MARKET UPDATE

September 2019

Malling & Co Project Finance has acquired Grenseveien 95 at Helsfyr in Oslo, which consists of 10 700 m² office and parking facilities – and arranged a "club deal" on behalf of its investors.

Latest figures Norway

- Statistics Norway's (SSB) new forecast for GDP-growth for Mainland Norway released 5 September was reduced from the June estimates to 2.4 % for 2019, while the 2020 estimate was kept at 2.2 %. Moreover, GDP-growth is expected to fall in 2021 and 2022, to 1.6 % and 1.4 % respectively. This is a significant reduction from the previous estimates from June.

- The unemployment rate (LFS) was measured at 3.6 % in June (avg. May-July), which is up 0.1 % points from the previous three month period measured in March (avg. February - April). Employment numbers from the LFS are showing a slight increase of approx. 3 000 employees over the same period, on a national level.

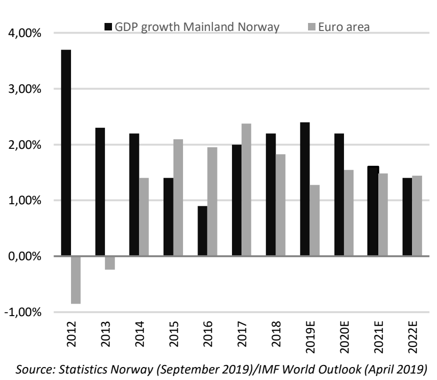
- The key policy rate was increased further to 1.25 % in June. This is the third increase since the record low level of 0.50 % that lasted from March 2016 to September 2018. The Norwegian Central Bank has signalled further hikes in 2019, but SSB signalled in their newest outlook that the key policy rate most likely have seen the top for now.

- Money market rates (3m NIBOR) have increased significantly over the first half of 2019 and is currently just below 1.70 %, up from 1.25 % at the start of January.

- The NOK has depreciated significantly against the EUR in the beginning of August. One EUR now trades at around 9.9 NOK.

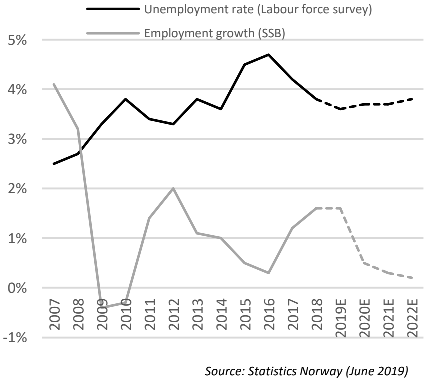
- 12 month rolling inflation for August was measured at 1.6 % and 2.1 % for the CPI-ATE. CPI has decreased over the past eight months.

GDP: Mainland Norway vs. Eurozone



Source: Statistics Norway (September 2019)/IMF World Outlook (April 2019)

Labour market Norway



Source: Statistics Norway (June 2019)

Latest lease contracts

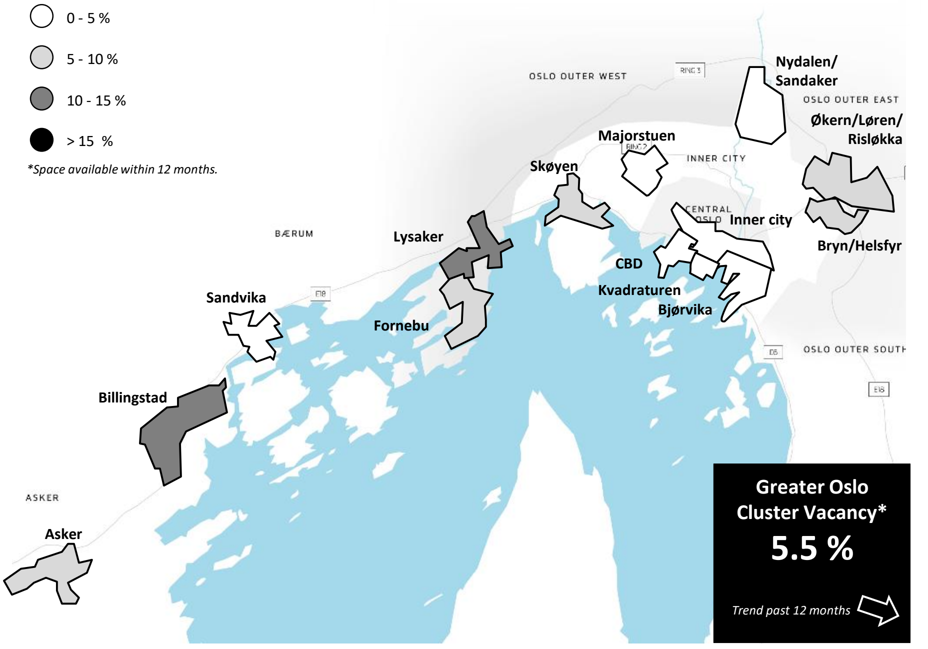
Tenant	Address /Cluster	Size (m²)
Høyskolen Kristiania	Urtegata 9 / Inner City	~ 10 000
Haavind	Haakon VIIs gate 10 / CBD	~ 6 000
Norconsult	Kongens gate 21 / Inner City	~ 2 800
Visolit	Pilestredet 33 / Inner City	~ 2 600
Lowell Norway	Brynsveien 14 / Bryn-Helsfyr	~ 2 200
Randstad Norway	Kristian Augusts gate 15 / Inner City	~ 1 600

Latest transactions

Buyer	Address	Size [1] (NOK million)
Union Real Estate Fund II	Valle Wood + View	1 830
Høegh Eiendom	Kristian Augusts gate 23	N/A
DNB Markets	Vinkelgården	375
Google	Land plot in Skien	Est. 300
Angelo Gordon	13 property retail portfolio	N/A

[1]Deal size may be rounded due to confidentiality

Vacancy* in office clusters in Greater Oslo (September 2019)



Number formatting: SI style (English version)

Commercial Real Estate

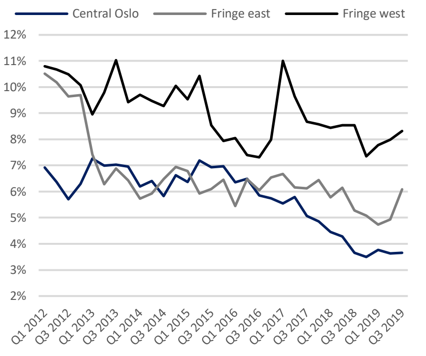
Oslo office market

- As discussed in our previous 2-pager update, the arithmetic average of all new office contracts signed in Q2 2019 jumped incredible 9 % from Q1 to Q2. The outlook for the Oslo office market remains strong well into 2020, despite a somewhat weaker economic outlook due to the global trade war and a chaotic Brexit situation.
- Our office rental growth forecast remains at 10-15 % for 2019 vs. the 2018 average. Office rental growth projections for 2020 is for now around 5 %, which is still way above expected inflation.
- Office vacancy remains at 5.5 % on average in the office clusters. It increased slightly in July after reaching 5.0 % earlier this year. This is however due to new constructions entering the vacancy, as they are being finalized next year. Net construction is expected to increase over the coming 24 months.
- The volume of large tenants on search is down from previous years due to lower volumes of expiring lease contracts in 2021 and 2022. However, the growth among Serviced Office providers is also affecting take up, and we expect WeWork to leave additional traces in the take up numbers before year end.

Transaction market

- The very strong H1 2019 transaction volume has, albeit not yet visible in the statistics, carried over into Q3. The tally is currently at 143 transactions for a total volume of NOK 46 billion. There is a positive sentiment among investors, and the deal flow is looking to be very positive for continuing the liquid market throughout 2019. We maintain our projection for 2019 of NOK 85-95 bn.
- Office continues to be the largest segment with a 50 % share. The second largest segment is industrial at 20 %, still driven by demand for logistics assets, and on par with retail which is at a 19 % share.
- Greater Oslo has close to a 50 % share of the market by volume, and other regions outside of the major tier two cities is close to a 35 % share by volume. Up roughly 10 percentage points over the last two years share, we see this as a continuation of the demand side coupled with the low yield levels. Please see our view on this in the special topic section.
- The prime office yield estimate remains at 3.75 % for CBD, and Prime office in the fringe areas are at 4.25 % and 4.35 % for Helsfyr and Lysaker, respectively. Prime logistics is now at 4.90 % and Prime retail is now estimated at 4.00 %. All levels are stable, but the development in interest rates could reapply pressure on yield levels, especially in the office and logistics sector.

Office vacancy development, Greater Oslo



Source: FINN.no/Malling & Co

Key facts real estate (office Oslo)

	PER SEP. 2019	PER SEP. 2018
Prime yield	3.75 %	3.75 %
Normal yield***	5.10 %	5.10 %
5 yr. swap rate (COB 10 Sept.)	1.64 %	1.88 %
Average of 15 % highest rents in Oslo, NOK/m²/yr. (Q2)	4 200	3 830
Office contracts signed, m² (Oslo) (Q2)	182 920	152 940
Largest office contract, m² (Oslo) (Q2)	13 940	15 173
Avg. contract length, yrs. (Oslo) (Q2)	4.9	5.4

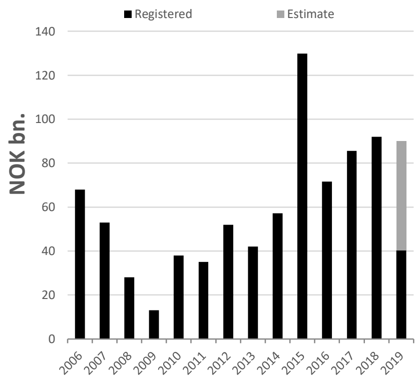
Source: Malling & Co/DNB Markets/Six/Arealstatestikk

Indicative office rents in Oslo (NOK/m²/yr.)

Office cluster	Prime rent*	Normal rent**
CBD (Vika/Aker B./Tjuvh.)	5 600	3 000 – 3 600
Bjørvika	4 200	3 200 – 3 400
Inner City	3 900	2 600 – 3 000
Skøyen	3 200	2 200 – 2 600
Lysaker	2 400	1 750 – 1 950
Nydalen/Sandaker	2 400	1 750 – 1 950
Bryn/Helsfyr	2 350	1 600 – 1 950
Økern/Løren/Risløkka	2 200	1 200 – 1 700
Fornebu	1 950	1 450 – 1 650

Source: Malling & Co

Transaction volume (>50 NOK million)



Source: Malling & Co

**Prime rents are consistently achievable headline rental figures that relate to a new, top located, high specification unit of a standard size commensurate demand within the predefined market area. The prime rent reflects the tone of the market at the top end, even if no new leases have been signed within the reporting period. One-off deals that do not represent the market are discarded.*
*** Normal rents reflect the interval where most contracts are signed in the specified market area.*
**** Normal yield is defined as the net yield of a well maintained building situated in the fringe zone with strong tenants on a 5 – 8 year lease contract.*

Special topic: Property yields in a world of inverted yield curves

Over the summer, we have seen inverted yield curves and government bonds plunge down further into the negative territory. This triggers most macro economists to ring the alarm bells of recession. What is likely to happen with real estate yields in a global recession scenario with ultra low interest rates?

Property values are usually quoted with net initial yields, which are current net rent over price. In a low interest rate scenario following a recession, the numerator is not affected in the short term as lease contracts continue towards expiry. However, the recession scenario will affect investors' long-term view on rents and might therefore affect the price the investor is willing to pay for the property. The individual effects of lower interest rates and a weaker rental outlook affect the price the investor is willing to pay in opposite directions. Reducing future nominal cash flows reduce the value all things equal, while reduced interest rates increase the value of future cash flows. So, which effect will be the strongest?

Let us assume that we are looking at prime office bought at net yield 3.75 %, that comes with a 10-year lease on market terms with 100 % CPI-adjustment. Given that market rents follow the CPI-change and yields remain at 3.75 %, the IRR would be 5.75 % (nominal unleveraged cash flows).

Over the past six months, the 10-year NOK swap rate has fallen from 2.2 % (Aug. 18) to 1.5 % (Aug. 19). This is 70 bps. down and will highly affect the discount rate used to value future cash flows. We will assume the 70 bps. reduction in discount rate will fully affect investor's willingness to pay for future cash flows.

In the 10-year case, we may allow market rents to have dropped almost 25 % from passing rent at the end of the 10-year lease, without affecting the initial yield at 3.75 %. If we reduce the rental income decrease from 25 % to 15 %, the initial yield could be lowered to 3.50 %. This indicates a potential for further yield compression unless investors are very bearish on the office letting market in the long run. Since the passing rent usually is signed long before the transaction, this rent is likely to already be below market rent due to the strong office rental increase seen over the past few years. In that case, the actual drop in future market rents from current market rents could be even higher without it affecting current yield. We believe this case could easily argue that the recent fall in long interest rates will push yields even further down from current levels.

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