantages should be obtainable before FDI is be made. If it is not so and conditions are not fully met, then there exists another more profitable way enter an overseas market for the firm, through different kind of activities such as, exports and licenses (O’Connor, 2003).

4.1.8 Market power approach

The market power approach examines the motivation of the firm to enhance its market power, when facing oligopolistic competition, through using particular ownership-specific advantages (Pitelis, Sudgøen, 1991). The theory suggests that during the early stages of growth, the oligopolist firm goes through a steady growth phase in the domestic market. However, home market concentration increases to the limit, and at some moment it will only be possible to preserve or enlarge the market share by expanding overseas. Implied to real estate, the theory states that having reached the “limit” on its own market the firm will start FDI overseas. It can also be connected with one of the common motivating factors for FDI property investments - the lack of domestic opportunities.

4.1.9 The oligopolistic reaction theory (follow-the-leader theory)

This theory is based on the market power approach but extends its arguments to consider the specific behaviour of MNEs in oligopolistic markets. By definition, oligopoly theory states that competitor firms in oligopolistic industries answer each others’ moves by making moving similarly themselves. Knickerbocker (1973) suggested that this line of common behaviour – “follow the leader” – is extended to FDI as well.

Among the Knickerbockers’ conclusions were: first - entry concentration (the grouping together of FDI) is positively associated with industry concentration. Secondly, this positive association observed between the two factors can be a result of the behaviour industry leading companies. Thirdly, entry concentration tended to be highest in industries for which marketing capacities was the key factor to succeed. Therefore any FDI, into property or another sector can be caused by the behaviour of market competitors.

However oligopolistic reaction theory can only provide a rather incomplete explanation of
foreign direct investment. The theory clarifies that oligopolist firms invest defensively to offset the FDI of the initiating MNE, but it does not provide any insights about the reasons for the initiating firm to give priority to cross-border investments (Lizondo, 1991).

4.1.10 Hecksher-Ohlin model

In a Heckscher-Ohlin model, there are few incentives for international factor movements. The main reason is that due to free trade factor prices become equal, therefore in countries where the wages are high before the start of an international trade, there will be a tendency for wages to decrease. At the same time, in countries with low initial wages trade will make them take up (O’Connor, 2003). Basing on this theory, if the prices in the countries do not equalize, the incentive for enterprises to establish foreign subsidiaries appears, which would let them benefit from the lower costs in other locations. Another central assumption of the Heckscher-Ohlin model, is the similarity of production technology in various countries. This hypothesis is not always true which encourages firms to invest abroad - the cost of producing similar a property in another country can be lower, though the investment will later supply the identical yield level. The variation in the production function may result from the technical knowledge inequality or managerial skills advantages (Södersten, Reed, 1994).

4.1.11 Behavioural theories of FDI

The above listed theories rely on firms and managers as on rational profit maximizers where uncertainty is often reduced so that rationalization conditions can be developed. However, FDI location decisions require a large amount of information, include many steps where a huge number of small decisions during several months or years period. The invested capital is rather immobile and is usually employed for a long term (Aharoni, 1999). Environmental variables are permanently changing in unpredictably and decision makers themselves are affected by various events. The process involves a lot of people who influence the final location either directly or indirectly. As a result each FDI location decision is determined not only by the “economically rational” part, but also the “behavioural” part, which considers perceptions and other cognitive features of managers (Katona, 1975). The main behavioural approach to FDI suggests that the appropriate factor for the location decision is psychic distance, that is, “... the sum of factors preventing the flow of information from and to the market”. Examples are the differences in language, education, business practices, culture and industrial development.” (Johanson, Vahlne, 1977). These conclusions can be entirely related to FDI into property.
Therefore, the behavioural approach considers how the extrinsic and intrinsic motives of managers, which are the source of their changing expectations, influence the decision-making process in the presence of uncertainty.

4.2 Effects of FDI

The inflow of foreign direct investments into the host country can result in some changes to inner country market and processes. Researchers however sometimes define between the influence of FDI on developed and developing countries, noticing that FDI effects can be positive for export promoting countries but negative for import substituting ones; the reduction of foreign import goods in the domestic market reduces competition and efforts to improve efficiency among the domestic firms. Main FDI effects are however positive and can be summarized as follows (Axelsson, Victorin, 1999, Blomström, Kokko 2003):

- Impact of on capital flow – the inflow of foreign capital into a country can increase demand for labour, therefore FDI can also add liquidity to a market. Once the investment is profitable higher tax revenue can be obtained.
- Force local firms to increase their managerial efforts, or to adopt some of the marketing, introduce new know-how by demonstrating new technologies and training workers who later take employment in local firms; techniques used by MNCs, either on the local market or internationally.
- Transfer and diffusion of technology – MNCs foster research and development and spread technology to domestic firms as a huge part of research and development takes place within; MNCs can transfer techniques for inventory and quality control and standardization to their local suppliers and distribution channels.
- Impact on the structure of the market – increased competition for the domestic firms can foster more efficient production.
- Break down monopolies and stimulate competition and efficiency or create more monopolistic industry structure, depending on strength and response of local firms.

4.3 Problems with international investments

FDI as any other kind of investment activities is associated with some considerable risk-taking. Common problems investors face when they come to an overseas market can be summarized as follows (Worzałk, Ball):

- Lack of local expertise
- Taxation differences
- Ability to identify acquisitions on the foreign market
- Management and operations after investment is made, information costs
- Misunderstandings due to cultural or language difficulties
- Increased transaction costs
- Uncertainty due to currency fluctuations
- Regulations, restrictions on foreign ownership
- Market efficiency and liquidity problems, inefficient pricing
- Risk of political and currency instability

4.4 Summary

The FDI theories and previously listed investment theories have different explanatory power concerning real estate FDI investments. Most importantly it’s obvious that no single theory can fully explain the process of investment and all the investor incentives. Another factor is the regional difference between investors, their preferences and motivations and also historical issues, in the current case for Sweden. Therefore the next part of this thesis is devoted to empirical investigation of investor motives and analyzing of how much they are related to listed theories.
5. SWEDISH REAL ESTATE MARKET

Foreign investors showed their interest in the Swedish properties since early 1990s. To explore this question from the perspective of international investors it’s necessary to define the motivations behind their interest. The attractiveness of Swedish property is linked to the state of Swedish economy as well as to characteristics of real estate market in Sweden such as high liquidity, high yields, favorable tax regime and low transaction costs. In addition to some political factors should be considered such as stable legal system, political stability and business culture issues. Therefore the following chapter will be devoted to the investigation of current conditions for FDI into Swedish property.

5.1 Swedish economy

Swedish economy has gone through different phases during the 2000-2010. In general economical situation has improved a lot since the deep recession of early 1990s, even though the growth rate decreased considerably in during 2001-2003 and 2008-2009 periods. Being an export driven economy, Sweden has performed surprisingly well during the recent global financial crisis and its economy is now rapidly recovering. Strong increasing demand in other countries makes Swedish exports surging nowadays. Like other economies such as the USA and Germany, Sweden has recorded an increase in FDI outflows in 2010 clearly reflecting strong economic growth (World Investment report, 2010).

According to the Swedish National Institute of Economic Research (2010), exports were up 10% for 2010. Together with an increase in household consumption and business investment, this has raised Swedish GDP by 4.3% in 2010 and is supposed to increase it by 3.4% more in 2011 according to forecasts. Employment is rapidly improving and is expected to increase by 140 000 persons in 2010-2012 (NIER, 2010). Improved financing environment, strengthening of the banking sector and increased activity on the labour market contribute to a growing demand for space and increased activities within the real estate sector (Leimdörfer, 2011).

![GDP Growth and Market Interest Rates](source: Newsec)

Figure 1. GDP growth and market interest rates’ dynamics during 2000-2100. Source: Newsec
Real estate market in Sweden has benefited from historically low interest rates, which were in a 0.25-4.74% interval during the 2000-2010, reaching the minimum in 2005 - 1.5%, and 2009 - 0.25% (Riksbanken, 2011). Together with the factors considered the above this makes investors see attractive opportunities on the Swedish market again, though the Swedish central bank has started increasing interest rates in 2010 (ISA. 2011). Through increasing demand for exports and investors’ higher willingness for risk, global recovery is affecting Nordic and Baltic countries (Newsec, 2010).

5.2 Real estate market in Sweden

Development of the Swedish property market during the 2000-2010 reflected to a large extent to the general economic cycles with the downturns in 2001-2003 and 2008-2009. Some of the primary consequences of the current crisis for the Swedish real estate market were a smaller size of transactions and an increased time of sales processes. Similar to many other countries, the number of transactions was reduced due to the difficulties in obtaining financing on reasonable conditions (Bergh & Co Advokatbyrå AB, 2011).

Given the positive outlook for the Swedish economy in 2010, there is an upturn in the real estate transaction market, which is expected to rise further during 2011. Interest in doing business in the Swedish property market raised sufficiently in 2010. The total transaction volume amounted to almost SEK 110 billion, twice more than the turnover in 2009 (ISA 2010). Now there’s an increase in rent levels across all markets in the Nordics - mainly in the newly built segments. Vacancy levels became stable and entry of newly built space on the Swedish market is expected to be limited during 2011. These factors ensure continued low supply and upward pressure on rent levels in the future (Nordic City report, 2011).

![Figure 2. Transaction volume during 2000-2010. Source: Newsec](image-url)
Increasing liquidity in the market is explained by such factors as the improved willingness of banks to finance transactions, the re-entrance of foreign banks, leveled off rents, and optimistic investors’ expectations in the light of a strong economic recovery. At the same time, both investors and banks became more selective considering the quality and location of targets, and increasing price levels are typical mainly for prime properties with long, stable lease agreements (Newsec, 2010).

5.3. FDI into Swedish real estate

Foreign direct investments play a considerable role in the Swedish economy and during the period 2000-2010 the net FDI inflows yearly amounted on average to 7-10% of GDP, reaching maximum in 2000 and minimum in 2004 (World Bank, 2010). FDI into Swedish real estate where mostly increasing during the period, the share of foreign ownership increasing and reaching its maximum in 2008 (around 220 SEK billion).

![Figure 3. Foreign ownership in Swedish real estate, 1999-2010. Source: Newsec, DTZ](image)

In the aftermath of the financial crisis of 2008, cross-border transaction volumes stabilized in the middle of 2009 and started recovering gradually since then. A decreasing liquidity trend of the Nordic real estate markets has finally changed and activities started to increase. The main explanation for this recovery is the well performing real estate industry in Sweden compared to alternative European markets, which has allowed foreign actors divestments from Swedish real estate at acceptable profits. The proportion of cross-border transactions has increased as a consequence. In the second half of 2010 it was 61% for Stockholm, which is a huge increase, compared to the indicator of the first half of 2010 - 26%. (Nordic City report, 2011).

Not only the total volume of cross-border transactions increased in 2010, but also the average size of the deal – in 2010 it amounted to SEK 275 million, compared to SEK 160 million in 2009. Eighteen transactions exceeding SEK 1 billion in property value took place in the Swedish market in 2010, whereas in 2009 this amount was only four (ISA, 2011).
Obviously core single assets and residential portfolios were in focus throughout 2010 and Swedish institutions were very aggressive on the buy side. German and Norwegian investors became the most active foreign buyers in the Swedish property market in 2009 and 2010. During the whole period of 2000-2010 German public funds and banks remained one of the main forces in Swedish cross-border investment, whereas the most active players changed every year, for instance Danish in 2008, UK and Norwegian in 2007-2006, US in 2003. During the earlier period of 2000-2003 many US banks were involved in financing acquisitions in Sweden (Morgan Stanley, GE capital, Lehman Brothers). Nowadays the foreign investors with the largest presence in the Swedish market are: Aberdeen property investors, GE Real Estate, Acta, Boultbee, Hemistaden, ING Real Estate, Klepierre, London and Regional, Nordisk renting, SveaReal, Vital, Rodamco, Northen European Properties etc.
According to Leimdörfer, there is currently a strong desire for investment among, for example, new property funds, well capitalized property companies and, not least, institutions that want to increase their exposure to property. The current situation with low interest rates, very strong public finances and improved access to financing offers plenty of attractive investment opportunities in the coming future.

The high yield gap (the difference between interest rates and property yields), particularly for secondary assets, together with the accessibility of bank debt, generates an opportunity to earn high returns for leveraged investors, and puts a downward pressure on yield levels. (ISA, 2011). There was a large increase in transaction volume in Stockholm in the second half of 2010, which was comparable to crisis-prior levels if estimated on a half year basis. An obvious trend was the increasing the share of residential property transactions mostly as a substitute for the office property holdings. In the second half of 2010 transactions worth SEK 22.5 billion were completed, which showed a 76% increase compared to the first half of the year. (Nordic City report, 2011).
Now an important issue for FDI investors coming to Sweden is the choice of an investment object. The question originates from the difference in economic recovery of the countries where investors come from. The bottom line for property investors is obvious - finding the property segments directly connected to domestic demand which give the opportunity to generate safe property cash-flows. However it is clear, that not all properties will perform well in the future, though it’s more likely for the sectors connected to domestic demand. Therefore the main issue for investors nowadays is picking the best-performing assets considering the uncertain conditions of the global economy (Newsec, 2010).

5.4. Legal features of property investment system for FDI

Legal issues for foreign property investors in Sweden are similar to those for domestic since the “Law of Foreign Acquisition of Swedish Firms” was abolished and the “Law of Foreign Acquisition of Real Property” was changed in 1993. There is no restriction on foreign ownership. During 2010 other laws like “Pre-emption Act” and “Act on Acquisition of Rental Property” were abolished and these changes led to considerable simplifications of formalities in transfers of ownership in real properties and are believed to result in larger mobility on the real property market (Bergh & Co Advokabyrå AB, 2011)

However there are some administrative restrictions concerning acquisitions of agricultural property and “Property Acquisition Act” granting cooperative building societies a pre-emption right to acquire rental buildings. Relevant international laws for foreign investors acquiring real estate in Sweden can also be applicable regarding capacity and authorization.

Below the most important features for property FDI investors are outlined (ISA, 2011):

- **The regulation of property**
  All essential aspects of private real estate law are regulated by the Swedish Land Code (Jordabalken), including property fixtures, mortgages, formal requirements, usufructs (the right to use and derive profit from a property), leases, easements, registration of property rights. Swedish land is divided into individually identified property units (by name and code).

- **Due diligence process**
  In Sweden due diligence is coordinated either by the legal consultants or directly by the investor. As the liability of the sellers is usually limited to the warranties given in the transfer agreement, the due diligence process is crucial. Normally, legal, tax and financial, technical and environmental consultants are involved in the process.

- **Mechanisms**
  Investments can be made through a limited liability company (“AB”), a non-resident company,
or a partnership. Investors adopt either a resident or a non-resident holding company structure, for instance a holding company owning stock in one or more subsidiary companies. For Swedish corporate entities capital gains tax exemption applies when gains are related to the disposal of shares. As there is no real estate transfer tax on indirect transfers, transfers of real estate properties are often made through indirect transactions. Even direct investment would more likely be effected through a Swedish special purpose company.

- **Corporate taxes**
  Corporate income tax rate in Sweden is 26.3%, though the effective tax rate is lower because of the possibility to defer the profit taxation. Interest expenses on externally borrowed funds, and property-related expenses are tax-deductible for both residents and non-residents.

- **Property tax**
  Swedish real estate tax is at a rate of 0.5 – 1% on the tax assessment value, depending on the building’s classification (industrial – 0.5%, commercial - 1%). The tax assessment value equals 75% of the fair market value and is set by the Tax Agency. Real Estate tax is deductible cost for corporate income tax purposes.

- **Tax depreciation**
  With respect to buildings an annual depreciation rate for tax purposes is 2.5% of the acquisition cost. Parts of the building may be depreciated as machinery and equipment. Depreciation for land is not allowed.

- **Group relief**
  Each company within a group is considered a separate taxable entity. The group itself is not taxed. However, there are rules allowing the profits transfer between group companies (“group contributions”), so taxation of consolidated income can be achieved effectively.

- **Tax treatment on direct sale of real estate**
  Companies owning property in Sweden, both resident and non-resident, are exposed to corporate income tax on capital gains when the sale of real estate takes place. Capital losses on the sale of such assets can only be offset against capital gains, realized by one or another company within the group. It is allowed to carry forward losses on real estate without time limitations.
6. EMPIRICAL DATA AND ANALYSIS

The data for the research was obtained with the help of questionnaires from foreign investors and companies providing consulting services for investors. Some of the companies considered were acting at the market for the whole analyzed 10-year period others became active on the Swedish market later or quite recently. Total number of companies participating in the research amounted to 27. Remarkably, the response rates for these groups were very different. Out of 24 consulting companies 16 have replied and fully completed the survey, so the response rate for this category is 66%. Investor response rate was on the contrary very low – 18%, 11 out of 61, and only 7 surveys were fully completed. This is probably explained by the type of respondents – not all of the investors considered FDI into Sweden as a prior investment destination, and the expectations about future investments – in case the companies are not planning to invest into Swedish market in the future. For instance funds with large portfolios having a relatively low share invested into Sweden and companies who invested in the beginning of the 2000-2010 period not investing into Sweden any more.

Therefore the low response rate for investors is likely to result from the fact that the research horizon is rather long and only a small number of investors was active on the market during the whole period. Consulting companies on the contrary were mostly long-term actors. It might be useful for the future research to study all the investors in more detail and to reorganize the questionnaire in a way more suitable for short-term and not strategic investors.

The questions in the survey were dived into a few sections to capture background information of respondents, their view of general investment conditions in Sweden, sectorial investment conditions, company specific issues and opinion about perspectives on FDI into Sweden. All of the questions were multiple choice, some were structured so that respondents could indicate the relevance of a particular question to their company and choose several option or a specific issue. This method was chosen to enable statistical evaluation and comparison of different respondents, which would not be achievable in the case of open-ended questions.

6.1 Background information

The first section of the survey was designed to collect and verify the background of the companies interviewed. This includes classifying the respondent’s company type, period of activity in the Swedish market, period of employment in a company of a person answering a survey, dynamics of their investments into Sweden during the 2000-2010 and opinion about correlation with other alternative real estate markets. The results for the two groups of respondent were as follows:
- **Which category best describes your company’s main business?**

![Figure 8. Investor types.](image)

Most of the companies providing services are consultancy/advisory firms, however two companies were funds and one positioned itself as a pension fund and investment manager. Among the investors the majority is real estate development companies (3) and real estate funds (3), what notwithstanding the low quantity or of respondents corresponds to the information of market reports - a strong tendency to undertake FDI into Sweden among new property funds (Leimdörfer, 2010). Other types of investors indicated were asset management companies (2) and public and private real estate companies.

- **How long has your company been active on the Swedish property market?**

![Figure 9. Period of market activity.](image)

The responses for this question are somewhat in line with the assumption made in the beginning of this section – FDI investors during the 2000-2010 period were likely to be more of a short and medium term participants and and only a small number of investors was active on the market during the whole period. Only one investor indicated more than 10-year activity period and this company identified itself as an asset manager. Whereas more than 70% of the
investment service providing companies were involved in FDI property operations during the whole period, most of which were consulting firms.

- **How long have you been employed in the company?**

![Companies providing services](image1)

![Investors](image2)

**Figure 10. Respondents’ employment period.**

The average period of employment among both categories of respondents was rather long – more than five years. Though this parameter doesn’t directly indicate how objectively the respondents could characterize the market, it still indicates that they had necessary knowledge about the company to describe its activities on the market during whole 10-year period. This is likely to affirm the sufficient level of reliability of the data obtained.

- **On average how has the share of your companies' (your client/partner companies') FDI into Sweden changed during the flowing time periods?**

![Companies providing services](image3)

![Investors](image4)

**Figure 11. Share of FDI into Sweden.**

As far as the analyzed period was long the companies where asked to analysed different timelines within the 10 years. Quite expectedly both types of respondents gave quite similar description of their investment tendencies, indicating a major increase starting with 2003 and a downturn after financial crisis in 2008.
Which of the following property markets in your opinion are the most correlated with the Swedish property FDI market? (several answers are possible)

![Figure 12. Correlation of Swedish FDI market with alternative markets.](image)

The opinion about market correlations was also alike – Finland and Germany chosen as most correlated markets. However theoretical research (Lim et al., 2008) states that Norwegian real estate market has the highest correlation with Swedish, followed by Danish market. Another feature of the Swedish property market is high correlation with UK market, though with some time lag (Swedish is lagging behind). It is especially well-seen if to compare dynamics in commercial property sector of London and Stockholm.

6.2 General investment conditions

The second section of the questionnaire tried to investigate the investors' general opinion about the changes of conditions in Swedish FDI real estate market during the 2000-2010. The questions were with regards to micro and macro economical conditions, political stability, geographical diversification and business climate/cultural issues. The opinions of the two types of respondent about suggested statements were as follows:

- **Micro economical conditions (property tax, operating expenses, transaction cost etc.) in Sweden have improved**

![Figure 13. Opinion about micro economical conditions.](image)
- **Macro economical conditions (interest and exchange rates, inflation, GDP etc.) in Sweden have became more favourable**

**Companies providing services**

**Investors**

**Figure 14. Opinion about macro economical conditions.**

In general, both groups of respondents agreed on the fact that the FDI market conditions have improved in Sweden during the 2000-2010 period. 73% of investors and 43% of consultancy firms indicated the improvement of micro economical conditions and almost 100% of the companies had positive opinion about macro economical issue, which may be to some extent explained by a quick recovery of the Swedish economy after crisis.

- **Cultural issues (business environment, language etc.) for foreign investors in Sweden have improved during 2000-2010**

**Companies providing services**

**Investors**

**Figure 15. Opinion about cultural issues.**

90% of investment service providers and 100% of investors have indicated the improvement of cultural issues for FDI property market. This reflects the improvements of consultancy services and the preservation of a traditionally favourable business environment, characterized by high integrity, cultural awareness, effective communication between real estate market participants and language issues.
• Issues of geographical diversification (region, climate etc.) have become more important for FDI decision in Sweden

Figure 16. Opinion about geographical diversification.

• Political factors (stability, regime) have gained more influence on FDI investors’ decision

Figure 17. Opinion about political factors.

Geographical and political region diversification has gained more importance for investors during the 2000-2010, whereas consultancy service providing companies don’t indicate it to be the most important factor attracting the investments. The growing importance of “environmental factors” for the investors can be explained by the behavioural FDI theory which indicates the significance of non-economical rationales for investors. According to the answers consulting firms have a very positive estimate on micro economical changes during the 10-year period, probably considering it as the most attractive factor for investors.

Overall investment service providing companies tended to be more optimistic it their view on the Swedish real estate market then foreign investors. This might be both due to their better expertise about the local market and regulations, as all of the firms have offices in Sweden as well as native Swedish employees or due to their more positive outlook on the perspectives of the Swedish economy. More negative opinion of foreign players however can be explained not by lower expertise, lack of information or different expectations regarding the Swedish
economy but also by the fact they compare Swedish FDI market with many other markets when investing into different regions. Therefore investors can often have a different reference point evaluating the conditions, whereas consultancy companies acting for a long period on the market can compare various periods.

6.3 Sectorial investment conditions

Sectorial conditions section included the analysis of changes in specific characteristics and opportunities of the Swedish property FDI market during the 2000 – 2010 period. The questions were targeted to obtain the respondent’s opinion about transparency, liquidity, informational efficiency, etc. as well as the change of preferred investors’ time-line. The results of the section are as follows:

- **The Swedish FDI market has become less transparent due to the use of structured deals**
  
  **Companies providing services**
  
  **Investors**

![Pie charts showing opinions on structured deals impact on transparency](image)

**Figure 18. Influence of structured deals on transparency.**

As it was previously outlined in the analysis of the Swedish real estate market the use of structured deals has increased lately. The traditional FDI methods are still in use, but there is a trend of an increased use of structured deals and JVs (joint venture vehicles). This is motivated by aspiration of among investors and developers to share the risk in construction. Such deals are more complex and involve a higher level of sophistication regulating the co-investments and making agreements (Mannheimer Swartling, 2010). This issue influences transparency of the deals, and according to the results of the questionnaire many of market participants agree it makes the market in general less transparent (47% of the FDI service providers and 43% of investors). However a large part of investment service providers (46%) are optimistic about this kind of deals and believe that it doesn’t reduce the transparency compared to the beginning of the 2000-2010 period. It can be explained by their high market expertise about the local investment terms and ability to successfully participate in different kinds of deals.
Information provided by consulting companies indicates that the Swedish real estate market has become more transparent during the 2000-2010. The Jones Lang LaSalle Real Estate Transparency Index, which is now measured for 81 countries places Sweden into highly transparent category, with the 4th rank for 2010, whereas it was ranked 7th, though in the same category in the year 2000.

- **How in your opinion have the following characteristics and opportunities of the Swedish property market for FDI changed during the period 2000 - 2010?**

### Companies providing services

![Bar chart showing changes in characteristics of the market during 2000-2010 for companies providing services.](chart1.png)

**Figure 19. Changes of the characteristics of the market during 2000-2010.**

### Investors

![Bar chart showing changes in characteristics of the market during 2000-2010 for investors.](chart2.png)
Both categories of respondents agreed that the liquidity of the Swedish market has increased during the 10-year period. The majority indicated the following positive changes during the 2000-2010: improvement of diversification opportunities, taxation regime, transparency, liquidity, informational efficiency, consultancy services, access to local networks, business climate, slight decrease on interest rate levels (if not to consider the period of historical minimum in 2008), lower transaction costs. One of the companies mentioned that the main factors to bring FDI investors into Sweden are the financial strengths of foreign companies and lack of opportunities on domestic market. Negative opinions were about changes in access to financing, mostly explained by financial crisis, higher risk levels than before and decreased yield levels. Many investors also noticed some decrease of business opportunities.

- *Investors in the Swedish property market for FDI have become more long-term oriented towards the end of 2000 - 2010 period*

Figure 20. Changes in the timing of investments during 2000-2010.

The time horizon has changed negatively according to the answers obtained from consultancy companies, who disagree that investors became more long-term oriented than before (47%). However the majority of investors answered the same question differently, indicating that they “partly agree” on the statement about being more long-termed (72%). Taking into consideration the low representativeness of the investors’ category, the answers of consulting companies are more likely to clearly outline the market situation. Investors’ answers might indicate though that some of them are likely to take some long-term investments in the future.

6.4 Company specific issues

This section focused on the opinion of the companies on the influence of FDI market changes during the 2000-2010 on their own business. The questions focused on the change of the FDI share in the overall volume of investments, changes of investments into different sectors, problems that the companies have experienced during the 10 years doing business in Sweden.
back out of investments, the consequences of the current financial crisis, changes in the type of transactions (portfolio deals vs. single property deals). The answers of the section according to the company types are as follows:

- **In average how have the FDI into the following sectors changed in your company/among your clients’ companies during 2000 - 2010?**

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<table>
<thead>
<tr>
<th></th>
<th>Companies providing services</th>
<th>Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>31%</td>
<td>33%</td>
</tr>
<tr>
<td>Retail</td>
<td>31%</td>
<td>33%</td>
</tr>
<tr>
<td>Residential</td>
<td>23%</td>
<td>27%</td>
</tr>
<tr>
<td>Industrial</td>
<td>15%</td>
<td>17%</td>
</tr>
<tr>
<td>Hotel</td>
<td>15%</td>
<td>33%</td>
</tr>
<tr>
<td>Other</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
```

*Figure 21. Sectorial change of FDI during 2000-2010.*

The changes in sectorial investments indicated by consultancy service companies are in line with the data about market changes presented in the market overview chapter of this thesis. Recently there is an increase into high-yield commercial property like retail and office and into residential properties. Some respondents however indicated slight decrease in investments into industrial, residential and hotel properties, supposedly referring to the crisis time. Some investors however indicated decrease in all kinds of investments, which can be either due to financial crisis, diversifying away from Nordics or active behaviour of domestic investors creating good conditions for divestment. Anyway the most attractive type of real estate investments for FDI during the period 2000-2010 was office space.

- **Companies undertaking FDI in the Swedish property market have become more involved in portfolio transactions than in single property transactions**

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<table>
<thead>
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<th></th>
<th>Companies providing services</th>
<th>Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>I fully disagree</td>
<td>33%</td>
<td>17%</td>
</tr>
<tr>
<td>I partly disagree</td>
<td>31%</td>
<td>17%</td>
</tr>
<tr>
<td>No opinion</td>
<td>31%</td>
<td>17%</td>
</tr>
<tr>
<td>I partly agree</td>
<td>23%</td>
<td>17%</td>
</tr>
<tr>
<td>I fully agree</td>
<td>15%</td>
<td>17%</td>
</tr>
</tbody>
</table>
```

*Figure 22. Changes in the type of transactions during 2000-2010.*
Most consulting companies (53%) and investors (50%) also agree on the fact that the type of investments has changed and nowadays FDI investors are more often involved in portfolio transactions. However a large part (46% and 33%) holds an opposite opinion. Therefore it’s difficult to draw a common conclusion on this question; supposedly it depends on the type to investor and the sector of investment. The transaction data for the period shows that most deals nowadays are with core single assets and property portfolios.

- **Your company/FDI investors who were the clients of your company have backed out of some planned investments in the Swedish property market during the following periods**

![Graph showing the percentage of companies and investors who have backed out of investments](image)

**Figure 23. Back out of investments during 2000-2010.**

The results obtained from this question indicate that all companies faced the back out of some investments during the 10-year period, only some investors indicated that they didn’t. Most of the back out was after the 2008.

- **My company has experienced the following problems when investing directly into Swedish property market during 2000 - 2010**

![Bar chart showing the percentage of companies experiencing problems](image)
Indicating the problems experienced with FDI into Swedish property investors stated that major back out of investments was during the 2008-2009 period, and consulting companies indicated that the major outflow has started earlier in 2006-2008. Among the main investment problems which they have faced most of the respondents have marked the following: problems with access to financing, problems with identifying available properties for acquisition, management and operational difficulties, lack of exit opportunities and local expertise and high cost of hedging about currency risks. Difficulties with financing and finding objects are seen as the main changes which have appeared after the 2008 crisis and reduced the business opportunities for the companies.

- **The global financial crisis has changed the opportunities for FDI in Sweden for my company due to:**

![Figure 24. Problems experienced while undertaking FDI into Sweden during 2000-2010.](image)

Difficulties with financing and finding objects are seen as the main changes which have appeared after the 2008 crisis and reduced the business opportunities for the companies. 80% of investment service providing companies and 50% of investors agreed on the first
parameter, 66% and 50% respectively on the second parameter. According to the market information access to financing is now improving as well as the Swedish economy in general, but the problem of picking high-quality and best-performing assets in an uncertain global economy remains a current issue (Newsec, 2010).

6.5 The perspectives of FDI into Swedish real estate

The questions in this section were made to define investors’ general expectations about the perspectives of FDI into Swedish property and plans regarding their own (or their client companies) possible future activities in the market.

- *In your opinion how will FDI investments into Sweden change in the future?*

![Figure 26. Opinion about future changes of FDI into Sweden.](image)

- *Does your company plan to undertake FDI into Swedish property market in the future?*

![Figure 27. Intention to undertake FDI into Sweden in the future.](image)

The responses to these questions demonstrate the overall positive outlook for FDI into Sweden from the point of view of both investors and consultancy companies. The majority of investors indicated the intention to invest into Sweden again in the future (83%) and also think that the investments in general will slightly increase (50%), what seems quite reasonable considering
the outlook of Swedish economy. Consultancy companies stated that 90% of their clients are likely to undertake the investments again and 82% believe that the FDI property investment volume will increase in the future. This is in line with the information provided in the Leimdörfer’s “Investor Survey 2011” – most of the investors (62%) have positive expectations for the Swedish real estate market and indicate that they expect the increase of transaction volume estimating it to be SEK 100-150 billion. This would be an increase compared to the 2010 transaction volume which was approximately SEK 105-110 billion.

- *Changes in the following factors could improve the attractiveness of FDI into the Swedish property market: (several factors are possible)*

![Figure 28. Improving attractiveness of Swedish FDI property market.](image)

Among the changes which can be made to improve the Swedish market for FDI all respondents mention first of all better access to financing (50% and 66% for two types of respondents), also changes in taxation (52% and 65% accordingly), increase in transparency and liquidity (80% and 66%) and simplification of transaction process (35% and 32%). The latter might be connected with a question of structured deals usage, discussed previously in this chapter.

### 6.6 Summary of results

The main findings obtained through the empirical study of the changes in the Swedish FDI property market during 2000-2010 period can be summarized as follows:

- Dynamics of FDI property transactions and market activities have changed several times during the 2000-2010 period:
  - 2000-2002 - slightly decreased
  - 2003-2006 - mostly increased,
  - 2006-2008 - remained stable with insufficient decrease
  - 2008-2009 - sharply decreased, major back out of the investments
  - 2010 - started taking up
Most of the respondents positively evaluate the dynamics of macro and micro economical conditions in Sweden during the period 2000-2010

The type of investors has changed – now the major category undertaking property FDI in Sweden is property funds

The “geography” has changed – in the beginning of the period UK and US investors were the main actors, now the leading ones are Nordic and German investors

Respondents agree that the cultural issues for FDI in Sweden have improved

Investors indicated that geographical and political diversification became more important for them - behavioural issues gain more weight for FDI decisions

Legal issues have improved – a few restrictions for non-residents were abolished

The market became more sophisticated due to the use of structured deals, but market participants believe that the Swedish FDI market still stays transparent

Most of the market participants believe that during the 10-year period the liquidity and legal issues, business climate, consultancy service, informational efficiency, investment and diversification opportunities of the Swedish FDI have improved

Risk and yield levels have decreased

Access to financing has become worse due to the problems caused by 2008 crisis

Investors have become more long-term oriented and the quantity of portfolio transactions has increased

The focus of the investments has switched to large residential property portfolios and single strategic commercial properties, mostly office

The range of problems has changed - now investors experience mostly difficulties with access to financing and identifying appropriate properties for acquisition

The majority of respondents indicated the intention to undertake FDI into Sweden again

The major improvements, market participants mentioned which could make the Swedish FDI real estate market more attractive for foreigners were the following:

- Improving access to financing
- Increasing in transparency and liquidity
- Changes to taxation regime
- Simplification of transaction process
- Giving investors more/different opportunities compared to those on domestic markets

Taking into consideration the data obtained from market participants it can be said that their view on the changes during the 2000-2010 in mostly positive. In general the economic crisis didn’t reduce the attractiveness of Swedish real estate market.
7. CONCLUSIONS AND DISCUSSION

The main goal of the current research was to provide an insight about recent investment situation in the Swedish real estate market for FDI and analyse the changes which have taken place during the 2000-2010 period, in terms of conditions for cross-border investments, factors motivating foreign actors and tendencies on the property market.

This study adds to the knowledge about FDI into Swedish property and originates from the prior research in the field started by KTH scholars - Axélsson and Victorin (1999), O’Connor (2003), Arntell and Olfoßon (2004), Falk and Olsén (2009). However, the main difference and contribution of the current research is the attempt to analyze and quantify the changes during the long time-horizon – 2000-2010 period considering both “economical rationale” and “behaviour rationale”. The previous research was more focused on identifying current situation on the market, motives, identifying property transactions for the period. Only one of the studies was devoted to identifying the changes during a long period 2000-2008 (Brisman, Olsén, 2009), but it focused on analyzing changes of the efficiency in the Swedish market and only from the point of view of Portfolio theory, not considering FDI concepts. Behavioral aspects of FDI were previously investigated in O’Connor’s thesis. Furthermore authors of the mentioned studies have neither presented the results separately for investors and companies providing investment services/advice, nor outlined any changes in the opinions of these two groups of market participants.

Another difference of the current research is in limitations – previous studies didn’t consider real estate investments related to support of organization core businesses (for example to supply business facilities) and investments related to specific business concepts. This study on the contrary didn’t impose any restrictions regarding investment purposes.

Sufficient changes in the Swedish property FDI market during the 2000-2010 period were caused by the following factors:

- Macro economical issues (interest and exchange rates, inflation, GDP etc.)
- Micro economical issues (property tax, operating expenses, transaction cost etc.)
- “Behavioural issues” – according to investment theories factors like language, business practices, culture, industrial development, policy etc. (Johanson, Vahlne, 1977).

These factors have shifted motives and preferences for FDI investors, and changed their investment opportunities, expectations and extent of interest in the market. The data analysis was based on a range of different FDI theories and took into consideration the following motives of investors when analyzing their opinion about the changes:

- Maximizing return and minimizing risk (Markowitz’s Portfolio theory)
• Ability to get a competitive advantage - economies of scale, market expertise, information, competitiveness etc. (The theory of competitive advantage)
• Gaining due to life-cycle patterns (The Product cycle model)
• Using market imperfections - market opportunities (The market imperfections theory)
• Specific advantages of locating in another country (Production theory)
• Owner-specific, location, internalisation advantages (OLI and Eclectic theory)
• Getting new opportunities in comparison with domestic (Market power approach)
• “Behavioural” rationales - language, culture, policy etc. – (Behavioural theory)

Apart from the motives, highlighted by these FDI theories, investors who came to the country during the 2000-2010 where attracted by specific characteristics of Sweden such as:

• High transparency and liquidity
• Favourable taxation, policy, legislation business climate
• Accessibility of information, business networks
• Low transaction costs
• High quality consulting and legal service

Empirical investigation indicated different changes, such as change of investor type, fluctuations of transaction volume within different time-pieces of 10-year period etc., which are fully presented and analysed in chapter 6. However the main differences from the findings of the previous research are as follows:

✓ Increased difficulties with financing

The issue became important in the aftermath of financial crisis. Considering that now Swedish economy is recovering and banking sector is strengthening the problem is temporary, but it was the main feature for investors during the last quarter of 2000-2010

✓ Higher selectiveness with regards to finding objects

Both investors and banks became more selective regarding the quality and location of target objects. They try to picking the best -performing assets considering the uncertain conditions of the global economy. Increasing price levels are typical for prime properties with long stable lease agreements.

✓ More emphasis is put on diversification

The empirical data proves that geographical and political diversification became more important to investors. This is likely to indicate two changes: first, investors now pay more attention to “behavioural factors”, driving their decision. Secondly, there is a difference from what was going on in the market 10 years ago. In the thesis of 1999 (Axelsson, Vittorin) it was stated, that “diversification is not a primary motive...investors have discovered temporary
opportunities in line with their usual business activities”. Nowadays some investors on the contrary indicate the lack of business opportunities as a consequence of financial crisis. Whereas in the 2003 thesis (O’Connor) it was found that “only one participant in the interviews conducted in 1999 mentioned diversification as a motive for acquiring Swedish real estate, whereas all the participants in 2002 mentioned diversification as a motive”. This is in line with the findings of current study.

✓ The market became more sophisticated

Recently the use of structured deals has increased, but market participants believe that the Swedish FDI market still stays transparent. This is also supported by The Jones Lang LaSalle Real Estate Transparency Index which places Sweden into the highly transparent category.

Other important changes are the decreasing levels of risk and yield, switch of sectorial preferences to residential portfolios and high-quality office assets, higher propensity to participate in portfolio transactions, etc. Most importantly almost all investors have positive expectations with regards to Swedish FDI market and indicate the intentions to invest again.

This research was an attempt to generalise the results of the 10-year period development of the Swedish real estate market for FDI and provide a better understanding of it from the point of view of foreign investors. The empirical results of the study prove that the aim was achieved; however there are obviously some ways to improve and continue this research. There is a number of issues to be further investigated in this area.

It wasn’t expected that the response rate among investors would be rather low. Therefore in the future it might be useful to study investments considering the category of investors. The current study considered many types of companies, not dividing them according to time-line preference, type of investment – strategic or not, sectorial preference, share of FDI in real estate in overall investment volume. This could give different highlights about their motivations and also make the response rate better. Same could be done considering geographical types of investors and their preferences. Investors from one or another country can be more or less likely to invest into Sweden basing on how their country’s property market is correlated with the Swedish. Another issue to explore concerns behavioural theories – as the current study has shown the investors nowadays pay more attention to behavioural factors and supposedly this is one of the FDI theories which explains foreign investors’ choices and strategies better than classical ones.
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