DNB Næringsmegling

MARKET REPORT

1. HALF-YEAR 2017

Strandveien 4-8. Buy side advisor for Oslo Areal

Foto: Jon Terje Hellgren Hansen

DNB NÆRINGSMEGLING AS

DNB

DNB Næringsmegling

We are one of the country's leading commercial real estate brokers and the only one with offices in the four largest cities. We can provide support with analysis and valuation, advice, letting and the sales/acquisitions of commercial property. Our team have extensive experience and a broad range of expertise and their work will be dedicated to finding the best solution for you as client.

TRANSACTIONS
Our experienced team can provide support through the entire process of buying or selling commercial property, tailored to our clients' preferences. We have a very good understanding of the investor market within commercial property.

LETTING
Our brokers can find good and value-creating solutions for clients and tenants. We focus on the letting of office premises, warehouses and combination properties as well as retail premises.

ANALYSIS
Whether one is looking to develop, buy/sell or let commercial property, there are often substantial values involved. We offer high-quality advice and analysis which considerably increases the likelihood of success. Since establishment in 2003 we have closely followed the market and built-up extensive know-how and a comprehensive set of databases.

VALUATION
In a steadily more professional property market there is an Increasing need for external property valuation. We have long experience in carrying out valuations. whether these are of portfolios, individual properties or development projects. We are one of the largest and most well-known participants in the market.

A new year and new opportunities

Anne Helene Mortensen
CEO, DNB Næringsmegling

2016 is now history and the Norwegian commercial real estate market can once again look back on new records – among others we registered as many as 271 transactions and new yield records have been set in several segments/areas. We are well under way with 2017 and continue to experience considerable interest in commercial property as an asset class, in addition to being able to confirm that the reported change in momentum in the office rental market is continuing. The early months of 2017 show good activity around the country, including Stavanger which is showing the first signs of recovery after the oil crisis.

One of today's buzzwords is digitalisation. Digitalisation affects us with regard to working methods, efficiency improvements, rationalisation, profitability and professionalism. What will the tenants of tomorrow look like in some sectors? With regard to DNB and the financial sector substantial changes have already taken place and we know that this wave will continue. Digitalisation may be experienced as a threat by employees whose jobs will be directly affected but it also definitively creates opportunities.

You have now received our market report electronically and in a new format. This gives increased flexibility and the report is more accessible. We continually try to adapt and renew ourselves, and this year's report is full of information that we hope you will find relevant. We have put further emphasis on underlying analyses that support our market view. Based on the present report we also have a good basis to tailor a review of the market together with you. We continue to work on new and relevant angles that we also hope will be of interest.

We have seen record yields from Kristiansand in the south to Trondheim in the north, and have recently completed several transactions using both local and national expertise. In this way the client has obtained the best price for the property as we have presented it to local, national and international investors. Several of our leading clients acknowledge that the interaction that they experience between local and national expertise is a big plus.

We are pleased to have Lars Erik Wirsching in place as head of the Bergen Office and will be welcoming two new colleagues in March – April: Stian Miljeteig as letting broker in Stavanger and John-Kenneth Porten as advisor on transactions in Bergen. We look forward to an active 2017 together with our clients and partners.

Contents

Editorial team. From left**:** Magnus Havikbotn Jacobsen. Analyst. Ida Wæraas. Market Coordinator. Mads Hofrenning Wanderås. Analyst. Gunnar Selbyg. Director. Analysis and Anne Mortensen. CEO.

Summary

There are good prospects today for commercial property due, among other reasons, to the fact that the Norwegian economy is improving. Macro forecasts indicate continued moderate growth in demand for space while low interest rates and good CPI growth (particularly in 2017) will contribute to holding up property values.

The prime yield for offices in Oslo has bottomed out at 3.75%. Since last autumn's market report long interest rates have risen by 50-70 bp and expectations regarding letting markets have strengthened, particularly for offices in Oslo. From a historical return perspective prime office property in Oslo appears to be expensive, while normal office property still seems to be cheap. We expect however that growth in market rent levels will lead generally to a good rise in value towards 2020 for office properties in Oslo. In central areas the rise in value will be dominated by rental price growth. With regard to the office clusters that surround the centre we expect somewhat lower growth in market rental levels, but that a further slight decrease in yields will also contribute to higher values.

We registered a record number of 271 transactions in 2016. The aggregate transaction volume totalled NOK 80.5 bn.

The credit market is generally functioning well and several factors make a high volume of sales likely in future. DNB Næringsmegling has already been involved in “billion kroner transactions” on both the acquisition and sale side this year.

Conversion to residential use is triggering several transactions for properties with both short and long leases. At relevant locations this gives greater security with regard to exit value and contributes to increasing the universe of buyers and sale prices.

The most frequent reason for sales in 2016 was that the buyer side came with a good offer.

Office vacancy in Oslo, Asker and Bærum has been reduced from a peak of 9.0% in the autumn of 2015 to 8.2% today. Our forecast indicates that vacancy will fall to 6.1% at the end of 2019.

Market rent levels for offices in Oslo bottomed out last year and tended upwards in the second half-year. For the next three years we expect gradually stronger growth and that rents for “high standard” premises will increase on average by 18% to NOK 2.700 per m2 in Q4 2019.

In Bergen, Trondheim and Stavanger 69 transactions were completed last year for an aggregate value of NOK 18.5 bn. Measured by value ”non local” buyers have taken a 70% share in the last two years.

Yield levels for prime property in Bergen, Trondheim and Stavanger are generally 100-175 bp above Oslo. Correspondingly, yield levels for normal property across the property segments are generally 75-150 bp over Oslo.

Strandveien 4-8 bought on behalf of Oslo Areal

Lounge/coffee bar. Lundin Norway. Photo: Arne N. Schram. Inviso.

Summary

Office vacancy in in the three cities varies from 8.9% in Trondheim to 11.3% in Stavanger. We expect that vacancy in Bergen will level out and fall in the future, while Stavanger and Trondheim have still not yet reached peak vacancy. In the case of all three cities we expect that the fall in market rents is largely over and that we will see a levelling out this year.

Retail: Demand for retail property remains good and last year we registered 56 transactions for a total of NOK 15.7 bn. International investors were behind the investments with the lowest yields last year. Internet retailing has risen by 75% in the last five years and annual leakage from retail property to e-commerce is estimated at around NOK 30 bn.

Logistics: Internet retailing increases demand for logistics property close to the main cities and in the last half-year approximately 30.000 m2. of warehousing has been let to companies that sell food on the Internet. We registered 50 transactions last year for NOK 11.7 bn. Two sales of properties with particularly long leases were at yields below 5%. We estimate the prime yield for logistics in Oslo is 5.25%.

Hotels: We consider the prime yield for hotels in Oslo is 4.00%. Last year there were 14 transactions with an aggregate value of NOK 4.4 bn. International investors were behind acquisitions in Oslo. Drammen and Ålesund. Among the main cities only Stavanger had a fall in RevPAR in 2016.

Municipal buildings: an increasing number of Norwegian and international investors are showing interest in municipal buildings and the volume of transactions reached NOK 5.6 bn. last year. Nearly all the sales involved properties with long leases. The lowest registered yield was on the purchase by Balder Fastigheter of Hedmark Higher Education at Elverum on a yield of approx. 4.9%.

Housing: Interest in housing development is at an all time high and this segment has given a very good return over many years. Last year we registered 10 transactions with a value over NOK 250 million related to the residential sector. DNB Markets still expects some growth in secondary house prices and DNB Eiendom expects a continuing good market for new houses.

Macro and loan financing	2015	2016	2017E	2018E	2019E
GDP Mainland Norway	1.1%	0.8%	1.3%	1.6%	2.0%
CPI	2.2%	3.6%	2.6%	1.8%	1.5%
Employment	0.4%	0.0%*	0.4%	0.5%	0.8%
Private consumption	2.1%	1.4%	1.9%	2.3%	2.5%
House prices	7.2%	8.3%	9.0%	1.0%	1.0%
3m NIBOR	1.3%	1.0%	1.1%	1.0%	1.0%
10y SWAP	2.0%	1.5%	1.8%	1.8%	1.9%
Typical cost of credit***	3.2%	3.2%	3.7%	3.7%	3.8%

Office market	Prime yield	Prime rent	Office vacancy	Forecast rents	Forecast Vacancy
Oslo og Akershus	3.75%	4 200	8.2%	↗	↘
Bergen	4.75%	2 700	10.0%	→	→
Trondheim	5.00%	2 400	8.9%	→	↗
Stavanger	5.50%	2 600	11.3%	→	↗

Transaction market	Key factor	2015	2016	Prime yield Oslo****	Volume. bn. NOK (number)
Office	Employment	0.4%	0.0%*	3.75%	31.1 (93)
Retail	Turnover shopping centres	1.9%**	1.7%**	3.75%	15.7 (56)
Logistics	Top rent warehouses	1150	1200	5.25%	11.7 (50)
Hotel	RevPar Norway	481	492	4.00%	4.4 (14)

* Forecast 2016 (DNB Markets)

** Adjusted for space changes
*** 5Y SWAP + margin
**** 7-year lease for offices. and 12-year lease for logistics properties and hotels

Source: DNB Markets. SSB. and Kvarud

Kjøita 18, Kristiansand – Agder Energi

Buy side advisor for Arctic Securities

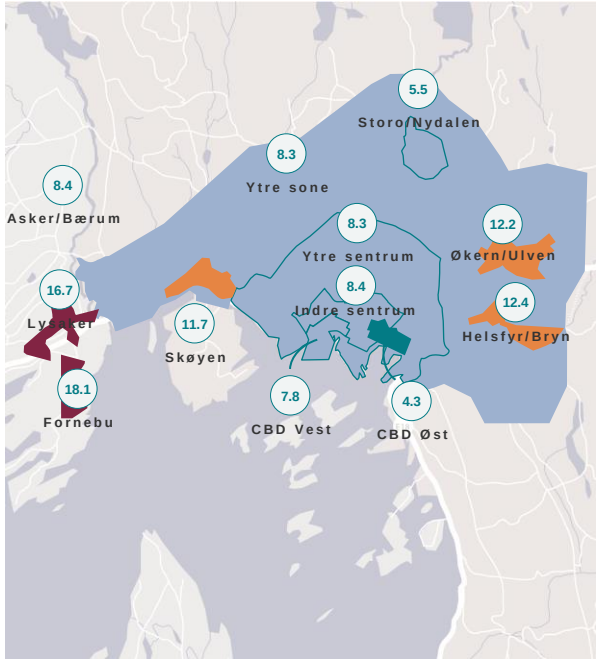
Oslo

The office market in Oslo, Asker and Bærum is in the process of recovering from the hit it took due to the collapse in the oil price, and reduced vacancy and growth in market rents is expected.

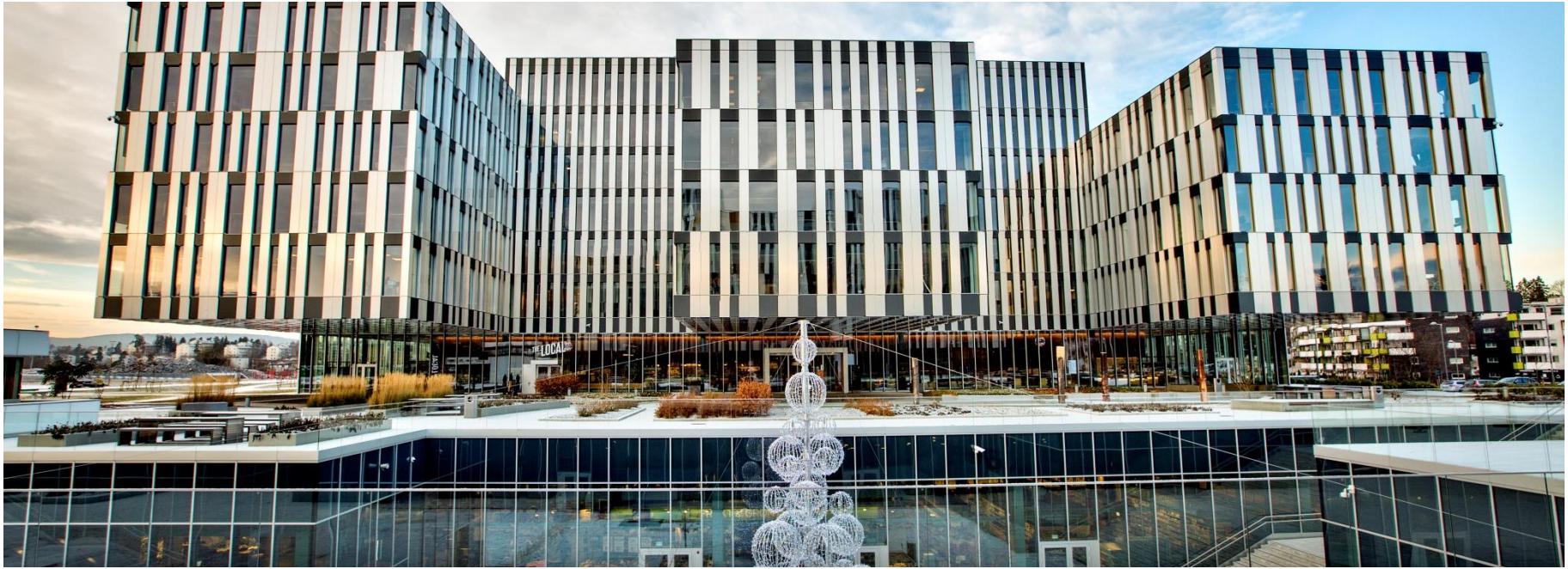
Prime Yield	Since Q3-16	Prime Rent	Since Q3-16	Office vacancy	Rent forecast	Vacancy forecast
3.75%	-0.10	4 200 (EUR 467)	+100	8.2%	↗	↘

- **Office vacancy is down 0.5 percentage points year-on-year to 8.2%, and is forecast to be 6.1% at the end of 2019.**
- **We expect that market rent levels for high standard premises will rise 18% up to 2020.**
- **Growing optimism among companies will contribute to increased demand for space.**

Office vacancy Oslo Q1 2017 in percent



Oksenøyveien 10 – «Fornebuporten»



Letting assignment on behalf of Kværner

Main features – Reduced vacancy and growth in market rents

Office vacancy in Oslo, Asker and Bærum ('OAB") has fallen for the third half-year running. Vacancy is down 0.5 percentage points over the last 12 months, and supports the downward trend in vacancy since the peak in the autumn of 2015 of 9.0%.

Demand – growing optimism among companies is lifting demand forecasts

NAV Oslo estimates employment growth of 1.6 % in 2017 with the majority within less office-intensive jobs, such as construction healthcare, social work and education. DNB Markets expects that office employment will have roughly the same percentage growth as the country as a whole in the next three years.

Business leaders in the capital region expect stronger wage growth than in the period immediately after the fall in the oil price.

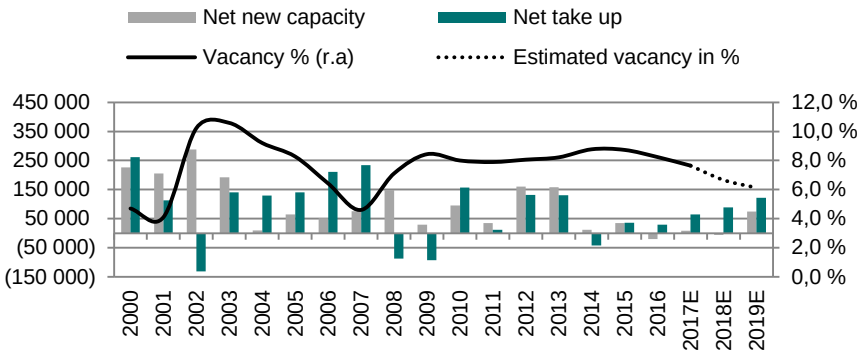
A survey of expectations by Norges Bank for the fourth quarter of 2016 supported a positive development in net employment going forward.

Companies in the Oslo region are considerably more positive about taking on new staff than in the previous period, according to Manpower Group's Labour market barometer («MEOS») for the first quarter of 2017. It reports that companies and public institutions expect employment growth of 4%, which is up three percentage points since the first half of 2016.

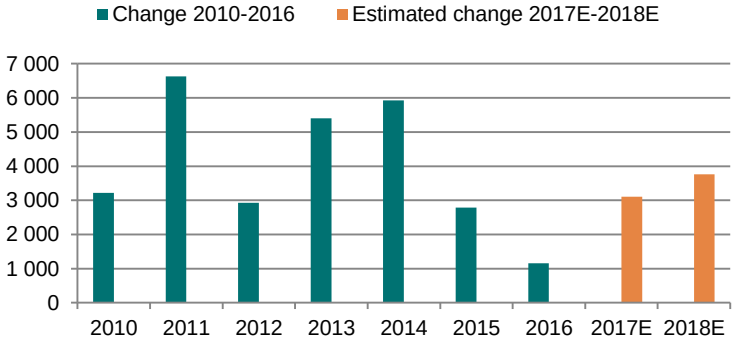
On the other hand demand forecasts may be reduced by rationalisation in several sectors due to digitalisation and increased automation. Several major companies have already communicated great uncertainty about the number of future office employees and in the last 1–2 years have considerably reduced the number of employees due to digitalisation. In our estimate we have however assumed a limited effect in the short-term because most lessees will not make changes before their leases expire.

We expect that in the period to 2020 leased space will increase by 276,000 m2.

Office vacancy



Changes in number of office employees (Oslo, Asker and Bærum)



Source: DNB NM/SSB/NAV

Supply – low level of newbuilding

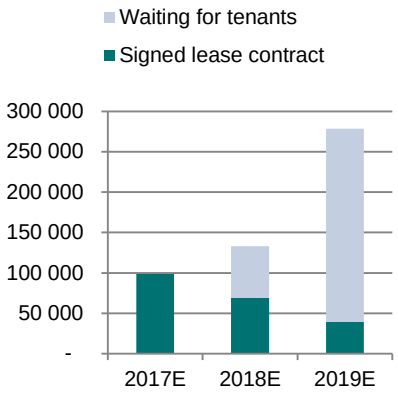
Since 2014 new building has been below the annual historical average of 120,000 m2. In 2017 new office buildings corresponding to 99,000 m2 will be completed, of which roughly 2/3 are located in central districts, including Storo/Nydalen. Avantor's office project, Spikerverket 2 & 3 in Storo/Nydalen will be completed in the autumn of 2017. The building will serve as head office for Elkjøp, as well as housing Oslo Kemnerkontor and ICE.net.

There is considerable newbuilding in CBD East. Watrium Eiendom's office building is included in our count for the first time and in December 2016 EnterCard signed a lease for 3,300 m2. Between "Watrium" and the Opera is HAV Eiendom and Thon's project, Diagonale. TV2 will occupy the new building in 2018, and in addition Vinmonopolet's head office will be in the same building. OSU's project "Eufemia" building stage 1 is now almost fully let after Microsoft decided to group its activities at Bjørvika and vacate premises at Lysaker Torg and in Torggata.

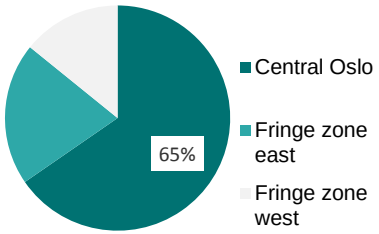
In the city centre a refurbishment/new build project will be completed at Youngs gate 7-9 and Torggata 15 during 2017, which will involve a net increase in new office space of about 5,000 m2. Sundtkvartalet is now 91% let after IBM signed a lease on more than 7,000 m2. IBM will move in the autumn of 2017 and will share the office building with Skanska, Mattilsynet, Tidal, Knowit and Manpower.

Assuming a strong housing market, we expect conversion volumes up to 90,000 m2 in 2017 and 75,000 m2 in both 2018 and 2019. Lower volumes in 2018/2019 are due to the fact that the most obvious and attractive properties have already been converted, or are in the process of conversion. Most office buildings that are converted to other purposes are often outside the established office clusters. Their location is considered less attractive to office users due, for example, to long distances to public transport or less appropriate layout arrangements. Conversions in the coming period will mean that the remaining office stock will generally be of a higher quality. Without conversion office vacancy would be 8.4% in 2019.

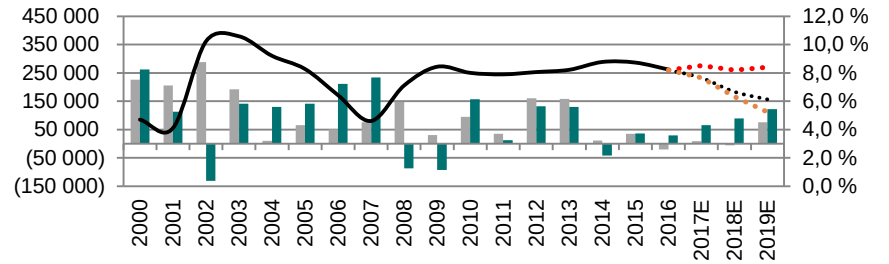
New building volume 2017-2019



Completion of new buildings in 2017



Alternative scenarios with low/high conversion in the period 2017-2019



Searches – The high volume from 2016 is continuing in 2017

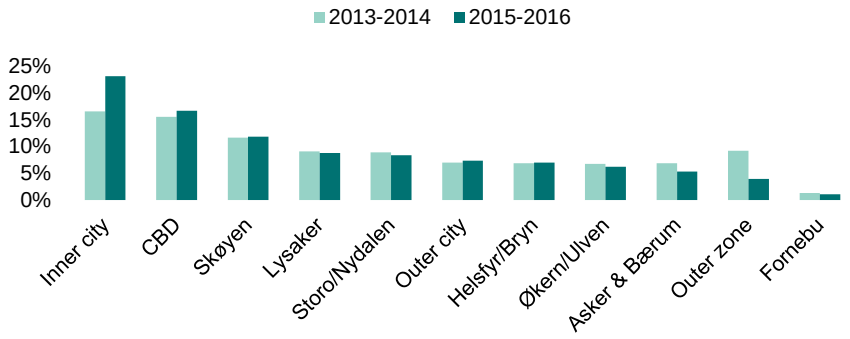
There is a good level of activity in the letting market with searches in all office clusters, but with the majority in the central areas. Interest for new buildings that will be completed in 2018/2019 is good and most tenants looking for new premises are being given many alternatives. A high willingness to pay for centrally located premises of a high standard is establishing a basis for rental price growth in the central areas.

In 2016 we registered almost 200 searches amounting to more than 350,000 m2, and so far in 2017 searches already exceed 50,000 m2. Many searches from 2016 have not yet been concluded, while Statsbygg is acting as the biggest search broker in our database with a market share of almost 15 % measured by m2. A high proportion of the searches relate to the city centre, with tenants looking for offices with modern facilities close to transport hubs.

There is still a lot of hidden vacancy and subletting in the western corridor as a result of the downturn in the oil sector in 2014, something that can be seen in an increasing vacancy trend at Fornebu in recent quarters. At Lysaker several leases have been signed since last autumn on centrally located high standard office buildings at good rent levels.

In the last half-year more searches have included Lysaker compared with the previous period. Combined with lower office vacancy in the area we have adjusted upwards our expected development and market rents in the office cluster.

Searches registered in the period 2013-2016 measured in m2.



Market rent levels

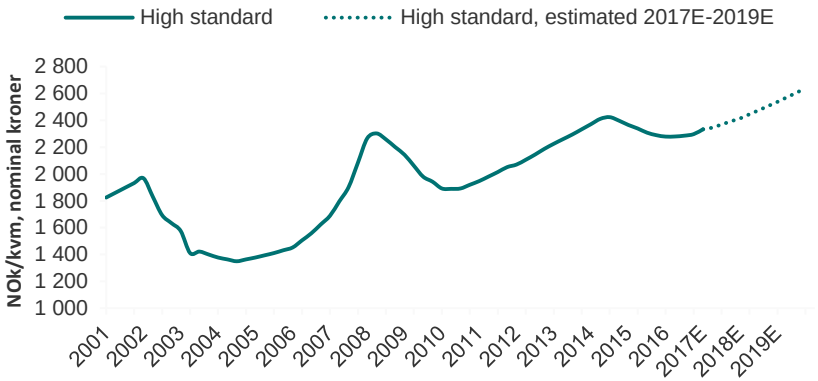
Market rents – Growth!

The Q4 figures from Arealstatistikk confirmed the hypothesis that market rents bottomed out in the winter of 2016, as the 15% most highly priced leases on a six-month rolling average in OAB were up 5.7% since the winter's low point. Looking at the trend against the same quarter last year, the 15% most highly priced leases were up 3.5%, while for average rents in the same period a corresponding increase of 9.5% has been recorded. For the first time since the autumn of 2014 the level is over NOK 2,000 m2/year.

We expect more growth in market rent levels for high standard premises and in total 18 % over the next three years. The estimated growth in market rents is partly a result of lower office vacancy and office premises of a higher standard, as well as a better balance in the market. In addition tenants are tending to a large degree to choose the best locations in each cluster. Market rents fell less following the oil price crash than in previous downturn periods (following the dotcom boom and the financial crisis), and we therefore expect somewhat slower growth than in the two previous cycles.

During 2016 and so far in 2017 we have registered a high level of demand for office premises in the most attractive areas. Prices have risen more quickly in the city centre than on the western and eastern corridors. To the west and east of the centre the practice of discounts in the form of rent-free periods and similar must be reduced, and more vacant space taken up before we will see significant growth in market rent levels.

We have adjusted downwards our vacancy forecasts from the autumn against the background of a continuing reduction in the supply side as well as increased business optimism. The combination of a high number of conversions and low volume of new building is contributing to vacancy continuing downwards. We believe that this trend will continue and that negative net new building will continue in 2017/2018. There is substantial potential for new office buildings in Oslo, Asker and Bærum and there are several large projects with planning permission which may increase the vacancy level in time



	Good standard	High standard	Δ last 12 months	Forecast, high standard in%	Vacancy Q1 2017	Ten largest vacant offices, share of total vacancy
Asker & Bærum	1 200 - 1 600	1 600 - 2 000	2,3 %	1 %	8 %	8 %
Lysaker	1 400 - 1 800	1 800 - 2 200	-0,4 %	3 %	17 %	7 %
Fornebu	1 300 - 1 500	1 500 - 1 850	-1,0 %	3 %	18 %	9 %
Skøyen	1 650 - 2 300	2 300 - 2 750	2,6 %	3 %	12 %	6 %
CBD West	2 400 - 2 850	2 850 - 4 200	3,1 %	4 %	8 %	4 %
Inner city	1 800 - 2 500	2 500 - 3 100	2,5 %	5 %	8 %	7 %
CBD East	2 100 - 2 500	2 500 - 3 300	2,7 %	4 %	4 %	2 %
Outer city	1 550 - 1 900	1 900 - 2 600	2,2 %	3 %	2 %	3 %
Storo/ Nydalen	1 400 - 1 900	1 900 - 2 300	3,7 %	5 %	5 %	2 %
Økern/ Ulven	1 300 - 1 500	1 700 - 2 000	0,5 %	1 %	12 %	4 %
Helsfyr/ Bryn	1 300 - 1 550	1 550 - 2 000	1,1 %	1 %	12 %	6 %

Øvre Vollgate 15

Letting assignment on behalf of Abel Eiendom

The transaction market

Excess demand and a high volume of transactions will continue.

Prime Yield offices Oslo	Forecast Q1 2018	Trend normal yield	Expected credit cost	Value development offices in Oslo	Forecast volume 2017	Bergen. Trondheim. Stavanger 2017
3.75%	3.75%	↘	→	↗	NOK 75 bn. /240 transactions	NOK 15 bn. /60 transactions

- **Rising market rent levels for offices in Oslo will contribute to future increases in values.**
- **Most property segments offer an attractive spread between yield and cost of credit.**
- **Conversion to housing is triggering the sale of commercial property with both short and long leases.**
- **New Norwegian and international investors on the buying side.**
- **The credit market is generally functioning well and the banks' lending capacity has been strengthened by the sale of loans to life insurance companies.**

Tollboden. Kristiansand – part of the Entra portfolio

In 2016 a record high number of 271 transactions were registered, and the conditions are in place for a continued well-functioning sale market.

Last year's volume ended at NOK 80.5 bn. Compared with 2015 there were fewer major portfolio transactions which led to a reduction in volume. Compared with last autumn we think the following are the most important changes affecting the investor market:

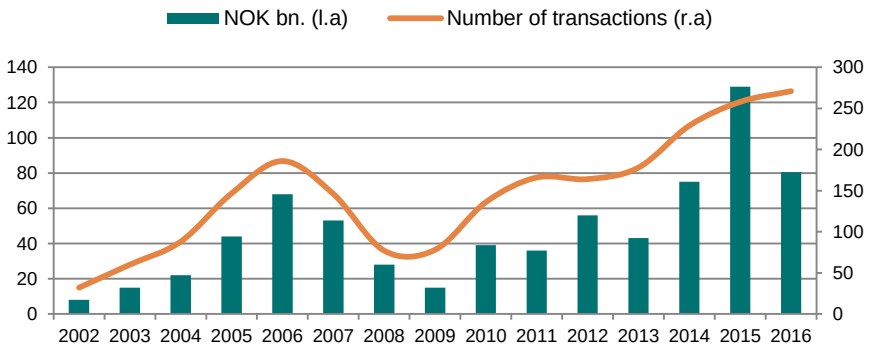
- Long interest rates have risen 50 to 70 bp and it appears even more clearly that the bottom for interest rates has passed.
- Given today's prices and borrowing costs normal property tends to still be cheap, while prime property appears expensive from a yield perspective.
- The picture is influenced by increased optimism in relation to letting markets in general and the office market in Oslo in particular.

We expect a continued high volume of sales in 2017 because:

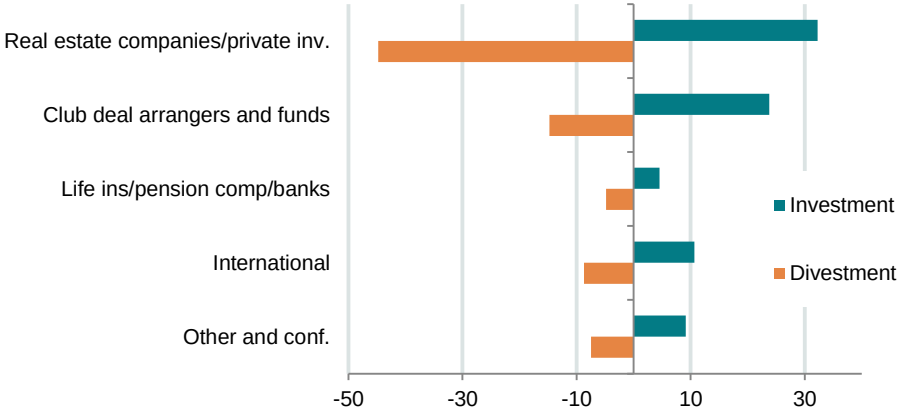
- Commercial property still gives a good yield when compared with other low-risk investments. Rental growth will be a more important driver of value in future and demand for commercial property investments will remain high. The loan market is generally functioning well. The banks' lending capacity has been reinforced through the sale of loans to the life insurance companies. In addition the bond market for commercial property has become more favourable due to falling margins.
- Arrangers, purchase advisors and a number of market participants are creating transactions from the buyer side. Our survey shows that the most frequent reason for selling in 2016 was that owners chose to take a profit after the buyer side came with a good offer.
- There are still many sales related to a strategy of selling fully developed properties, as well as portfolio refinement.

As many as 136 different participants purchased commercial property last year and arrangers are back as the largest net buyer. Apart from purchase advice, syndication and fund managers were behind some 70 purchases last year with an aggregate value corresponding to NOK 24 bn. Several Norwegian and Nordic fund managers raised equity in the second half year and we do not believe they will be held back to any particular extent by a lack of access to loan capital. As in 2015 the biggest surprise was that equity investors were not the largest net buyers. Several these investors however are planning substantial purchases in the future.

Annual development and transaction volume measured by number and value



Transaction volume in 2016 divided between investor categories – NOK bn.



As in 2015 the group property companies, private investors and developers were the largest net sellers last year. They continue to be very interested in new investments and completed almost as many purchases as sales last year, but they tend to take profits on expensive developed property and purchase cheaper property with value growth potential.

International investors continue to show strong interest for commercial property and last year 16 different investors completed 24 purchases for a total of approximately NOK 11 bn. Among these were several new entrants, including Balder Fastigheter, Round Hill Capital and SBB Norden. The latter was established last year, listed in January and in is in the process of establishing a position as a major purchaser in Norway. DNB Næringsmegling was the sale advisor on behalf of Entra Eiendom and dealmaker when SBB purchased a portfolio from Entra in January, as well as the NAV building from Kurt Mosvold. In total this portfolio of centrally located properties in Kristiansand extends to about 54,000 m2 with leases to public tenants. The aggregate property value amounts to about NOK 1.05 bn. and is thus the largest purchase ever in Kristiansand.

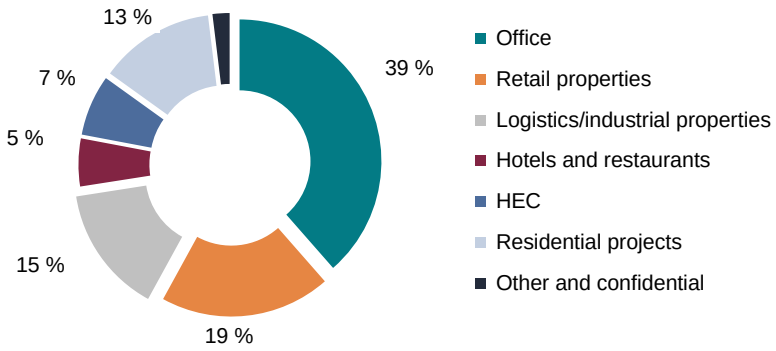
In addition this transaction further resulted in a process with DNB as broker when the municipal property company KNAS sold the head office of Agder Energi for about NOK 560 mill. to a company established by Arctic Securities.

Housing is a steadily more important driver of the transaction market, particularly in the Oslo region

The office, retail and logistics segments continue to constitute the dominant part of the market, but house price growth and positive expectations for the housing market mean that more properties with long leases in growth regions are being sold for conversion to housing as a form of safety net.

This can be used as an «exit» or alternatively if it is not possible in the future to re-let for current use. In relevant locations the housing alternative is now triggering the sale of commercial properties, on both short and long leases at good prices. While developers buy properties with short leases there is a broader range of buyers of potential «residential cases» that today seek long leases. The table reflects that commercial property turnover in the last 3 years has been at a record high level (NOK 285 bn.) with many transactions in all value categories. The market has become more buyer-driven and dynamic, which has contributed to a rising «normal level».

2016 volume measured in value divided by segments



Number of transactions per value interval

NOK million	# 2016	# 2014-2016
50-149	119	331
150-299	81	202
300-999	60	175
1.000 +	11	50
Total	**271**	**758**

Low interest rates, a focus on housing and an improvement in the office rental market is resulting in a continued hectic transaction market in Oslo/Akershus.

Our summary of 2016 for Oslo shows:

- A buyer-driven market with the arrangers as the largest net buyers.
- Transaction volume: NOK 45 bn., 137 deals and 71 different buyers.
- 50 office transactions with a value of NOK 21.3 bn. (70% of the volume in Norway).
- 10 transactions relating to residential development with a value above NOK 250 mill.
- International investors have been active on both the buying and selling side.
- A handful of properties in offices and retail sold on a yield below 4%.
- Average yield of 5.6% - down 90 bp against corresponding average in 2014.

The largest office transaction so far this year has been the Lundin building at Lysaker which Ferd Eiendom sold to Oslo Areal for NOK 922.5 mill. DNB Næringsmegling was the buyer's advisor. The 23,500 m2 property was sold on a yield just below 5% and with a remaining weighted lease term of around 11 years .

We consider that the prime yield at the end of last year was 3.75% and that many centrally located properties could be sold on a yield under 4%.

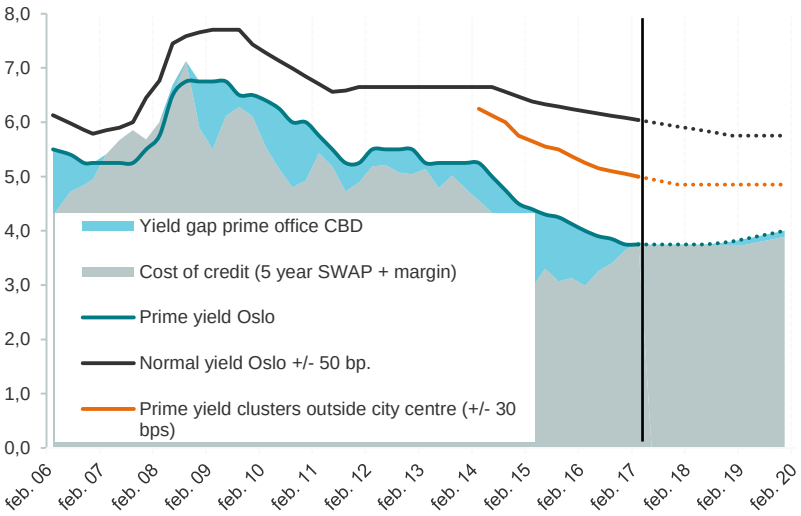
The BA-HR building is an example of a «new building» with long leases that could be sold on an even lower yield than 3.75 %. So far we have not recorded any Norwegian «leveraged investors» that have bought on a yield under 4%, but solid investors can still achieve a yield gap of about 50 bp (assuming a loan at 50% floating rate and 50% fixed rate for 5 years). The current keen pricing and low yield gap mean however that the prime segment is available to fewer buyers, and primarily investors who buy with a low level of debt.

Our forecast indicates a flat development in the short term and the prime yield rising by 25 bp in 2018/2019 to 4.00%. In our assessmen we have put weight, among other things on DNE Markets' expectations that the 5-year swap rate will rise 15 bp at the end of the period, and that forward pricing indicates the level increasing almost 70 bp In the next 3 years. A lower rate of inflation from 2018 also points in the same direction. Expectations of gradually lower office vacancy and rising market rent levels, suggest however a continuing low yield level. We expect that international investors, equity capital investors and several private investors continue to wish to make acquisitions in the prime segment.

Number of transactions in Oslo/Akershus per value interval

NOK million	# 2016	# 2014-2016
50-149	55	157
150-299	40	105
300-999	36	112
1.000 +	6	25
Total	**137**	**399**

Development for yields, yield gap and borrowing cost for offices in Oslo



In addition we consider the prime yield for office property in the clusters along Oslo's outer ring-road to be at a level of 5.0% +/- 30 bp. We have assumed 10-year leases and a good location in the clusters. The record low yields in the centre are contributing to strengthen demand in this segment which is sought by investors in most categories, including equity capital investors, syndication managers and international investors. We expect that the yield level here will fall by roughly a further 15 bp this year, followed by a mainly flat development.

We define here «normal property» to be offices with 4-5 years remaining on their leases, a normal good standard and with an acceptable location in one of the office clusters along the ring-road. While the prime yield has been reduced by 150 bp in the last 3 years, the level for normal property has only been reduced by roughly 50-60 bp. This means that the yield gap is high (viewed against the historical average) and gives buyers a very good return if properties are fully let. Expectations with regard to the office rental market have strengthened considerably in the last year, and we see that willingness to pay is already rising for normal property. Our forecast involves the yield level falling a further some 25-30 bp in the next 2 years to around 5.75% +/- 50 bp.

Properties in this segment that are suitable for conversion to housing in the short or long term could achieve particularly good sale prices.

Our rough estimates for the development in yields and market rent levels in the three office segments indicate growth in values of between 10 and 20% up to 2020, and with the best development for prime property in the office clusters that surround the centre.

In an international yield perspective prime property in the Norwegian cities stands out as giving a relatively good return for equity capital investors but it appears expensive for leveraged investors. If we adjust for higher credit margins in Norge, Oslo is the most expensive in Europe based on aggregate borrowing costs. Prime property in Oslo however gives an attractive risk-adjusted return, and several international investors are dedicated to expanding their portfolios in Oslo and the Nordic region. Norway has shown its ability to tackle low oil prices, and given current rent levels, the NOK exchange rate and not least expectations regarding rents, prime office property in Oslo continues to offer relatively attractive square metre prices.

Yield levels in different property segments in the main Norwegian cities

Q1 2017	Oslo/Akershus	Bergen	Trondheim	Stavanger
Prime yield offices*	3,75 %	4,75 %	5,00 %	5,50 %
Normal yield offices	+/- 6,0 %	+/- 7,00 %	+/- 7,00 %	+/- 7,50 %
Prime yield retail	3,75 %	5,00 %	5,00 %	5,25 %
Normal yield retail**	+/- 6,50 %	+/- 7,25 %	+/- 7,25 %	+/- 7,50 %
Prime yield logistics***	5,25 %	6,00 %	6,00 %	6,50 %
Normal yield logistics	+/- 6,75 %	+/- 7,50 %	+/- 7,50 %	+/- 8,00 %
Prime yield hotels ***	4,00 %	5,00 %	5,25 %	5,50 %

** Offices 7-year lease, ** Retail outside the centre, *** Logistics and hotels; 12-year leases*

Yield levels for Norwegian and European cities ranked by gross yield gap

Offices	Prime yield	10-year swap 9 Feb. 2017	Spread
Brussels	5,00 %	0,75 %	4,25 %
Dublin	4,50 %	0,77 %	3,73 %
Milan	4,50 %	0,77 %	3,73 %
Amsterdam	4,50 %	0,77 %	3,73 %
Stavanger	**5,50 %**	**1,92 %**	**3,58 %**
Helsinki	4,25 %	0,77 %	3,48 %
Madrid	3,90 %	0,77 %	3,13 %
Geneva	3,25 %	0,12 %	3,13 %
Trondheim	**5,00 %**	**1,92 %**	**3,08 %**
Copenhagen	4,00 %	1,00 %	3,00 %
Berlin	3,75 %	0,77 %	2,98 %
Hamburg	3,75 %	0,77 %	2,98 %
Zürich	3,00 %	0,12 %	2,88 %
Bergen	**4,75 %**	**1,92 %**	**2,83 %**
Stockholm	3,75 %	1,15 %	2,60 %
Paris	3,00 %	0,77 %	2,23 %
London West End	3,50 %	1,27 %	2,23 %
Oslo	**3,75 %**	**1,92 %**	**1,83 %**

Source: DNB Næringsmegling og Knight Frank

Sjøgata 45-47, Bodø - Luftfartstilsynet

Sales mandate on behalf of Breeze AS

Bergen

A record volume of transactions in Bergen in 2016 of more than NOK 9 bn. Office vacancy varies considerably between clusters.

Prime Yield	Since Q3-16	Prime Rent	Since Q3-16	Office vacancy	Forecast rents	Forecast vacancy
4.75%	-	2 700 (EUR 300)	-	10%	→	→

- **Record year in the transaction market.**
- **International and national investors were behind many of the major aquisitions.**
- **Stable rent levels. but greater differences.**

Office vacancy Bergen Q1 2017 in percent

The office rental market – still a clear division between Bergen South and the central areas

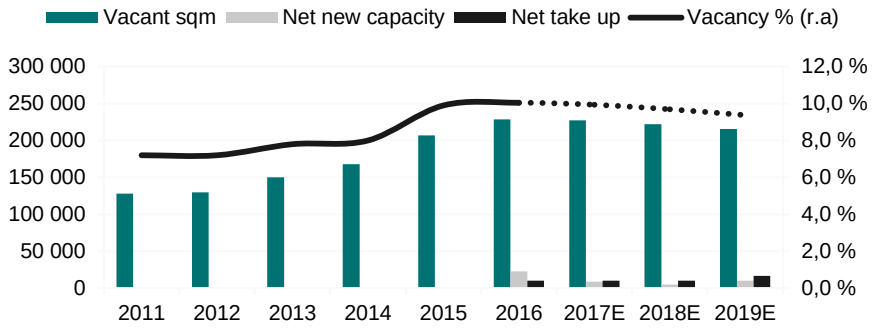
Office vacancy in Bergen is virtually unchanged from the previous count at 10.0%. There is still a clear division between Bergen South, which struggles with high vacancy levels, and the central areas where we see good activity and much better demand for office premises. Bergen Sør, with the oil-centric Sandsli and Kokstad districts, had office vacancy of 15% at the end of the year, while all the office clusters closer to the centre had office vacancy under 8.5 %.

Our forecast for office vacancy indicates a flat development this year, before being gradually reduced from 2018 in line with somewhat lower newbuilding volumes, more conversion from commercial use to housing, as well as increased employment growth. We see a clear tendency to give increased attention to possible conversion projects from commercial use to housing, which we believe will play a steadily more important role in the future. With the relatively high vacancy level in certain office clusters combined with a strong housing market, this could be an important contributor to lower vacancy in time. An example of this is Sandsliåsen 57, where it is planned to convert the existing office building of 6,000 m2 to apartments.

Stable rents, but nevertheless a slightly greater difference between Bergen South and the central areas

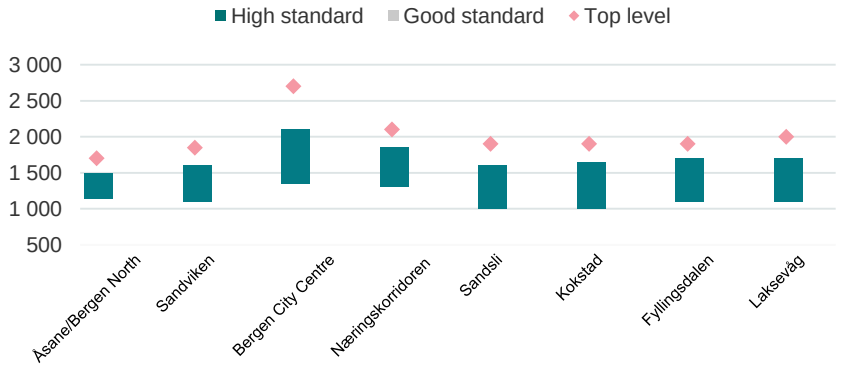
We see relatively stable office rents in Bergen compared with last year. The division of the market between Bergen South and centrally located properties has nevertheless become clearer and the price differential has increased further. In the central area we have seen several leases signed at very good levels for high-quality premises and new buildings. On the other hand Bergen South is characterised by high office vacancy, price pressure and active use of discounts/rent-free periods.

Office vacancy*



**New builings net and growth in leased space from 2016*

Market rent levels



Kokstadvegen 23, Bergen

Sales mandate on behalf of Aberdeen Pan-Nordic Norway

The transaction market

Last year we recorded the highest ever annual transaction volume in Bergen of NOK 9.1 bn., which in comparison was almost as high as Trondheim and Stavanger combined in 2016. Activity is very good, and far more transactions than normal have been completed. As many as 32 transactions over NOK 50 mill. were registered in 2016, against an average of less than half thate number in the previous 5 years.

The substantial growth mainly relates to larger non local investors taking a serious interest in Bergen. In the last 2 years these buyers have invested more than NOK 11 bn. in Bergen property and we believe they will continue to be active in future. We see particular interest for prime property with a long and secure cash flow, and many of these transactions have been completed at very keen prices. In 2016 alone we saw 5 examples of transactions completed at a net yield of 6% or lower in Bergen.

Due to the strong housing market in Bergen, we are registering considerable demand for housing land with planning permission in central Bergen. House prices have continued to rise in 2016, and we expect that demand will remain strong in this segment.

We consider that the prime yield for offices in Bergen is 4.75% for properties with a central location. We expect a continued liquid market, stable yield level and, not least, continuing strong demand for low-risk property.

Transaction examples Bergen 2016

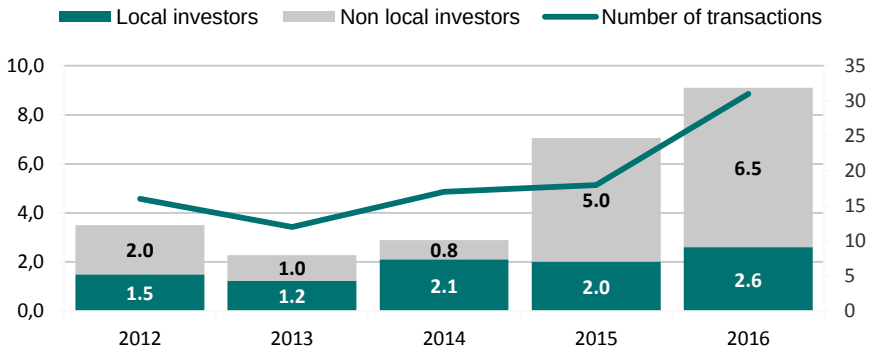
- Olav Thon bought Åsane Storsenter from Nordea Liv. Property value approx. NOK 2 bn.
- COOP bought 50 % of Horisont shopping centre. The transaction values the centre at approx. NOK 1.15 bn.
- KLP bought the new building Zander Kaas gate from Rom Eiendom. Property value NOK 760 mill.
- Citycon bought Folke Bernadottesvei 50 from Tryg Forsikring AS for NOK 710 mill.
- Posten Eiendom bought a zoned commercial site of 42. 7 hectares from Forsvarsbygg/Skifte Eiendom.

Yield table

	Offices	Hotels	Logistics	Retail
Prime Yield	4.75 %	5.0 %	6.0 %	5.0 %
Normal Yield	+/- 7.0%	-	+/- 7.50 %	+/- 7.25%

** Offices 7-year lease, ** Retail outside the centre, *** Logistics and hotels; 12-year leases*

Transaction volume 2012-2016, NOK bn.



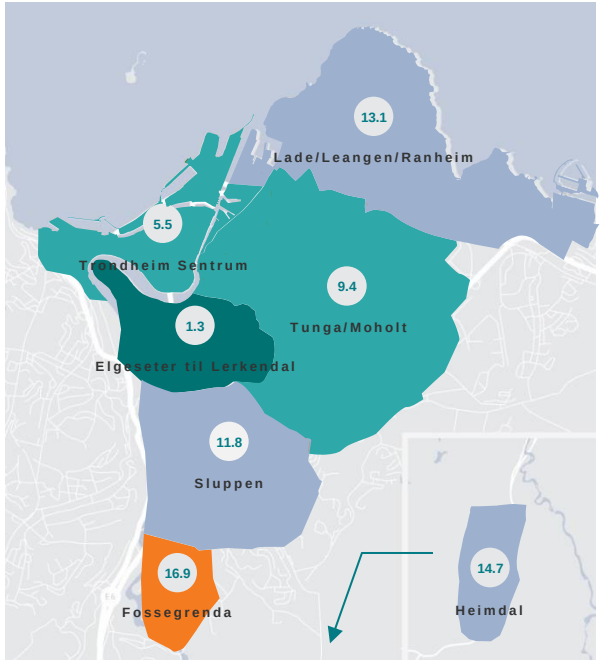
Trondheim

Good level of activity in the transaction market in spite of there being no major portfolio transactions. In the letting market office vacancy was slightly down, while rents are rising significantly in the city centre.

Prime Yield	Since Q3-16	Prime Rent	Since Q3-16	Office vacancy	Forecast rents	Forecast vacancy
5.00%	-	2 400 (EUR 267)	-	8.9%	→	↗

- **Office vacancy is down from 9.9% to 8.9%, but we expect an increase to over 11% in 2017.**
- **Rents in the centre up 10% in 2016.**
- **Transaction volume in 2016 of NOK 3.9 bn.**

Office vacancy Trondheim Q1 2017 in percent



Office rental market – expectations of increased office vacancy in 2017

Office vacancy in Trondheim shows a decline from the last count (9.9 %), to a level around 8.9 %. 2016 was characterised by good activity, particularly in the central area, but also in the district that stretches from Elgseter to Lerkendal. The latter has become an extension of the city centre with good activity, rising prices and low vacancy. Much of the fall in vacancy, which we regard as temporary, has been in areas where there has been less activity, such as Heimdal and Fossegrenda. Here there have been several examples of empty office buildings being taken out of the market for conversion into housing. Activity in the market has been rising during the last year and we are now recording several large tenants looking for premises.

We believe that the fall in office vacancy is temporary and expect that vacancy will increase to over 11% during 2017 due to the large amount of new building. Close to 60,000 m2 of offices are expected to be completed in the coming year. From 2018 however we expect that vacancy will gradually fall in line with a reduction in new building and increased employment growth.

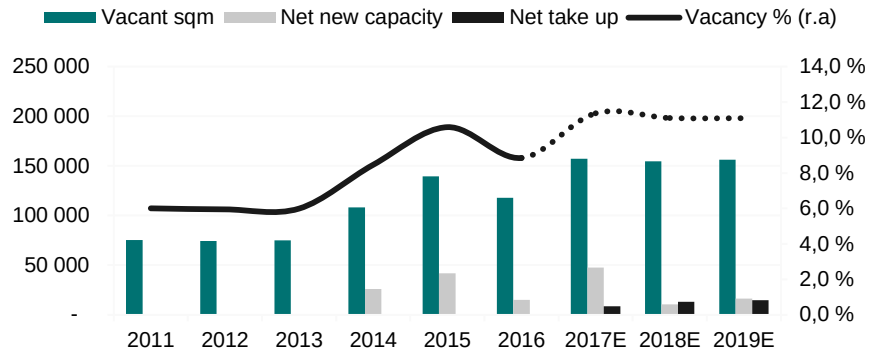
Development in market rents – strong price growth in the city centre and development areas

The city centre has been one of the year's winners with an increase in rents of 10 % over the last year to an average rental level of NOK 1,700 per m2/year. 48,000 m2 has been let, divided between 94 leases, and more examples of rents above NOK 2,000 per m2/year have been reported than previously.

It still surprises us that the most attractive new building projects in the centre do not achieve an even higher rent level than they do, as the price differential against corresponding projects in the peripheral zone continues to be low.

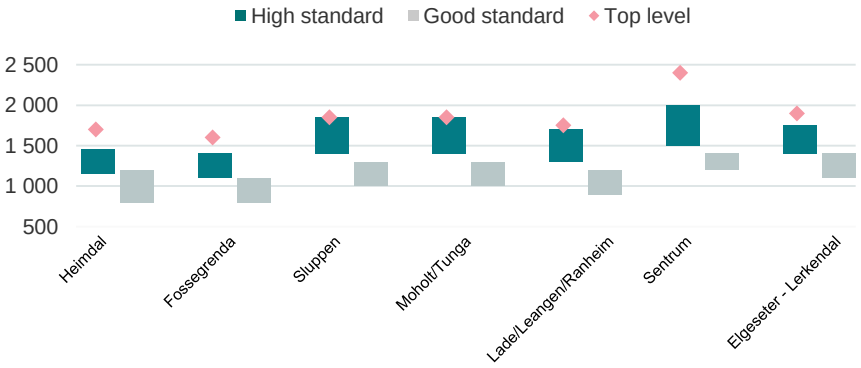
The trend in the market is still that the centre and development areas are holding up well, while we see falls in rents in several places in the peripheral zone. Trondheim as a whole is nevertheless achieving an average price of NOK 1,470 per m2/year, corresponding to an increase of more than 2 %. Activity in the market is being maintained and overall 90,000 m2 (97,000) was recorded as let, divided between 220 leases (187).

Office vacancy*



New building net and growth in leased space from 2016

Market rent levels



Falkenborgveien 28. Trondheim

Sales mandate on behalf of Realinvest

Good demand for low risk properties

There was a good level of activity in the transaction market in Trondheim in 2016. We recorded more completed transactions than in previous years, but there was nevertheless a decrease in volume due to the absence of the major portfolio transactions that we saw in 2015. In 2016 transactions for NOK 3.9 bn. were registered, divided between 22 deals above NOK 50 mill. If we include transactions below this limit, the volume in Trondheim would be significantly higher.

Non local investors have been considerably more active and have accounted for 2/3 of the volume in the last 2 years. In comparison this corresponds to more than the 4 previous years in aggregate and is a trend we believe will continue. After a quiet start to 2016 there has been considerably more activity in the second-half year and at the start of 2017. Interest has been particularly high for properties with solid tenants and long leases. During 2016 we registered 7 completed transactions with a remaining lease period >10 years for a total value close to NOK 1 billion.

We believe that the prime yield is still at 5.0% for for offices with the best location and a high standard. The yield for normal property with a normal standard, along the communication arteries with short/medium-term leases is considered to be in the range 6.25-7.50 %.

Transaction examples in Trondheim 2016

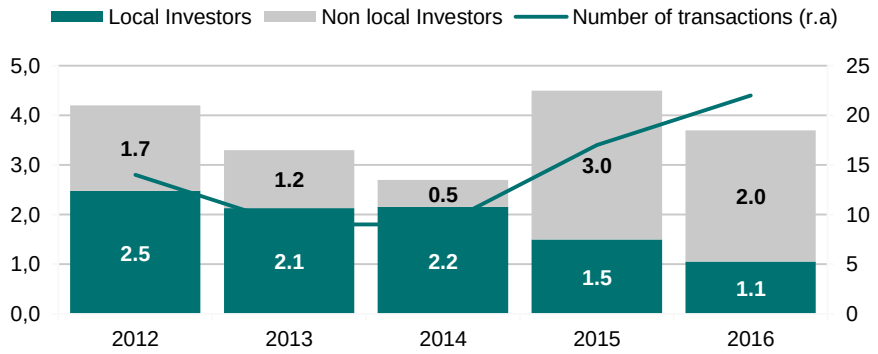
- Bassengbakken 4, sold for NOK 260 mill. at a net yield under 5.4 %.
- DNB Liv bought NHP's interest in Lade Arena, and sold at the same time Haakon VIIs gate 4 to NHP.
- Trondheims landmark, the Tyholt tower, was sold for NOK 55 mill. to Trym Næring AS.
- The former main fire station, Kongens gate 20, in Trondheim was sold by Sparebank 1 to Aberdeen.

Yield table

	Office	Hotel	Logistics	Retail
Prime Yield	5.0 %	5.25 %	6.0 %	5.0 %
Normal Yield	+/- 7.0 %	-	+/- 7.50 %	+/- 7.25 %

Offices: 7-year lease,. Retail: outside the centre, Logistics and hotels: 12-year lease

Transaction volume 2012-2016, NOK bn.



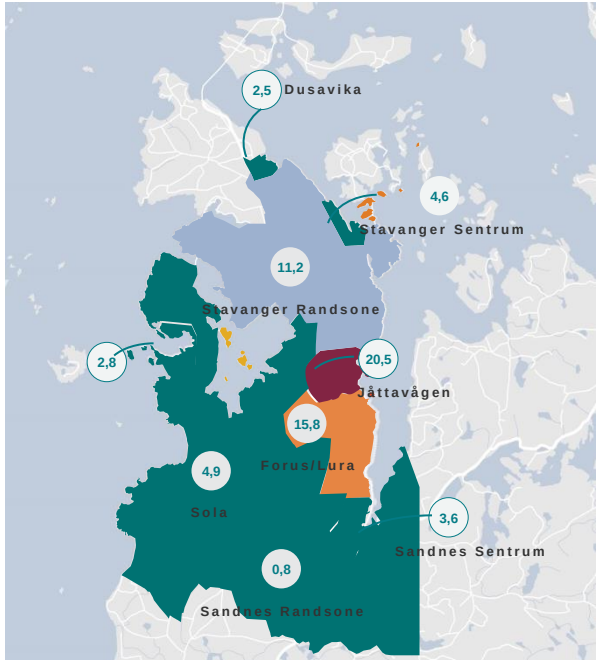
Stavanger

Transaction volume fully in line with the record year 2015. The letting market is still challenging at Forus and in the peripheral zone, while the central areas are seeing a good level of activity.

Prime Yield	Since Q3-16	Prime Rent	Since Q3-16	Office vacancy	Forecast rents	Forecast vacancy
5.50%	-	2 600 (EUR 289)	-	11.3%	→	↗

- **Office vacancy at 11.3% and expectations of increased vacancy in 2017.**
- **Good level of activity and low office vacancy in the centres of Stavanger and Sandnes.**
- **Transaction market 2016 – NOK 5.5 bn.**

Office vacancy Stavanger Q1 2017 in percent



Forus and the peripheral zone remain demanding, but there is a good level of activity in the central areas.

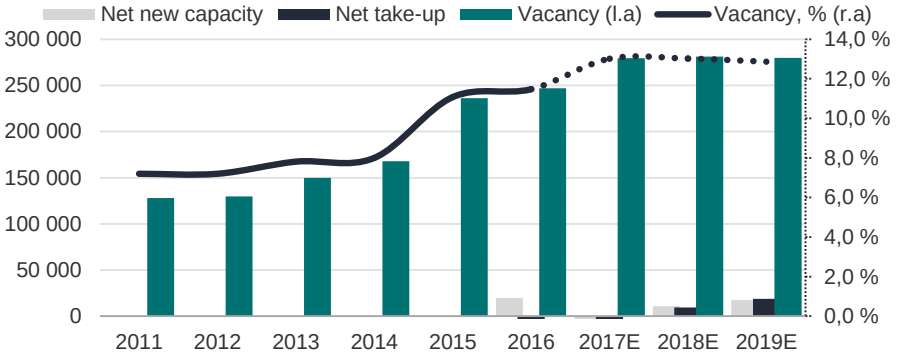
In our last office account we registered a vacancy level in the Stavanger area of 11.3%. There continues to be a clear division in the market with low vacancy and good activity in the central areas of Stavanger and Sandnes, while the peripheral zones, and particularly Forus, are characterised by high office vacancy. At the same time we have record substantial volumes of hidden vacancy in the market.

Office vacancy in Stavanger is expected to peak during 2017. Subsequently we expect a flat and gradually downward trend in vacancy in line with expectations of increased optimism and space demand, combined with a low supply of new office buildings. The increase in vacancy in the short-term is due to a continued demanding situation in the oil sector and much hidden vacancy. We also look with anticipation at the major development in the centre of Sandnes. A total of 153,000 m2 of land has been freed for urban development. Of this 76,000 m2 is planned for offices and commercial use. The first stage of the office building Havnespeilet was in progress last year (Sandnes Sparebank – 6,000 m2), while the development of Rådhuset (12,000 m2) has a planned construction start this year.

Large difference in rents between the central areas and Forus/the peripheral zone

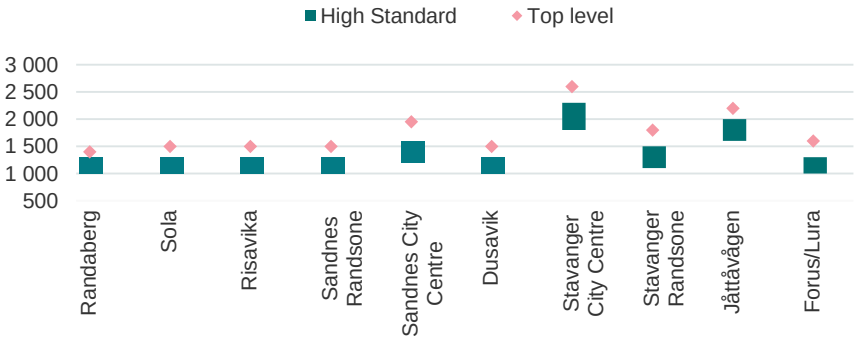
The differences between the various business clusters and geographic areas in the region continue, and to some extent have intensified. There are signs of improvement in the central areas and surrounding clusters, while in the peripheral zone and at Forus there is still little activity and strong price pressure. We nevertheless see some signs that rents have stabilised a little in the most demanding areas, which may indicate that we are close to the bottom for rents.

Office vacancy*



** New building net and growth in leased space from 2016*

Market rent levels



Domkirkeplassen 3, Stavanger

Sales mandate on behalf of Stavanger municipality

Good activity in the transaction market and strong demand for low-risk property. In 2016 the transaction market experienced both volume and activity in line with the record year 2015. We see nevertheless that volume in 2016, in common with 2015, was linked to a few large transactions. The four largest transactions in 2016 accounted for over 80 % of the transaction volume in Stavanger.

We find that the buyer side in Stavanger continues to be very selective, and the preference is still for low risk property and then preferably with public sector tenants. Nordea Liv's purchase of Nykirkebakken 2 and Verksgata 1A is a good example of a very attractive low risk property, and that the level of activity in the city centre in particular has been good. 6 of the year's 15 transactions have been completed with leases of 10 years or longer and several have achieved very keen pricing. Stavanger historically has been characterised by a large proportion of national and international investors on the buyer side. They adopt an "international" approach to investment that we believe will continue in spite of the fact that certain large individual transactions meant this proportion was unusually low in 2016.

Transaction examples Stavanger

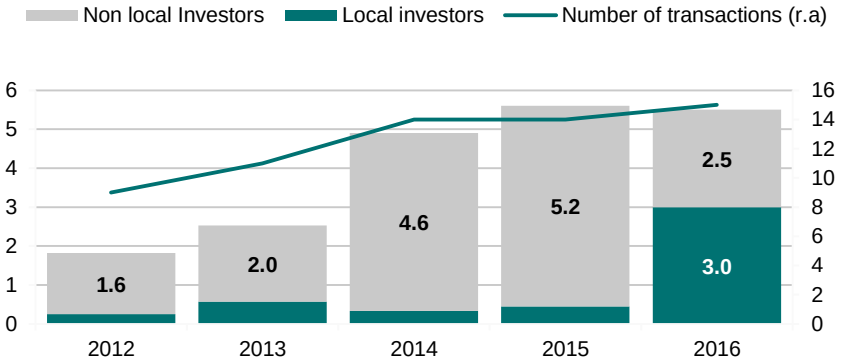
- Stavangerregionen Havn IKS bought Risavika havn AS from local investors.
- City Finansiering bought Unik Terminal/Kolumbus bus station at Forus from local investors.
- Kraft Finans purchased Kirkegaten 22. Eiendomsverdi for about NOK 170 mill.
- Rom Eiendom acquired the city transport terminal in Stavanger from ANS Terminalbygg. The property value was around NOK 80 mill.
- Camar Eiendom bought Lervigsveien 32/Tinngata 8 from Entra.
- Nordea Liv purchased Nykirkebakken 2 and Verksgata 1A in Stavanger city centre. The property value was NOK 777 mill.

Yield table

	Offices	Hotels	Logistics	Retail
Prime yield	5.50 %	5.50 %	6.50 %	5.25 %
Normal yield	+/- 7.50 %	-	+/- 8.0 %	+/- 7.50 %

Offices: 7-year lease,. Retail: outside the centre, Logistics and hotels: 12-year lease

Transaction volume 2012-2016, NOK bn.



Retail

Transaction volume shows a decrease from 2015, but activity has picked up a little since last summer and there are several major pending transactions.

Prime Yield	Since Q3-16	Total transactions	Transaction Volume
3.75%	-0.10%	56	NOK 15.7 bn.

- **E-commerce has led to retail leakage of NOK 30 bn.**
- **Stronger turnover growth for shopping centres in Oslo and Akershus than the national average.**
- **Certain properties in “high street” locations were sold on a yield under 4 % in 2016.**

Billingstadsletta 11.
Lessees include Møller Bil, Jysk and Elektroimportøren

Internet retailing grew by 16 % in 2016.

The latest estimate from DIBS indicates that Internet retailing was expected to increase to NOK 90 bn. in 2016. The figures from DIBS' annual e-commerce report also show that the Norwegian market has grown by as much as 75 % in five years, with the sale of goods on the Internet amounting to roughly NOK 30 bn. Despite the strong growth, the sale of goods on the Internet is still only just above 5 % of all such sales in Norway.

Good growth for the shopping centres in Oslo and Akershus, but slightly lower growth on a national basis.

The shopping centres in Kvarud's shopping centre index recorded growth in 2016 of 1.7 % adjusted for space changes. Total sales for shopping centres in the index were NOK 151 bn. including VAT. The shopping centres in Østfold (4.4 %), Oslo (2.9 %) and Akershus (2.8 %) accounted for most of the growth last year. With the exception of Rogaland (- 0.5%) and Sogn og Fjordane/Møre og Romsdal (- 0.5 %) there was growth in all counties after adjusting for space changes.

Continued high demand for retail properties in the transaction market.

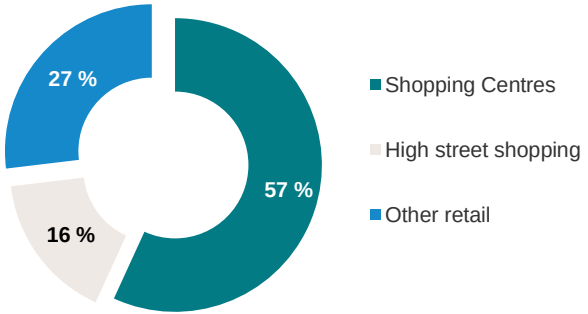
In 2016 56 (45) retail transactions were recorded for an aggregate value close to NOK 16 (38) bn. Activity has been very good in spite of a fall in volume from 2015, mainly due to the absence of large portfolio transactions.

In the last three years shopping centres have had by far the largest share measured by value of retail transactions in Norway. Since 2014 shopping centres with a value of close to NOK 35 bn. have been sold, corresponding to 57 % of the aggregate transaction volume we have registered. The average yield for the15 shopping centres that have been sold in the last year has been below 6.5 %. The square metre price varied from under NOK 15,000 to over NOK 25,000 in five of the transactions.

Key figures

Turnover growth	2013	2014	2015	2016
Internet retailing	16 %	15 %	13 %	16 %
Shop sales	3.3 %	1.8 %	3.4 %	4.5 %
Private consumption	2.1 %	1.9 %	2.1 %	1.4 %
Shopping centres	1.7 %	2.7 %	1.9 %	1.7 %

Retail transactions measured by value split between different types of retail property 2014-2016



Source: DIBS, Virke og DNB Markets

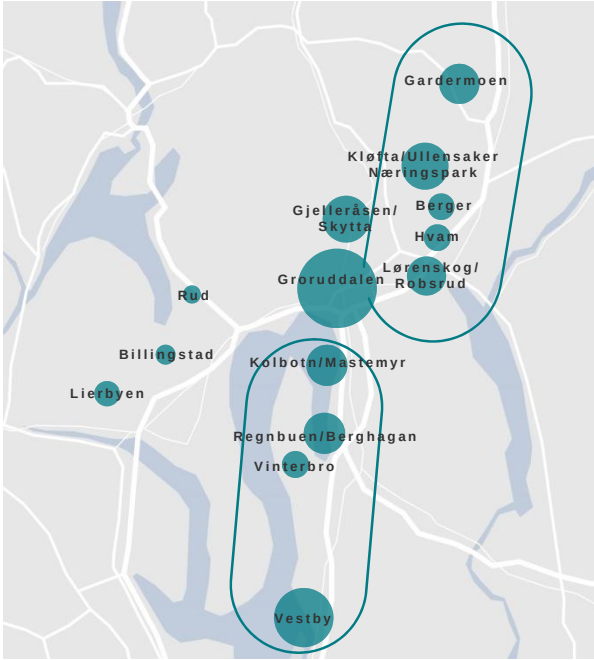
Warehousing and logistics

During 2017 several major tenants will need to make decisions with regard to premises.

Prime Yield	Since Q3-16	Prime Rent	Total transactions	Transaction volume
5.25%	-	1 200 (EUR 133)	50	NOK 11.7 bn.

- **Continued good and stable demand for warehouse and logistics premises.**
- **To an increasing extent tenants have to solve their space requirements outside Oslo.**
- **2016 transactions vary from NOK 3.500 per m2 to over NOK 20.000 per m2.**

Warehouse clusters, Oslo region



Main features

There have only been a few lease signings for large logistics properties in recent months but several major users must make a decision on their leases in 2017.

Within the Oslo outer ring-road in recent years there have been few good long-term alternatives for tenants due to conversion to housing and offices. The same will happen in the coming years in areas outside the ring-road so that users will need to solve their warehouse requirements outside Oslo's boundaries. Fierce competition for assignments is reported, with both price and rental periods under strong pressure.

There is still a broad range of projects/new buildings on offer both to the north and south of Oslo. In addition there has been an increase in the supply of large existing buildings compared to one year ago.

Rent levels for new buildings continue to put pressure on rents in existing buildings. We assess top rents in existing buildings with central locations at NOK 1,200 m2/year, with most in the interval NOK 950-1,050 m2/year.

Letting examples

- BaneNor, approx. 5,000 m2 new building in Aurvegen Næringspark (Nannestad).
- Waba Europaller, approx. 5,800 m2., Vestby.
- Vinmonopolet, approx. 2,800 m2., Vestby.
- Asko, approx. 4,600 m2. in Sandstuveien 70 at Ryen after the previous tenant Rett Hjem.

Transaction market

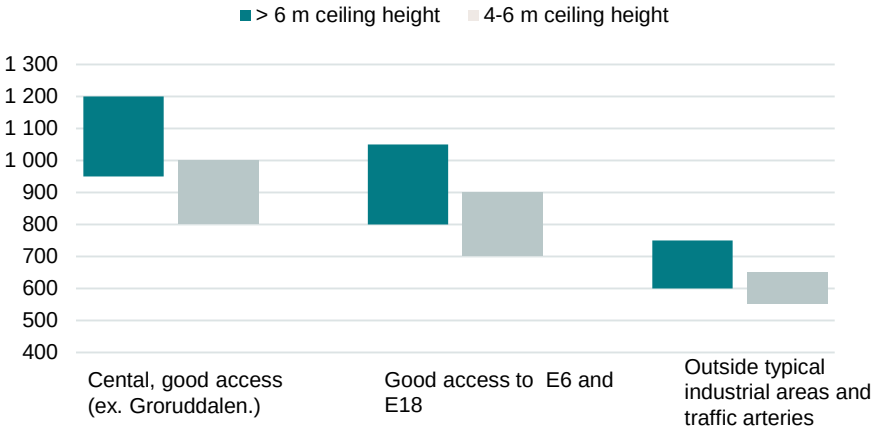
In 2016 we registered 50 transactions with an aggregate value of approx. NOK 11.7 bn.

Pricing within warehousing and logistics is very sensitive to the remaining lease period and last year's transactions vary from NOK 3,500 per m2 to several transactions over NOK 20,000 per m2. We assess the prime yield within warehousing and logistics to be around 5.25%, subject to a long lease and solid tenant.

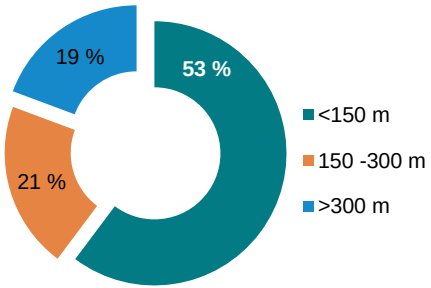
Transaction examples:

- NRP's sale of the Berger terminal to Arctic.
- Anthon B. Nielsen's sale of Staples Lahaugmoen to NRP.
- Ragde Eiendom's sale of the remaining 50% of the Arcus-building to Canica.

Market rent levels



Transactions 2014-2016 (NOK million)



Bølerveien 65, Berger

Illustration, Architects Astrup and Hellern

Leased to OneMed on behalf Fabritius

Hotels

Good and stable growth in key figures nationally, but still big regional differences. The Stavanger market continues to be strongly affected by overcapacity and demanding market conditions.

Prime Yield	Since Q3-16	RevPAR	Since Q3-16	Total transactions	Transaction volume
4.00%	-	492	+2.3%	14	NOK 4.4 bn.

- **Growth of 10% in overnight stays by foreign visitors.**
- **The hotel strike hit all 4 of the largest cities.**
- **Hotel transactions for NOK 4.4 bn. in 2016.**

Quality Hotel Expo Fornebu

Purchase adviser for DNB Scandinavian Property Fund DA. 2015

Stable growth for hotels on a national basis, but continued large regional differences

2016 was the first year in which more than 15 million room days were sold in Norway, and RevPAR was up 2.3% compared to 2015. A weak Norwegian krone contributed to strong growth in overnight hotel stays by foreign visitors (10%), while the hotel strike (23 April-20 May) hit all of the four largest cities with a decline of between 11 and 18% in the number of rooms sold in the strike period.

- Oslo hotels continue to show strong key figures and set new records for both the number of rooms sold and prices achieved. Capacity is expected to be slightly reduced in 2017 as, among others, Clarion Hotel Royal Christiania will be closed for rebuilding.
- Bergen had good growth in both room prices (4 %) and RevPAR (5 %). A substantial increase in capacity is expected in 2017, counteracted to some extent by Hotel Norge being taken out of the market until 2018.
- Trondheim experienced a solid rise in both room prices (4%) and RevPAR (13%). The market balance has improved after several years of growth. The reduction in capacity against 2015 is due, among another things, to the refurbishment of Hotel Britannia which is planned to reopen in 2017/2018.
- Stavanger continues to be affected by a decline in demand and the strong capacity growth the city has had in recent years. There was a fall in all key figures in 2016, and RevPAR was down as much as 37 % compared to the peak year 2013. Little new capacity is expected in the market and Hotel Atlantic has already been taken out for renovation. This may improve the market balance slightly.

Transaction examples

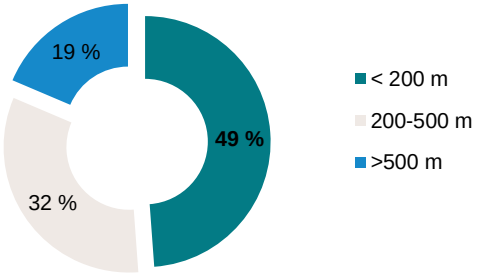
14 hotel transactions were completed in 2016 for an aggregate volume of NOK 4.4 bn. Examples of completed hotel transactions in 2016 include:

- Scandic Fornebu was sold by Utstillingsplassen/Koksa to Storebrand Eiendomsfond for NOK 660 mill.
- Norefjell Ski & Spa was sold by Danske Bank to Edda Utvikling/Hospitality Invest.
- Quality Hotell 33 was sold by OBOS/Aspelin Ramm to Ragde Eiendom.
- DNB Scandinavian Property Fund bought Smarthotel Oslo for NOK 378 mill.

Key figures

	Room price		RevPAR		Capacity (million rooms)		Capacity utilisation	
	2015	2016	2015	2016	2015	2016	2015	2016
Norway	879	903	481	492	27,440	27,946	53,7 %	54,5 %
Oslo	956	964	663	663	4,415	4,656	69,3 %	68,8 %
Bergen	943	979	631	662	1,728	1,728	66 8%	67,6 %
Trondheim	803	835	472	533	1,302	1,238	58,8 %	63,9 %
Stavanger	943	876	495	445	1,183	1,139	52,5 %	50,8 %

Hotel transactions 2014-2016 (NOK million)



Source: NHC, Wiederstrøm Hotel consulting, SSB, DNB Næringsmegling

Macro-economy

Jeanette Strøm Fjære
DNB Markets

Higher growth, but many risk factors.

Read more about DNB Markets' economic outlook here

	2014	2015	2016	2017E	2018E	2019E
Mainland GDP	2.3 %	1.1 %	0.8 %	1.3 %	1.6 %	2.0 %
Interest rate – 10-year swap	2.8 %	2.0 %	1.5 %	1.8 %	1.8 %	1.9 %
Inflation/CPI	2.0 %	2.2 %	3.6 %	2.6 %	1.8 %	1.5 %
Employment	1.2 %	0.4 %	0.0 %	0.4 %	0.5 %	0.8 %

DNB Markets January 2017

- **Global:** Higher growth but increased risk.
- **Norway**: A slow upturn is on the way.
- **Housing market:** Increased activity and risk.

Global

Global GDP growth appears to have picked up over the last year and will probably increase a little more in the coming year. Growth is highest in the emerging economies, but has also improved in the industrialised countries. We have adjusted upwards our forecast for industrialised countries, after several years of downward adjustments. Unemployment continues to fall in most industrialised countries and inflation appears to be rising. The risk of deflation has diminished, and the central banks no longer need to resort to steadily new and untried methods in their efforts to raise inflation. Despite somewhat brighter growth prospects there is a lot that can go wrong in future. The risk factors are exceptionally numerous and serious, and mainly on the downside. Political risk dominates the industrialised countries with a possible trade war and increased protectionism initiated by the USA, a ”hard Brexit” and possible election victories for populist right-wing parties in Europe. In addition the debt of Chinese companies continues to increase. If one or more risk factors should materialise, economic growth will be weakened.

Norway

The Norwegian economy faces another weak year, with low growth in the mainland economy dampened by a further fall in oil investments and subdued private consumption. Looking forward we see gradually higher growth, driven by the fall in oil investments levelling out and lower inflation lifting households’ purchasing power a little. A slightly higher oil price, combined with extensive cost-cutting in the supplier industry means that the profitability of many projects on the Norwegian continental shelf has significantly improved. The powerful stimuli that we have had, in the form of a fall in interest rates and weakening of the NOK exchange rate, will not continue. Even though oil revenues will probably increase as well in the coming years, this will not be enough to lift economic growth significantly. Continued low production growth will similarly not be sufficient to bring unemployment down very much, even though it appears to have levelled out in the last year. Moreover, there are large regional differences, with continued high unemployment in western Norway, and decreasing unemployment in other parts of the country.

Global key figures

GDP	2017E	2018E	2019E	2020E
Eurozone	1.4 %	1.3 %	1.3 %	1.3 %
Sweden	2.3 %	2.0 %	1.9 %	1.9 %
United Kingdom	1.9 %	1.4 %	1.1 %	0.8 %
10 year SWAP	**2017E**	**2018E**	**2019E**	**2020E**
Eurozone	0.5 %	0.8 %	1.0 %	1.0 %
Sweden	1.0 %	1.3 %	1.5 %	1.5 %
United Kingdom	1.3 %	1.5 %	1.5 %	1.3 %

Key figures Norway	2014	2015	2016	2017E	2018E	2019E
GDP Mainland Norway	2.3 %	1.1 %	0.8 %	1.3 %	1.6 %	2.0 %
CPI	2.0 %	2.2 %	3.6 %	2.6 %	1.8 %	1.5 %
CPI-JAE	2.4 %	2.7 %	3.0 %	2.1 %	1.5 %	1.2 %
Private consumption	1.7 %	2.1 %	1.4 %	1.9 %	2.3 %	2.5 %
Export of traditional goods	2.5 %	5.8 %	-6.3 %	0.5 %	2.8 %	3.0 %
Employment	1.2 %	0.4 %	0.0 %	0.4 %	0.5 %	0.8 %
Unemployment rate, AKU	3.5 %	4.4 %	4.8 %	4.9 %	5.0 %	5.0 %
Gross investment petroleum activities	-1.7 %	-15.0 %	-15.0 %	-10.0 %	0.0 %	5.0 %
Oil price (USD/bbl)	99	53	45	65	70	70
Secondary house prices	2.3 %	7.2 %	8.3 %	9.0 %	1.0 %	1.0 %
Interest rates and currencies	**2014**	**2015**	**2016**	**2017E**	**2018E**	**2019E**
3m NIBOR	1.7	1.3	1.0	1.1	1.0	1.0
10 year swap	2.8	2.0	1.5	1.8	1.8	1.9
EUR/NOK	8.4	8.9	9.3	8.8	8.6	8.4
USD/NOK	6.3	8.1	8.4	8.6	8.3	7.5

Source: DNB Markets Økonomiske utsikter januar 2017

Price growth

Inflation was pushed up last year by a rise in import prices as a result of the weakening of NOK during 2014 and 2015. Consumer price inflation ended at 3.6% last year, while core inflation was slightly lower at 2.6%. This year we expect that inflation will gradually fall during the year as the effect of the lower NOK is gradually phased out. We forecast that consumer price inflation will be on average 2.6% this year, before falling further to 1.4% in 2020. In January inflation fell considerably more than expected. In addition the National Accounts show wage growth of 1.7 % last year, much lower than our forecast. Together this means that there is some downside risk in our inflation forecasts.

Despite continued weak resource utilisation and inflation falling below the target of 2.5% this year, we do not believe Norges Bank will cut interest rates further. With strong house price growth and high household debt, there is a danger of financial imbalances building up. We do not believe that Norges Bank will raise interest rates either, with continued weak growth, high unemployment and inflation coming out below the target. Therefore our forecasts show an unchanged base rate of 0.5% throughout the whole forecast period. Long interest rates are expected to correct a little, after a significant increase towards the end of last year. We expect however at the end of the forecast period slightly higher long interest rates, once growth in the mainland economy has picked up to around 2%.

Housing

The low interest rate is contributing to strong demand for housing. This has been particularly apparent in the Oslo region. The greatest risk in the Norwegian economy is considered to be that strong house price growth will drive debt levels even higher. This means that many households will be sensitive to a rise in interest rates or loss of income.

Alternative scenario

In our main scenario we forecast a slowdown in house price growth this year and only a marginal rise in the period 2018-20. A reversal could however be more marked. We have therefore outlined a downside scenario, where prices fall by almost 20% over the next years. The consequences would be weaker growth (but not a fall) for private consumption in spite of the base rate falling. to zero and NOK weakening. We also forecast that housing investments will fall much more in a scenario with decreasing house prices. Overall GDP will increase much less during the forecast period if house prices should fall as we indicate in the downside scenario. This also means that unemployment will rise if this scenario Is realized.

Bond market

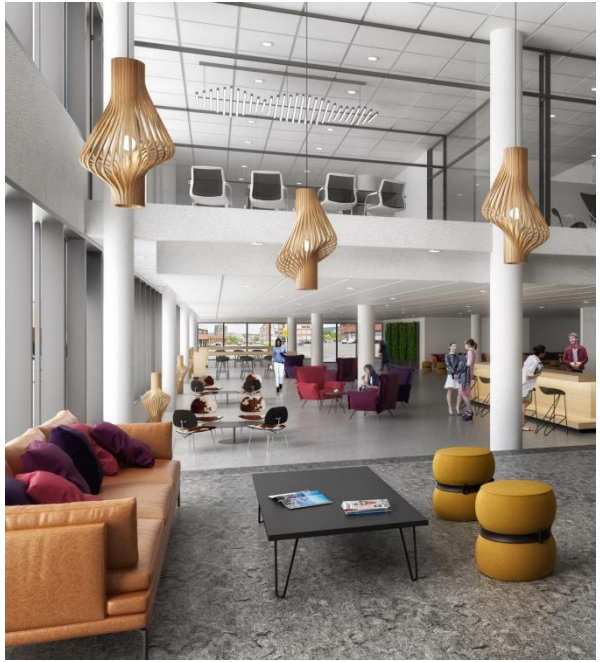
Kristina Solbakken
DNB Markets

The substantial increase in the volume of property bonds from 2015 to 2016 is partly due to the fact that the Swedish property companies Vasakronan and Rikshem issued bonds in the Norwegian market as well as the Swedish.

- **NOK 23.9 bn. of property company bonds were issued in 2016, against NOK 15.5 bn. in 2015.**
- **High level of activity so far in 2017 in the Norwegian bond market.**
- **Property companies in the Norwegian bond market have seen spreads widen over the last year in line with the general market.**

Ulvenveien 90 - Torgbygget

Office and retail space to be let on behalf of Obos | Ulven



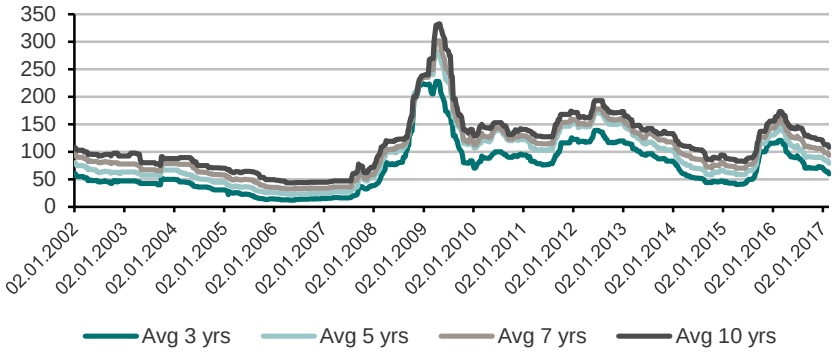
Spreads narrowing in the Norwegian bond market

2016 was a year with many surprises. The United Kingdom voted to leave the EU and Donald Trump was elected as the USA's new president, to mention two. Nevertheless we have experienced a narrowing of spreads in the Norwegian bond market over the last year. An important factor has been the expansive monetary policy which continues to contribute to keeping international credit margins artificially low. At the end of 2015 there was a significant correction with an increase in spreads (see graph to the right). With hindsight this correction was a little too strong, which contributed further to the narrowing of spreads in 2016. We also saw that international money flows contributed to reduce borrowing costs for Norwegian mortgage companies, which again affected the rest of the bond market. The last important factor for the narrowing in spreads that we saw over the last year is that the Norwegian economy has developed better than feared, helped by an increase in the oil price from a low of USD 27 a barrel in January 2016 to USD 56 a barrel in February 2017.

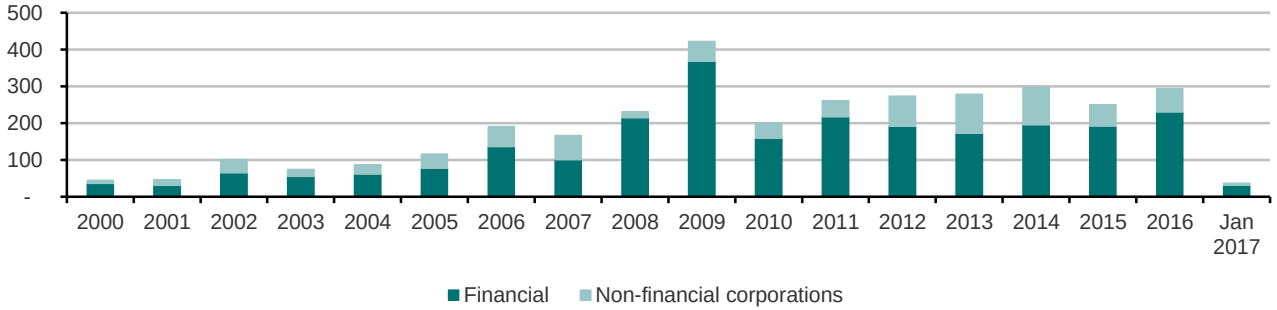
Higher activity in the Norwegian bond market

The graph below shows historical issues in the Norwegian bond market excluding state and municipal bonds. We saw a relatively large fall in volume in 2015, mainly as a result of the fall in the oil price which led to the market for high-yield bonds closing for several months. In 2016 volume increased to NOK 293 bn. which is the third best year measured by volume after 2009 and 2014. Higher activity so far in 2017 has also led to a higher volume so far this year compared with the same date last year.

Average spread development for Norwegian industrial companies (bp)



Volume issued in the Norwegian bond market (NOK billion, adjusted for state and municipal bonds)



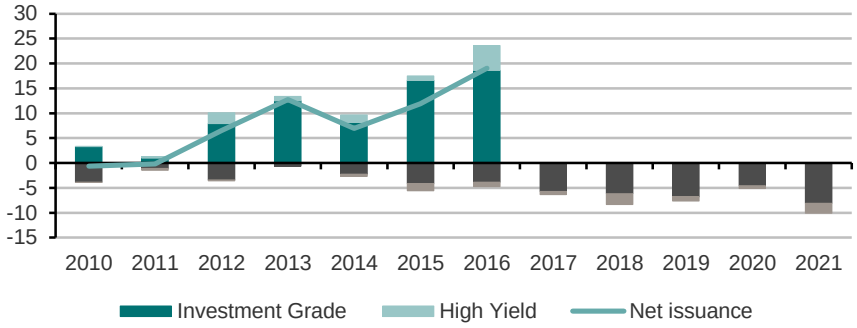
Substantial increase in the volume of property bonds

The volume of bonds issued in NOK by property companies rose from NOK 15.5 bn. in 2015 to NOK 23.9 bn. in 2016. Part of the reason for this is that Swedish companies such as Vasakronan and Rikshem have begun to issue bonds in the Norwegian bond market in addition to the Swedish market. The Swedish spread curve for this type of company is steeper than the Norwegian. It is cheaper for these companies to issue long-dated bonds in NOK, even though shorter issues are cheaper in SEK. Some of the largest property companies are dependent on raising large amounts of capital in the bond market and it is therefore also important to have access to several different bond markets. Vasakronan had, for example, ~SEK 29 bn. in outstanding bonds at the end of 2016, of which NOK 4.95 bn. were outstanding in the Norwegian bond market.

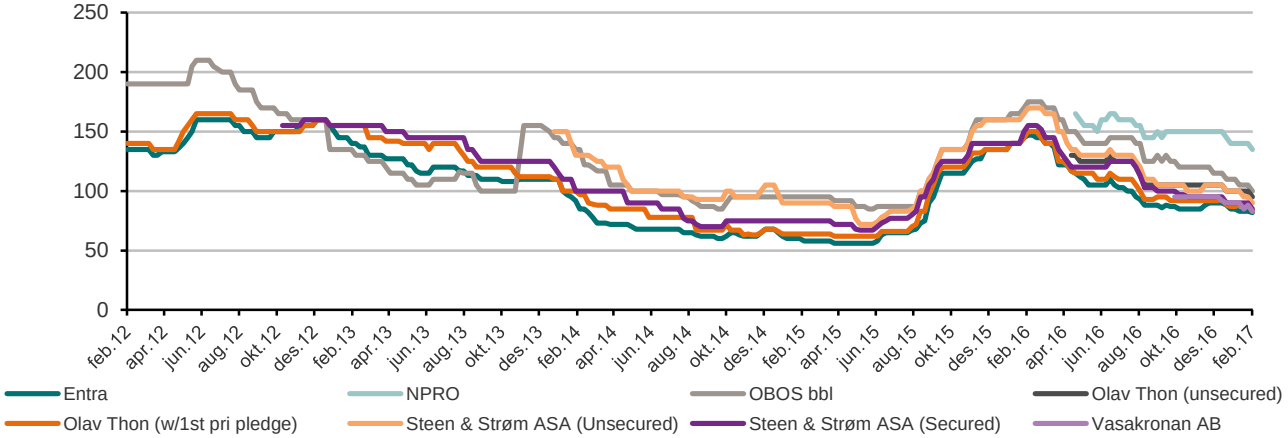
Spreads narrow for Norwegian property companies

The development in spreads for selected property companies in the Norwegian bond market (5 years) also shows a narrowing during the last year, in common with the general market. The financing cost of these companies in the bond market continues to be very low and lower than what they pay for corresponding bank loans.

Volume issued by property companies in the Norwegian bond market (NOK bn.)



Spread development for selected property companies (bp)



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