INVESTMENT MARKET UPDATE

Interest continues

Norway Q2 2016

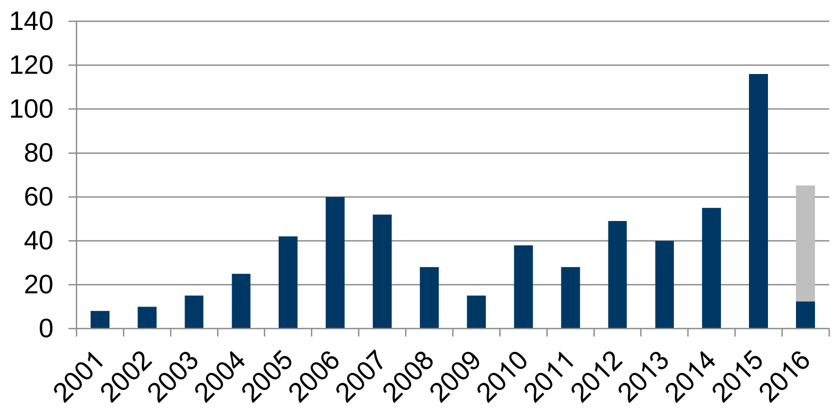
Date: 06 April 2016

Contents

- The Norwegian real estate market hit all-time high in 2015 with a transaction volume of 116 bNOK. Due to uncertainties in the macro economy the market this year has opened sluggishly, with few eye catching transactions initiated.
- Thus, Q1, which normally is an inactive quarter due to the overly active Q4, has so far logged a transaction volume of 12.3 bNOK, which is approx. 30% down from Q1 2015.
- However, interest both international and domestic has been reported, supporting activity to catch up the next months.
- Borrowing costs for real estate companies remain relatively unchanged despite increase in bond spread.
- Yield gap has decreased marginally since Q4, but remains attractive.
- The Central Bank had its first announcement of the Executive Board's interest rate decision on 17 March. The interest rate decreased 25 bps to 50 bps.
- The largest transaction this quarter was an NRP Finans' syndicate purchase of Raufoss Industripark for 1.3 bNOK.
- Alternative investments in bonds and stock market remain uncertain and incentivise real estate investments.
- Prime office yield is estimated to around 4.00%, and we believe in a further compression towards 3.75%

Figure 1

Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: Cushman & Wakefield Research

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Skedsmo Senter, Akershus, sold to Scala Retail Property in January. Cushman & Wakefield advised the vendor, Ica Eiendom Norge, in the transaction.

The Capital Market

Cost of Capital

Bond spreads experienced a significant increase in 2015 with a constant steep upwards development since February. However, this was a global trend which most analysts explain by tighter liquidity. Looking at Figure 2, it appears bond spread slopes are flattening out entering the new year. On the other hand, swap rates were significantly decreasing since Q2 2015, keeping the sum of bond spreads and swap rates mostly at the same level. Regarding recent activity, it appears swap rates continue downwards, implying higher bank margins.

Borrowing Terms

The Central Bank's latest survey of banks' lending policy was slightly more positive than the previous quarter, when the number of banks expecting to reduce exposure was the highest since 2008, both for commercial real estate and total lending. The most obvious reason for this is that the banks got too restrictive in Q4.

A direct effect of the stricter bank policies is the gradually decreasing LTV-ratio, which now rarely exceeds 60%. Furthermore, banks are increasing their lending margins, implying fewer loans are given, resulting in less competition and perhaps a stabilizing yield gap.

It is worth noting that life insurance companies are issuing real estate loans. The equity ratio requirement when investing in direct real estate is higher than when issuing real estate loans. The lower equity ratio requirement also applies to bond investments, making these placement alternatives more attractive with regards to maintaining the exposure to the real estate asset class.

Restrictions in credit have led to longer closing processes in certain deals, and to abortion of others.

The Central Bank had its first announcement of the Executive Board's interest rate decision on 17 March. As expected, the interest rate was reduced with 25 bps to 50 bps.

Real Estate Yields

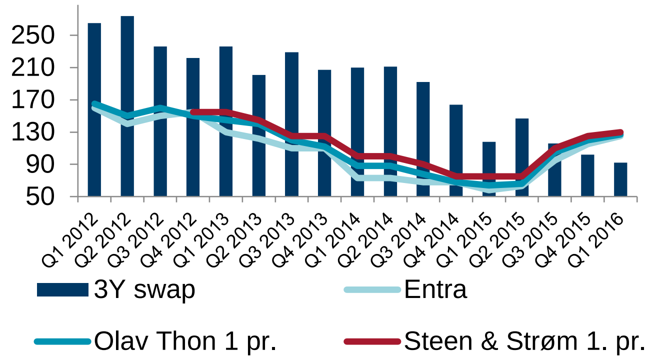
Evidence of the low yield level includes German Bayerische Versorgungskammer's purchase of Landkredittgården, at a reported yield around 4.00%, and CBRE Global Investors purchase of Hieronymus Heyerdahlsgate 1, which we estimate at +/- 4.00% depending on which parameters included in the calculation. We therefore lower our estimate for prime yield to 4.00%.

Equity Market

Entra's share price is up 10%, while NPRO's share price is down 0.1%. Olav Thon's share price is down 6.6% and the total OSEBX index is down 5%. Rate changes are from 04 January to 29 March 2016.

Figure 2

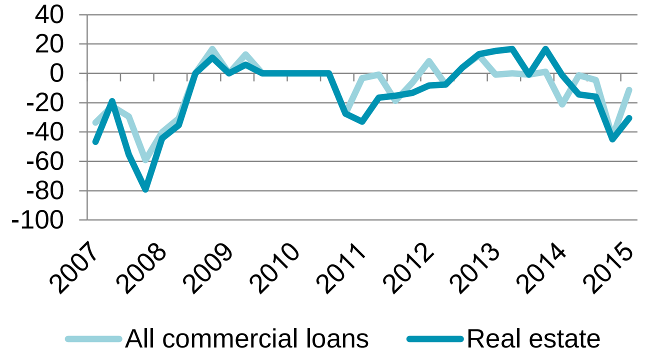
Swap rates 3Y and Bond spreads 3Y (bps)



Source: DNB Markets, Kommunalbanken Norway

Figure 3

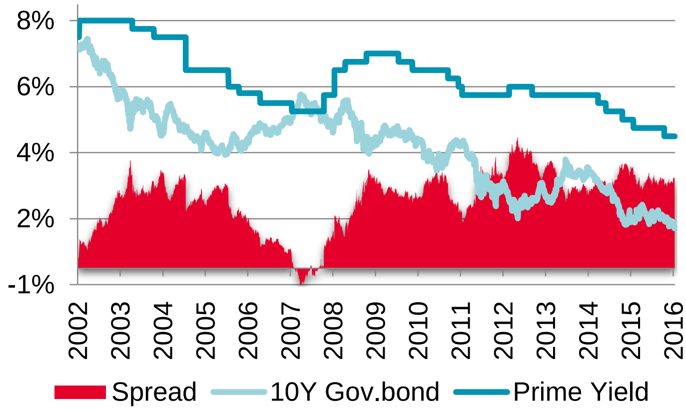
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield gap



Source: SEB , Central Bank, Cushman & Wakefield Research

Kongens gate 12, Oslo sold to Canica in December. Cushman & Wakefield advised the vendor, Alliance Eiendom, in the transaction.

Norway Q2 2016

Activity in Q1

Transactions worth 12.3 bNOK have been logged in Q1. 22% of the transaction volume had international buyers, which is 2 percentage points higher than the last quarter and 13 percentage points lower than Q1 2015. The vendor categories "Corporate" and "Private individuals" have been more active the last quarter than before. This indicates smaller property owners utilize the attractive yield levels. It is also worth noting that institutions and syndicates constitute 24% and 25% of the purchasing volume, respectively.

The sale of Raufoss Industripark, comprising 240,000 m2 mixed use property was finalized in late February. An NRP syndicate with H.I.G. Capital as the major investor purchased the property. We estimate the international share of this transaction to around 70-80%. The industrial park is located 120 km north of Oslo and is a well-known supplier of diversified and advanced mechanical products.

After a sales process initiated in October 2015, the ownership of Hieronymus Heyerdahls gate 1 changed hands in mid-February. The transaction received great attention due to its prime location next to the city hall in Oslo. Beating the most recognized real estate players in Norway, CBRE Global Investors acquired the 14,000 m2 office building for 920 mNOK.

The private equity company Hitec Vision established the real estate company Asset Buyout Partners in 2015 with intention to buy distressed office assets from companies within the oil and gas sector. Their first acquisition was completed early January and comprised five properties from the NorSea Group. Two of the properties are located outside of Bergen, another two in Hammerfest and the last one outside of Kristiansund. Total area equals 31,000 m2 and the sales price was reported at 875 mNOK.

Eiendomsspar, a Norwegian property company sold one of their prime located properties, Rådhuspassasjen, in January. The property was acquired by Nordea Liv, Nordea Bank's life insurance subsidiary, for 602 mNOK.

Table 1

Selected transactions Q1 2016

Asset	Purchaser	Vendor	mNOK	Type
Raufoss Industripark	NRP syndicate (H.I.G Capital)	Storebrand	1 300	Industrial
Hieronymus Heyerdahls gate 1	CBRE Global Investors	Bendixen family	920	Office
NorSea Portfolio	Hitec Vision	NorSea Group	875	Office
Zander Kaaes gate 7	KLP Eiendom	Rom Eiendom	760	Office
Statens Hus, Stavanger	NRP syndicate	Pareto syndicate	700	Office
Total transaction volume Q1			**12 300**	

Figure 5

Property transaction types Q1 2016

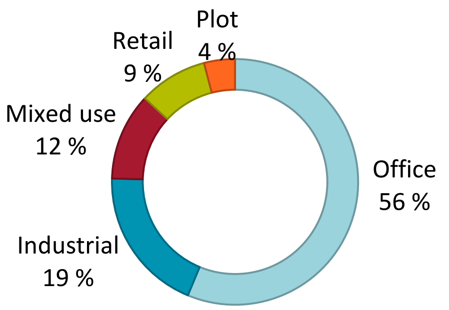


Figure 6

Buyer nationalities Q1 2016

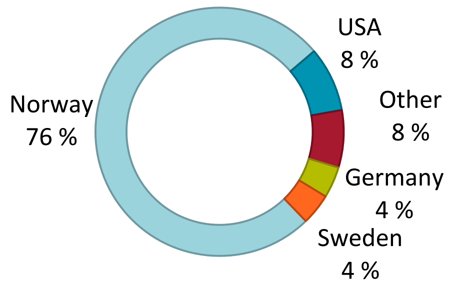


Figure 7

Buyer categories Q1 2016

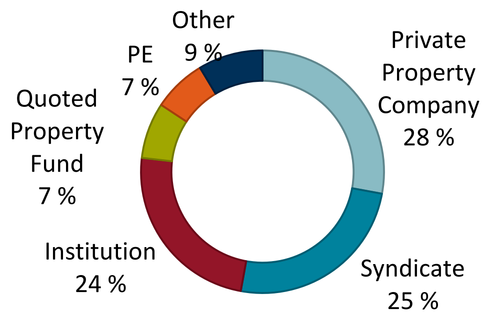
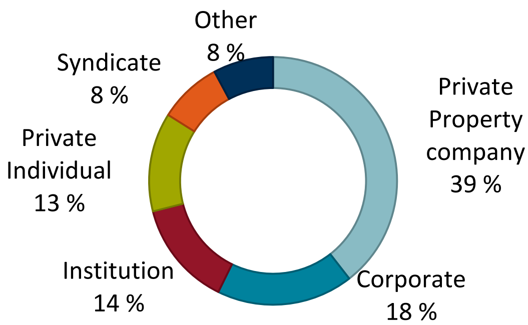


Figure 8

Vendor categories Q1 2016



Outlook

Leaving 2015 with both a transaction and yield record affected the activity in the first quarter negatively. Most eye catching transactions had slid over from Q4 and few new objects were released in the marked. However, we are aware of some yield record breaking bids reported this quarter and we expect some of them to cause attention to the office market as Q2 emerges.

As in the previous quarter, low yield levels incentivise smaller property owners to sell. We expect that prime locations in Oslo owned by family offices or non-real estate corporations will change hand.

We expect life insurance companies with exposure to real estate to gradually divest this asset class to free up capital with regards to the stricter capital cover standard proposed in the Solvency 2 and reinvest this capital in real estate bonds and issue loans. This could compensate for the increasing bond spreads.

The need for alternative financing through bonds and investor equity will continue to increase due to the stricter lending policies. This has already slowed down some and terminated ongoing deals.

Furthermore, we expect 3-year bond spreads to stabilize between 120 and 130 bps and swap rates to decrease gradually, making borrowing terms for real estate companies better.

The oil price has had great impact on a city like Stavanger and a submarket like Fornebu, due to their oil exposure. Still, property owners in the respective areas haven't yet been willing to cut losses by selling off their constantly value losing assets. We don't expect this to change considerably this quarter, but as we know the liquidity gets tighter, some might be forced to sell. Reportedly, attention for distressed assets in oil and gas exposed locations has increased lately. With an increasing oil price we expect some activity to arise in this segment.

On the other hand, Trondheim, with limited exposure to the oil price and investments could experience interest from both national and international investors. Norway is still considered as an attractive country to invest in and Trondheim's best office locations haven't seen the same yield compression as in Oslo.

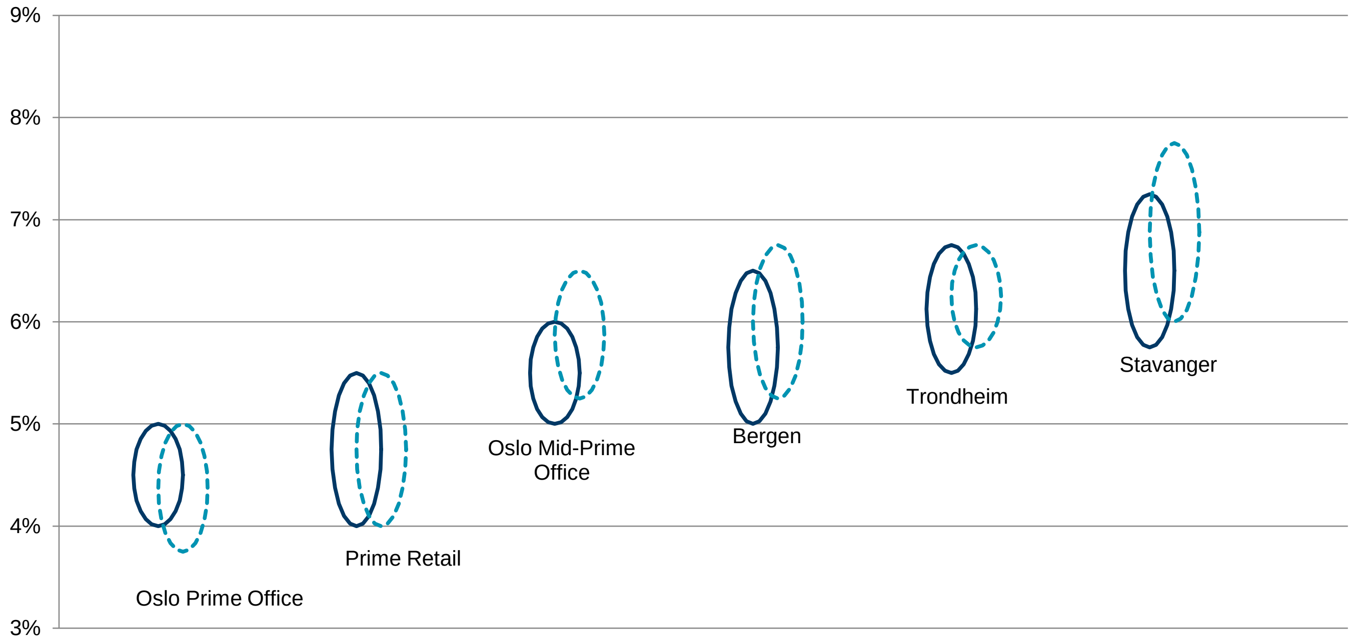
The impact of 0.3% property tax in Oslo implemented in January 2017 will depend much on the valuation principles. In Bergen, Stavanger and Trondheim, the tax base for office property is NOK 8,400, NOK 7,000-8,500 and NOK 5,000 per m2, respectively, but with case-by-case adjustments. The base amounts in these cities were fixed in 2003-6, and we believe Oslo's valuations would average at least 10-15,000 NOK per m2. This would imply an additional cost of 30-50 NOK/m2 year or an upwards yield shift of around 10-15 bps on the present net rent, all other factors being equal.

The Central Bank has two announcements of the Executive Board's interest rate decision in Q2. We expect a decrease of 25 bps to 25 bps in Q2 if the oil price does not pick up.

We expect the prime yield in Oslo to decrease to 3.75% based on ongoing transaction processes with bids supporting this. These and other events occurring in Q2 will be elaborated in our Q3 Investment Market Update.

Figure 9

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



Source: Cushman & Wakefield Research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