

INVESTMENT MARKET UPDATE

Yield record

Norway Q4 2016

Date: 10 October 2016

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- The Norwegian real estate market demonstrates historically high liquidity with annual transaction volume expected to be second highest off all time, only beaten by the record breaking volumes seen in 2015
- Above bNOK 43 in transactions have been recorded so far and several large transactions are expected to close in 2016. Average of the first three quarters since 2010 has been around bNOK 35
- International investors are still active both at confirmed deals (above 15%) and in the bidding processes of ongoing deals
- Yield gap has decreased due to yield compression and increase in Government bonds
- Borrowing costs are still increasing due to higher bank margins
- The largest transaction this quarter was Arctic's syndicate purchase of the Statoil Building at Fornebu sold by Madison International Realty for bNOK 3.9
- The Central Bank had its fourth announcement of the Executive Board's interest rate decision on 22 September. The key interest rate remained unchanged at 0.50%
- The "lower for longer" interest rate scenario keep fuelling the hunt for yield and incentivise real estate investments
- Prime office yield is estimated to 3.75%, down 25 bps since last quarter

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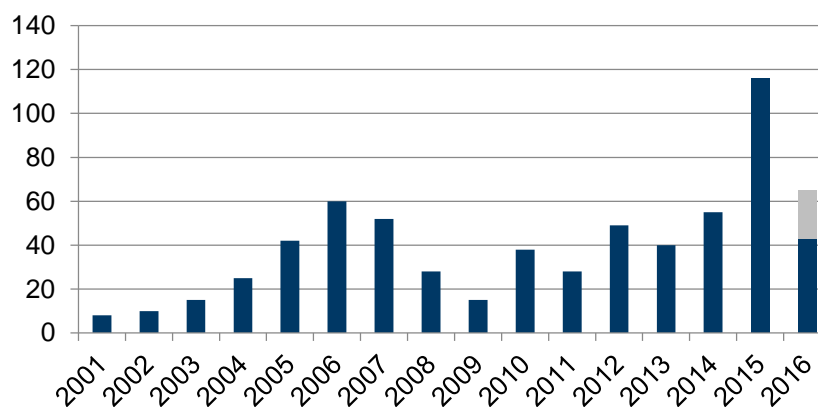
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Figure 1

Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: DTZ Realkapital Research



Eikveien 19/20. DTZ Corporate Finance
syndicated the buildings earlier this year.
Price was 137.5 mNOK

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The Capital Market

Borrowing Terms

Borrowing costs are increasing for the fifth consecutive quarter. Having seen swap rates decrease since Q3 2015, rates have the latest period slightly increased, and are expected to increase over the next months. Simultaneously banks' own funding costs are increasing, incentivising them to increase bank margins.

DTZ Realkapital's Corporate Finance and Capital Markets departments are close on the debt providers, banks included, in structuring projects. Experience from Q3 suggests durations are rarely longer than 5 years, most common 2-3 years until refinancing. LTV ratio mainly ranges between 60% and 65% for low risk projects, and fewer banks are offering loans. Bank margins vary significantly between projects and range normally between 200 – 250 bps.

The bond market has primarily appetite for large deals, above mNOK 250, solid tenants and long lease contracts. Expected duration is 7 – 10 years and expected bond yields are between 370 and 430 bps.

The result from Central Bank's latest survey of banks' lending policy indicated again stricter policy compared to previous quarter, yet this time only marginally. The survey measures the banks' attitude towards real estate lending by asking if they are in this quarter more or less strict than in the previous. Results show that banks have become stricter for five consecutive quarters (fig. 3). They are also more selective with investors, exemplified by carefully consider counter-part risk in syndicate structures.

The Central Bank had a key policy rate decision on 22 September where it decided to keep the key policy rate unchanged at 50 bps. Oil prices increased toward the end of the quarter and the NOK has appreciated somewhat since the last policy meeting. Norway's trading partners have lower growth prospects for imports and expected policy rates abroad have declined slightly.

Real Estate Yields

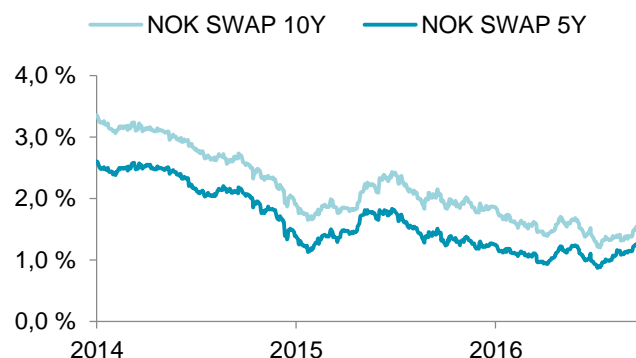
Oslo Centre located Stortingsgata 6 was recently sold for a yield at 4% adjusted for vacancy. However, the location is outside of what we define as CBD, and we believe this supports a lower prime yield. In addition, we are aware of bids on other CBD properties with lower yields, indicating the market in reality has already broken the 4% limit. 10-year government bonds are up about 30 bps over the quarter, narrowing the yield gap accordingly. As of 1 October 2016 yield spread versus 10-year Norwegian Government bonds is 2.51%, which is still well above the 10 years average of 2.23%

Equity Market

The board of NPRO declined John Fredriksen mandatory offer to acquire all outstanding shares of NPRO at a price of 10.80 NOK/share after he through his company Geveran Trading Co Ltd acquired another 5.25% of NPRO. Meanwhile, the Norwegian state has engaged advisors in conjunction with a reduction of their share of Entra to 33.4%

Figure 2

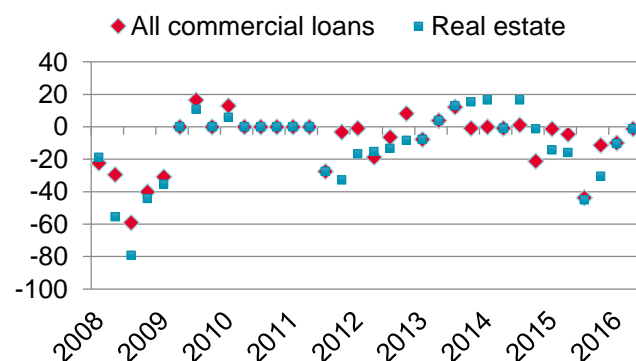
Swap rates 5 Y and 10 Y NOK



Source: Nordea Markets

Figure 3

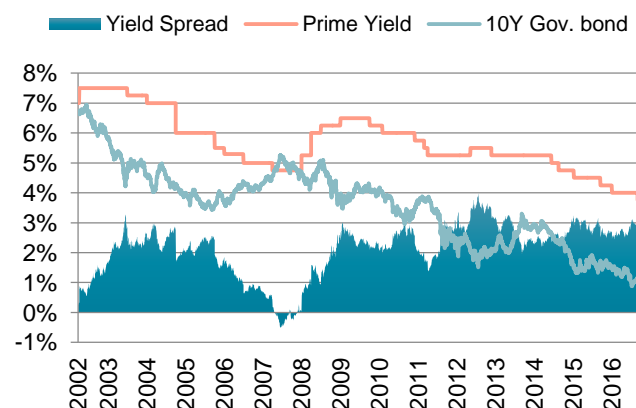
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield gap



Source: Central Bank, DTZ Realkapital Research



Refurbishment of Wergelandsveien 15 was completed in September. DTZ advised the owner Utdanningsforbundet from "A-Z" in the process of the whole value creation chain.

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Activity in Q3

So far in 2016 we have logged a total of 136 deals of which only 36 of them in Q3. The volume however, has been higher than both the previous quarters. Transactions worth bNOK 17 have been carried out in Q3. Year-to-date the total volume of bNOK 43 is above historical average of the first three quarters. Office stands for almost 50% of the volume.

We see international investors being part of the bidding process in most major transactions. However, being outbid by domestic players only 16% of the transactions so far have included international buyers. On the sell side, international players are getting more active. We believe international investors have a shorter holding period preference, which might trigger some larger sales in the years to come, considering their activity on the buy side in recent years.

The sale of the Statoil building at Fornebu was this quarter's largest transaction. Arctic's syndicate purchase of the 65 000 m2 building from Madison International Realty for mNOK 3 900 was estimated to a yield at 5.2%.

Olav Thon purchased Åsane Storsenter in September from Steen & Strøm and Nordea Liv. The price was approx. mNOK 2 000 making it this quarter's second largest transaction. The shopping centre is located at Åsane right outside of Bergen in West-Norway. This transaction is yet to be completed, due to an ongoing process at The Competition Authority.

Nordea Liv also disposed Lille Grensen 7 to AXA for mNOK 420. The property is centrally located in Oslo and was sold with substantial vacant area.

Unik Terminal, a bus depot at Sola with a lease agreement with Kolumbus, owned by Rogaland municipality for 20 years from commencement, was acquired by City Finansiering at a yield of 4.7% and a value of mNOK 600. This supports our opinion that the Stavanger region transaction market is fragmented and still attracts investors to low yields.

Table 1

Selected transactions Q3 2016

Asset	Purchaser	Vendor	mNOK	Type
Statoil Fornebu	Arctic Securities	Madison International Realty	3 900	Office
Åsane storsenter	Olav Thon	Steen & Strøm / Nordea Liv	2 000	Shopping Centre
Forskningsparken	NRP Finans	Arctic syndicate Lerka Eiendom 82%	850	Office
Unik Terminal	City Finansiering	Det Stavangerske Investerings-selskap	600	Infra-structure
Other transactions			9 898	
Total transaction volume Q3			17 248	
Total transaction volume 2016			42 779	

Figure 5

Buyer nationalities 2013-

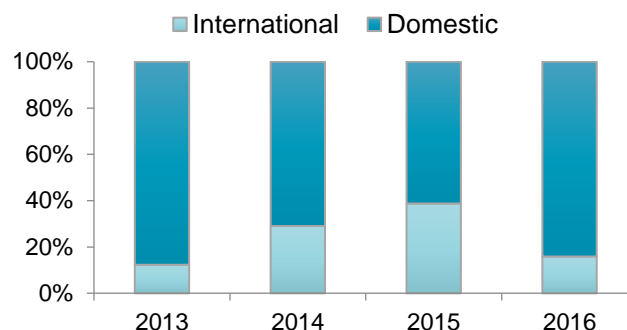


Figure 6

Seller nationalities 2013-

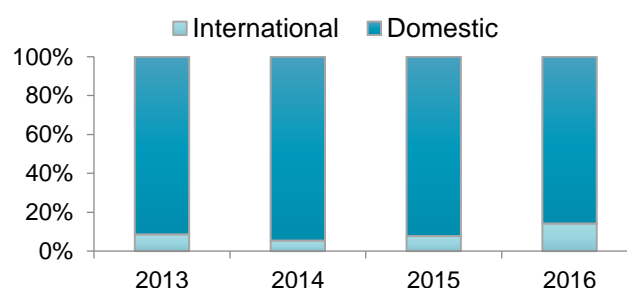


Figure 7

Transaction types 2013-

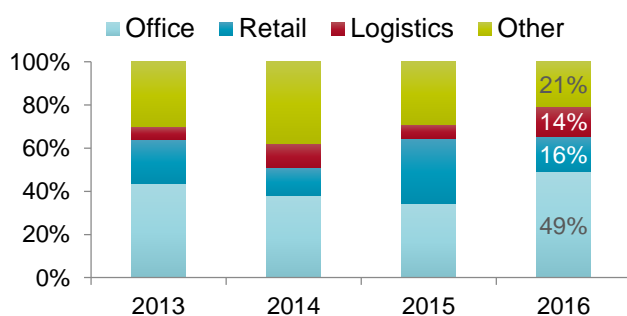
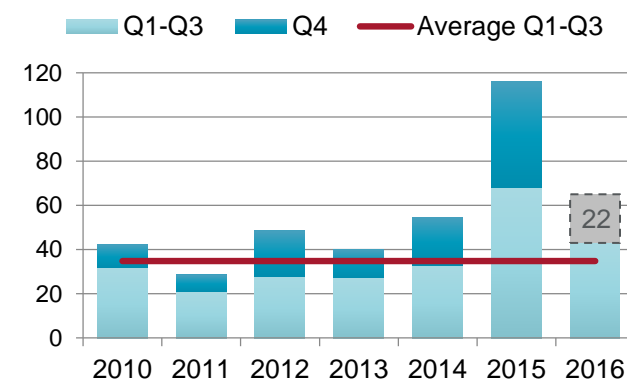


Figure 8

Volume and average since 2010



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Outlook

Since June 2012 our quarterly prime yield estimate has decreased or remained unchanged, breaking the former all time low at 4.75%, from pre financial crisis, already back in 2014. Having kept our prime yield estimate at 4.00% the two first quarters, we now lower our estimate to 3.75%, despite not having seen a transaction conclude at this level. We await the details of transactions within the heart of CBD before potentially adjusting prime yield estimate further down.

We expect healthy volumes also in Q4 this year and our annual transaction volume estimate from back in January of bNOK 65 is still unchanged. This implies a Q4 volume of mNOK 22, comparing to Q4 average last five years of bNOK 20.

To mention some large transactions in pipeline, the sale of ICA Fastigheter AB is expected to close this year. At Tjuvholmen, in Oslo CBD, Selvaag is disposing one of their prime properties with yield indication below our prime yield estimate at 3.75%, but with particular favourable contractual structure with law firm BA-HR as counterpart.

As we have experienced for a while supply is the limiting factor as more capital seek placement in real estate. One of the driving forces, which we also suggest will continue, is the low returns on alternative secure investments such as bonds. Due to pension and insurance funds' required rate of return, they have incentives to move their capital over to real estate investments, and in turn favouring low risk real estate with attractive lease structures.

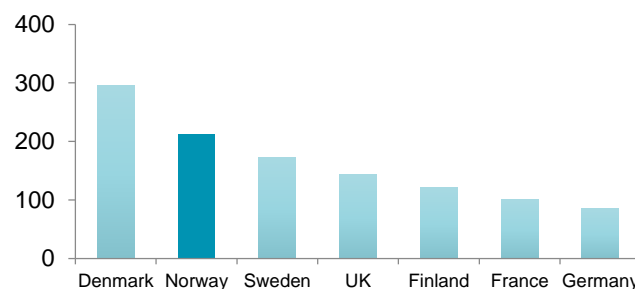
Regarding bank financing we believe sum of swap rates and margins will level out, despite increasing swap rates. We expect banks to be more positive in their attitude toward lending to commercial real estate and that margins will stay at current level.

Due to lack of new constructions in Oslo, housing prices has, in nominal terms, increased 75% the last 10 years and as much as 16.6% the last 12 months (Source: Eiendomsverdi). Simultaneously, interest rates have decreased steadily and fuelled the trend. The trend has been bolstered by investors purchasing apartments for leasing purposes and benefitting from the price hikes. A concern could be increasing household debts, which are high in a historical and international comparison. However, as housing prices stay high the conversion from miss-placed or obsolete commercial to residential real estate continue to appear attractive and we expect continued increased activity in this space.

The Central Bank has an announcement of the Executive Board's interest rate decision on 27 October. Governor Olsen stated in the last press release: "Our current assessment of the outlook suggests that the key policy rate will most likely remain at today's level in the period ahead."

Figure 9

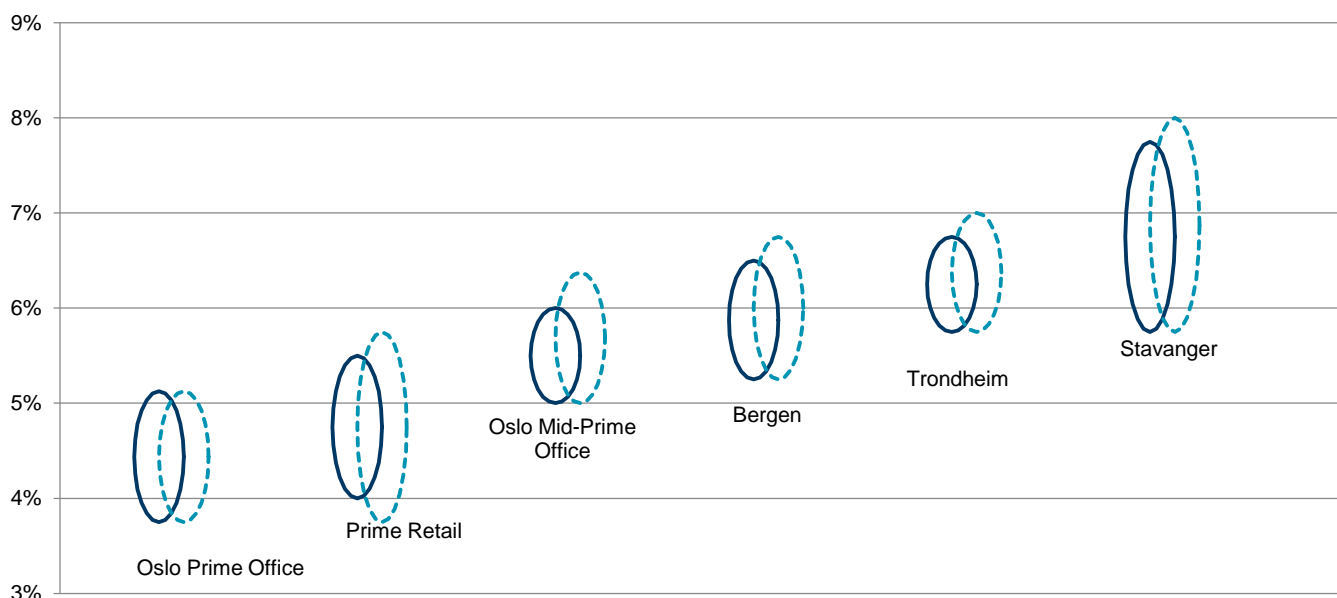
Household debt, % of net disposable income



Source: OECD Stat, 2015 numbers

Figure 10

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



Source: DTZ Realkapital Research





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