

Prices of one-room flats are defying gravity in places

Aktia



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During the past few years, there has been a property investment boom in Finland. Very low interest rates make property investments attractive. The interest rates for households' bank accounts have been around zero for several years now and the return on Government bonds is negative in many countries. There are no hikes in rates on the horizon. Concurrently, the return on rental income is positive and its steady cash flow creates security. The exceptional tax practice according to which you can deduct the housing company's loan repayments from the taxable income increases the attractiveness of investment properties.

Differences in rental return describe the different risk levels in areas

The average rental return for one-room flats has increased in the entire country.

At the end of 2015, the estimated return was approximately 5.7 per cent in Finland. At the end of 2019, the return had already increased to 6.2 per cent. The rental return is calculated based on the average price per square metre for old one-room flats and the average rent per square metre for old tenancy agreements published by Statistics Finland. The estimated maintenance fees are deducted from the rental return.

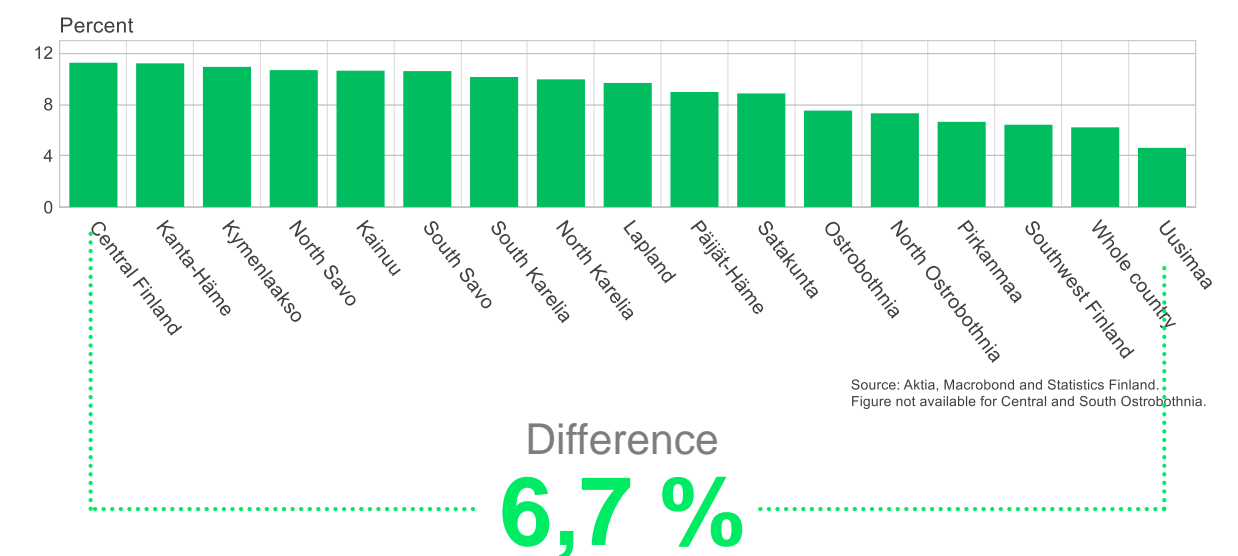
The regional differences in return are significant. The dif-

ference between the highest (Central Finland) and the lowest (Uusimaa) regions in Finland was 6.7 percentage points in 2019. However, return and risk go hand in hand. The significant differences in rate of return reflect the vitality in different regions and hence the investment risks. High rates of return are a consequence of both reduced flat prices and increased rents. Particularly the increased rents seem unsustainable in many areas, considering the population trends.

Rental return



Average rent return of single-room flats in 2019 (net)



The rental market has broken away from the price development of flats

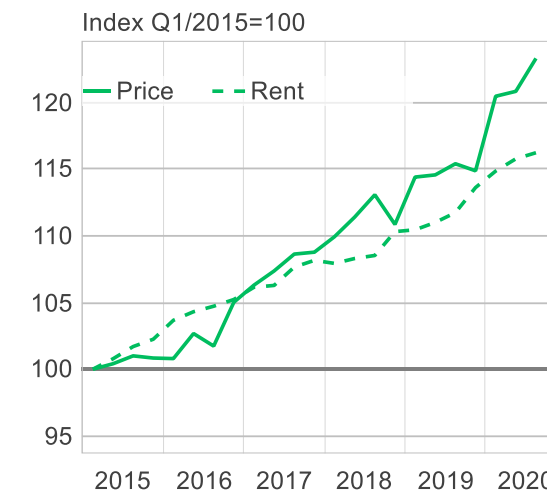
The rents for one-room flats have continuously increased since 2015 both in the metropolitan area as well as in elsewhere in Finland. During the same time period, there have been significant differences in the price development for one-room flats.

The prices for one-room flats in the metropolitan area have since 2015 increased by over 20 per cent, whereas they elsewhere in Finland have increased by only a few percentages. The differences between regions are also vast.

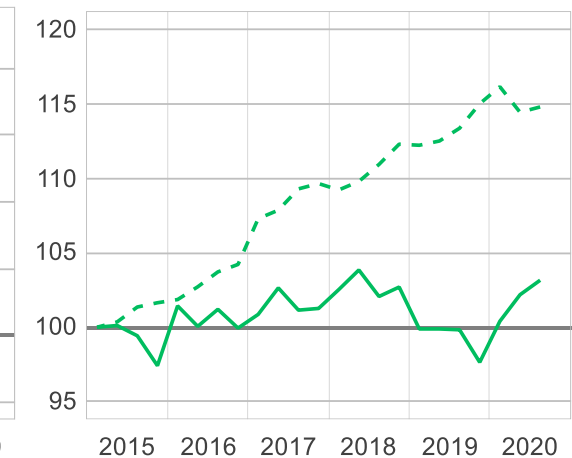
The rents have increased surprisingly evenly. In all regions in continental Finland, rents have increased since 2015.

One could assume that when prices for one-room flats decrease, rents would follow along. However, this has not happened. The development is the same for rental flats in all sizes. The prices for one-room flats have since 2015 clearly increased only in Uusi-maa, Pirkanmaa, Southwest Finland and Lapland. Despite the partially lacking time series, it seems clear that the prices

Prices and rents of single-room flats*
Greater Helsinki



Whole country excluding Greater Helsinki



Source: Aktia, Macrobond and Statistics Finland.
*Q1-Q3/20 preliminary information. Old rent contracts.

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have decreased in nearly all other 14 regions. The most blatant diverge between prices and rents has happened in Kanta-Häme. Prices for one-room flats in the region have decreased by approximately 30 per cent since 2015, while rents have increased by almost 5 per cent. Flat prices and rents cannot continue developing in different directions forever.

Flat prices and rents cannot continue developing in different directions forever.

The rental market has detached itself from the population trends in many areas

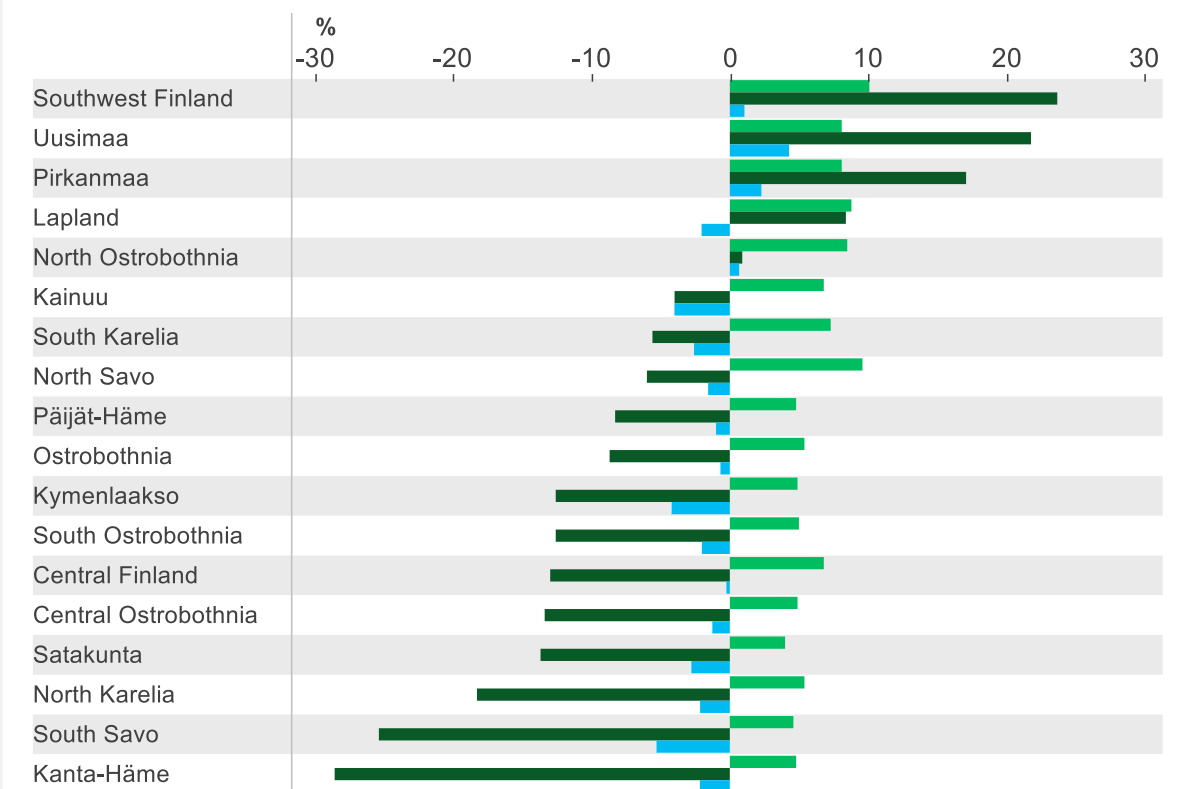
From 2015 to 2019, the Finnish population increased by 0.7 per cent, or in other words by approximately 38.000 inhabitants. The regional differences are significant, which suggests that the urbanisation in Finland has been long ongoing.

The prices for one-room flats seem to follow the population trend well: the prices for small flats increase in regions where the population rises. In regions where the population is shrinking, prices decrease. This is a natural development. As the demand goes down, the prices

for one-room flats decrease. However, flats do not disappear from the regions at the same rate as the population declines. The rental market, however, is developing in a completely different way. Rents increase in all regions, whether the population trend is positive or negative.

Rents, prices and population. Regional changes

- Square meter rents of non-subsidised single-room flats Q1/15-Q3/20*
- Square meter prices of old single-room flats Q1/15-Q3/20*
- Population growth 2015-2019



Source: Aktia, Macrobond and Statistics Finland.
*Q1-Q3/20 preliminary information. Old rent contracts.

Depopulation is an increasing risk for the property investor. It is more difficult to find a tenant than before, and the risk of empty months is higher. Concurrently, the number of empty flats increases. The costs for a flat run monthly in which case empty months eat up the

rental return for an investment property. One might think that renters in regions where the population is shrinking would have to compete for tenants and hence offer lower rents. A tenant who pays a low rent is better than an empty flat.

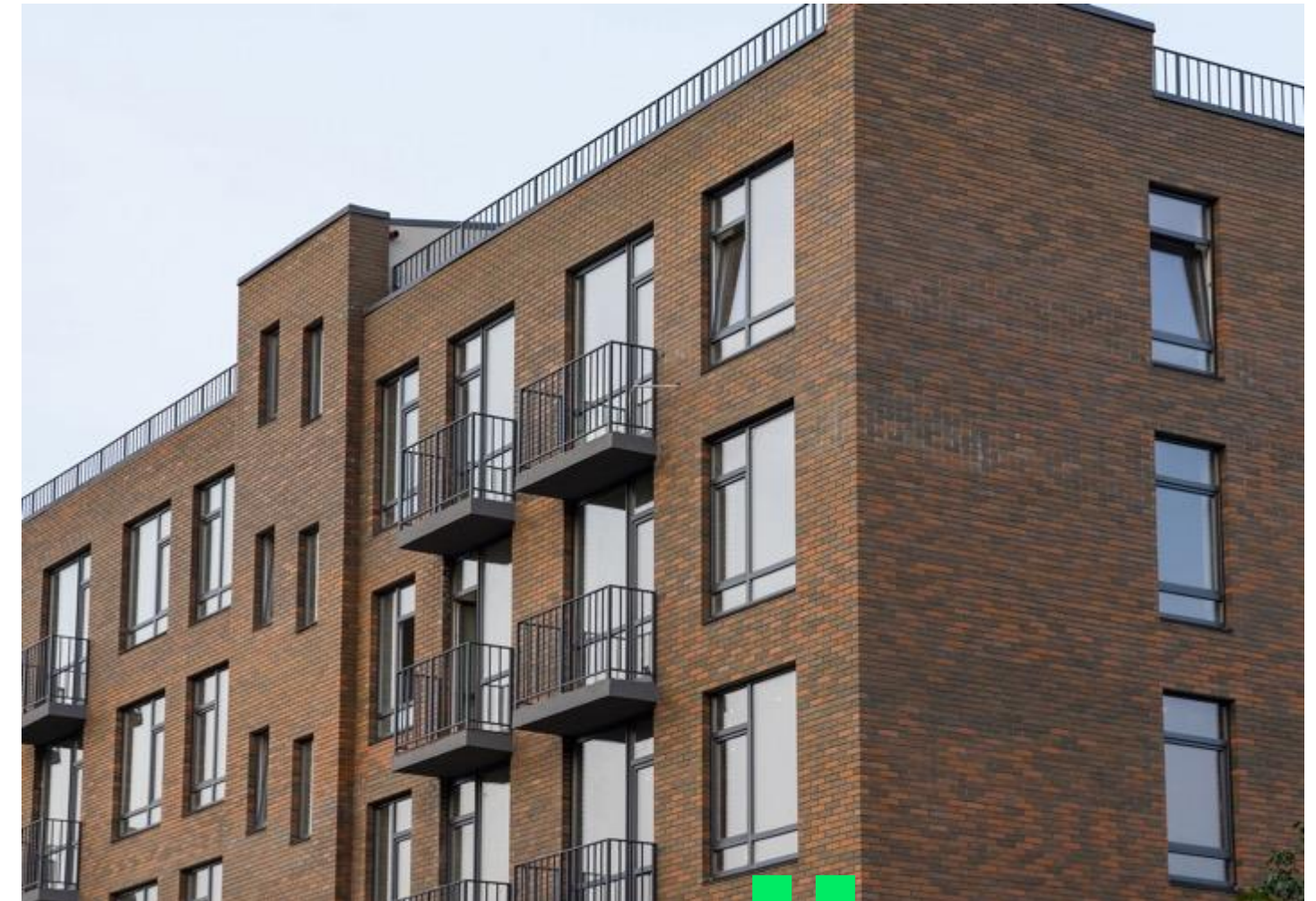
Do expenditure cuts shake the unhealthy rental market?

In 2018, KELA paid out EUR 2.1 billion in housing benefits.

Housing benefits do not affect the level of rent in an unambiguous way but financially the state plays a significant role. Housing benefits as an entity will most likely be considered in the public economy re-balancing measures that are to be expected. The reforms in the system may shake the market for rental homes and restore sustainable development of rents. From the public economy's point of view the development is welcome, if it enables savings.

For the property investor there is a risk involved in this. It is important to be aware of the risk when choosing an investment object. The high rates of return for investments compensate for the risks but in many areas, the level of monthly rent seems unnaturally high considering the development in the surrounding area.

The rental market for one-room flats defies gravity in parts of Finland. Rent increases in all regions, despite the



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population trends. On the other hand, the general prices for one-room flats have for a longer time decreased in municipalities that experience net emigration. However, the long-term sustainability of increased rents should be questioned. If the population chronically is shrinking and the demand for flats is reduced, it is difficult to find grounds for continuously increasing rents.

The long-term sustainability of increased rents should be questioned.



Lasse Corin

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Lasse Corin has functioned as Aktia's Chief Economist since spring 2020 and in this role, he monitors and analyses the development of macroeconomics and the investment market. Lasse Corin has an extensive experience of expert positions in the banking sector and his goal is to focus especially on domestic economy and to discuss how changes in the world economy affect Finland and Finnish households.

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