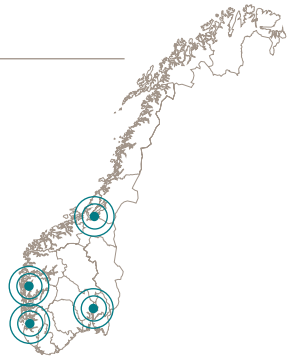
MARKET REPORT



2. HALF-YEAR 2016

Workplace Oo, Vitaminveien 4
Letting assignment on behalf of Skanska CDN

DNB NÆRINGSMEGLING AS

DNB

MARKET REPORT

2. HALF-YEAR 2016

DNB NÆRINGSMEGLING

We are one of Norway's leading commercial real estate agents and the only one with offices in each of the four main cities. Our aim is to be your preferred partner and provide support with analysis, valuation, advice, letting and the purchase/sale of commercial property. Our employees have long experience and broad expertise, and are dedicated to finding the best solution for you as client.

Transactions

Our expert team has conducted transactions for more than NOK 30 billion in the last three years. We provide support throughout the entire process of buying or selling commercial property, adapted to our clients' preferences. We have very good knowledge of the investor market in commercial property.

Letting

Our brokers find the best solution for clients and tenants. We focus on letting office premises, warehouse and combination properties and some retail premises. In the last three years we have arranged leases for more than 600,000 m2 of space.

Analysis

Whether you are planning to develop, purchase/sell or let commercial property, substantial values are involved. We offer high quality advice and analysis, which considerably increases the likelihood of success. Since our establishment in 2003 we have closely followed the market and built up detailed knowledge and a comprehensive set of databases. This report has been prepared by our Analysis Department.

Valuation

In a steadily more professional property market there is an increasing need for external valuations of property. We have long experience of undertaking valuations for portfolios, individual properties and development projects. We have seen significant growth in the number of our assignments and are one of the largest and most recognised market participants. In the last three years we have completed valuations of properties for an amount in excess of NOK 200 billion.

CONTENTS

CEO'S LETTER

Anne Helene Mortensen,
Chief Executive,
DNB Næringsmegling

***The autumn hunting season doesn't just take place in the mountains** - there is a hunt going on for investments around the country, at the same time as property owners on their side are hunting for tenants. The situation hasn't changed significantly since the winter, but rather has intensified. There is however a different make-up to the investors that have dominated the transaction market compared with 2015. At the same time, we can confirm a positive shift in the office rental market in Oslo.*

At the start of 2016 many people felt that the market was saturated following the hectic activity we saw throughout 2015. At the time of writing in October 2016 we can confirm however that the number of transactions this year will probably achieve a "podium place". In the office market in Oslo it is pleasing to confirm that vacancy is falling and rents are up.

You now have in front of you DNB Næringsmegling's fresh market updates as at the beginning of October. This is supported by underlying analysis of the movements we see in the market. We are proud to be able to look back over a long history at the same time as we analyse trends and look forward.

In DNB Næringsmegling we wish to provide our customers with tailored reviews of the market. We prepare a large number of analyses that we do not publish. This autumn, among others, we have studied equity issues and the investment plans of the equity funds, international funds as well as Norwegian fund managers.

Three quarters of the transaction market takes place in and around the four largest city regions, and our offices in Oslo, Trondheim, Bergen and Stavanger work closely together to carry out assignments together where appropriate. In this way clients can get the best price for properties they are selling because we have been able to present them to local, national and international investors. Several leading clients confirm that the interaction that they experience between local and national expertise is a big plus. Ingrid E. Moe has taken over a position as a letting broker in Oslo after many years as an analyst on the office market. This means that the letting team in Oslo now consists of eight experienced advisors. Mads H. Wanderås, Ingrid's replacement, is in place and has already started work on an analysis of the office market in Oslo. Also in Oslo the fifth and sixth members of the transaction team have joined and we're pleased to have on board Bjørn Olav Smørgrav (from DNB Markets) and Henrik Baardsen (from Pangea Property Partners). The transaction team in Oslo is thus fully equipped for the future with a combination of experienced brokers and advisors with a background from finance.

We see that today's property transactions are becoming steadily larger and more complex and involving an increasing proportion of institutional investors from both Norway and abroad. In arelight of this in DNB Næringsmegling we are strengthening our cooperation, particularly in connection with purchase assignments, with DNB Markets, which is a market leader in capital market activities (bonds and equities) in Norway. DNB Markets for its part has increased its focus on commercial property as an asset classes in recent times.

DNB is thus a one-stop shop within commercial property - with advice and broking for purchases/sales/letting as well as analysis and valuations, not to mention debt and equity capital solutions and M&A.

Good hunting!

HIGH RETURN AND PRIMARILY GOOD OUTLOOK

2016 is proving better than expected for property investors, who are on course for a third year of outstanding returns. There are however large geographic variations and in several segments around Norway the letting markets are challenging. Overall however, commercial property has a reduced downside risk this year and in general terms a primarily positive outlook.

- Falling yield trend and high CPI growth are contributing to a high return this year.
- The oil market is in better balance and there is less risk of continuing low prices. This reduces the risk of a long-lasting economic downturn in Norway. DNB Markets expects that the Norwegian economy will gradually strengthen and return to its trend growth in 2019, something which again indicates a reduction in letting risk.
- The office segment in Oslo constitutes a large proportion of many portfolios and vacancy here has been on a falling trend over the last year. Market rents are now increasing for the first time since the autumn of 2014.
- Office vacancy is 10% or higher in Bergen, Trondheim and Stavanger and RevPar in Stavanger in the first half-year was down by 43% compared with the same period in the peak year 2013.

Economic situation and the impact on commercial property

The Norwegian economy is characterised by weak growth, but expectation indicators show that business now considers prospects to be a little brighter. Property investors can derive some comfort from the fact that DNB Markets has increased its growth estimates for CPI by a total of 2.3 percentage points for the present 3-year period compared with the corresponding forecast last winter. After three outstanding return years, macro forecasts suggest now that from next year broadly composed property portfolios will see a moderate return in line with the direct return.

Loan financing

We have for the most part a well-functioning loan market for commercial property, something that is reflected, among other things, by the fact that the arrangers have been the largest net buyers this year. The DNB group has contributed both through increased lending and through the life insurance company's increased bond purchases. In several local markets we see that participants without established bank relationships that wish to invest in property with an ordinary level of risk face challenges in obtaining finance. Credit margins have risen a little over the last year, at the same time as floating interest rates have trended lower.

Yield development

Continuing excess demand is still pushing yields lower. Properties with long leases have been traded over the last year in the range 5.00 to 5.50% at places such as Elverum, Lillehammer and Haugesund. International investors with moderate debt levels or 100% equity finance have shown the most willingness to purchase at higher prices in Oslo, where the prime yield has been reduced to 3.85%.

The transaction market

Many investors face challenges in finding property to buy and arrangers, purchase advisors and investors are active in approaching owners with purchase enquiries. Demand is concentrated on Oslo, the other main cities and properties that give a predictable return. 2016 is likely to be the third year running with more than 200 transactions. Compared with 2015 there have been fewer large portfolio transactions and international investors have to a lesser extent been able to satisfy their requirements.

The office market in Oslo

A low level of construction, a high volume of conversions and moderate growth in the amount of leased space has contributed to office vacancy being on a slightly falling trend since the peak in the autumn of last year. The current level is 8.3% of total office space and our forecasts indicate that the level will fall to 7.1%

by the end of 2019. Data from Arealstatistikk suggest that market rent levels are now rising for the first time since the autumn of 2014. Our expectation is that market rents will continue to rise slowly in the coming years. The development will be best for premises with a high standard in central areas.

Bergen, Trondheim and Stavanger

Low borrowing costs and excess demand for commercial property with a low risk have contributed to a generally falling yield trend for Bergen and Trondheim as well. A higher letting risk has limited the fall in yield in Stavanger but properties with long leases to the public sector are being sold in the oil capital at yield levels of around 5.0%. A lack of large individual properties with good locations for sale, combined with less aggressive demand (fewer purchase approaches) has contributed to the three cities in total only having about 16% of the transaction volume so far this year. To date in 2016 we have registered a total of 29 transactions with a minimum value of NOK 50 million in the three city regions. These amount to NOK 6.8 billion. While conditions have been challenging for the office and hotel segments, the logistics and retail segments have experienced a moderately good development. In particular, the shopping centres have few vacant premises.

Other segments

Shopping centre turnover is up 3.0% as at the end of August when one adjusts for space changes/capacity growth, but retail property in general has only moderately good prospects. DNB Markets' estimate for private consumption now shows a growth rate of only 2.3% on average for the years 2017–2019. Furthermore, Internet retailing is growing rapidly and is now likely to amount to around NOK 30 billion this year. The hotel market varies from very good in Oslo to very challenging in Stavanger. Vacancy in the warehouse market in the Oslo area has been reduced in recent years and rents are rising slightly for properties with the right location. The fall in interest rates from the autumn of 2013 has however contributed to developers offering new buildings at lower rents. The Swedish company Hemfosa has invested in community buildings and we are now seeing some other international investors showing interest. Turnover in this segment has been particularly characterised by properties with long leases.

Main figures	2015	2016E	2017E	2018E	2019E
GDP mainland	1,0 %	0,8 %	1,4 %	1,9 %	2,1 %
CPI	2,2 %	3,7 %	2,6 %	1,7 %	1,5 %
Employment	0,6 %	0,4 %	0,5 %	0,8 %	0,8 %
Consumption	2,0 %	1,3 %	1,8 %	2,5 %	2,7 %
House prices	7,2 %	7,8 %	7,0 %	4,0 %	3,0 %
3m NIBOR	1,3 %	1,0 %	1,0 %	1,0 %	1,0 %
10y SWAP	2,0 %	1,5 %	1,8 %	1,8 %	2,0 %
Average cost of debt (5y SWAP + margin)	3,2 %	3,5 %	3,6 %	3,6 %	3,7 %

Office market	Prime yield	Prime rent	Vacancy	Estimated rents	Estimated vacancy
Oslo and Akershus	3,85 %	4 100	8,3 %	↗	↘
Bergen	4,75 %	2 600	10,3 %	→	→
Trondheim	5,00 %	2 400	9,9 %	↘	↗
Stavanger	5,50 %	2 600	11,3 %	↘	↗

The transaction market	Key indicators	2015	2016	Prime yield Oslo	Transaction volume NOK bn (quantity)
Office	Employment growth	0,6 %	0,4 % *	3,85 %	18,4 (51)
Retail	Turnover shopping center	2,3 %	3,0 % **	3,85 %	9,0 (33)
Warehouse/logistics (long lease)	Prime rent warehouse	1 150	1 200	5,25 %	5,7 (24)
Hotels	RevPar Norway	481	469**	4,00%	2,7 (9)
HEC (long contract)	Housing prices	7,2 %	7,8 %*	4,00 %	1,5 (5)
Other/confidential					1,4 (8)
Housing related	Population growth	0,9 %	1,1 % *	3,00 %	3,4 (16)

*Estimations 2016 (DNB Markets, SSB) | **YTD | Source: DNB Markets, SSB, DNB Næringsmegling

THE LETTING MARKET IN OSLO

The office market continues to be "saved" by a reduction in the supply side as a result of a continued high level of conversions and a low level of newbuilding. Vacancy is expected to fall to 7.1% at the end of 2018.

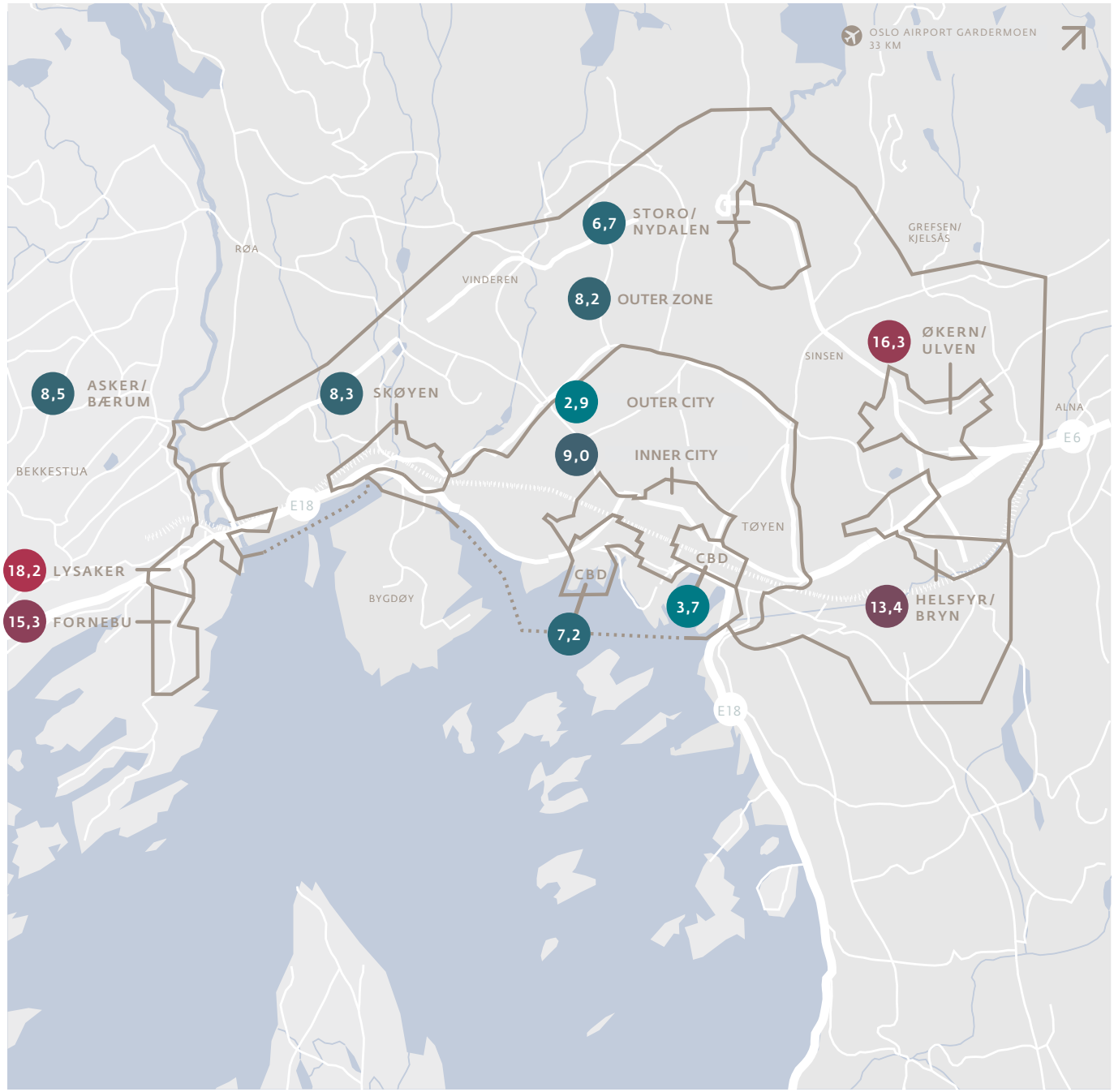
- Reduction in vacancy of 20,000 m2 into since Q1 2016 to 8.3%.
- We estimate that up to including 2019 there will be at 370,000 m2 of new building and 320,000 m2 of conversions.
- An increasing interest in new buildings that will be completed from 2018/2019.

Øvre Vollsgate 15
Letting assignment on behalf of Abel Eiendom

OFFICE VACANCY OSLO, ASKER AND BÆRUM SEPT. 2016 (%)

TOTAL OFFICE VACANCY OSLO, ASKER/BÆRUM: 8,3 %

Our definition of vacancy includes office premises that are vacant today or are ready for occupation within the next 12 months.



Main features

For the second year running we are seeing a fall in vacancy in the office market, with vacancy now standing at 820,000 m2 (840,000 m2) which corresponds to 8.3% (8.7%). Vacancy is down 0.7% over the last 12 months and marks a turning point from a trend of increasing vacancy in Oslo, Asker and Bærum as a result, among other things, of weak demand from oil industry related tenants. Vacancy peaked in the autumn of 2015 and the forecast indicates that vacancy will trend down to 7.1% at the end of 2019.

The main reasons for the reduction in vacancy Is a decline in the supply side with the completion of few new office buildings, a high level of conversion of office premises and moderately positive demand for space. The level of new building is low this year and next and amounts to respectively 70,000 m2 in 2016 and 90,000 m2 in 2017. Office properties have several alternative uses and helped by the high level of house prices we see continued extensive conversion, which combined with the low level of new building is resulting in a negative supply of office buildings in 2016. We expect that the trend will continue up to 2019.

There is still a good level of activity in the letting market with some geographic exceptions. In addition, we see clearly increasing interest in new buildings that will be completed in 2018/2019. Large public sector users have commissioned searches through Statsbygg and several of these have received a large number of offers. We find that there is high demand and good willingness to pay for centrally located high quality premises. The exception is to be found along the western corridor where the oil-related companies continue to reduce staffing and thereby their space requirements. As a result there is some subletting but also property owners are withdrawing buildings from the market for further development. This is the case at Lysaker where we see a fall in office vacancy of almost 20,000 m2, but where little is derived from pure space absorption.

Demand – Main indicators signal employment growth

Over the last 10 years employment in typical office jobs has risen more than employment in general in Norway. Office employment in Oslo, Asker and Bærum accounts for roughly one third of all office employment in Norway, and during the same period has risen by more than the country in general.

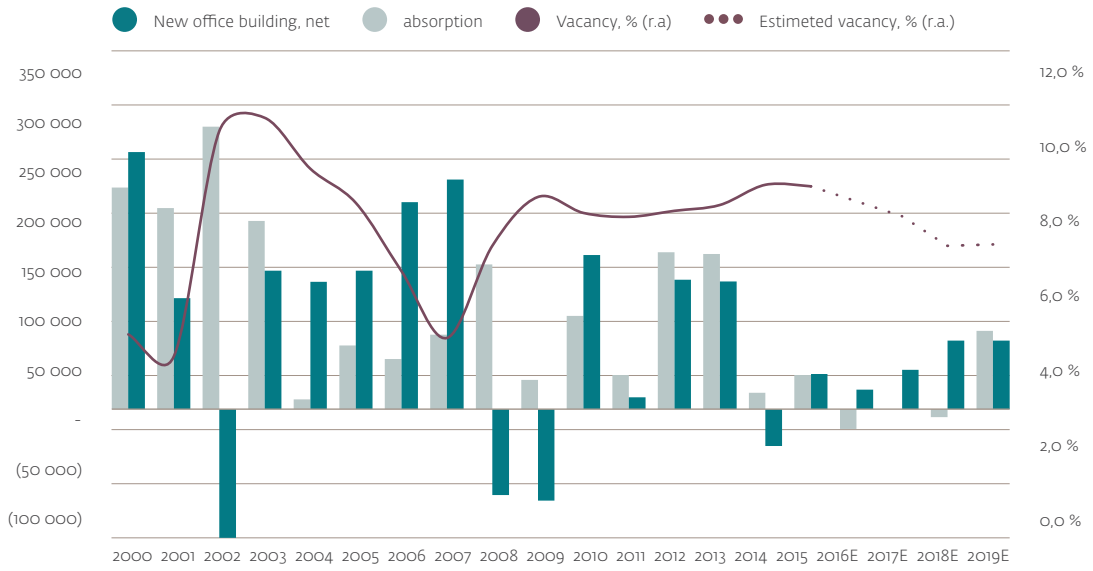
According to DNB Markets employment in office occupations will probably increase less than employment overall in the next three years and represent a smaller proportion in future. They estimate a marked reduction in petroleum investments in 2016 and 2017, something that will have knock-on effects for employment. The greatest growth is expected to be in less office intensive occupations such as health, welfare and education. In the case of more office-intensive sectors, such as the oil industry, banking and media, demand for space may be reduced compared with previous years. In recent years a new type of space absorption has emerged in which tenants lease larger amounts of space with a view to subletting to smaller companies with limited space requirements and start-up businesses. Such solutions can have synergy benefits, lead to increased productivity and the exchange of information across disciplines. The trend is international and growth in Greater Oslo has been good although the concept is not so appropriate in the city centre or in buildings which otherwise are difficult to fill.

Oslo, Asker and Bærum have been hit by the reduction in staffing in oil-related businesses as a result of the fall in the oil price since 2014 to a lesser extent than in other regions, and have seen positive employment growth during the period. We still see however examples of companies that are reducing costs in the oil segment, which again results in lower space demand.

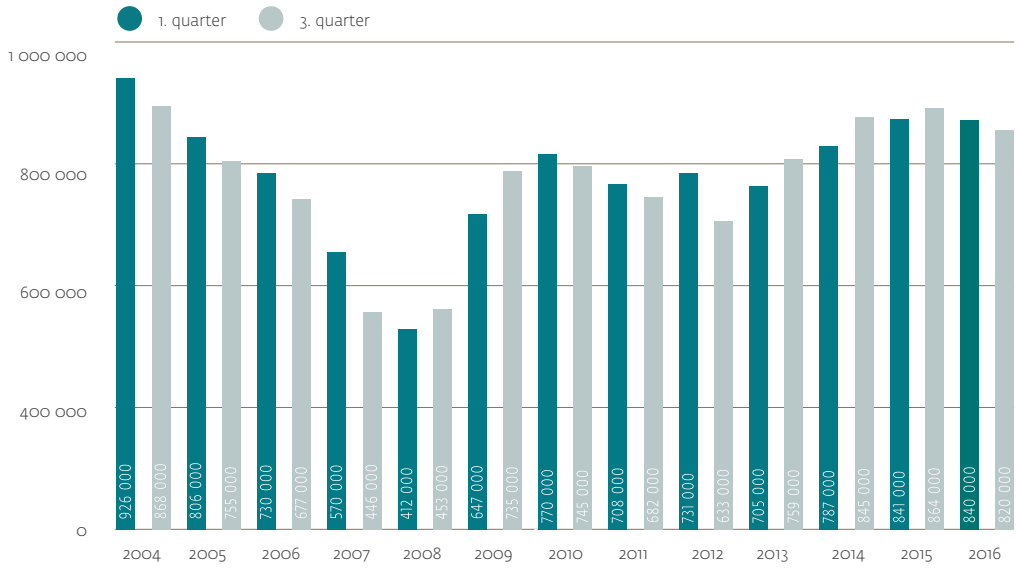
In DNB Næringsmegling we find that so far in 2016 there has been a high level of activity in the office market with a good level of interest from public sector tenants, as well as the private sector apart from the oil industry. **We believe that there are several important indicators pointing towards growth in office employment** in Oslo, Asker and Bærum. The national business outlook survey carried out by Norges Bank was marginally positive in the first quarter and negative in the second quarter. In the third quarter the index has been positive and Norwegian business leaders are optimistic with respect to future growth. The Manpower group conducts a similar outlook survey which differentiates between regions, the size of employer and sector. The Manpower survey indicates net employment growth in Greater Oslo where the majority is expected to be from large companies with more than 250 employees. This is an improvement from the fourth quarter of 2015 when net expected employment was negative.

Against a background of both increased business optimism and low macro-economic growth prospects we choose to retain the same moderate estimates on space demand as in our previous report. Space absorption will probably be less than what employment growth should indicate because of both hidden vacancy and the fact that more tenants are using space more efficiently.

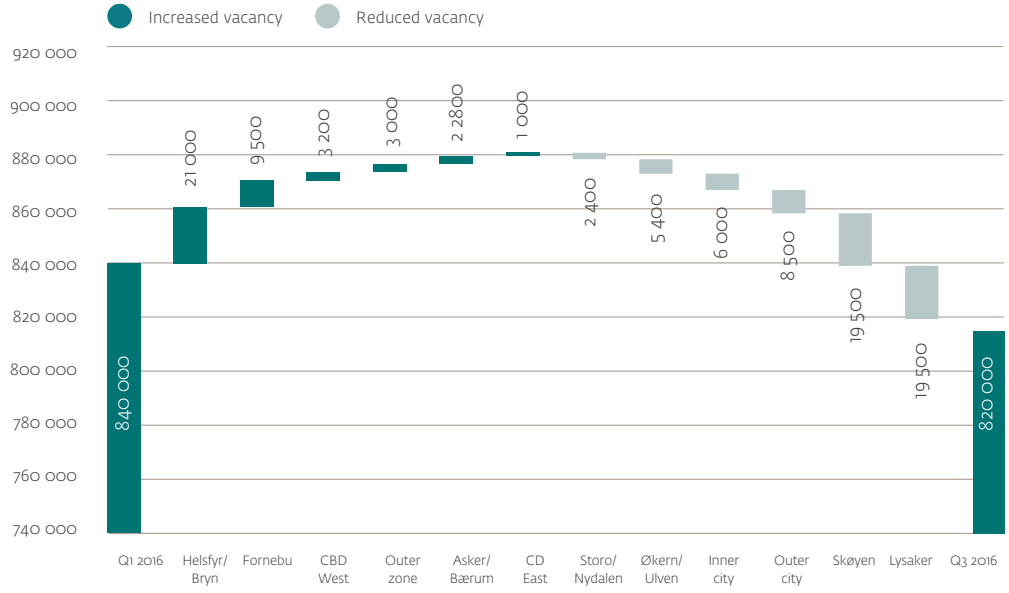
Supply, demand and vacancy (sqm. %)



Office vacancies in Oslo, Asker og Bærum (sqm, %)



Change in office vacancy between office clusters (sqm)



Supply – Office space is converted to more than just housing

The variation in the supply side is determined primarily by three components: new buildings, vacated premises and the conversion of existing office properties. 160,000 m2 of new office space is expected in Oslo in 2016 and 2017, with the largest projects involving Riksrevisjon's move to Olav Thon's building in Storgata and Entra and Skanska's new building Sundtkvartalet. In CBD East OSU has signed an agreement with PwC in Eufemia which will be completed in 2019, while two buildings are being put up on a speculative basis at Dronning Eufemias gate 6B and Dronning Eufemias gate 42. In Nydalen Avantor will complete Spikerverket stages 2 and 3 for occupation by Elkjøp and the Tax Office in the autumn of 2017. There is also a large amount of newbuilding around the Hasle/Ulven/Økern area and at Karvesvingen 2 where Hoegh Eiendom is developing a new building for occupation by Securitas in 2018. There is currently a lower level of newbuilding along the western corridor but Ferd Eiendom started the construction of Asker Tek after Indra Navia signed for 6,600 m2 of a total of 14,500 m2 in the building, which is to be completed in mid-2017.

There are few big leases that expire in the period 2016–2017, which has reduced demand for new office buildings in the last two years. It is seldom for developers to commence new buildings speculatively. This means that developers must wait for the big leases that expire in the period 2019–2020, where several searches related to this are expected to be signed in the second quarter of 2017. We can thus expect a significantly higher volume of lease signings in the next 12 months than in the last two-year period, and as a result a higher level of completions from 2019.

Conversion

Demanding office users and an over-supply of office space has resulted in certain properties no longer being sufficiently attractive for office use and being given a new life through **conversion to another use.** This takes place most often outside the established office clusters because the location is considered to be less attractive for office users, e.g. because it is far from the nearest public transport hub or that the layout is less appropriate. Such outdated office properties have often been converted to housing, and on some occasions to use as schools, shops or hotels. In the last half-year we have also seen centrally located office properties being converted to hotels. An example is the old NAL building at Jernbanetorget where Petter Stordalen and the Choice chain will operate a luxury hotel in the present office building close to Østbanehallen from 2019.

A strong housing market and over-capacity in the office market make a high level of conversion in future more likely. We believe in a continued good sale of new housing in the future, as the conditions are right for this as long as new house prices are not significantly higher than the prices of newer houses in the secondary market.

The future

The combination of a high level of conversion and low new building volumes has contributed to vacancy falling in the last half-year. We believe that this trend will continue and that negative net newbuilding will mean that office vacancy is further reduced in future. Our forecast means that vacancy will fall from the current level of 8.3% to 7.9% at the end of 2017 and further to 7.1% in 2018 and 2019.

We have **adjusted downwards our vacancy forecasts** from last winter due to a reduction in the supply side. This is due to both properties being withdrawn from the market as well as reduced newbuilding estimates. It is first in 2019 that we expect a positive net supply of space.

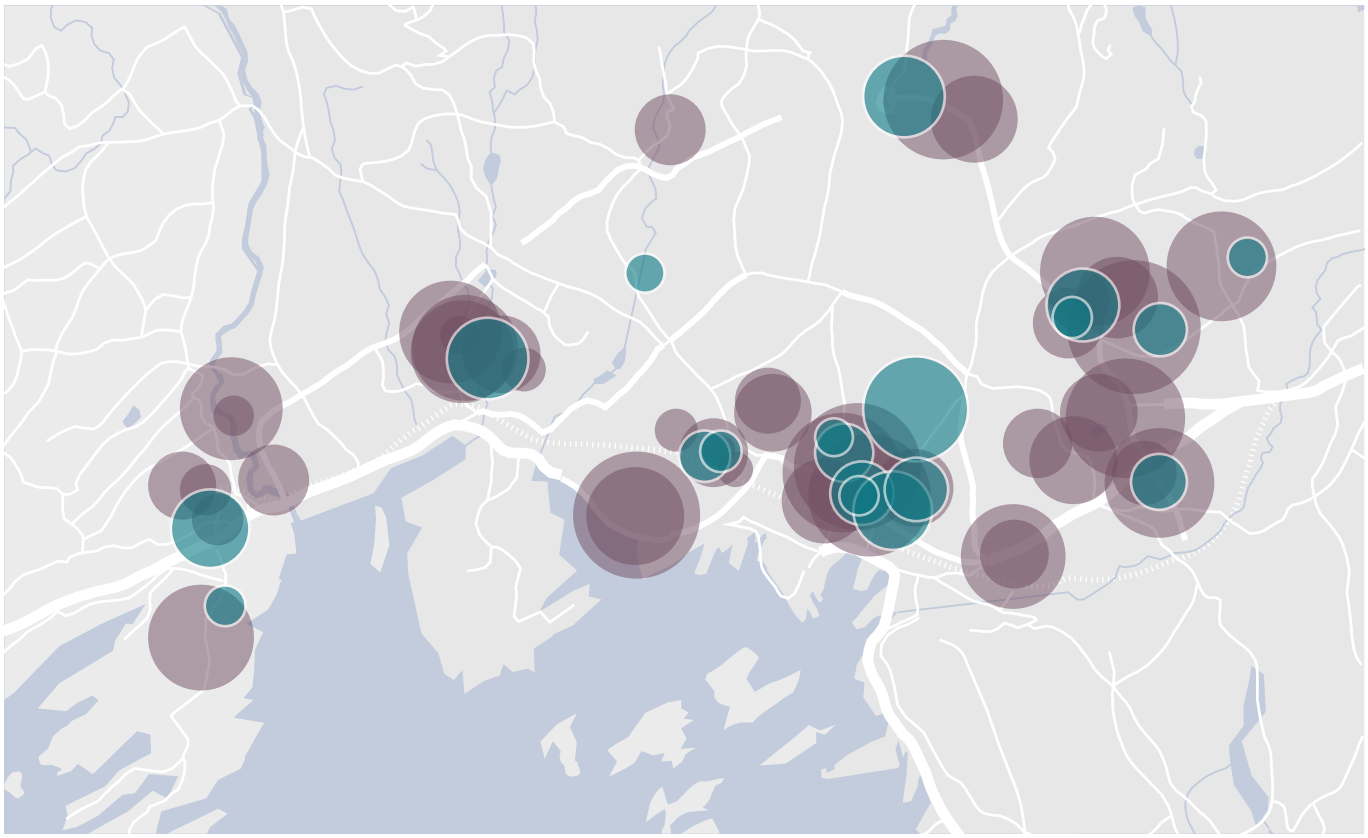
During 2015 and in 2016 we have experienced **increased differentiation in the market,** not only, as before, between attractive properties close to public transport hubs against properties with long walking distances to such hubs, but also to an increasing extent between the western corridor and the rest of Oslo. The oil industry is much more important for the western corridor and vacancy is now particularly high at Lysaker, Fornebu and Asker and Bærum. The western corridor is also to a lesser extent a natural location for the many government and NGO tenants that are looking for space in connection with the capital.

As one can see from our rent chart the trend is towards a more differentiated development in the various areas. We believe that the correction has been taken out in the most attractive areas, and that price growth will come more quickly in the city centre than along the western corridor, where a considerable amount of vacant space must be absorbed before the market returns to balance. Rebates in the form of rent-free periods etc. must also be reduced before there will be any upward movement in rents.

We introduce **Storo/Nydalen** as a single office cluster in this report. The previously separate office clusters are growing closer together and we now regard them as a single market. The attractiveness of Storo/Nydalen as an area is increasing among tenants and together with falling vacancy will lead to price pressure for attractive office properties.

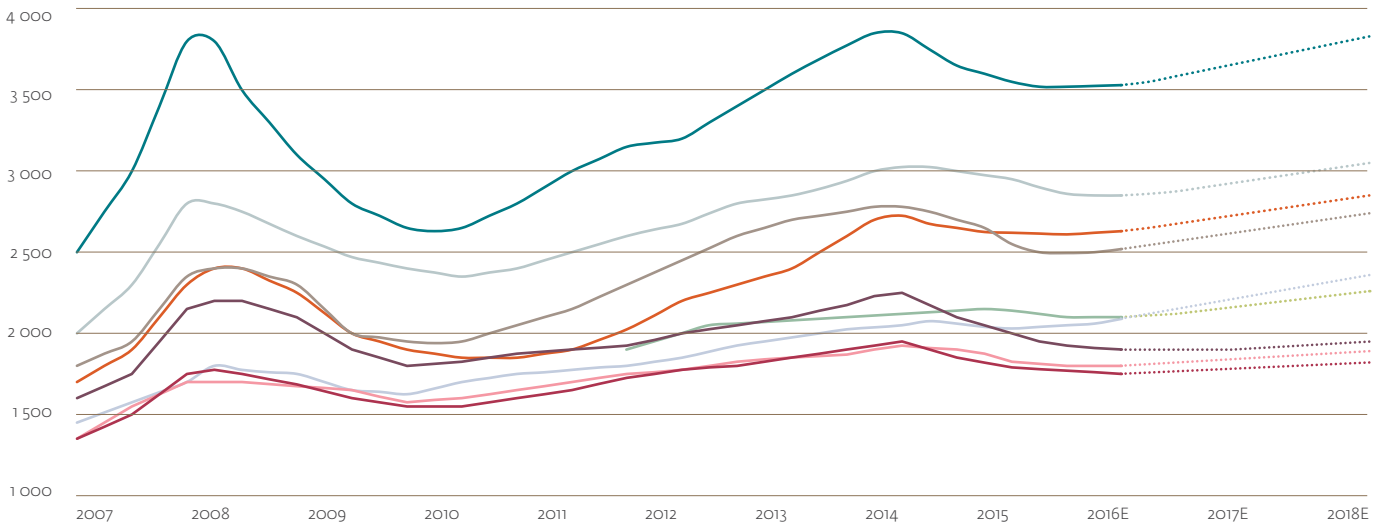
New building, potential

Signed Potential



Rent trends per area, 2007-2019. High standard, nominal price (NOK per sqm)

CBD West CBD East Inner city Skøyen Storo/Nydalen Økern/Ulven Lysaker Helsfyr/Bryn Sandvika/Asker

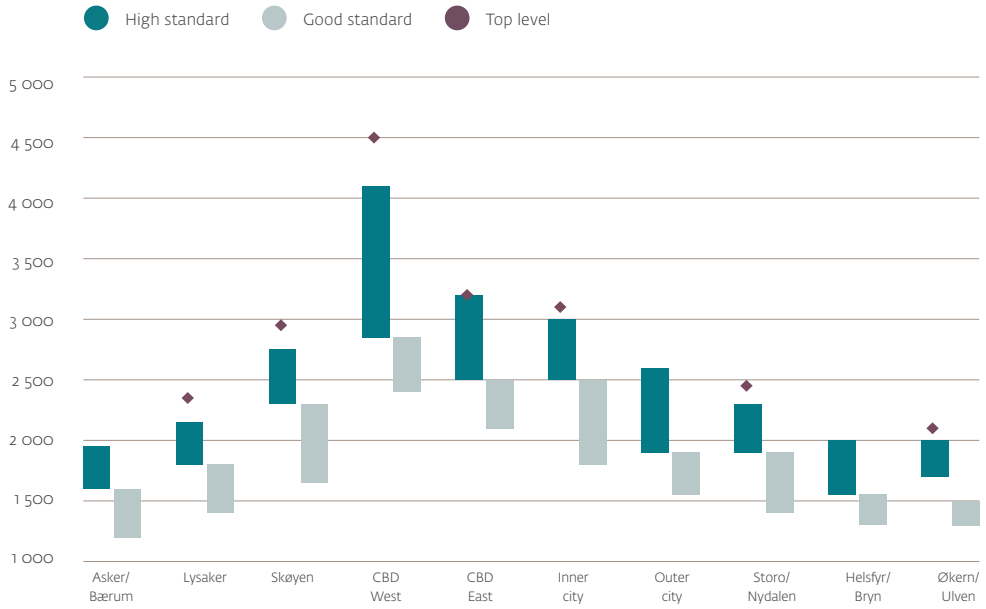


Development in rents and vacancy levels (Nominal NOK, %)

-5%-0% 0%-5% 5%-10% 10%->

Area	High standard	Δ % last 12 months	Forecast High standard %-vis vekst	Vacancy q3 2016	Δ last 6 months
Asker/Bærum	1 600 - 1 950	-5 % - 0 %	0 % - 5%	8 %	→
Lysaker	1 800 - 2 150	-5 % - 0 %	0 % - 5%	18 %	↘
Fornebu	1 500 - 1 850	-5 % - 0 %	0 % - 5%	15 %	↗
Skøyen	2 300 - 2 750	-5 % - 0 %	5 % - 10 %	7 %	↘
CBD West	2 850 - 4 100	-5 % - 0 %	5 % - 10 %	7 %	→
Inner city	2 500 - 3 000	0 % - 5%	5 % - 10 %	9 %	→
CBD East	2 500 - 3 200	-5 % - 0 %	5 % - 10 %	3 %	→
Outer centre	1 900 - 2 600	0 % - 5%	5 % - 10 %	3 %	→
Storo/Nydalen	1 900 - 2 300	0 % - 5%	10 % ->	7 %	→
Økern/Ulven	1 700 - 2 000	-5 % - 0 %	5 % - 10 %	16 %	↘
Helsfyr/Bryn	1 550 - 2 000	-5 % - 0 %	5 % - 10 %	13 %	↗

Nominal prices – High standard average (NOK per sqm)



Fiskebrygga

Letting assingment on behalf of Hav Eiendom. Ilustration: Alliance Arkitekter and Mir Arkitekter.
The project is under planning and the illustrations are preliminary.

THE TRANSACTION MARKET

Many transactions are taking place but the market is not able to meet demand for properties that give a predictable return.

- As many as 146 transactions were registered in the period to the end of September 2016 and it looks likely that this will be the third year running with more than 200 transactions
- Properties with long leases to public sector tenants have been traded over the last year in the range 5.00 to 5.50% at places such as Elverum, Lillehammer and Haugesund.
- Many investors face challenges in finding property to buy and arrangers, purchase advisors and investors are active in approaching owners with purchase enquiries.

Luftfartstilsynet, Sjøgata 45/47, Bodø
Sales mandate on behalf of Breeze AS

The transaction market

The situation as at the end of September shows that the transaction market in 2016 has been characterised by a high level of demand for property in the main city regions. Macro-economic factors are moving in the right direction and generally speaking we have a well-functioning loan market. However, for many investors it is difficult to get hold of property and then particularly property with good locations and/or long leases to solid tenants. In spite of record low yields many owners are hesitating to sell the top properties because they lack attractive reinvestment alternatives or wish to retain some buildings with secure earnings in order to preserve the solidity of their portfolios.

Many owners used 2014 and 2015 to take profits on developed property and refine their portfolios (for example by making acquisitions in defined segments and selling properties that were outside their strategy). Volume was therefore extraordinarily high with 482 transactions that in total amounted to NOK 205 billion. 2015 was particularly noticeable for large portfolio transactions that represented approximately NOK 50 billion. In addition, 2015 provided many extraordinary purchase opportunities relating to prime properties and there were 29 transactions in excess of NOK 1 billion. Some slowdown in transaction volume is therefore natural and we have only recorded four NOK 1 billion transactions so far this year. The range of outcomes is naturally wide, but we are aware of some 30 ongoing processes with an aggregate value in excess of NOK 12 billion and estimate a volume of around NOK 65 billion in 2016. The number of sales with the minimum value of NOK 50 million passed 200 for the first time in 2014 and reached 253 last year.

General trends

The downside risk in the property market has been reduced and Norway has strengthened its position as a country for investment.

The petroleum market is now more in balance and the likelihood of continuing low oil prices (USD 35 a barrel or less) has been reduced. This once again gives a better basis for economic growth and increased demand from tenants, and thereby also a reduction in letting risk. While much of the macro news internationally (Brexit, weaker growth prospects in the USA) has been on the negative side, much of the news in Norway has been on the positive side - including higher than expected GDP growth in the second quarter and better prospects for the office market in Oslo.

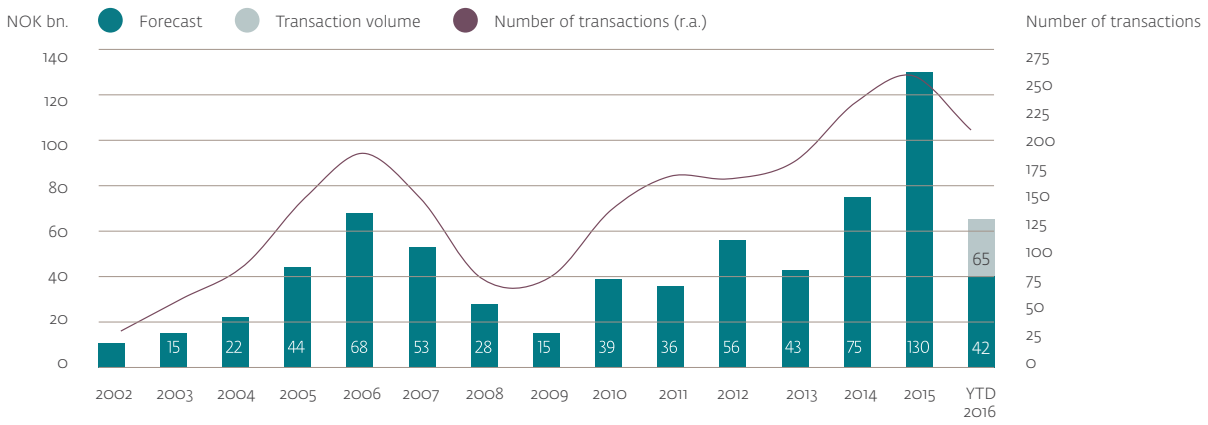
The loan market is generally functioning well and has developed better than many feared.

Last autumn a number of market participants indicated a fear of a reduction in access to commercial property loans. Our assessment is that very few transactions have failed due to a lack of access to credit. Smaller investors without established bank relationships that wish to purchase property with short leases may however experience challenges. The DNB group has contributed to a well-functioning loan market both through increasing lending on the bank side and through the life insurance company increasing its holding of bonds linked to commercial property.

Increased inflation expectations

We now have a combination of high CPI growth and expectations of continuing low interest rates, something that together makes a narrow yield gap (on leveraged property) more attractive, particularly for property with long leases. For property with short leases there is only a limited value effect, as the value is derived to a greater extent from market rent levels. In the case of leveraged investments CPI growth contributes to a higher real return on equity, primarily because the real value of the debt is falling. CPI forecasts from DNB Markets for 2016–2018 have increased by a total of 2.3 percentage points compared with last winter. DNB Markets expects that the annual trend for the consumer price index will be 3.7% at the end of November 2016 and aggregate CPI growth for 2016–2018 will be around 8%. In order to illustrate the effects, we can take as a starting point property with a long lease at ordinary rent levels which at the start of 2016 has a debt ratio of 70% and an unchanged yield level. The increase in inflation expectations gives, when viewed in isolation, an aggregate increase in the real return on equity of around 5 % for the three years compared with if one had used the CPI forecasts from last winter. Correspondingly the estimated CPI growth in this case gives, when viewed in isolation, almost 20% extra aggregate real return on equity for the three years compared with if CPI growth had been zero. The real return arises mainly as result of the loan having a lower real value in the period. Note that the calculations involve some assumptions in which the most important are a long lease (multiple pricing of increased rent) and that the interest rate is fixed. In addition, higher CPI growth can be reflected in higher interest rates which again can push up the yield over time, but the particular feature at the present time is the combination of high CPI growth in the short term and expectations of continuing low interest rates.

Transaction volume in Norway (transactions valued NOK 50 mill. an upwards)



Investor categories purchases and sales

There has been a continuing high level of interest from international investors for Norwegian property, but so far in 2016 few acquisitions have materialised ... so far.

- There has been a continuing high level of interest from international investors for Norwegian property, but so far in 2016 few acquisitions have materialised ... so far.
- As at the end of September international investors had completed ten purchases for a total of NOK 4.3 billion, and three sales for NOK 4.5 billion.
- Throughout 2016 we have received enquiries from a number of international investors looking to make their first investments in Norway and able to invest in the range NOK 0.5 to 2 billion.
- Three new international investors have made their first purchases in Norway in 2016. In total these three purchases amount to more than NOK 2 billion
- In common with many Norwegian market participants several international investors have the capital ready but have difficulties in obtaining properties that fulfil their criteria. This autumn there have been several processes with large individual properties and portfolios where international investors have made or are making bids.

International investors were the largest net buyers last year through investments in, among others, several large portfolios and made purchases totalling NOK 47 billion. There has been considerable variation in what international investors buy in Norway. In the last two years they have purchased property in all segments, individual properties in all the four largest city regions, property within "value added" and opportunistic property. Measured by value however the bulk of international ownership has been directed to large individual properties with low tenant risk.

The trend for property companies, private investors and developers to take profits on developed property has been a less significant element in the market than last year.

- The average yield on sales has only been 35 basis points lower than on purchases.
- They have been behind at least 12 purchases with yields of 5.5% or less.
- They often say no to aggressive bids because they have difficulties in finding attractive reinvestment alternatives.

The category "property companies, private investors and developers" usually constitutes the largest investor group on both the sale and purchase side, and so far this year has completed 72 purchases for NOK 18 billion and 83 sales for NOK 20 billion. So far there have been 65 different participants in this group that has purchased commercial property with a minimum value of NOK 50 million, with Ragde Eiendom as the only one with more than five purchases.

The arrangers have been successful with regards to both equity and loan capital and have been by far the largest net buyers.

- Syndication and fund managers have carried out at least 37 purchases for a total of NOK 12 billion. In addition, there have been several transactions where they have acted as purchase advisers for various investors that bought 100% of a property.
- Both the bank market and bond market have been used. Several fund managers have raised equity.
- Measured by the value the focus has been on properties offering a return with long leases on aggressive yields.

By arrangers we mean those entities managing syndicates and Norwegian fund managers. With regard to purchases by arrangers we have got yield data on 30 transactions and the average is 6.5%. When we look at them based on value however, by far the most are on yields below 6%. On average these acquisitions have 10 years remaining on the leases and many can be characterised as "dividend cases". Often the willingness of syndication managers to pay for buildings with secure long leases outside the Oslo region is based on investors receiving a 10% annual dividend on equity subscribed (a lower return level is accepted for Oslo property). The loan terms are therefore decisive, and in several cases long-term bond finance has been used that contributes to predictability as well as good dividend possibilities due to be absence of repayment instalments. Arrangers have also been important on the sale side with 31 sales for a total of NOK 7.7 billion.

Equity-based investors have so far been net sellers, but have significant acquisition plans.

- By equity-based investors we mean life and non-life insurance companies/ pension funds/banks and their funds.

- Participants within the category life and non-life insurance companies/ pension funds/banks and their funds have made 9 sales this year for NOK 3.8 billion (we assume here that the transaction involving Åsane Storsenter is completed) and "only" four purchases for NOK 2.2 million.

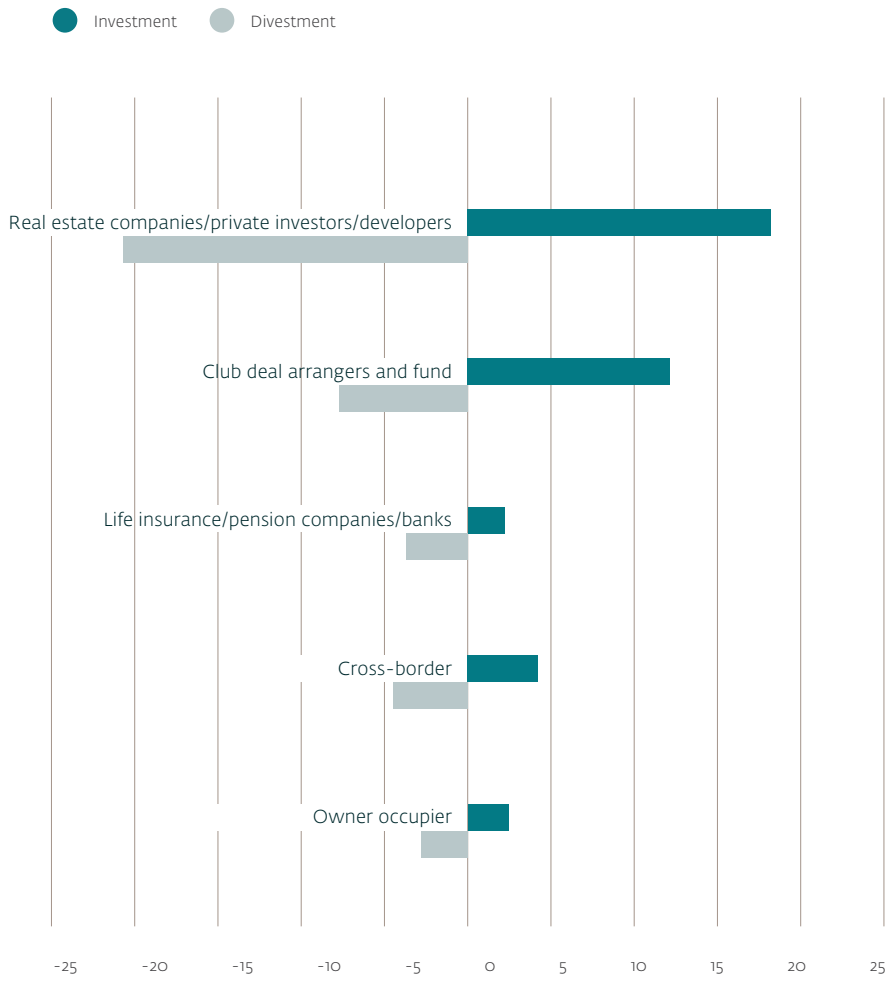
- New capital weighting rules were an important reason for last year's sales and are still relevant. However, most participants in this group will be in a buying position in future. KLP alone has intentions to invest a total of NOK 5 to 10 billion in Norway and abroad. We expect that equity-based participants will continue to sell property outside their strategies, but in total be net buyers in future.

- The most important explanation for the sales this year has been that these participants are refining their portfolios. As an example Nordea is reducing its weighting in retail. Refinement of portfolios triggers both sales of good properties at aggressive yields and the sale of properties outside the main city regions on high yields.

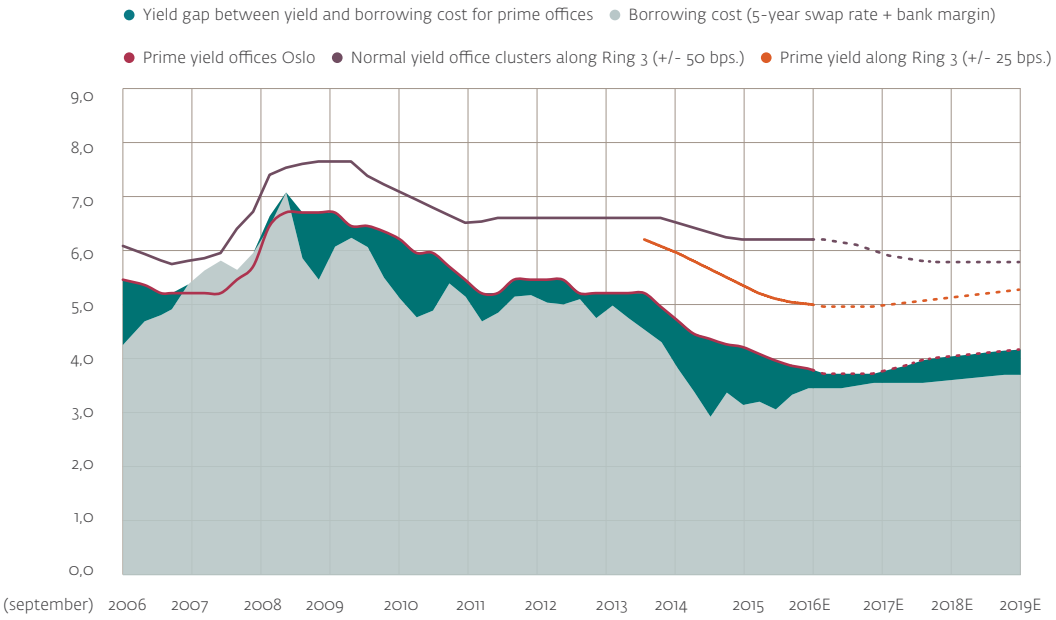
- However, three of the sales this year can be explained by the owners taking gains on three properties (roughly NOK 1 billion) after receiving approaches at good prices. The banks have contributed to a further two sales on two projects that have failed.

On the buying side all investments have been in the four largest city regions and mainly properties with long leases on low yields. So far the buyers include DNB, KLP, OPF and Storebrand.

Transaction volume By investor categories in 2015 (NOK bn).



Yield development 2006-2019 (%)



The development in yields for offices in Oslo

Yields are trending lower.

- Continuing excess demand for office property generally in Oslo is pushing yields down.
- International investors with moderate or zero debt ratios are leading the decrease in yields and international investment alternatives have become a more important factor for understanding developments in Oslo and Norway.
- A large number of rejected purchase offers/bids as well as the sale of Stortingsgaten 6 mean that we consider the prime yield stands at 3.85% and that a few properties could be sold on a yield of +/-3.70% with market rents.
- Expectations of higher inflation in the short term and low interest rates in the longer term are contributing to yields trending lower.

Last winter we considered that the prime yield was in the range 4.25 to 4.00%, but closer to the figure four. We put forward five arguments for a fall in yields and four arguments for a rise in yields, as well as for an associated levelling out in the curve. Our forecast means that we believe 3.85 % is at or very close to the lowest yield level in this cycle. The reason we consider that the prime yield has fallen below 4% is that there is a substantial amount of international property capital looking for investments with the best locations, at the same time as it appears there are very few owners ready to sell prime property in general. In addition, those considering a sale can wait if the bids are above 4%. We are finding that certain international investors are accepting yield levels lower than we had previously assumed, particularly when we adjust for currency hedging costs. Furthermore, certain foreign investors have said that they are able to buy property in Norway on yields of 3.5% with little or no debt. In other words, we could have certain transactions at market rents well below 4%. It is most likely that if one wants to buy a building in the CBD today one would have to pay a figure corresponding to yield clearly below 4%. We find that very few Norwegian participants will stretch themselves below 4% today. It may be that it will take some time for the re-pricing of property to sink in and for Norwegian participants to gradually accept a lower return. On a somewhat longer view we nevertheless expect that the prime yield will rise because interest rate forecasts in any event show an increase in time, together with the fact that alternative investments gradually will have better prospects so that the substantial excess demand will be reduced.

The figure below shows the development in yields for various categories of offices in Oslo, together with the development in the borrowing cost for an ordinary 5-year loan in grey. The borrowing cost is based on the 5-year swap rate and margin data from DNB. The red line shows the prime yield and the green field illustrates the yield gap. The yield gap however is wider for the most solid buyers of prime property as they tend to have lower credit margins. With a purchase at 3.85% they could today have a yield gap of some 60 to 85 basis points, depending on the proportion of borrowing at a fixed interest rate.

The orange line shows the prime yield in the office clusters along the outer ring road. We assume here a lease of 10 years. Excess demand also means that the trend is falling here. The lowest yield has been reduced by around 100 basis points since the autumn 2014 and we expect that the curve will bottom out at close to 5.00 +/- 20 points so that the level varies from around 4.80% at Lysaker to 5.30% on the Økern/Hasle line. The development over the last couple of years means that the yield difference between East and West Oslo has become smaller – also for properties with long leases. We believe that most Norwegian investors buying in the low yield segments are more likely to buy a 10-year lease on a yield of around 5.00% in one of these areas, or down to 4.5% for a long Skøyen lease rather than a CBD property on a yield beginning with the figure three.

The black line is meant to illustrate the development in yield for normal property. We have defined this to be office property with 5 years remaining on the leases, of a normal good standard, normal sound companies as tenants and with a satisfactory location in one of the office clusters along the outer ring road. The requirement for equity has risen slightly over the last year and may affect the willingness of investors to pay. However, it appears investors are increasingly willing to take the risk, and we believe that the downside risk in the office market in Oslo has been reduced over the last half-year. Continuing low oil prices are less likely and it seems that the "oil correction" has been taken out. Office vacancy has been falling over the last year and market rent levels are showing signs of an increase for the first time since the autumn of 2014. Compared with the winter we are giving less weight to the increased equity requirement and believe that the fall in yield will come more quickly and a little more strongly. This involves a normalisation of the yield gap at around 250 basis points. We have retained our estimate at 6.25% and the difference against the low yield segments is not being pulled down as much as in the overheated markets before the financial crisis.

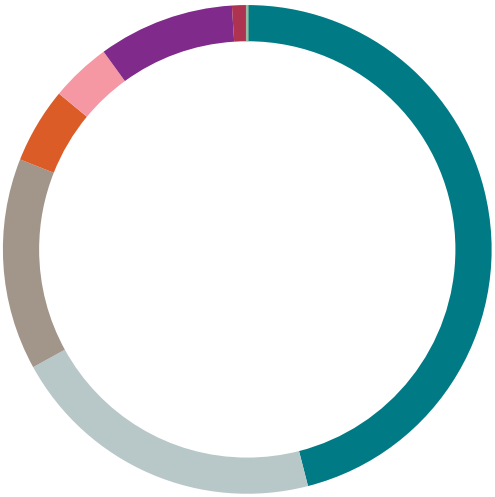
The transaction market in Oslo/Akershus

There has been a high volume of transactions in Oslo/Akershus, but the market is characterised by excess demand and for many it is challenging to obtain purchase opportunities.

- So far we registered 75 transactions with a total value of NOK 23 billion.
- The average yield on sales has been down 25 basis points compared with 2015 and 75 basis points compared with 2014.
- There have been many "closed processes" and arrangers have been the largest net buyers

We have recorded sales in all property segments and a total of 46 different investors have bought property in Oslo/Akershus with a minimum value of NOK 50 million. Despite the fact that we have a market suitable for broad and structured sales processes we find frequently that properties are sold after closed processes on an initiative from the buyer's side. In addition to the volume sold we are aware of several processes with bids in excess of NOK 1 billion on aggressive yields that have subsequently been rejected. In part this can be attributed to a lack of reinvestment alternatives and in part the refusal may be due to a fear of selling "too early". The market has perhaps never been so buyer-driven as now, and we find that investors in several different categories are initiating purchase processes towards property owners in the Oslo area. International investors continue to show a high-level of buying interest and an increasing number of new international investors are seeking commercial property in the capital region. As at the end of September however they were only behind five purchases for a total of NOK 1.8 billion. The largest net buyers have been the arrangers who accounted for 22 purchases for around NOK 10 billion and in addition acted as purchase advisers on several acquisitions.

Transaction volume in value by type of property, 2016



- Office 49 %
- Shopping malls 20 %
- Retail properties 9 %
- Logistics/industrial 8 %
- Residential projects 6 %
- Hotels/restaurants 4 %
- Health/education/culture 3 %
- Other/confidential 1 %

Transaction volume in value by geografi, 2016

- Oslo/Akershus 50 %
- Geographically dispersed 28 %
- Oslofjord region 6 %
- Bergen region 5 %
- Stavanger region 4 %
- Rest of Norway 4 %
- Trondheim region 3 %

Breakdown of the transaction volume by geography and segments

Measured by value the transaction volume has to a large extent been concentrated on low yield properties in the main city regions.

- Measured both by value and numbers three quarters of the transaction volume has been concentrated on the four largest city regions.
- Roughly half of the sales volume has been in transactions with a value of NOK 500 million and more.
- Of this by far the most has been on yields of 5.5% or less.

46% of the sales volume has been in offices. The syndication managers have been the largest net buyers and have preferred secure cash flows to specific property segments. Measured by the value the proportion in Oslo/Akershus has been 58%, while five geographically spread portfolios account for roughly 10% of the sales volume. The market this year has generally been less characterised by large portfolio transactions compared with 2015. All property segments and regions have seen a turnover volume in excess of NOK 1 billion so far this year. In the case of community buildings, we mean property used for purposes such as health, education, culture and kindergartens etc. Last year we recorded 14 sales for NOK 3.4 billion, while so far this year we have recorded four sales for NOK 1.4 billion. On 15 out of these 18 transactions we have data on the remaining lease period and on average this amounts to as much as 17 years. A strong housing market in the capital region Is also contributing this year to a substantial volume of transactions related to housing development in Oslo/Akershus. We find that very many investors are looking for property suitable for building apartments and that landowners/sellers are obtaining a higher proportion of the development gain than previously.

Return

In spite of some challenging market conditions, high CPI growth and a falling yield trend are contributing to a good return for the large property portfolios in 2016.

- Both DNB Markets' CPI forecast for 2016 and the estimate for annual growth as at November have been increased to 3.7%. in addition, the forecasts for the period 2016–2018 have been increased by 2.3 percentage points compared with corresponding forecasts last winter.
- Yields have primarily had a flat to falling trend in 2016. In the case of many low-risk properties the yield has been reduced by 25 to 50 basis points compared with the autumn of 2015.
- There is a challenging vacancy situation in several cities and the introduction of property taxes in Oslo and increased credit margins are among factors that dampen the return.

If one takes as a starting point a property with long lease contracts where the yield has been reduced in 2016 by 30 basis points from 5.25% to 4.95% and that both rental income and costs increase by an amount corresponding to a CPI adjustment of 3.7%, viewed in isolation the property will increase in value by 10% in 2016 as a result of these factors. A CPI adjustment of 3.7% corresponds to DNB Markets' estimates for annual growth in November. Experience shows that CPI growth in November to large extent is the result of random effects. If one takes a broadly composed portfolio of commercial property in Norway there have been several factors that have contributed to limiting the return. There is a continuing difficult letting situation for offices in the big cities as well as high tenant alteration costs. In Oslo the introduction of the property tax means, in isolation, that office properties are generally reduced in value by 2 to 6%. For certain locations in western Norwegian cities where there is net vacation by lessees and particularly high vacancy levels, yields have risen. In addition, several cities, such as Stavanger, have a challenging hotel market. In a number of segments, such as medium-size shopping centres and logistics, there are "C properties" for which it is difficult to find tenants. This is due, among other things, to the fact that the best properties to an increasing extent are winning the competition for customers. In the loan market credit margins have been rising since the summer of last year. To some extent this is counteracted by lower money markets interest rates, and investors that have opted for floating rates for parts of their loans have benefited from money market interest rates so far this year being 25 basis points lower than the level during 2015. In spite of these factors we believe that the large property portfolios will have a good return year in 2016, with a falling yield trend and the likelihood of a high CPI adjustment as the most important explanations. Many of the solid portfolios could see a nominal return on total assets of close to 10% (the sum of the direct return and value changes). After three golden years (2014–2016) we believe that the return at the portfolio level in the coming years will be more in line with the direct return. Slow GDP and employment growth suggest moderate demand from tenants and continuing vacancy in portfolios. Continued low interest rates, combined with relatively good but falling CPI growth, will contribute to keeping property values up.

BERGEN

There has been a good level of activity in the transaction market with a volume in excess of NOK 4 billion so far in 2016. We are experiencing some reduction in activity in the letting market for offices and continued high office vacancy in Bergen South for the business areas Kokstad and Sandsli.

- High office vacancy in Bergen South
- Large differences in rents between market areas
- Good sale prices for prime properties

Kokstadvegen 23
Sales mandate on behalf of Aberdeen Pan-Nordic Norway AS

COMMERCIAL AND INDUSTRIAL AREAS, BERGEN

Krinkelkroken 1

Letting assigment on behalf of Nordea Liv Eiendom Norge AS

Office vacancy

Our latest survey shows approximately 219,000 m2 of vacant office space, which gives an office vacancy ratio in excess of 10%. Our calculations show an estimated total volume of office premises in our market area of around 2.1 million m2. The reduction in activity by oil and offshore related companies in Bergen South has led to increased vacancy and pressure on rents. Close to 50% of the vacant office space in Bergen is located in these districts. We have few indications that we will see a significant and rapid change in office vacancy in the short term. On a medium-term view fewer planned new office buildings and increased focus on conversion to housing, hotel and retail will contribute to space absorption in the coming years. Our forecasts suggest that vacancy will level out in 2017/18.

Rental market

We are recording relatively stable office rents in virtually all market areas, at similar levels to 2015. However, we are seeing especially large differences in rents between market areas. There has been a moderate increase in rents in the city centre due to a greater supply of high-quality premises in new buildings and a reduction in rents in areas where vacancy is high, such as Kokstad and Sandsli. There may be reasons to believe that the reduction may be greater than our table indicates as rebates, rent-free periods etc. are not covered by our surveys.

Transaction market

In Bergen/Hordaland we have recorded a transaction volume of around NOK 4 billion so far this year. This figure includes 11 transactions of more than NOK 50 million as well as Olav Thon's purchase of Åsane Storsenter for about NOK 2 billion. The latter transaction is being reviewed by the competition authorities.

The volume of transactions is a very good and, subject to approval of the Åsane Storsenter sale, we may approach the same levels as the record year 2015.

The largest recorded and completed transaction so far in 2016 is Rom Eiendom's sale of the new building in Zander Kaaes gate by Bergen Station to KLP Eiendom for NOK 760 million. The property is 90% let to Konkurransetilsynet, KLP, Folkehelseinstituttet and KGJS AS.

Foreign buyers and national investors are showing increasing interest in Bergen and account for around 25% of the transactions in the first half of 2016. Such investors are looking primarily for prime properties with long and secure cash flows.

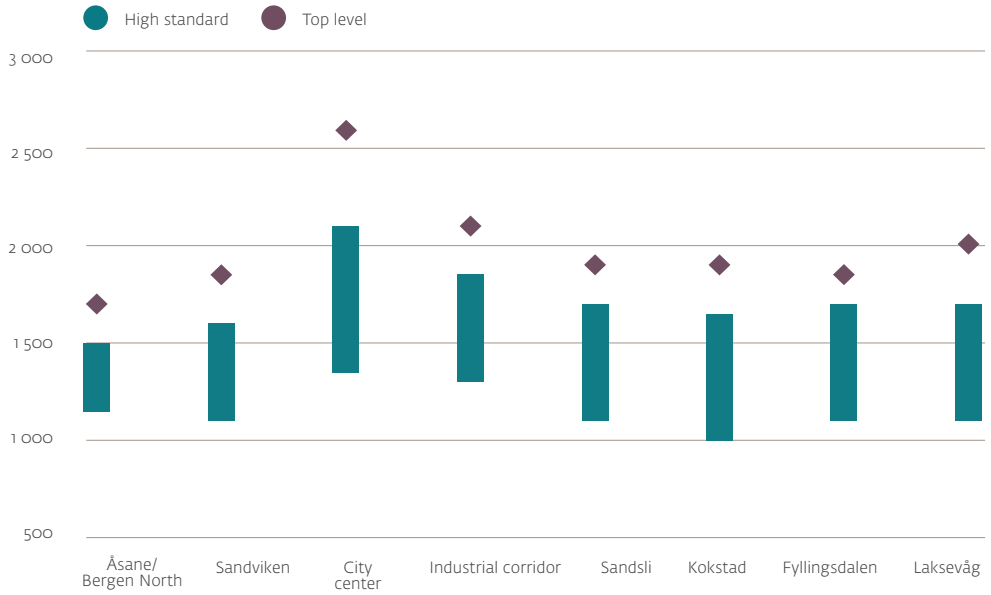
We see that the prime yield for offices in Bergen is just under 5% for buildings with good locations, long leases and solid tenants.

There is currently a considerable overweight of development properties in the market. One of the largest site sales in Bergen took place at Kokstad west, where Forsvarsbygg acting through Skifte Eiendom sold a zoned commercial site of around 427,000 m2 to Posten Eiendom AS.

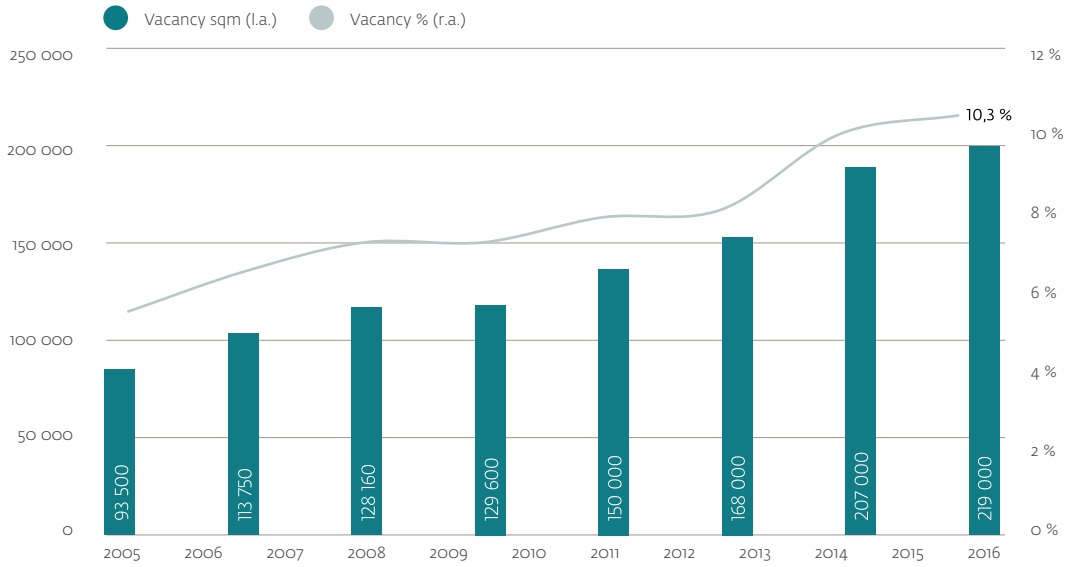
The strong housing market has led to increased and substantial demand for housing land with planning permission in central Bergen.

Our forecast for 2016 indicates continued good sale prices, stable yields, and continuing high demand for prime properties with long leases. Subject to the Åsane Storsenter transaction being approved and completed, we expect a transaction volume in the region of NOK 6 billion.

Rent levels in Bergen (NOK per sqm.)



Vacancy Bergen (sqm, %)



TRONDHEIM

The volume of transactions is showing a decline compared with 2015, but activity has picked up somewhat since the summer with several large ongoing transactions. In the rental market office vacancy is slightly down and rents in the city centre are rising.

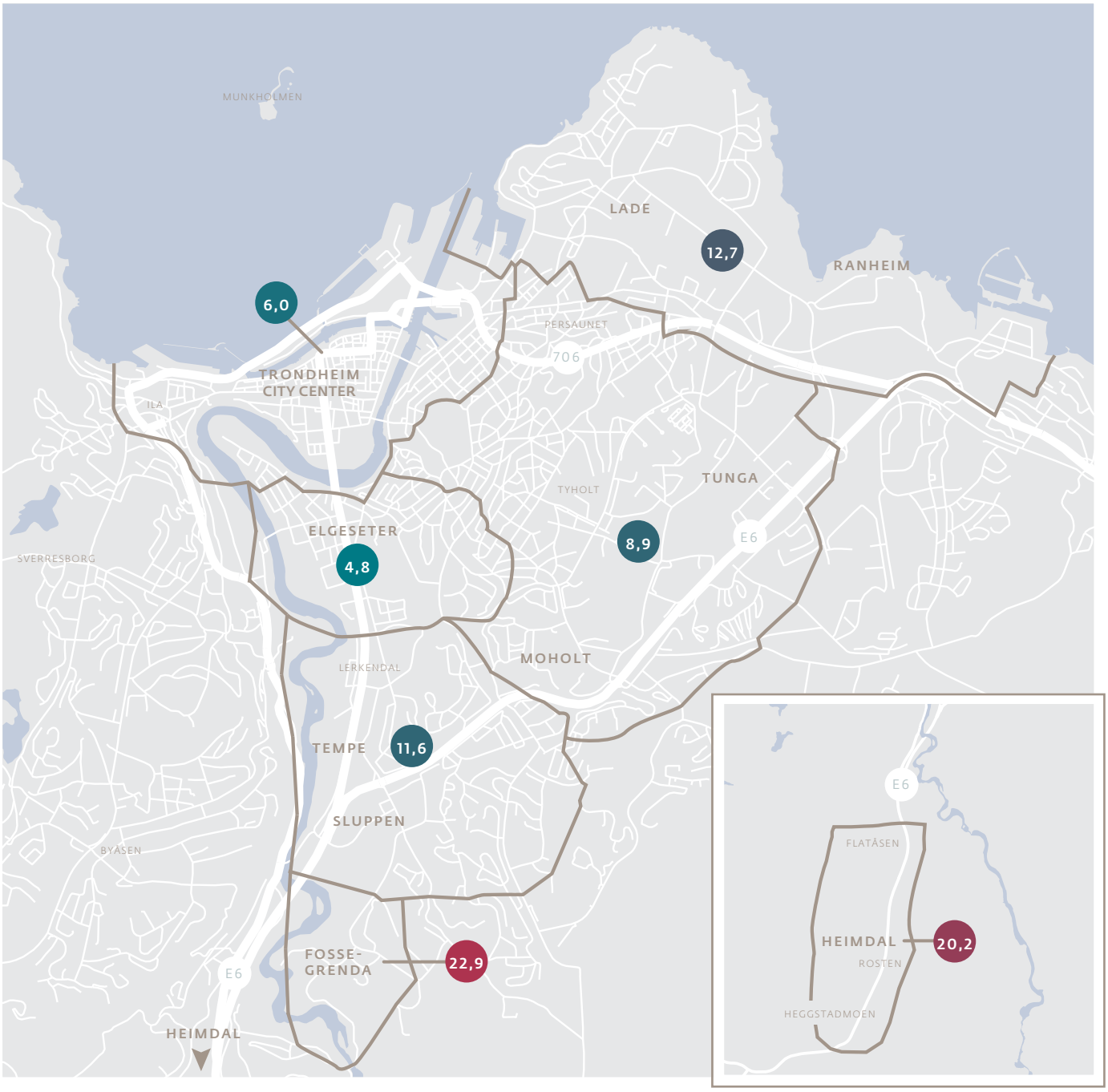
- Office vacancy down to 9.9%, but expectations of increased vacancy in 2017
- Rents in the city centre up 12.2%
- Transactions for NOK 1.3 billion so far this year.

Bassengbakken 4

Let and the sold on behalf of Kaisa Holding AS (Photo: Trondheim, fototrondheim.no)

VACANCY TRONDHEIM, SEPT. 2016 (%)

TOTAL OFFICE VACANCY TRONDHEIM: 9,9 %



Løvåsmyra 4
Sold on behalf of the former owner of FAS AS

Kontorleiemarkedet

The first half-year has been characterised by relatively little interest among tenants in relocating. This has especially been the case for the largest users of space. We see this through the absence of applications for official consents compared with last year. After several years with a high level of activity it is natural that there is some consolidation to adjust the supply and demand sides for new office projects. This does not mean that there is a low level of activity in the market and there are four new office buildings being completed in 2016 (Trapphuset, Trondheim Maritime centre, as well as new buildings for respectively Autronica and Kongsberg group). Furthermore, there is even greater building activity ongoing which will involve the completion of five new office buildings in 2017. In 2017 alone some 60,000 m2 of new offices will be added to the market. Even though the general impression is that demand has decreased we have recorded lettings at roughly the same level as the first half of last year.

Overall we have recorded 62,073 m2 of leased space divided between 192 leases.
Offices: 45,351 m2
Retail: 6,885 m2
Warehousing: 9,387 m2

We have written that the city centre is "the winner": This is based on the fact that of the 45,351 m2 that has been let in the first half-year more than 50% is in the city centre.

Examples of new leases in the first half-year:
NAV – Falkenborgveien 28 – 8,000 m2
BI – Brattørkaia – 10,000 m2

The trend from last year is intensifying in that price levels are holding stable in development areas while falling in peripheral locations. Rents in the centre have increased on average by 12.3% since the previous half-year survey. If we take all the peripheral zones together, we see that prices have been adjusted slightly down by around 1%. The average rent for the city centre is NOK 1,772 per m2/year. This figure includes some leases in the most central city centre properties which have pulled the average up. Rents also reflect alteration costs that are covered by the lessor. The average rent level in premises outside the city centre is NOK 1,317 per m2/year.

Office vacancy

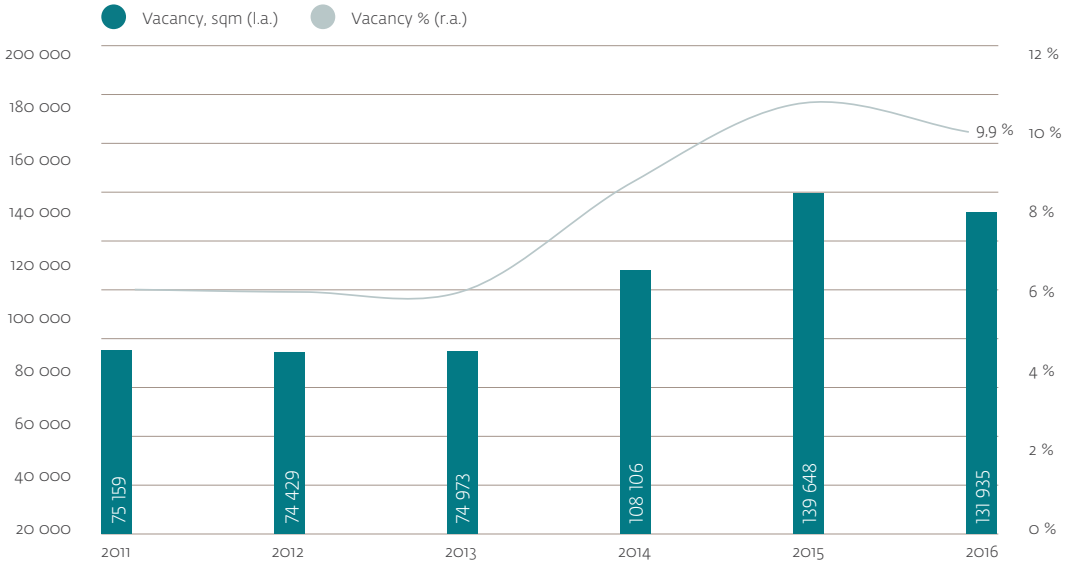
The total amount of available space in Trondheim at the end of the first half of 2016 was 180,000 m2. Vacancy is thus slightly down from the figure of 194,502 m2 at the start of 2016. The amount of vacant office space is 131,937 m2, which is a decrease of 7,700 m2 in the first half of 2016. We have divided Trondheim into seven zones and have surveyed vacancy for each zone. The average vacancy for Trondheim as a whole is 9.9%. The city centre has the lowest proportion of vacant space at 6 percent, while Heimdal/Rosten and Fossegrenda have office vacancy above 20%. Our forecasts suggest that vacancy this year will be lower than last year but we expect increasing vacancy in 2017 as a result of the completion of a number of new office projects during the year.

Transaksjonsmarkedet

2016 has started much more quietly than last year. So far transactions corresponding to NOK 1.3 billion have been registered, which is around one third less than 2015. The main reason is the absence of portfolio transactions which last year accounted for as much as NOK 1.9 billion. So far this year we have recorded eight transactions for more than NOK 50 million. Among the largest transactions we can mention Bassengbakken 4 on Solsiden which was sold in January for NOK 260 million with a net yield below 5.4%. Oti shopping centre at Orkanger was another large transaction in the first half-year, while Trondheim's landmark, the Tyhol Tower was sold for close to NOK 55 million. In addition, an industrial/warehouse property Løvåsmyra 4 at Tiller was sold on a yield of 6.4%. Since late summer we have seen some increase in activity with several properties in play. The larger portfolios continue to be absent from our region and we expect that turnover volume will end in line with a normal year. During the autumn DNB Næringsmegling will be offering several properties in the market priced at NOK 50 million and higher. We consider that the prime yield is 5.0% for new property with a central location and good, long leases to solid tenants. The yield for "normal" properties of a typical standard located along the communication arteries with short/medium length leases is in the range 6.5–7.5%.

Rent levels in Trondheim (NOK per sqm.)

Vacancy Trondheim (sqm, %)



STAVANGER

There has been a somewhat lower level of activity in the transaction market but we are seeing continued good interest for low-risk property. The trend of increased activity in the rental market is continuing but most leases are for somewhat smaller areas than previously.

- The investor side and the banks continue to be very selective.
- A decrease in transaction volume but mainly due to fewer properties with the desired investment profile.
- Rising activity in the letting market, but smaller areas per lease.

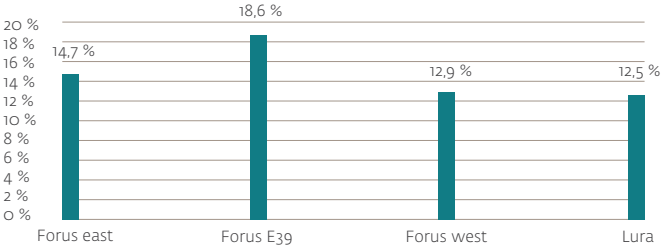
Fjordpiren, Hinna Park
Letting assignment on behalf of Hinna Park

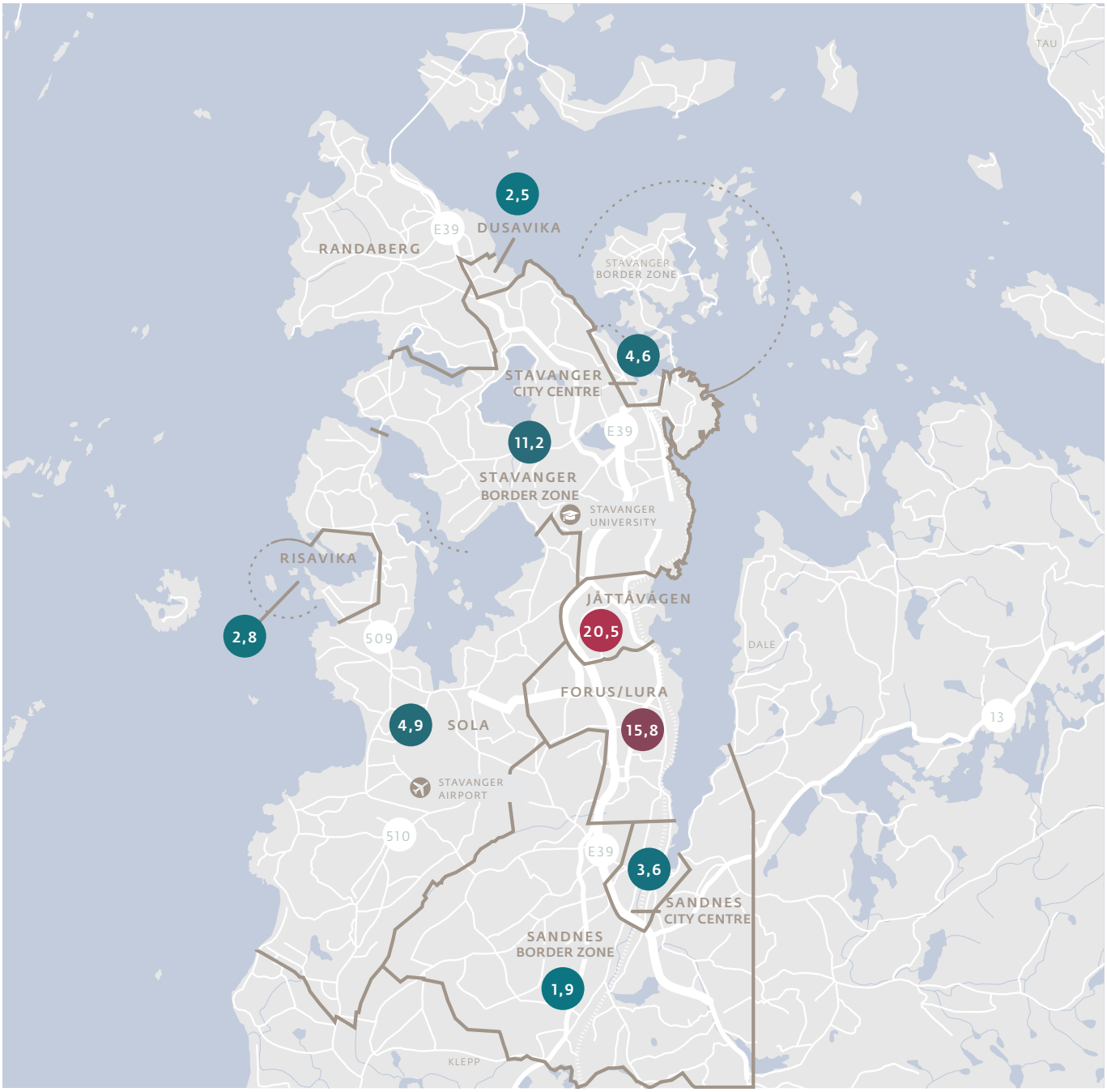
VACANCY STAVANGER, SEPT. 2016

TOTAL OFFICE VACANCY STAVANGER: 11,4 %

Vacancy Forus/Lura

Significant local variations





Ankerkvartalet, Stavanger city center
Letting assignment on behalf of Øgreid Eiendom Sentrum

Office vacancy

Vacancy in the office segment is somewhat lower compared with Q2 this year. According to our databases and surveys we are now at around 11.3%, which is a decrease of one percentage point in relation to Q2. The reality behind the decrease is somewhat debatable as there is some space that is no longer publicly offered for unknown reasons, where we have not been able to clarify the status with the lessor. We saw the same situation between the surveys in Q4 2015 and Q1 2016 and, as the space came back in Q2. Our overall assessment is that vacancy seen as a whole is relatively stable.

If one looks at the different geographical areas in the region the change is greatest in Sola where we have a marked reduction from around 14.3% to around 4.9%, but the reduction is mainly related to two properties where we have not been able to obtain confirmation of the status from the lessor. The survey also shows a decrease at Jåttåvågen/ Hinna Park of roughly 5% to around 20.5% and of about 3% to around 15.8% at Forus/Lura. The centre of Stavanger has experienced a rise of around 1% to 4.6% compared with Q2. The issues referred to above are naturally also relevant to these figures.

The letting market

Activity in the letting market has been rising so far this year, continuing the trend from the second half of 2015. Several leases have been signed and it is positive to see more specific movement on the tenant side compared with last year. On the other hand, we see that the majority of the leases that have been signed are for smaller amounts of space compared with previous years. The highest activity we have seen has been in the size range 300–800 m2 and there are few large space users in the market at the present time. Aggregate vacancy for all segments is around 7.2% which is a marginal increase in relation to the previous survey of around 6.9% in Q2 this year.

The differences between the various business clusters and geographic areas in the region is continuing and to some extent has intensified. We see some indications of improvement in central zones and central areas, while at Forus and in peripheral areas there continues to be higher competition and pressure. Rent levels appear nevertheless to have stabilised somewhat more, also within the latter areas.

In relation to the subletting issue we are currently seeing a slight reduction in the amount of new space but continue to record that there is hidden vacancy that for various reasons is not in the market at the moment. Among other things we see occupiers that have a not inconsiderable amount of surplus space but have premises which are not necessarily suitable for division and subletting. We also see some sublet space being offered at very low levels where there is a short remaining period on the lease, but which has not been taken up, due among other things to tenants requiring greater foreseeability. In general, there have been growing expectations from the customer side and the use of lease adaptations in the form of rent-free periods, buy-outs of existing leases, step models etc.

Other segments

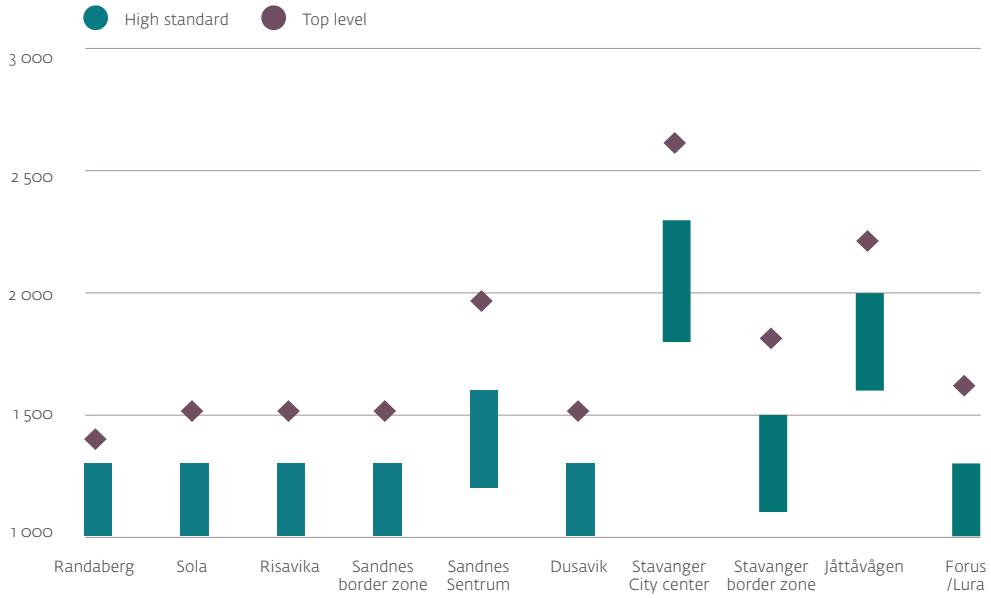
In aggregate we have registered a marginal increase in vacancy for combination property from around 4.7% in Q2 to around 5.0% in Q3. The increase mainly relates to an increase in available office space in connection with combination buildings. Vacancy related to retail space is virtually unchanged at around 4.5% against some 4.4% in Q2. With regard to the segment industrial/warehousing/logistics there has been a decrease from around 2.6% % to around 2.0%.

The transaction market

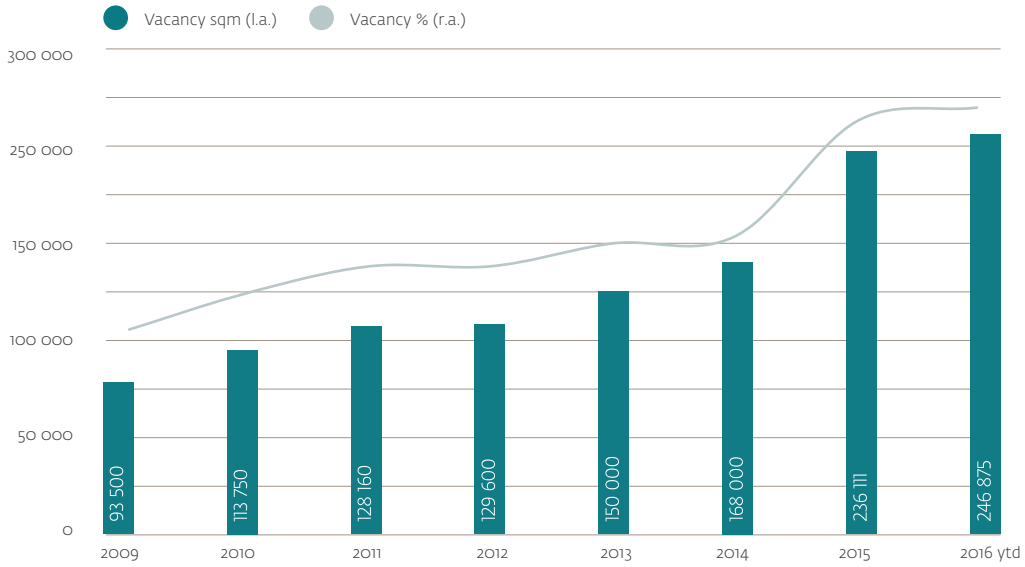
Transaction volumes so far this year show a considerable decrease compared with the same period in 2015 and 2014. We have recorded a volume of approximately NOK 1.3 billion against some NOK 4.7 billion in 2015 and NOK 2.8 billion in 2014. It should be mentioned that transaction volumes in both 2014 and 2015 were at record levels and that 2016 is closer to a "normal year" with roughly the same volume as for corresponding periods in the years 2006–2013 (apart from 2008 and 2009).

In addition, we find that there is good availability of capital for both local and national investors, but buyers (and the banks) continue to be very selective. We see that the main focus and preferences among investors are still more or less along the same lines as in 2015 when there was substantial appetite for low-risk property - preferably buildings with leases to central or local government bodies - which as a result achieved very aggressive pricing. The sale of Unik Terminal AS/ Kolumbus bus terminal at Forus underlines this trend and it is by far the largest transaction this year. Properties with a normal or higher risk, including development property, have received much less attention from the market and the price range for this type of property is currently wide. In our view location is most important for sale properties in this category, and so far we have seen very good interest in properties where there has been only a little foreseeability regarding leases provided that the location has been right.

Rent levels in Stavanger (NOK per sqm.)



Vacancy Stavanger (sqm, %)




L-FORBUND
16

Østensjøveien 16

Letting assignment on behalf of Ferd Eiendom

RETAIL

Growth in consumption is expected to fall a little in 2016, before gradually picking up again from next year. Internet retailing is continuing to grow strongly, and this year's transactions evidence continued good interest for retail properties.

- Growth in consumption is expected to rise by only 1.3% this year to 2.7% in 2019.
- E-commerce is expected to rise by 16% in 2016.
- Shopping centre turnover is up by 3% so far this year.
- Aggressive yields where there have been expectations of increased rental income.

Vik-properties (Furnesvegen 18 and Nordåsvegen 4, Brumunddal)
Sales mandate on behalf of Salto Eiendom AS

Growth in consumption

DNB Markets expects that growth in consumption will be 1.3% in 2016. This is lower than last year (2.0%) and also a little lower than previously forecast. The lower rate of growth corresponds to weak growth in household disposable income, which combined with higher inflation is expected to lead to a fall of 1.2% in real incomes in 2016. On the positive side low interest rates and an upturn in consumer confidence indices suggest a rise in consumption in future. DNB Markets forecasts that growth in consumption will rise to 1.8% in 2017 before increasing gradually to 2.7% in 2019.

E-commerce

The Norwegian e-commerce market is expected to grow by as much as 16% in 2016 to reach a total turnover figure of NOK 90 billion. Figures from the DIBS annual e-commerce report show that the Norwegian market has grown by as much as 75% in 5 years with online purchases of goods accounting for roughly 1/3 of Internet trade. The sale of groceries on the Internet is one of many sectors that is taking market share from traditional retailers by using new e-commerce solutions. Every 10th Norwegian is now shopping online and the sector is estimated to have sales of NOK 3 billion in 2016, which will probably be almost 2% of total sales of groceries in Norway.

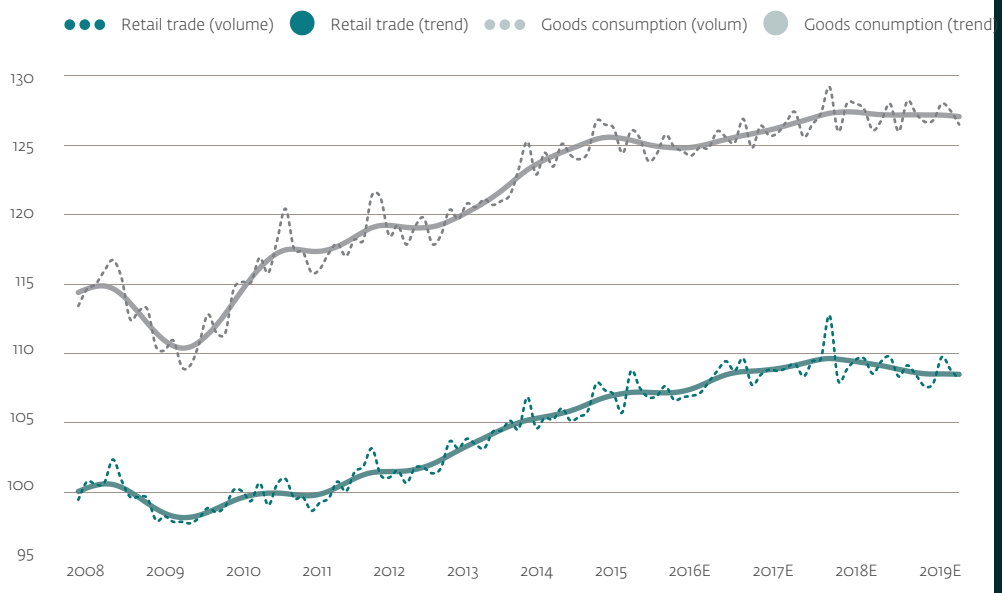
Shopping centres

Kvarud's shopping centre index for the first eight months shows that shopping centres have seen growth of 3.0% (adjusted for changes in space) compared with the same period last year. The 237 shopping centres in the index had total sales of NOK 93 billion, including VAT, to the end of August 2016. The shopping centres in Østfold (6.3%), Akershus (4.7%) and Oslo (4.5%) had the greatest growth, while district and local centres had relatively greater growth then regional and city centres. With the exception of Rogaland (-0.5%) there has been growth in all counties once adjustment is made for changes in space.

Transaksjonsmarkedet

So far in 2016, 30 retail transactions have been recorded with an aggregate value in excess of NOK 8 billion. This is below the levels we saw in the record year 2015 but at the same time in line with what was registered for the whole of 2014. On the buyer side property companies have been the main buyers with transactions for roughly NOK 3.6 billion, while foreign investors so far have bought for approximately NOK 1 .5 billion. Six shopping centres have been sold so far this year for an aggregate value of around NOK 3.5 billion and an average yield of 6.3%.

Retail sales/goods consumption. Seasonnaly adjusted volume index. As of January. (Source: SSB)



From among the main retail transactions we can mention:

- **Åsane Storsenter, Bergen.** Olav Thon has signed heads of agreement with the current owners Nordea Liv and Steen & Strøm to buy the centre.
- **Lade Arena, Trondheim**. DNB Liv is acquiring NHP's interest in Lade Arena.
- **Grensen 7.** The French company AXA has bought the property from Nordea Liv for NOK 420 million.

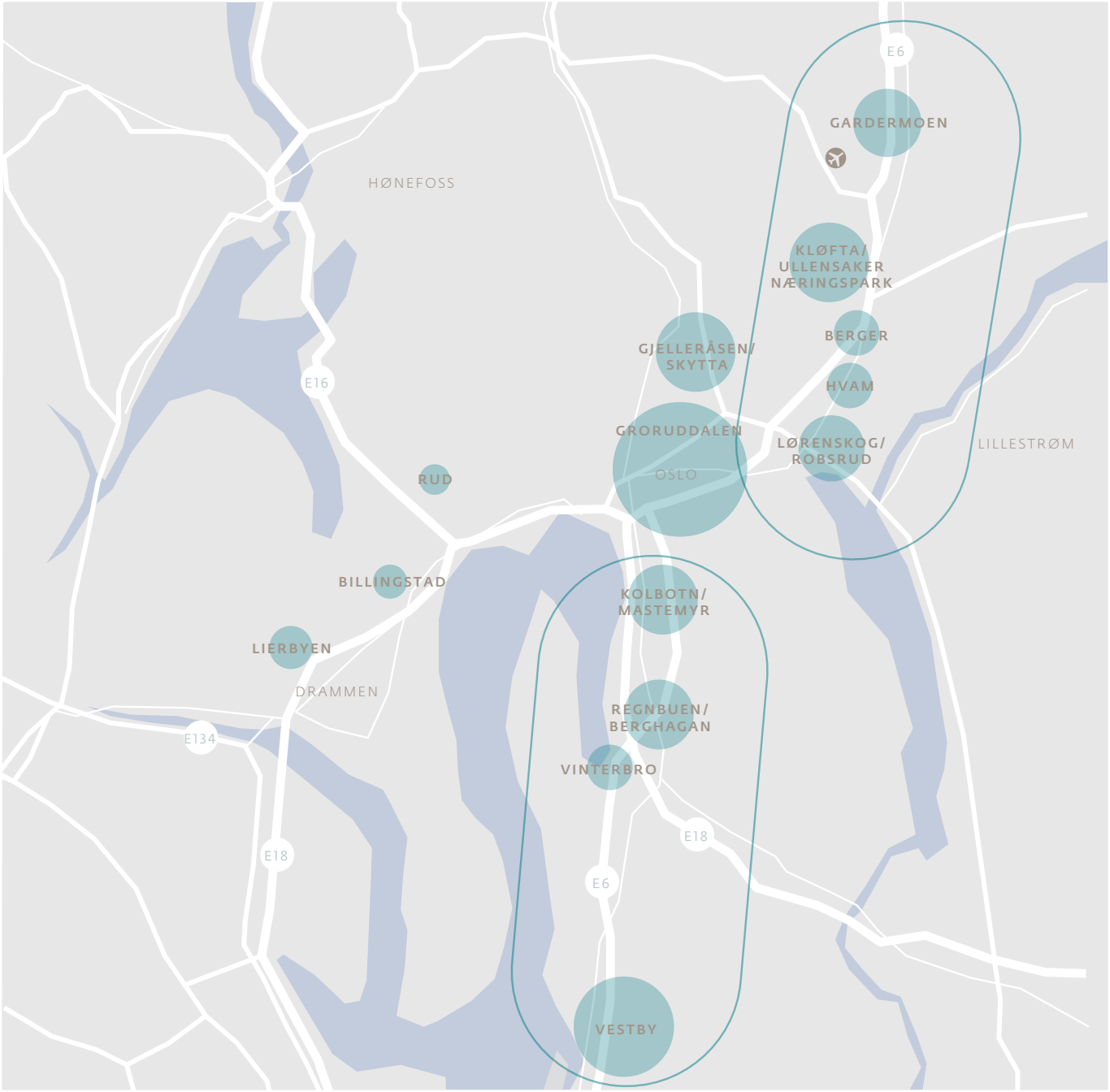
WAREHOUSE AND LOGISTICS

New e-commerce businesses within food and fresh products have absorbed large amounts of space in parts of the Oslo region during 2016 and these new businesses are reinforcing the greater price differentiation between good and less good premises.

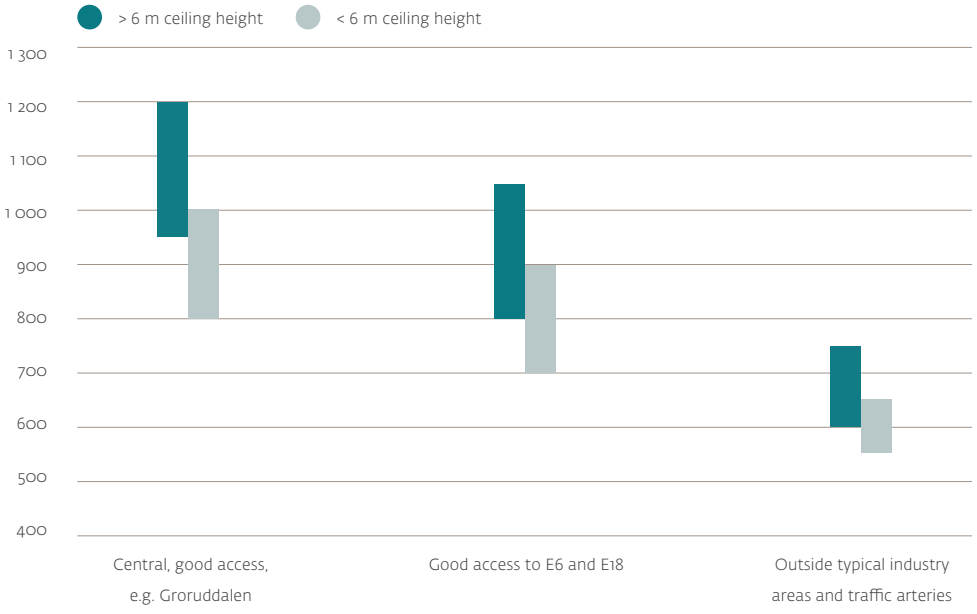
- Continued good demand for warehouse and logistics space.
- The food sector on a net basis has absorbed in excess of 33,000 m2 of warehousing in the last two years.
- Continued high frequency of lease signings on new buildings

Kjeller vest 12-14. Planned new building, Hvam
Letting assignment on behalf of Hetti Kjeller Vest AS

WAREHOUSE/LOGISTICS CLUSTERS, OSLO AND SURROUNDING AREAS



Rent levels for warehouses and logistics premises (NOK per sqm)



General

Det There continues to be a good level of activity in the segment and the last half-year shows a marked increase in demand for warehouse and logistics properties. A good number of leases have been signed for all space categories in both existing and new buildings. A number of new large leases have been signed, particularly for new buildings – See examples below. By far the largest lease signing for many years has been for Europris' establishment in Moss where Fabritius will put up a new warehouse extending to around 60,000 m2 with completion in Q3 2019.

The first half of 2016 was characterised by considerable demand from food businesses. Three leases were signed with different companies involved in Internet retailing of food products, which alone absorbed a total of some 21,000 m2. If one includes the lease signed by marked.no in 2015 food businesses have absorbed on a net basis in excess of 33,000 m2 of warehouse space. The last year has also seen increased demand from companies in other fresh product segments such as flowers, fruit and bakery products. These are companies which due to the type of products need central and easily accessible locations. The above has resulted in there now being a very limited number of good vacant premises in existing buildings in sizes up to around 5,000 m2 in central areas of Oslo East.

The most attractive areas outside Groruddalen have traditionally been Langhus and Berger. As mentioned in the previous report Lahaugmoen has developed as an attractive area, something that has been confirmed with new major lease signings in the last half-year.

The letting market

Rent levels have remained stable with a slight upward trend for centrally located warehouse buildings of a good standard, cf. the increasing tendency for price differentiation between good and less good warehouse premises. This has intensified slightly with the last half-year's absorption of space by food companies. Low interest rates, low yields and attractive building costs contribute to property owners being able to offer new buildings at lower rents than previously. This is mainly the case for new buildings located outside central Oslo.

The top rents on warehouses are around NOK 1,200 per m2 while most of the leases signed have been at levels between NOK 950 and NOK 1,050 per m2 for buildings with good storage qualities, good locations and which have been well maintained.

The transaction market

So far in 2016 we have recorded 24 transactions in the segment warehouse and logistics properties with an aggregate value of approximately NOK 5.7 bn.

Warehouse transactions this year have an average price of NOK 12,500 per m2 but pricing is very sensitive with respect to the remaining lease period. Transactions this year vary from just NOK 3,500 per m2 to over NOK 16,000 per m2. In 2015 we also saw several examples of transactions with a price up to NOK 20,000 per m2 for long leases, and the table below shows that pricing in the same period varies considerably both with respect to location and the remaining lease period. We consider the prime yield for warehouse and logistics properties to be 5.25% for those with a long lease.

If more detailed information is required on the warehouse and logistics segment DNB Næringsmegling can provide specially tailored analyses. Call us to discuss your requirements.

Some examples of transactions so far in 2016:

- **Round Hill Capital's** purchase of the portfolio of NLI Eiendomsinvest AS (9 out of 19 properties in Norway).
- **Ferd's** purchase of Stokkamyrveien 15-17 in Stavanger from Rafoss Eiendom.
- **Elena AS's** purchase of Orkidehøgda 3 from Terje Stykket.

Some examples of new signings in the last half-year:

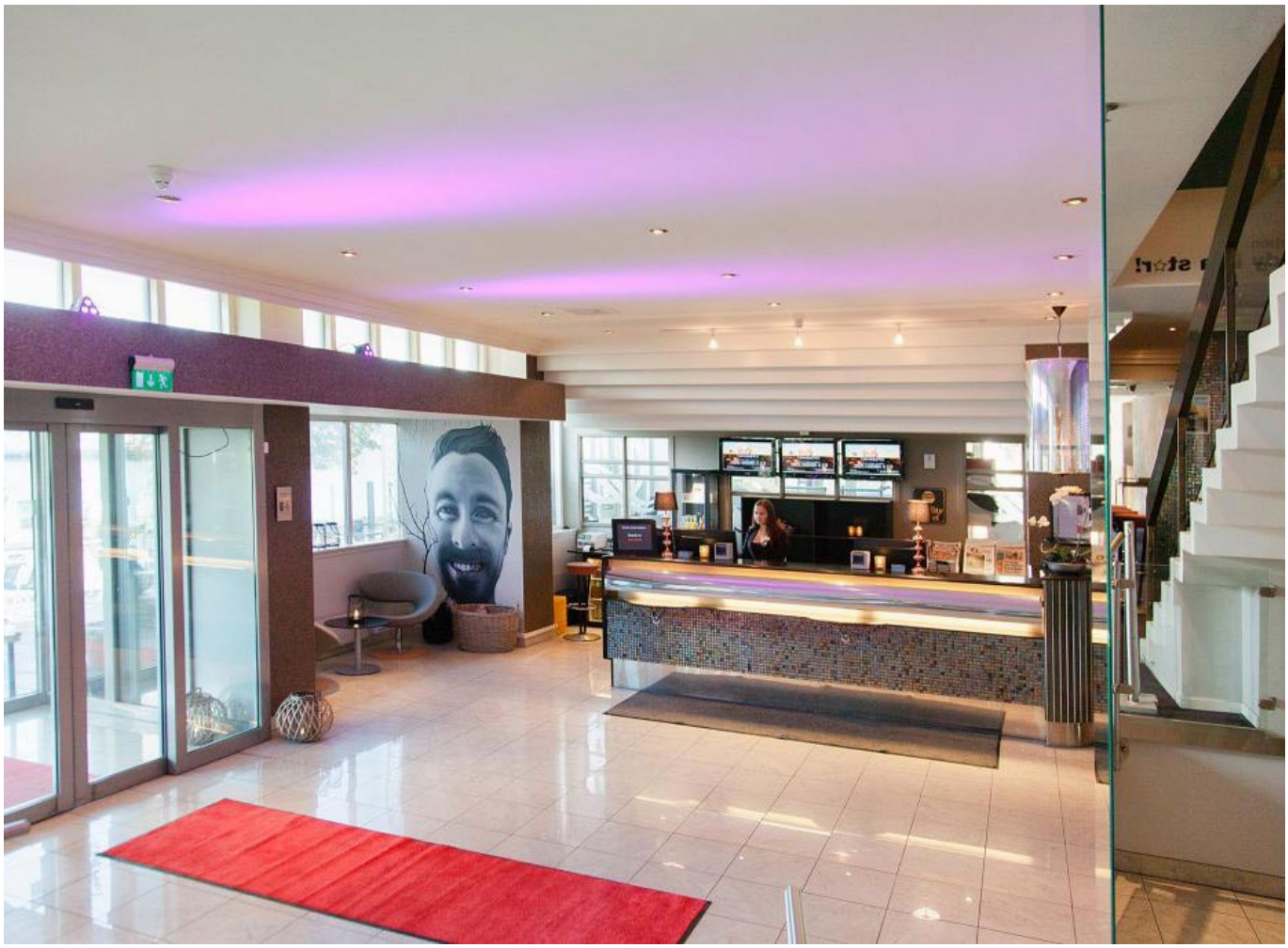
- **XXL** are extending their existing warehouse at Gardermoen by more than 8,000 m2.
- **BlomsterRingen and Primafloor** are moving from Økern Torg to Lahaugmoen, where they will occupy 15,000 m2 of warehousing from 2018.
- **Bertel O. Steen** has bought land on the other side of Berger where it will establish a new central warehouse with completion in 2019/20.
- **Nor Tekstil** is building a new laundry facility of 7,000 m2 with Fabritius at Berger.
- **Kolonial.no** has leased in excess of 13,000 m2 in Solheimveien 3 at Lørenskog.
- **Bjørgs Budbil og Transport** is leasing 4,000 kvm of warehousing from January 2017, also in Solheimveien 3.
- **Godtlevert.no** has leased 6,700 sqm in Søren Bulls vei 2.
- **Cater Storkjøkken** has recently decided to lease 17,000 m2 at Lierskogen.
- **Europris** has chosen Fabritius to build a big warehouse of 60,000 m2 in Moss.
- **Vinmonopolet** has signed a lease for 2,600 m2 at Torvuttaket in Vestby for occupation early in 2017.
- **Synnøve Finden**, which leased 2,400 m2 in the same area in 2015, is extending now with an additional 2,400 m2 from the summer of 2017.

HOTELS

The hotel market is showing stable growth but with continued large regional differences. The key figures for the Oslo market have reached a high level but there continue to be few bright spots with regard to developments in Stavanger.

- A stable hotel market on a national basis, but with large regional differences
- RevPar 21% in Stavanger in the first half of 2016
- A weak Norwegian krone is contributing to growth in the number of international visitors

Hotell Klubben, Tønsberg
Sales mandate on behalf of AC NOR



Norway

On a national basis there have only been minimal changes compared with the corresponding period last year, but there have been large regional differences. We have noted however that a weak Norwegian krone has been an important contributor to an increase in international traffic of 9.3%, but there has been a decline of 0.3% in domestic traffic. The hotel market was affected by strikes for four weeks in April and May, which has had some impact on the figures for the first half-year.

Oslo

The key figures for the capital have reached high levels following strong growth in 2015. An all-time high was recorded for the number of rooms sold and prices are at their highest level since 2008. The reduction in RevPAR (-1.4%) is mainly related to increased capacity as well as some effects from the strike. The holiday and leisure segment accounts for an increase of 11.3% and it is somewhat unusual for Oslo to have more guest days in the holiday market than in business traffic. Capacity growth in the capital has been 3.8% so far this year and is mainly due to the fact that Comfort Hotel Karl Johan (181 rooms) and Best Western Hotel Kampen (70 rooms) have come onto the market. Capacity is expected to be reduced a little in 2017 when, among others, Clarion Hotel Royal Christiana will be closed for rebuilding.

Trondheim

Trondheim has had good growth in both prices (2.9%) and RevPAR (8.2%) in the first half of 2016. Growth has been related to the course and conference and leisure segments, while we have seen a fall in business traffic of 8.5%. Trondheim appears to have established a better market balance after a capacity increase of almost 34% in the last five years, which has put pressure on both prices and occupancy levels. After many years of strong growth capacity is down however by around 4% in the first half-year compared with the same period last year, due among other things to the closure of Britannia Hotel, which is expected to reopen in 2017/2018.

Bergen

Bergen shows a fall in both occupancy and RevPAR but prices are slightly up. Business traffic Is down 5% compared with the same period last year showing more clearly the impact of the downturn in the oil industry than previously. There has however been strong growth in the course and conference segment of 35.6%, which largely can be related to increased capacity. In the first half-year Bergen has had the highest hotel prices on a national basis and has only been beaten by Oslo on RevPAR, in spite of a fall from last year. A lot of new capacity is expected to come onto the market in 2017, which will put further pressure on RevPAR. The capacity increase will however be balanced somewhat by Hotel Norge being taken out of the market until 2018.

Stavanger

Stavanger shows a fall in all key figures and RevPAR is down by a full 21% compared with the first half of last year. The decline in recent years largely relates to the substantial increase in capacity combined with the downturn in the oil industry that has hit business traffic particularly hard. In the last three years capacity in Stavanger has increased by 24% while the number of rooms sold has fallen by 11%. In the same period prices and RevPAR have been reduced by 20% and 43% respectively. In future little new capacity is expected, which may improve the balance in the market somewhat. Quality Pond (Sandnes) opened in April, while Thon Hotel Stavanger opened in the summer. In addition, Radisson Blue Atlantic Hotel is being closed for renovation and will therefore be out of the market for about a year.

The transaction market

So far this year we have recorded seven hotel transactions in excess of NOK 50 million, with an aggregate value of around NOK 2 billion.

Among 2016 transactions we can mention:

- **Smarthotel Oslo.**
  DNB Scandinavian Property Fund has acquired the hotel from Smarthotel Eiendom (Hodne/ Incoronato) for NOK 378 million.
- **Norefjell Ski & Spa**.
  A&B Invest has bought the hotel from Danske Bank.
- **City Living Hotel Tromsø.**
  Viking Eiendom has acquired City Living Hotel in Tromsø from Hoff Hotell for NOK 63 million.
- **Quality Hotel Vøringsfoss.**
  EGD Property has bought the hotel from Home Invest (Petter Stordalen).
- **Alstor Hotell, Stavanger.**
  Petter Hagland has bought the hotel from a local group

RevPAR and price per room

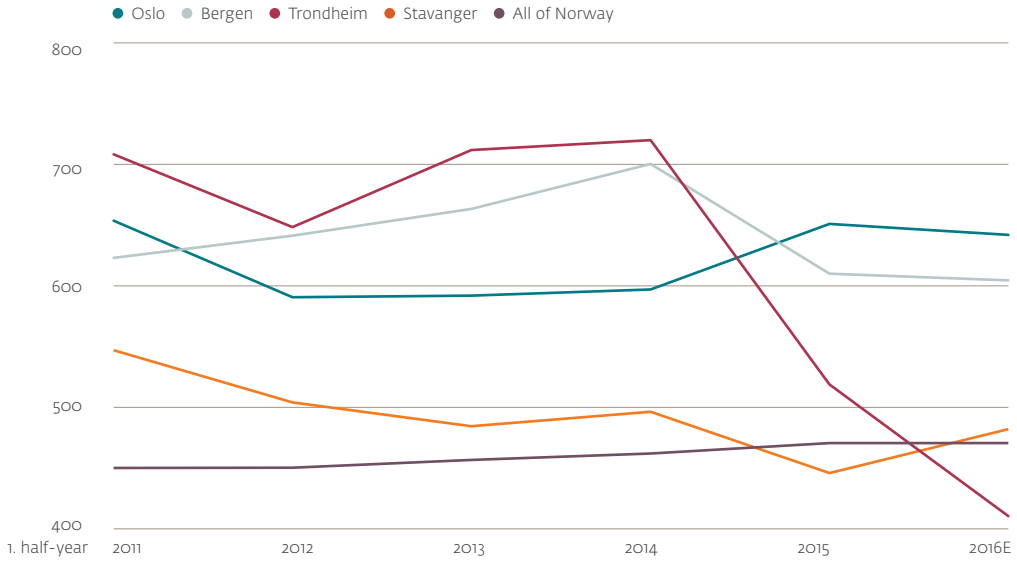
RevPAR (NOK)	H1 2015	H1 2016	%
Norge	469	469	0,0
Oslo	650	641	-1,4
Bergen	609	604	0,9
Trondheim	445	481	8,2
Stavanger	518	409	-21,0
Price (NOK)	**H1 2015**	**H1 2016**	**%**
Norge	910	908	-0,2
Oslo	972	979	0,7
Bergen	967	986	2,0
Trondheim	797	821	2,9
Stavanger	996	866	-13,0

Capacity increase and number of sold rooms (NOK mill.)

Price capacity (in 1000)	H1 2015	H1 2016	%
Norge	13 590	13 754	1,2
Oslo	2 183	2 265	3,8
Bergen	867	863	-0,5
Trondheim	646	623	-3,6
Stavanger	590	574	-2,7
Rooms sold (in 1000)	**H1 2015**	**H1 2016**	**%**
Norge	7 009	7 109	1,4
Oslo	1 460	1 484	1,6
Bergen	547	528	-3,5
Trondheim	360	365	1,4
Stavanger	307	271	-11,7

Source: SSB

Development of RevPAR



Drammensveien 145-147, Skøyen Atrium (illustration)

Letting assingment on behalf of Schage

HOUSING

- House price growth continues at a high rate even though several of the main demand drivers have weakened in recent years.
- House price growth and the increase in household indebtedness represents a risk for the Norwegian economy.

Text:
Kyrre Aamdal,
DNB Markets

Krydderhagen, new building project
DNB Eiendom Nybygg has the sales assignment

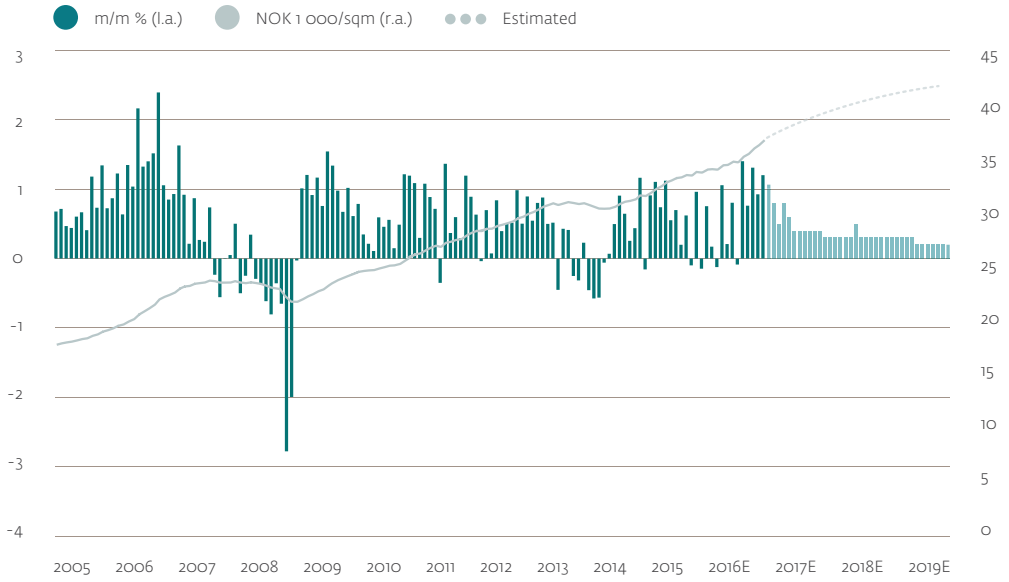
The growth in house prices looks likely to be high again this year, despite higher unemployment and lower growth in household incomes. Very low interest rates and interest rate expectations are stimulating demand for housing. The regional differences in the housing market have increased during the year and price growth is ever higher in Oslo and Akershus where the demand drivers are strong. At the same time restrictions on the supply side are keeping housebuilding down. Even though housebuilding is expected to increase, the high price growth in eastern Norway will draw up prices in the country as a whole in future as well. In Western Norway, which has been hardest hit by the oil slowdown, price growth is weak and some areas are experiencing falls. In this part of the country we expect a gradual normalisation in the housing market.

In the last 10 years prices in the Norwegian secondary house market have almost doubled. The marked increase in house prices can largely be explained by high growth in household disposable income, which has led to increased demand for housing. Low unemployment and the fall in interest rates has also increased demand and favourable taxation of housing relative to other forms of investment may also have contributed. Economic migration and increased urbanisation has led to a particular increase in demand for housing in central districts, especially in Oslo. Population growth has exceeded the number of new houses in the capital for many years, which has reinforced the price rise.

Several important demand drivers have weakened in the last couple of years. Growth in real wages has decreased and unemployment has risen. Viewed in isolation this indicates lower house price growth, while a fall in labour immigration also points in the same direction. In the last half of 2015 it appeared that house price growth was in the process of slowing but from March this year however it has picked up again, so that in August the annual rate of growth was 9.1%.

In assessing the housing market in recent years we have probably undervalued the effects of particularly low interest rates and, not least, that long-term interest rate expectations have fallen considerably in recent years. In addition, regional differences in the housing markets may have contributed to undervaluing price growth. It may also be that housing has become more attractive as an investment compared with many other investment opportunities for non-professional investors. It is difficult to find statistics that can confirm or rebut the hypothesis of an investment-driven increase in demand. However, for the Oslo area it appears that an increasing part of the demand for apartments is related to letting or to providing buyers' children with an entry ticket to the housing market. If this represents a significant part of demand and thus the increase in prices, the danger of a marked reversal in prices increases. In our forecasts for house prices going forward we have taken into account interest effects and geographic differences, but not assumed price bubbles in the markets. A shortage of housing in Eastern Norway and low interest rates mean that price growth will probably remain strong in this area. Together with a normalisation of the housing market in Western Norway this will lead to continued growth in house prices for the country as a whole in the coming years. Weak income growth, a continued rise in unemployment, limited scope for a further fall in interest rates and increased house building suggest that house price growth after a time will diminish. High house price growth combined with an indebted household sector also represents a risk for the Norwegian economy. Even if our main scenario is for further growth in house prices in future, the high level of debt makes Norwegian households sensitive to an increase in interest rates or loss of income. This may lead to a marked fall in house prices and intensify any downturn in the economy.

House price development (% and NOK 1.000/sqm)



MACRO-ECONOMIC SITUATION

- Forecasts for house prices in the secondary market changed from slightly negative to clearly positive.
- The track for money market interest rates has been adjusted upwards from this winter and means that the money market interest rate is stable at 1% during the forecast period

Text:
Kyrre Aamdal,
DNB Markets

Global economy

The world economy is maintaining a reasonable growth rate. Global GDP will probably rise by 3% this year, roughly the same as last year. But growth is unevenly divided. The emerging economies are now growing three times as fast as the industrialised countries, where we – for the seventh year running – have had to trim our growth forecasts a little. And almost eight years after the financial crisis the industrialised countries as a whole continue to be characterised by unutilised capacity, low price inflation and historically low interest rates. This also colours the political landscape, which appears to be more and more fragmented. Brexit was unexpected, but at the same time an expression of increasing popular frustration in many countries, frustration that could send globalisation into reverse. Increasing differences are part of the same picture. Our main view, however, continues to be that globalisation, with associated strong growth in the emerging economies, will continue. In the coming years higher energy and commodity prices will give a further lift to many of the producing countries, including Norway.

The industrialised countries scrape along, for the seventh year running. Following the recovery year 2010 GDP in the wealthy countries has increased by roughly 1.5% annually. This is a good deal less than what we were accustomed to before the crisis, lower than we had expected, not least in the light of the fact that the industrialised countries are in a cyclical upturn, and in many countries lower than what it is necessary to achieve full resource utilisation. In the seventh year after the end of the recession, it appears to be fruitless to expect that growth will accelerate. More and more it is recognised that this is probably the new norm: the potential growth in the wealthy countries is probably much lower than before. During a cyclical upturn, as now, it is reasonable to assume that actual growth will exceed the potential, among other things because investment picks up and available resources can be brought into use. While unemployment continues to be above the expected normal level in the Eurozone, the USA and Japan are probably close to full capacity utilisation. In both places the strength of the upturn could be diminished by an increasing shortage of resources, and in the USA furthermore by a fall in corporate investment.

Growth in the **American economy** has slowed. In the last three quarters GDP has only increased by an annualised rate of around 1%. The slowdown is attributed to a fall in oil investments, an unusually large inventory build-down and the effect of the strong dollar on exports. We expect that growth will pick up a little in future, but a continued modest improvement in productivity suggests a further slight fall in unemployment. In spite of this the nominal picture will probably remain moderate with weak wage growth and inflation below target. This suggests that the Fed will continue to adopt a cautious approach to normalisation of interest rates and that towards the end of the forecast period the signal rate will reach 2%. The greatest risk factor in the short term is the outcome of the presidential election in November. If against expectations Donald Trump should win, one must expect increased uncertainty and financial turbulence.

The surprising outcome of the referendum in June will hit the British economy in both the short and long term. We expect that **Great Britain** will seek a trading agreement with the EU based on the Canadian model. But it will probably take a long time before a model and agreement is in place. This suggests a

long period of increased uncertainty, and a weaker development in private consumption, Investment and employment. Against this background we have adjusted downwards our forecast GDP growth next year by around one percentage point compared with the previous report. After falling for five years, unemployment will rise again. The weaker pound and the Bank of England's support package will contribute to preventing an even greater deterioration. But with already very low interest rates the central bank will probably have to increase stimulus measures further to prevent the economy going into recession. This will nevertheless not prevent poorer terms for foreign trade resulting in lower trend growth in time.

The Eurozone's GDP rose by 1.6% last year, in the first instance driven by increased domestic demand. After a surprisingly strong first-quarter it is likely that growth will be as high this year. We expect the modest cyclical upturn will continue with, among other things, relatively strong growth in housebuilding after many years of higher savings. Pulling in the opposite direction however is the impact of a higher oil price and lower exports to a Brexit-hit Great Britain. Price inflation will probably reach the ESB's target in the New Year before subsequently slowing again, so that the ESB will have to continue its asset purchases and cut deposit rates further to accommodate it. The political risk has increased over the last year and this could dampen growth prospects further. Low growth potential indicates in any event modest growth.

The Swedish economy is in a cyclical upturn. Last year was characterised by solid growth in production, falling unemployment and rising inflation. Production will probably rise again this year, but the rate of growth will slow. Private consumption and housing investments have been stimulated by record low interest rates. Growth in public consumption is high, due, among other things, to the increase in the number of asylum seekers in recent years. Net exports also contributed to growth last year but, viewed in isolation, will draw overall activity down this year. Even lower unemployment will push prices higher, but a strong krona and less price pressure from abroad will ensure however that it remains below the Riksbank's target of 2% over the whole forecast period. The upturn in the Swedish economy means that the Riksbank will not need to ease monetary policy further and will begin to remove its negative interest rates in 2018.

Norwegian economy

Last year growth in **Norwegian mainland GDP** came out at 1.1%, half that of the previous year. This year growth looks likely to be even lower, at roughly 0.8%. A lower rate of growth derives from the fall in demand from the petroleum sector. The decline in the oil price has reinforced the fall in petroleum investment, reduced cost inflation in the supply industries, dampened the optimism of companies and households and resulted in lower income for both the state and private sector. The development has hit the economy unevenly both in terms of region and industry. An expansive financial policy and a lower krone exchange rate are moderating the effects and contributing to there still being growth in the Norwegian economy. In future the negative drag from the petroleum sector will be less, at the same time as government stimulus will continue and private consumption pick up. Therefore, growth is likely to rise again from as early as next year to approximately 1.4%, and to above 2% in 2019.

Between 2010 and 2013 **oil investments** rose by almost NOK 85 billion. Calculated by volume the increase was 53%. This constituted a substantial growth impulse for the Norwegian economy. High cost growth over several years, both in price and volume terms, damaged the profitability of the oil companies however. A drop in investment therefore was already likely before the oil price fall in the the autumn 2014. The oil price fall reinforced the need for cuts and in 2015 oil investment was down by 15%. The fall in oil investment seems likely to be as large this year. Several developments are now taking place that are expected to be completed in the next couple of years. The low oil price means that few new projects will be commenced, Indicating a downward adjustment in the level of investment over time. The development of the Johan Sverdrup field is contributing to keeping investment up but we nevertheless expect a fall in oil investments of respectively 15% this year and 10% next year. We assume that the Johan Castberg project, which will be profitable at the current oil price, will be undertaken. In addition, development of the field Snorre 2040 and other smaller developments will lead to an increase in investments a little further into the future. We estimate that oil investments will rise by respectively 5% and 10% in 2018 and 2019.

Growth in **private consumption** slowed throughout last year. Following weak growth in the second half-year, consumption growth ended at 2.1% last year. However, consumption of goods was unchanged and the entire increase was represented by consumption of services. Growth in household disposable income was roughly the same in 2015 as in 2014 but slightly higher inflation contributed to weakening growth in real incomes. The weak development in the consumption of goods has continued this year, with zero growth in the first quarter. Consumption of services continued to contribute positively to growth, but the rate was slightly lower than last year. In total we expect that growth in consumption will come out at 1.3% this year. Furthermore, we see inflation falling and growth in real incomes picking up. It is therefore likely that growth in private consumption will be lowest this year, and increasing to just under 3% in 2019.

Unemployment has stabilised this year, after a marked rise last year. The increase in registered unemployment has hit sectors relating to the oil industry particularly hard. It has also been concentrated in the four western counties and has only to a limited extent spread to other parts of the country. In the counties of Eastern and Central Norway unemployment is lower than at the start of 2015, while in the western counties unemployment has stabilised this year. The labour market survey shows however that employment has fallen since the end of 2015 and the reason that unemployment has only increased marginally is that some people have left the workforce. Economic migrants contribute to a very flexible labour market in Norway and unemployment would probably have increased considerably more in the last couple years if immigration from countries such as Sweden, Denmark and Poland had not fallen. We expect that unemployment will rise a little more, as although the biggest cuts have been made in the oil sector, there are probably some more to come. The increase is countered by the fact that some of those who have lost their jobs will find new work. It also seems less likely that the increase in unemployment will spread significantly to other parts of the economy and that the flexible labour market is limiting the increase. All in all, we estimate that

unemployment as measured by the Labour Market Survey will be 4.8% on average for 2016. It will then rise gradually to a peak of 5.0% in 2018, before falling a little in 2019 after a couple of years of stronger growth in the Norwegian economy.

The weakness of the Norwegian krone during 2015 has resulted in significantly higher imported price growth in the last couple of years which has contributed to lifting **inflation**. We estimate an increase in consumer prices of 3.7% this year, while core inflation (where tax and energy prices are excluded) is expected to rise by 3.2%. The weak economic situation has led to moderation in wage settlements and we estimate wage growth of 2.5% this year. This corresponds to a fall in real wages of 1.2% this year, the lowest real wage growth for 35 years. In future we expect the effect from the weak krone to decline and gradually have an opposite effect. This will contribute to low inflation in future and we estimate that inflation will fall to 2.6% next year and 1.7 and 1.5% respectively in 2018 and 2019.

In spite of high unemployment and lower growth in household income, **house price growth** is likely to remain high again this year. Very low interest rates, which are expected to remain low for a long while, are stimulating housing demand. The regional differences in the housing market have increased this year however. Price growth is ever higher in Oslo and Akershus where demand is strong and housebuilding is held down by restrictions on the supply side. Even if housebuilding is expected to pick up a little, the high house price growth in Eastern Norway will continue to push price growth for the country as a whole in the future. In Western Norway, which has been hardest hit by the slowdown in the petroleum industry, price growth is weak or negative. In this part of the country we expect a gradual normalisation of the housing market. An ever more indebted household sector may contribute to pushing house prices further up, which may increase the risk of a fall in house prices exacerbating any downturn in the economy.

High house price growth and ever higher household debt suggest an increased risk of financial imbalances. Together with inflation, which will be above the inflation target of 2.5% for longer than previously expected, this suggests that Norges Bank will allow **interest rates** to remain at the current level. The risk of an even greater downturn in the Norwegian economy has also been reduced, as there are several signs that the low point for growth is now behind us. The economy continues to be fragile and it will take a long time before the central bank can begin to raise interest rates. We thus forecast that the base rate will remain at the current 0.5% for the coming years.

During the last eight years the central banks in most western economies have adopted an ever more expansive monetary policy. Again this year the central banks both in Norway and abroad have increased stimulus measures. In the USA base rates have admittedly been unchanged but the indicated interest rate rises have been pushed further out in time. In the Eurozone, Japan, Great Britain and Sweden interest rates have been reduced and the countries' central banks have extended the period of securities purchases and further expanded their balance sheets. Further easing is possible in future but we believe that the central banks are approaching a point where they consider the gains from any such further easing to be less than the costs. In practice they will throw in the towel but will never say this out loud. Continuing low base rates, continued purchases of government bonds in many countries, low growth and low inflation indicate that long interest rates will raise very little. The yield curves will thus remain unusually flat at today's low levels.

The super cycles in the **foreign exchange market** in recent years have diminished, and for some currencies reversed. Growth has been disappointing in many of the major industrialised countries and expectations as to monetary policy have been revised. Increased scepticism with regard to monetary policies that have been implemented has furthermore at times had a significant and unexpected impact. In the USA we now expect that the increase in interest rates will be very cautious and that the period of a marked strengthening of the dollar is therefore behind us. Despite weak inflation prospects in Japan we believe that its central bank will tread water. This will probably contribute to strengthening the yen over the coming year. Uncertainty following Brexit will put a damper on interest in the pound and we foresee weaker sterling in both the short and long term. The Swedish krona appears to be undervalued and in the absence of further monetary policy easing this will contribute to a stronger Swedish krona in spite of a decline in the rate of growth. Better prospects for the Norwegian economy mean that Norges Bank has finished lowering interest rates and the bricks are in the process of falling into place for a stronger krone.

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Letting assignment on behalf of Skanska CDN

THE BOND MARKET

Text:
Kristina Solbakken,
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"Entra issued its first "green" unsecured bonds in an amount of NOK 1bn., with a 7-year term and a coupon of 3-month NIBOR +94 bp.

- Activity in the Norwegian bond market has now begun to pick up after a quiet start to the year
- A high volume of new property bonds has been issued so far in 2016
- A phasing out of shadow ratings will make it more difficult and more expensive for small and medium-sized companies to finance themselves in the bond market

The Norwegian bond market had a turbulent start to 2016 following the substantial fall in the oil price during 2015. There was a low level of new issues during the rest of the first half of 2016 with the exception of a two-week period in May and June. It became more expensive to borrow money in the Norwegian bond market for all types of company and oil-related high yield companies have been excluded from bond financing this year due to the problems in the sector, and as expected we have seen several restructurings for this type of company this year. We believe the primary market for non oil-related high yield companies is now beginning to look brighter and the market for the lowest risk of these companies opened again at the beginning of September.

There was a substantial price correction for investment-grade companies in the Norwegian bond market last year after a long period of tightening spreads. Due to improved international sentiment as a result of continued support buying by the European Central Bank (ECB) and the fall in the oil price, this market normalised more quickly than expected, if at higher spreads than in 2014 and 2015. The most solid and frequent issuers, such as, for example, the major Norwegian property companies, have not had problems in raising money in the bond market at good levels since the summer. For example, both Entra and Steen & Strøm raised finance during September. Entra made its first green unsecured bond issue of NOK 1 billion with a 7-year term and a coupon of 3-month NIBOR plus 94 bp. and Steen & Strøm issued NOK 400 million of bonds with a 6.5-year term and a coupon of 3-month NIBOR plus 110 bp.

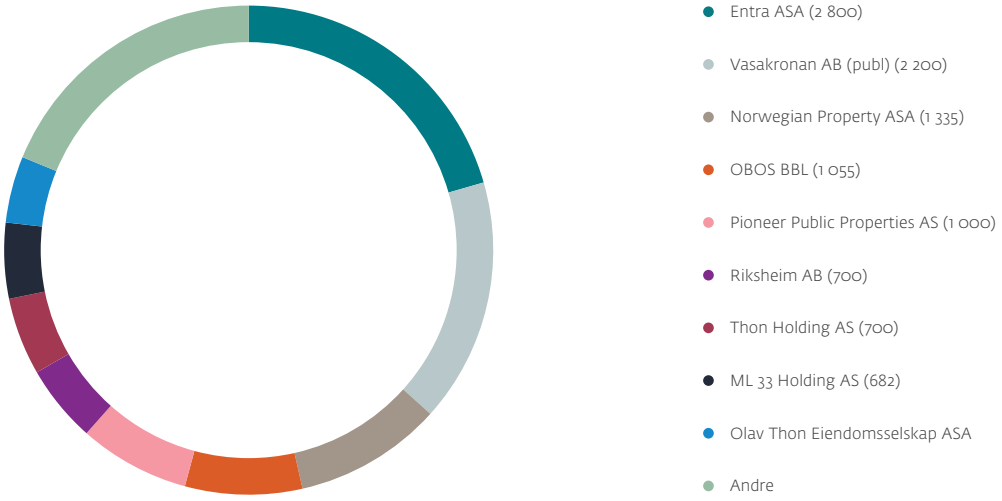
The **volume of bonds issued by Norwegian property companies** has largely been affected by the volume of transactions in the property sector. In 2015 a new record transaction volume was set of around NOK 130 billion and a corresponding new record of new property bonds of close to NOK 18 billion. The volume of transactions so far in 2016 has been much less than in 2015 but nevertheless we see that the volume of bond issues is already almost NOK 14 billion. Part of the reason for this is that Swedish property companies such as Vasakronan and Rikshem have raised large amounts in the Norwegian bond market during the year. In addition, there has been a relatively high number of issues from companies such as Entra and Norwegian Property.

We believe that there will be **more volatility in the bond market in future** then we have seen in the last three years, when we have had a relatively even tightening of spreads. Due to the expansive European monetary policy and inflated property values, the market has become more sensitive to surprises that can affect spreads. Increased global credit risk has also led to more frequent "risk on" and "risk off" periods. In addition, the EU's common supervisory body, ESMA, has decided that it will be forbidden to publish credit ratings if one is not an official rating agency such as, for example, Standard and Poor's, Moody's and Fitch. Shadow ratings prepared by broking firms, which has been common practice in Scandinavia, will therefore be phased out during 2016. Credit analysts will continue to analyse the same companies and bonds without giving a specific rating. The Nordic bond market will continue to function because it is a reasonable supplement to bank finance for companies. There are, however, grounds to fear that it will be more difficult and more expensive for small and medium-sized companies to raise money in the bond market because it will be a little less transparent then it has previously been.

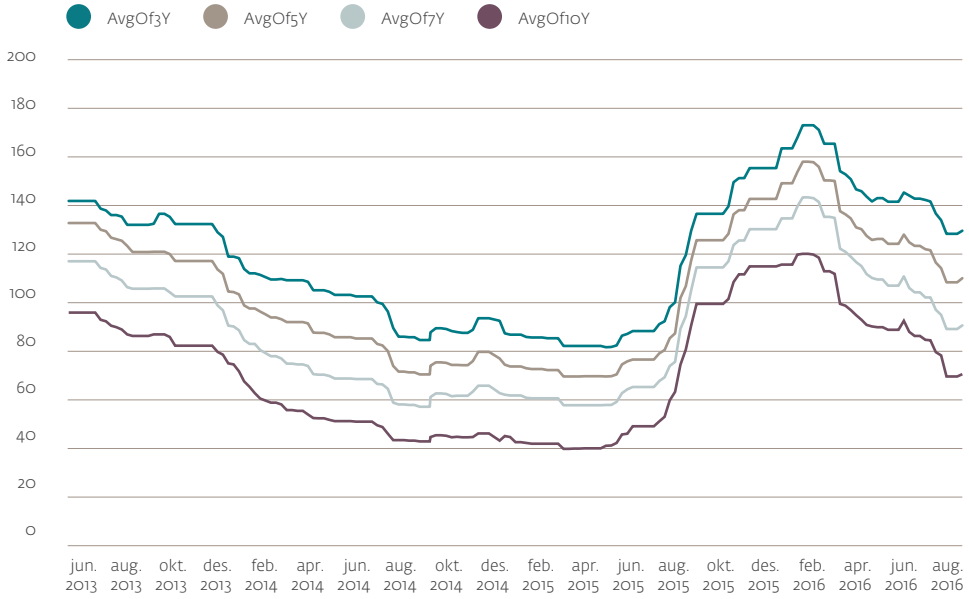
*High yield segment (HY) = companies with a B+ rating or lower

Investment grade segment (IG) = companies with a BB- raising or higher

Bond issuers in the real estate sector, YTD 2016.



Credit speads industry companies (including commercial property).



Bond volume issued in commercial property in the Norwegian bond market by year (NOK bn.)

Source: Stamdata, DNB Markets

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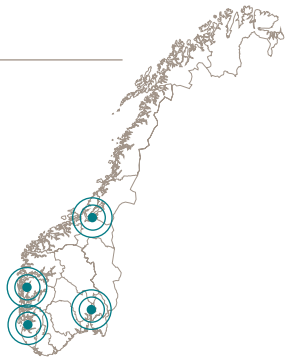

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