MarketBeat

Q3 2018
Norway

CUSHMAN & WAKEFIELD | Realkapital

Overall Economy

The general economic outlook is healthy with 2018 GDP growth forecast to land at 2.4%, up from 2% in 2017. Growth continues to be domestically driven - partly by increased consumer purchasing power. Tighter mortgage regulations introduced in Q2 2017 after record residential price increases in 2016 led to a fall in house prices in 2017. However, this trend has now reversed with prices having recovered to Q1 2017 levels. The unemployment rate remains low and companies continue to have a positive view on the economy.

	GDP MAINLAND GROWTH (1)	INFLATION Y/Y (1)	UNEMPLOYMENT (2)	10Y SWAP (3)	KEY POLICY RATE (4)
2017	**2.0%**	**1.8%**	**4.9%**	**2.0%**	**0.5%**
2018E	**2.4%**	**2.1%**	**3.8%**	**2.2%**	**1.0%**

Labour Market

The unemployment rate remains low at around 3.8% and is expected to remain stable going forward due to an overall strengthening of the Norwegian economy. Norway, as a net oil exporter, is impacted by the price of crude oil, hence the 40% price increase seen since mid-2017 has given the employment market a further boost. Oil and gas investments are expected to increase going into 2019 which again is good news for the labour market.

The residential real estate market saw a downwards correction in 2017 following the 2016 boom but since January this year prices have gradually increased and are currently on a par with Q1 2017 prices. This results in higher activity in the construction industry and again, good news for the labour market.

Inflation

Inflation dropped throughout 2017 and was expected to remain well under Norges Bank's target rate of 2-2.5%. However, inflation has increased during the first two quarters of 2018 and currently stands at 2.8%. The strongest drivers behind the increase are food prices, electricity and hotels/restaurants. It remains to be seen if this is a short-term or sticky increase. Even with an improving labour market some slack in capacity utilisation remains and results in modest pressure on wages and thus less inflationary pressure.

Key Policy Rate

The key policy rate has been unchanged since Q1 2016 at 0.5% and the Norwegian central bank has indicated that it expects to see the first increase in the fall of 2018 if the economy continues to grow as expected. Expectations as to the longer term are that by the end of 2020 the central bank sees the key policy rate at 1.6%, which is marginally up from its previous guidance, mainly due to higher interest rates in the United States, a strong employment market and increased inflation.

Source: *Oxford Economics (1), SSB (2), SEB (3), Norges Bank (4)*

Capital Market

The strong cycle continues into 2018 with a high level of capital targeting commercial real estate from both domestic and foreign investors (the 80/20 split remains stable). Among international investors, Sweden-based investors are dominant and account for about half of the purchase volume. So far in 2018, the investments have been relatively even spread between office, retail and industrial which is somewhat unusual. The office segment which in 2017 account for nearly half of the volume has slowed down in 2018, accounting for only about 30% so far. Retail, including the Scala & Salto merger, and logistics account for 20-25% each.

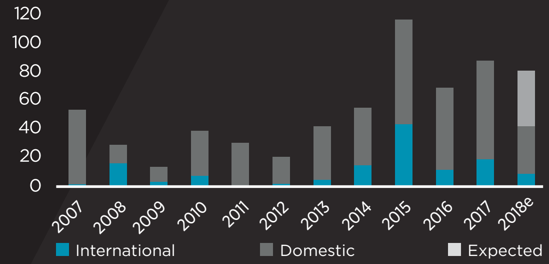
Activity was somewhat lower than most expected in Q1 but has since picked up. Volumes at the time of writing are now on a par or higher than our expectations for the year as a whole, given the normal seasonality in transaction volumes. Not surprisingly, Oslo and the surrounding area have seen the largest volumes.

The prime office yield has been stable over the last quarter with a few submarkets decreasing. Beyond prime, and unable to source core assets, investors are continuing increasingly to accept additional risks, resulting in an acceleration in yield convergence.

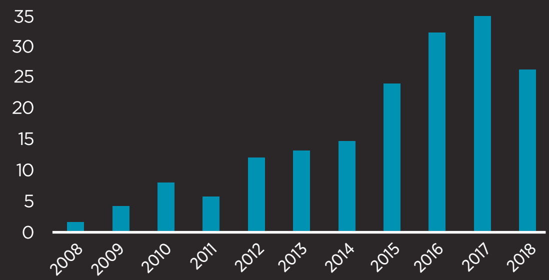
According to a survey of banks' real estate lending practices borrowing terms offered are reported to have been tighter nearly every quarter from mid-March 2014 to mid-2017. However, so far in 2018 lending practices are reported to be unchanged, despite expected volume increases.

Over the last few years the bond market has been an important factor within the financing market for commercial real estate due to less traditional lending from the banks. After a record year in 2017 the bond market is expected to remain strong in 2018. In fact at the time of writing it accounts for approximately 60% of total commercial real estate financing and thus is expected to surpass the 2017 record. The costs of financing are still low, but interest rates have risen and margins have fallen, reducing the profit for both banks and bond investors.

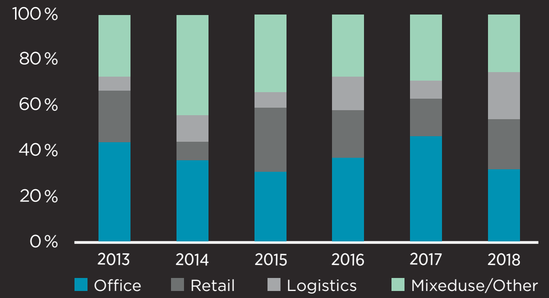
Transaction Volume NOKbn



New Real Estate bond issues in Norway NOKbn (5)



Type of Transactions



Source: *Nordic Trustees (5)*

The Oslo Office Rental Market

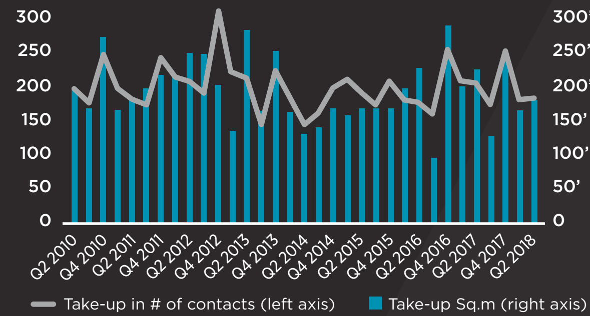
The letting market in Oslo still favours lessors. The vacancy level is continuing to drop and now stands at 6.7%. Macroeconomic factors such as declining unemployment, GDP, employment and population growth have been positive, resulting in strong demand for office space. Overall, there is lack of new build activity and the demand for office space is leading to a fall in vacancy and putting upwards pressure on rent levels going forward.

For the fifth consecutive quarter rental prices in Oslo have reached record heights. According to Arealstatistikk the average rental price in Oslo for Q2-2018 is 2,230 NOK/sq.m, an increase by 6% from Q1-2018. The rent level for category A space (15% highest price per sq.m) in the CBD is 5,160 NOK/sq.m, an increase of 9% during the same period. Furthermore, rents rose in almost all office clusters, even though the city center including the CBD had the most significant increase in rents.

Nine new office buildings totalling 115,000 sq.m are expected to be completed in 2018. Almost all these buildings are fully let, substantiating the strong demand for new build space with proximity to a transportation hub. However, a modest 65,000 sq.m of new office space has been confirmed for 2019, and this number will likely remain unchanged since construction time for a new build is between 18 and 24 months. From 2020 and onwards several large office projects have already been confirmed and this, seen together with greater adoption of agile- and co-working, the switch from manpower to technology and increased utilisation of office space, could have a longer-term dampening effect on rents.

The vacancy level has fallen by 0.5% to 6.7% during the last six months. This drop is in part due to strong demand for office space, but is mainly due to few office projects being completed. Low new build activity is thus contributing to mid-term vacancy remaining low and as a result rent levels continue to increase in the short to medium term.

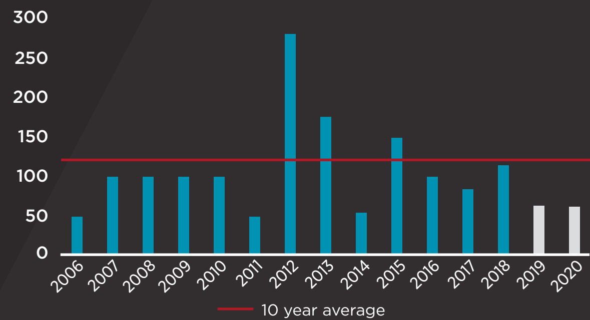
Take-up, Oslo (6)



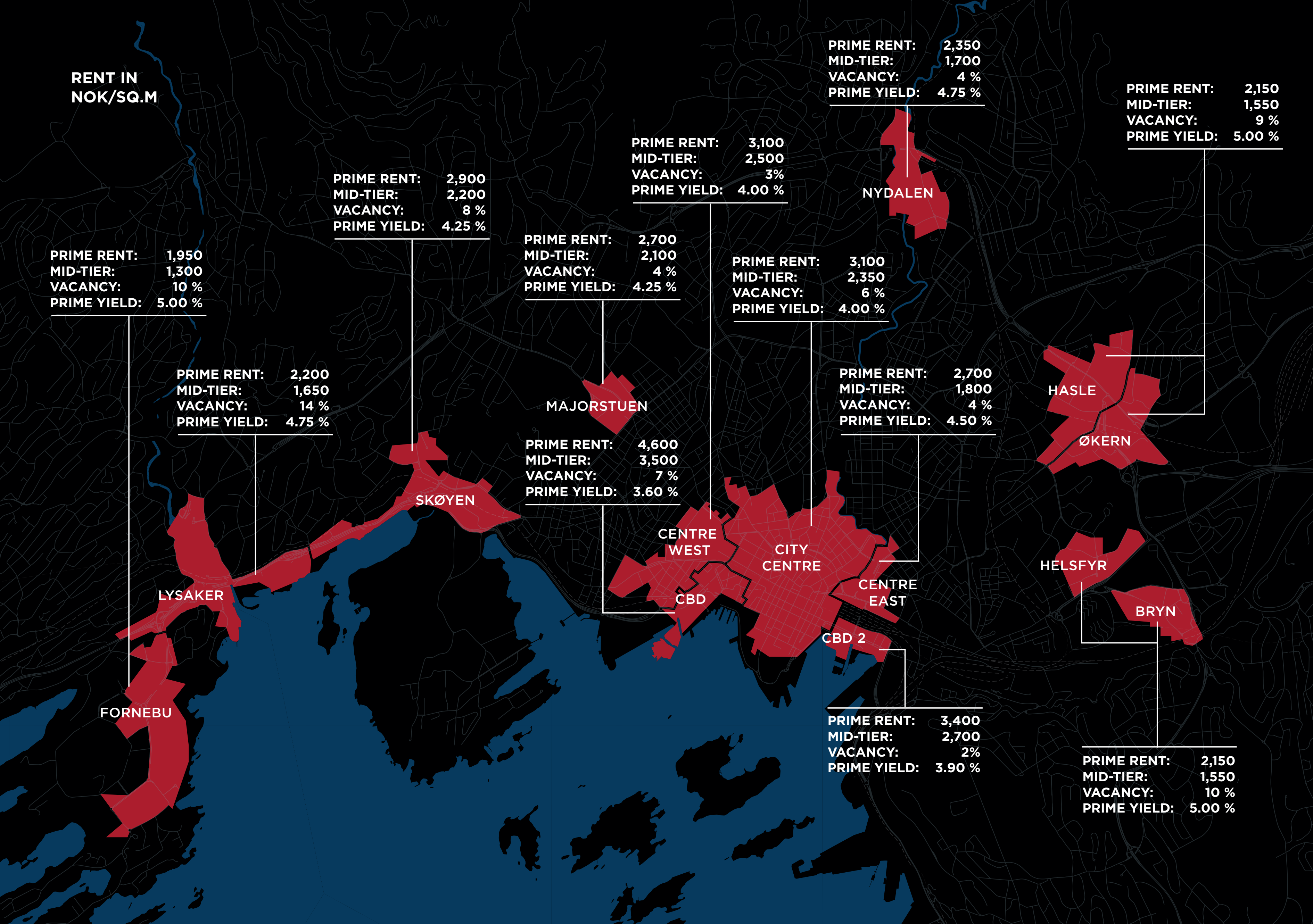
Office Projects 2018, Oslo

Project name	Main tenant	Sq.m	Developer	Let
Vitaminveien 4	Directorate of Health	24,000	Skanska	100%
Drammensveien 151	Orkla	19,500	Orkla	100%
Diagonale	TV2	16,250	HAV Eiendom	100%
HasleLinje	Securitas	13,000	Höegh Eiendom	100%
Schweigaardsgt. 33	Bane NOR	12,000	ROM Eiendom	100%
Grenseveien 80 - 82	Omsorgsbygg	11,000	BundeBygg	100%
Philip Pedersens vei 9	Nemko	6,300	NCC	76%
Hoffsveien 17	Metier OEC	4,500	Fram Eiendom	71%
A14 Bjørvika	EnterCard	4,000	Watrium	100%
SUM 2018		**~115,000**		

Completed Office Stock, Oslo 1,000 sq.m



Source: *Arealstatistikk (6)*


RENT IN NOK/SQ.M
PRIME RENT: 1,950 MID-TIER: 1,300 VACANCY: 10 % PRIME YIELD: 5.00 %
FORNEBU
PRIME RENT: 2,200 MID-TIER: 1,650 VACANCY: 14 % PRIME YIELD: 4.75 %
LYSAKER
PRIME RENT: 2,900 MID-TIER: 2,200 VACANCY: 8 % PRIME YIELD: 4.25 %
SKØYEN
PRIME RENT: 2,700 MID-TIER: 2,100 VACANCY: 4 % PRIME YIELD: 4.25 %
MAJORSTUEN
PRIME RENT: 4,600 MID-TIER: 3,500 VACANCY: 7 % PRIME YIELD: 3.60 %
CBD
PRIME RENT: 3,100 MID-TIER: 2,500 VACANCY: 3% PRIME YIELD: 4.00 %
CENTRE WEST
PRIME RENT: 3,100 MID-TIER: 2,350 VACANCY: 6 % PRIME YIELD: 4.00 %
CITY CENTRE
PRIME RENT: 2,350 MID-TIER: 1,700 VACANCY: 4 % PRIME YIELD: 4.75 %
NYDALEN
PRIME RENT: 2,700 MID-TIER: 1,800 VACANCY: 4 % PRIME YIELD: 4.50 %
CENTRE EAST
PRIME RENT: 3,400 MID-TIER: 2,700 VACANCY: 2% PRIME YIELD: 3.90 %
CBD 2
PRIME RENT: 2,150 MID-TIER: 1,550 VACANCY: 9 % PRIME YIELD: 5.00 %
HASLE
ØKERN
PRIME RENT: 2,150 MID-TIER: 1,550 VACANCY: 10 % PRIME YIELD: 5.00 %
HELSFYR
BRYN

Outlook

As mentioned the cycle continues to see an extraordinary level of capital targeting real estate and according to the Cushwake Investor Confidence index Q3 2018 (CICI) 2 out of 3 of all investors have an objective to be net buyers, partly driven by expectations of a further increase in occupier demand and a consequent rise in asset values. This reinforces the view that H2 2018 will continue on the same path as laid down over the last few years, with yields at low levels and investors facing challenges to deploy capital and achieve their desired returns.

The market consensus (ref. CICI and Entra's Consensus report) suggests office yields have levelled out and will be unchanged in the near future. On the other hand, CICI recorded a dramatic shift in retail where nearly half of all investors now expect an increase in retail yields during the coming six months. However, there is a more positive sentiment when it comes to logistics yields. As e-commerce fears are hitting bricks-and-mortar retail, industrial and logistics assets represent a credible diversification alternative for investors.

Given the substantial investment appetite, and prevailing shortage of assets, we expect to see continued greater acceptance of risk and more investment schemes targeting alternative real estate asset classes.

The letting market favours lessors and there is general agreement that it will remain strong on a 1-1.5 year perspective as the supply/demand balance suggests continued upward pressure. CICI supports this view with above 60% of investors expecting a further improvement in demand from office occupiers. However, forecasters have a more mixed long-term view given a combination of development catch-up, greater adoption of agile- and co-working, the switch from manpower to technology and increased utilisation of office space.

CICI reports that most investors expect retail occupier demand to move sideways, but we have also seen a growing minority expecting a decline in demand. This will be an area to follow with interest over the years to come.

In short, interest rates and yields have now probably bottomed-out and value gains are expected instead to be derived from a strong and strengthening letting market, which is predicted to continue throughout 2019. Beyond 2019, we might experience returns driven by rent increases to be offset by an increase in yields as interest rates slowly start to rise.

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