

Market Views

- analysis and updates from the Norwegian real estate market

March 2024

Increasingly Tight Office Market

Macro Insights

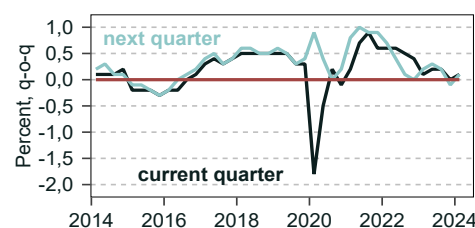
Robust Labor Market

- GDP growth has weakened, but unemployment remains very low. So far, the labour market has held up better than expected
- There is a significant difference between industries, but office occupations are generally less sensitive to economic cycles. This has been the case this time as well
- Sentiment has improved recently, and likely we will see a gradual improvement in the labour market throughout 2024

Unemployment rate remains very low



Businesses are observing improvement in employment rate



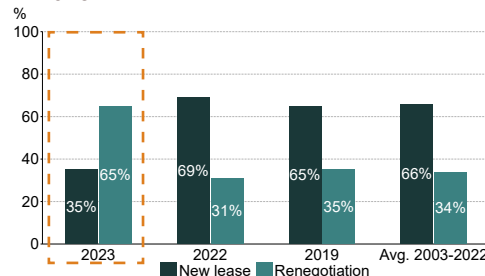
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Commercial Real Estate

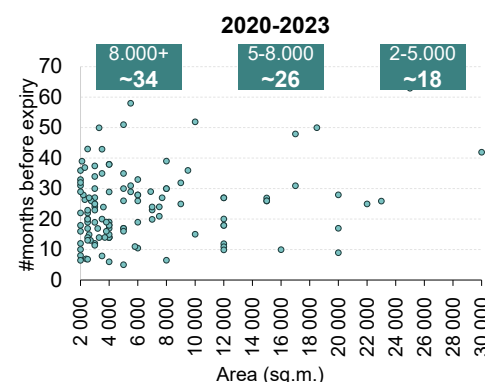
Supply-Demand Imbalance

- Large and medium-sized companies currently seeking new office space in Oslo are facing a more constrained supply side than in a long time
- The result has been an unusually high proportion of lease renegotiations. We expect this to continue in the short term
- Additionally, we observe that companies are initiating the search process for new office space earlier than before

Record-high proportion of renegotiations in 2023



Companies initiate the search process earlier



Macro | Robust Labor Market

GDP growth in the Norwegian economy has markedly decreased since the recovery following the pandemic, and progressively weaker activity growth has led to a slowdown in employment growth as well. However, despite this, unemployment has remained low, and if anything, the labour market has been stronger than expected.

However, there are significant differences between industries. On one hand, retail trade and construction experience weak activity, while activity growth in the petroleum industry has been record-strong, and the service sector has also performed well. Regarding office occupations, employment growth in these professions is typically less sensitive to economic cycles than overall employment, and this is also the case now.

Throughout much of last year, there was considerable uncertainty about how high interest rates would rise and whether the Norwegian and international economies would experience a soft or hard landing. In the fourth quarter of last

year, policy rates finally peaked in Norway, the eurozone, and the USA. Subsequently, fears of a hard landing have diminished. Domestically, both consumer confidence and business sentiment have improved since the New Year. According to the Norwegian Central Bank's regional network, businesses report increased employment in the first quarter, and they anticipate further employment growth towards the summer.

In December of last year, the Norwegian Central Bank assumed a soft landing for the Norwegian economy this year. Now, in March, their updated assessment is forthcoming. The Central Bank's December forecast suggests a slight decline in employment this year before picking up again from next year. So far, however, it seems that the labour market is holding up better than expected. An expectation of a soft landing also seems to be spreading among households and businesses. As fears dissipate, this in itself can contribute to increased activity. Therefore, we should expect a gradual improvement in the labour market during this year.

CRE | Supply-Demand Imbalance

Over the next five years, leases for a substantial number of square meters in Oslo will expire, and several large and medium-sized companies are actively seeking alternatives for potential relocation. These tenants face a more constrained supply side than in a long time. Years of minimal new construction, low expectations for future development schemes, and low office vacancy rates suggest that this situation will persist. Additionally, tenants are increasingly demanding high-quality office spaces in the right locations. We also anticipate a rising demand for green office buildings in the coming years, further limiting viable alternatives.

As a result, there has been, and likely will continue to be, an unusually high proportion of lease renegotiations in the short term. For leases above 3,000 square meters registered by Akershus Eiendom last year, renegotiations accounted for 65 percent. This is significantly higher compared

to previous years, where renegotiations on average constituted 34 percent of signed lease agreements. The renegotiation rate has been particularly high in the city centre, where large lease contracts saw an 84 percent renegotiation rate last year, largely due to extremely low office vacancy rates.

In addition to the increased share of renegotiations, the limited supply has prompted companies to initiate the search process earlier than before. Some companies with particularly large space requirements begin this process four to five years before their existing contracts expire.

Assuming a soft landing for the Norwegian economy, as most expect, employment trends in the coming years are likely to drive continued high demand for office spaces. If building costs remain elevated and there are too few attractive alternatives in existing building stock, we anticipate that the situation will persist.

Robust Labor Market

by Kari Due-Andresen, Managing Partner & Chief Economist - Akershus Eiendom

Despite the slowdown in employment alongside weaker GDP growth, unemployment has remained very low. There are now prospects for a soft landing in the Norwegian economy, and employment is likely to begin picking up again from next year.

Continued very low unemployment

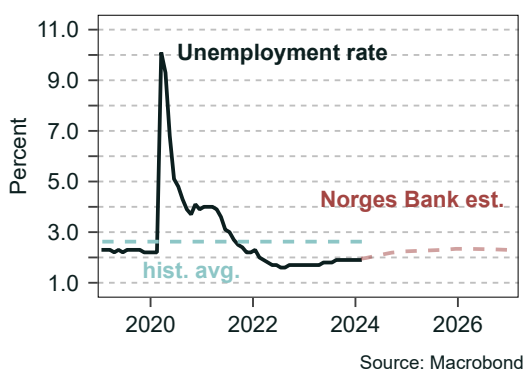
GDP growth in the Norwegian economy has markedly declined since the recovery following the pandemic and approached zero in the third quarter of last year.

Figure 1: GDP growth in Mainland Norway



Continuously weaker activity growth has led to a slowdown in employment growth as well. However, despite this, unemployment has remained low. Anecdotal evidence may suggest that many companies have chosen to retain qualified labour they finally acquired after the pandemic, despite lower activity levels. Since December of last year, unemployment, if anything, has remained lower than the Norwegian Central Bank's forecast.

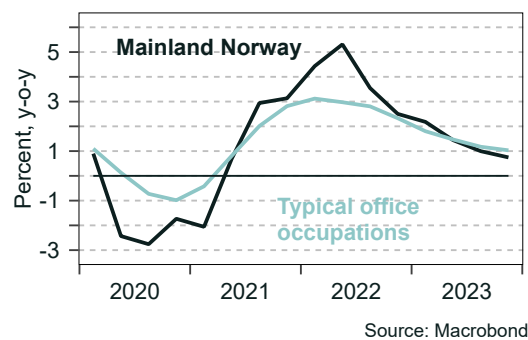
Figure 2: Registered unemployment rate, NAV



There are currently significant sectoral differences in production and turnover. In the retail trade and construction sectors, activity growth has been weaker than in a long time. On the other hand, activity growth in the petroleum industry has been record strong, and the service sector has fared relatively well.

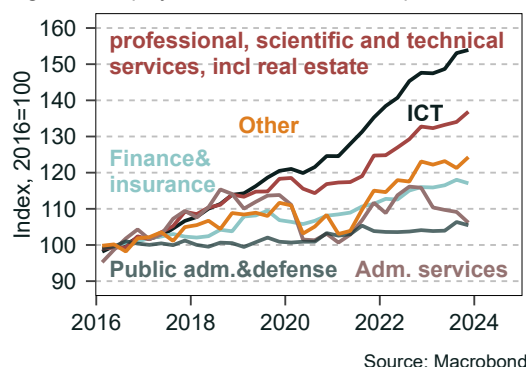
Regarding office jobs, employment growth in these occupations is typically less cyclical than total employment. This has also been the case in the recent cycle, with a more limited increase in employment at its peak, but also a more moderate slowdown thereafter.

Figure 3: Employment growth, mainland Norway vs. typical office occupations



Looking closer at Oslo and the various office occupations, employment growth since the pandemic has been strongest in ICT and other types of technical and scientific services, including real estate.

Figure 4: Employment in Oslo, office occupations



Soft Landing

Throughout much of last year, there was considerable uncertainty about how high interest rates would rise and whether the Norwegian and international economies would experience a soft or hard landing. In the fourth quarter of last year, policy rates finally peaked, both in Norway, the eurozone, and the USA. Eventually, fears of a hard landing have also diminished.

At home, consumer confidence among Norwegian households has significantly improved since the turn of the year, according to Finance Norway's measurement. The improvement is driven by increased expectations for both the country's and the personal economy.

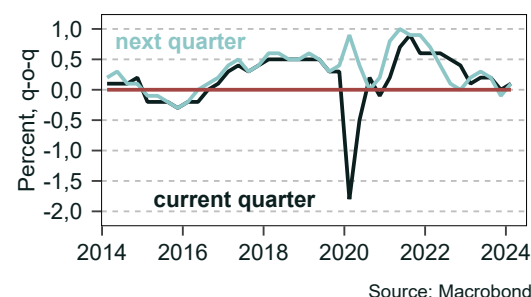
Figure 5: Consumer confidence



Business sentiment has also improved in recent months. According to the Norwegian Central Bank's regional network, which is supposed to represent a cross-section of Norwegian businesses, a flattening in economic activity is expected in the first half of this year. This is an upgrade from the survey in the fourth quarter. Companies also report that employment has

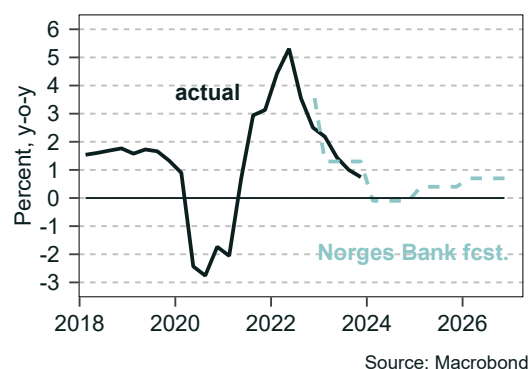
increased in the current quarter, and they expect to further increase employment in the coming quarter.

Figure 6: Employment growth, current quarter and next quarter



In December of last year, the Norwegian Central Bank assumed that the Norwegian economy would experience a soft landing this year. Now, in March, their updated assessment is coming. The Central Bank's forecast from December implies that employment will decline somewhat this year before picking up again from next year.

Figure 7: Employment growth, Mainland Norway



Conclusion

So far, it appears that the labour market has remained more robust than anticipated. An expectation of a soft landing seems to be spreading among households and businesses. As fear dissipates, it is something that can contribute to increased activity in itself. During this year, we should therefore be able to see a gradual improvement in the labour market.

Supply-Demand Imbalance

by Birgitte Heskestad Ellingsen og Sindre Vesje Bråtebæk - Akershus Eiendom

Recently, it has become much more difficult for large companies to find suitable alternatives when searching for office space in Oslo. The reason is several years of strained supply, combined with strong tenant demand. This has resulted in an unusually high proportion of lease renegotiations. Companies are also starting their search process significantly earlier than before. Several large companies are currently seeking new premises, but market conditions may make it harder for them to find suitable options.

More Demand, Fewer Alternatives

Over the next five years, the number of large leases expiring in Oslo will increase quite significantly. Our experience indicates that even though these tenants are presented with several options that could meet their timing requirements, few can be characterized as actually real alternatives that meet the company's wishes and needs. The options are limited, and several companies find themselves forced to renegotiate in existing premises.

Historically, 65 percent of large and medium-sized companies choose to relocate to new office premises upon expiration in the Oslo office market. This could pose a challenge in the coming years. For companies with significantly changed space requirements, or where the office is not functioning optimally for other reasons, renegotiation will only be a short-term solution.

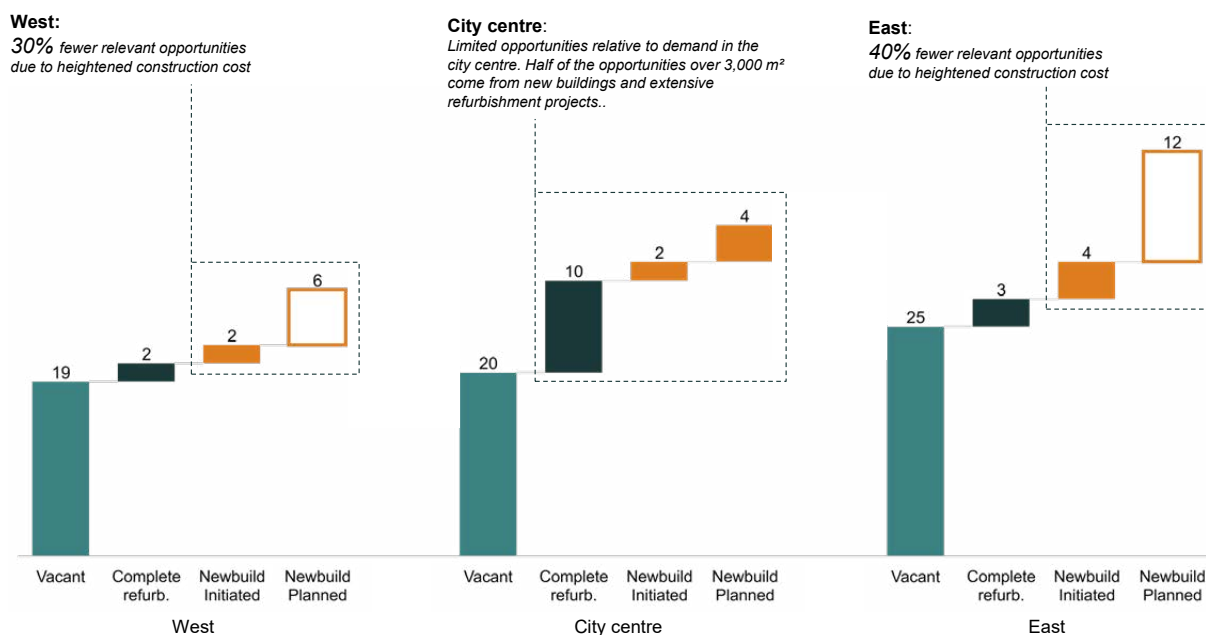
Limited Supply

Large companies have typically been able

to initiate new office projects at the planning stage, in addition to existing office buildings being vacated. However, recent record-high construction costs have contributed to most office schemes are being put on hold. Opportunities for companies that need to move are increasingly limited to existing building stock.

Office vacancy rates in Oslo are currently around 6 percent, and as low as 3 percent in some inner city areas, according to our observations. Nearly 500 buildings offer vacant premises today. This means that smaller companies have plenty of opportunities, while the situation is entirely different for medium-sized and large corporations. Only 38 premises currently vacant premises offer space larger than 3,000 square meters. The problem is thus due to the record-high construction costs. The rent level necessary to provide adequate return on an office development scheme is now so high that we have seen a significant slowdown in new construction. The result is that large and medium-sized companies are left with very few relevant options.

Figure 1: Number of available office premises over 3000 sq.m offered in the market - Existing and future buildings



From the graph above, we can see that a company seeking a minimum of 3,000 square meters of office space in Oslo's eastern office clusters may have up to 40 percent fewer relevant opportunities if new projects price themselves out. In the western axis, the proportion is almost 30 percent. This problem is not material in the in the Oslo city centre as market rent is high enough to justify new development.

In addition, taking into account that the layout of some buildings may not suit certain tenants, the opportunities are further reduced.

High-Demanding Tenants

In addition to fewer total offerings, relevant options are further limited by tenants' increasingly stringent demands for the workplace. In the years following the pandemic, the role of the office has changed, and tenants have very specific desires for their workspace. More than ever, tenants demand high-quality spaces in the right locations. The office should be so attractive and easily accessible that employees themselves prefer to come to the office rather than working from home.

Over time, we have observed a clear trend of companies moving towards the city centre, with many viewing a central location as strategically

important. In the past year, we have noted that companies are much more loyal to the areas they are situated in. This is evident in our relocation pattern analysis for 2023, which shows that companies that did relocate moved shorter in distance than ever before. Tenants who, for various reasons, do not seek space in the city centre often require immediate proximity to a public transport hub.

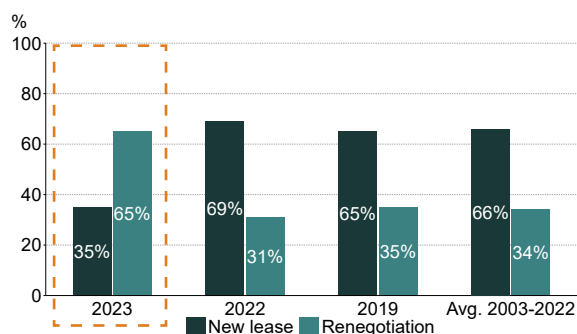
In the years to come, demand for green office buildings is expected to increase. This will further limit relevant options. New, stringent requirements for sustainability reporting (CSRD) are currently being rolled out among Norwegian companies. Once the gradual rollout is completed by 2026, nearly 2000 Norwegian companies will be affected. Therefore, we expect demand for green office space offices to increase significantly as companies are actually measured on sustainable activities.

High Proportion of Renegotiations

Few real options for tenants on the search resulted in a record-high proportion of lease renegotiations in 2023. For lease contracts of at least 3,000 square meters registered by Akershus Eiendom throughout last year, renegotiations accounted for 65 percent. This is high compared

to previous years, where renegotiations on average constituted 34 percent of signed lease contracts.

Figure 2: Proportion of renegotiations in 2023 compared to previous years (contracts of 3,000 sqm+)



The proportion of renegotiations has been particularly high in the city centre, where the renegotiation share among large lease contracts was as high as 84 percent last year. This is much higher than the historical average of between 30 and 40 percent.

Figure 3: Proportion of renegotiations in 2023 by location (contracts of 3,000 sqm+)

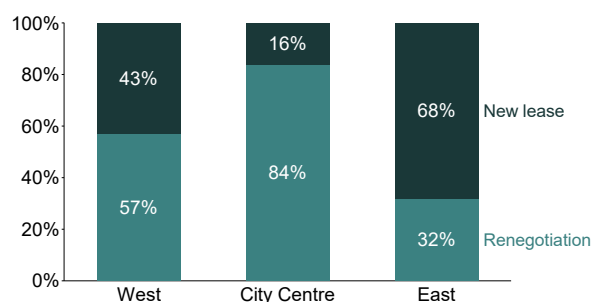
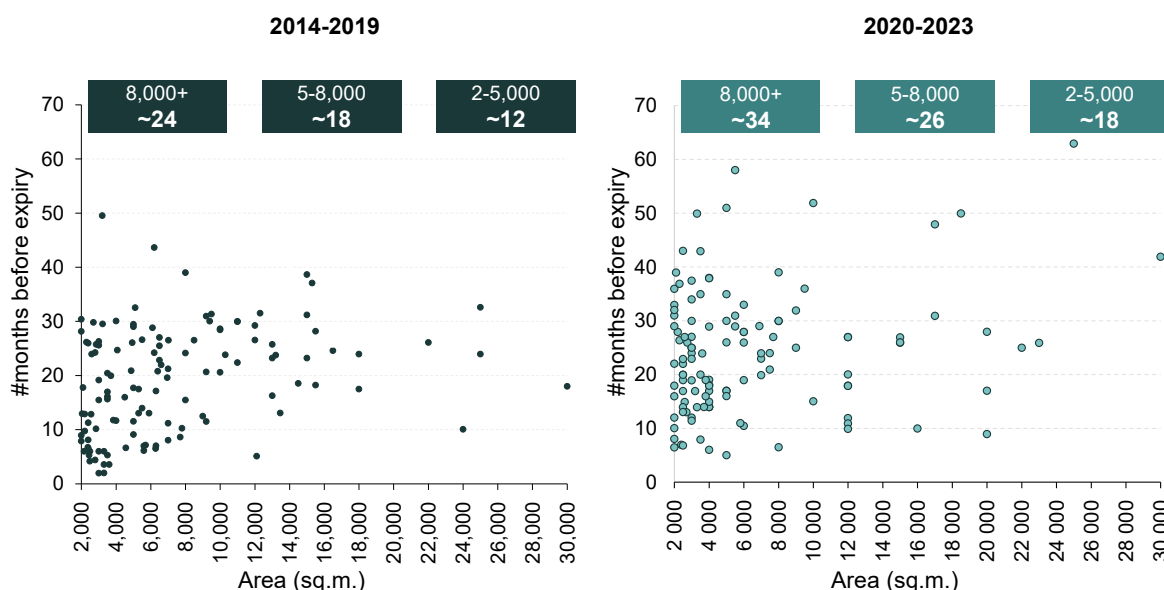


Figure 4: Tenant size vs. number of months actively searching for space



Given increased construction costs, there are still prospects for a tight supply side in the coming years. At the same time, there are expectations of a soft landing in the Norwegian economy and a robust job market, which suggests that demand for office space will remain strong. This likely points towards a high proportion of renegotiations in 2024 as well, as there will be few real alternatives for tenants approaching contract expiry.

Earlier Initiation of Search Process

In addition to an increased proportion of renegotiations, the limited supply has led companies to initiate the search process increasingly early.

Between 2014 and 2019, our statistics show that companies seeking office space of 8,000 square meters or more typically began the search process around two years before desired occupancy in new premises. However, over the past four years, the same statistics indicate that companies with the same space requirements are initiating the search process almost three years before contract expiration, on average. Some companies with particularly large area requirements start the process as early as four to five years before the expiration of their existing contracts.

However, it's not just the largest tenants that are starting the search process earlier. Our data shows that tenants that need between 2,000 and 5,000 square meters of office space typically start the search process around six months earlier than they did in the years before the pandemic.

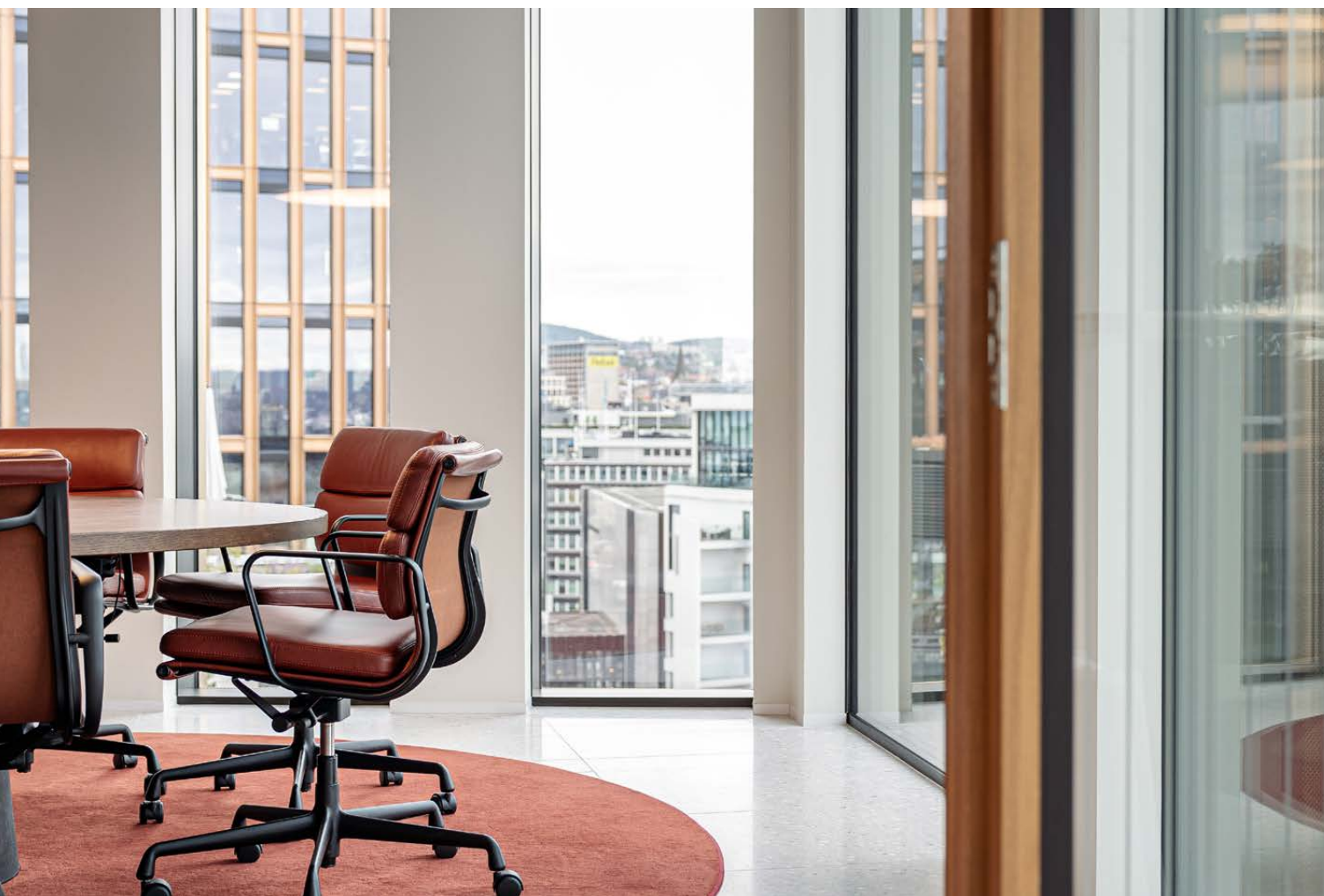
An explanation for this trend is likely that companies feel the need to be earlier in the market to even have a chance of securing alternatives that meet their needs before the competition. For the largest tenants, the reason is that these companies often desire a new building, and these processes today take significantly longer than before.

Conclusion

Large and medium-sized tenants searching for new office spaces are facing a more strained supply side than in a long time. Several years of minimal new construction, low expectations for future new construction, and low current office vacancy rates suggest that the situation

will continue. In addition, tenants' increasingly stringent requirements for office space further tighten the situation. The result has been, and is likely to remain in the short term, an abnormally high proportion of renegotiations. Leading companies are adapting to the situation by initiating their search process significantly earlier than usual, in some cases as much as five years before contract expiry.

Recently, there has been a complete halt in the initiation of new office developments. Short term, this means increased pressure for opportunities in the existing office stock. Longer-term development will depend on construction costs and future demand for office space. With a soft landing in the Norwegian economy, as most now expect, continued strong employment is likely to indicate continued high demand for office space. If construction costs remain high and alternatives of a certain size in existing building stock remains limited, we expect that new construction will be forced at elevated rent levels.



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