THE INVESTMENT MARKET

SPRING 2024

UNION

Cautious optimism

Following a challenging period in the transaction market for much of the previous year, sentiment improved around the turn of the year. This optimism coincided with a decline of approximately 100 basis points in long-term interest rates. Currently, about half of the interest rate decrease has been reversed.

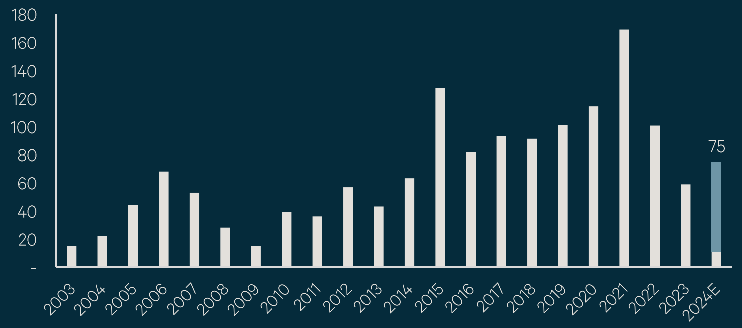
Nevertheless, there is more optimism in the market now compared to last autumn. This is likely due to higher yields, coupled with less of rising interest rates, even though rates remain volatile. Additionally, inflation is now significantly lower in major economies, all without experiencing a global recession.

For this year, we anticipate a transaction market that will perform better than in 2023. However, we believe that many of the trends observed in 2023 will continue to influence the market:

- **Interest rate volatility** will continue to pose challenges in transaction processes.
- **Publicly listed companies** will persist in divesting, thereby being net sellers of assets.
- **The syndicate market is likely to remain challenging.** Historically, syndicates have accounted for around 25 percent of transaction volume.* This figure dropped to 12 percent in 2023, and we expect this segment of the market to continue facing challenges in 2024.
- **Norwegian and foreign real estate funds will remain significant buyers.** In 2023, funds net-purchased approximately NOK 18 billion worth of real estate, emerging as the largest net buyer by a substantial margin. Many funds still hold considerable dry powder, particularly those of international origin.

This only includes syndicates, excluding acquisition advisory.

Transaction volume (NOK bn.)



Net acquisition in syndicates (NOK bn. – 12-month rolling)

Source: UNION

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More buyers this year

While the main trends from last year persist, we simultaneously observe that some market participants are in the process of changing their behavior:

- **Pension and insurance companies,** which have been significant sellers over the past three years, are likely to be more on the buying side this year. Most pension funds are now either neutral or underweight in real estate in terms of allocation. As market values and valuations increasingly reflect the new interest rate environment, and uncertainty surrounding interest and yield peaks diminishes, there is good reasons to believe that many will seek to reallocate toward their targeted allocations.
- **Additionally, several family offices** are exploring potential purchases. Yields have increased significantly, and more players are considering the opportunity to acquire attractive properties at reasonable price levels.

The demand side appears stronger than last year, likely influenced by substantial price declines and slightly improved fundamental conditions.

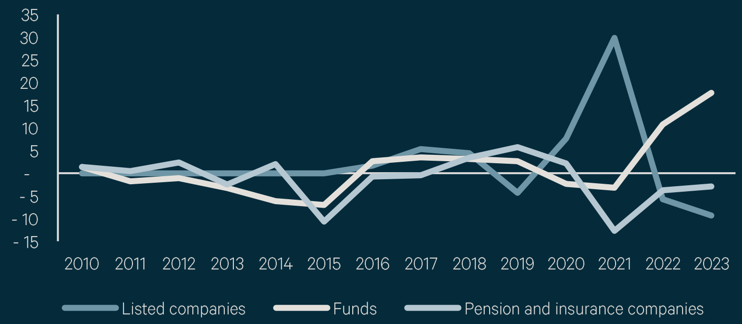
Investors will continue to favor logistics

Last year, logistics, mixed-use, and industrial properties accounted for 29 percent of the transaction volume. For the first time, office was not the largest segment measured by volume. We expect the interest in logistic properties to remain robust in 2024.

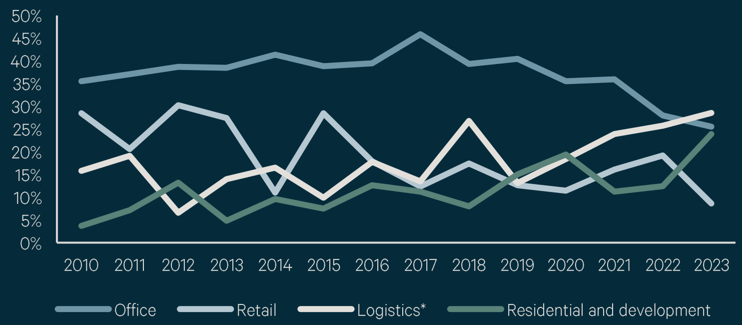
Certain significant transactions strongly contributed to the volume of logistics, mixed-use, and industrial properties last year. The three largest transactions represented 46 percent of the volume. The last big transaction was the sale of the Wilog portfolio for NOK 3.1 billion right at the end of last year, where NREP was the anchor investor in a structure set up by Propcap. Foreign funds were, incidentally, on the buying side in the three largest logistics transactions last year.

We anticipate an increase in demand for office buildings in line with the substantial rise in yields, and this is likely to be reflected in transaction activity. So far this year, for instance, we have seen Entra sign a letter of intent for the sale of the Trondheim portfolio to Reitan Eiendom for NOK 6.5 billion.

Net acquisition (NOK bn.)



Share of transaction volume



Source: UNION *Logistics/mixed-use/industrial

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Yields may have peaked

The prime office yield has risen by approximately 75 basis points since last summer and 150 basis points since early 2022. An important question is whether yields have peaked. This notion gained traction when we received multiple references supporting the yield estimate of 4.75 percent around the New Year.

The optimism around the turn of the year coincided with a decline of about 100 basis points in long-term interest rates since the peak in October last year. Currently, about half of the interest rate decrease has been reversed. While we have not observed any indications of an increase in yields in recent weeks, the lack of robust references leaves us uncertain.

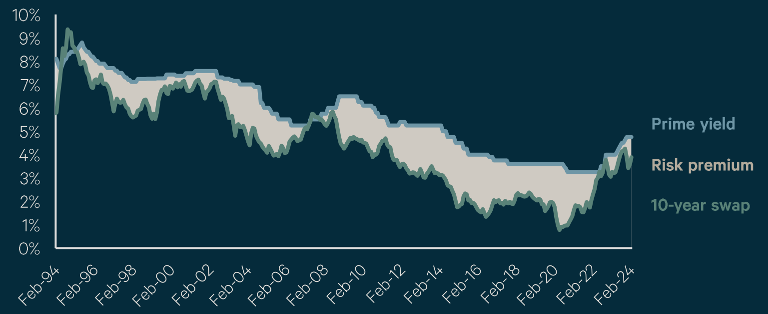
In summary, the current situation is as follows:

- **Yields still appear somewhat low compared to nominal interest rates,** especially since bank margins and credit spreads still are higher than normal.
- **However, when modeling yields based on estimated long-term real interest rates,** property yields seem to be approaching a long-term equilibrium.
- **Current pricing offers solid intrinsic value,** meaning that, in many cases, it is not possible to introduce new supply into the leasing market at current construction costs, yields, and rent levels. A correction in construction costs alone is probably not sufficient to alter the landscape. This implies that it is challenging to bring new space to the market before rent levels increase or yields start to decline again.

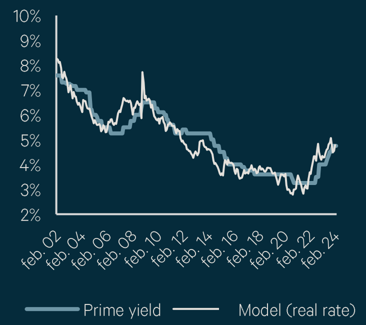
How much weight should you give to the latter argument? It depends on what you think about the leasing market in the years to come. The lower the office vacancy, the more crucial the marginal cost of obtaining new space becomes. And vice versa. In many cities in the USA, where office vacancy rates are high, replacement cost is obviously irrelevant.

In summary, we have a pricing situation that seems close to neutral. However, we cannot rule out the possibility of yields rising a bit further, especially if interest rates continue to trend upward. Nevertheless, the overall picture is much more balanced than it was a year ago. We also experience that more investors seem comfortable with the pricing, contributing to stabilize the market.

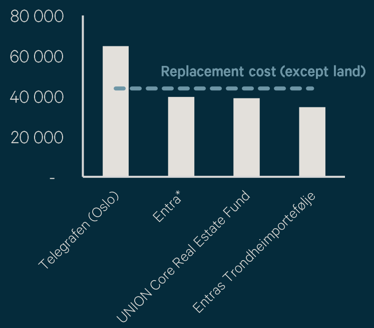
Prime yield and risk premium



Prime yield office Oslo



Value per square meter



Source: UNION, Macrobond *Stock price at 02/28/2024

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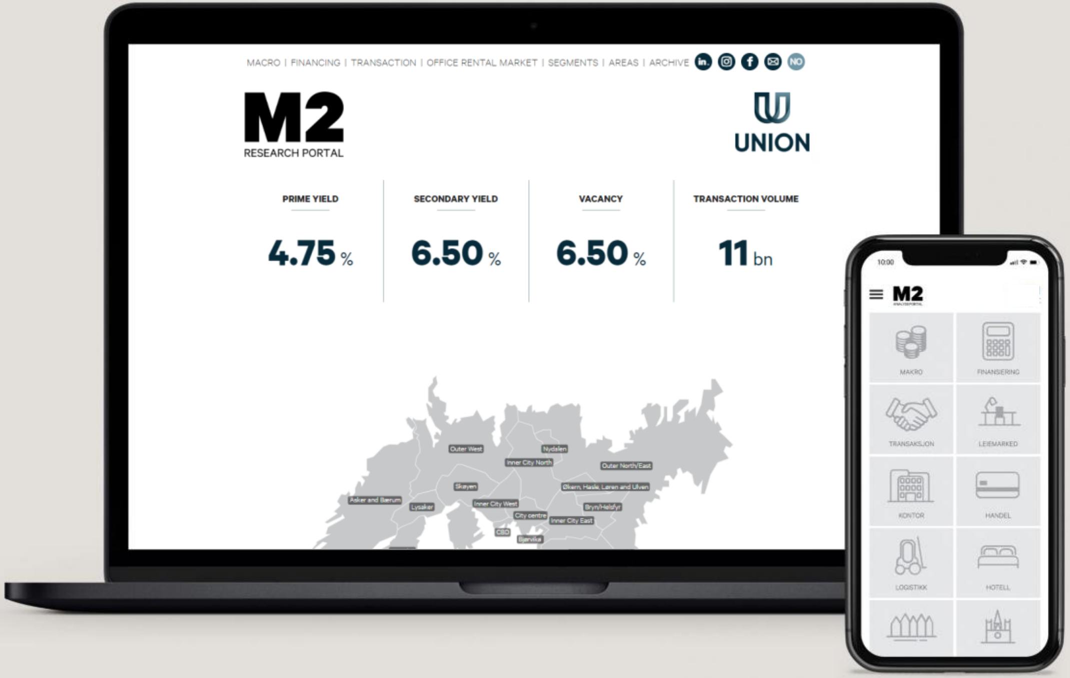

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