DTZ Research

INVESTMENT MARKET UPDATE

Leaving the record year

Norway Q1 2016

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Contents

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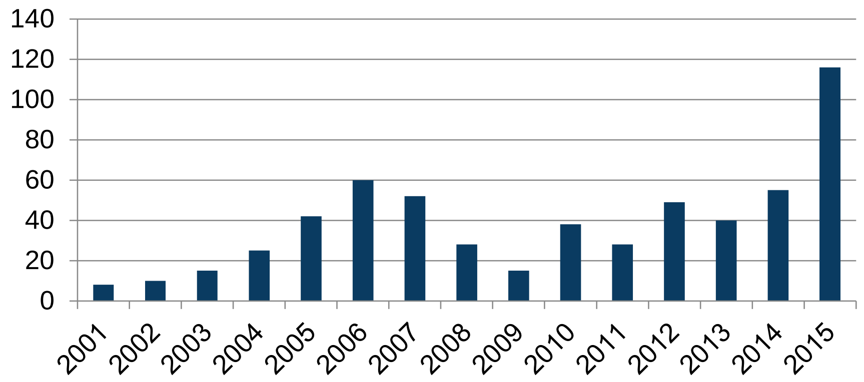
- 2015 was a year of unprecedented activity in the transaction market. By the end of Q4, transaction levels had reached incredible 116 bNOK, almost twice as high as the previous record from 2006
- Q4, which normally is the most active quarter ended up with a total of 48 bNOK
- DNB Liv has completed four major sales transactions, comprising the shopping center and office property Oslo City, the headquarters of DNB at Bjørvika, the Clarion Hotel Royal Christiania and Sjølystparken at Skøyen.
- Borrowing costs for real estate companies remains relatively unchanged despite increase in bond spread. Tougher to get bank financing
- Yield spread increased in Q4 and remains attractive even at record low yield levels.
- The Central Bank decided to keep the key interest rate at 75 bps both in November and December. They pointed out that the effects from the oil price decline and the reduction in oil investments slowly appear, and that expected growth will be weaker than expected. Furthermore, they fear real estate prices and debt would increase additionally with lower interest rates and by that justify their defensive monetary policy
- The largest transaction this quarter was Swedish pension insurance company AMF's purchase of 50% of Oslo Areal for 3.3 bNOK.
- Alternative investments in bonds and stock market remain unattractive and incentivise real estate investments.
- Prime office yield stands at around 4.25%, as in Q3, but with potential of a downwards shift to 4.00% as Q1 initiates

Figure 1

Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: DTZ Research

Kongens gate 12, Oslo sold to Canica in December. DTZ advised the vendor, Alliance Eiendom, 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. This was however, a global trend which most analysts explain by tighter liquidity. Looking at Figure 2, it appears the increase of the bond spreads is stabilizing closing 2015. On the other hand, swap rates decreased gradually throughout the year, keeping the sum of swap rates and bond spreads unchanged or decreasing. This indicates that the borrowing costs for the three selected real estate firms have not increased significantly the last three quarters, despite the significant bond spread increase.

Borrowing Terms

The Central Bank's survey of banks' lending policy was slightly better in Q4 than in Q3 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 the previous quarter and realised they could ease down.

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

It is worth noting that life insurance subsidiaries of banks are issuing real estate loans with the freed up capital from the real estate divestment. Interestingly, the equity ratio requirement when investing in real estate is often twice as high as when issuing real estate loans. The lower equity ratio requirement also applies to bond investments, making those two placement alternatives more attractive with regards to keeping 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 kept the interest rate in at 75 bps in both November and December.

Real Estate Yields

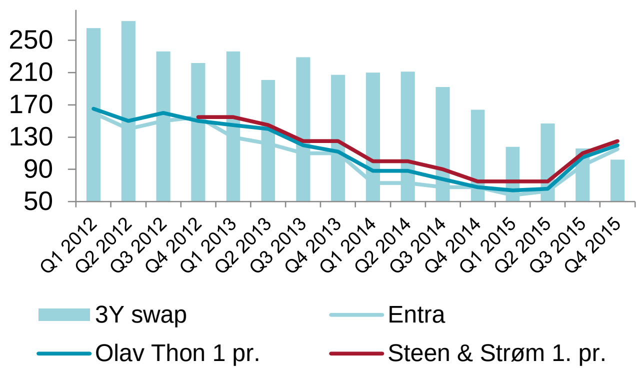
Evidence of the low yield level include the purchase of DNB's headquarters at Bjørvika by Trond Mohn in November, at a reported yield of around 4.3% and a Pareto syndicate's purchase of Sjømannsskolen in December at around 4.0%. We keep our estimate for prime yield at around 4.25% knowing DNB's headquarters are located in the *Barcode,* which not yet is considered as the prime CBD.

Equity Market

Norwegian real estate stocks performed poorly during 2015. Entra's share price was down 6.9% (3.6% adjusted for dividends), while NPRO's share price is down 13.4% (no dividend declared). Olav Thon's share price is 13.1% up (14.6% adjusted for dividend). The total OSEBX index is up 5.8%.

Figure 2

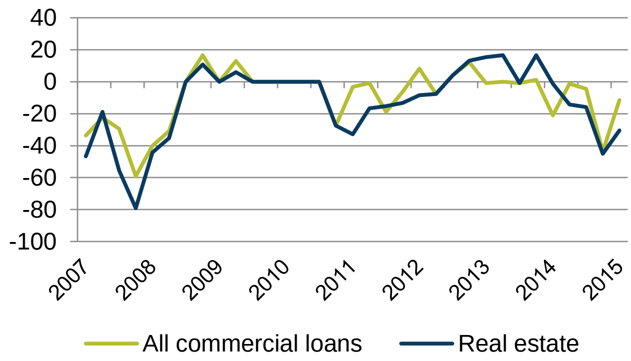
Swap rates 3Y and bond spreads 3Y (bps)



Source: DNB Markets

Figure 3

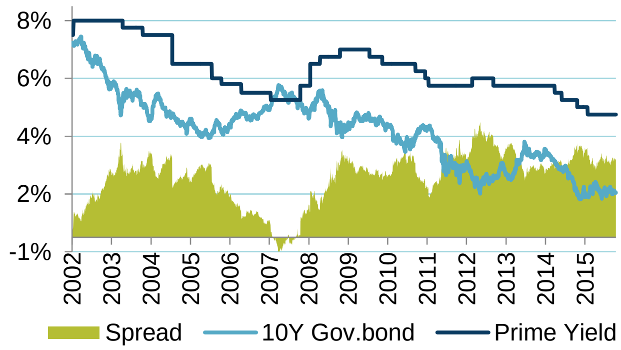
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield spread



Source: SEB , Central Bank, DTZ Research

Ammerudveien 20-22, Oslo sold to Fredensborg Eiendom for 139 mNOK. DTZ advised the vendor, Fearnley Finans, in the transaction.

Activity in Q4

Transactions worth 48 bNOK were logged in Q4, which is more than twice as high as the volume in Q4 2014 and 160% more than in Q3 2015. 27% of the transaction volume had international buyers, which is less than the 48% share looking at the whole year. In comparison, less than 2% of the transaction volume in Q4 had international vendors, which also was less than the 7% for the whole year.

AMF, the Swedish pension insurance company purchased 50% of Oslo Areal from Gjensidige Forsikring in October for 3.3 bNOK. Oslo Areal's portfolio comprise 250,000 m2 spread between 21 properties.

DNB Liv, which is the bank's life insurance subsidiary, sold Oslo City, the shopping center with one of the highest turnover per square meter in Norway for 5 bNOK to Steen & Strøm and Entra. Steen & Strøm and Entra purchased the retail and office sections, respectively. The property's total area amounts to 80,000 m2.

DNB Liv also sold DNB's main building at Bjørvika to Trond Mohn for 3.9 bNOK. This price divided on the property's area of around 49,000 m2 indicates a square meter price of about 80,000 NOK.

Late November Petter Stordalen and Varner acquired the Clarion Hotel Royal Christiania from DNB Liv for 1.8 bNOK. The property comprises 42,000 m2 shared between hotel, retail and office. The hotel also has a substantial development potential.

The three above mentioned sales by DNB Liv as well as the fourth the forth sale mentioned in the summary were all incentivised by the stricter capital cover standard proposed in the Solvency 2. The sales advisors for the projects Oslo City and the DNB headquarter were given only 2 months to complete the transaction in order to close the deals before the end of 2015.

Fornebuporten, 83,500 m2 office and retail including new headquarters of Aker ASA was sold by Aker to a Pareto syndicate in October for 3.2 bNOK. Main shareholders of the syndicate were Joh. Johannson Handel AS, Fornebuporten Holding AS (subsidiary of Aker ASA), Watrium AS and The Resource Group TRG AS.

Oslo Airport's best located hotel, Radisson Blue Hotel Gardermoen, was in November acquired by O.G Ottersland for 1.58 bNOK. The hotel has 500 rooms and has been owned by state-owned Avinor since the opening in 1998.

Pareto Securities syndicated the purchase of two Statoil offices in Trondheim and Stjørdal for 1.75 bNOK. The transaction comprised 72,000 m2.

Table 1 – Selected transactions, Q4 2015

Asset	Purchaser	Vendor	mNOK	Type
Oslo City	Steen & Strøm (2/3) Entra (1/3)	DNB Liv	5 000	Retail/ Office
DNB HQ, Oslo	Trond Mohn	DNB Liv	3 900	Office
Portfolio Oslo Areal	AMF	Gjensidge Forsikring	3 300	Mixed use
Fornebuporten	Pareto syndicate	Aker ASA	3 200	Office
Land plot at Ulven	OBOS	Storebrand	2 300*	Land plot
Shopping centers	Amfi Eiendom	Reitan	2 100	Retail
Clarion Hotel Royal Christiania	Stordalen/ Varner	DNB Liv	1 800	Hotel
Statoil buildings	Pareto syndicate	Statoil ASA	1 750	Office
Radisson Blue Hotel Gardermoen	O.G. Ottersland	Avinor	1 580	Hotel
DNB building, Bergen	Storebrand	GC Rieber Eiendom	1 472	Office
Total			**48 000**	

Source: DTZ Research
** Estimated*

Figure 5

Buyer categories 2015

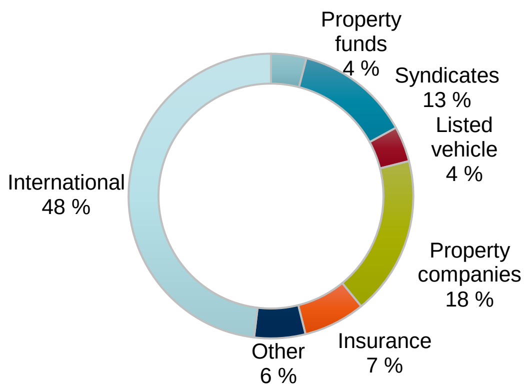
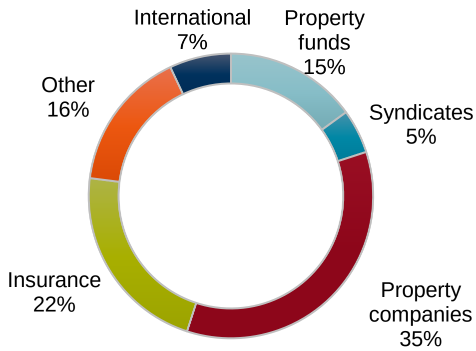


Figure 6

Vendor categories 2015



Outlook

Leaving 2015 with both a transaction and yield record it is reasonable to believe the market will slow down again. Especially, since Q1 normally has less activity and most big deals done this quarter mostly have slid over from Q4. However, as we know the interest in real estate from investors is not over yet we expect an eventful first Q1 with further yield compression.

Record low yield levels incentivise smaller property owners to sell. It is expected that prime locations in Oslo owned by family offices will change hand. Hieronymus Heyerdahls gate 1, the building next to the town hall in Oslo, which has been owned by three generations of the Bendixen family, has already been announced in the market and is expected to be sold in Q1 at a yield below 4.50%.

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.

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.

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.

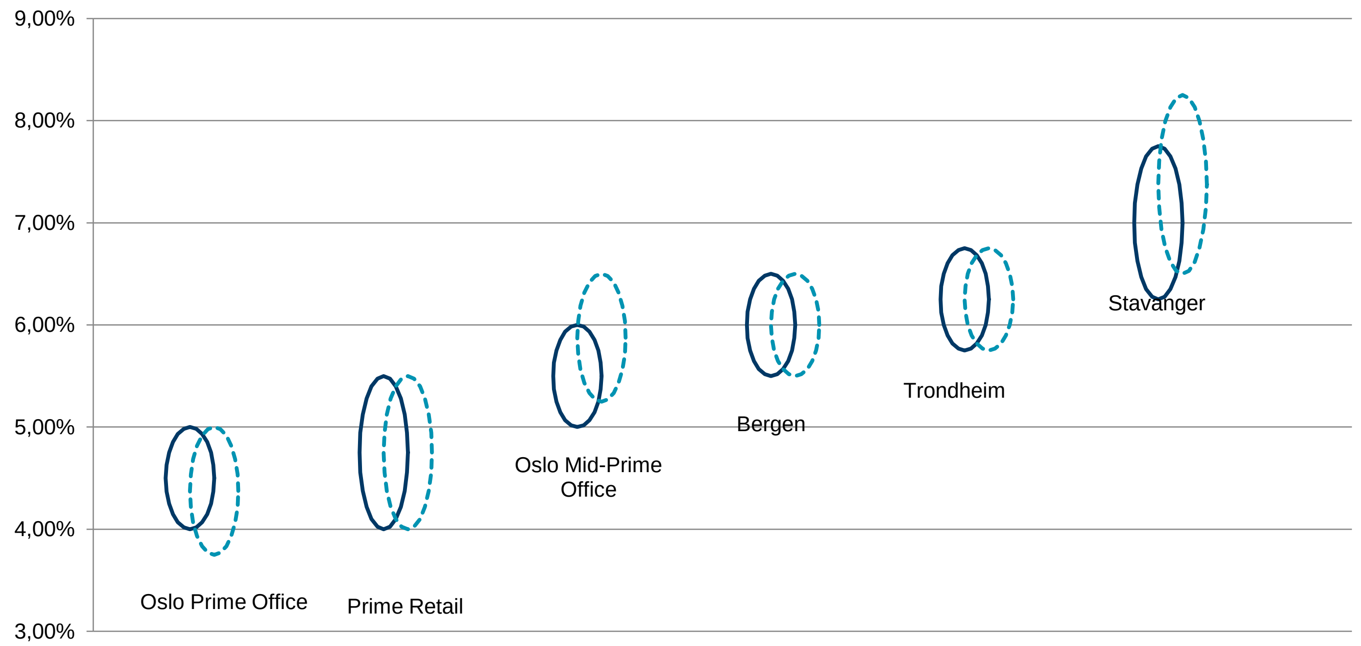
The impact of 0.3% property tax in Oslo implemented in January will depend much on the valuation principles. In Bergen, Stavanger and Trondheim, the tax base for office property is NOK 8,400, NOK 7,000-8,500 and NOK 5,000 per m2, respectively, but with case-by-case adjustments. The base amounts in these 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 says they await the consequences of the situation regarding the oil and opens up for an interest rate reduction in the first half of 2016.

We expect the prime yield in Oslo to decrease to 4.00% based on ongoing transaction processes with bids supporting this. These and other events occurring in Q1 will be elaborated in our Q2 Investment Market Update.

Figure 7

Yield curve; Q1 (full line) and forward estimate (dotted line)



Source: DTZ Research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