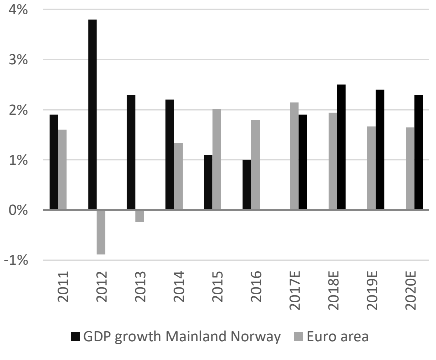
MARKET UPDATE
January 2018

Lysaker Park
Malling & Co Corporate Real Estate acted as advisor to Storebrand Livsforsikring in the sale of the 55 000 m² office complex. The property was sold to a syndicate set up by Arctic Securities for NOK 2.225 billion.

Latest figures Norway

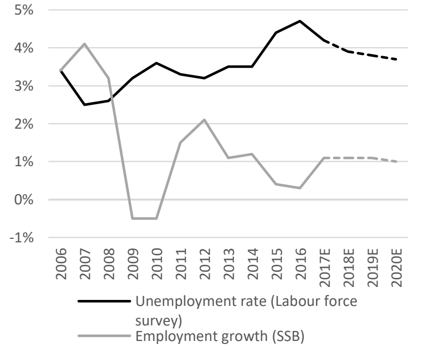
- The latest yearly estimate for Mainland Norway GDP-growth 2018 is 2.5 %, according to Statistics Norway (SSB). The estimate for 2019 stands at 2.4 %.
- The unemployment rate has been trending downwards since July 2016, and ended at 4.0 % (LFS) in October 17 (avg. Sept.-Nov). Employment is increasing, and the increase is expected to continue.
- The key policy rate was kept at the record low level of 0.50 % at the last meeting in December. The Norwegian Central Bank expects an increase in the key policy rate already in 2018, and the weakening of the NOK supports a potential increase.
- Money market rates (3m NIBOR) have been quite steady around 0.8 % since the summer.
- The NOK has depreciated approx. 8 % against the EUR comparing start of January 17 with start of January 18, while the NOK has appreciated about 5 % against the USD in the same period.
- CPI Nov-Nov, the most common period for rental adjustments, ended surprisingly low at 1.1 %. CPI is according to Statistics Norway expected to be approximately 2 % p.a. in the coming years.
- The crude oil price has increased steadily since the summer of 2017 from below 50 USD per barrel, and is currently trading just below 70 USD per barrel.

GDP: Mainland Norway vs. Eurozone



Source: Statistics Norway/IMF

Labour market Norway



Source: Statistics Norway (Nov. 17)

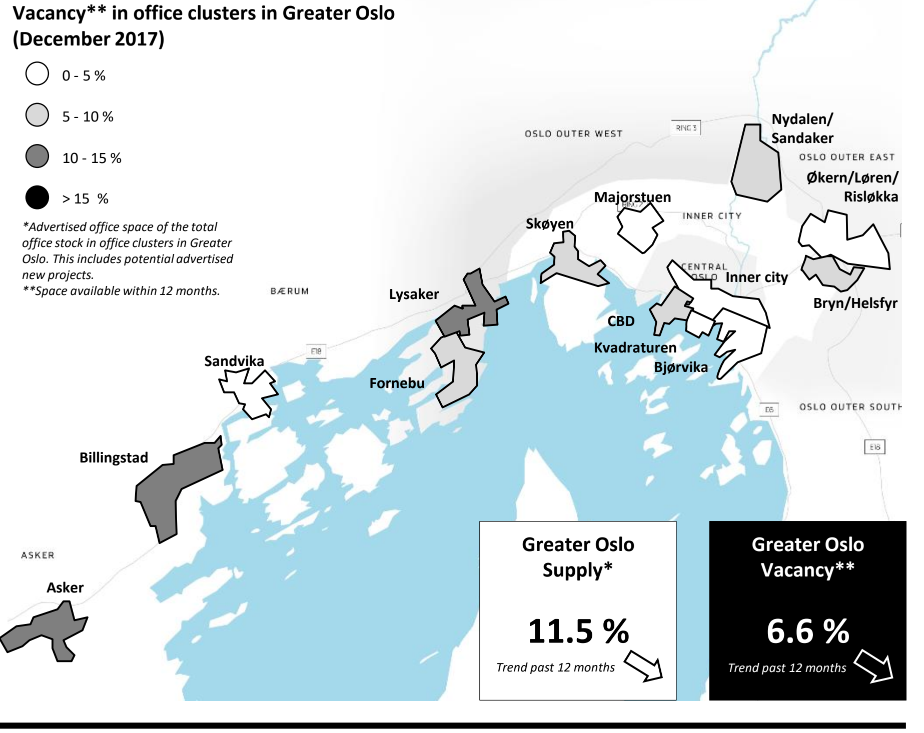
Latest lease contracts

Tenant	Address /Cluster	Size (m²)
Bane Nor SF	Schweigaards gate 33 / Inner City	~ 22 600
Thommessen	Ruseløkkveien 26 / CBD	~ 8 000
Via Egencia (Renegotiation)	Cort Adelers gate 30 / CBD	~ 4 120
Ræder	Dronning Eufemias gt. 11 / Bjørvika	~ 3 500
Geodata (Renegotiation)	Schweigaards gate 28 / Inner City	~ 3 400

Latest transactions

Buyer	Address	Size (NOK million)
NRP	Gaustadalléen 21	418
Aberdeen – NPF I	Bradbenken 1	N/A
Artmax AB	Arbins gate 2	321
Bergen kommune	Kanalvegen 52B	240
Hjertnes Eiendom	Borgerskogen 42	110

Vacancy** in office clusters in Greater Oslo (December 2017)



**Advertised office space of the total office stock in office clusters in Greater Oslo. This includes potential advertised new projects.*
***Space available within 12 months.*

Greater Oslo Supply*
11.5 %
Trend past 12 months

Greater Oslo Vacancy**
6.6 %
Trend past 12 months

Number formatting: SI style (English version)

Commercial Real Estate

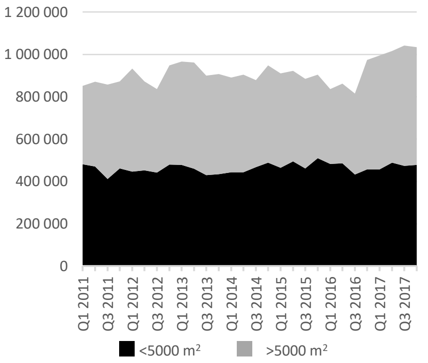
Office market

- The office vacancy level (office premises available within 12 months) has decreased since the summer of 2017, and is now at 6.6 % in the office clusters we follow. It should be noted that measuring vacancy leaves quite significant uncertainty. However, we are quite confident that the trend of decreasing vacancy in central locations is real, and supports a stronger office rental market.
- As we saw the total amount of offered office projects (supply) increased during 2017, this has now decreased as a consequence of several projects having secured an anchor tenant. We therefore expect construction to increase somewhat compared to previous years, however net additional supply is still rather limited.
- Office rents continue on a positive trend, and is expected to continue the growth throughout 2018. Low office vacancy, increasing economic growth in Norway, and low vacancy among central and high quality assets supports the positive outlook. The latest rental statistics from Arealstatistikk supports the strong letting market in 2017 with a y/y growth of around 10 %, way above the CPI of 1.1 %.

Transaction market

- The transaction market ended the year with a registered volume of approximately NOK 85 billion divided into almost 290 transactions, making 2017 a record year with the highest amount of transactions we have observed so far. Although the transaction volume is less than the record year of 2015, it is historically very strong.
- We have observed that banks are eager to finance projects, and thus we expect a strong market going forward with an estimated transaction volume of NOK 90 billion in 2018.
- We estimate prime office yield to be 3.65 % while our estimate for normal yield is down to 5.10 %.
- The Oslo region is the largest region by volume, accounting for 45 % of the market. Other major cities had an even share of approximately 6-7 % of the market.
- The two most prominent segments have been office, making up roughly 53 % of the volume, and retail, making up roughly 17 % of the total transaction market volume. The residential segment has declined to a historical low of 2 % compared to 7 % in 2016.
- The presence of international buyers in terms of volume is still strong, with a market share of approximately 17 %, compared to 10 % in 2016. However, we are nowhere near the 35 % we observed in 2015.

Advertised office space in Oslo (m²)



Source: FINN.no/Malling & Co

Key facts real estate (office)

	PER JAN. 2018	PER JAN. 2017
Prime yield	3.65 %	3.80 %
Normal yield***	5.10 %	5.75 %
5 yr. swap rate (COB 12 January)	1.63 %	1.49 %
Average of 15 % highest rents in Oslo, NOK/m²/yr. (Q4)	3 510	3 280
Office contracts signed, m² (Oslo) (Q4)	203 380	247 510
Largest office contract, m² (Oslo) (Q4)	12 400	17 060
Avg. contract length, yrs. (Oslo) (Q4)	5.0	5.2

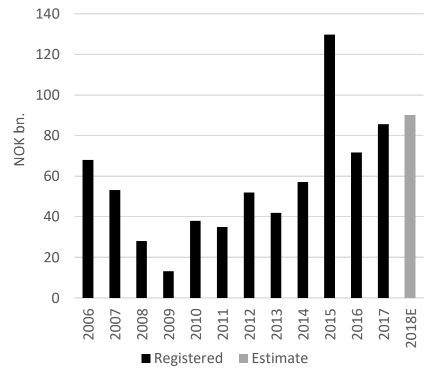
Source: Malling & Co/DNB Markets/Six/Arealstatistikk

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

Office cluster	Prime rent*	Normal rent**
CBD	5 200	2 800 – 3 500
Skøyen	3 000	1 800 – 2 300
Inner City	3 500	2 300 – 2 700
Bjørvika	3 800	2 700 – 3 000
Lysaker	2 350	1 700 – 1 900
Fornebu	2 000	1 400 – 1 600
Nydalen/Sandaker	2 350	1 500 – 1 700
Økern/Løren/Risløkka	2 200	1 000 – 1 500
Bryn/Helsfyr	2 200	1 500 – 1 700

Source: Malling & Co

Transaction volume (>50 NOK million)



Source: Malling & Co

**Prime rents are consistently achievable headline rental figures that relate to a new, well 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.*

Topic of the month: Could higher interest rates spoil real estate returns?

After a long period of record low inflation and almost zero interest rates in the industrial world, the prospect of rising inflation and interest rates is a hot topic. For real estate investors, concerns about the prospect of rising property yields might put an end to the easy value increase through yield compression seen for many years now.

Let us look at changes in interest rates as an isolated variable affecting real estate values, all other factors kept constant. Traditional finance theory implies that rising interest rates should push risk free return upwards, and consequently cause higher cap rates and a decline in asset values.

However, the beauty of commercial real estate is that income streams normally are inflation adjusted. As economic theory describes, interest rates usually comes hand in hand with inflation. In most cases, real and financial assets usually move together in response to macro economic variables. However, when it comes to interest rate increase, inflation may come handy to restore property values despite higher cap rates.

Several studies have looked into the topic. Fama and Schert (1977) found that real estate was the only asset class that was positively correlated with unanticipated inflation, whilst Huang and Hudson-Wilson in 2007 found that all types of property, except for retail, are shown to be a strong hedge against both expected and unexpected inflation. Ultimately, if the increase in property value from inflation outweighs the decrease caused by rising interest rates, the net result can be positive for the value of the asset. We could also argue that the effect of higher inflation over time will affect the market rents, making future cash flows higher, also in future lease contracts.

As a result of the monetary policy that we have observed over the last 10 years, both financial and real assets are trading at historical low cap rates. Only time will tell if interest rates and inflation will ever come back to the levels we observed before the financial crisis.

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