CUSHMAN & WAKEFIELD | Realkapital

MarketBeat

Q1 2018

Economic Overview

2018 GDP mainland growth is forecast to be 3.2%, up from 1.9% in 2017. Growth is domestically driven, with increased consumption and mainland investment the main sources. Housing prices have increased rapidly over recent years, mainly due to lower interest rates, but since Q2 2017 and the implementation of tighter mortgage regulations, prices have been under pressure. However, the general economic outlook is healthy as unemployment is low and falling and businesses are positive in their own assessment of the economy.

Labour Market

The unemployment rate has decreased slowly throughout 2017, and is expected to remain stable at around 4% in 2018 due to an overall strengthening of the Norwegian economy. As the crude oil price has increased to around USD 70 in recent months the employment market has improved as petroleum sector dependent companies have started hiring again. However, the correction in residential real estate prices could potentially, if it continues in strength, lead to a sustained reduction in construction with consequentially a negative impact on the labour market. However, both the infrastructure and oil sectors are likely to be able to pick up some of the potential slack in the construction industry in the coming years.

Inflation

Inflation dropped in 2017 to 1.8% after topping out at 3.6% in 2016. The high 2016 inflation rate was mainly due to an increase in import prices caused by a historically weak NOK in 2014 and 2015 following the drop in the oil price. Inflation is forecast at 1.2% for 2018 which in such event will undershoot the central bank's long-term rate target of 2.0% - 2.5%. Even with an improving labour market the remaining slack in capacity utilisation means there is little 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 they expect to see the first increase in late 2018 or in Q1 2019 if the economy continues to grow as expected. Expectations as to the longer term are that by end 2020 the central bank sees the key policy rate at 1.6%, which is marginally up from its previous guidance, mainly due to employment growth overshooting expectations.

	GDP MAINLAND GROWTH (1)	UNEMPLOYMENT (2)	INFLATION Y/Y (1)	10Y SWAP (4)	KEY POLICY RATE (3)
2017	**1.9%**	**4.9%**	**1.8%**	**2.0%**	**0.5%**
2018E	**3.2%**	**4.1%**	**1.9%**	**2.4%**	**1.0%**

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

Capital Market

This cycle continues to see an extraordinary level of capital targeting real estate, both from international and domestic investors. 2017 ended with a continued high activity level, with several transactions being completed at the end of Q4. Activity was broadly spread across segments and geography. Foreign investors accounted for more than 20% of recorded transactions in 2017 measured by deal volume, with Swedish investors accounting for about half of this. While most non-domestic buyers tend to limit their investment criteria to Oslo, in 2017 we also saw both domestic and non-domestic investors with an increased appetite for both secondary assets and tier 2 cities.

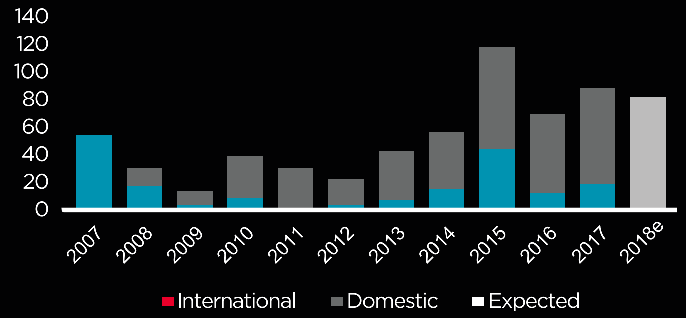
The prime yield has decreased for offices and logistics, while retail has been stable over the last quarter. The office market accounted for nearly 50% of transaction volume last year, the highest percentage in the past decade. This can likely be explained by the expected increase in rent levels, driven by limited supply and generally positive investment sentiment from the broader economy.

Logistics and industrial properties with longer leases have been in high demand with yields being pushed further down as investors are attracted by the long-term stability offered. Not surprisingly, Oslo and the surrounding area have seen the largest volume.

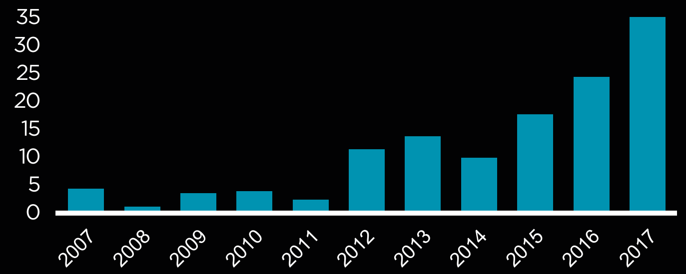
According to a survey of banks' real estate lending practices, from mid-March 2014 until the middle of last year the borrowing terms offered have been reported to be tighter nearly every quarter. However, Q3 2017 marked a shift as lending policy was not reported to be tougher, a trend that continued in Q4.

Activity in the bond market has seen a strong increase, lead in large part by commercial real estate issues, which experienced growth of just below 50% last year and 260% since 2014. The bond market is expected to continue this pattern throughout 2018. In total NOK 35bn was financed by the bond market in 2017 as many of the largest listed property companies either increased their portfolio or refinanced their existing loans on better terms. Swap rates were fairly steady in 2017 and margins offered by the banks ranged from 220 – 270 bps dependent on the specific property and client - basically unchanged from recent quarters.

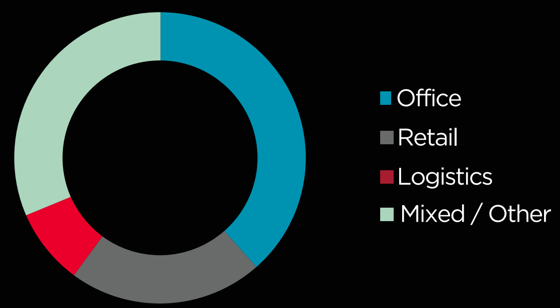
Transaction volume NOKbn



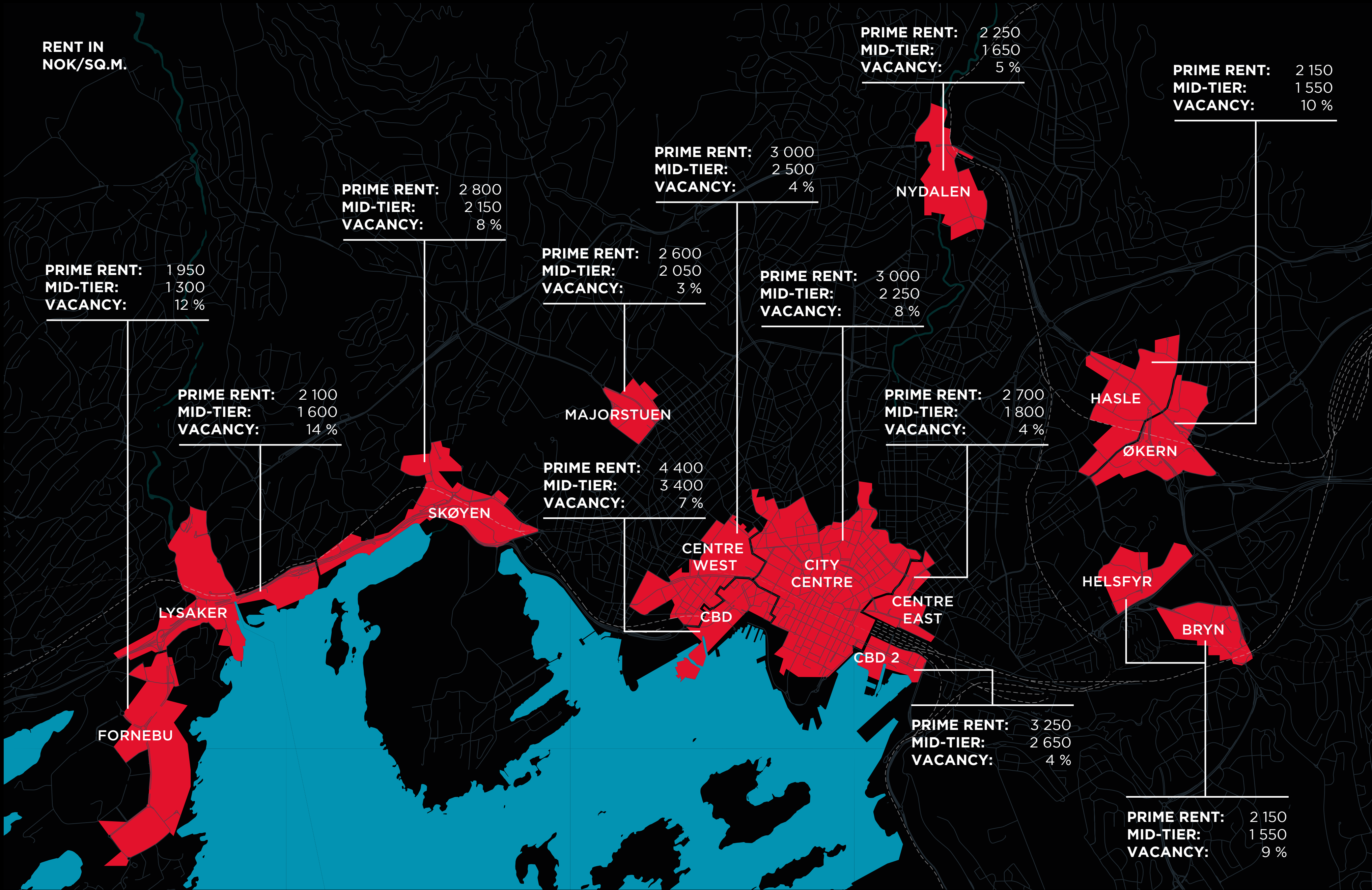
New Real Estate bond issues in Norway NOKbn (5)



Transactions, sector split 2012-2017



Source: Nordic Trustees (5)



RENT IN
NOK/SQ.M.
PRIME RENT: 2 250
MID-TIER: 1 650
VACANCY: 5 %
NYDALEN
PRIME RENT: 2 150
MID-TIER: 1 550
VACANCY: 10 %
PRIME RENT: 3 000
MID-TIER: 2 500
VACANCY: 4 %
PRIME RENT: 2 800
MID-TIER: 2 150
VACANCY: 8 %
PRIME RENT: 2 600
MID-TIER: 2 050
VACANCY: 3 %
PRIME RENT: 3 000
MID-TIER: 2 250
VACANCY: 8 %
PRIME RENT: 1 950
MID-TIER: 1 300
VACANCY: 12 %
PRIME RENT: 2 100
MID-TIER: 1 600
VACANCY: 14 %
MAJORSTUEN
PRIME RENT: 2 700
MID-TIER: 1 800
VACANCY: 4 %
HASLE
ØKERN
PRIME RENT: 4 400
MID-TIER: 3 400
VACANCY: 7 %
SKØYEN
CENTRE
WEST
CITY
CENTRE
HELSFYR
LYSAKER
CENTRE
EAST
CBD
BRYN
CBD 2
FORNEBU
PRIME RENT: 3 250
MID-TIER: 2 650
VACANCY: 4 %
PRIME RENT: 2 150
MID-TIER: 1 550
VACANCY: 9 %

Rental Market

The letting market currently favours lessors. We have seen a drop in vacancy levels, in part because of strong demand for office space, but mainly due to there being a lack of office projects under construction. With a high rate of conversion from office to residential, the net new office stock in Oslo in 2017 was marginally negative. Overall the result has been upward pressure on rent levels, most noticeably in central locations.

Once again, the latest figures from Arealstatistikk on the rental market broke several records. Its report shows that 832 contracts were entered during 2017, which is above the 5-year average of 778 contracts annually, and the total volume for the year ended at 671,670 sq.m, which is again slightly above the 5-year average. The average rental price in Oslo for Q4-17 was 2,071 NOK/sq.m., marginally up from Q4-16 and representing an all-time high in nominal terms. The numbers support our overall view that rents will continue to trend upwards. Furthermore, Arealstatistikk reports the average rent for category A (15% most expensive leases) in CBD is 4,652 NOK/sq.m for 2017, an increase of 7% from 2016, resulting in another all-time high and substantiating the strong demand for office space. At the same time most submarkets reached record rent levels.

In 2017, 8 new office buildings were completed in Oslo totaling 85,000 sq.m. of office space, well below the 10-year annual average at 120,000 sq.m. However, construction activity has picked up and 115,000 sq.m. of office space is confirmed for 2018 and another 65,000 sq.m so far for 2019. Few buildings have been built on speculation (not pre-let) during the last few years, but we currently also see more speculative projects, admittedly from low levels. Examples include Vitaminveien 4, Schweigaards gate 33, Hoffsveien 17 and Valle Wood, which are all expected to be completed in 2018.

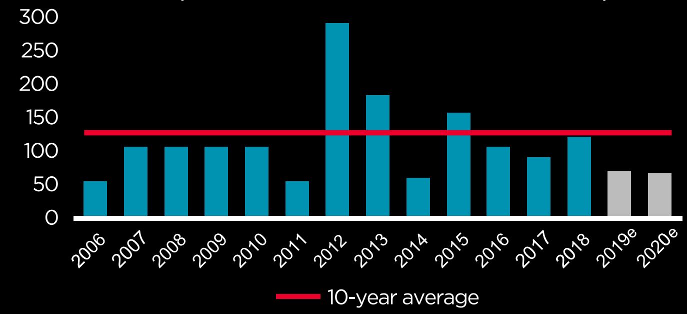
Vacancy is declining and most areas have had a positive development throughout the last 12 months. The vacancy rate currently stands at 7.3% in Greater Oslo, down from 7.6% in Q1-17. The drop in vacancy is in part due to strong demand for office space, but mainly due to few office projects being completed at the same time as there have been many conversion projects from office to mainly residential use.

Number of lease agreements and volume (6)

Office Projects 2018, Oslo

Project name	Main tenant	Sq.m.	Developer
Vitaminveien 4	The Health Dir.	24,000	Skanska
Drammensveien 151	Orkla	19,500	Orkla
Diagonale	TV2	16,250	HAV Eiendom
HasleLinje	Securitas	13,000	Höegh Eiendom & AF Gruppen
Schweigaardsgate 33	Bane NOR	12,000	ROM Eiendom
Grenseveien 80-82	Omsorgsbygg	11,000	BundeBygg
Philip Pedersens vei 9	Nemko	6,300	NCC
Hoffsveien 17	Metier OEC	6,000	Fram Eiendom
A14 Bjørvika	EnterCard	4,000	Watrium

Completed office stock, Oslo, 1000 sq.m



Source: Arealstatistikk (6)

Outlook

As mentioned the cycle continues to see an extraordinary level of capital targeting real estate and according to the Cushwake Investor Confidence index Q1 2018 (CICI) close to 70 percent 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 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 konsensusrapport) 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 the number of investors expecting an increase in retail yields has risen fourfold since Q3 2017. However, there is 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. This mirrors the broader European view on logistics.

Given the substantial investment appetite, and prevailing shortage of assets, we expect to see greater acceptance of risk and a narrowing of the gap between prime and secondary assets and between tier 1 and tier 2 cities, particular within the office sector.

The letting market favours lessors and there is general agreement that it will remain strong on a 1-2 year perspective as the supply/demand balance suggests continued upward pressure. CICI supports this view with 67 percent of investors expecting improved 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. Also, the ongoing residential repricing, if it continues in strength, will impact conversion rates and may dampen the broader economy, in turn impacting occupier demand.

CICI reports that most investors expect retail occupier demand to move sideways, but we have also seen a more than doubling of the 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 2018. Beyond 2018, 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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