DTZ Research

INVESTMENT MARKET UPDATE

Yield compression slows down

Norway Q4 2015

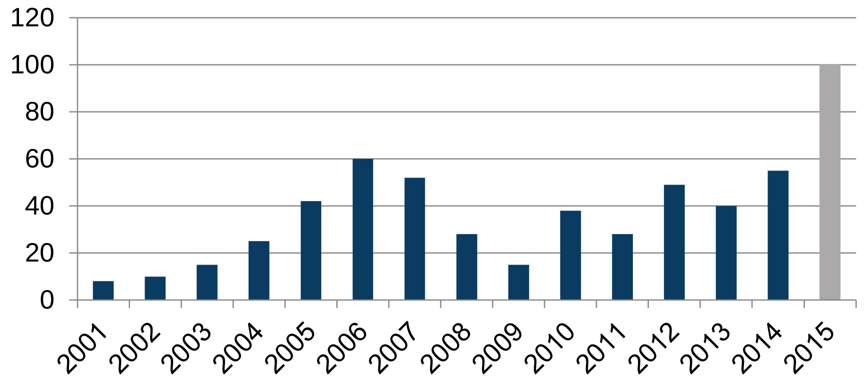
Date: 20 October 2015

Contents

- 2015 has been a year of unprecedented activity in the transaction market. By the end of Q3, transaction levels had already reached 69 bNOK, higher than the previous full-year record from 2006 – with the traditionally most active fourth quarter yet to come.
- Q3 is normally a relatively quiet transaction market in Norway, but total transactions in the quarter reached 18 bNOK this year.
- There is growing concern over events in the credit market. Indicative bond spreads have moved out more than 50 bps for the strongest issuers, and banks also see increased cost of marginal funding. Some banks have already increased margins, especially for new clients.
- Regional elections in September resulted in victory for left-wing coalitions in Bergen and Oslo. In Oslo, introduction of 0.2% property tax seems probable in 2017, increasing to 0.3% in 2018. The new coalition in Bergen intends to leave the property tax there unchanged.
- Despite a further reduction in the policy rate, to 0.75%, in September, and lower 5-year SWAP rates, we expect that higher bank margins might have a higher impact and that total borrowing cost could increase if the situation persists. An upwards pressure on yields could result.
- The largest transaction this quarter was Meyer Bergman's purchase of a prime retail portfolio in central Oslo for 5.3 bNOK. Estimated net yield was close to 4.0%.
- Blackstone acquired a global portfolio, worth 23 billion SEK, from Obligo investor vehicles in July. Around 3.7 billion NOK related to assets in Norway.
- Prime office yield stands at around 4.25%, as in Q2, but with risk of upwards shift going forward.

Figure 1

Commercial Real Estate Transaction Volumes, Norway (bNOK)



Source: DTZ Research

Author

Jørn Høistad
Partner, Analysis & Research
+47 928 28 437
jorn.hoistad@dtz.no

Contacts

Carl Mikael Sundberg
Analyst
+47 452 08 583
carl.mikael.sundeberg@dtz.no

Nikolai Staubo
Analyst
+47 930 27 540
nikolai.staubo@dtz.no

Magali Morton
Head of EMEA Research
+33 61217 1894
magali.marton@dtz.com

Smallvollveien 65, Oslo, sold to W. P. Carey for 815 mn NOK including transaction costs. DTZ advised the vendor, Coop Norge, in the transaction.

Norway Q4 2015

The capital market

Cost of Capital

Bond spreads had started to widen in Q2, but In September, the market changed considerably, with steep increases in the spreads. This is a global trend, which most analysts explain by tighter liquidity. By October, spreads for the best Norwegian real estate issues (Olav Thon and Entra) had widened by around 50 bps, according to DNB.

To date in 2015, real estate bonds worth 9.2 bNOK have been issued in Norway. Of this, 4.25 bNOK related to the Citycon and Colony acquisitions of Sektor Eiendom and Statoil Forus, at 155 and 170 bps, respectively. The market has stalled with only two other, relatively small, issues in Q3.

Borrowing terms

The volatility in the bond market has not yet caused dramatic change in the market for direct lending, but as banks' own funding costs increase, we are likely to see more impact if the situations persists. Some of the larger banks have already increased margins for new clients, and consider increasing margins for existing clients as well going forward.

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

The Central Bank's survey of banks' lending policy was very negative in Q3. Banks expecting to reduce exposure was the highest since 2008, both for commercial real estate and total lending.

The Central Bank announced yet another interest reduction in September, and the 5-year swap rate came down around 40 bps during Q3. This has eased the impact of higher spreads, and caused total borrowing cost to remain relatively stable.

Real Estate Yields

Evidence of the low yield level include the purchase of Munkedamsveien 62 by Deka Immobilien in July, at a reported yield of around 4.3%-4.4%. We now estimate prime yield at around 4.25%. The property is located just outside the conventional CBD, and had been acquired by the seller, Ragde Eiendom, at 5.6% yield only 10 months earlier. This substantiates a prime yield estimate of 4.25%, though the deal was made in an environment with lower credit spreads than today.

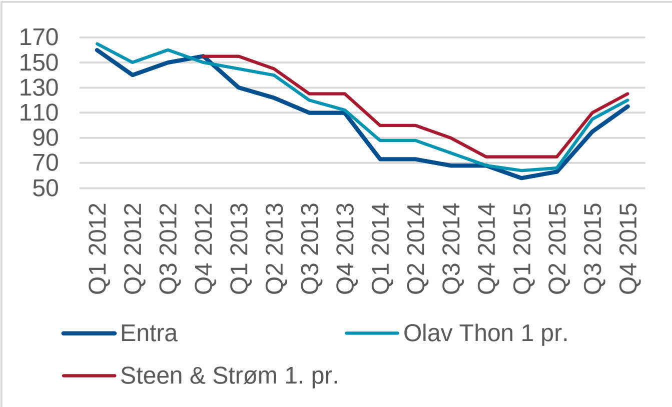
Equity market

Norwegian real estate stocks performed very well during Q1, but peaked in March. Entra's share price is down 9.6% YTD (6.4% adjusted for dividends), while NPRO's share price is down 6.8% YTD (no dividend declared). Olav Thon's share price is 9.5% up YTD (11.5% adjusted for dividend). The total OSEBX is index is up 6.2% YTD.

.

Figure 2

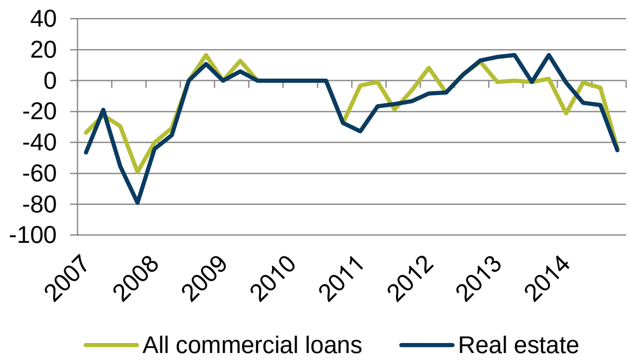
Bond spreads (bps)



Source: DNB Markets

Figure 3

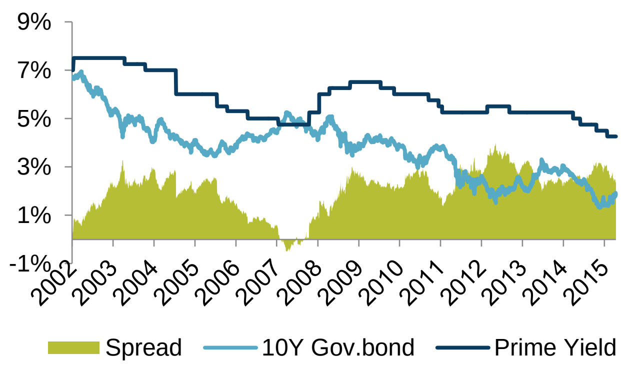
Banks' lending policy towards commercial real estate



Source: Central Bank

Figure 4

Yield spread



Source: SEB , Central Bank, DTZResearch

Sundtkvartalet, Oslo. DTZ has assisted Manpower throughout the process of relocating their head office to this new location near the Aker river.

Norway Q4 2015

Activity in Q3

Transactions worth 18 billion NOK were logged in Q3.

Meyer Bergman purchased the "Promenaden" portfolio of prime retail assets in central Oslo for its European Retail Partners II fund. The sellers were Søylen Eiendom (65%) and Madison International Realty (35%). The properties are located around Eger square, and have been developed into luxury-brand outlets by Søylen during the last years. Tenants include Hermes, Gucci, Bottega Veneta and Georg Jensen. Madison's investment in the company came in 2013. Meyer Bergman had previously (2014) purchased another property, Grensen 17, from the Søylen-Madison partnership.

Blackstone Group LP acquired a Northern Europe portfolio valued at bSEK 22 in July, of which an estimated bNOK 3.7 relates to assets in Norway. The deal also comprised real estate in Sweden, Germany, Finland, and Latvia – many within the residential sector. The Norway assets were predominantly office in regional towns, of which a complex in Kongsberg, let by Kongsberg Maritime and FMC was the largest – originally purchased by Acta/Obligo for 1375 mNOK in 2007.

DNB Liv, which is the bank's life insurance subsidiary, sold the easternmost of the bank's buildings in Bjørvika to DNB Scandinavian Property Fund, for 1.2 bNOK. The transaction comprised the lower eight floors of the building. A total of 6,000 sq m of residential space, located on the upper seven floors, were not included in the deal. DNB Scandinavian Property Fund also acquired Quality Hotel Expo at Fornebu for 530 mNOK, or mNOK 1.75 per room.

Nedre Skøyen vei 24-26 has been a question mark in the Skøyen market since its only tenant, Evry, moved to Fornebu in 2013. Orkla has subleased the property from Evry, but will move into a new headquarter nearby. The situation has now been clarified through the sale to Veidekke, which will construct a new headquarter as well as 400 residential units at the site.

In late July, Wintershall Norge AS called an option to buy the 17900 sq m "Gullfaks" building at Hinna, Stavanger. The property is under development by Entra and Camar Eiendom and Wintershall will occupy the building from its completion in Q3 2016.

The identity of the purchaser of Strandveien 4-8 has not yet been made public. The seller, Ferd Eiendom, acquired the property in 2013 and has invested mNOK 128 in rehabilitation prior to leasing 13.500 sq m (of a total 18.000 sq m) to Lundin.

Union Real Estate Fund has acquired Østre Aker Vei 264 from the Coop group. The property has been Coop's main storage and headquarter in Oslo, but Coop will vacate the premises and the property is subject to redevelopment. The price equals around NOK 12,000 per sq m.

In Q3, 57% of the transaction volume had international buyers. In total, international buyers have represented 50% of all acquisitions, and only 5% of the sellers.

Table 1 – Selected transactions, Q3 2015

Asset	Purchaser	Vendor	mNOK	Type
Retail portfolio	Meyer Bergman	Søylen / Madison	5300	Retail
Obligo Fund	Blackstone	Obligo	3700	Office
Østbygget, Bjørvika	DNB Scand. Pr. Fund	DNB	1224	Office
Confidential	Confidential	Confiden-tial	950	Indus-trial
N. Skøyenv. 24-26	Veidekke	NPRO	799	Office/ dev.
Gullfaks	Wintershall Norge	Hinna Park AS	700	Office
Strandveien 4-8	n/a	Ferd Eiendom	670	Office
Sommerogata 1-3	Aspelin Ramm, Home Invest ++	Høegh Eiendom	650	Office
Østre Aker vei 264	Union Real Estate Fund	Coop Norge	630	
Quality Hotel Expo	DNB Scand. Pr. Fund	Pareto	530	Hotel
Portfolio of 4 public-service assets	Arctic, Lerka Eiendom	Ski Holding AS	443	Public
Total			**18000**	

Source: DTZ Research

Figure 5

Buyer categories, Q1-Q3 2015

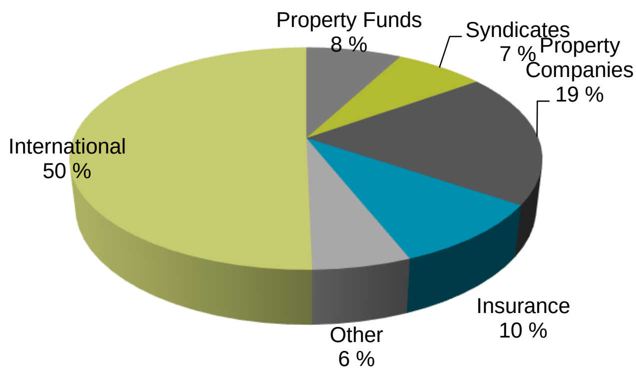
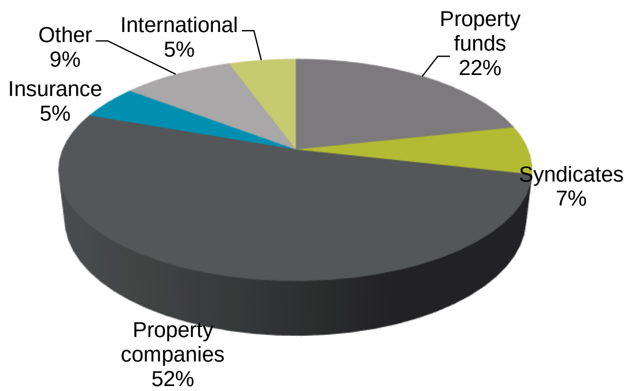


Figure 6

Vendor categories, Q1-Q3 2015



Outlook

The impact of 0.3% property tax in Oslo 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 sq m, 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 sq m. This would imply an additional cost of 30-50 NOK / sq m / year or an upwards yield shift of around 10-15 bps on the present net rent, all other factors being equal.

If events in the credit market persist, borrowing cost could also increase going forward. So far, the impact has not yet materialized in full. This is partly due to the time lag in transaction processes and in passing bank's marginal funding costs on to customers. It is also partly due to the fact that the fall in SWAP rates has, so far, compensated for wider margins.

The slowdown in the rental market continues, particularly in the fringe areas of Oslo, Stavanger and Bergen, but to a lesser extent in Trondheim. The central parts of Oslo (CBD, Skøyen) also see relatively low vacancy.

In sum, we expect that investors in markets sensitive to vacancy will find that a tougher credit market and uncertainty about property tax will add to the risk caused by the macro economic challenges. As there are few evident impulses strong enough to fully compensate for the increased risks, yields could move upwards in some segments.

There have been reports of transactions that have been aborted due to financing difficulties. In particular, special-purpose vehicle with no resort to parent group balance sheets or organizations could face more difficult processes.

Going forward, the transaction market will also 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.

Some early movers among the international investors have benefitted both from yield compression and a weakening of the Norwegian currency. It will interesting to see whether they now choose to monetize their gain. Madison, with their exit from Promenaden, and Genesta, with their sales in Karl Johans gt and Grensen, are the only notable international sellers so far.

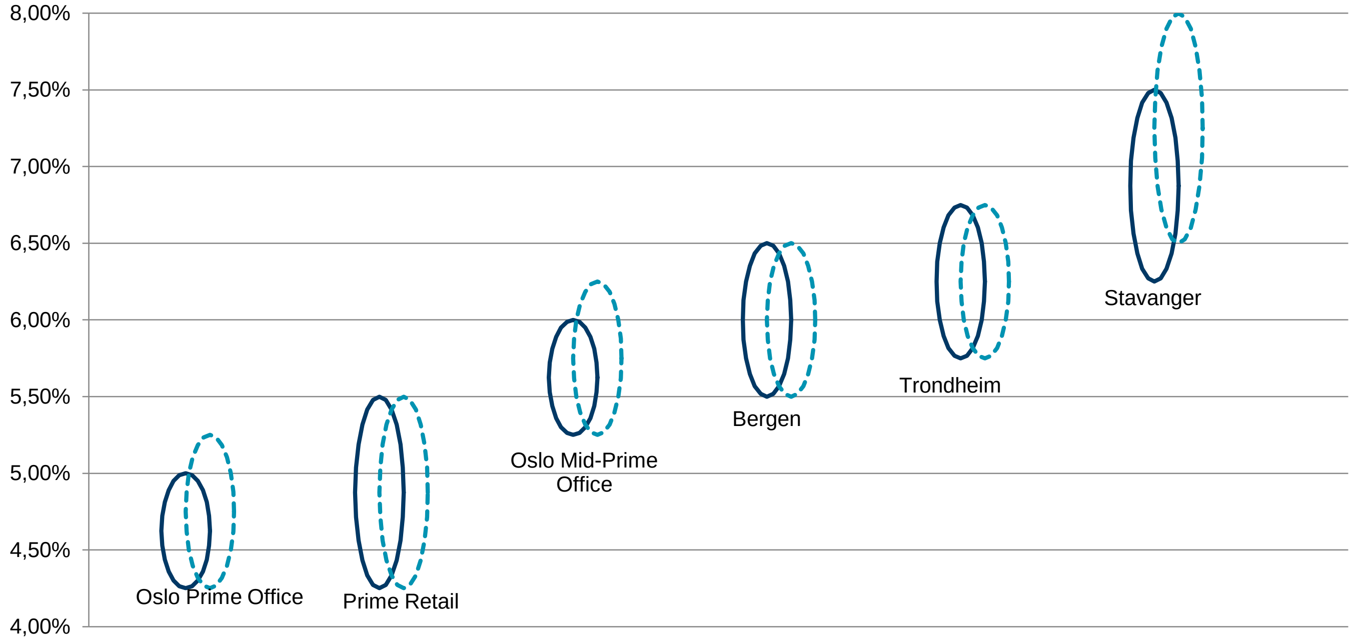
The U.S. Fed chairwoman, Janet Yellen, surprised the markets when the U.S. policy rate was left unchanged in September. International unrest appears to delay the expected increase.

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.

Q4 is always an active quarter. The transaction pipeline includes several large deals. These and other Q4 events will be elaborated in our next Investment Market Update.

Figure 7

Yield curve; Q4 (full line) and forward estimate (dotted line)



Source: DTZ Research


Kjøkken

Anne Bruun-Olsen
CEO / Partner DTZ Realkapital Eiendomsmegling
+47 91 78 65 15
anne.bruun.olsen@dtz.no

Anders Rennesund
Senior Advisor / Partner
Occupier Services
+47 90 03 91 84
anders.rennesund@dtz.no

Peer Christensen
CEO / Head of Capital Markets
Capital Markets
+47 90 91 51 77
peer.christensen@dtz.no

Lars Bruflat
Senior Advisor
Capital Markets
+47 46 92 40 30
lars.bruflat@dtz.no

Tor Svein Brattvåg
Head of Occupier Services
+47 91 55 70 47
tor.svein.brattvag@dtz.no

Arthur Havrevold Lie
Head of Valuation / Partner
+47 90 25 71 08
arthur.lie@dtz.no

Marius G. Dietrichson
Senior Advisor / Partner
Capital Markets
+47 98 65 72 15
marius.dietrichson£dtz.no

Terje Sorteberg
CEO
Realkapital Utvikling
+47 41 55 27 74
terje.sorteberg@rku.no

Maria H. Eriksen
Senior Advisor / Partner
Occupier Services
+47 90 07 75 65
maria.eriksen@dtz.no

Arne TW Eriksen
Senior Advisor
Valuation
+47 95 70 67 30
arne.eriksen@dtz.no

Erik Nic. Ingebrigtsen
Senior Advisor / Partner
Capital Markets
+47 92 82 39 04
erik.ingebrigtsen@dtz.no

Anders Brustad -Nilsen
CEO
DTZ Corporate Finance
+47 95 19 01 78
abn@dtz.no

To see a full list of all our publications please go to www.dtz.com/research

DTZ Realkapital AS
Munkedamsveien 35
0125 OSLO
NORWAY
Tel: +47 23 11 68 68
Mail: mail@dtz.no
www.dtz.no