Akershus Eiendom

Semi-annual Report Autumn 2022

Akershus Eiendom's Semi-annual Report is intended to provide an overview of the Norwegian commercial real estate market, and has been prepared by the our research department, which currently consists of 6 experienced research analysts. The report was last edited 14 October 2022.

Feel free to get in touch if there is anything we can assist with.

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Read the report online ↗

Menu

Design by Vild Oslo

Introduction

The Norwegian economy will probably continue to cool ahead, while inflation is expected to remain elevated also next year. Short-term interest rates are expected to increase further from today's levels, while long-term interest rates are expected to have limited further upside potential.

The office market has been red-hot this year, and we expect vacancy rates to remain low and office rents to increase further in Oslo next year. In the CRE transaction market, we observe upside pressure to yields and expect them to increase over the coming months.

The Norwegian economy rebounded strongly after the COVID-19 pandemic, and activity has remained strong until relatively recently. Unemployment in Norway is now at its lowest level since before the financial crisis. However, activity growth has begun to slow down of late, while consumer price inflation has been far stronger than expected. Many of Norway's trading partners are finding themselves in a similar situation. Major problems in the international value chains, sharp rises in the cost of energy and electricity and strained labour markets have piled pressure on costs throughout the supply chains.

High inflation can in itself help push up inflation expectations, causing high inflation to become entrenched. Central banks in the West, including Norges Bank, have therefore raised their interest rate forecasts sharply in an attempt to quash inflation. High inflation and rapid interest rises will help curb consumption and investment, and in the markets there have been growing fears of recession in recent months.

If we do get a recession, the central banks are like to cut interest rates at some point, but not before they have gained some ground on current levels. It will probably take some time until we see a return to the current policy rate levels. According to Norges Bank, the policy rate will most likely peak at 3.0 percent this winter, which is another 75bp up from today’s level, and from there on gradually decrease, reaching 2.5 percent by the end of 2025. Norwegian long-term interest rates, which reflect expectations for the Norwegian economy in the longer term, broadly follow international trends and have already reached elevated levels. If the global, and the Norwegian, economy cools down, long-term interest rates will probably begin to fall at some point.

The robust growth in the Norwegian economy until recently has contributed to a red-hot office market with very low vacancy rates and unusually high rent increases. Even if demand for office space were to diminish, we expect vacancies to only increase moderately and remain below its historical average toward the end of 2023. Combined with high CPI growth, we expect low vacancy rates to underpin rising office rents next year.

Outlook

Despite rapidly rising financing costs, activity in the transaction market for commercial property remained surprisingly high until the summer. However, we have recently noted a greater degree of hesitance, both in Norway and neighbouring countries. As we see it, yields have begun to rise. This is putting pressure on property values, but properties which can quickly capitalise on the rent hike will probably do better.

Transaction

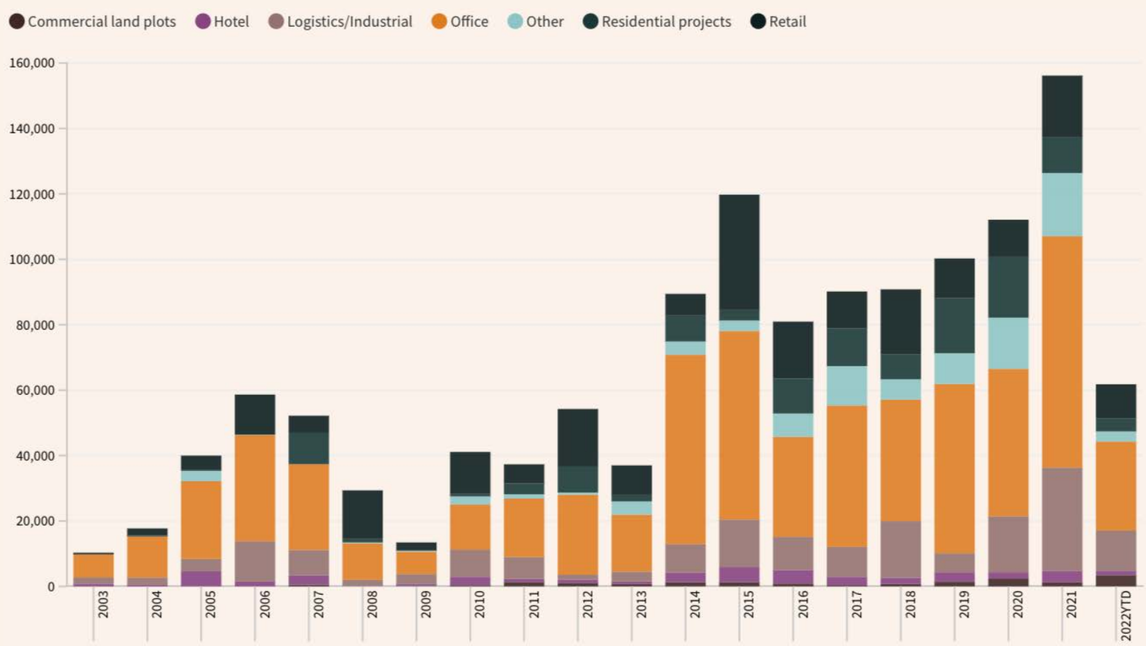
Investor sentiment was strong in the Norwegian and international property markets at the start of 2022. However, high inflation, geopolitical unrest and rising interest rates began to create uncertainty in the markets as the year wore on.

Transaction volume, billion NOK

62

Liquidity remained good in the first six months but stalled in the third quarter as a result of a more hesitant market in a state of repricing. By mid-October, we had recorded a transaction volume of NOK 62 billion, which is 36 per cent lower than at the same time last year.

Transaction volume per segment



Menu

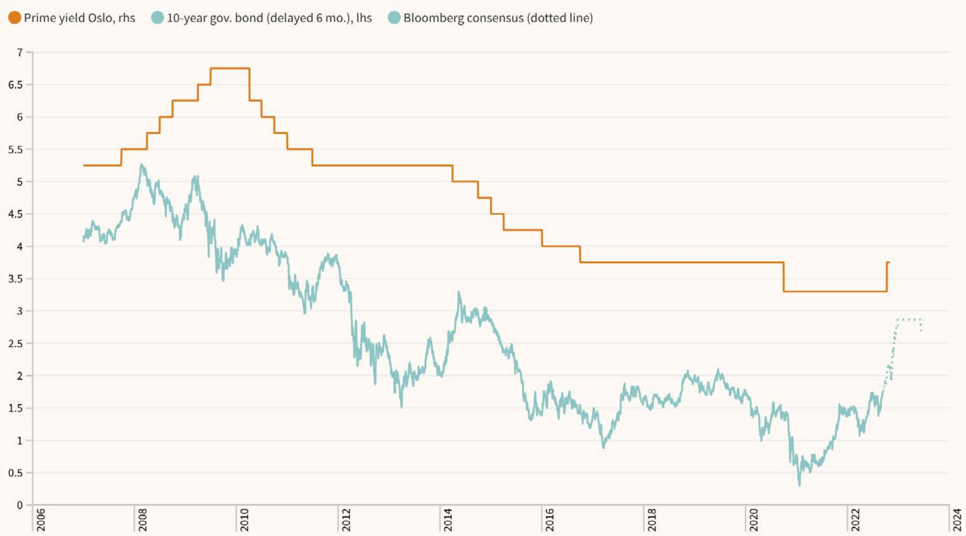
Increase in five and 10-year swap rates YTD, bps

~190

Increased funding costs

Five and 10-year swap rates have risen from just over 2 per cent at the start of the year to the interval 3.60 – 3.90 per cent in mid-October. Credit spreads in the same period have increased, meaning funding costs are now far higher than they have been in the last couple of years. Higher financing costs are perceived very differently by different investor groups depending on the loan to value ratio. The most interest-rate sensitive investors, such as leveraged funds and transaction-driven property companies, were behind much of the activity in the property market and have been forced to downgrade their risk-adjusted rate of returns. This has helped create a far more selective market.

10-year govt. bond vs. Oslo Prime yield, percent



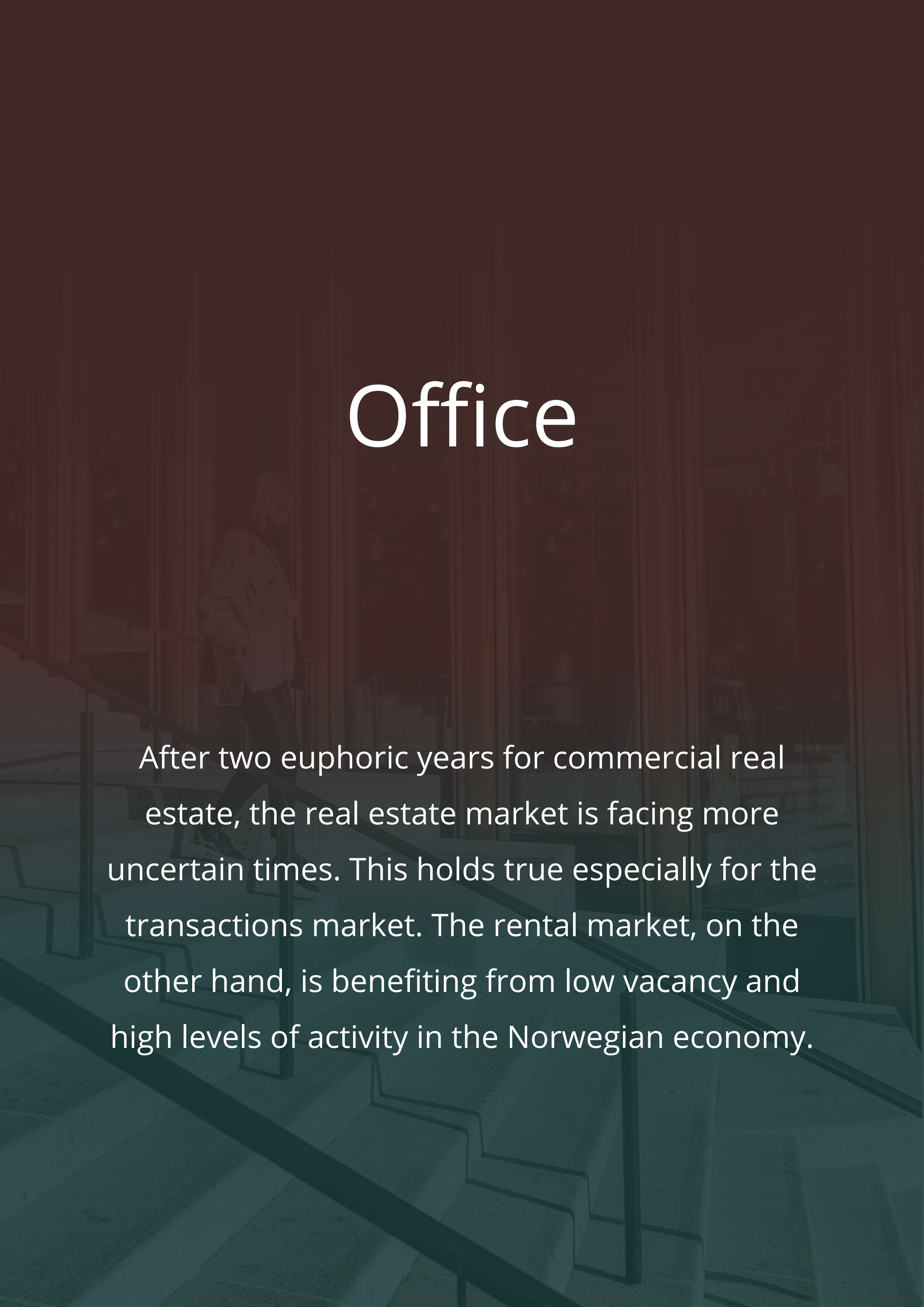
Prime yield

3.75%

Prime yield

Prime yield for offices in Oslo has, according to our experience, increased from 3.30 percent to 3.75 per cent, which corresponds to the yield level before the pandemic. In line with the office prime yield, yields for the other segments have all also been adjusted upwards. There is further upward pressure on yields and further developments in interest rates will govern the development in prime yields.

More information about the transaction market is available in the October edition of our analysis product “Market Views”.



Office

After two euphoric years for commercial real estate, the real estate market is facing more uncertain times. This holds true especially for the transactions market. The rental market, on the other hand, is benefiting from low vacancy and high levels of activity in the Norwegian economy.

Transaction market

Office buildings continue to make up the most transacted segment within commercial real estate, and per mid-October we have recorded transactions of NOK 27.4 billion office buildings, making up 47 per cent of the total transaction volume. Market sentiment was strong at the start of the year. Due to the war, a shortage of goods, problems in the supply chains, inflation and rising interest rates, there has been a gradual shift and we are now seeing signs of repricing in the market. Our prime yield has been raised from 3.3% to 3.75% in Q4 2022. There is upward pressure on the yields across segments, including offices.

↑ Prime yield office

3.75 %

↑ Prime rent CBD, per sq m

5 700

↓ Vacancy rate Oslo

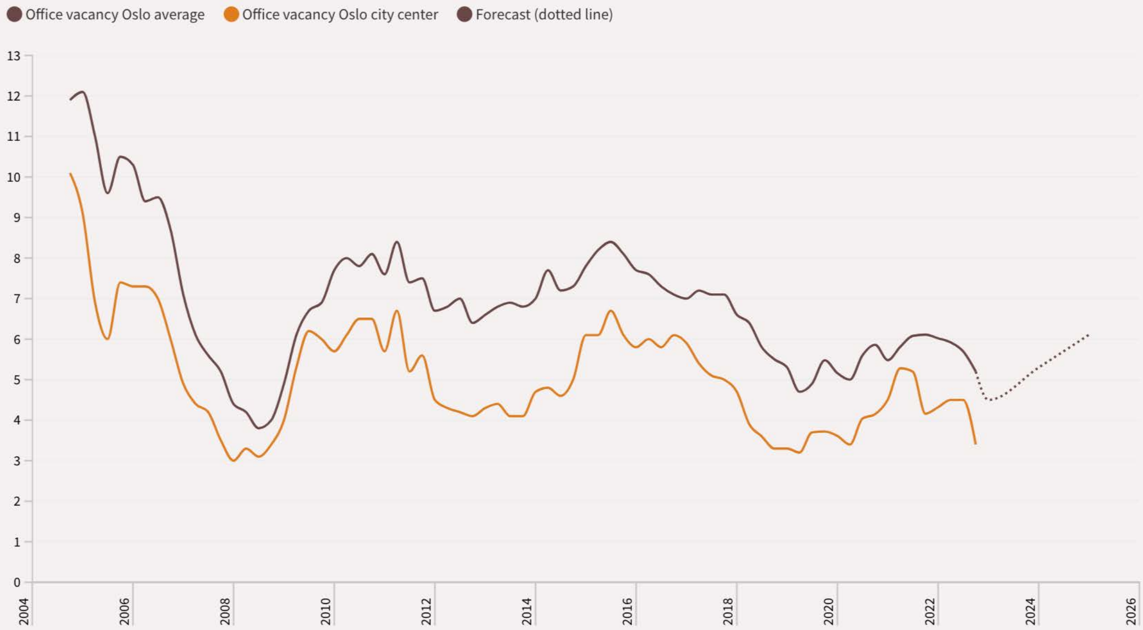
5.16 %

Rental market

The Norwegian economy has seen solid growth in 2022, and employment figures for office-based positions have been especially strong. This has led to high demand for office space. Combined with low unemployment and few new premises on the market, it has also led to rent increases. At the start of the year, market rents for “high standard” offices in the Vika / Aker Brygge (CBD) area stood at around NOK 5,000 per square metre, given our observations. By the end of the third quarter, market rents had risen to NOK 5,700 per square metre in the same area, a spike of 14 per cent. Although the city centre has experienced the highest growth in rent levels, all areas have benefited from rent increases. Our estimates show increases across Oslo, even in Nydalen, where rents have remained unchanged for several years.

Office rent Oslo city centre

Vacancy rate Oslo (average), Oslo CBD, forecast Oslo (average)



Outlook

The transactions market is dominated by uncertainty, and we experience upwards pressure on the yields. On the other hand, few newbuilds are being brought to the market, which means low supply of offices in the short to medium term. As a result of high demand and low supply, rent levels have risen sharply and we expect them to continue rising by a further 2.5 per cent in 2023 in the CBD.

Regions

Bergen

During the first six months of 2022, the Bergen region saw similar high volumes to last year. Transactions are expected to reach between NOK 10 billion and NOK 20 billion in 2022. Prime yield for Bergen is up by 75 basis points in 2022 and has now reached 4.50 per cent, whilst the secondary yield stands at 5.75 per cent. Demand for office space is stable, and rents in central locations have risen. Prime rents in Bergen are NOK 3,200 per sq m. Figures from KYTE Næringsmegling show that office vacancies have risen in 2022. The most recent vacancy rate in central Bergen is 8.5 per cent. The spike in vacancies is due to increased supply with several newbuilds yet to be absorbed.

↑ Bergen prime yield

4.50 %

↑ Trondheim prime yield

4.75 %

Trondheim

Following impressive transaction volumes in 2021, Norway's third largest city got off to a good start in the first six months of the year. Trondheim is home to many students, and residential transactions continue to dominate sales volumes in Trondheim in 2022. The sale of Voll Studentby with 689 student flats for around NOK 750 million is the single largest transaction so far this year. Prime yield in Trondheim has risen by 75 basis points in 2022 and now stands at 4.75 per cent. Prime rents in central Trondheim are stable at NOK 2,500, and we have seen top rents of NOK 3,000 for the best properties. Demand for office space is high, and rents in the city centre are expected to rise over the next 12 months. Around 29,000 square metres of new office space is expected to be introduced in 2022. The Trondheim market absorbs 30,000 square metres a year on average. This means vacancy rates are likely to remain unchanged in 2022.

Stavanger

Like the other regions, The Stavanger region got off to a good start in the first start six months of the year. The acquisition of Tjelta Eiendom with its 22 properties for around NOK 2 billion is the biggest transaction so far in 2022. In addition to office and logistics transactions, the city centre also saw a retail transaction with the sale of the Arkaden shopping centre to Aurora for around NOK 380 million. Prime yield in Stavanger has risen by 75 basis points in 2022 and now stands at 4.75 per cent. Prime rents remain stable at NOK 2,700, with the best properties fetching significantly higher prices. The overall vacancy rate in Stavanger is now 9.2 per cent, according to Eiendomsmegler 1. We have to go back to spring 2015 to find similarly low vacancy figures in the region. Factors such as continuing high demand for office space and falling vacancy rates point to higher market rents in the times ahead.

↑ Stavanger prime yield

4.75 %

Logistics

The market for logistics property has seen marked change in recent years. A pandemic, bottleneck effects and geopolitical unrest have laid bare the vulnerabilities in global supply chains and elevated warehousing demand in a bid for predictability. Uncertain times combined with high demand for goods have opened a growing number of investors' eyes to warehousing and logistics property.

Supply chain resilience

In the past six months the war in Ukraine and new lockdowns in China have yet again shone a light on the delivery problems in the global supply chains, and several logistics firms have switched their supply chain strategies in an attempt to mitigate challenges in the value chain. Firms are now looking to stock greater volumes of raw materials throughout the value chain and more of their finished goods closer to the end users. One direct consequence of this risk aversion is a growing demand for warehousing space. More information about the freight crisis and its impact on logistics property can be found in the August edition of our monthly analysis product *Market Views.*

Rental price range in various logistics areas., NOK / sq m.

Leasing market

High demand for logistics property has led to considerable pressure on rents. Since the end of 2020, rents for the best logistics properties have risen by more than 23 per cent from NOK 1,300 to NOK 1,600 per square metre. As a result of the expected weakening of household consumption, we believe that most of the rent increases for logistics property have been realised in the short term, but the outlook is good further ahead once household consumption settles back into its rising, long-term trend.

↑ Prime yield
Up 25 bps in Q2 2022

4.75 %

Menu

Prime rents, NOK
→ Large warehouses (>6 000 sq m) and
↑ Small warehouses (<6 000 sq m)

1 600

2 000

Transaction volume, billion NOK
2022 YTD and
2021

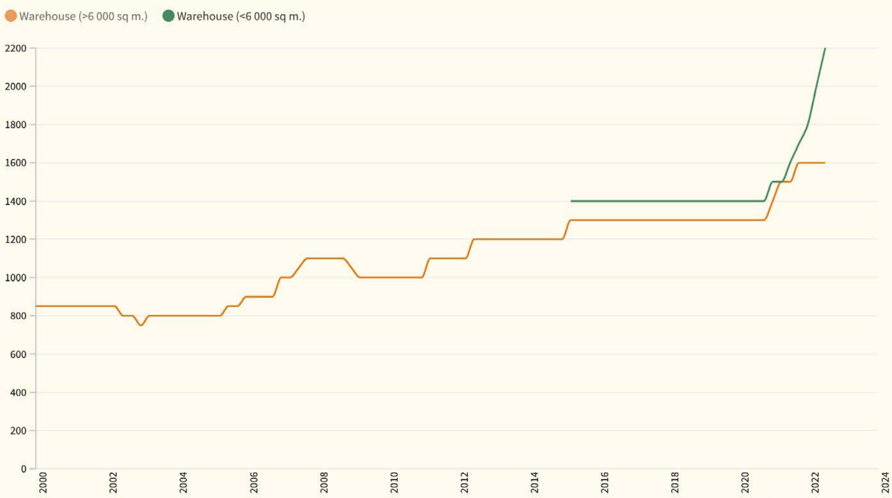
12.2

31.3

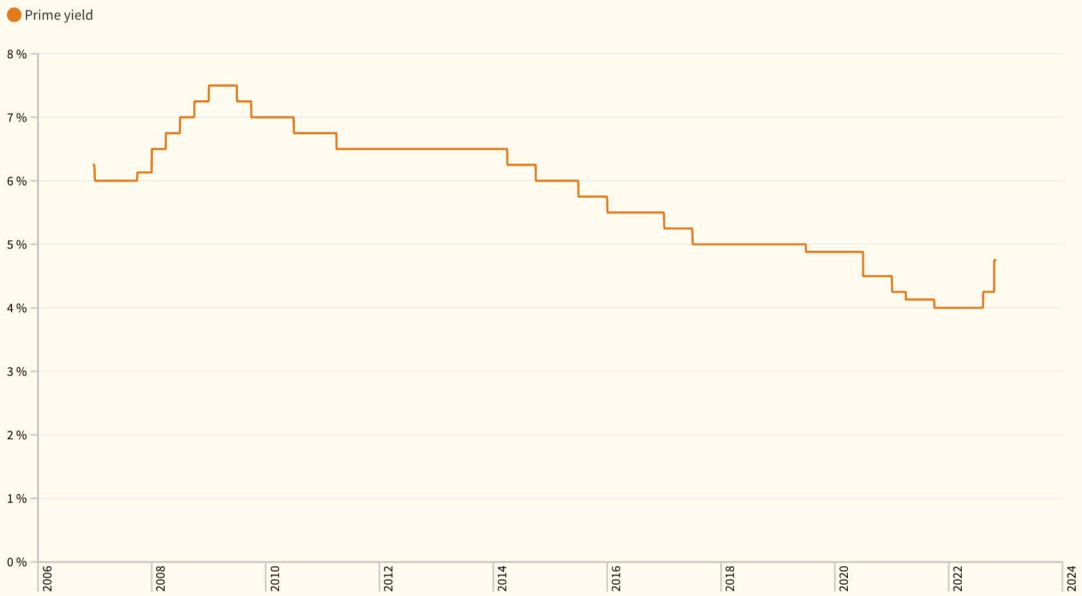
Menu

Consumers are being increasingly demanding when it comes to the online shopping experience, and there is a growing need for swift and environmentally friendly delivery. This is borne out by the demand for centrally located warehouses which can be used for last-mile distribution. A significant number of such premises have been repurposed in recent years, primarily into homes. Recently we have also seen atypical logistics tenants renting traditional warehouse spaces in central locations but using them for other purposes. Examples include electric car retailers in need of fulfilment centres and garages, as well as unmanned shops/warehouses.

Logistics rent, large and small warehouses



Logistics prime yield, percent



Outlook

Investor sentiment for logistics property remains positive, and liquidity holds up well for properties with a potential for further value-creation, often in the form of development or rental growth. The segment has matured as an asset class, and we expect logistics property to continue to be an attractive investment proposition.

Retail

Consumers have started to return to their pre-pandemic consumption patterns, and since the start of the year household consumption has been trending downwards, while spending on services has been trending upwards. Increasing optimism and activity in the rental market for retail property were predicted, but exceptionally high inflation and increased interest rates continue to create uncertainty. Investor appetite for retail property has been good so far in 2022.

General

The pandemic led to material changes in consumption patterns, and household consumption soared as the service sector shut down. When society began to reopen Norwegians once again chose to spend more money on services and less on goods, which is entirely in line with the long-term trend seen before the pandemic. Online retailers, which reached new heights during the pandemic, have also felt the decline in household consumption but still performed better than overall retail sales.

↑ Prime yield high-street

3.75 %

↑ Prime yield shopping centres

4.75 %

↑ Prime yield big-box

4.75 %

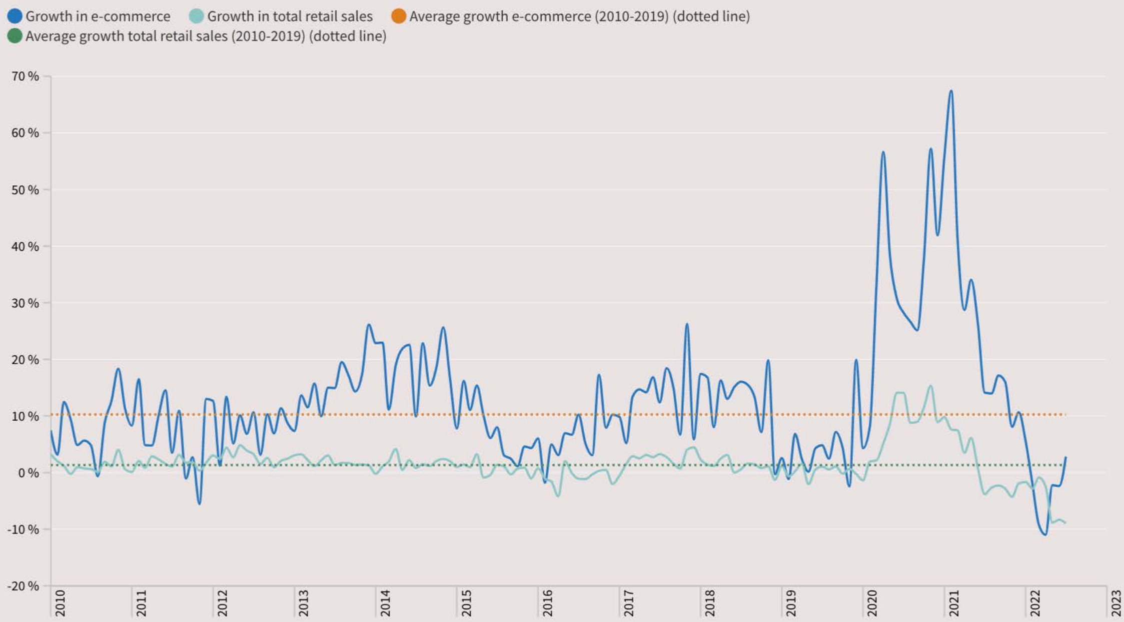
Transaction market

We are seeing a healthy appetite for retail property, with around NOK 10.3 billion of sales by October 2022 – which accounts for 16 per cent of all property transactions in the year to date. Because of the sharp hike in interest rates, we have adjusted our prime yield estimates up to 3.75 percent for high-street retail and 4.75 percent for shopping centre and big-box.

Rental market

Following a period of very low activity in the rental market because of the pandemic, things began to pick up somewhat before the summer in the form of several enquiries from tenants looking for premises. Despite growing interest, we have yet to see similar levels of activity when it comes to signed contracts.

Growth in e-commerce vs total retail sales, percent year/year



Consumer confidence, points

-26,8

Transaction volume YTD 2022, billion NOK

10.3

Transaction volume, share of total volume

16 %

Outlook

High inflation and rapid interest rises sent consumer confidence to an historical low in September and will probably curb overall consumption in the next year or two. Following a short-term correction, we expect online retail figures to grow far more quickly than overall retail in the coming years. Macroeconomic unrest is causing uncertainty in the rental market and could prompt some tenants to put their processes on hold.

Hotel

After two difficult years in which the pandemic had a dramatic and immediate impact on the market for hotel property, hotel prices are now back at pre-pandemic levels, both in Oslo and in Norway as a whole. Even though occupancy rates were marginally below normal levels during the summer season (Jun–Aug), prices have risen so much that RevPAR is now 18 per cent above the 2019 summer season in the country as a whole and as much as 24 per cent higher in Oslo.

Increase in RevPAR (Norway) summer season 2022 vs. 2019 (Jun-Aug)

18 %

Occupancy and room rates

Hotels targeting holidaymakers came off best through the pandemic. In Norway it was particularly hotels in attractive holiday destinations that came out on top. Regions and segments more dependent on international guests and business travellers found life harder.

Figures from the Benchmarking Alliance (BA) show that budget, luxury and conference hotels in Oslo have returned to similar or higher occupancy rates in spring 2022 compared with spring 2019. In August, hotels in Oslo saw 20 per cent higher RevPAR than in 2019 and twice as high as in 2021, according to BA.

Transaction market

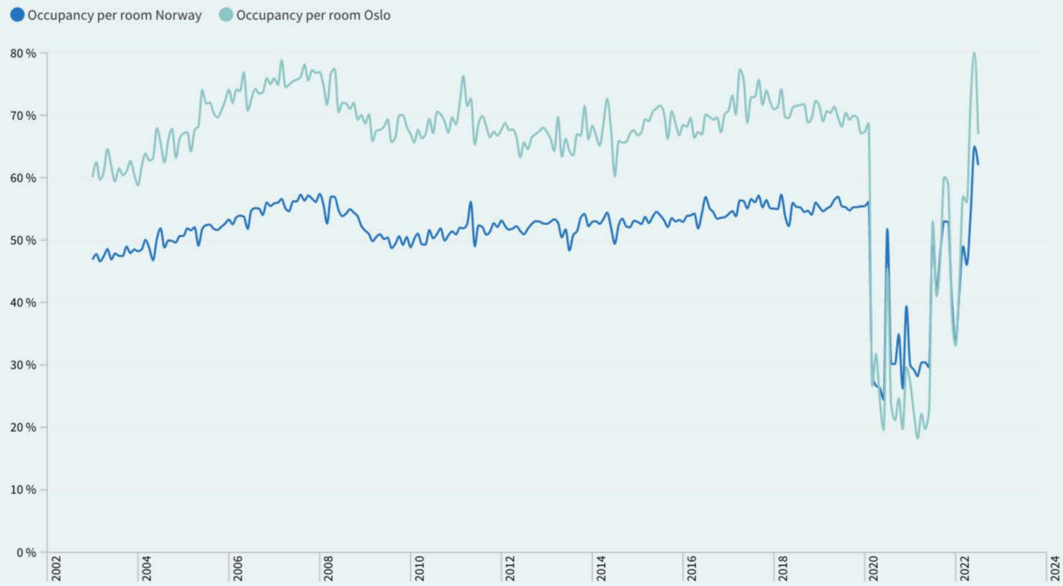
The pandemic brought the hotel real estate transaction market to a total halt in 2020, both globally and in the Norwegian market. Towards summer 2021, however, we observed a substantial rise in demand from investors. While there has been increased demand for resort and luxury hotels and limited appetite for hotels targeting business and conferences globally, Norway has experienced demand for several different hotel segments, including conference hotels.

So far in 2022 we have only seen five hotel transactions compared with 16 last year. The buyers are exclusively Norwegians, and the majority of them are syndication sponsors. This is in line with the wider trend whereby syndication sponsors consider a broader spectrum of property as they look for returns on their investment.

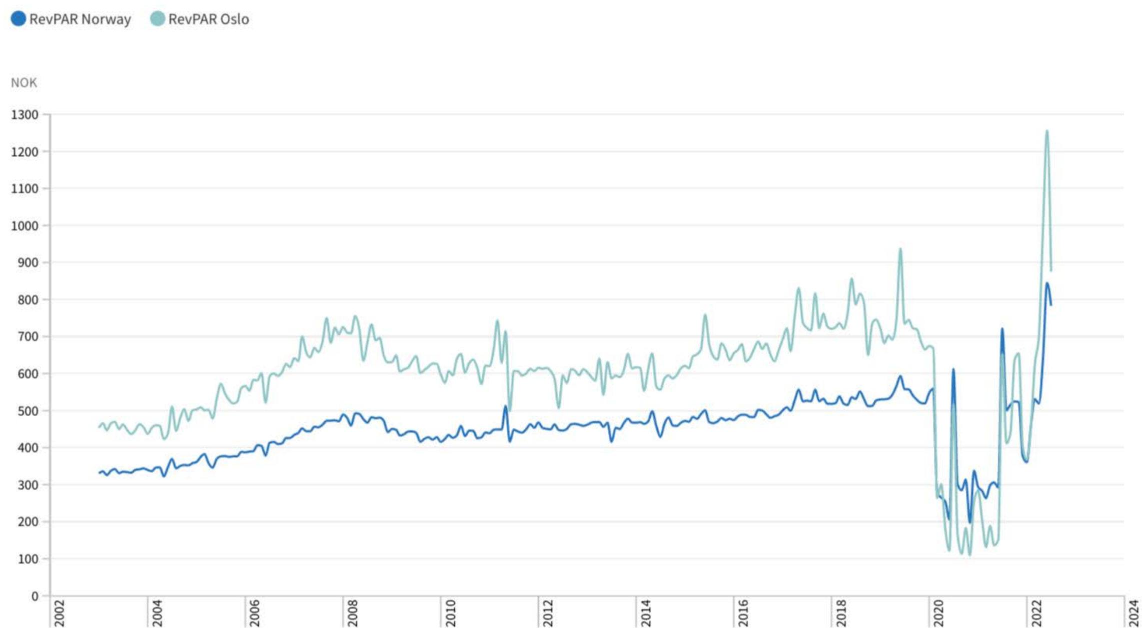
Increase in average daily rate (Oslo) July 2022 vs. July 2019

43 %

Occupancy per room percent – Oslo vs. Norway



RevPAR – Oslo vs. Norway



Residential

There has been strong demand in recent years for residential property, both for development projects and private rented housing. This trend has continued in 2022. Land plot transaction volumes, however, are still lower than in an historical perspective.

Transaction market

Despite rising interest rates, demand for residential property remains strong among professional investors. The transaction volume for private rented property are well on the way to reach the historic highs witnessed last year. We have great confidence in this segment, both due to the increasing professionalisation and consolidation in the professional private rented market and because of the continued strong demand from tenants looking to lease. Land plot transaction volumes are surprisingly low in 2022, but this is thought unrelated to demand, and is rather due to the limited availability of large plots.

Y-o-y growth residential resale prices

4.40 %

Resale property - Seasonal adjusted

Y-o-y growth newbuild prices

8.7 %

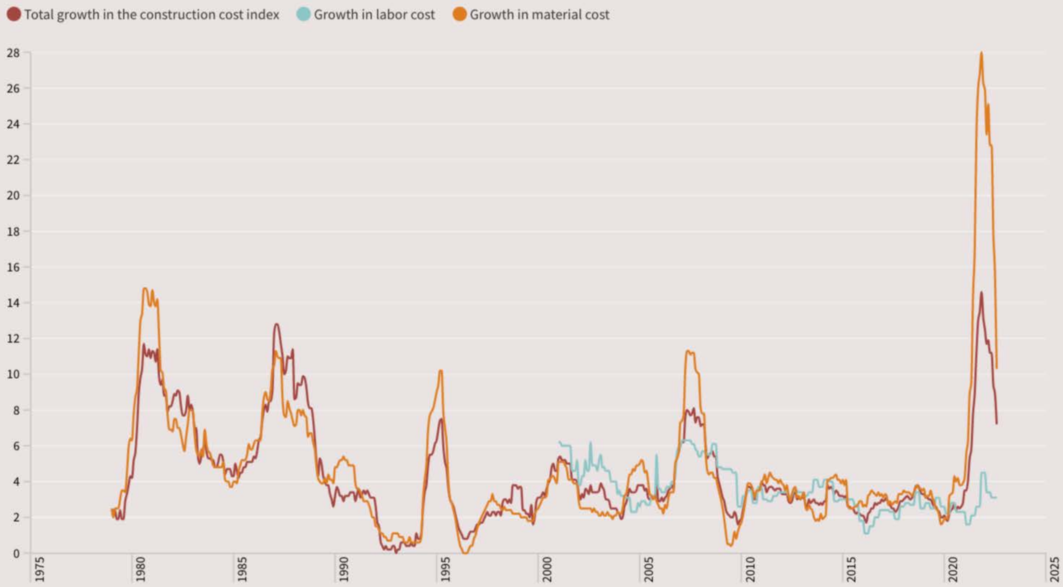
Rental market

The lettings sector in Norway is relatively small compared to other European countries as some 80 per cent of Norwegian households own their own home. In the larger Norwegian cities, with large student populations and a young demographic, the proportion of renters is far higher than in the country as a whole. After the summer, newspapers flourished with stories about tenants complaining about limited selection and rising rents. According to Finn.no there are half as many available rental properties in Oslo now compared to a year ago. Eiendom Norge's rental housing price statistics show a historically strong rise in rental housing prices in Norway and it is the cities of Stavanger and Oslo that are experiencing the strongest growth.

Housing price growth

House prices in Norway have so far risen by 6.7 per cent in 2022, but are still only 4.3 per cent higher than 12 months ago. After a long period of rising house prices, prices fell in September by 2.2 per cent - the largest house price fall in a single month since the financial crisis, and the worst September ever recorded according to figures from Eiendom Norge. It is expected that prices will continue to fall this year and next, before picking up in late 2023 and 2024.

Construction cost index, incl. Components



Outlook

We believe that demand for residential property will remain strong, both when it comes to rental property and development projects. Due to the increasing rate of interest, demand from home buyers will probably tail off in the second half of 2022. At the same time we expect to see strong demand from tenants, putting pressure on rents.