THE INVESTMENT MARKET

SPRING 2025

UNION

The market is expensive

We saw moderate downward pressure on prime yields during the summer of last year, **with the market clearing at around 4.50% in Q3/Q4**. Interest rates have risen significantly since then, but pricing in several key benchmark transactions was established when the 10-year swap rate was not far from current levels.

At the same time, the overall interest rate environment has shifted notably in recent weeks—particularly in terms of expectations around central bank rate cuts. A clear example of this was **the so-called "March cut," which just weeks ago appeared almost guaranteed, but ultimately did not materialize.**

Several market participants may now be reassessing their views on the path of interest rates and what constitutes a "normal" level, **which in turn could influence both sentiment and pricing.**

Recent weeks have seen limited transactional evidence to guide valuations, **but available indications suggest that prime yields remain at the same level as last fall.**

That said, there's little doubt the market currently appears expensive:

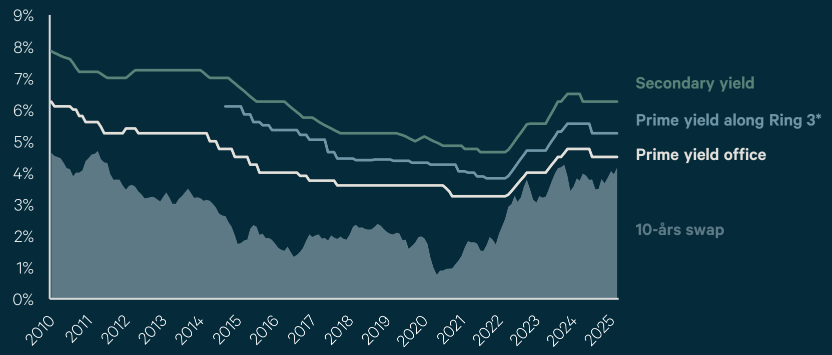
- Prime yield now sits two standard deviations away from our yield model. The model pointed to a fair value yield of 4.5% in Q3 last year but now indicates a level north of 5%. Of course, market pricing can deviate from the model for both shorter and extended periods – but historically, the model has provided a strong fit.

- Market participants continue to expect healthy rental growth over the longer term, which is partially reflected in today's pricing. However, near-term leasing market outlook has weakened compared to earlier expectations. While we still believe rents will increase over time, rental growth is likely to be more muted in the short-term.

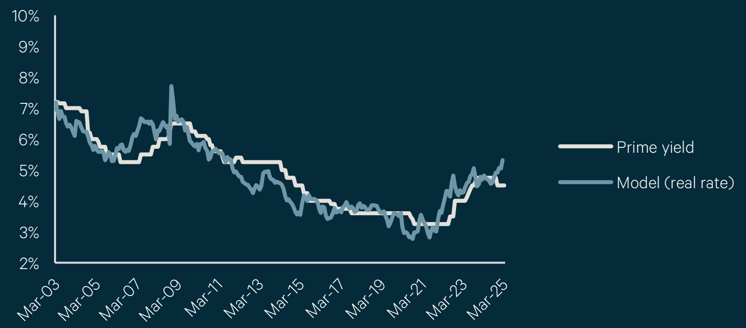
In other words, the market is currently facing headwinds—both from the rate environment and the occupier side. That said, we still observe more buyers than sellers for prime office assets in Oslo. This part of the market continues to benefit from a **high share of unleveraged capital, which clearly helps support pricing.**

Given today's rate levels, however, there is a risk that yields could spread out.

Yields vs. interest rates



Model based on real rate vs. prime yield office Oslo



Source: UNION, Macrobond, DNB Markets *Average across multiple areas

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All-equity byers and international investors are driving the market

After two consecutive years of declining transaction volumes, the market experienced a much-needed rebound in 2024, with a 42% increase in activity. **The growth was driven primarily by transactions in the office segment.**

Pension funds were major contributors, having had to deploy substantial capital into real estate in order to realign with their target allocations. These investments were made both directly and indirectly through unleveraged funds. These investors are generally targeting the same type of low-risk assets, **which contributed to a 25 basis point compression in prime office yields in Oslo during the autumn of last year.**

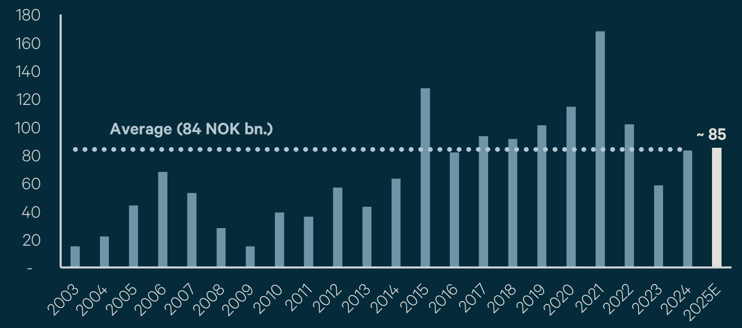
Measured as a share of total transaction volume in the Oslo office market, **unleveraged capital accounted for near 70% of all activity**—by far the highest level on record, and significantly above historical norms.

Although these players invested heavily throughout 2024, **there is still ample dry powder.** Combined with the fact that many of these investors are focused on centrally located office assets in Oslo—and that there are few distressed sellers in this segment—**this dynamic will likely continue to support low prime yields relative to interest rates going forward.** However, the risk of upward pressure on yields has increased over the past quarter.

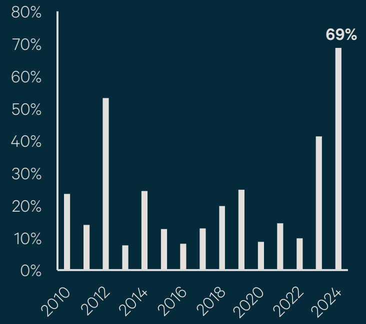
The buyer group that has increased its net exposure to the real estate market the most over the past year is in fact international investors. However, unlike pension funds, foreign investors show little appetite for office assets. **For the first time since 2010, not a single office acquisition by international investors took place in the Norwegian market in 2024.**

Instead, international capital is almost exclusively targeting logistics, industrial, and residential assets. What these sectors have in common is an **attractive supply-demand balance in the leasing market**—whether it be strong demand-side fundamentals (logistics) or the prospect of extremely tight supply (residential rental).

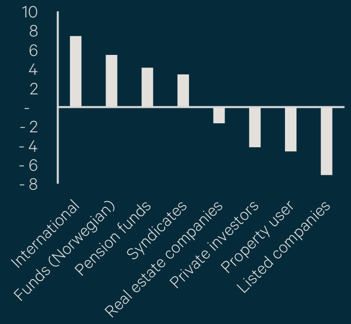
Transaction volume (NOK bn.)



Share of unleveraged transactions in total office volume in Oslo*



Net investments by investor group in 2024 (NOK bn.)



Source: UNION *Including core-plus funds

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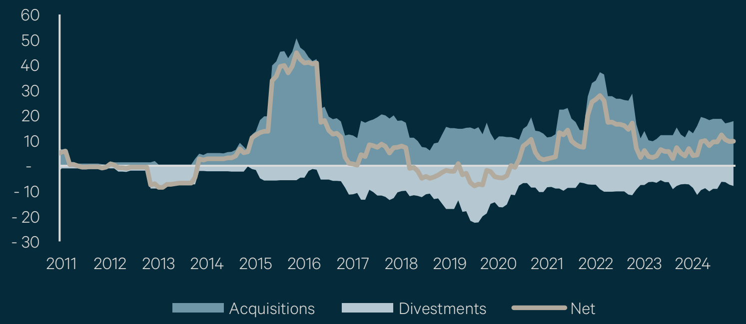
Unleveraged capital and international investors are driving the market

From a global perspective, recent quarters have shown early signs of international capital returning to office investments in the US and major European cities. **Demand is largely focused on state-of-the-art, sustainable office buildings**—often at yields significantly different from those observed in the Norwegian market.

Unlike other countries, Norway's office market has not experienced the same degree of repricing, which means office investments here may not be at the top of investors' lists under the current interest rate and yield conditions.

Acquisitions, divestments, and net acquisitions by international capital (NOK bn, 12-month rolling)



Source: UNION

Equity raising remains challenging

Despite the significant improvement in the transaction market over the past year, **the market for traditional syndications—where equity is raised for new projects—remains challenging**. It is difficult to identify projects that offer competitive equity returns for private investors who rely on leverage.

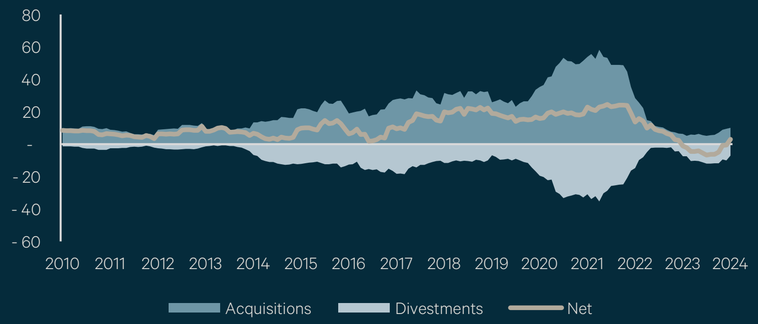
Many syndicators have now increasingly shifted focus towards buy-side advisory, where assets are placed with a single or small group of investors—including pension funds. For the second year in a row, buy-side advisory has outpaced traditional syndication activity.

In total, syndicators were involved in transactions amounting to approximately NOK 27 billion, with 60 percent of the volume stemming from buy-side advisory.

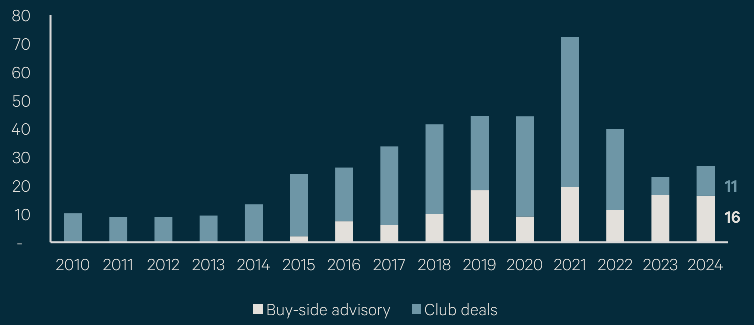
Syndicates were net sellers of real estate for most of the year. This was not driven by increased sales activity, but rather by reduced acquisition volumes. Overall, both purchase and sales volumes of syndicated real estate remain low.

There are few signs that this segment of the market will pick up in the coming months.

Acquisitions, divestments, and net acquisitions by syndicates (NOK bn, 12-month rolling)



Transaction volume by buy-side advisory and club deals (NOK bn.)



Source: UNION

Risk of renewed slowdown?

The latest developments in the interest rate market may pose challenges for the transaction market. This is not necessarily due to Norges Bank's decision to abandon the "March rate cut"—a cut that seemed almost certain just a few weeks ago—but primarily because of the general trend in market interest rates and expectations for future rate movements.

At the same time, there is more political and economic uncertainty globally than ever before. Developments in several leading indicators suggest that the probability of a recession in the U.S. has significantly increased over the past few weeks, **while the office leasing market in Oslo has gradually cooled, with stagnant rent growth.**

We would not be surprised if this impacts activity and sentiment in the transaction market. However, it is worth noting that the main scenario for most remains that a global recession will be avoided, and that economic growth in Norway will gradually pick up going forward.

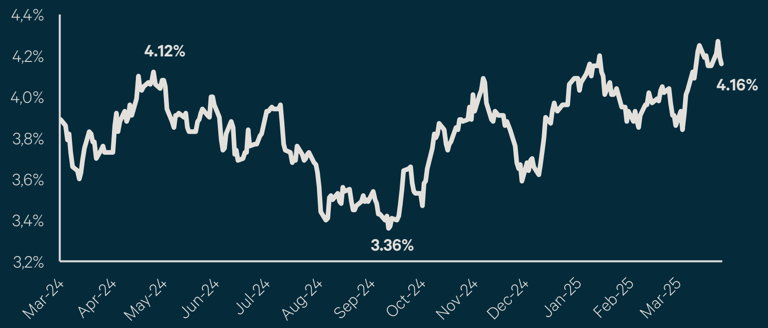
Additionally, we observe that the transaction market is somewhat less sensitive to interest rate fluctuations than it was one or two years ago. **Perhaps market participants have become somewhat more accustomed to both higher and more volatile interest rates?**

Furthermore, developments in the interest rate market may trigger more sales:

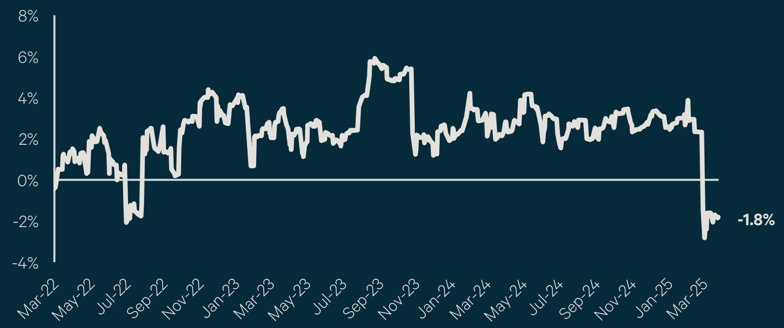
- Several players could face greater pressure to divest **due to higher financing costs and limited prospects for improvements.**
- Others may choose to sell for different reasons, as sellers increasingly realize that they **may not necessarily receive a poor price, even if the value is far below the peak** seen in early 2022.

Since the downturn in this cycle was driven by a sharp rise in the cost of capital globally, rather than a recession in the leasing market, **it is harder to envision that simply waiting for "values to come back" will be the best approach, as has been the case in previous downturns.** In that case, we would need a completely different interest rate environment than we have today, without much else going wrong at the same time.

10-year swap (NOK)



Atlanta Fed GDPNow



Source: Macrobond

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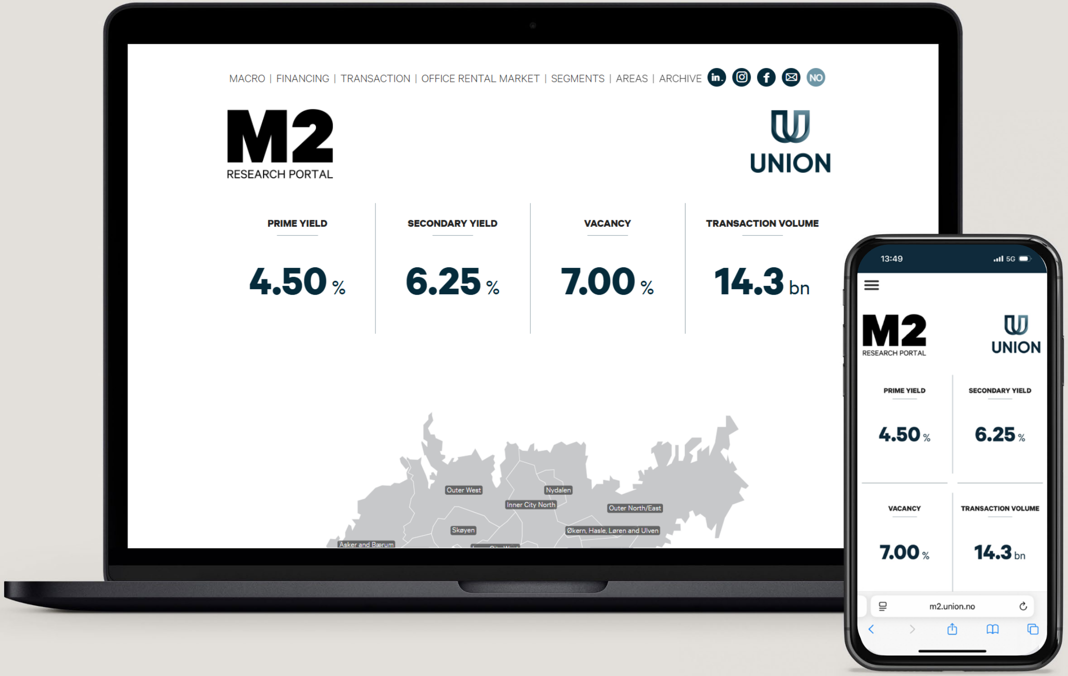

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