

## **Development of Brokerage for Commercial Premises in the Finnish Real Estate Market**

**Heidi FALKENBACH and Kaisa LAATIKAINEN, Finland**

**Key words:** brokerage services, rental brokerage, transaction agency, commercial real estate, Finland

### **SUMMARY**

The Finnish commercial real estate market has developed and professionalized notably during the past two decades. This paper discusses the development of brokerage services in the Finnish commercial real estate market both in terms of overall development of the property market as well as the nature of the brokerage services. The study focuses on developments from the end of 1980's until 2007 and has a special emphasis on office market. The analysis is further delimited to include only two core functions of real estate brokerage, rental brokerage and transactions agency.

The findings show that the brokerage services in Finnish commercial real estate markets have evolved markedly within the study period. The development of both of the studied services has been dependent on the general economic environment in Finland. In addition, especially in the earlier part of the reference period, the development of these services has been interdependent, as the services have traditionally been offered by same service providers and individuals, and the role of rental brokerage has been somewhat subordinate to the transactions agency services.

The studied services have also had their individual development characteristics. Although these developments have occurred at different times and with different implications, three predominant trends causing the development, i.e. internationalisation, increasing complexity in decision making practises and the Internet, could be identified.

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## **1. INTRODUCTION**

The real estate brokerage services in Finland are regulated by law. The law on real estate agencies and agencies of leased premises (15.12.2000/1075) defines brokerage services as activities in which for acquiring income or other financial advantage contract parties are brought together for making a contract which aims at transferring the ownership or occupancy right, or creating a lease contract.

The activities of real estate brokers include four core functions (Yavas 1994): the provision of market information, transaction agency, rental brokerage and valuation of properties. In this paper the focus is on the transaction agency and rental brokerage activities, as defined as real estate brokerage services in the Finnish law. To avoid ambiguity in the concepts, in this paper we use the term transaction agency when referring to the brokerage services with relation to purchase or sale of property and the term rental brokerage when referring to the brokerage service which aims at creating a lease contract between the contract parties. The concepts of real estate brokerage and brokerage services, in this paper, include both of the services.

This paper discusses the development of brokerage services in the Finnish commercial real estate market, with a special emphasis on office market. The brokerage services for residential real estate are outside the scope of the paper. The development is described from the end of 1980's until 2007. As there is no extensive literature on the development of brokerage services for commercial real estate, the topic was approached through an interview study. The research methodology applied in the study is discussed more thoroughly in the second section of the paper. The rest of the paper concentrates on describing and analysing the development of brokerage services in the Finnish commercial real estate market. The discussion begins with the overall development of the services and its relation to the general economic development in Finland (section 3.1). Due to the nature of the development of the services, they are discussed here together. Thereafter the following sections (3.2 and 3.3) discuss the special development characteristics for rental brokerage services and transaction agency services, respectively. The fourth section focuses on the developments in the service providers. The final section presents the conclusions of the paper.

## **2. METHODOLOGY**

As there is no extensive literature or framework that would describe the development of brokerage services in commercial property market in Finland or elsewhere, it was decided to approach the research question through an interview study. The reason for choosing interviews was that many professionals, who have been operating in the Finnish commercial real estate market, have views, experiences and conceptions on the topic.

Interview studies can take the form of a structured, semi-structured or unstructured interview. In a structured interview, the form and order of questions are typically predefined. In an unstructured interview, also known as open interview, on the other hand, the interviewer introduces the topic briefly and records the replies of the respondent (Fellows and Liu 2003). According to Hirsjärvi and Hurme (1995), this type of interview is the most appropriate when the experiences of the interviewed persons differ a lot or when events of the past are considered. Semi-structured interviews, or themed interviews, fall between these two. The method is appropriate for outlining experiences, conceptions and expectations of the interviewees related to beforehand-determined themes (Hirsjärvi and Hurme, 1995).

The study was conducted as a themed interview. Two main themes were chosen to examine the past and current development of the brokerage services. The first one was to find out how the service had developed by its nature or content within commercial property market from the end of the 1980's until 2007. The second theme was to clarify which events had affected the development of the service, especially from the demand and supply point of view.

## **2.1 Interviewees**

When selecting the persons to be interviewed, the interviewees' long-term experience in the market was emphasized. This was because it was considered important that the interviewees would have experiences from all, or at least major part of the study period. Both service providers as well as their customers were represented in the group: more than half of the interviewees were currently working for some kind of service provider. The rest of the interviewees' group consisted of investors or persons otherwise closely connected to the service field.

Altogether 30 interviewees were invited to participate in the study. One person refused to participate in the study and in one interview two of the invited persons were present, making the amount of interviews 28. The aim of inviting interviewees with long experience in the field was well achieved. 45 per cent of the interviewees had been working within the commercial property market for at least 20 years.

## **2.2 Method for processing and analysing the interview data**

The analysis method applied for discussing the results is data based content analysis, which is a basic analysis method suitable for all traditions of qualitative research. All interviews were recorded and after that a three-phase analysing process, consisting of (1) reducing (2) and grouping the data and (3) creating theoretical concepts as described by Tuomi and Sarajärvi (2004), was conducted.

### **3. DEVELOPMENT OF BROKERAGE SERVICES IN FINNISH COMMERCIAL REAL ESTATE MARKET**

This section describes the development of brokerage services in Finnish commercial property market based on the interviews conducted. The discussion is divided in three parts, the first one (section 3.1) focusing on the development of brokerage services in relation to general economic developments. The following parts discuss the individual development trends in rental brokerage (section 3.2) and transaction agency (section 3.3) services, respectively.

#### **3.1 Development in relation to general economic development in Finnish commercial real estate market**

Throughout the reference period, the development of commercial brokerage services has been dependent on the development of the commercial real estate market in general. The development of leasing brokerage has been dependent on the success, or better said failure, of the transactions market.

Finnish economy was growing rapidly at the end of the 1980's and the commercial real estate market was characterised by active investment. The investment market of the time was dominated by a small number of large Finnish institutions, and the market was characterised by all the actors knowing each other as well as the properties in the market. Even when there was no special need for transaction agency services in such a small market, the services were available. Those interviewees who had worked in transaction agency at that time, however, acknowledged that the service was not very professional in those days. It was described to be more of an extension of housing brokerage and it was done in the spirit of "bigger sales and bigger fees". Consequently the reputation of advisors was not necessarily that good compared to the one of today's advisors.

The transaction advisors' way of working in the booming market was characterised by "hawking", as described by of one experienced service provider. Usually the owner decided to sell his property at some given price and commissioned several agents. None of them did the preparatory work properly but rushed to sell the property in the same style as products are sold in food market or fairs. Thus no one led or managed the project.

During the economic boom, there was almost no vacant office space available in the rental market and also most of the new developments were occupied immediately. In addition, the rent levels increased constantly. (Karakozova 2005, p.4.) Partly because of the active investment market, leasing was often considered a sort of a side business for brokers at that time. Moreover, the status of a tenant was perceived in a very different way than in 2007: the real estate owners did not regard tenants as customers.

The economic boom came to an end in 1990, and a severe recession followed. The GDP growth collapsed from +5.4 % to -6.5 % in 3 years, and the unemployment rate was extremely high (Honkapohja and Koskela 1999). In property market this meant a dramatic decrease in property values, rents and development activities. (Karakozova 2005, p.4.) The

success of transaction agency services crashed due to the recession when the transaction volume was non-existent and not much of agency services were needed. The transactions during the recession were mainly liquidation sales, in which also the transaction processes were very simple.

The recession period made real estate owners and investors see the status of the tenant from a different point of view and the importance of tenants was acknowledged. The recession period raised the rental brokerage services from the role of a side business to agents' main business from 1992 till the middle of the 1990's. The motivation for this, however, was not the change in broker's appreciation of tenant, but rather a constraint: agents did not have much else to do. No one wanted to buy real estate and, moreover, none would finance it.

Gradually, at the end of the 1990's, business and trading started to pick-up again. More and more attention was paid to real property and a lot of professionalisation happened in many sectors, including the transaction agency services. In the end of the 1990's the financing-led property trade started to increase again and the first transactions of property portfolios were conducted. In 1997 international investors had already entered the Swedish property market, and from a know-how point of view, the Swedish property market provided Finnish advisors with a window onto a market that was already developing towards the European real estate market. It was seen that the know-how related merely to real estate would not be enough any more, and that banks, financing and investment logic would become more important in a new way. With the high transaction volumes of the 2000's, leasing started again to some extent to lose its appeal among the brokers.

### **3.2 Development of rental brokerage service**

Interviews indicated that the development of rental brokerage service has been quite stable during the reference period, i.e. from the 1980's until 2007. The most dominant description used by the majority of interviewees for the development of the rental brokerage services was that as a service it has not changed significantly but remained rather constant as regards the basic work. Some considered this even surprising, as according to them there would have been more development possibilities.

However, the interviewees drew attention to the fact that the service for rental brokerage has become more systematic and professional than it was at the end of the 1980's or in the beginning of the 1990's. Some investors, on the other hand still argued that even nowadays the quality of the service varies. According to them some brokers operate within short time spans and are not very effective, whereas it was still agreed that some brokers do their job well.

The internationalisation of Finnish commercial real estate market has involved new requirements to rental brokers. The ways of action of international investors and tenants may differ from the ones of Finnish players, which means that these new ways of working need to be adopted by the Finnish service providers. Also rental agreements of commercial premises have undergone some modifications. Firstly, the language of agreements used to be Finnish.

Nowadays it is often English. Secondly, as the agreement used to be one tenancy agreement form with only one appendix – the floor plan, it can now be similar to these days deed of sale.

The interviews indicated that one thing which has affected the rental brokerage business is the introduction of asset management organisations at the end of the 1990's. As a result chains of parties have become longer and more complicated. According to the interviews the process of leasing premises has evolved in stages. In the past, the property owner and the tenant found each other by themselves. The second step of development introduced the agent who took care of organising the leasing process. This intermediate role evolved in the 1970's. The phase remained the same for some twenty years. The introduction of asset management organisations complicated this: now in the chain between the customer and the owner is first the broker and then the asset management organisation and the chains are even more branched and complicated.

Even though the basic work in rental brokerage has not undergone any significant changes, development has occurred through some individual features of the service, changing the ways of working and means of doing it. The most profound changes have occurred in commissions as well as marketing and communications. These changes are discussed in the following sections.

### 3.2.1 Changes in commissions

In the eighties commissions of rental brokers in Finland were exclusive, i.e. the owner of premises assigned only one rental broker, who then had exclusive right to find the tenant and receive the brokerage fee. In addition the owner might do the leasing himself. This method of working has changed so that now owners use several agents simultaneously. Thus agents compete with each other and the one who succeeds in finding the tenant gets the fee.

In Finland the traditional model for rental brokerage has been that the agent presents the owner's case. As there is no contract between the tenant and the broker, the tenant also has no formal power over the broker or his actions. The globalisation and the entry of foreign tenants have led to the introduction of tenant representation. In tenant representation the broker represents and advocates only the tenant's interests (Morris, 2000). Tenant representation, or tenant-oriented brokerage, emerged in U.S. already in the mid-to-late 1980's (Morris, 2000), but is not yet widely used in Finland – especially not among Finnish tenants. This is, however, expected to change. For example in Sweden this model is more common. However, even in Sweden this service is still quite undeveloped and very few companies provide the service (Anop and Kharlamova 2007, p.39)

Interviews indicated that the role of rental broker has provoked a lot of discussion recently. Traditionally the rental broker has had a contract with the owner of a property and the owner pays the fee to the broker when the broker finds a tenant for the premises. However, when looking for a tenant, the broker has also to keep the tenant's interests in mind because the potential tenant (user) wants to have premises that are the best from his point of view. When a tenant contacts a broker and wants to find rental premises, the broker looks for the most

optimal premises from the database that lists all commissioned premises. Thus the broker serves the user too - even though the user does not pay anything to the broker. This results in a bit two-sided and somewhat contradictory situation. It also poses a question as to whether the broker can or should be expected to satisfy both the owner and the tenant.

If the agent works on the tenant's behalf, there will not be any conflict. In that case the broker serves only one client, the tenant, and makes the owners of premises compete with each other. In the traditional broker's role, where the broker is commissioned by the owner, the broker cannot make the premises compete with each other, as he only acts as one marketing channel for the owners he represents. Interviews suggested that this may be one major difference between Finnish and more developed market. The difference is also expected to reduce gradually to some extent as tenant representation becomes more common.

### 3.2.2 Marketing and communication

Most of the interviewees agreed that the introduction of the Internet has been the most important factor for change as far as rental brokerage service is concerned. It was estimated that effective use of the Internet has been adopted during the six last years – from the year 2002. It is used as a way of marketing and tenants use it as a way of searching for information and for vacant premises. There are search services that cover thousands of vacant commercial premises to be sold or leased. The importance of the Internet is related to the fact that it is close to its user. It has enabled the users to start the searching process without the need to contact an agent straight away. Nowadays people are used to processing information by themselves. Service providers are aware of this, even though some of them are still quite concerned that in this way users may also waste time. While earlier phone books were used, nowadays many users make contact with a consultant by some link in the Internet. For this reason, investments in data systems are considered essential by brokers. Some stated, though, that the Internet is only a supporting channel which should not be relied on totally. However, the fact is that rental brokerage is already to some extent and will be more Internet-based.

Also marketing methods have undergone significant changes over this period. Traditionally, marketing was done by newspaper advertisements or street advertising. Electrical means of communication have changed everything. In addition, the technical development has involved some new features concerning real estate services. For example, advanced desktop publishing programs have prepared the way for impressive brochures. More developed marketing methods also enable mass marketing which is considered very important.

### **3.3 Development in the transactions agency**

As described in section 3.1, the development and activity of the transaction agency has been dependent on the external market environment, a factor that has been found effective also in explaining the business performance in housing estate agency (Ke 2008). In Finland, the first international commercial property investments were conducted in 2002, the internationalisation being thereafter rapid. In the changed international transaction environment also the agent's way of working has undergone significant changes. This section

thus focuses on the changes that have occurred as a result of the internationalisation, focusing on the content of the service, commissions and materials produced.

The transaction agency service at end of 1980's could be described as amateur, whereas the service of the mid 1990's could be described as simplified. Lately, the nature of the service has developed from agency towards advisory, and also the service providers refer to themselves as transactions advisors, rather than transactions agents. Nowadays the skilled advisor makes a transaction a project with proper materials, a fixed schedule and a defined target group. Especially, in cases when an informal bidding competition is organised for the property, the seller's agent cannot operate without exclusive right.

The role of the agent can be approached from two different points of view: whether the advisor is acting for the vendor or the buyer. Acting for the vendor, the agent gets a commission of organising a transaction of one property or a portfolio that contains several properties. An information memorandum is compiled and distributed to those investors that are expected to be interested in the object in question. Interviews suggested that during the booming transaction market in mid 2000's, the number of invited bids might have been as high as 180. The agents take responsibility of organising vendor's due diligence: data is organised in such form that the buyer can reliably access it and is able to make an offer based on the information. The object related data is often compiled in an internet-based data room, which accelerates and increases the availability of information. On the buyer's side the transaction agent represents the buyer. The agent provides the buyer with up-to-date market information, participates in transaction negotiations and controls the due diligence process. The agent may even organize financing. The assignments of the agent depend on the mandate given by the buyer

According to the interviewees the entry of international investors and service providers has involved using advisors on both the vendor's and buyer's side. This has also become more and more common, and also the supply of the service has increased markedly. When the interviewed service providers were asked whether there is any difference between their foreign and domestic customers, the most common answer was that domestic customers do not give buying commissions as frequently as foreign ones. If the buyer is foreign, it almost always uses a transaction agent, whereas a domestic vendor does not necessarily use one – although this is expected to change gradually. Some stated that there have been cases where vendor's own resources have not been enough; if the buyer uses lawyers, accountants and technical and environmental experts, the vendor may notice that it can not manage the whole process alone, even if it had intended to do so.

As regards the current quality of transaction agency service, many investors as well as service providers acknowledged that the overall quality has improved a lot. There are still differences in the professionalism and in the quality of reports among service providers. Some stated that the quality level of service providers has evened out since poor players have been eliminated. However, some unfavourable development has recently been observed on account of the extensive use of processes similar to company transactions. The interviewees stated that it is no use making extensive vendor's due diligences in cases where it is obvious that no surprises



are to be found. Such a case could be, for example, a transaction of a minor new property with a newly established real estate company. Advisor should be able to see whether extensive surveys are needed or not. Neither it is worthwhile to conduct the transaction process as a bidding competition in every case. In addition one investor agreed that investors should also be professional enough to be able to clearly define what they want; as service providers naturally are eager to provide their services as widely as possible.

The material produced by advisors must without exception be of high quality. The requirement level has increased since internationalisation. Interviews indicated that the difference between nowadays materials, for instance information memorandums, compared to their quality 15 years ago is significant. Today information memorandum has to be so good that every investor could make an indicative offer without travelling to Finland. When also due diligence is done by vendor, investors can rely on the cash flows and see all the essential risks and possibilities. From this point of view many interviewees considered the transaction agency service to be on as a good level as in the company transactions at the moment. Also the process has to be similar and advisors have to think in the same way as in company transactions. However, some investors argued that nowadays information memorandums are sometimes too detailed and extensive, and that they contain also lots of unnecessary information.

Interviewees indicated that the quality level of transaction agency as regards smaller objects has increased as well. Interviewed service providers agreed that there has always been and still is the need for transaction agency business for objects with a value that varies between 5 to 10 million euros. Also private investors and end-users are involved in the investment market for these properties. Competition in the field, entry of new players and internationalisation raises the required quality level. Regardless of the value of the object, advisors' working environment is not the same as before: more skills and effort are now required.

#### **4. SERVICE PROVIDERS**

Earlier, the brokerage market was characterised by less specialisation than today. Real estate agencies were brokers for both the premises that were to be sold and those to be leased. It was also common that the same agencies dealt with both commercial property and residential brokerage. Even though in some companies there were separate departments for commercial and residential properties already in the 1980's, the service provided included both the transaction and rental brokerage. Growing specialisation has been a significant development feature of the service. Nowadays there are companies who are specialized only in rental brokerage of commercial properties or only on transactions agency. The field of brokers consists of both large, full-service providers who provide the leasing of commercial premises as one of their many services, and small, specialized companies who do nothing but rental brokerage. A typical feature of rental brokers is and has been that most of them operate regionally since the rental market is regionally focused as well.

The interviews suggested that many consultants, who are not specialized merely in rental brokerage, are not particularly interested in rental brokerage or at least not in the rental brokerage for small premises. During the time the interviews were conducted, the Finnish transaction market was booming. In this situation many consultants felt that it was preferable to concentrate on transaction agency services, which at that time were a more profitable business. Many interviewees considered this somewhat alarming, since after all, the whole real estate market is dependent on the tenants.

As suggested by Ball (2007), commercial real estate brokers tend to specialise in some particular business segment within the commercial real estate market. In Finland, the segment for leasing of shopping centre premises has diverged from the leasing of other type of commercial property, for example. The agents for leasing shopping centre premises are mainly different since chains of trade do not work with real estate agents. Instead they cooperate with consultants of trade who represent a totally different and a minor group. This group consists of small players, companies of one or two persons. Interviews indicated that these players conduct the business from the same point of view they always have. Therefore, as a service sector, rental brokerage of shopping centre premises in Finland was described as totally undeveloped and further development was expected.

#### **4.1 Transaction agents in the Finnish commercial property market**

The service provider field of transaction agency service in Finland has undergone significant changes in the 2000's. The supply of different types of transaction agency services has increased rapidly in recent years. The providers include both management companies and some specialist service providers. As a result of the development of the Finnish property market new companies have been encouraged to enter the market. Currently it consists of a varied mixture of small domestic entrepreneurial firms as well as big global companies. (KTI 2007.)

In line with the observations in other European cities (see de Magalhães 2001), the majority of international service providers entered the market during the investment boom period and the beginning of international interests in Finnish commercial real estate investment market. Before the internationalisation of property investment market, there was in practise only one big international service provider in the Finnish property market, Catella. Since 2004 large international brands have entered the market, among others DTZ, GVA, Jones Lang LaSalle, CB Richard Ellis and Cushman & Wakefield.

A significant development feature as regards the providers of transaction agency service in Finland is the entry of investment banks and corporate finance teams in real estate business. Thus an agent is no longer just a broker or an expert in real estate but also an expert in company transactions who structures the deals as well as their financing. It was described in the interviews that investment banks have been able to see the looseness in competition and therefore possibilities in the agency service market and stepped in to fill the gap. As a result they have become one of the leading advisor groups in property transactions. Moreover, the

global business consultancy firms, for example KPMG and PricewaterhouseCoopers are strengthening their real estate specific services in Finland. (KTI 2007.)

The transaction agency market is currently characterised by tough competition. Advisors need to compete for their customers. A field survey of The Finnish Association of Building Owners and Construction Clients (RAKLI) indicated in 2005 that the operation of financial advisors and agents is based on long-term customer relationships and trust is a prime factor for their operation. Thus even though competition in the field is tough customers do not usually call for bids before giving the assignments. The field survey of RAKLI was based on research with a representative sample of transaction advisors. (Rautio 2005.)

#### **4.2 Field of rental brokers**

The field of rental brokers has seen a change in Finland and the number of brokers in the sector has increased. Even though outsourcing is an overall trend, real estate ownership has become more professional and many real estate owners have their own organisations to take care of the leasing of premises. It was estimated by the interviewees that the amount of this activity has grown a lot. However, it was also stated that at least in the Helsinki metropolitan area, the provision of rental brokerage service can be profitable business for those who specialize in and concentrate on it.

There are a number of agents that have been working within brokerage market in Finland since the end of 1980's – from the beginning of the reference period studied – but in addition the field has seen a lot of new brokers emerging. The change has partly happened through corporate acquisitions and mergers. The internationalisation of commercial real estate service sector, as also observed by e.g. Ball 2007, has led to the arrival of international agents also in the Finnish commercial real estate market.

The interviewees emphasized the importance of electronic data-processing systems, an essential element of these days' rental brokerage services. The data about leased objects are stored in data processing systems. A company may have for example 100 clients who have given 1000 objects to be leased. For each object all the facts, for instance photos and ground plans, are stored. Nowadays merely maintaining this data often requires a considerable amount of resources.

The change and development of the market has resulted in the consolidation of consultant companies. Even though rental brokerage was formerly widely done by private individuals or small players, there were some strong opinions among the interviewees that, because of consolidation and growth in market volume, exclusion of small companies ensues. Those companies who survive the continuous change of the market need to invest in information technology and mass marketing. These requirements may be problematic for small players. It was considered by many that small players might succeed by being niche players or by monopolising some submarket.

## 5. DISCUSSION AND CONCLUSIONS

The brokerage services in Finnish commercial real estate market have evolved markedly during the past 20 years. The overall development of the services has been highly dependent on the overall economic development of the country. In addition, the development of transaction agency and rental brokerage services has been interdependent, as the services have traditionally been offered by same service providers and individuals, and the role of rental brokerage has been somewhat subordinate to the transactions agency services. The late developments in the brokerage services have, however, included specialisation within the field, which could lead to the weakening of the link between the popularity of transactions and rental brokerage.

In addition to their development depending on the general economic environment in Finland, the transaction agency and rental brokerage services have also had their individual development characteristics. Although these developments have occurred at different times and with different implications, we can identify at least *three* predominant development trends affecting the services. First of all, the internationalisation of the Finnish economy, both in general as for investment market, has changed the ways of behaviour as well as content of the both services. Services are today provided in a European style, including an increase in documentation, and are also more commonly provided in English. Also the field of service providers has internationalised, which has supported the implementation of international business practises.

A second profound change has occurred in the increased complexity of decision-making practises and number of parties involved in the business. In rental brokerage the commissions used to be exclusive, but have evolved towards non-exclusivity, whereas in the transaction agency services the development regarding commission has been reversed. In both services, however, the commission used to be typically with the seller or the owner of the property, and the representation of the other party, the tenant or the buyer, has gained popularity only during the recent years.

The effect of the Internet has been significant especially in the rental brokerage services, where the marketing and communication is transferring to an online service. In the field of service providers, this has put pressure on small companies and led to some consolidation in the field. The effects of Internet in the transaction agency provision have been more limited than in the rental brokerage, but also as in the brokerage services increasingly for residential real estate. Today, the Internet is utilised by transaction advisors for marketing of their own services as well as in the sharing of data rooms.

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