

## INVESTMENT MARKET UPDATE

# Capital ready to be placed

Norway Q3 2016

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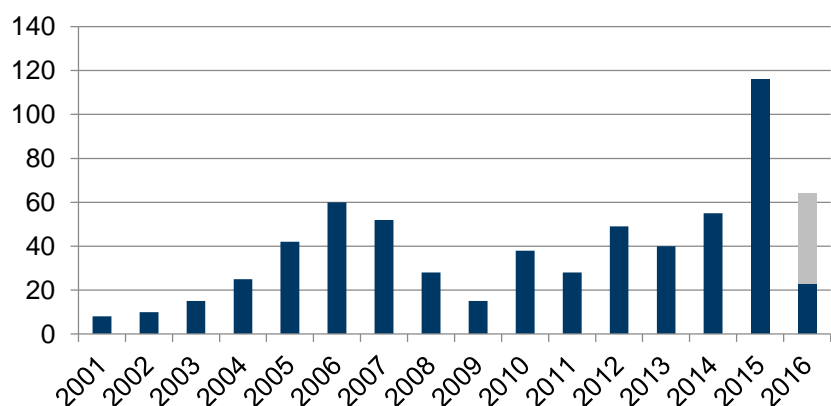
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- The Norwegian real estate transaction volume is for the first two quarters down from 49.6 bNOK in 2015 to 22.9 bNOK. As a more normalized comparison, the first two quarters in 2014 had a transaction volume of 17.9 bNOK.
- Thus, knowing of several large sales coming up the next quarters, this year's transaction volume is presumably going to be the second highest of all time.
- International investors are still active both at confirmed deals (more than 20% so far), but also in the bidding processes of ongoing deals. As an example German investors, now with negative government bonds have an attractive margin when purchasing prime yield offices at around 4%.
- Yield gap has increased marginally since Q4 and remains attractive.
- Borrowing costs for real estate companies have decreased this quarter, due to a drop in the bond spreads.
- The largest transaction this quarter was Norwegian Property ASA's sale of their Skøyen portfolio to Entra ASA. The transaction value was 2 529 bNOK and the yield was approx. 4.7% when considering the 5% vacancy in the portfolio.
- The Central Bank had its second and third announcement of the Executive Board's interest rate decision on 12 May and 23 June. The key interest rate remained unchanged at both meetings at 50 bps.
- A day after the last interest rate decision, the Brexit was announced, sending most European stock exchanges down due to the uncertainty about the consequences.
- Alternative investments in bonds and the stock market remain uncertain and incentivise real estate investments.
- Prime office yield is estimated to 4.00%, and we believe in a widening of the gap between prime and secondary assets.

Figure 1

### Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: DTZ Research



Dyrskuevegen 44, north of Oslo, bought by Catella this quarter. DTZ supported Catella in the transaction

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## Cost of Capital

After four consecutive quarters with decreasing swap rates, Q2 2016 experienced an increase of about 10 bps looking at the mid-May numbers. Simultaneously, bond spreads, which had increased over the same period, experienced a drop of about 30 bps. The change in sum of swap rates and bond spreads indicates that Entra, Olav Thon and Steen & Strøm now have cheaper borrowing costs. Knowing the lending market has become more challenging for smaller companies, this confirms the impression that the gap between prime and secondary is widening.

## Borrowing Terms

The Central Bank's latest survey of banks' lending policy was again stricter than in the previous quarter. The survey measures the banks' relative attitude towards lending to real estate and in general by asking representatives if they are in this quarter more or less strict than in the previous. Figure 3 shows that banks are only a little more restrictive this quarter.

The Central Bank has had its second and third announcement of the Executive Board's interest rate decision this quarter. Keeping it unchanged at the quarter's first meeting, the market expected the rate to remain unchanged at the second meeting, having in mind UK's vote on stay in or leave the EU the same day, 23 June.

On 24 June 2016, the Brexit was announced with 51.9% voting no to continue the EU membership. This announcement sent most of the largest stock exchanges in the world significantly down and weakened the Sterling against the US dollar to its lowest in 30 years. Isolated, the Brexit might not affect the Norwegian market, but some fear the exit to be copied by other European countries. This could weaken the euro against the other currencies and Norwegian krone and make Norwegian goods less attractive to import for the euro using countries.

Naturally, the consequences of the Brexit are difficult to predict, but we can so far determine that the situation causes uncertainty. Certainly, this has no positive effect on the already tightened lending market.

## Real Estate Yields

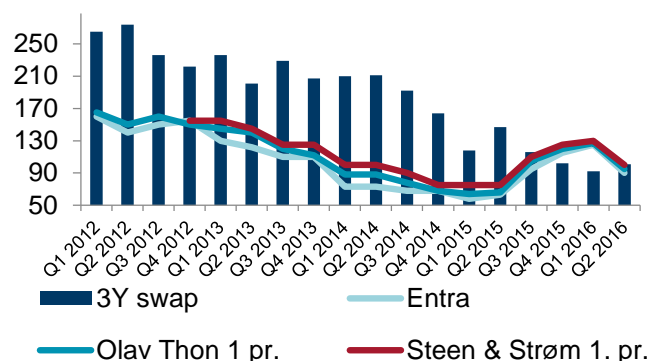
In Q2, there have been no finalized prime yield transactions as we know of. However, transactions at sharp yields at secondary locations support our prime yield estimate at 4.00%. In addition we are aware of ongoing processes that support the estimate. The 10 year government bonds are down about 10 bps over the quarter, widening the yield gap accordingly. As of 20 June 2016 yield spread versus 10-year Norwegian Government bonds stands at 286 bps.

## Equity Market

Entra's share price is down 2.9%, while NPRO's share price is up 2.7%. Olav Thon's share price is up 4.8% and the total OSEBX index is up 0.6%. Rate changes are from 01 April to 27 June 2016.

Figure 2

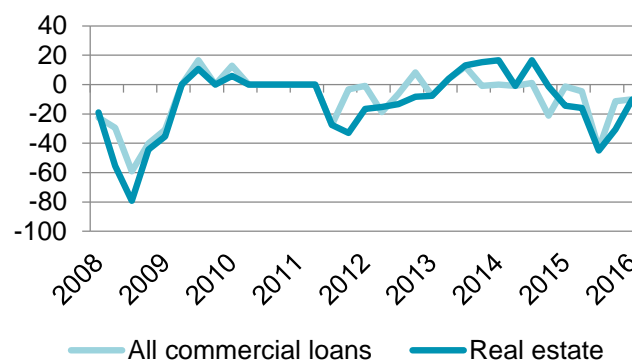
Swap rates 3Y and Bond spreads 3Y (bps)



Source: DNB Markets, Kommunalbanken Norway

Figure 3

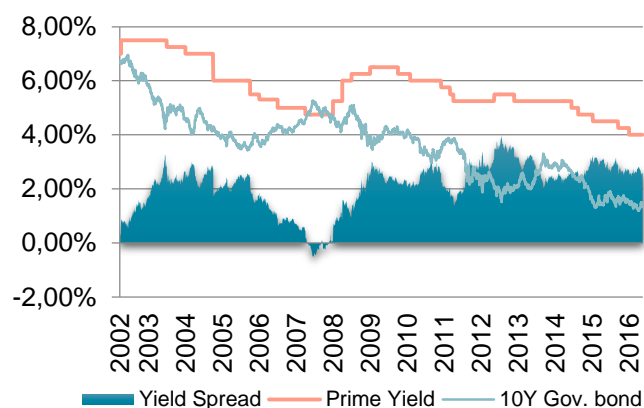
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield gap



Source: Central Bank, DTZ Research





Fritzners gate 12, Oslo sold in April. DTZ advised the vendor, Entra ASA, in the transaction.



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## Activity in Q2

Transactions worth 10.6 bNOK have been logged in Q2. Looking at 2016 the total volume is 22.9 bNOK, which is significantly down from the 49.6 bNOK same time last year. However, last year had several large portfolio sales like Sektor (12.5 bNOK), Storebrand (3.7 bNOK) and Aberdeen II (3.6 bNOK). Office is the most transacted area type with 52%.

International investors represent about 20% of the real estate acquisitions so far this year. Last year, they represented about 48%, due to their big portfolio acquisitions. There have been international investors in several of the bidding processes this year, confirming their interest in the Norwegian market. Private property companies and syndicates are the most active in the transaction market, making out about 50% of both the buy and sell side.

The sale of Norwegian Property ASA's Skøyen portfolio was this quarter's largest deal. The properties Verkstedveien 1, Verkstedveien 3 and Drammensveien 134 were all included in the transaction worth 2 529 mNOK. The portfolio comprised 61 009 m2 of which 43 061 m2 was office. With a 2016 rent of 128.6 mNOK the initial yield equalled approx. 4.7% given a vacancy of 5%. Entra ASA acquired the portfolio.

The sale of 7 of the last 10 properties in the Storebrand Eiendomsfond portfolio was finalized in Q2 with a price of 820 mNOK. The properties that are located from Kristiansand in the south to Orkanger in the north, comprised 88 808 m2 of mostly retail and logistics space. The buyer(s) are currently not public information.

Hedmark University was sold to the Swedish quoted property company Fastighets AB Balder for 700 mNOK. The property comprised 16 400 m2 of educational and training stock and the 2016 rent equalled 35.45 mNOK. The yield is reported at around 5%, which is particularly low for this location. 90% of the rent comes from public tenants. A Pareto Securities syndicate was the former owner, and we know there were several financial investors/syndicates in the bidding process.

Syndicates are still chasing cashflow properties with long duration and public tenants.

Table 1

### Selected transactions Q2 2016

Asset	Purchaser	Vendor	mNOK	Type
NPRO Skøyen portfolio	Entra ASA	Norwegian Property ASA	2 529	Office
Storebrand Eiendomsfond 7 properties	Unknown	Storebrand	820	Office
Hedmark University	Fastighets AB Balder	Pareto Securities	700	Educational
Handelsparken Stoa Vest	Tristan Capital Partners	Nordea Liv	440	Retail
Other transactions			7 766	
<b>Total transaction volume Q2</b>			<b>10 600</b>	
<b>Total transaction volume 2016</b>			<b>22 855</b>	

Figure 5

### Property transaction types Q1 and Q2 2016

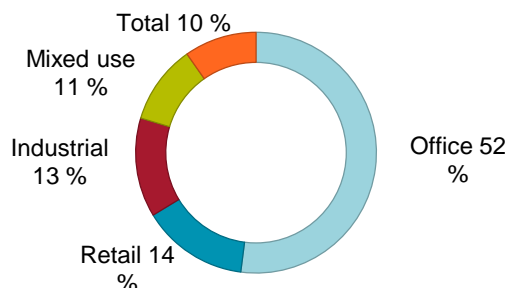


Figure 6

### Buyer nationalities Q1 and Q2 2016

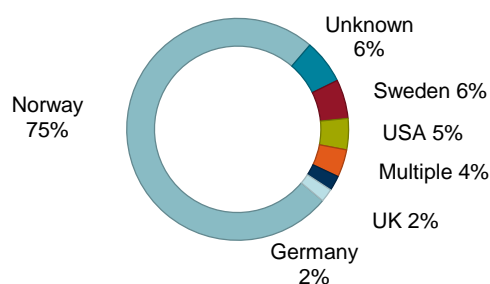


Figure 7

### Buyer categories Q1 and Q2 2016

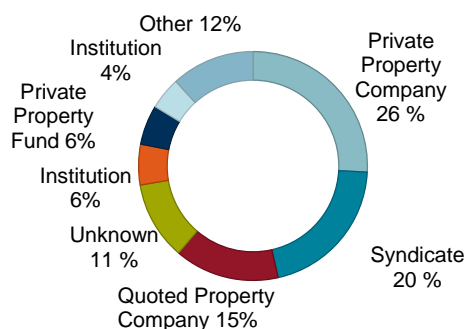
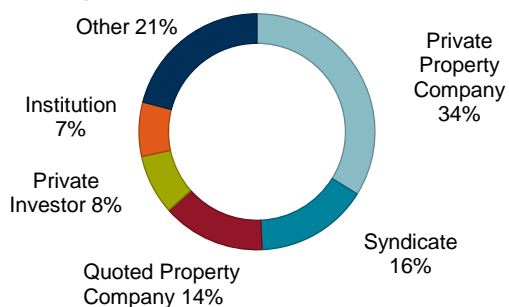


Figure 8

### Vendor categories Q1 and Q2 2016



# Norway Q3 2016

## Outlook

Last quarter we expected prime yield to decrease to 3.75% due to bidding processes at that level. Currently, none of them have been finalized, but we still expect them to go through in the near future and therefore keep our forward prime Oslo yield estimate at 3.75%.

Last year's record high transaction volume was driven by property owners' interest in utilising the attractive yield levels and forced sales from life insurance companies. This year, the demand for prime yield properties are as strong as before, but the supply side is biding its time.

The gap between prime yield and risk free rate is still attractive for domestic investors, and might attract international investors considering their "cheap" government bonds. Compared to London, Stockholm, Munich and Paris, prime yield in Oslo is still at least 25 bps higher. We expect the international share of the Norwegian transaction volume to normalize between 20-25% in the coming years. Property funds are placing 59 billion USD in Europe over the next years.

Central Oslo has a significant demand for residential properties, due to the population growth and lack of new build projects. We believe in an increase conversion of obsolete office buildings to residential buildings.

Several large portfolio transactions are in the pipeline. To mention one, ICA Fastigheter AB announced that they are selling out their whole 59 properties portfolio spread from Kristiansand in the South to Tromsø in the North. The portfolio consists mostly of grocery stores and logistics properties. DTZ was engaged by ICA for valuation of the whole portfolio ahead of the announcement.

The Statoil building at Fornebu is also being closed these days at a price worth 3.9 bNOK, making it 2016's largest deal. We will elaborate on this deal in the Q3 report.

Mid-June, Oslo municipality presented the guidelines for commercial real estate taxation that was announced after the election in 2015. The square meter market price is tax basis and is estimated by using Arealstatistikk's database on rent levels adjusted for owner's costs, area vacancy and yield. Furthermore, the square meter market price is weighted on the attractiveness of the area, multiplying Oslo CBD's market price with the factor 1, followed up by Oslo Center with 0.58. The rest of the office areas in Oslo are multiplied between 0.21 and 0.48. The owner's costs, which are to be withdrawn from the rent levels, are set to 250 NOK/m<sup>2</sup>. Properties in Oslo CBD that have been given the square meter market price of 53 200 NOK/m<sup>2</sup> will be taxed with 160 NOK/m<sup>2</sup>, equalling 0.3% of the market square meter price. Nydalen, with a square meter market price at 21 056 NOK/m<sup>2</sup> and a weight factor of 0.39 will be taxed with 25 NOK/m<sup>2</sup>. However, if the surveyor does not agree with the proposed base values, he may adjust the weight factor accordingly.

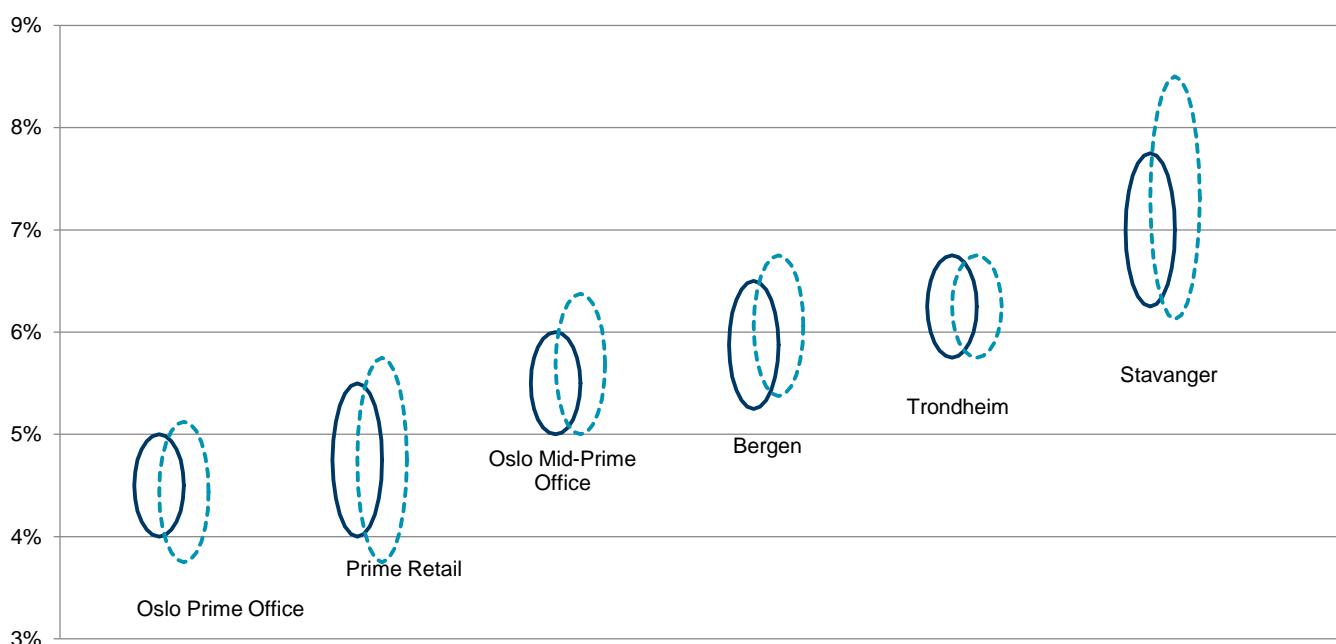
The Central Bank has an announcement of the Executive Board's interest rate decision on 22 September.

As mentioned earlier, the Brexit was announced on 24 June. The market's immediate reaction was undoubtedly negative due to its fear for something new and unfamiliar. Going forward, it is expected that activity and economic growth will be lower in anticipation of the new economic framework being negotiated.

We are happy to announce that Håvard Bjørå, former Vice President of MSCI, will be joining us as Head of Research in Norway and the Nordics ultimo August this year.

Figure 9

**Yield curve; now (full line) and forward estimate (dotted line)**



Source: DTZ Research









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