

INVESTMENT MARKET UPDATE

All time high

Norway Q3 2015

Date 2nd of July 2015

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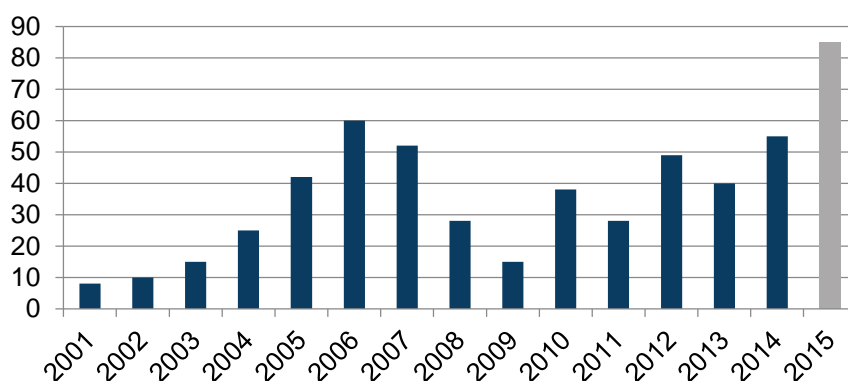
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- The Norwegian real estate market hit all-time high in 2014 with 84 billion NOK in transaction volume, of which 55 billion NOK occurred in the direct market, 26 billion NOK with the privatisation of Entra Eiendom ASA in October, and 3 billion NOK in the purchase and de-listing of BWG Homes ASA by OBOS BBL.
- Transaction activity has been even higher in 2015. A total of 84 transactions, with a total value of 49 billion NOK, had been executed by the end of June. This makes 2015 the most active two quarters on record.
- In Q2, the largest transaction was the purchase of the Sektor shopping center group by Citycon of Finland. The deal, at 12.5 billion NOK, was Norway's largest ever real estate transaction.
- KLP Eiendom has completed three major transactions, comprising 9 properties and more than 5 billion NOK asset value, in Q2.
- Colony Capital (USA) acquired Statoil's headquarter at Forus, Stavanger, for 2.5 billion NOK in June.
- International investors have represented 48% of acquisitions, and only 4% of the sales, in 2015.
- The Central Bank reduced the policy rate by 25 bps, to 1.00%, on 17 June, and guided on a possibility for further reductions this fall.
- Bank margins have remained broadly unchanged this quarter. Margins of 140-150 bps are achieved for premium projects; implying that total borrowing cost has reached 3.0%.
- Prime office yield stands at around 4.25%, down from 4.5% in Q1.

Figure 1

Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: DTZ Research



Smallvollveien 65, Oslo, sold to W. P. Carey for 735 mn NOK including transaction costs. DTZ advised the vendor, Coop Norge, in the transaction.

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The capital market

Cost of Capital

European interest rates are at an historical low. As of early July, 1-year government bond yields are negative in seven Western European countries, and Switzerland has negative 10-year yield. This unprecedented interest rate market has caused asset inflation throughout Europe's real estate industry.

In Norway, the Central Bank reduced the policy rate by 25 bps, to 1.25%, in December 2014, and a further reduction took place on 17 June. The policy rate now stands at 1.0% and the Central Bank has guided on a possibility for further reductions this fall. The Norwegian policy rate is still the highest among its main trading partners, and with a weaker macro sentiment, many factors could indicate a further reduction in the Bank's next meeting. The key argument against a reduction is the risk of overheating the residential market, where prices had grown 8.1 year-on-year by June.

Borrowing terms

Bank margins as low as 100 bps have been reported in exceptional cases, but in DTZ's experience, the going spread ranges from 130-150 bps for high-quality projects. With the 5-year NOK SWAP rate at 1.57% in July, this means that borrowers can achieve a borrowing cost at 3.0% or lower.

In the bond market, Olav Thon has achieved margins as low as 50-60 bps. However, the bond market is highly dependent on the issuer and the market for high yield bonds is not active at all.

In the Central Bank's quarterly survey of bank's lending policies, bank's report that they have tightened lending policy towards real estate during the last quarter, while overall credit policy has been neutral.

Real Estate Yields

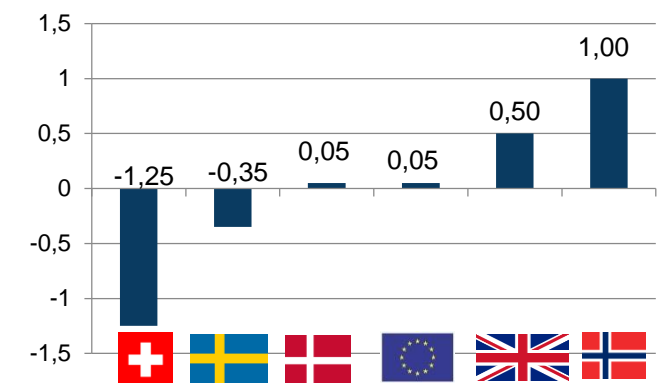
Deals such as Bolette Brygge 1 at Tjuvholmen (sold for 4.5% in late 2014) indicated prime yield of around 4.5% in Q2. Deals completed in the second-tier market in Q2, such as Lysaker Torg 35, Sektor Gruppen, and Forusbeen 50, indicate that there has been a further yield compression. We now estimate prime yield at around 4.25%.

Equity market

Norwegian real estate stocks performed very well during Q1, but underperformed the market in Q2. Olav Thon, NPRO and Entra saw their share prices decline by 7.8%, 5.8%, and 11.4%, respectively, between 1 April and 1 July. The total OSEBX index rose by 3.5% during the same period. Ex-dividend adjustment, the change was minus 6.8% for Thon and minus 8.4% for Entra. NPRO did not declare dividends this year.

Figure 2

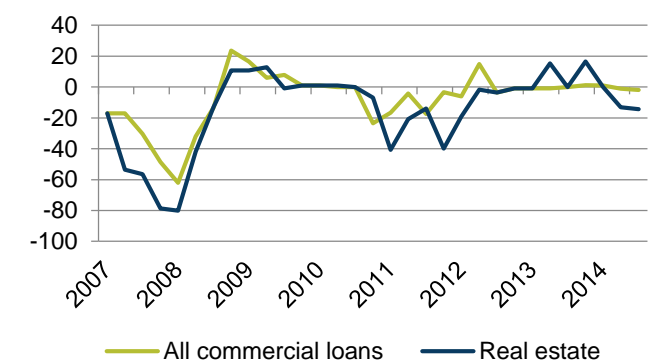
Central Bank policy rates at end of Q2 2015 (% p.a.)



Source: Global-rates.com

Figure 3

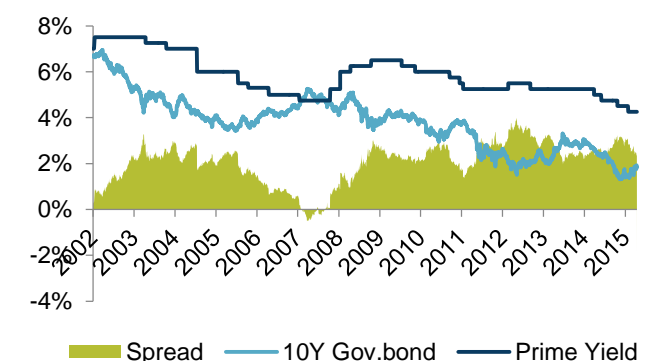
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield spread



Source: SEB, Central Bank, DTZResearch



Aker Brygge, Oslo. DTZ has assisted many of the largest tenants at the location, including Kluge, DLA Piper, Grieg Group, Protector, DNO and Carnegie (occupier services), and Wiersholm (development supervision).

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Activity in Q2

Transactions worth 32 billion NOK were logged in Q2.

By far the largest transaction was Citycon oyj's purchase of Sektor Gruppen in May for 12.5 billion NOK. Sektor is Norway's second largest shopping center group, with a portfolio that comprises a total of 34 shopping centres, of which 20 are fully or majority-owned, 4 are minority-owned, 2 rented and 8 managed. The shopping centers have more than 60 million visitors per year. Net yield has been reported at 5.2%. The sellers were the Johansson, Varner and Stordalen families; Citycon's largest shareholders are Gazit-Globe and Canada Pension Plan Investment Board.

KLP Eiendom acquired the seven remaining properties in Aberdeen Eiendomsfond Norge II AS. The largest properties were Lysaker Torg 45 and Munkedamsveien 35 in Oslo, and Solsiden shopping center in Trondheim. The transaction comprised a total of 160.000 sqm, and annual rental income of 220 mNOK, valued at NOK 3.626 million. Net yield has been estimated at 5.5%. With this transaction, Aberdeen Eiendomsfond Norge II AS has sold all its properties.

KLP also acquired Citypassagen, in central Oslo, a property with CappelenDamm publishing house as the largest tenant. Further, KLP purchased Lysaker Torg 35 from Norwegian Property ASA for 601.5 mNOK. The asset was formerly the headquarter of the insurance company If, but is now a multi-tenant property with 14.000 sqm of office and storage space, plus parking. With 33.9 mNOK in annual rental income, net yield would translate to around 5 ¼ %.

Colony Capital of USA acquired Forusbeen 50, Statoil ASA's headquarter at Forus, Stavanger, for 2.5 billion NOK in June. The property has around 100.000 sqm of lettable space. Statoil is the single tenant, on a 15-year lease. Media reports estimate net yield at 5.6%.

The only major sale by an international party in Q2 was GevNor's sale of Oslo Boligeiendom, a company that owns around 20 residential lease properties, to Fredensborg Eiendomsselskap. GevNor was owned by the remnants of Icelandic bank Glitnir, which had assumed control over the portfolio as a bad-bank case in 2009.

Hemfosa Fastigheter AB of Sweden made a further investment in Norway by acquiring 65% share in Gardermoen Campus Utvikling, a company that will construct a specialist hospital leased to Norwegian Heart and Lung Patient Organization (LHL) on a 25-year lease starting in 2018. The remaining 35% is owned by Aspelin-Ramm.

Scala Retail Property, a company owned by Martin, Petter and Morten Fredriksen through Fredriksborg AS (51%) and Norgesgruppen (49%), acquired four shopping centers (Tangen Nærseier at Nesodden, Fagernes Kjøpesenter, Rykkinn Nærseier and Grorud Nærseier) from Norgesgruppen in April. The portfolio has a total floor space of 68.000 sqm and a total shop turnover of around 1.4 billion NOK.

Coop sold Smalvollveien 50, a retail property at Alnabru in northern Oslo, to W.P. Carey for 735 mNOK including transaction costs. DTZ advised Coop in the deal.

Table 1 – Selected transactions, Q2 2015

Asset	Purchaser	Vendor	mNOK	Type
Sektor	Citycon	Various	12500	Retail
Aberdeen II	KLP	Investors	3626	Mixed
Statoil Forus	Colony	Statoil	2550	Office
Oslo Bolig-eiendom	Fredensborg	GevNor	1300	Residential
Gardermoen Campus	Hemfosa	Aspelin Ramm	920	Health
4 assets	Scala	Norges-Gruppen	900	Retail
City-passagen	KLP	Berner	860	Office
Coop Alnabru	WP Carey	Coop	735	Retail
H-2 Eiendom AS	Various	Pareto	650	Retail
Lysaker Torg 35	KLP	NPRO	602	Office
Ole Deviksv 10-14	Pareto	Nordea Liv	465	Office
Total			31700	

Source: DTZ Research

Figure 5

Buyer categories, Q1 & Q2 2015

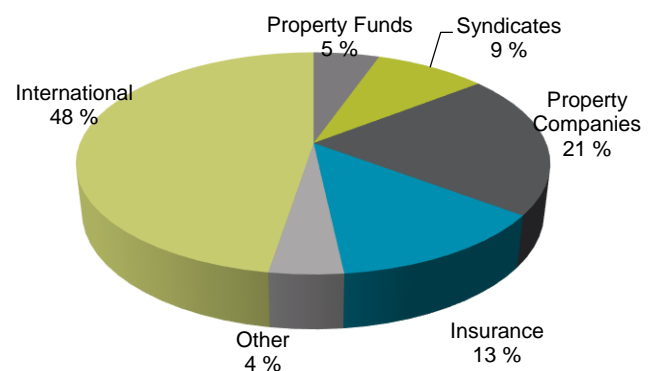
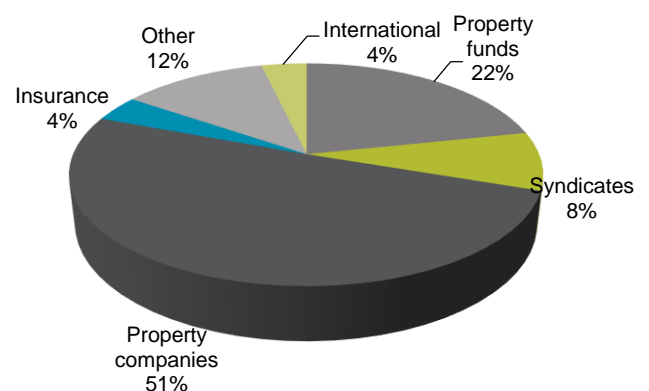


Figure 6

Vendor categories, Q1 & Q2 2015



Outlook

Both domestic and international liquidity is very high, and placement of excess liquidity is challenging in an environment of none or negative real return on commercial paper. We expect that further funds will be diverted from other asset classes into real estate, despite the slowing down of the rental market. The spread between prime yield and risk-free interest rates is still relatively generous, as shown in figure 4, though it has narrowed in Q2. At least so far, the market has accepted this spread as a sufficient premium for reduced rents and other real estate risks.

The combined effect of narrower bank margins and low SWAP rates has resulted in a reduction in borrowing cost of at least 150 bps during the last two years. By contrast, prime yield has fallen by around 125 bps during the same period.

In sum, we expect a continued strong market in the short term, both in terms of volume and pricing.

As a word of caution, though, it should be borne in mind that the current boom is mainly a result of poor choice among alternative investments, more than a bet on strong demand for real estate among occupiers. In the medium term, we therefore expect the transaction market and the occupier market to become better aligned, with more modest activity as a result.

Going forward, the transaction market will be influenced by the realisation of assets held by property funds and single-purpose investment vehicles. Many of these owners can now exit their investment at a better price than ever possible since the vehicles were set up, and at the same time, more and more of the costly interest swaps are now closer to expiry.

A slower rental market will sharpen investors' appetite for properties with long lease durations, and low reletting risk. We believe that if and when the transaction market recedes, this will first occur in the secondary markets most exposed to rental market volatility, while prime properties would still see low yields due to the low funding costs. If so, the yield spread between prime and secondary properties, which has narrowed in recent months, could widen again.

Tentative interest rates increases have been observed in international money markets in Q2. Five-year government bonds in Denmark and Germany, which were negative in Q1, have returned to positive in Q2. The U.S. Fed chairwoman, Janet Yellen, reconfirmed rate increases this year but left the rate unchanged in its latest meeting on 29 July.

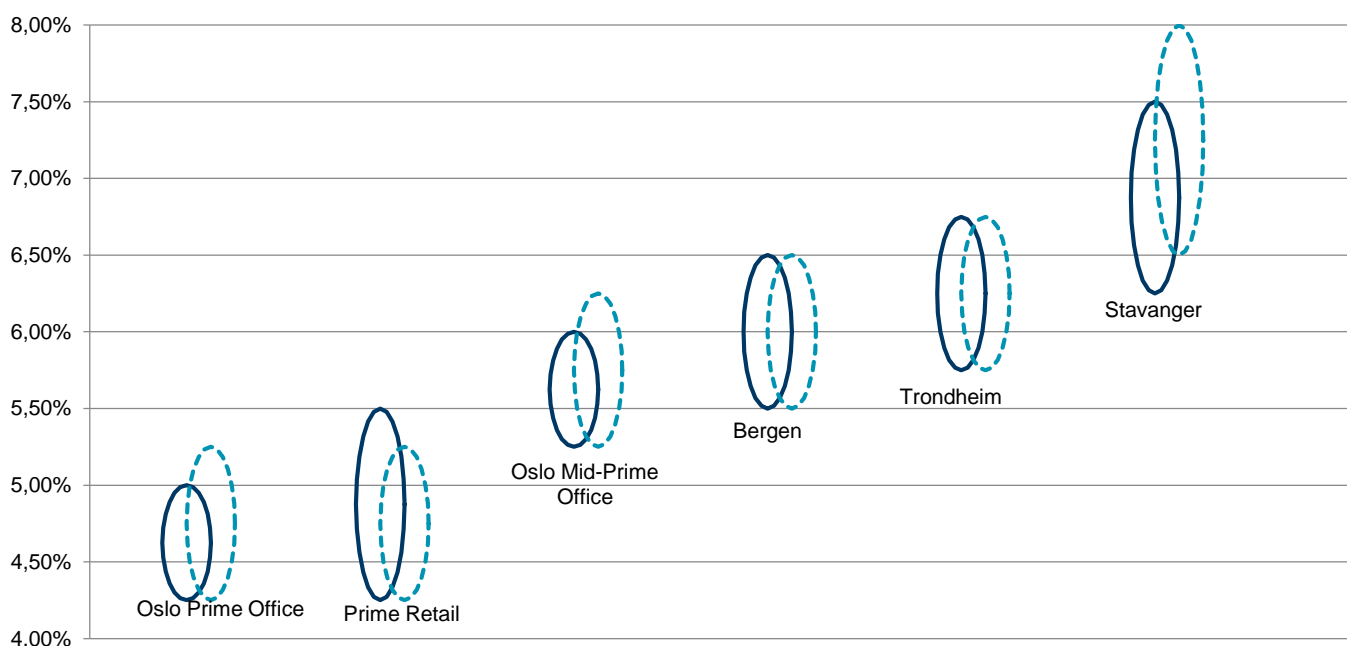
The Chinese economy has entered into a period of extreme volatility in the stock market. The impact on global real estate is still unresolved.

All aspects considered, we do not expect further yield compression during the next quarter. A further preference for retail, where rents are more stable than in the office market, could emerge.

Q3 has started actively, with two major transactions completed in July (DNB's sale of one of the three buildings in Bjørvika, and Wintershall's purchase of its own building in Stavanger from Entra. These and other Q3 events will be elaborated in our next Investment Market Update.

Figure 7

Yield curve; Q2 (full line) and forward estimate (dotted line)



Source: DTZ Research





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